

ASSESSING STRENGTHS AND WEAKNESSES: DOING AN INTERNAL ANALYSIS

4

LEARNING OUTCOMES

- 4.1 Describe an internal analysis.**
- 4.2 Explain how to do an internal analysis.**
- 4.3 Discuss why an internal analysis is important.**

STRATEGIC MANAGEMENT IN ACTION

CASE #1 Making Over Avon

As the world's top direct seller of cosmetics and beauty-related items, Avon Products is building a global brand and attempting to get younger consumers to buy its products.¹ The company sells and distributes its products in more than 100 countries and territories and has a sales force of 6.5 million representatives. During the recent global recession with persistently high unemployment rates around the world, Avon increased its number of independent representatives by more than 12 percent. "Avon further enhanced its image as 'The Company for Women' by promoting business opportunities for women in countries where fewer choices are available to them." It has focused particularly on building its ranks of sales representatives in countries such as Russia and China where it's hoped that a growing middle class will increase its spending on consumer goods and services.

In 2010, Avon celebrated its 125th year—a remarkable achievement, for sure. The company manufactures and packages almost all of its beauty products. Raw materials, which include essential oils, chemicals, containers, and packaging materials, are purchased from various suppliers. Most fashion and home products are purchased from various suppliers. However, as raw materials prices climbed, it hit the company hard. In addition, operational inefficiencies and an inability to execute strategies have negatively impacted the company. The company's 2011 revenues were almost \$11.3 billion—a gain of 3.95 percent. However, net income declined 15.29 percent to \$513.6 million. Its market share price also fell by 45 percent in 2011.

Then, there's the issue of the company's CEO. When Andrea Jung was hired in 1999, she was the first woman to run the woman-oriented company. Her first six years in charge saw double-digit growth. However, with no re-investment in the business, the company began showing its blemishes. As sales declined in major markets, Avon's share price dropped. Ms. Jung's restructuring strategies included



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laying off 25 percent of the senior staff, streamlining global manufacturing, and cutting costs everywhere except for advertising and promotion. Despite these actions, Avon never fully recovered. During the global economic crisis, Jung saw an opportunity to overtake Avon's rivals, but it didn't work. Some of the problems were beyond Avon's control: Brazil's economy (a big market) slowed down, Europe was in crisis, and even shoppers in America were cutting back. However, other problems were self-inflicted. In addition to those mentioned previously, the company screwed up its new IT system in Brazil, and its inventory management is poor. All these factors led to Avon's board replacing Jung as CEO, although she's staying in her position until a new CEO is hired, at which point she will serve as full-time executive chairman. Two of Jung's predecessors have objected, saying that Jung needs to step aside as they fear "her continued presence would make it hard to attract a new leader." In an interesting twist to Avon's story, in early April 2012, the fragrance manufacturer Coty offered to buy Avon for \$10 billion, a take-over bid that was immediately rejected by the company, "which called it uncertain, stingy and opportunistic." (As of May 2012, Coty had withdrawn its offer.)

Despite its strengths, Avon has struggled. In this chapter, we're going to study the final step in analyzing the current situation—an internal analysis. (See Figure 4.1.) Just as we've done in earlier chapters, we'll first look at *what* an internal analysis is, then at *how* you do one, and finally at *why* an internal analysis is an important part of managing strategically.

LEARNING OUTCOME 4.1

Describe an Internal Analysis

In order to formulate appropriate and effective strategies, it's important to know what an organization can and cannot do particularly well, and what assets it has or doesn't have. As part of managing strategically, an **internal analysis** is the process of evaluating an organization's resources and capabilities. It provides important information about an organization's assets, skills, and work activities—what's good and what's lacking or deficient? The most important part of this analysis involves evaluating the organization's resources, capabilities, and core competencies, all of which we're going to look at next.

