From Industry to Firm Resources: Resource-Based View of Competitive Advantage

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The emergence of resource-based view of the firm in strategic management during 1980s has become a dominant framework and it shifts our attention from the industry to the firm level as a prime determinant of firms' profitability. The theory is still in the evolving phase and its epistemology is getting richer day-by-day. The paper traces the roots of resource-based view, elucidates its economic logic and presents the critics' views. In addition, the theory's empirical assessment is presented and the methodological concerns of the research are discussed. Finally, its managerial significance is elaborated and a conclusion is drawn with regard to its contribution in the field of strategic management.

Introduction

Since the advent of the Resource-Based View (RBV) of the firm in strategic management literature, much has been debated, written and tested to validate this theoretical perspective. During its long journey, we have also witnessed the proliferation of different domains like dynamic capability (Teece *et al.*, 1997), strategic leadership (Finkelstein and Hambrick, 1996) and knowledge-based view (Kogut and Zander, 1992) within the RBV framework. Breaking the influence of Porter's (1980) Structure-Conduct-Performance (S-C-P) paradigm and establishing itself as a stand-alone model of competitive advantage is not an easy task to the RBV scholars, yet this stream of research has shown an immense potential with regard to the strategic implication of the firm's resources. Though RBV is still in its infancy, it is imperative for the strategy scholars to assess its past so as to embark its future path. Keeping this need in mind, this paper traces the origin of RBV, elicits its underlying economic rationale and presents the critic's views. Finally, we also find the answers as to what extent the empirical tests support the theory and how far it helps managers in crafting strategies.

RBV: A New Era in Strategic Management

During 1980s, the field of strategy has seen a paramount shift from the traditional concepts of Ansoff (1965), Andrews (Learned *et al.,* 1965) and Chandler (1962), who have provided the foundation of strategic management (Rumelt *et al.*, 1994). Porter (1980) in his framework has explicitly recognized that a firm's performance is determined by the industry attractiveness and to some extent by firm effects (Grant, 1991a). As industry structure to some extent is susceptible to firm's strategy, these two determinants of performance are interrelated. Therefore, once the firm gains its competitive advantage

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over its rivals either by 'cost leadership' or 'differentiation', it will try to cope with the industry forces and ideally changes those industry forces in its favor to sustain the competitive advantage. Though, it is well-understood now that Porter's (1980) framework is primarily based on the Bain-Mason's Industrial Organization (IO) economics concept (S-C-P paradigm), it differs from it in several ways. First, unlike Bain-Masonian concept, Porter focuses on the role of firm activities and positioning as a fruitful way for the development of the dynamic theory of strategy (Spanos and Lioukas, 2001), even though industry structure still remains the central tenet in explaining the firm's performance. Second, his five-forces framework of industry is much more tangible as compared to the unclear industry structure of the IO economics (Hoskisson *et al.*, 1999). According to Barney (2002), the contribution of Porter is most influential in the strategic management field to make strategy from an 'informed conversation' to an 'academic discipline' with important managerial implications. However, the central tenet of Porter's model is questioned whether industry factors are primary determinants of firm's profitability. The amount of evidences in support of S-C-P paradigm is few. On the contrary, a number of studies (Schmalensee, 1985; Cubbin and Geroski, 1987; and Jacobsen, 1988) have indeed found that it is the firm-level factors and not the industry factors that explain greater variance in firm's profitability. In more recent studies (Rumelt, 1991; Powell, 1996; and Hawawini *et al.*, 2003), the earlier view is again echoed that firm-specific factors have a dominant effect on firm performance. Though not clearly reflected, McGahan and Porter (1997) have found in their study that industry represents an important factor in explaining firm's economic performance and more specifically industry effects are more important in accounting for firm's performance in service industry than in manufacturing industry. Therefore, the question whether performance is driven by industry or firm-specific factors remains the central issue in strategic management and the debate is still open.

In search for the answer, scholars have started looking inside the firm and it gives rise to a new approach in strategic management field. Closely in line with the Chicago school of thought, this approach sees industry structure as the efficiency outcome instead of market power, to indicate that performances vary among firms due to the differences in resource endowments (Rumelt *et al.*, 1991). This new approach is known as RBV. Though the footprints of RBV is found much earlier works of Penrose (1959) and Wernerfelt (1984), it has not gain popularity until it has been diffused single-handedly by Prahalad and Hamel (1990) explaining the business world how a firm like NEC becomes the world leaders by seeing themselves in terms of core competencies (Wernerflet, 1995).

