

## 5.2.6: The Internal Environment

### Learning Objectives

1. How and why do managers conduct an internal analysis of their firms?

A firm's internal environment is illustrated in Exhibit 8.4 by the innermost orange circle. The **internal environment** consists of members of the firm itself, investors in the firm, and the assets a firm has. Employees and managers are good examples; they are firm members who have skills and knowledge that are valuable assets to their firms. Evaluating a firm's internal environment is not just a matter of counting heads, however. Successful firms have a wide range of resources and capabilities that they can use to maintain their success and grow into new ventures. A thorough analysis of a firm's internal situation provides a manager with an understanding of the resources available to pursue new initiatives, innovate, and plan for future success.

### Resources and Capabilities

A firm's resources and capacities are the unique skills and assets it possesses. **Resources** are things a firm has to work with, such as equipment, facilities, raw materials, employees, and cash. **Capabilities** are things a firm can do, such as deliver good customer service or develop innovative products to create value. Both are the building blocks of a firm's plans and activities, and both are required if a firm is going to compete successfully against its rivals. Firms use their resources and leverage their capabilities to create products and services that have some advantage over competitors' products. For example, a firm might offer its customers a product with higher quality, better features, or lower prices. Not all resources and capabilities are equally helpful in creating success, though. Internal analysis identifies exactly which assets bring the most value to the firm.

### The Value Chain

Before examining the role of resources and capabilities in firm success, let's take a look at the importance of how a firm uses those factors in its operations. A firm's **value chain** is the progression of activities it undertakes to create a product or service that consumers will pay for. A firm should be adding value at each of the chain of steps it follows to create its product. The goal is for the firm to add enough value so that its customers will believe that the product is worth buying for a price that is higher than the costs the firm incurs in making it. As an example, Exhibit 8.8 illustrates a hypothetical value chain for some of Walmart's activities.

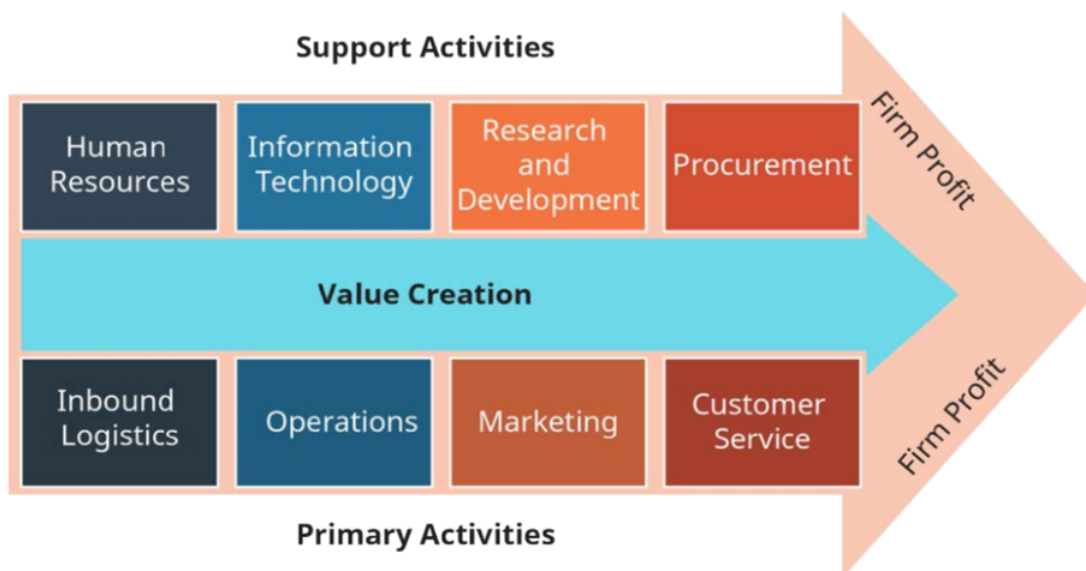


Exhibit 8.8 A Value Chain Example (Attribution: Copyright Rice University, OpenStax, under CC-BY 4.0 license)

In this example, note that value increases from left to right as Walmart performs more activities. If it adds enough value through its efforts, it will profit when it finally sells its services to customers. By working with product suppliers (procurement), getting those products to store locations efficiently (inbound logistics), and automatically keeping track of sales and inventory (information technology), Walmart is able to offer its customers a wide variety of products in one store at low prices, a service customers value.

**Primary activities**, the ones across the bottom half of the diagram, are the actions a firm takes to directly provide a product or service to customers. **Support activities**, the ones across the top of the diagram, are actions required to sustain the firm that are not directly part of product or service creation.