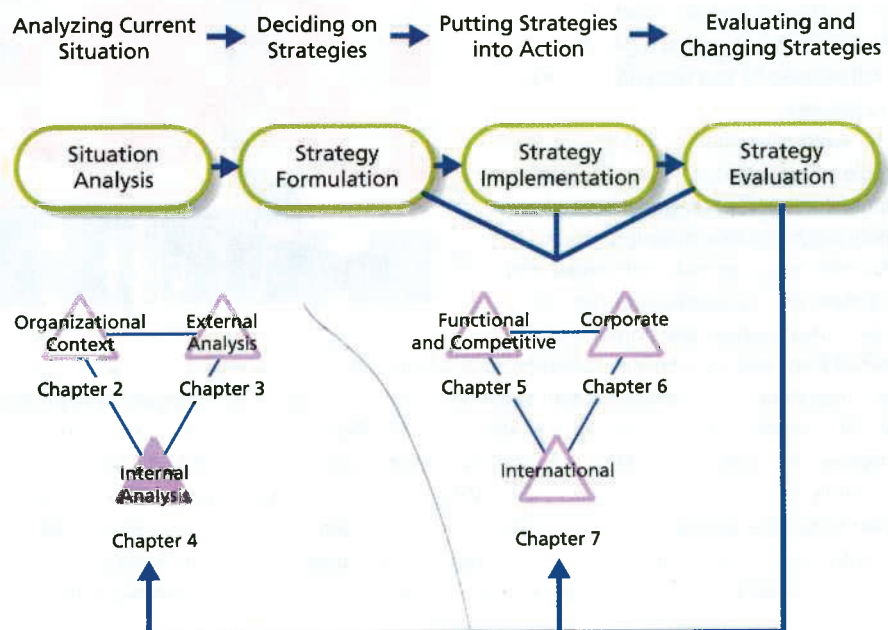


FIGURE 4.1

Strategic Management
in Action

A Quick Review of Organizational Resources

We've already discussed resources in relation to the resource-based view of competitive advantage (see Chapter 2). As you'll recall, resources are simply the assets an organization has for doing whatever it's in business to do (making tacos, providing at-home healthcare, or creating and selling cosmetics). These resources (or assets) can be financial, physical, human, intangible, and structural-cultural. Financial resources include debt capacity, credit lines, available equity (stock), cash reserves, and other financial holdings. Physical resources include tangible assets such as buildings, equipment and fixtures, raw materials, office supplies, manufacturing facilities, machines, and so forth. Human resources include the experiences, knowledge, judgment, skills, accumulated wisdom, and competencies of the organization's employees. At Google, for example, employees' programming skills would be part of its human resources. Intangible resources include brand names, patents, trademarks, databases, copyrights, registered designs, and so forth. For instance, Nike's "swoosh" symbol is an intangible resource, as are the Avon and Crayola brand names. Finally, structural-cultural resources include such things as organizational history, culture, work systems, policies, relationships, and the organizational structure being used. For example, 3M Corporation's culture stresses employee innovation—an important resource because its competitive advantage is based on the ability to continually develop and market innovative products.

Although an organization's resources can be a source of competitive advantage (see Chapter 2), they're also important to the organization's capabilities and core competencies. Figure 4.2 illustrates this relationship.

From Resources to Organizational Capabilities

An organization's resources are the inputs needed to perform its work, whether that's making hamburgers, collecting blood plasma, or producing *Cats* at a local community theater. You can view them as the organization's "whats"—what it has, or owns. To illustrate, let's use the example

