Chapter 4: Evaluating the Internal Environment

Learning Objectives

After reading this chapter, you should be able to understand and articulate answers to the following questions:

1. What is the Resource-Based View and why is it important to organizations?
2. How is the VRIO tool applied to strategic resources?
3. In what ways can intellectual property serve as a value-added resource for organizations?
4. What are isolating mechanisms and how can they contribute to a firm's competitive advantage?
5. How can the Value Chain be applied to achieve a competitive advantage?

4.1 Introduction

In addition to evaluating the external environment of a firm and the industry in which it operates, strategic management requires that a firm conduct an internal assessment of its resources and capabilities. This further helps the firm answer the question "Where are we?" before setting strategies for reaching the goals and vision of the organization. Part of this assessment is the organizational performance evaluation discussed in Chapter 2 that deals primarily with financial and other quantitative information. This helps the firm determine where it is in comparison with its competitors. Next, the firm needs to look inside to see how it can achieve a competitive advantage over its rivals, so customers will buy what the firm has to sell instead of buying from competitors.

One method of internal assessment is using the Resource-Based View. This model examines any resources and/or capabilities of the firm that may provide a competitive advantage. The VRIO framework is used to evaluate each resource or capability to determine what type, if any, of competitive advantage it brings. If a resource or capability cannot be imitated by a competitor, then that resource may create a sustained competitive advantage. Patents or isolating mechanisms can reduce or eliminate temporarily the opportunity for a rival to imitate.

Another tool used for internal assessment is Value Chain Analysis. Each element of a firm's primary and supportive activities are examined to see if it can provide a competitive advantage over its rivals. Weaknesses that are identified can be addressed to improve organizational performance.

Once the external and internal assessments are complete, the firm can use the most relevant information to develop a SWOT analysis and identify the most pressing strategic issue(s) the firm must address, as discussed in Chapter 5.

4.2 Managing Firm Resources

Southwest Airlines: Let Your LUV Flow

Figure 4.1: Southwest Airlines marked forty-seven consecutive profitable years in 2019

In 1971, a new firm named Southwest Airlines opened for business by offering flights between Houston, San Antonio, and its headquarters at Love Field in Dallas. From its initial fleet of three airplanes and three destinations, Southwest has grown to operate hundreds of airplanes in scores of cities. Despite competing in an industry that is infamous for bankruptcies and massive financial losses, Southwest marked its forty-seventh profitable year in a row in 2019.

Why has Southwest succeeded while many other airlines have failed? Historically, the firm has differed from its competitors in a variety of important ways. Most large airlines use a "hub and spoke" system. This type of system routes travelers through a large hub airport on their way from one city to another. Many Delta passengers, for example, end a flight in Atlanta and then take a connecting flight to their actual destination. The inability to travel directly between most pairs of cities adds hours to a traveler's itinerary and increases the chances of luggage being lost. In contrast, Southwest does not have a hub airport; preferring instead to connect cities directly. This makes flying on Southwest attractive to many travelers.

Southwest has also been more efficient than its rivals. While most airlines use a variety of different airplanes, Southwest operates only one type of jet: the Boeing 737. This means that Southwest can service its fleet much more efficiently than can other airlines. Southwest mechanics need only the know-how to fix one type of airplane, for example, while their counterparts with other firms need a working knowledge of multiple planes. Southwest also gains efficiency by not offering seat assignments in advance, unlike its competitors. This makes the boarding process move much faster, meaning that Southwest's jets spend more time in the air transporting customers (and making money) and less time at the gate relative to its rivals' planes.

Organizational culture is the dimension along which Southwest perhaps has differed most from its rivals. The airline industry as a whole suffers from a reputation for mediocre (or worse) service and indifferent (sometimes even surly) employees. In contrast, Southwest enjoys strong loyalty and a sense of teamwork among its employees.

One tangible indicator of this culture is Southwest's stock ticker symbol. Most companies choose stock ticker symbols that evoke their names. Ford's ticker symbol is F, for example, and Walmart's symbol is WMT. When Southwest became a publicly traded company in 1977, executives chose LUV as its ticker symbol. LUV pays a bit of homage to the firm's humble beginnings at Love Field. More important, however, LUV represents the love that executives have created among employees, between employees and the company, and between customers and the company. This "LUV affair" has long been and remains a huge success. As recently as March 2011, for example, Southwest was ranked fourth on Fortune magazine's World's Most Admired Company list.

In early 2020, the US and the world were hit by the coronavirus pandemic. The number of airline passengers dropped by over 90% during the peak months early in the pandemic. Southwest implemented cost saving measures, but still lost $94 million in the first quarter (PRNewswire, 2020). Known for its efficiency, how can Southwest drive down costs to reflect the new reality of less air travel and lower volumes for years to come? Where in its value chain can it not only trim costs but reinvent itself as a more cost effective organization? What resources and capabilities does the airline have to help it re-tool and not only survive the crisis, but come out a sustainable winner for the future?

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Image Credits

Figure 4.1: Seeger, Stuart. "A Southwest Airlines Boeing 737 aircraft parked on the tarmac under cloudy skies at Bob Hope Airport in Burbank, California, United States." CC BY 2.0. Cropped. Retrieved from https://upload.wikimedia.org/wikipedia/commons/d/d8/Southwest_737_At_Burbank.jpg.

4.3 Resource-Based View

Figure 4.2: Southwest Airlines's unique organizational culture is reflected in the customization of their aircraft, such as the "Lone Star One" design.

According to resource-based theory, organizations that own "strategic resources" have important competitive advantages over organizations that do not. Some resources, such as cash and trucks, are not considered to be strategic resources because an organization's competitors can readily acquire them. Instead, a resource is strategic to the extent that it is valuable, rare, difficult to imitate, and organized to capture value. Consider how Southwest Airlines's organizational culture serves as a strategic resource.

Table 4.1 Resource-Based View: The Basics

Strategic Resources	Expansion
VALUABLE resources aid in improving the organization's effectiveness and efficiency while neutralizing the opportunities and threats of competitors.	Although the airline industry is extremely competitive, Southwest Airlines's turns a profit virtually every year. One key reason for their success is a legendary organizational culture that inspires employees to do their very best.
RARE resources are those held by few or no other competitors.	Southwest Airlines's culture provides the firm with uniquely strong employee relations in an industry where strikes, layoffs, and poor morale are common.
DIFFICULT-TO-IMITATE resources often involve legally protected intellectual property such as trademarks, patents, or copyrights. Other difficult-to-imitate resources, such as brand names, usually need time to develop fully.	Southwest's culture arose from its very humble beginnings and has evolved across decades. Because of this unusual history, other airlines could not replicate Southwest's culture, regardless of how hard they might try.
ORGANIZED TO CAPTURE VALUE: Having in place the organizational systems, processes, and structure to capitalize on the potential of the resources and capabilities of the firm to provide a competitive advantage.	The influence of Southwest's organizational culture extends to how customers are treated by employees. Executives strongly encourage flight attendants to entertain passengers, like hiding in an overhead compartment. Processes related to passengers are infused with customer service attention and actions.