The Underlying Core of RBV

The founding base of RBV is given by Penrose (1959) when she describes a firm as a collection of resources and goes on arguing that it is the heterogeneity of the services available from resources that gives each firm its unique character. She adopts a broad definition of resources to include managerial skills as well as entrepreneurial skills. Later on, Wernerfelt (1984) defines firm's resources as tangible and intangible assets which are tied semi-permanently to the firm and posits that it is possible to develop a theory of competitive advantage based on the resources that a firm controls in accordance with the dualistic reasoning of economics. The implication of his thought is that competition for resources and among firms based on their resource profiles can have an important implication for the ability of the firms to gain competitive advantage in implementing the product-market strategy. Following his work, a group of researchers (Rumelt, 1984; Barney, 1986a; and Diericx and Cool, 1989) have been trying to build a normative theory of RBV to explain the logic of rent generation. Rumelt (1984) in his paper also views firms as a bundle of resources and asserts that economic values of resources vary depending on the context in which they are used and introduces the concept of 'isolating mechanism' for inimitability of resources. As opposed to the Porter's (1980) view of superior firm-performance as a result of entering and operating in an attractive industry, Barney (1986c) argued that if the factor market of resources are perfectly competitive, it is not possible for a firm to get economic rent even if it is successful in creating an imperfect product-market because the price paid to such resources will be equal to its value that the resource will create in the product-market. There is an imperfection in the factor-market which is result of luck or insights of the firm. An extended view of Barney's concept is reflected in Diericx and Cool's (1989) paper where the authors show how a resource, already in the possession of a firm, can create rent. According to them, if a resource is causally ambiguous, characterized by interconnected asset stocks or asset mass efficiencies and are subject to time compression diseconomies, it is less likely that the resource would be affected by the factor-market competition.

In parallel, another group of researchers emphasize on examining which specific resource gives rise to sustainable competitive advantage. They identified the following resources: human resources (Amit and Schoemaker, 1993), response lags (Lippmen and Rumelt, 1982), organizational routines (Nelson and Winter, 1982), organizational culture (Barney, 1986b) and invisible assets which are difficult to imitate (Itami, 1987). Though advancement is made in several fronts, this theoretical perspective is lacking an integrative and comprehensive framework. Barney (1991) first presents a framework of the RBV of the firm, which subsequently became an authoritative literature in the strategy field. His seminal work is considered as the first formalization of the fragmented resource-based view into a comprehensive, empirically testable theoretical framework (Newbert, 2007).

Barney (1991) in his framework has made two fundamental assumptions: (1) firm resources and capabilities are heterogeneously distributed among firms; and (2) resources and capabilities are imperfectly immobile (i.e., resources are sticky). Following these two assumptions, he made two arguments. First, resources and capabilities that are both valuable and rare will attain competitive advantage. Second, the resources and capabilities that meet the first criteria and if they are simultaneously inimitable and not substitutable, generate sustained competitive advantage. Therefore, rarity and value are each necessary but not sufficient condition of competitive advantage, whereas inimitability and non-substitutability are each necessary but not sufficient condition for sustainable competitive advantage. From the strategic perspective, the RBV then suggests that a firm should identify its strategically relevant resources and capabilities which are valuable, rare, inimitable and non-substitutable. These resources and capabilities would enable the firm implementing a strategy to generate sustainable competitive advantage (Barney, 1991; and Spanos and Lioukas, 2001). The above resources are sometimes called critical resources (Welnerfelt, 1989) and they help the firm to participate in its product-market relatively more efficiently (more economically) and effectively (better satisfy customer wants) (Barney, 1991; and Peteraf, 1993). The two words, efficiently and effectively have important connotation in RBV. To gain competitive advantage, the firm has to create greater economic value to the customers, as compared to the least efficient competitor capable of braking even (Pereraf, 1993; and Peteraf and Barney, 2003). In RBV, greater economic value (competitive advantage) is created from the efficiency of the resources which enable the firm to produce greater perceived benefits for the same cost (efficiency in differentiation) or same perceived benefits for a lower cost (lower cost). Therefore, in RBV, the firm competes in the product-market either by offering differentiated products or by attaining low cost position relative to its rivals (Conner, 1991) and the competitive advantage it gets arises from the efficiency of the critical resources. So RVB is essentially an efficiency-based theory (Peteraf and Barney, 2003). At this point, one must remember that competitive advantage requires both—valuable and rarity—of resources. This argument follows the following logic. A resource may be valuable but not scare. In this case, all firms competing in a product-market will get the resource in question and hence implement the common strategy resulting no firm to get competitive advantage. On the other hand, a resource may be scare but not valuable. It means that the firm holding such resource will not be able to use it efficiently and effectively to create economic value than its rival. The opportunity cost of such resource to the firm may be sufficiently high to offset much of the perceived benefit produced. Thus, little or no competitive advantage will be created despite the scarcity of such resource.