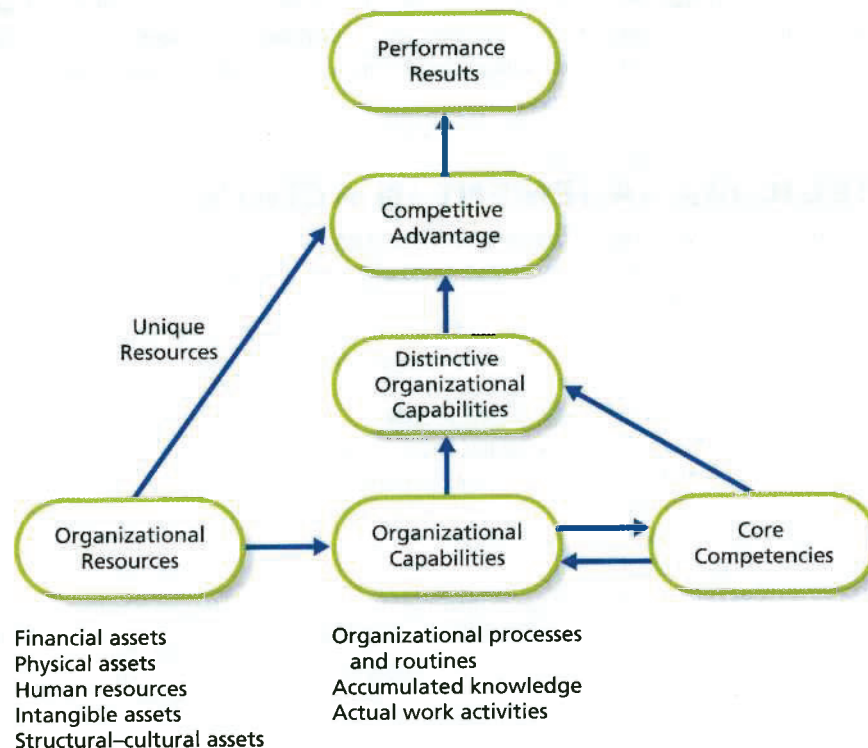


FIGURE 4.2

The Strategic Role of Organizational Resources and Organizational Capabilities

Source: Based on G. S. Day, "The Capabilities of Market-Driven Companies," *Journal of Marketing*, October 1994, pp. 37–52.

of someone who's considered an excellent chef. This person has resources such as pots and pans, spices, cooking skills, equipment, utensils, an efficiently designed kitchen, and other culinary supplies that are used in preparing delicious meals. Likewise, an organization has resources that are used by organizational members to do their work and are valuable in helping the organization reach its goals and hopefully contributing to a sustainable competitive advantage. However, by themselves, resources aren't productive—think of the chef who has to rely on his skills and experience to combine the spices and food ingredients using the best equipment to make those gourmet meals. Likewise, organizational resources must be combined and used in some way to get the value out of them. For instance, Travelocity's customer database isn't valuable unless someone uses her knowledge to "mine" the database and find the information needed to make good decisions. As such, resources are the inputs used in **organizational capabilities**, which are the various routines and processes that transform those inputs (resources) into outputs (products including physical goods and services).² These **organizational routines and processes** are the regular, predictable, and sequential work activities done by organizational members. An organization is a huge, complex network of these routines and processes encompassing such work activities as procuring raw materials to establishing various product pricing structures to generating end-of-quarter financial and other statistical reports. Think about Avon and the various capabilities needed in producing and marketing its products.

As organizational members do their work using organizational resources and routines and processes, they learn how best to capture the value of these resources and turn them into possible core competencies or distinctive organizational capabilities. After all, organizational capabilities don't result from just gathering resources. Instead, capabilities involve interactions between people and between people and other resources.³ In fact, some organizations never get the hang of it. They're never quite able to develop efficient and effective capabilities, and they struggle exhaustively to survive in an increasingly dynamic and competitive marketplace. For instance, look at how Southwest Airlines and American Air Lines differ. Both have organizational resources (planes, logos, employees, customer information databases, etc.) and organizational routines and processes (loading and unloading planes, making reservations, doing safety inspections, customer service, etc.), yet Southwest has developed valuable capabilities and competitive advantages while American has struggled. However, organizational capabilities can change. Just because they were once the source of competitive advantage doesn't mean they will continue to be a source of



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How might an organization's resources and capabilities have to change when its product continually changes?

Hoover's Inc., a subsidiary of Dun & Bradstreet, is managing its resources and capabilities quite well under that scenario. It sells company, market, industry, and competitive data—covering basic information on more than 23 million public and private companies and in-depth information about some 44,000 of the world's top businesses. Maintaining this information's value to its customers means it must be constantly and continually updated. Its traditional information products, *Hoover's Handbooks*, available in libraries, have been surpassed by its online offerings. In fact, the majority of its revenues now come from Hoover's Online [www.hoovers.com]. In order to further support Hoover's Online, the company recently partnered with business network LinkedIn. Users (who are thought to be primarily sales professionals) will have more information

available about contacts, which is a real value because "once users have found a key decision maker for the company they're targeting, it's helpful to find out as much as you can about that person so the salesperson can make a personal connection and get an 'in' at that business."

THINK ABOUT

- What resources and capabilities might be needed for a transition from a paper-based information company to an Internet-based information company? Describe and explain.