Important Points to Remember:

1. Resources such as Southwest's culture that reflect all four qualities—valuable, rare, difficult to imitate, and organized to capture value—are ideal because they can create sustained competitive advantages. A resource that has three or less of the qualities can provide an edge in the short term, but competitors can overcome such an advantage eventually.
2. Firms often bundle together multiple resources and strategies (that may not be unique in and of themselves) to create uniquely powerful combinations. Southwest's culture is complemented by approaches that individually could be copied—the airline's emphasis on direct flights, its reliance on one type of plane, and its unique system for passenger boarding—in order to create a unique business model in which effectiveness and efficiency is the envy of competitors.
3. Satisfying only one or two of the valuable, rare, difficult-to-imitate, organized to capture value criteria will likely only lead to competitive parity or a temporary advantage.

Resources and capabilities are the basic building blocks that organizations use to create strategies. These two building blocks are tightly linked—capabilities from using resources over time.

Resources can be divided into two main types: tangible and intangible. While resources refer to what an organization owns, capabilities refer to what the organization can do. More specifically, capabilities refer to the firm's ability to bundle, manage, or otherwise exploit resources in a manner that provides added value and, hopefully, advantage over competitors.

Table 4.2 Resources and Capabilities

Resources
Tangible resources are resources that can be readily seen, touched, and quantified. Physical assets such as a firm's property, plant, and equipment are considered to be tangible resources, as is cash.
Intangible resources are quite difficult to see, touch, or quantify. Intangible resources include, for example, the knowledge and skills of employees, a firm's reputation, and a firm's culture. In a nod to Southwest Airlines' outstanding reputation, the firm ranks eighth in Fortune magazine's 2018 list of the "World's Most Admired Companies."
Capabilities
A dynamic capability exists when a firm is skilled at continually updating its array of capabilities to keep pace with changes in its environment. Coca-Cola, for example, has an uncanny knack for building new brands and products as the soft drink market evolves. Not surprisingly, this firm ranks among the top twelve in Fortune's "World's Most Admired Companies" for 2020.

Resources and Capabilities

The tangibility of a firm's resources is an important consideration within resource-based theory. **Tangible resources** are resources that can be readily seen, touched, and quantified. Physical assets such as a firm's property, plant, and equipment, as well as cash, are considered to be tangible resources. In contrast, **intangible resources** are quite difficult to see, to touch, or to quantify. Intangible resources include, for example, the knowledge and skills of employees, a firm's reputation, brand name, exclusive rights to intellectual property, leadership traits of executives, and a firm's culture. In comparing the two types of resources, intangible resources are more likely to meet the criteria for strategic resources (i.e., valuable, rare, difficult-to-imitate, and organized to capture value) than are tangible resources. Executives who wish to achieve long-term competitive advantages should therefore place a premium on trying to nurture and develop their firms' intangible resources.

Capabilities are another key concept within resource-based theory. An effective way to distinguish resources and capabilities is this: resources refer to what an organization owns, capabilities refer to what the organization can do (Table 4.2). Capabilities tend to arise over time as a firm takes actions that build on its strategic resources. Southwest Airlines, for example, has developed the capability of providing excellent customer service by building on its strong organizational culture. Capabilities are important in part because they are how organizations capture the potential value that resources offer. Customers do not simply send money to an organization because it owns strategic resources. Instead, capabilities are needed to bundle, to manage, and otherwise to exploit resources in a manner that provides value added to customers and creates advantages over competitors.

Some firms develop a dynamic capability. This means that a firm has a unique ability to create new capabilities. Said differently, a firm that enjoys a dynamic capability is skilled at continually updating its array of capabilities to keep pace with changes in its environment. Coca-Cola has an uncanny knack for building new brands and products as the soft-drink market evolves. Not surprisingly, Coca-Cola ranks among the top twelve in Fortune's "World's Most Admired Companies" for 2020.

VRIO: Four Characteristics of Strategic Resources

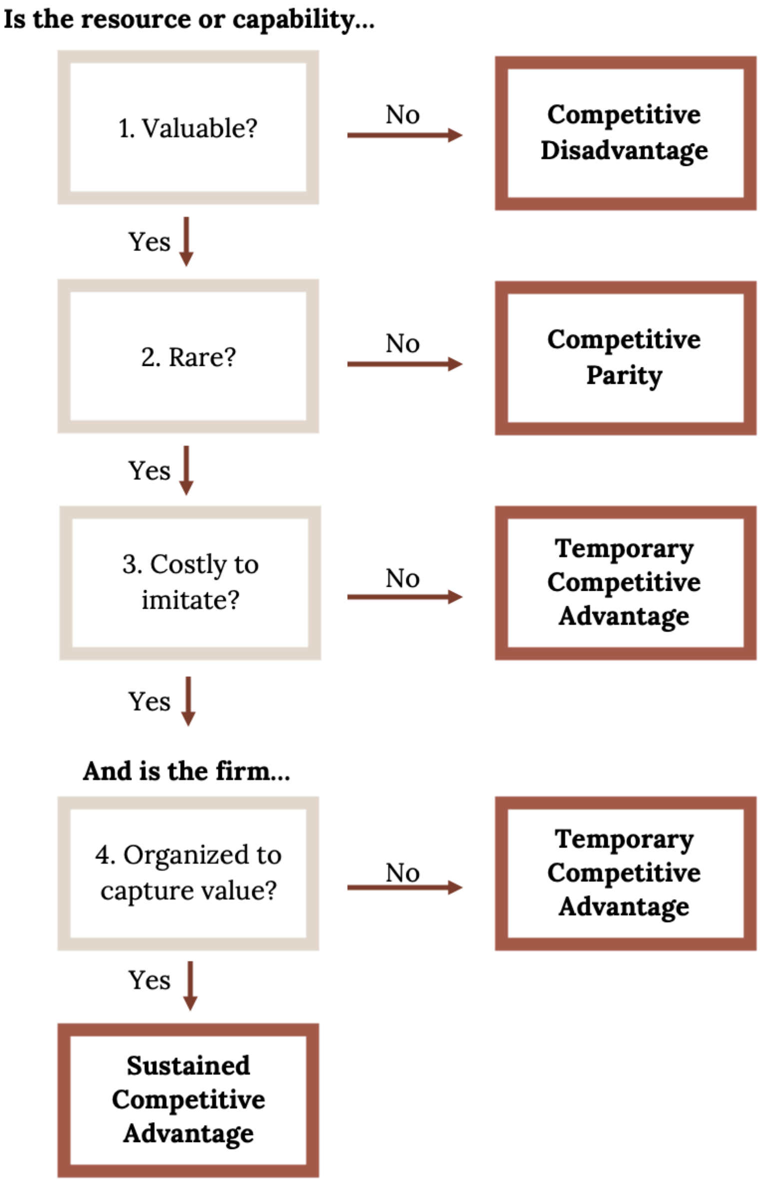

Figure 4.3: The VIRO Framework

Resource-based theory can be confusing because the term resources is used in many different ways within everyday common language. It is important to distinguish **strategic resources** from other resources. To most individuals, cash is an important resource. Tangible goods such as one's car and home are also vital resources.

