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# Internal Resource Audit for Strategists—A Proposal

**Tom Connor**

The Business School, University of Bedfordshire, London, UK.
Email: tjj.connor@virgin.net

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## ABSTRACT

*It is the purpose of this article to suggest a structured approach to internal resource audit, which, whilst of necessity general-purpose in design, would be capable of adaptation to particular company cases. Consequently this paper does not aim at theory development, but to make a conceptual contribution to the art and practice of management. It will, however, offer some criticism of current theory from a management perspective.*

***Keywords*****:** *Strategy*, *Internal Audit*, *Resources*

## 1. Introduction

It is a commonplace view within strategic management circles that an internal resource audit (IRA) is a basic step in determining a firm's strategic standing and for providing a key part of the platform for decision-making about the firm's feasible strategic options.

In view of the important role that an IRA plays in strategic deliberation it is curious to note that there seems to be no generally recognized procedure or process for conducting such an audit which is aimed at identifying the company's strengths and weaknesses.

In practice this identification of resources susceptible of management control, and which hold the potential for value creation and the establishment of competitive advantage, has traditionally been an *ad hoc* process. As Hax and Majluf [1] pointed out,

*It is unfortunate that the current state of knowledge in management precludes structuring this activity in a more precise way. We rely on an intuitive treatment because we lack a sounder and more solidly scientific method* (p. 77).

In the quarter of a century since they wrote, it would not appear that we have become appreciably more methodical or systematic in approaching this important activity.

### 1.1. Treatment of Internal Resource Audit

Most strategic management textbooks normally devote a section to analysis of the internal environment. This usually involves a discussion of company resources and capabilities with some generic observations about identified strengths and weaknesses. This may be useful as far as it goes, but these treatments are usually essentially descriptive and *ex post facto* in nature. It is suggested in this article that there is a need for a model or concept of an internal audit process which concentrates, not on the form that resources may take at points in time, but on the organic nature of the firm and the extent to which this nature will provide the long-term viability and competitiveness which lies at the heart of successful strategy. Thus the capacity to produce resources is as important, if not more so, as the possession of them now or in the past. This would predicate the conclusion that we should think not of strategy but rather of a 'strategic stream'. To this end it is suggested here that the main objective of an IRA is to assess the firm according to five key principles. These principles relate to the internal and structural condition of the firm, and will prompt certain proposed questions the answers to which will provide a clear assessment of its strategic capability. The questions are:

1) Is the firm in a fit condition for the strategic task facing it?

2) Is the firm alert to change signals in the broad environment?

3) Has the firm the durability to last the course over time?

4) Is the firm innovative in its pursuit of its strategic directions and methods?

5) Has the firm the capacity and disposition to adapt to

changes in environmental forces?

Many writers have addressed versions of these questions from both cybernetic and organic viewpoints. Whatever the viewpoint, which must be a matter of management choice, it is postulated here that they have to be considered in conjunction rather than sequentially or separately and, further, that the need is to provide managers with tractable principles for resource audit and development which they can deploy in dynamic, task-oriented environments.

It is suggested that the answers to these questions will provide an insight into the firm's quality of resource endowment. The answers would indicate if the firm is resourced for the competitive challenge implicit in its future strategic aspirations. The value of such an approach is that it concentrates on the potential of the firm to produce strategic success. Chandler [2] famously observed that "structure follows strategy". But is this necessarily true? One can see how a firm might make adjustments to its structure as strategy develops, but it is unlikely that any firm would have the appetite, time, or freedom for root-and-branch structural change whenever it changes its strategy significantly. If this is so then, it might be hypothesized that the successful firm is more likely to be one whose structure, culture, systems and management are capable of adjusting to shifts, both major and minor, in its strategic path and tasks. In other words, a flexible posture by managers is the key to strategic success rather than seeking the perfect fit of resources and environment.

## 1.2. The Literature of Resources within Strategic Management

The deployment of assets and resources lies at the heart of the strategic management discipline. Yet throughout the extensive literature in the field there is relatively little that addresses the issues of internal resource audit or the generation of resources critical to strategic success. McKiernan [3] has classified the strategy literature into four broad approaches:

1) Planning and practice
2) Learning
3) Positioning
4) Resource-based view (RBV)

The first of these classes (planning and practice) reflects the view of strategy created on a rational basis as a design for the deployment of corporate assets to exploit identified external opportunities. The emphasis is on systematic forecasting, information gathering, and planning procedures. This approach might be said to be within the tradition of scientific management. Writers within this tradition would include, amongst others; Taylor [4], Gilbreth [5], Barnard [6], Fayol [7], Ansoff [8], Steiner [9] and Andrews [10].