Sources: Based on B. N. Viveiros, "Hoover's Connects With IT," *ChiefMarketer.com*, October/November 2011, p. 14; B. Brynko, "Hoover's Links Up with LinkedIn," *Information Today*, February 2011, p. 32; and R. A. Oppel, Jr., "A Company Short on Buzz but Long on Results," *New York Times*, July 21, 1999, p. C1.

competitive advantage—that is, they don't always lead to a *sustainable* competitive advantage.⁴ In today's dynamic and complex environment, capabilities that lead to a competitive advantage now may not do so in the future as conditions and competitors change. Some researchers have proposed that we need to think in terms of **dynamic capabilities**—an organization's ability to build, integrate, and reconfigure capabilities to address rapidly changing environments.⁵

From Capabilities to Core Competencies and Distinctive Capabilities

As we said earlier, every organization has capabilities that enable it to do what it's in business to do. Any major value-creating capabilities organizations have that are essential to their business are known as **core competencies**.⁶ For example, executives at Nokia Corporation use their core competencies in product design and customer research to continually look for new applications and services.⁷ At Nordstrom's, customer service is a core competency that results from capabilities in sales training and employee recruitment.⁸ Although an organization's capabilities are the source of its core competencies, these core competencies also contribute to improving and enhancing other organizational capabilities. (Note the two-directional arrow in Figure 4.2.) So, which comes first? Organizational capabilities do. They're the fundamental building blocks for developing core competencies. Every organization has processes and routines to get work done. Any core competencies of an organization are created out of those routines and processes, accumulated knowledge, and actual work activities. If core competencies *are* established—and not every organization is able to do so—they can, in turn improve and enhance other organizational capabilities and contribute to developing distinctive capabilities, which as Figure 4.2 shows, is what leads to a competitive advantage.

Distinctive organizational capabilities are the special and unique capabilities that distinguish an organization from its competitors. For example, Southwest Airlines has developed distinctive organizational capabilities in organizational processes and routines such as gate turnaround, ticketing, and employee–customer interactions. Although every airline has these same organizational processes and routines, Southwest has developed them into distinctive capabilities, leading to a sustainable competitive advantage that has resulted in above-average performance. Even the company from our chapter-opening case, Avon, has developed its own set of distinctive capabilities. Distinctive capabilities have three characteristics (see Figure 4.3).⁹ First, a distinctive capability contributes to superior customer value and offers real benefits to customers. You need to be good at—that is, have a distinctive capability in—whatever it is that your customers value. For instance, Aristocrat Leisure Limited, an Australian company, recognized that many gamblers at smaller, rural casinos wanted flashy, multiple-line penny, nickel, and dime slots that paid out more frequently

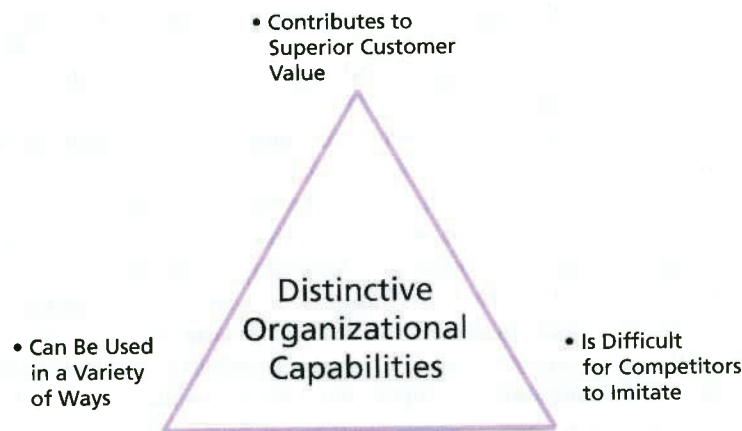


FIGURE 4.3

Characteristics of Distinctive Organizational Capabilities

than dollar slots. Aristocrat responded and turned these small-coin slots into the gaming industry's hottest product. One analyst said, "Aristocrat got ahead by figuring out what people want."¹⁰ Why be good at something that your customers don't value? For example, Western Union, probably best known for its telegrams, sent the last one on Friday, January 27, 2006. Why? Because nobody sends telegrams anymore. That capability isn't valued by customers in today's world.¹¹

The second characteristic of distinctive organizational capabilities is that they should be difficult for competitors to imitate. Think how we described organizational capabilities as the various organizational routines and processes that transform inputs into outputs. Making these capabilities difficult to imitate means balancing a complex array of employee skills and knowledge and harnessing the considerable learning that exists in the organization. It also means recognizing how capabilities span functional areas and how those areas interact with each other. If these complex interactions are strategically managed and exploited, it can be difficult for competitors to imitate even if they have similar resources and organizational processes and routines. For example, Anheuser Busch InBev (AB) has an incredibly accurate approach to finding out what beer drinkers are buying, as well as when, where, and why they're buying.¹² Its data-mining capability—known as BudNet—is AB's little-known "jewel" and the primary reason the company's share of the U.S. beer market edged up to over 50 percent from 48.9 percent, a huge gain in a market where a weak economy, lousy weather, and the threat of tougher drinking laws kept competitors' sales down. AB executives use the data from BudNet to constantly change marketing strategies, to design promotions for particular ethnic groups, and to get early warnings when rivals might have an edge. It's a capability that spans different functional areas, making it hard for competitors to imitate.