When analyzing organizations, however, common resources such as cash and vehicles are not considered to be strategic resources. Resources such as cash and vehicles are valuable, of course, but an organization's competitors can readily acquire them. Thus an organization cannot hope to create an enduring competitive advantage around common resources.

Southwest Airlines provides an illustration of resource-based theory in action. Resource-based theory contends that the possession of strategic resources provides an organization with a golden opportunity to develop competitive advantages over its rivals (Table 4.1). These competitive advantages in turn can help the organization enjoy strong profits (Barney, 1991; Wernerfelt, 1981).

A strategic resource is an asset that is valuable, rare, difficult to imitate, and organized to capture value (Barney, 1991; Chi, 1994). A resource is valuable to the extent that it helps a firm create strategies that capitalize on opportunities and ward off threats. Southwest Airlines' culture fits this standard well. Most airlines struggle to be profitable, but Southwest makes money virtually every year. One key reason is a legendary organizational culture that inspires employees to do their very best. This culture is also rare in that strikes, layoffs, and poor morale are common within the airline industry. Southwest embraces a culture of fun for both its customers and employees. Most other airlines do not have this philosophy.

Competitors have a hard time duplicating resources that are difficult to imitate. Some difficult to imitate resources are protected by various legal means, including trademarks, patents, and copyrights. Other resources are hard to copy because they evolve over time and they reflect unique aspects of the firm. Southwest's culture arose from its very humble beginnings. The airline had so little money that at times it had to temporarily "borrow" luggage carts from other airlines and put magnets with the Southwest logo on top of the rivals' logo. Southwest is a "rags to riches" story that has evolved across several decades. Other airlines could not replicate Southwest's culture, regardless of how hard they might try, because of Southwest's unusual history.

A resource is organized to capture value when the firm has organizational systems, processes, and structure in place to capitalize on the resource for a competitive advantage. This may provide bargaining power for the firm in the marketplace. A key benefit of Southwest's culture is that it leads employees to treat customers well, which in turn creates loyalty to Southwest among passengers. This customer loyalty is why many passengers choose Southwest over other airlines.

The key to using the Resource Based View is to evaluate a firm's resources and capabilities using the VRIO framework decision tree.

Note that the decision tree is used to assess resources and capabilities, NOT a firm's products, services, or the firm itself. The evaluation occurs within the industry of the firm being evaluated. Using Southwest Airlines culture as the resource to evaluate with VRIO:

1. Is Southwest's culture valuable? If not, all the effort to develop it is a waste of resources and a competitive disadvantage. If yes, go to number 2.
2. Is Southwest's culture rare within the airline industry? If not, then this resource only provides Southwest competitive parity. It does not help or hurt Southwest competitively. If yes, go to number 3.
3. In the airline industry, is Southwest's culture hard to imitate? If not then culture provides Southwest with a temporary competitive advantage over its rivals, but competitors can imitate it. If yes, go to number 4.

4. Has Southwest organized this resource of culture to capture value? If not, then it still only provides a temporary competitive advantage. If yes, then Southwest's culture is providing a sustained competitive advantage.

For the company culture resource of Southwest Airlines, a yes can be answered for each of the four steps, providing a sustained competitive advantage for this organization. As can be seen from its exceptional organizational performance over many years when compared to other airlines, VRIO shows that company culture is one reason why it is more successful than its competitors.

Figure 4.4 The VRIO Framework Decision Matrix: Southwest's Company Culture

Valuable?	Rare?	Difficult to imitate?	Organized to capture value?	Competitive Advantage
Yes	Yes	Yes	Yes	Sustained Competitive Advantage

As another example, what about Southwest Airlines' capability to arrive on time at a much higher rate than the industry average? What kind of competitive advantage, if any, does this capability provide?

Capability: High on-time arrival

Figure 4.5 VRIO Analysis of On-Time Arrival Capability of Southwest Airlines

Valuable?	Rare?	Difficult to Imitate?	Organized to Capture Value?	Competitive Advantage?
Yes	Yes	No		Temporary Competitive Advantage

In the case of on-time arrival capability, Southwest Airline enjoys a temporary competitive advantage (the third line), but it is not that difficult for rivals to imitate this ability. In working through the decision tree, once a no is obtained, there is no need to continue through the tree.

Ideally, a firm will its own resources, like Southwest's culture, that embrace the four VRIO qualities shown in Table 4.1. If so, these resources can provide not only a competitive advantage but also a sustained competitive advantage—one that will endure over time and help the firm stay successful far into the future. Resources that do not have all four qualities can still be very useful, but they are unlikely to provide long-term advantages. A resource that is valuable and rare but that can be imitated, for example, might provide an edge in the short term, but competitors can eventually overcome such an advantage.

Figure 4.6 VRIO Analysis Worksheet

Resource or Capability	Valuable?	Rare?	Costly to Imitate?	Organized to capture value?	Competitive Implication

Resource-based theory also stresses the merit of an old saying: the whole is greater than the sum of its parts. Specifically, it is important to recognize that strategic resources can be created by taking several strategies and resources that each could be copied and bundling them together in a way that cannot be copied. For example, Southwest's culture is complemented by approaches that individually could be copied—the airline's emphasis on direct flights, its reliance on one type of plane, and its unique system for passenger boarding—to create a unique business model whose performance is without peer in the industry.