## Using Resources and Capabilities to Build an Advantage over Rivals

A firm's resources and capabilities are not just a list of equipment and things it can do. Instead, resources and capabilities are the distinctive assets and activities that separate firms from each other. Firms that can amass critical resources and develop superior capabilities will succeed in competition over rivals in their industry. Strategists evaluate firm resources and capabilities to determine if they are sufficiently special to help the firm succeed in a competitive industry.

## Using VRIO

The analytical tool used to assess resources and capabilities is called **VRIO**. As usual, this is an acronym developed to remind managers of the questions to ask when evaluating their firms' resources and capabilities. The four questions of VRIO, which focus on value, rarity, imitation, and organization, are illustrated in Exhibit 8.9.

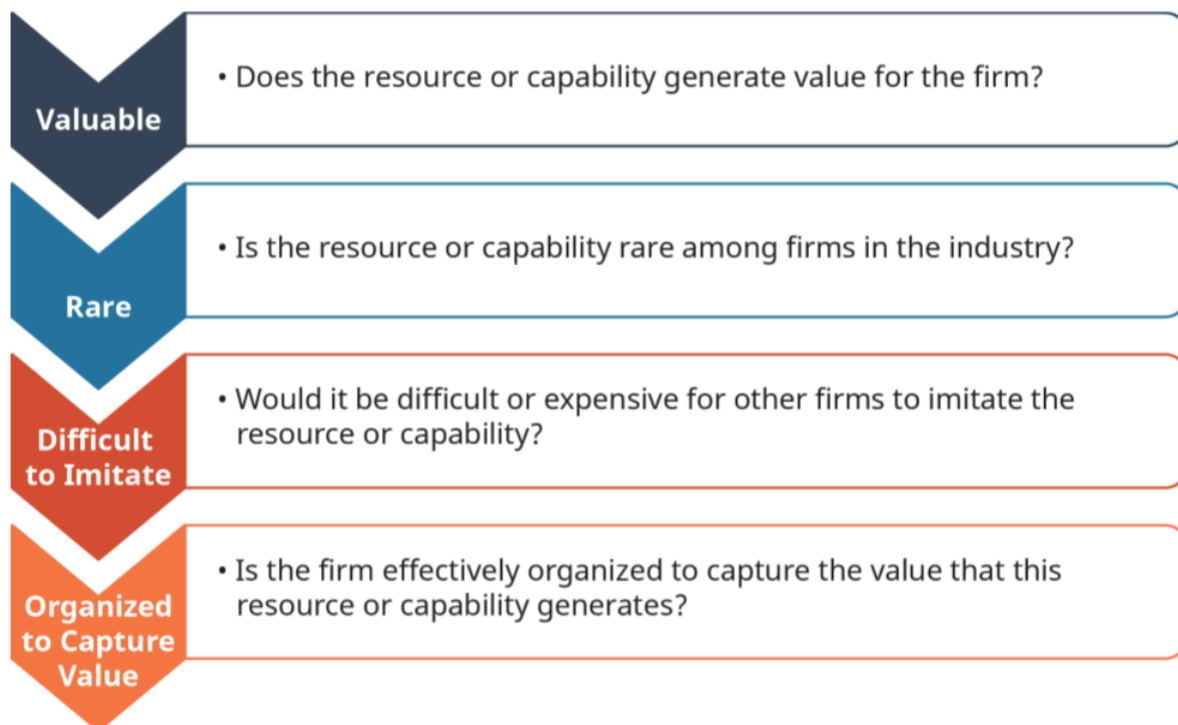


Exhibit 8.9 VRIO, a Tool for Evaluating Firm Resources and Capabilities (Attribution: Copyright Rice University, OpenStax, under CC-BY 4.0 license)

If each question can be answered with a “yes,” then the resource or capability being evaluated can be the source of a competitive advantage for the firm. An example will help you better understand the VRIO process.

Imagine that you are a top manager for Starbucks and you want to understand why you are able to be successful against rivals in the coffee industry. You make a list of some of Starbucks' resources and capabilities and use VRIO to determine which ones are key to your success. These are shown in Table 8.1.

Starbucks' Resources and Capabilities	
Resources	Capabilities
Brand name	Making quality coffee drinks
Thousands of locations worldwide	Delivering excellent customer service
Cash	Training excellent staff

Loyal customers	Paying above-average wages
Well-trained employees	Retaining quality employees

Table 8.1 (Attribution: Copyright Rice University, OpenStax, under CC-BY 4.0 license)

You look at your list and decide to pick a few of the entries to evaluate with VRIO (Table 8.2):

Evaluating Starbucks' VRIO					
Resource/ Capability	Is it valuable?	Is it rare?	Is it difficult to imitate?	Is Starbucks organized to capture its value?	Can it be a basis for competitive advantage?
Brand Name	Yes	Yes	Yes	Yes	Yes
Delivering excellent customer service	Yes	Yes	Yes	Yes	Yes
Thousands of locations worldwide	Yes	No	No	Yes	Yes

Table 8.2 (Attribution: Copyright Rice University, OpenStax, under CC-BY 4.0 license)

According to the evaluation above, Starbucks' brand helps it compete and succeed against rivals, as does its excellent customer service. However, simply having a lot of locations globally isn't enough to beat rivals—McDonald's and Subway also have thousands of worldwide locations, and both serve coffee. Starbucks succeeds against them because of their brand and customer service.