The RBV views competitive advantage (i.e., creating the greater value than rivals) as a rent to the critical resources which are valuable and rare. If competitive advantage is not created due to use of such resources, RBV cannot be applied. Once a firm establishes competitive advantage, the next question would obviously be whether it is sustainable or not. The answer to this question lies in the fact that to what extent the resources are inimitable and non-substitutable. The RBV scholars suggest that the rent that is created by the superior resources (valuable and rare) may be temporary or short-lived because scarcity need not be a long-lived phenomenon. For instance, a newly invented technology may be a scare resource to the firm. If this technology is easy to imitate, it becomes no longer a scare resource. If the firm enforces strict secrecy, rarity may be a long-term phenomenon. At the same time, if the valuable and rare resources are substitutable, sustainability of competitive advantage is not possible. Therefore, sustainability requires both inimitability and non-substitutability of resources.

The central tenet for explaining the sustainability of competitive advantage in the resource-based framework is this 'barriers to imitation' (Mahoney and Pandian, 1992). According to Barney (1991), a firm's resources are imperfectly imitable for one or more of the following reasons: (1) resource obtained through unique historical conditions; (2) causal ambiguity; and (3) social complexity. Unique historical conditions may create an opportunity to acquire or develop a resource for a firm which may not be recreated and hence make the resources difficult to imitate. For instance, Caterpiller was chosen as a sole supplier of construction equipments to military bases around the world, at a time when no supplier had global presence. History may be viewed as creating a path-dependency, so that the development of the resource arises from a series of events, occurring over time that would be difficult to replicate. Causal ambiguity arises when the linkage between the firm resources and competitive advantage is not understood or imperfectly understood. Thus it would be difficult for firms to imitate the actions to duplicate the strategies to tap competitive advantage. To be source of sustained competitive advantage, it is necessary that both the firms that possess these kind of resources that create competitive advantage and the imitating firms must have the same level of causal ambiguity. If the link is understood by any of these firms, it will be diffused in the long run to eliminate the causal ambiguity. However, Reed and DeFillippi (1990) argued that even if the firm that possess resources understands better the underlying causal relationship than its rivals, it can sustain the advantage by reinvesting in sources of ambiguity (tacitness, complexity and asset specificity). Many firm resources are socially complex to systematically manage and influence and this acts as a barrier to imitation. Social complexity arises from the interpersonal relations among managers, firm culture, relationship with suppliers and relationship with customers. For instance, Hewlett Placard (HP) has a strong and enabling culture which promotes teamwork and cooperation across divisions. HP uses this capability to enhance the compatibility of various products. This is very difficult to imitate this culture for others.

The final requirement of sustainable competitive advantage is non-substitutability. It signifies that there should not be any equivalent valuable resources that are not rare or imitable. If there is any substitute, then other firms will pursue the same strategy which will eventually dissipate the competitive advantage.

It is very interesting to note the several changing perspectives of strategic management orientation. Porter's framework is based on IO which does not allow firms' heterogeneity within an industry. Seth and Thomas (1994) have commented clearly that theories which assume firm homogeneity may have a little use in strategic management research. From this perspective RBV allows this flexibility to understand what is going inside the 'black box'. RBV treats resource heterogeneity as an outcome of luck as opposed to strategic behavior of the firm (resources to strategy), whereas Porter's framework suggests that a firm accumulates productive resources from a combination of some strategic behavior and stochastic processes (strategy to resources). There is another way to look into these two theoretical perspectives. Porter emphasized on the creation of imperfection of a firm's product-market for competitive advantage. RBV emphasizes on the factor-market imperfection. However, it is better to view these two thoughts not as rivals but as complementary as Wernerfelt (1984) considered that product market and resource market are two sides of the same coin.

