

Chapter IV

Theories of the Firm

Introduction

In this book, we need to develop a general understanding of business firms to enable strategic IS/IT planning. In this chapter, we will present the resource-based theory of the firm, the activity-based theory of the firm, and the firm in terms of its value configuration.

An understanding of firm theories and value configurations is important to later discussions of the topics in the book. The resource-based theory is applied to understand resources needed for e-business, sourcing, and governance. An important resource is knowledge in terms of know-what, know-how, and know-why.

Resource-Based Theory of the Firm

According to the resource-based theory of the firm, performance differences across firms can be attributed to the variance in the firm's resources and capabilities. Resources that are valuable, unique, and difficult to imitate can provide the basis

for firms' competitive advantages. In turn, these competitive advantages produce positive returns. According to Hitt, Bierman, Shimizu, and Kochhar. (2001), most of the few empirical tests of the resource-based theory that have been conducted have supported positive, direct effects of resources. An important and often critical resource is IS/IT applications in the firm.

The essence of the resource-based theory of the firm lies in its emphasis on the internal resources available to the firm, rather than on the external opportunities and threats dictated by industry conditions. Firms are considered to be highly heterogeneous, and the bundles of resources available to each firm are different. This is both because firms have different initial resource endowments and because managerial decisions affect resource accumulation and the direction of firm growth as well as resource utilization (Loewendahl, 2000).

The resource-based theory of the firm holds that, in order to generate sustainable competitive advantage, a resource must provide economic value and must be presently scarce, difficult to imitate, non-substitutable, and not readily obtainable in factor markets. This theory rests on two key points. First, resources are the determinants of firm performance. Second, resources must be rare, valuable, difficult to imitate, and non-substitutable by other rare resources. When the latter occurs, a competitive advantage has been created (Priem & Butler, 2001).

Resources can simultaneously be characterized as valuable, rare, non-substitutable, and inimitable. To the extent that an organization's physical assets, infrastructure, and workforce satisfy these criteria, they qualify as resources. A firm's performance depends fundamentally on its ability to have a distinctive, sustainable competitive advantage, which derives from the possession of firm-specific resources (Priem & Butler, 2001).

The resource-based theory is a useful perspective in strategic management. Research on the competitive implications of such firm resources as knowledge, learning, culture, teamwork, and human capital was given a significant boost by resource-based theory — a theory that indicated it was these kinds of resources that were most likely to be sources of sustainable competitive advantage for firms (Barney, 2001).

Firms' resource endowments, particularly intangible resources, are difficult to change except over the long term. For example, although human resources may be mobile to some extent, capabilities may not be valuable for all firms or even for their competitors. Some capabilities are based on firm-specific knowledge, and others are valuable when integrated with additional individual capabilities and specific firm resources. Therefore, intangible resources are more likely than tangible resources to produce a competitive advantage. In particular, intangible, firm-specific resources such as knowledge allow firms to add value to incoming factors of production (Hitt et al., 2001).

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