On occasion, events in the environment can turn a common resource into a strategic resource. Consider, for example, a very generic commodity: water. Humans simply cannot live without water, so water has inherent value. Also, water cannot be imitated (at least not on a large scale), and no other substance can substitute for the life-sustaining properties of water. Despite having three of the four properties of strategic resources, water in the United States has remained cheap; however, this may be changing. Major cities in hot climates such as Las Vegas, Los Angeles, and Atlanta are confronted by dramatically shrinking water supplies. As water becomes more and more rare, landowners in Maine stand to benefit. Maine has been described as "the Saudi Arabia of water" because its borders contain so much drinkable water. It is not hard to imagine a day when companies in Maine make huge profits by sending giant trucks filled with water south and west or even by building water pipelines to service arid regions.

Strategy at the Movies

That Thing You Do! [02:48]

How can the members of an organization reach success "doing that thing they do"? According to resource-based theory, one possible road to riches is creating—on purpose or by accident—a unique combination of resources. In the 1996 movie *That Thing You Do!*, unwittingly assembling a unique bundle of resources leads a 1960s band called The Wonders to rise from small-town obscurity to the top of the music charts. One resource is lead singer Jimmy Mattingly, who possesses immense musical talent. Another is guitarist Lenny Haise, whose fun attitude reigns in the enigmatic Mattingly. Although not a formal band member, Mattingly's girlfriend Faye provides emotional support to the group and even suggests the group's name. When the band's usual drummer has to miss a gig due to injury, the door is opened for charismatic drummer Guy Patterson, whose energy proves to be the final piece of the puzzle for The Wonders.

Despite Mattingly's objections, Guy spontaneously adds an up-tempo beat to a sleepy ballad called "That Thing You Do!" during a local talent contest. When the talent show audience goes crazy in response, it marks the beginning of a meteoric rise for both the song and the band. Before long, The Wonders perform on television and "That Thing You Do!" is a top-ten hit record. The band's magic vanishes as quickly as it appeared, however. After their bass player joins the Marines, Lenny elopes on a whim, and Jimmy's diva attitude runs amok, the band is finished and Guy is left to "wonder" what might have been. *That Thing You Do!* illustrates that while bundling resources in a unique way can create immense success, preserving and managing these resources over time can be very difficult.

The Wonders- That Thing You Do!

This video is the song "That Thing You Do!" by the Wonders.

You can view this video here: https://youtu.be/BJn-Jl2ZeQU.

Key Takeaway

- Resource-based theory suggests that tangible or intangible resources that are valuable, rare, difficult to imitate, and organized to capture value best position a firm for long-term success. These strategic resources can provide the foundation to develop firm capabilities that can lead to superior performance over time. Capabilities are needed to bundle, to manage, and otherwise to exploit resources in a manner that provides added value to customers and creates advantages over competitors. The VRIO tool can be used to determine if resources or capabilities are valuable, rare, difficult-to-imitate, and organized to capture value, and thereby understand what type of competitive advantage they offer to a firm.

Exercises

1. What tangible and intangible resources does your favorite restaurant have that might give it a competitive advantage?
2. Do any of the resources or capabilities of your favorite restaurant have the four qualities of resources (VRIO) that lead to success as articulated by resource-based theory?

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Image Credits

Figure 4.2: Planephotoman. "Southwest Airlines Boeing 737 Lonestar One (N352SW) at LAS in November 2005." CC BY 2.0. Cropped. Retrieved from https://commons.wikimedia.org/wiki/File:Southwest_737_Lonestar_One.jpg.

Figure 4.3: Kindred Grey (2020). "The VRIO Framework with numbers." CC BY-SA 4.0. Retrieved from https://commons.wikimedia.org/wiki/File:The_VRIO_Framework_with_numbers.png.

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4.4 Intellectual Property & Isolating Mechanisms

Intellectual Property

Defining Intellectual Property

The inability of competitors to imitate a strategic resource is a key to leveraging the resource to achieve long-term competitive advantages. Companies are clever, and effective imitation is often very possible. But resources that involve intellectual property reduce or even eliminate this risk. As a result, developing intellectual property is important to many organizations.

Intellectual property refers to creations of the mind, such as inventions, artistic products, and symbols. The four main types of intellectual property are patents, trademarks, copyrights, and trade secrets (Table 4.5). If a piece of intellectual property is also valuable, rare, difficult to imitate, and organized to capture value, it constitutes a strategic resource. Even if a piece of intellectual property does not meet all four criteria for serving as a strategic resource, it can be bundled with other resources and activities to create a resource.

The term ***intellectual property*** *refers to creations of the mind, such as inventions, artistic products, and symbols. Some forms of intellectual property are protected by law while others can best be defended by surrounding them in secrecy.*

Table 4.5 Intellectual Property

Types of Intellectual Property
Patents protect inventions from direct imitation for a limited period of time. Within the pharmaceutical industry, patents protect the new drugs created by firms such as Merck and Pfizer for up to twenty years. If a new drug gains acceptance in the market, its patent creates a window of opportunity for the patent holder to enjoy excellent profits.
Trademarks are phrases, pictures, names, or symbols used to identify a particular organization. McDonald's golden arches, the phrase "Intel Inside," and the brand name Virginia Tech are examples of trademarks.
Copyrights provide exclusive rights to the creators of original artistic works such as books, movies, songs, and screenplays. Sometimes copyrights are sold and licensed. The late pop star Michael Jackson bought the rights to The Beatles' music catalog and later licensed songs to Target and other companies for use in television advertisements.
Trade secrets refer to formulas, practices, and designs that are central to a firm's business and that remain unknown to competitors. One famous example is the blend of eleven herbs and spices used in Kentucky Fried Chicken's original recipe chicken. KFC protects this secret by having multiple suppliers each produce a portion of the herb and spice blend; no one supplier knows the full recipe.

A variety of formal and informal methods are available to protect a firm's intellectual property from imitation by rivals. Some forms of intellectual property are best protected by legal means, while defending others depends on surrounding them in secrecy. This can be contrasted with Southwest Airlines's well-known culture, which rivals are free to attempt to copy if they wish. Southwest's culture thus is not intellectual property, although some of its complements such as Southwest's logo and unique color schemes are.

Patents

Patents protect inventions from direct imitation for a limited period of time. Some examples and key issues surrounding patents are illustrated below.

Table 4.6 Patents

Examples of Patents
To earn a patent from the US Patent and Trademark Office, an inventor must demonstrate that an invention is new, non obvious, and useful.
Perhaps the greatest inventor in history was Thomas Edison, who was awarded over one thousand patents.
As several different inventors raced to create a workable system for voice transmission over wires, Alexander Graham Bell was awarded a patent for the telephone in 1876.
Apple and Samsung began suing each other in 2011 for patent infringement, with numerous court cases and appeals. The multiple lawsuits were finally settled in 2018, with a jury awarding Apple $539 million (Reuters, 2018).

Figure 4.7: Patenting inventions such as the Slinky helps ensure that the invention is protected from imitation.

