Organisational Capabilities: Pathways to Sustainability?

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Abstract: In an environment of free market and open competition, marketing scholars no longer debate whether or not firms attempt to improve performance to outperform their rivals. Instead, firms want to know the answer of question that what are the sources of sustainable superior performance? Three theories that have been significant in the literature discuss different sources of sustainable performance and provide different answers to this question. These are industry-based theory, resource-based theory and capability-based theory. This article analyses the different explanations of the origin of performance differentials among firms proposed by these theories. The conclusion is that the capability-based theory seems to be the most relevant for explaining performance differentials in contemporary business environments that are dynamic, rapidly changing and increasingly competitive.

Keywords: Sustainable Performance, Organisational Capabilities

1 Introduction

Three theories capture the degree of the heterogeneity of firms' performance and profitability: *industry-based theory* (Porter, 2004, 1979), *resource-based theory* (Barney, 1991; Wernerfelt, 1984) *competence-* or *capability-based theory* (Prahalad and Hamel, 1990). These theories have become popular theories for explaining and understanding the sources and determinants of sustainable performance. In this article, we review the literature relevant to provide an understanding of these theories. These theories propose different explanations of the origin of performance differentials among firms. Our goal in this article is twofold: first, to discuss each theory; and second, to justify why, among these theories, the capability-based theory seems to be the most relevant for explaining performance differentials in contemporary business environments that are dynamic, rapidly changing and increasingly competitive.

The remainder of this article is organised as follows. First, a brief review of the evolution of performance theories is presented (Figure 1). This is followed by a discussion of each theory.

2 Industry-Based Theory

The industry-based theory has viewed the industry as a homogeneous unit. Firms in an industry are assumed to be alike in all economically important dimensions except for their size (Porter, 1979). Implicitly, this theory assumed that (1) firms within a particular industry are identical in terms of resources they control and the strategies they pursue, and (2) the heterogeneity in an industry will be very short-lived because the resources that firms use to implement their strategies are highly mobile (i.e. they can be bought and sold in the markets) (Barney, 1991).

Since environmental characteristics usually affect all firms in the industry and firms in an industry are assumed to be alike in all economically important dimensions except for their size, the structural attributes of an industry determine the average profit potential of the industry as a whole and then the profit rates of firms in an industry should be equal (Porter, 2004). By examining the key structural features for any particular industry, it is possible to predict the type of competitive behaviour likely to emerge and the resulting level of profitability.

Industry Based Theory

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- **Firms within a particular industry are identical in terms of resources they control and the strategies they pursue.**
- **The heterogeneity in an industry will be very short lived because the resources that firms use to implement their strategies are highly mobile (i.e., they can be bought and sold in the markets).**

Industry based theory is unable to provide a rigorous explanation for intra-industry heterogeneity in performance. It is not difficult to see that there is a significant variation in the performance of the firms, often within the same industry.

Resource Based Theory

- **Resource based theorists rejected the view of organizations as identically resourced, homogenous entities and presented organizations as heterogeneous in the long term.**
- **Resource is anything which could be thought of as a strength or weakness of a given firm.**
- **An organization can be viewed as a bundle of resources and organizational success is assumed not to be a function of industry structure, but rather can be explained in terms of the resources possessed by the organization.**

Resource based theory falls short of being able to explain why some firms, despite the relatively superior resources they possess, are not able to sustain their competitive advantage over time. Superior resources possession is not a guarantee of superior performance. There are great differences do exist between firms in the market with a given amount of resources.

