THEORETICAL FOUNDATION OF FUNCTIONAL COMPETENCIES
AS SOURCE OF COMPARATIVE ADVANTAGE

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ABSTRACT

The manufacturing sector has been recognized as a significant driver of economic expansion globally. It has been evidently that any industry plays a key important role in labor Market because of labor advantage, creating jobs, contributing to social and political stability, and earning high value exports in developed and developing countries of this World. As both developed and developing countries become more and more vibrant in their search of global economic integration, the entry of many multinational giants into their own domestic market will surely intensify the strategies competition. The understanding of the importance
Using functional competencies to improve a firm's performance will help manufacturing companies improve their competitiveness. Therefore, this research paper integrates functions to investigate the relationship between functional competencies and firm performance.

**Key Words:** Theoretical, Functional competencies, Comparative advantage.

**INTRODUCTION**

The key objective of this research paper is to understand a theoretical foundation that is relevant to development of the relationship between functional competencies and firm performance. It is organized into five main sections: The first section introduces the concept of strategy as frame of the research. The second section presents the conceptual framework underlying the literature review. The third section introduces the key concepts in Competitive Advantage. In this section, the relationships of resources, capabilities, competencies and competitive advantage are also presented. The third section reviews factors determining sustainability of Competitive Advantage. The next section identifies sources of Competitive Advantage, especially focusing on functional competencies. The fifth section covers the criteria used to measure the company performance and the last section covers the conclusion for the research paper.

**THE CONCEPT OF STRATEGY AS FRAME**

The word strategy can be traced from Greek word “strategia” which means “generalship” (Long and Vickers-Koch, 1995). Back in the 19th century, it was first used in indication to the science and art of employing political, economic, military and other forces to support
the policies of a nation or group of nations. The word did not surface into management literature until the 1950s.

The amount of literature on strategy development is large and growing at an accelerating rate. Despite the large amount of research on this subject there is no single approach for strategy development. As a result, a wide range of conceptual framework exists for the formulation and implementation of strategies (Feurer and Chaharbaghi, 1994).

Peter Drucker appears to be one of the first to talk about the strategy in a business context. In 1954 he spoke about it only in terms of answering the question: “what is our business? And what should it be?” (Long and Vickers-Koch, 1995). Also Chandler was one of the first to offer an explicit definition of strategy (Long and Vickers-Koch, 1995).

Chandler (1962) gave strategy as the determination of the basic long-term goals and objectives of an enterprise, and the adoption of course of action and the allocation of resources necessary for carrying out these goals.

It can be traced that the first scholars to focus on the concept of strategy in term of its development and implementation were Andrews and Ansoff (Long and Vickers-Koch, 1995). Andrews (1965) defined strategy as the pattern of objectives, purposes, goals, and major policies and plans for achieving the goals. In Ansoff (1965), he stressed strategy as being the common thread for deciding on five components: market scope; growth vector (the direction in which scope was changing); competitive advantage (unique opportunities in term of product or market attributes); synergy internally generated by a combination of capabilities or competencies; and the decision to make or to buy.
Henderson (1979) proposed that the fundamental rule of strategy is to induce competitors not to invest in those products, markets, and services where firms expect to invest most. To achieve strategic success, firms must use corporate resources to substantially outperform a competitor with superior strength. Strategy is a deliberate search for a plan of action that will develop a business’s competitive advantage and compound it. Strategy is the direction and scope of an organization over the long run. It ideally matches its resources to its changing environment (Johnson and Scholes, 1993).

**COMPETITIVE ADVANTAGES**

The common and exact definition for competitive advantage does not exist. Alderson (1965) was one of the first to lay foundation that firms should strive for unique characteristics in order to distinguish themselves from competitors in the eyes of the customers. He argued that differential advantage might be achieved through lowering prices, selective advertising appeals, and/or product improvements and innovations (Hoffman, 2000).

Hall (1992) asserted that for a business to succeed in an aggressive and dynamic global environment, it ought to either achieve the lowest cost or most differentiated position. Henderson (1983) emphasized that organizations that are able to adapt best or fastest will gain an advantage relative to their competitors. The message to managers is to respond to changes in the business environment by providing the best option in terms of product/service or be the quickest to respond to the needs of the market (Yamoah, 2004).