Patents are legal decrees that protect inventions from direct imitation for a limited period of time (Table 4.6). Obtaining a patent involves navigating a challenging process. To earn a patent from the US Patent and Trademark Office, an inventor must demonstrate that an invention is new, non-obvious, and useful. If the owner of a patent believes that a company or person has infringed on the patent, the owner can sue for damages. Patenting an invention is important because patents can fuel enormous profits. Imagine, for example, the potential for lost profits if the Slinky had not been patented. Shipyard engineer Richard James came up with the idea for the Slinky by accident in 1943 while he was trying to create springs for use in ship instruments. When James accidentally tipped over one of his springs, he noticed that it moved downhill in a captivating way. James spent his free time perfecting the Slinky and then applied for a patent in 1946. To date, more than three hundred million Slinkys have been sold by the company that Richard James and his wife Betty created.

Trademarks

Trademarks are phrases, pictures, names, or symbols used to identify a particular organization (Table 4.7). Trademarks are important because they help an organization stand out and build an identity in the marketplace. Some trademarks are so iconic that almost all consumers recognize them, including McDonald's golden arches, the Nike swoosh, and Apple's outline of an apple.

Other trademarks help rising companies carve out a unique niche for themselves. For example, French shoe designer Christian Louboutin has trademarked the signature red sole of his designer shoes. Because these shoes sell for many hundreds of dollars via upscale retailers such as Neiman Marcus and Saks Fifth Avenue, competitors would love to copy their look. Thus, legally protecting the distinctive red sole from imitation helps preserve Louboutin's profits.

Trademarks are important to colleges and universities. Schools earn tremendous sums of money through royalties on t-shirts, sweatshirts, hats, backpacks, and other consumer goods sporting their names and logos. On any given day, there are probably several students in your class wearing one or more pieces of clothing featuring your school's insignia; your school benefits every time items like this are sold. Schools' trademarks are easy to counterfeit, however, and the sales of counterfeit goods take money away from colleges and universities. Not surprisingly, many schools fight to protect their trademarks. Virginia Tech filed a lawsuit in 2011 against a new local business called Hokie Real Estate, claiming trademark infringement. Virginia Tech had received a legal trademark for its nickname Hokies. Hokie Real Estate prevailed, as there were a number of other businesses in the locality also using the Hokie name.

Figure 4.8: Fashionistas instantly recognize the trademark red sole of Christian Louboutin's high-end shoes.

An organization's trademarks consist of phrases, pictures, names, or symbols that are closely associated with the organization. Some examples and key issues surrounding trademarks are illustrated below.

Table 4.7 Trademarks

Examples of Trademarks
To be fully protected in the United States, a trademark must be registered with the United States Patent and Trademark Office. A capital R with a circle around it denotes a registered trademark.
As part of the punishment for German aggression during World War I, German drug maker Bayer lost its trademark on "Aspirin" in France, Russia, the United Kingdom, and the United States. Today, Bayer still retains its trademark in Germany, Canada, Mexico and dozens of other countries.
Many small companies use their founders' name as the basis for a trademarked company name.
The distinctive pattern of clothing retailer Burberry Ltd. is an example of a trademark that does not involve words or symbols.

Copyrights

The rights of creators of original artistic works such as books, movies, songs, and screenplays are protected by copyrights. Some examples and key issues surrounding copyrights are illustrated below.

Table 4.8 Copyrights

Examples of Copyrights
Illegal downloads of music are copyright infringements. In spite of laws and increased enforcement, millions of songs are obtained illegally.
Today's cheesy television ads aimed at inventors follow a long tradition of companies offering to help individuals copyright their ideas–for a small fee, of course.
The presence of the copyright symbol tells consumers that they are not allowed to duplicate the product that carries the copyright.
A painting such as Johannes Vermeer's "Girl with a Pearl Earring" enters the public domain (i.e., is not subject to copyright) one hundred years after its creator's death.
When it became apparent that The Verve's 1997 hit single "Bittersweet Symphony" duplicated a Rolling Stones song, The Verve was forced to give up the copyright for the song.

Copyrights provide exclusive rights to the creators of original artistic works such as books, movies, songs, and screenplays for an author's lifetime plus 70 years (Figure 4.8). Sometimes copyrights are sold and licensed. In the late 1960's, Buick thought it had an agreement in place to license the number one hit, "Light My Fire" by The Doors, for a television advertisement until the band's volatile lead singer Jim Morrison loudly protested what he saw as mistreating a work of art. Classic rock by The Beatles has been used in television ads in recent years. After the late pop star Michael Jackson bought the rights to the band's music catalog, he licensed songs to Target and other companies. Some devoted music fans consider such ads to be abominations, perhaps proving the merit of Morrison's protest decades ago.

Figure 4.9: He looks calm here, but the licensing of a copyrighted song for a car commercial enraged rock legend Jim Morrison.

Over time, piracy has become a huge issue for the owners of copyrighted works. In China, millions of pirated DVDs are sold each year, and music piracy is estimated to account for at least 95% of music sales. This piracy deprives movie studios, record labels, and artists of millions of dollars in royalties. In response to the damage piracy has caused, the US government has pressed its Chinese counterpart and other national governments to better enforce copyrights.

Trade Secrets

Trade secrets refer to formulas, practices, and designs that are central to a firm's business and that remain unknown to competitors (Table 4.9). Trade secrets are protected by laws on theft, but once a secret is revealed, it cannot be a secret any longer. This leads firms to rely mainly on silence and privacy rather than the legal system to protect trade secrets.

Trade secrets are formulas, practices, and designs that are central to a firm's business and that remain unknown to competitors. Everyone loves a good mystery, so it is no surprise that legends have arisen around some trade secrets. Some examples and key issues surrounding trade secrets are illustrated below.

Table 4.9 Trade Secrets

Examples of Trade Secrets
Low-end fast food chain Long John Silver's considers its "crumblies" (small bits of fried batter) to be a trade secret, but would anyone really want to solve the mystery?
In 2006, Pepsi was offered a chance to buy a stolen copy of Coca-Cola's secret recipe. An FBI sting was created and the thieves were arrested.
WD-40 was developed to repel water and prevent corrosion, but it was later found to have over two thousand uses. Creating WD-40 took a lot of work: the product's unusual name stands for "Water Displacement, 40th attempt." Despite being created in 1953, the formula for making WD-40 remains unknown outside the company that sells it.
FarmVille creator Zynga alleged in a lawsuit that Disney had lured away Zynga employees to work for Disney and then urged the employees to turn over a secret "playbook" that described Zynga's strategy. The case was settled out of court in late 2010.
In a 1995 episode of the hit comedy Seinfeld, a very successful but mean-spirited restaurateur nicknamed the "Soup Nazi" saw his business collapse when his secret recipes were revealed to customers. Individuals could now make delicious soups at home rather than endure the Soup Nazi's verbal abuse when buying soup.