### ? Concept Check

1. What are firm resources and capabilities?
2. Describe a value chain and what the activities in the chain represent.
3. What is VRIO? What questions do the letters stand for, and how does using VRIO help a manager make decisions?

### ✓ ManaginG Change

#### Technology and Innovation: Uber, Lyft, and the Self-Driving Car: The Transportation of the Future Is Coming Soon

Although the ride-sharing industry is still relatively new, it has seen explosive growth, and its two main rivals, Uber and Lyft, are looking for ways to increase their capacity to serve riders. Both firms, and rivals like them, operate in basically the same way. A person needing a ride uses a smartphone app to alert a nearby person with a car of their location. The driver, usually an independent contractor for the service (meaning they are just a person with a car that has signed up to provide rides in exchange for a portion of the fare the customer pays), picks up the customer and drives them to their destination. Paying for the ride is also handled through the app, and the driver receives about 75–80% of the fare, with Uber or Lyft keeping the balance.<sup>12</sup>



Exhibit 8.10 Rideshare pickup area The ride-share pickup area at Pierre Elliott Trudeau Airport in Montreal. Due to the popularity of ride sharing with companies such as Uber and Lyft, municipalities and airports have had to accommodate the changing demands of customers. (Credit: Quinn Dombroski/ flickr/ Attribution-ShareAlike2.0 Generic (CC BY-NC 2.0))

The popularity of ride-sharing services has soared, and both companies are constantly recruiting more drivers. However, both companies have also explored alternatives to independent drivers: self-driving cars. Uber and Lyft have taken different paths to develop this capability. Uber has worked to internally develop its own software technology and self-driving car technology, while Lyft has focused on software interfaces that can accommodate other companies' self-driving cars.<sup>13</sup> Lyft's partnerships with firms such as Google and GM that are already developing self-driving cars has put it ahead of Uber in the race to get driverless vehicles into its ride-sharing network, and it was able to test self-driving cars in Boston by partnering with NuTonomy in 2017.<sup>14</sup> Lyft offered a demonstration to journalists at the Consumer Electronics Show in Las Vegas in 2018, offering rides in self-driving cars developed by Aptiv.<sup>15</sup> Uber had been testing similar technology in Pittsburgh but suspended its self-driving car program after a fatal pedestrian accident in Arizona.<sup>16</sup>

Sources: Ridester (2017). "How Much do Uber Drivers Actually Make? The Inside Scoop."Ridester.com. <https://www.ridester.com/how-much-do...-drivers-make/> Accessed July 29, 2017; Bensinger, Greg (2017). "Lyft Shifts Gears With New Driverless-Car Division; San Francisco company to hire hundreds of engineers and open new Silicon Valley office."The Wall Street Journal. July 21, 2017; Edelstein, Stephen (2017). "Lyft Finally Launches Its Boston Self-Driving Car Pilot Program."The Drive. Dec. 17, 2017. <http://www.thedrive.com/tech/16779/lyft-pilot-program>; O'Kane, Sean (2018). "I took a gamble by riding in a self-driving Lyft in Las Vegas."The Verge. January 8, 2018. <https://www.theverge.com/2018/1/8/16...vegas-cs-2018>; and Korosec, Kristen (2018). "Uber self-driving cars back on public roads, but in manual mode/"Tech Crunch. July 24, 2018. [techcrunch.com/2018/07/24/uber-self-driving-cars-back-on-public-roads-but-in-manual-mode/](http://techcrunch.com/2018/07/24/uber-self-driving-cars-back-on-public-roads-but-in-manual-mode/).

### Critical Thinking Questions

1. What resource or capability challenges have Uber and Lyft faced because their fast company growth?
2. What PESTEL factors do you think are contributing to the popularity of ride-sharing services?
3. What industry challenges (think of Porter's Five Forces) does the use of self-driving cars address?

### References

12. Ridester (2017). "How Much do Uber Drivers Actually Make? The Inside Scoop."Ridester.com. <https://www.ridester.com/how-much-do...-drivers-make/> Accessed July 29, 2017.
13. Bensinger, Greg (2017). "Lyft Shifts Gears With New Driverless-Car Division; San Francisco company to hire hundreds of engineers and open new Silicon Valley office."The Wall Street Journal. July 21, 2017.

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