Day (1984) explains how to determine the value of competitive advantage in the market by relating it to benefits which must be perceived by a customer group that willing to pay for those benefits and cannot easily obtain those benefits elsewhere. In contrast to the
competitive advantage terminology by Caves, this conception of competitive advantage appears to be linked to a firm’s being more competence in the market than its competitors (Flint, 2000).

Porter (1985) asserted that competitive advantage comes from the value that firms create for their customers that exceeds the cost of producing that value. The key concern for a business is to capture that value which is greater than its cost. He also identified two types of competitive advantage, which were cost leadership and differentiation.

Coyne (1986) suggested that because the meaning of competitive advantage is self-evident, there is no apparent need to define its exact meaning. However, he believed that differentiation based on key buying attributes of a product is the foundation of an advantage. This difference must be due to some resource capability that the firm possesses and competitors do not possess. Three conditions must be met for competitive advantage to have meaning:

1) that customers perceive differences between one firm’s product/service attributes and those of its competitors
2) the difference is often the result of a capability gap between the firm and its competitors.
3) that the aforementioned difference in attributes and the capability gap expected to suffer over time.

Barney (1991) tried to define competitive advantage with strategy view. He stated “a firm is said to have a competitive advantage when it is implementing a value-creating strategy not simultaneously being implemented by any current or potential competitors”. According to Flint
(2000), the definition of Barney is useful because it incorporates the idea that creation of value, competition among firms, and the durability of that value are all fundamental to the conceptualization of sustainable competitive advantages. However, it does not explicitly link competitive advantages to the resulting financial performance of a firm. In order to achieve competitive advantage, a company must implement a “value creating” strategy (Barney, 1991).

Value creation is measured by the difference between value to consumer and cost of production (Hill and Jones, 2001, Porter, 1985).

**TERM OF SUSTAINABLE COMPETITIVE ADVANTAGE**

The concept of a sustainable competitive advantage surfaced in 1984, when Day suggested types of strategies that may help to “sustain the competitive advantage”. The actual term of “sustain competitive advantage” emerged in 1985, when Porter discussed the basic types of competitive strategies that firm can posses in order to achieve a long-run sustain the competitive advantage (Hoffman, 2000). According to Barney (1991), a firm is said to have a sustained competitive advantage when it is implementing a value creating strategy not simultaneously being implemented by any current or potential competitors and when these other firms are unable to duplicate the benefits of this strategy”. He asserted that “a competitive advantage is sustained only if it continues to exist after efforts to duplicate that advantage have ceased”.

According to Hill and Jones (2001) believed that a sustained competitive advantage is simply a competitive advantage that has been maintained for a number of years. Flint (2000) suggests short-term and long-term competitive advantages. If there were a competitive advantage which was or had the potential of being over the entire length of
the foreseeable future, then one could label that as an “unthreatened competitive advantage” (Flint, 2000).

CONDITIONS FOR SUSTAINABLE COMPETITIVE ADVANTAGE

According to Hill and Jones (2001), the durability of competitive advantage depends on three factors: barriers to imitation, the capability of competitors, and the general dynamism of the industry environment.

BARRIERS TO IMITATION

A company with a distinctive competitive advantage will earn higher average profits. These profits signalize to competitors that the company is in possession of some valuable distinctive competency that allows it to create superior value. How quickly will competitors imitate a company’s distinctive competencies? This is an important question because the speed of imitation has a bearing upon the durability of a company’s competitive advantage. The critical issue is about time. The longer it takes competitors to imitate a distinctive competency, the greater the opportunity the company has to build a strong market position and reputation with consumers, which is then more difficult for competitors to attack.

Barriers to imitation are a primary determinant of the speed of imitation. Barriers to imitation are factors that make it difficult for a competitor to copy a company’s distinctive competencies.

Imitating resources is the easiest distinctive competencies for prospective competitors to imitate as they tend to be those based on possession of unique and valuable tangible
resources because these resources are visible to competitors and can often be purchased on the open market. On the other hand, intangible resources can be more difficult to imitate. Brand names are important because they symbolize a company’s reputation. Marketing and technological know-how are also important intangible resources. Technological know-how is protected from imitation by the patent right.

Company’s capabilities tends to be more difficult imitate than imitating its tangible and intangible resources. Since capabilities are based on the way decisions are made and processes managed deep within a company, it is hard for outsiders to disconcert them.