Figure 4.10: The recipe for Dr Pepper is a secret dating back to the 1880s.

Some trade secrets have become legendary, perhaps because a mystique arises around the unknown. One famous example is the blend of eleven herbs and spices used in Kentucky Fried Chicken's original recipe chicken. KFC protects this secret by having multiple suppliers each produce a portion of the herb and spice blend; no one supplier knows the full recipe. The formulation of Coca-Cola is also shrouded in mystery. In 2006, Pepsi was approached by shady individuals who were offering a chance to buy a stolen copy of Coca-Cola's secret recipe. Pepsi wisely refused. An FBI sting was used to bring the thieves to justice. The soft-drink industry has other secrets too. Dr Pepper's recipe remains unknown outside the company. Although Coke's formula has been the subject of greater speculation, Dr Pepper is actually the original secret soft drink; it was created a year before Coca-Cola.

Section Video

Understanding Intellectual Property (IP) [02:14]

The video for this lesson further explains intellectual property.

You can view this video here: https://youtu.be/UqZJPuyK9VY.

Isolating Mechanisms

The goal of a firm is to have a sustained competitive advantage, whereby a resource or capability of the firm provides a competitive edge for a long time. The length of time a firm can maintain a sustained competitive advantage depends on the industry. A company in a fast-moving industry, such as information technology or fast fashion, may be quite satisfied if they can hold a competitive advantage for a year. A sustained competitive advantage in another type of industry, like feminine hygiene that does not have such frequent changes may last much longer. No firm is able to keep a sustained competitive advantage indefinitely. The competition is always attempting to gain its own competitive advantage.

If a firm can prevent a competitor from imitating the resource or capability that gives it a competitive advantage, it is able to sustain that advantage longer. This strategy is called **isolating mechanisms**. A patent, for example, is a legal way to prevent imitation. Sometimes a competitor is able to "re-engineer" the patented concept by making slight changes, working around the patent to imitate the idea without infringing on the patent. There are other isolating mechanisms a firm may be able to employ to lessen the likelihood of imitation by a competitor. These other isolating mechanisms are Social Complexity, Path Dependence, and Causal Ambiguity.

Social Complexity

The interrelationships within a firm, along with relationships within or across a business process, can be difficult to imitate. For example, key relationships that members of a firm have with a supplier of a key strategic resource create a condition that a competitor cannot duplicate. This **social complexity** creates a barrier to imitation and can prolong a competitive advantage possessed by an organization. Social complexity might arise through certain customer relationships or with key political figures, provided they can help the firm's competitive position. For example, a CEO of a firm in the defense industry may cultivate relationships with key members of Congress that help bring business to that firm, at the expense of the competition (in this example, this might be called collusion, but that is a story for another day, and Chapter 11 on corporate ethics).

Path Dependence

The path that a firm takes over time to achieve the point of a competitive advantage may also provide a barrier to imitation. Decisions made in the past that brought a firm to its current position may make it very difficult for other firms to imitate. The accumulated learning and experience gained along the historical path are not easily duplicated. This **path dependence** can serve as an isolating mechanism to block competitors from gaining the same position in the market. Warby Parker, for example, made a decision early in its development to build relationships with a variety of suppliers and to use the "buy one, give one" strategy, where a pair of glasses is given away to someone in need for every pair sold. This decision and path created loyal suppliers and customers within the online eye wear industry, and a copycat strategy by a competitor would likely be cost prohibitive.

Causal Ambiguity

The third isolating mechanism, **causal ambiguity**, means the reason for achieving a competitive advantage is not apparent. The cause for success is obscure and not understood well. Because the firm itself does not really know why it has achieved success, it is quite difficult for a competitor to replicate it. For example, why does Netflix still enjoy immense popularity in spite of numerous streaming competitors? In 2020 Netflix had a market penetration of 54%, while Amazon Prime is a distant second at 30% (Roxorough, 2019). Is it because they were the first mainline streaming service? Is it related to CEO Reed Hastings? Does content make a big difference? Competitors find it difficult to duplicate Netflix's success model because it is not clear what has caused it.

It was noted earlier in this chapter that intangible resources are usually more valuable than tangible ones in the context of sustained competitive advantage. The reason for this is due, in part, to the isolating mechanisms discussed above. Physical resources tend to be in abundance and are far easier to obtain. So, if two firms have the same physical resources, then there is little to no differentiation. The key distinction that firms can make is how they use those physical resources in their value chain. The intangible resources including skills, knowledge, or brand name used to capitalize on physical resources are far more likely to produce an advantage for firms than simply possessing a physical resource alone. In this way, firms such as Nike can capitalize on marketing and their brand to sell shoes at a premium when their shoes have few physical differences from their competitors. In some cases, a manufacturing facility may very well produce the same product for multiple companies (e.g., t-shirts). In such cases the difference to consumers is the brand.

Key Takeaway

- Intellectual property can serve as a strategic resource for organizations. While some sources of intellectual property such as patents, trademarks, and copyrights can receive special legal protection, trade secrets provide competitive advantages by simply staying hidden from competitors.
- Utilizing isolating mechanisms strategically is a way for organizations to prevent imitation and maintain their competitive advantage.

Exercises

1. What designs for your college or university are protected by trademarks?
2. What type of intellectual property provides the most protection for firms?
3. Why would a firm protect a resource through trade secrets rather than by a formal patent?

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Image Credits

Figure 4.7: McLassus, Roger. "Metal slinky." CC BY-SA 3.0. Retrieved from https://upload.wikimedia.org/wikipedia/commons/f/f3/2006-02-04_Metal_spiral.jpg.

Figure 4.8: Arroser. "Christian Louboutin." CC BY-SA 3.0. Retrieved from https://upload.wikimedia.org/wikipedia/commons/6/62/Louboutin_altadama140.jpg.

Figure 4.9: Persson, Jan and Polfoto. "The Doors performing for Danish television in Copenhagen." Public Domain. Retrieved from https://upload.wikimedia.org/wikipedia/commons/1/15/The_Doors_in_Copenhagen_1968.jpg.

Figure 4.10: Anyjazz65. "Dr. Pepper." CC BY 2.0. Retrieved from https://flic.kr/p/7uDd8e.

