

Chapter I

Theories and Models of Business Firms

INTRODUCTION

A general understanding of business firms is required in order to be able to develop business and IT strategies. This chapter 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, business model, and e-business models. These theories and models describe conceptually how the firm is constructed and resourced in delivering uniquely differentiated customer value in sustainable ways. It highlights the ways in which IT is used in the process of value and revenue creation for the firm using the chosen value configuration. It also classifies the ways in which Internet-based business strategy, known as *e-strategy*, may be represented as e-business models. The purpose of IT strategy, which is the core subject of this book, is about analyzing the business vision, mission, and strategy and defining the value configuration (business process or business model) and the attendant IT architectural model from which the requisite IT infrastructure to support or enable the firm's business operating model is designed and implemented. It is hoped that by illustrating to the readers the varying contexts in which IT can add value to the business in each of the value configurations or e-business models, the integral nature of the ways that IT has embedded in our business today can be better appreciated.

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. Knowledge management theory and

principles and their relevance to business innovation will be discussed in Chapter XI of the book.

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 firms' 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 information systems/information technology (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, nonsubstitutable, and not readily obtainable in factor markets. This theory rests on two key points: first, that resources are the determinants of firm performance and, second, that resources must be rare, valuable, difficult to imitate, and nonsubstitutable 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, nonsubstitutable, 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. This theory indicates it is these kinds of resources that are most likely to be sources of sustainable competitive advantage for firms (Barney, 2001). We will return to discussion of knowledge management and business innovation in Chapter XI.

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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