CAPABILITY OF COMPETITORS

According to work done by Ghemawat (1986), a major determinant of the capability of competitors to rapidly imitate a company’s competitive advantage is the nature of the competitor’s prior strategic commitments. When competitors already have long-established commitments to a particular way of doing business, they may be slow to imitate an innovating company’s competitive advantage Hill and Jones (2001).

Another determinant of the ability of competitors to respond to a company’s competitive advantage is their absorptive capacity – that is the ability of an enterprise to identify value, assimilate and operate new knowledge. Taken together, factors such as existing strategic commitments and low absorptive capacity limit the ability of established competitors to imitate the competitive advantage of a rival, particularly when the competitive advantage derives from innovative products or processes.
INDUSTRY DYNAMISM

A dynamic industry environment is one that is changing rapidly. The most dynamic industries tend to be those with a very high rate of product innovation. In dynamic industries, the rapid rate of innovation means that product life cycles are limited and the competitive advantage can be very momentary.

In summary, the strength of a company’s competitive advantage depends on three factors: the height of barriers to imitation, the capability of competitors to imitate its innovation, and the general level of dynamism in the industry environment. When barriers to imitation are low, capable competitors abound, and the environment is very dynamic, with innovations being developed all the time, then competitive advantage is likely to be momentary. On the other hand, even within such industries, companies can achieve a more enduring competitive advantage if they are able to make investments that build barriers to imitation (Hill and Jones, 2001).

RESOURCES, CAPABILITIES AND COMPETENCIES

TERM AND CATEGORIES OF RESOURCES

The concept of resources was introduced into the strategic management field in the 1970s when Ansoff (1965) categorized skills and resources according to the major functional area, i.e. research & development, operations, marketing, general management and finance. But until the mid 1980s did the concept of resources as a source of sustainable competitive become dominant in the strategic field. There has been revival of interest in the role of the firm’s resources as the foundation for firm strategy.
Grant (1991) defined resources as the inputs into the production process, which are the basis of analysis. To identify resources, financial balance sheets are notoriously insufficient because they disregard intangible resources and people-based skills – probably the most strategically important resources of the firm (Grant, 1991). Barney (1986, 1991) also suggested that not all aspects of a firm’s physical capital, human capital, and organizational capital are strategically relevant resources. Some of these attributes do facilitate a firm to conceive and implement strategies that improve its efficiency and effectiveness. Others may have no impact on a firm’s strategizing processes or may even have a negative effect.

Porter (1991) confirmed that resources are not valuable in and of them self but they allow firms to perform activities that create advantages in particular markets. Resources are only meaningful in the context of performing certain activities to achieve certain competitive advantages. Several resource level categorizations have been presented in the literature.

One of the most famous classifications of resources is that of tangible and intangible resources.

Physical or tangible resources are normally obvious to firms, competitors, and customers. Intangible are less apparent to competitors and customers, or even the firm itself. Intangible resources include brand names; technological know-how; organizational capabilities embedded in a company’s routines, process, and culture; reputation; tacit design; production know-how; customer relationships; and organizational culture (Collis and Montogomery, 1995; Goodman and Lawless, 1994).

In conclusion, resources can be defined as a firm’s financial, physical, human, technological, and organizational capital. They can be divided into tangible resources (land, buildings,
plant, and equipment) and intangible resources (brand names, reputation, patents, and technological or marketing know-how).

TERM AND CATEGORIES OF CAPABILITIES

Capability has been used by many researchers as a different and substitute for “soft” resources to explain the notion behind a firm’s competitive advantage. Some researchers claim that resources cannot answer the question of sustainable competitive advantage caused by intra-firm factors, but that using capability as a unit of analysis can (Decharin, 1999).

Ansoff (1965) first used the term capabilities to describe a company’s ability to deal with different combinations of competitive environments and levels of entrepreneurial turbulence.

Strategic capability was defined by Ansoff (1979) as a measure of effectiveness of firms in supporting a particular thrust.

Capabilities can be thought of as transitional goods generated by the firm to provide enhanced productivity of its hard resources Amit and Schoemaker, (1993). Capabilities could also be defined as a set of strategic business. Capabilities are strategic only when they begin and end with the customer. Capabilities are also collective and cross-functional (Stalk et al., 1992).

Capabilities are what a firm can do as a result of resource teams working together. A firm’s capabilities can be identified and appraised using a standard functional classification of the
firm’s activities. For most firms, however, the most important capabilities are likely to be those which arise from an integration of individual functional capabilities (Grant, 1991).