Critics of RBV

Since its publication, Barney's (1991) RBV model, as described above, has attracted scholars' attention but it is not above criticism. Critics view RBV logic as paradoxical, contradictory, ambiguous and incompatible for managerial practice. For instance, Priem and Butler (2001a) have made four concerns over RBV: (1) the theory is tautological; (2) underdeveloped role of product market; (3) many different resource configurations can generate same value for firms and therefore, would not be the source of competitive advantage; and (4) limited managerial prescription. Among these, perhaps the first two are most serious ones. The underlying fundamental statement that 'valuable and rare organizational resources can be source of competitive advantage' is accused of being tautological because competitive advantage is defined in terms of value and rarity.[1] This statement is true by definition and cannot be subjected to empirical testing. For instance, Preim and Butler (2001b) comment 'if valuable resources are defined as those increasing efficiency and/or effectives, and competitive advantage is defined as achieving increase in efficiency and/or effectives, a tautology exists'. They further assert that resource characteristics and outcomes must be conceptualized independently to produce a synthetic statement. With regard to the underdeveloped product-market, the critics argue that in RBV, the determination of the 'value' of resource is exogenous. So, its implicit homogeneous and immobile product-market assumption may not reflect the reality. Moreover, this externally determined value has led RBV to contribute little in the prediction or explanation of competitive advantage.[2] In other words, this limits the RBV's prescriptive ability to practitioners. Some scholars argue that RBV can lead to 'infinite regress', a situation that can lead to endless and futile search for ultimate stock of resources and capabilities which generate sustained competitive advantage. Despite the above criticism, RBV continues to be a widely accepted area for strategic management research. It is so because the framework allows a dialogue from variety of perspectives and it is a good management science (Mahoney and Pandian, 1992). Conner (1991) has gone a step further to say RBV as a 'new theory of the firm' as it markedly differs from IO predecessors as well as from transaction cost theory. Lado *et al.* (2006) asserts that given the paradoxes of RBV logic, researchers can work to advance our understanding rather than insist on theoretical purity.

[1] Barney (2001a) responded to this criticism by arguing that at the definitional level many of the strategic management theories are tautological. We can still derive empirically testable meaningful hypotheses out of tautological statement.

[2] Preim and Butler (2001b) in fact argued that RBV is a theory of sustainability, not competitive advantage. Therefore a challenge for RBV is to develop a theory which explains how value is created and not just the sustainability of value.

Recent Trends and Advances

Advances have been made in several fronts. One of main critics of RBV is that this model is static in nature. In fact, Barney (2001a) himself has acknowledged that the assumption made in 1991 article that 'once a firm understands how to use its resources… implementation follows, almost automatically' has taken granted of this fact that the firm will exploit resources. In response to this, scholars (Mahoney and Pandian, 1992; and Peteraf, 1993) argued that mere existence of resources does not guarantee competitive advantage. What is important is that the process by which the firm exploits its resources. The reflection of this concern in RBV is first seen in Barney's (1997) VRIO framework where he suggests that a firm need to be organized in terms of structure, control systems and compensation policies so as to exploit the full potential of its resources if it wants to attain the competitive advantage. Shortly, Teece *et al.* (1997) have presented a concept of 'dynamic capability' to explain how combinations of competencies and resources can be developed, deployed and protected. According to them, dynamic capability is the firm's ability to integrate, build and reconfigure internal and external competencies to address rapidly changing environments. Montgomery (1995) observed that rigidities in acquiring resources could be different from rigidities in shedding resources and some resources may have negative value by creating core rigidities. Oliver (1997) has extended the boundary of the RBV to incorporate institutional perspective to explain firm-level performance variance. She argued that a firm's sustainable advantage depends on its ability to manage the institutional context of its resource decisions which includes internal culture and broader influences from state, society and interfirm relations. Some researchers are examining the specific resources that give rise to sustainable competitive advantage: organizational culture (Barney, 1986b), functionally-based distinctive competencies, (Hit and Ireland, 1985 and 1986) and invisible assets that are difficult to imitate (Itami, 1987) among others. There are also subareas coming out from RBV like strategic leadership and knowledge-based view of the firm (Hoskisson *et al.,* 1999). It is argued that a firm's strategic leaders (CEO, top management teams or board of directors) are unique resources and they have an impact of organizational performance. Past researches have found that organizational performance is associated with executives past performance, top-management team size, composition and tenure (Smith *et al.*, 1984; Pfeffer and Davis-Black, 1986; and Haleblian and Finkelstein, 1993). Knowledge-based view looks firms as a repository of knowledge bearing activities which is later on extended by Kogut and Zander (1992) to posit that firms do better than market when identity leads to social knowledge that supports coordination and communication. It is also argued that through tacitness and social complexity, a firm's knowledge-base is considered as source of competitive advantage. As a result, researchers under this school of thought explore various issues like absorptive capacity (Cohen and Levinthal, 1990), approaches of organizational learning (Pisano, 1994) and the process of knowledge creation (Nonaka, 1994).