Video Credits

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4.5 Value Chain

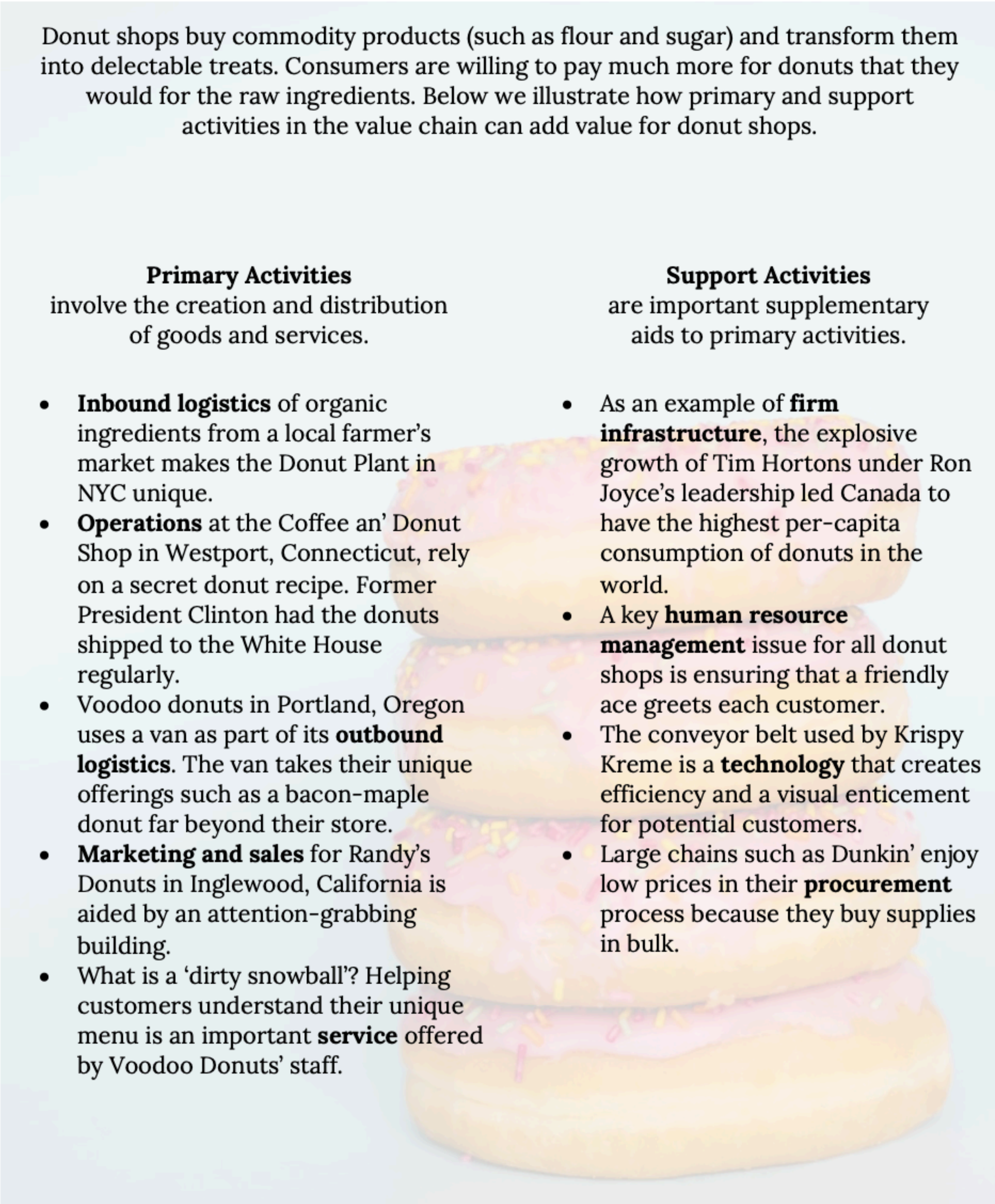

Figure 4.11: Adding Value within a Value Chain.

Elements of the Value Chain

When executives choose strategies, an organization's resources and capabilities should be examined alongside consideration of its **value chain**. A value chain charts the path by which products and services are created and eventually sold to customers (Porter, 1985). The term value chain reflects the fact that, as each step of this path is completed, the product becomes more valuable than it was at the previous step (Table 4.10). Within the lumber business, for example, value is added when a tree is transformed into usable wooden boards; the boards created from a tree can be sold for more money than the price of the tree.

The Value Chain is used as an internal assessment tool to help a firm determine where it might be able to achieve a competitive advantage. In which areas of the primary and secondary activities is the firm particularly strong? Can that activity be leveraged to provide a competitive advantage over its rivals? Resources and/or capabilities within that activity can be evaluated using the **VRIO framework** to determine what type of competitive advantage they provide. For example, Netflix was the first firm to leverage its technology development support activity to bring high quality movies to customers through streaming. Being the first mover in this industry gave Netflix a foothold and reputation in this industry, and others have not been able to catch up. When using this tool for internal assessment, each activity of the Value Chain should be examined for its potential to achieve a competitive advantage. Conversely, weak activities in the Value Chain are opportunities to improve organizational performance. The overall intent of the Value Chain is to produce a profit margin for the firm.