Collis (1994) defined organizational capability as the socially complex routines that determine the efficiency with which firms physically transform inputs into outputs. This definition contains two important elements. The first is the concept that organizational capabilities embedded in the firm routines. The second important element of the definition is that it involves the transformation of physical inputs into output inside the “black box” of the firm. In this role, capabilities function as the organizational complement to the technological determinants of the efficiency of production.

Long and Vickery-Koch (1995) had categorized capabilities into three types based on their importance to the firm. They are threshold, critical and cutting edge capabilities. Threshold capabilities or capabilities that is necessary just to be in the game. These include services to support internal customers as well as those skills and system that are conditions for doing business in the company’s industry. This type of capability could also be divided into support and basic capabilities. Critical capabilities are skills and system that are critical to customers and provide firms with today’s competitive advantage. Cutting edge capabilities are skills and system that need to be nurtured and developed as sources of tomorrow’s competitive advantage.

Collis (1994) classified three types of organizational capabilities based upon the influence of capabilities on the organization. First are those that reflect an ability to perform the basic functional activities of the firm more efficiently than competitors. Second are capabilities that express the common theme of vibrant improvement to the activities of the firm. Third are capabilities that comprise the strategic insights which enable firms to recognize the intrinsic value of other resources or to develop novel strategies before competitors.
However Collis argued that it is difficult to make hard and fast distinctions among the three categories of capabilities since they all concern the ability of firms to perform an activity more effectively than competitors with otherwise similar resource endowments. To this end, capabilities refer to a company’s skills at coordinating its resources and putting them to productive use. Capabilities are intangible. Unique capability is one that no competitor possesses. In other words they can be referred as core capabilities, which are most distinctive resources a company possesses and the most difficult to imitate when effectively matched to strategic targets.

**TERM AND CATEGORIES OF COMPETENCIES**

Distinctive competence emerged in the 1960s as a desired end-result of business policies (Reed and Defillippi, 1990). The term distinctive competence, first used by Selznick (1957) to describe the character of an organization, refers to what a firm does especially well in relation to its competitors (Long and Vickers-Koch, 1995). Thus, distinctive competence is an aggregate of numerous specific activities that organizations tend to perform better than other organizations within a similar environment Snow and Hrebiniak, (1980). Hofer and Schendel (1987) described distinctive competence as the patterns of resource and skill deployments that will help the firm achieve its goals and objectives.

Distinctive competency is defined fairly uniformly in management literature and textbooks. Hill and Jones (2001) and Thompson and Strickland (1996) textbooks for strategic management agree on the distinctive competency definition as centering around the uniqueness and comparative performance of something arising within an organization in the light of organization’s competitors’ efforts (Flint, 2000).
Prahalad and Hamel (1990) posit that competencies are the roots of competitiveness. They observe that in the short run, a company’s competitiveness derives from the price/performance attributes of current products. In the long run, competitiveness derives from an ability to build, at lower cost and more speedily than competitors, the core competencies that spawn unanticipated products. Core competencies are the collective learning in the organization, especially how to coordinate, diverse production skills and integrate multiple streams of technologies. If core competence is about harmonizing streams of technology, it is also about the organization of work and the delivery of value.

The force of core competence is felt as decisively in services as in manufacturing. Core competence is communication, involvement, and a deep commitment to working across organizational boundaries. It involves many levels of people and all functions. Core competence does not diminish with use but is enhanced as they are applied and shared. However, competencies still need to be nurtured and protected.

Thompson and Strickland (1996) suggested four traits of core competence.

- First, core competence seldom consists of narrow skills or the work efforts of a single department. Rather they are composites of skills and activities performed at different locations in the firm’s value chain that, when linked, create unique organizational capability.
- Second, because core competence typically originates in the combined efforts of different work groups and departments, individual supervisors and department head cannot be expected to see building the overall corporation’s core competence as their responsibility.
- Third, the key thing to leveraging a company’s core competence into long term competitive advantage is intending more effort and more talent than rivals on deepening and strengthening these competencies.
Fourth, because customers’ needs change in often unpredictable ways and the specific skills needed for competitive success cannot always be accurately forecast, a company’s selected bases of competencies need to be broad and flexible enough to respond to an unknown future.

