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Reading 2.12

The VRIO Framework: Evaluating Competitive Resources and Capabilities

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The VRIO framework — evaluating competitive resources and capabilities

As discussed earlier in this chapter, some of a company's heterogeneous resources and capabilities hold the potential for sustained competitive advantages. As Barney[68] suggests, to have this potential:

> a firm resource must have four attributes: a) it must be valuable, in the sense that it exploits opportunities and/or neutralises threats in a firm's environment, b) it must be rare among a firm's current and potential competition, c) it must be imperfectly imitable, and d) it must be able to be exploited by a firm's organisational processes. These attributes of company resources can be thought of as indicators of how heterogeneous and immobile a firm's resources are, and thus how useful these resources are for generating sustained competitive advantages.

These attributes have been further developed into a framework — the value, rarity, imitability and organisation (VRIO) framework — that can be applied in assessing the potential of a broad range of company resources to be sources of sustained competitive advantage. These analyses not only specify the theoretical conditions under which sustained competitive advantage might exist, they also suggest specific empirical questions that need to be addressed before the relationships between a particular company resource and sustained competitive advantage can be understood. A description of the four components of the VRIO framework follows.

1. The question of *value*: Do a firm's resources and capabilities enable the company to respond to environmental threats or opportunities? The traditional strengths, weaknesses, opportunities and threats (SWOT) model suggests that companies can improve their performance only if their strategies exploit opportunities or neutralise threats. Companies might have other characteristics that can serve as sources of competitive advantage (e.g. rarity, inimitability and organisational abilities/processes) but these characteristics become valuable resources only when they exploit opportunities or neutralise threats in the company environment.[69] A company must have valuable resources in order to create economic value and increase the willingness of customers to pay, decrease its costs, or both.
2. The question of *rarity*: Is a resource currently controlled by only a small number of competing companies? Valuable resources of a company that are also possessed by large number of competitors cannot serve as a source of competitive advantage. Each of these companies has the capability of exploiting that resource in the same way and implementing a common strategy which would not allow one company to create a competitive advantage.[70] In order to implement some strategies, companies need to form bundles of resources and these bundles have to be valuable to enable companies to create a competitive advantage. Companies must still maintain valuable but common resources. These help companies to survive when they are exploited to create competitive parity, a condition under which no one company is able to create a competitive advantage. According to Porter,[71] companies increase their probability of economic survival under conditions of competitive parity. The question of how rare a valuable company resource should be in order to serve as a source of a competitive advantage does not have a common answer. Barney and Clark[72] assert that

   > as the number of firms that possess a particular valuable resource (or a bundle of valuable resources) is less than the number of firms needed to generate perfect competition dynamics in an industry, that resource has the potential of generating a competitive advantage.

3. The question of *imitability*: Do companies without a resource face a cost disadvantage in obtaining or developing it? Companies with valuable and rare resources can enjoy a first mover advantage, acting as innovators because their resources allow them to conceive and engage in strategies that other companies could not conceive nor implement due to the lack of relevant resources. On the other hand, valuable and rare resources help companies to sustain their competitive advantage only if competitors cannot obtain these resources by direct duplication or substitution.[73] It depends on how difficult or costly it is to imitate the company's resources, which can be attributed to the following three main reasons:
   (a) **Unique historical conditions** determined the path a company followed to arrive at its current situation, and the company's long-term performance. Barney and Clark suggest that unique historical conditions can lead to a sustained competitive advantage in at least the following two ways[74]:

   > First, it may be that a particular firm is the first in an industry to recognize and exploit an opportunity, and being first gives the firm a first-mover advantage. Second, when events early in the evolution of a process have significant effects on subsequent events, path dependence allows a firm to gain a competitive advantage in the current period based on the acquisition and development of resources in earlier periods.

unique historical conditions: circumstances that determined the path a company followed to arrive at its current situation and the company's long-term performance

causal ambiguity: the situation in which the link between the resources controlled by the company and its competitive advantage is unclear or not understood

(b) There is **causal ambiguity** in the link between the resources controlled by the company and its competitive advantage. This link is either not understood or not understood clearly. The main situations in which managers may not fully understand their sources of competitive advantage include: when the resources and capabilities are invisible (e.g. relationships with customers and/or suppliers, and organisational culture); when managers are unable to evaluate which resources and capabilities or their combinations create a competitive advantage; and when the resources and capabilities are complex networks of relationships between individuals, groups and technology. This last source of competitive advantage is referred to as interconnectedness of asset stocks and asset mass efficiencies.[75] In general, when sources of competitive advantage are widely spread across processes of the company, locations and people, these sources are difficult to understand and costly to imitate.

social complexity: the degree to which sociocultural forces are organised

(c) **Social complexity** of a company's resources means that it is beyond the company's ability to systematically manage and influence these resources. A wide variety of resources may be socially complex, for example, the interpersonal relationships among managers in a company,[76] a company's culture,[77] and its reputation among customers and suppliers. Often it is clear how these socially complex relations add value to the company and there little or no causal ambiguity about the link between these resources and competitive advantage. At the same time, such understanding does not necessarily lead companies without these socially complex resources to the process of their creation.

4. The question of *organisation*: Are a firm's other policies and procedures organised to support the exploitation of its valuable, rare and costly-to-imitate resources? Valuable, rare and inimitable resources can serve as a source of competitive advantage if the company is organised to exploit the potential offered by these resources. Organisational processes assist companies in building and sustaining competitive advantage. The following components allow companies to exploit the full competitive potential of their resources and capabilities: their formal reporting structure, explicit management control systems and reward policies. These components are often referred to as complementary resources and capabilities as they have limited ability to generate competitive advantage in isolation. It is in combination with other resources and capabilities they can enable a firm to realise its full potential for competitive advantage.[78]

Bringing these questions of value, rarity, imitability and organisation together provides a single framework to understand the return potential associated with exploiting any of a company's resources and capabilities. This framework is summarised in table 5.3.[79]

TABLE 5.3 The VRIO framework

Is a resource or capability ...					
valuable?	**rare?**	**costly to imitate?**	**exploited by organisation?**	**Competitive implications**	**Economic performance**
No	—	—	No	Competitive disadvantage	Below normal
Yes	No	—	—	Competitive parity	Normal
Yes	Yes	No	—	Temporary competitive advantage	Above normal
Yes	Yes	Yes	Yes	Sustained competitive advantage	Above normal

The RBV asserts that the individual resources capabilities of companies provide a stronger basis for strategy development than industry analysis. The main argument for this view is that it will identify those resources and capabilities that are outstanding and thus have the potential for sustainable competitive advantage.