Empirical Support of RBV

Till now we have two studies which make an assessment of RBV. Barney and Arikan (2001) reviewed 166 articles on RBV and classify them into three broad disciplines: strategic management, human resources and others. Strategic management researchers emphasize on the following areas: (1) firm versus industry effect; (2) resources and firm performance; (3) corporate strategy, international strategy and strategic alliance which exploit valuable, rare and inimitable resources produce greater return than those which exploit other resources; and (4) no rule for riches. Under the human resource discipline, the main theme of research is whether human resources and human resource policies can affect firm performance. Studies falling in other category mainly test the linkage between various functional resources and firm performance. The authors report that the result of only four studies (one from firm versus industry effect and three from resources and firm performance) are not consistent with RBV logic.

Newbert (2007), however, criticizes the findings of the above assessment of RBV on the ground that non-findings are not treated as inconsistent results by Barney and Arikan (2001). Moreover, it is argued that there could be a selection bias in the sample. He assessed the results of the past findings on the basis of a carefully selected sample of 55 studies after grouping them into four categories: studies that use resource heterogeneity approach (relationship between specific resource/capability/core competency and firm performance/competitive advantage), studies that use organizing approach (relationship between the interaction of resource/capability and organizing context and firm performance/competitive advantage), conceptual level studies (relationship between value/rareness/inimitability and performance/competitive advantage/sustained competitive advantage) and studies that use dynamic capability approach (relationship between the interaction of resource/capability and, performance). He found that the overall support is marginal (53%). Conceptual level studies has obtained highest support (77%) followed by organizing approach (58%), resource heterogeneity approach (51%) and dynamic capability approach (38%). However, it is difficult to arrive at any definitive conclusion from these findings as RBV is still in its infancy and many of the strategic management theories yield similar level of support. For instance, transaction cost economics is assessed to have a support of only 47% (David and Han, 2004). Newbert (2007) concluded that the level of support of RBV is, therefore, not atypical.

Methodological Issues in RBV Research

The most challenging part of RBV research lies in the measurement of unobservable constructs, as in many cases firm capabilities and core competencies are difficult to measure. Mostly, it requires primary data collection which may bring greater slippage and respondent bias (Newbert, 2007). Using proxy variables for such measures, as common in RBV research, is also criticized for validity (Hoskisson *et al.*, 1999). Alternatively, researchers suggest adopting qualitative methods like ethnography, participant observation to measure unobservable resources. Measuring latent constructs using indicator variables and structural equation modeling also seems promising in this context.

Whether to conduct a single-industry or multi-industry study, is also a difficult question for the researchers. Single-industry study provides a rich context of examining resources and capabilities critical to a particular market, whereas a multi-industry study provides greater generalizability. The time period of analysis may also pose a challenge to the researcher in terms of cost and time because the examination of the sustained competitive advantage involves longitudinal approach (Barney, 2001b).