Even though the concept of distinctive competence has been very popular in recent years, there are some weaknesses in this concept (Decharin, 1999). Campbell at al. (1995) suggested that despite its powerful appeal, the core competence concept has not provided practical guidelines for developing and implementing strategy. Many companies have tried to define their core competence but lacking reliable analytical tools, few have achieved the clarity they sought.

Furthermore, the core competence model does not account for the success of companies whose businesses have limited or no overlap.

Competencies are classified into various types by using various criteria. They can be classified by the production process Lado and Wilson, (1994):

- Input-based competence encompasses the physical resources, organizational capital resources, human resources, knowledge, skills, and capabilities that enable a firm’s transformational processes to create and deliver products and services that are valued by customers.
- Transformational competence describes organizational capabilities required to advantageously convert input into outputs. These capabilities include innovation and entrepreneurship, organizational culture, and organizational learning.
Output-based competence includes all knowledge-based, invisible strategic assets, such as corporate reputation or image, product or service quality, and customer loyalty.

According to Malerba and Marengo (1995), competencies can also be classified by their nature.

Competencies can be classified along a series of continua: tacit vs. articulable; not teachable vs. teachable; not articulated vs. articulated; not observable in use vs. observable in use; complex vs. simple; and an element of a system vs. independent.

Competencies can also be classified according to the sources which originate them. Competencies may derive from formal or informal sources. The formal encompasses all the resources which are invested with the main purpose of creating new competencies. There is also a hierarchical classification of capabilities possible: strategic (or selective) capabilities; organizational (coordinating) capabilities; functional capabilities; and adaptive (learning) capabilities.

Hamel (1994) classified competencies by the impact that they have on the organization. Hamel distinguished three broad types of core competence:

- Market-access competence, or all those skills which help to put a firm in close closeness to its customers, such as management of brand development, sales and marketing, distribution and logistics, technical support, etc.
- Integrity-related competence, or competencies which allow a company to do things more quickly, flexibly or with a higher degree of reliability than competitors, such as quality, cycle time management, just-in-time inventory management, etc.
Functionality-related competence or skills which enable the company to endow its services or product with unique functionality, thus investing the product with distinctive customer benefits, rather than merely making it incrementally better.

It is believed that functionality-related competence is becoming more important as a source of competitive differentiation, relative to the two competence types. This is because companies are converging around universally high standards for product and service integrity and are moving through alliances, acquisitions and industry consolidation to build broadly matching global brand and distribution capabilities (Hamel, 1994).

The shift in the strategic model from the traditional Industrial Organization concept to a resource-based view has caused confusion among researchers and practitioners (Decharin, 1999).

This confusion is caused by the differences in terminology and definitions within the resource based view. There are various terms and definitions that illustrate the resource-based view of the firm such as: resource-based view, competence-based view, capability-based view. So far discussion about the domain of the resource-based view is marked by divergence and disagreement since key concepts, propositions, and terminology are only slowly being defined.

Even though there are differences in terminology and definitions, all of the concepts emphasize the internal factors within the firm that contribute to sustainable competitive advantage. The resource-based view theory was originally pioneered by Wernerfelt (1984), but only came to attention in recent years. Some researchers consider the resource-based view as an umbrella theory that encompasses both capabilities and competencies, but
some researchers disagree with this idea. They argue that resources, capabilities, and competencies are different and individually important.

Even though resources, capabilities and competencies have been described separately and individually, in reality, they are all closely related to one another. From previous review, it should be noticeable that in some circumstances these three concepts could be used interchangeably.

CONCLUSIONS

Based on theoretical and empirical research studies provide rational level of support for the positive relationship between functional competencies and various indicators of organizational performance. In the main, the evidence is supportive a direct relationship yet tends to be mixed in results regarding the significance of this relationship. More so, even if there is a growing number of research study of this kind in Western and non-Western context, there is limited, if any, research study in the context of developing countries. These underline the opportunities to extend research into this yet to be exploited area.

Besides, the study reveals that there is a methodological diversity in the research examining the multiple functional competencies at the organizational performance. One of the possible sources that were responsible for this variation is the influence of contextual factors. This is illustrated by the use of different performance measures and the heterogeneity of practices of each function included in the prior studies. While financial data such as ROE and ROA are more available in Western countries, they are difficult to be obtained in other countries such as China (Li, 2000) and Ukraina (Akimova, 2000), making it more appropriate to use subjective measure of firm performance.
LIST OF REFERENCES