Capability Based Theory

- **To establish competitive advantage, resources must work together to create capability (Grant, 2002). While resources are the source of a firm's capabilities, capabilities are the main source of its competitive advantage.**
- **Capabilities refer to a firm's capacity to deploy resources, usually in combination, using organizational process to effect a desired end.**
- **Distinctive competences describe things that an organization does particularly well relative to its competitors.**
- **A firm may achieve competitive advantage not because it has more or better resources, but because the firm's distinctive capabilities allow it to make better use of its resources.**

Figure 1 - The evolution of business performance theories

3 Resource-Based Theory

The resource-based theory looks *inside* the firm for sources of superior performance with respect to competition. In particular, it attempts to link superior firm performance to the resources possessed by firms (Dutta et al., 2005). However, two conceptual articles are still considered as seminal works in the more recent resource-based perspective: (Barney, 1991; Wernerfelt, 1984). Table 1 outlines the contributions of the main authors of the resource-based theory.

According to this view, an organisation can be viewed as a bundle of resources and organisational success is assumed not to be a function of industry structure, but rather can be explained in terms of the resources possessed by the organisation (Harrison, 2003; Leask and Parnell, 2005). Wernerfelt (1984) has defined a resource as 'anything which could be thought of as a strength or weakness of a given firm'. Examples of resources are brand names, knowledge of technology, machinery, etc.

Table 1 Main studies on resource-based theory.

Reference	Main contribution
Wernerfelt (1984)	Re-introduced the notion of the firm as a collection of resources. Considered resources and products as two sides of the same coin. Directed scholars back toward resources as important antecedents to products and, ultimately, firm performance. Coined the term resource-based view of the firm. Defined a resource as ‘anything which can be thought of as a strength or weakness of a given firm’.
Barney (1991)	First, the author rejected industry-based theory assumptions that resources are homogeneous and perfectly mobile. Instead, he argued that resources are heterogeneously distributed across firms and are imperfectly mobile between firms. Second, based on these assumptions, Barney has theorised that when firms have resources that are valuable, rare, inimitable and non-substitutable, they can achieve sustainable competitive advantage by implementing fresh value-creating strategies that cannot be easily duplicated by competing firms.

4 Capability-Based Theory

This perspective focusses careful attention on firm capabilities, and therefore constitutes what is referred to in the literature as the *capability-based theory*. Capabilities refer to a combination of resources that creates higher-order competencies. For example, brand reputation, customer base and ability to create repeat business can be viewed as independent resources which, when combined with organisational routines and technology in a judicious manner, could create a capability (Erramilli et al., 2002). In capability perspective, firms can create superior performance not due to mere possession of resources, but due to effective and innovative management of resources. Given the same bundle of resources, the capabilities that this bundle of resources renders typically will be different depending on idiosyncratic deployments (Kor and Mahoney, 2004).

Differences in firms’ relative abilities to coordinate deployments of resources imply that some firms may achieve distinctive competences using resources that are similar to those available to or used by other firms. Therefore, firms with unique and valuable resource endowments may fail to develop distinctive competences because they are not effective in coordinating those resources (Sanchez and Heene, 1997). It has been argued that a firm may achieve competitive advantage not because it has more or better resources, but because the firm’s distinctive capabilities allow it to make better use of its resources (Mahoney and Pandian, 1992). The firm may make better use of human capital by correctly assigning workers to where they have higher productivity in the firm (Mahoney and Pandian, 1992).

5 Conclusion

This article reviewed the prevailing theoretical explanations of superior organisational performance. We found that three basic theories capture the degree of the heterogeneity of firms’ performance and profitability: industry-based theory, resource-based theory and capability-based theory. These theories have become popular theories for explaining and understanding the sources and determinants of competitive advantage. These theories propose different explanations of the origin of performance differentials among firms.

The industry-based theory has viewed organisations as identically resourced, homogenous entities (Harris and Ogbonna, 2001). Firms within an industry faced identical conditions and the industry factors usually affect all firms in the industry. Thus, the profit rates of firms in an industry should be equal. Resource-based theorists reject the view of organisations as identically resourced, homogenous entities and present organisations as heterogeneous in the long term. They argue that differences in firms' resources will lead to differences in firms' performance. In the capability perspective, firms can create superior performance not due to mere possession of resources, but due to effective and innovative management of resources. Perhaps, competence-based competition is a perspective more suited – and more valuable – to today's business environment than are other two theories.

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