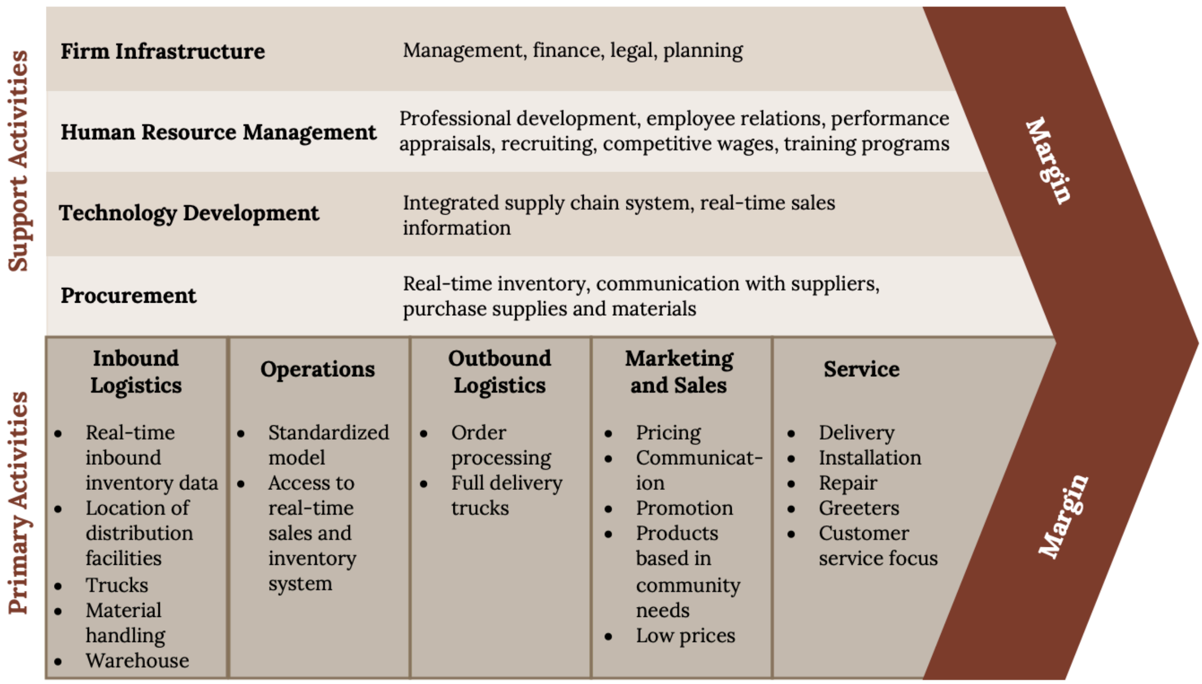

Figure 4.12: The Value Chain

Value chains include both primary and secondary activities. Primary activities are actions that are directly involved in creating and distributing goods and services. Consider a simple illustrative example: doughnut shops. Doughnut shops transform basic commodity products such as flour, sugar, butter, and grease into delectable treats. Value is added through this process because consumers are willing to pay much more for doughnuts than they would be willing to pay for the underlying ingredients.

There are five primary activities. Inbound logistics refers to the arrival of raw materials. Although doughnuts are seen by most consumers as notoriously unhealthy, the Doughnut Plant in New York City has carved out a unique niche for itself by obtaining organic ingredients from a local farmer's market. Operations refers to the actual production process, while outbound logistics tracks the movement of a finished product to customers. Referring back to Southwest Airlines, one of Southwest Airlines' unique capabilities is moving passengers more quickly than its rivals. This advantage in operations is based in part on Southwest's reliance on one type of airplane (which speeds maintenance) and its avoidance of advance seat assignments (which accelerates the passenger boarding process).

Attracting potential customers and convincing them to make purchases is the domain of marketing and sales. For example, people cannot help but notice Randy's Donuts in Inglewood, California, because the building has a giant doughnut on top of it. Finally, service refers to the extent to which a firm provides assistance to their customers. Voodoo Donuts in Portland, Oregon, has developed a clever website (voodoodoughnut.com) that helps customers understand their uniquely named products, such as the Voodoo Doll, the Texas Challenge, the Memphis Mafia, and the Dirty Snowball.

Secondary activities are not directly involved in the evolution of a product, but instead provide important underlying support for primary activities. Firm infrastructure refers to how the firm is organized and led by executives. The effects of this organizing and leadership can be profound. For example, Ron Joyce's leadership of Canadian doughnut shop chain Tim Hortons was so successful that Canadians consume more doughnuts per person than all other countries. In terms of resource-based theory, Joyce's leadership was clearly a valuable and rare resource that helped his firm prosper.

Human resource management is also important. Human resource management involves the recruitment, training, and compensation of employees. A recent research study used data from more than twelve thousand organizations to demonstrate that the knowledge, skills, and abilities of a firm's employees can act as a strategic resource and strongly influence the firm's performance (Crook et al., 2011). Certainly, the unique level of dedication demonstrated by employees at Southwest Airlines has contributed to that firm's excellent performance over several decades.

Technology refers to the use of computerization and telecommunications to support primary activities. Although doughnut making is not a high-tech business, technology plays a variety of roles for doughnut shops, such as allowing customers to pay using credit cards.

Procurement is the process of negotiating for and purchasing raw materials. Large doughnut chains such as Dunkin' and Krispy Kreme can gain cost advantages over their smaller rivals by purchasing flour, sugar, and other ingredients in bulk. Meanwhile, Southwest Airlines has gained an advantage over its rivals by using futures contracts within its procurement process to minimize the effects of rising fuel prices.

Sometimes competitive advantage is achieved from the support activities of a firm as opposed to the primary activities. Superior technology development or human resource management can produce a temporary if not a sustained competitive advantage. A strong research and development arm in a pharmaceutical company can develop medications that are patented and cannot be imitated. Incentives to staff such as those provided by 3M and Google to be creative and develop new products have resulted in a competitive advantage.

Section Video

Strategic Management: Value Chain Analysis [04:41]

The video for this lesson further discusses value chain analysis.

You can view this video here: https://youtu.be/Tpb1fxt9YfU.

Key Takeaway

- The value chain provides a useful tool for managers to examine systematically where value may be added to their organizations. This tool is useful in that it examines key elements in the production of a good or service, as well as areas in which value may be added in support of those primary activities.

Exercises

1. If you were hired as a consultant for your university, what specific element of the value chain would you seek to improve first?
2. What local business in your town could be improved most dramatically by applying the value chain? Would improvements of primary or support activities help to improve this firm most? Could knowledge of strategic supply chain management add further value to this firm?

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Image Credits

Figure 4.11: Kindred Grey (2020). “Adding value within a value chain.” CC BY NC SA 4.0. Image of donut: Annie Spratt (2016). “Stacked donuts.” Public Domain. Retrieved from: https://unsplash.com/photos/AjTclDIadpg Adaptation of Figure 4.10 from Mastering Strategic Management (2015) (CC BY NC SA 4.0). Retrieved from https://open.lib.umn.edu/app/uploads/sites/11/2015/04/9c5437a4d7bfd1ad4b0baa480978c7bd.jpg.

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4.6 Conclusion

This chapter explains key issues that executives face in managing resources to keep their firms competitive. Resource-based theory argues that firms will perform better when they assemble resources that are valuable, rare, difficult-to-imitate, and organized to capture value. When executives can successfully bundle organizational resources into unique capabilities, the firm is more likely to enjoy lasting success. Different forms of intellectual property—which include patents, trademarks, copyrights, and trade secrets—may also serve as strategic resources for firms. Examining a firm’s resources can be aided by the value chain, a tool that systematically examines primary and secondary activities in the creation of a good or service.

Exercises

1. Divide your class into four or eight groups, depending on the size of the class. Each group should search for a patent tied to a successful product, as well as a patent associated with a product that was not a commercial hit. Were there resources tied to the successful organization that the poor performer did not seem to attain?
2. This chapter discussed Southwest Airlines. Based on your reading of the chapter, how well has Southwest done in bundling together the resources recommended by resource-based theory? What theoretical perspective best explains the competitive actions of most firms in the airline industry?