Finally, a distinctive organizational capability should be able to be used in a variety of ways. The organizational routines and processes developed in one area should be transferable to other areas of the organization. For example, Honda Corporation's capabilities at developing fuel-efficient, reliable, and responsive engines and drive trains has provided it with access to different markets including automobiles, motorcycles, lawn mowers, snowblowers, tillers, all-terrain vehicles, power generators, marine outboard engines, and now small passenger jets. As a company ad states, "We are first and foremost, an *engineering* company. But we're also the world's largest engine manufacturer."¹³ Another example of using a capability in a variety of ways can be seen at United Technologies Corporation, which believes that its capabilities lie in developing technology that conserves energy. By transferring knowledge about the principles of energy conservation among its various business divisions, which include Pratt & Whitney (engines), Otis (elevators), Sikorsky Aviation (helicopters), Hamilton Sunstrand (aircraft systems and other flight controls), and Carrier (heaters and air conditioners), the company has been able to dominate most of its markets.¹⁴ Another example can be seen at W. L. Gore, a company best known for its Gore-Tex fabrics, which are used in a variety of products, especially outdoors apparel. The fact that it's posted a profit every year since it was founded in 1958 confirms that the company has developed significant skills and capabilities in product innovation. More important, the company has shared those critical innovation skills and capabilities across multiple product lines in diverse industries ranging from guitar strings and dental floss to medical devices and filtration equipment. And for at least one of its products—guitar strings—the shared capabilities have led to the number two position in the market in a short span of time.¹⁵

Now for the two remaining boxes in Figure 4.2, which address competitive advantage and performance results. Competitive advantage, as we know, is what sets an organization apart—its competitive edge. As the figure shows, competitive advantage must come from an organization's unique resources or from its distinctive capabilities. Having a competitive advantage will affect an organization's performance results positively. Although it's possible for an organization to enjoy strong performance results in the short run without a significant competitive advantage, there are limits to how long such results can last. Without a sustainable competitive advantage, long-run success and survival are uncertain. It's important, therefore, that organizational decision makers know where the organization's strengths and weaknesses are in terms of its resources, capabilities, and competencies.



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The clothing industry isn't an easy one to compete and be successful in. However, VF Corporation has become one of the world's largest, most profitable clothing conglomerates by doing many things well. One thing the CEO did was buy languishing fashion brands and turn them into winners. How? By using VF's capabilities: state-of-the-art distribution, global buying power, and keen merchandising instincts. For instance, VF bought the North Face brand for a bargain price of \$135 million, revamped its sourcing, distribution, and financial operations, and was able to nearly double sales over a five-year period. As one analyst said, "The North Face is a great example of

what VF can do. For VF it was easy, and it's not easy for everybody."

THINK ABOUT

- Which characteristics of distinctive capabilities does this illustrate? Explain.

Source: Based on, "VF Corporation: Company Profile," *Datamonitor*, December 30, 2011; A. J. Karr, "Global Growth Boosts VF Net," *Women's Wear Daily*, July 22, 2011, p. 2-1; R. Dodes, "VF Dresses Up Its Operations, Bucking Recession," *Wall Street Journal*, March 30, 2009, p. B3; and M. V. Copeland, "Stitching Together an Apparel Powerhouse," *Business 2.0*, April 2005, pp. 52-54.

The Role of Strengths and Weaknesses

The whole reason for doing an internal analysis is to assess what the organization has or doesn't have (resources) and what it can and can't do (capabilities)—in other words, its strengths and its weaknesses. **Strengths** are resources the organization possesses and capabilities it has developed, both of which can be exploited and developed into a sustainable competitive advantage. Not every strength will lead to a sustainable competitive advantage, but an organization's strengths should be nurtured and reinforced as its main competitive weapons. **Weaknesses**, on the other hand, are resources and capabilities that are lacking or deficient and prevent the organization from developing a sustainable competitive advantage. Organizational weaknesses need to be corrected if they're in critical areas that are preventing the organization from developing a sustainable competitive advantage. However, most organizations have limited resources to correct problems, so strategic decision makers often choose to simply minimize the impact of weaknesses as long as they aren't in areas crucial for developing a sustainable competitive advantage.