Newbert (2007) noted another concern that majority of the studies that adopt resource heterogeneity approach test the hypothesis that portrays the relationship between resource/capabilities and firm performance and not competitive advantage. It is because researchers often use performance and competitive advantage interchangeably. Hence they assume that if a firm achieves normal performance, it must have attained competitive advantage too. Powell (2001) argued that this is methodologically flawed because competitive advantage leads to increased performance but not the opposite.

Is RBV Helpful to Managers?

The main contribution of RBV to the practicing managers is that it reminds them that sustainable competitive advantage does not necessarily be the outcome of operating in a high opportunity and low threat environment, but also depends on the existence and exploitation of the firm's resources and capabilities that are valuable, rare and costly to imitate (Barney, 1995). As a result, it can be used by the managers to assess a firm's strengths and weaknesses in crafting strategies. Duncan *et al.* (1998) have provided a systematic procedure in this regard. According to them, a long list of strengths and weaknesses are generated primarily from the firm's value chain analysis. Strengths and weaknesses can also be generated form the financial statement, staffing standards, information resources, customer and employee surveys which are then compared to the industry standards or rival firms. In the second stage, these strengths and weaknesses are reclassified as either resources or capabilities[3] or both. Each of this resources and capabilities are then evaluated for competitive relevance in the context of value, rareness and imitability. In the third stage, managers emphasize only on the competitive resources or capabilities to judge whether along the value chain they add or subtract value and if the strategic implication lies in their ability to enable cost leadership or to develop perceived uniqueness. Finally, managers evaluate the competitive resources and capabilities in terms of generic strategies, i.e., either cost leadership or differentiation.

Grant (1991b) on the other hand, suggested a five-step procedure to formulate a firm's strategy based on RBV. First, resources are identified and classified and their relative strength and weaknesses are appraised vis-a-vis their competitors. Second, capabilities are also identified to see whether the firm can do these more effectively than rivals. In the third step, rent generating potential of resource and capabilities are assessed as to their

[3] Despite of many nuances of the term, capability here implies the integration of primary, support and/or primary and support activities in the value chain.

sustainability (on the basis of durability, transparency, transferability and replicability) and appropriability. Appropriability means the degree of control by a firm over its resources and capabilities. The fourth step requires crafting a strategy that best exploits these resource and capabilities relative to the external opportunities. Lastly, a firm should develop resource and capabilities for the future to extend its competitive advantage and to expand its strategic opportunities.

Though some scholars admit the managerial significance of RBV, there is still some existing debate over this issue. Priem and Butler (2001a) expressed their concern that RBV has a limited prescriptive ability because attributes of the resources may not be amenable to managerial manipulation—especially, the path dependence and social complexity. Barney (2001a) refuted this by saying that RBV logic helps managers of a firm having competitive disadvantages in gaining competitive parity by identifying those valuable and rare resources that the firm presently not possesses and finding out whether value of those resources can be duplicated either by substitution or by imitation. He further argues that RBV can be helpful as it can point out what resource and capabilities are to be nurtured and maintained to gain sustained competitive advantage. However, along with these advantages, he also identified two disadvantages. First, because of 'causal ambiguity', managers may not be able to find out which resource generates competitive advantage. Second, firms that do not have any critical resources cannot create competitive advantage. In addition to the above concern, Priem and Butler (2001a) argue that context misspecification of the applicability of the theory and all the inclusive definition of the resources also limit the managerial significance of RBV.

Conclusion

Despite of the debate among scholars regarding RBV, there is no denying of the fact that sustainability is a function of the firm's critical resources and immobility of these factors. Surely the question that what makes these critical resources valuable, suggests that product-market concept of strategy has also been extremely helpful to answer this. It follows, therefore that a firm's product market as well as the resource positions are both useful for strategy scholars as Peteraf and Barney (2003) claim that,

> Resource-Based Theory (RBT) is not a substitute for industry level analytic tools, such as five-forces analysis (Porter, 1980) and game theory. It is not a substitute for strategic group analysis or for analysis of the macro environment. Rather, it is a complement to these tools. It looks within the enterprise and down to the factor market conditions that the enterprise must contend with, to search for some possible causes of sustainable competitive advantage (p. 312).

As the theoretical debate goes on regarding the logical inconsistency of RBV, scholars should move on to examine RBV as a dialectical process to understand and gain newer knowledge of the firms' ability to generate superior performance.

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