Organizational members at all levels of the organization struggle with these types of strategic decisions: What strengths and weaknesses are in my area(s) of responsibility, and how can I strategically manage these areas to high levels of performance? Now that we have a good understanding of *what* an internal analysis is, it's time to look at *how* you do one.

LEARNING REVIEW LEARNING OUTCOME 4.1

- What is an internal analysis, and how is it different from an external analysis?
- Describe the relationship between resources, capabilities, and competitive advantage.
- What characteristics do distinctive organizational capabilities have?
- Define strengths and weaknesses.

In this section, we want to look at three different approaches for doing an internal analysis. The first views the organization's work—what it's in business to do—as a series of value-creating activities. The second is similar to a financial audit, but is used to examine and assess all internal areas of an organization instead of evaluating just financial information. The third focuses on developing a profile of the organization's capabilities. To conclude this section, we'll look at how to determine an organization's strengths and weaknesses.

LEARNING OUTCOME 4.2

Explain How to Do an Internal Analysis

Value Chain Analysis

Every organization needs customers if it's going to survive. Even not-for-profit organizations must have "customers" who use its services or purchase its products. The premise behind this approach is that customers want (demand) some type of value from the goods and services they purchase or obtain. This value can come from three broad categories: the product is unique and different, the product is low priced, or the product meets the needs of a specific group of customers quickly and efficiently. In order to assess an organization's ability to provide value, strategic decision makers can use an approach developed by Mike Porter called **value chain analysis**, a systematic way of examining all the organization's functional activities and how well they create customer value.¹⁶

As we said earlier, every organization has specific organizational routines and processes—work activities done by organizational members—that allow it to do whatever it's in business to do. Each of these activities creates varying levels of customer value and organizational costs. What strategic decision makers hope is that the customer value created—as evidenced by the products the organization distributes or the services it provides and what customers are willing to "pay" for that value—outweighs the costs of creating that value (the margin). In using the value chain, we're assessing the organization's ability to create customer value through its work activities. In other words, what are the organization's strengths and weaknesses in these areas? Porter believed there were nine activities—five primary and four support—that were important to assess.

The primary activities are those activities that create customer value. These include the organizational routines and processes involved with bringing resources into the business (inbound logistics), processing these resources into the organization's goods or services (operations), physically distributing them to customers (outbound logistics), marketing the goods and services to customers (marketing and sales), and servicing customers (customer service). However, it's not enough to know *what* these activities are; we must judge *how well* the organization is performing these activities. That's the information required to assess strengths and weaknesses. Table 4.1 lists some questions to ask when assessing the organizational activities that create value.

What about the support activities in the value chain? These activities support the primary activities as well as each other. Although it may seem that the primary activities are the most critical to the organization as they are the ones that create value, keep in mind that doing the primary activities wouldn't be possible without the support activities. For instance, if Hallmark didn't have effective human resources management processes and routines, it wouldn't have employees to design the cards, develop the marketing campaigns, or run the presses that imprint the latest holiday design on gift wrap. And if they can't do these things, they don't create value for the customer, the customer won't be willing to purchase the product, and organizational performance will suffer. How can you assess strengths and weaknesses in the support activities?



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Harley-Davidson (H-D) is best known for its motorcycles and apparel. However, it started selling a "new

source of fuel, one that goes into mouths instead of gas tanks and comes in such flavors as teriyaki and pepper." Yes, H-D is selling beef jerky. Joining forces with one of the largest U.S. packaged-foods companies, ConAgra Foods, H-D has put its familiar name and black-and-orange logo on a food product.

- Do you think this was a wise use of H-D's brand name? Why or why not?

Source: Based on K. Emmerson, "Product Review: Harley Davidson Motorcycles Road Food," January 4, 2008, <http://voices.yahoo.com/product-review-harley-davidson-motorcycles-road-food-761193.html>; and E. Fredrix, "Harley-Davidson Vrooms Way into Food Business with Jerky," *USA Today*, October 10, 2006, p. 3B.

THINK ABOUT

- Do you think H-D created customer value with this product? Explain.