The second class of the literature (learning) argues that planned strategy is rendered impossible by the complexity and volatility of the business environment. Strategic success here will be achieved by adjustment to the changing environment and will be driven by organizational power systems, managerial values and expectations, and the contingent behavioural patterns within firms. Contributors to this stream of thinking would include such as; Simon [11], Cyert and March [12], Lindblom [13], Weick [14], Beer [15], Quinn [16], and Senge [17].

Within the third class of the literature (positioning) successful strategy emerges from an understanding of market structure and the opportunity it affords for firms to create differentiated positions. Derived from the concept of monopolistic competition, the successful firm in this view is responsive to the structural forces within its industry which define the limits of its freedom of action. This literature tradition includes such as; Chamberlin [18], Kotler [19], Robinson [20], Levitt ([21], Porter [22, 23], Ohmae [24], and Hofer and Schendel [25].

The fourth class of the literature (RBV) is probably the dominant school in current discourse within the field of strategic management. Essentially an *inside-out* view, it posits strategic success through the development, acquisition and deployment over time of scarce resources and skills which are unique either in themselves or in the way they are combined with each other. Derived from classical microeconomics, this tradition is found in the writing of such as; Penrose [26], Schmalansee [27], Wernerfelt and Montgomery [28], Dierickx and Cool [29], Rumelt [30], Barney and Griffin [31], Amit and Schoemaker [32], Kay [33], Peteraf [34], Collis [35], Powell [36], and Alvarez and Barney [37].

*A central thrust of the RBV is the contribution of core competences as strategic assets which will be the continuing source of new products and services through whatever future developments may take place in the market, which by their nature, are unknowable. Thus the emphasis of the RBV approach to strategic management decision-making is on the strategic capability of the firm rather than attempting to constantly ensure a perfect environmental fit.* (Connor: 307) [38].

The RBV tradition in the literature is an explicitly *inside-out* approach and so it is within this body of writing that we might reasonably expect to see the greatest emphasis upon the audit of internal resources. Curiously however, the RBV literature is all but silent on this matter. A critical review of this literature suggests that its discussion of assets and resources (strategic assets) would appear to be more rhetorical than concrete. Even where RBV proponents suggest the nature of the strategic assets which explain the success of the firm the suggestion appears invariably to be an *ex post facto* assertion of causality rather than a statement of demonstrated causality between identified concrete assets defined *a priori* and ensuing strategic success. From an analytical viewpoint the language used to describe strategic assets in the RBV literature is vague and imprecise and frequently is little more than a collection of adjectives and abstractions as illustrated in **Table 1**.

In essence assets are defined by attributes rather than by identification. The RBV has been subjected to critical observation in the literature principally concerning its tautological nature and its *ex post facto* viewpoint including, amongst others, Priem and Butler [39,40], Collis [35], Connor [38], McGuiness and Morgan [41].

To conduct an audit it must be possible to define and identify what is being audited. The weakness of the RBV is that its discussion of strategic success is based upon the concept of strategic assets. But in the literature of the RBV strategic assets are imprecise, generalized notions which, if they can be identified, will only be so after the event. Definitions of strategic assets are not definitions of substance at all but rather attributions of purported characteristics. The link between the 'strategic asset' and the consequence is a retrospective imputation rather than an inductively demonstrated linkage. Similarly with such ideas as complementarities and capabilities. Do these words actually have specific *in situ ex ante* definitions?

A company has to be successful before the strategic assets can be suggested. This begs the question; can companies which are not successful have any strategic assets? Are strategic assets only strategic if they deliver success? If so then this imputation of success is an entirely tautological process. Throughout much of the research literature within the RBV it is suspected that many of the correlations identified and claimed may simply be the consequences of seeking relationships between variables which on closer investigation may well be simply paraphrases of each other. For these reasons it is argued that the RBV literature can provide little, if any, guidance to practicing managers facing the task of internal resource audit. The RBV is entirely retrospective. Good theory provides the basis for sound and reliable prediction. The RBV cannot do this other than in the most generalised and imprecise terms. In consequence RBV propositions would merely appear to beg the question of what produces strategic success.

**Table 1. Language of the RBV.**

| Strategic Assets | Characteristics within the RBV Literature |
|---|---|
| Strategic assets are *inter alia* | Valuable<br>Rare<br>Inimitable<br>Tacit<br>Durable<br>Competence<br>Capability<br>Institutional<br>Complementarity<br>Metaphysical insights<br>Etc. |

## 2. Premises

Consequently an approach is suggested here which is based upon properties of an organization which can be defined *a priori*. Firstly though, it is important to establish a number of premises in order to ground the proposed approach and to provide a conceptual boundary for its application.

1) Any effective IRA should be based upon a clear and structured view of the business model of the particular firm. For this purpose it is suggested that a comprehensive value chain analysis [23] would be an appropriate first step in the process. There is no intention to dwell further on this point here since the value chain concept should be well understood and its use has become common amongst managers.

2) The resources to be audited will be assets and skills. These are levers for managers to use. Anything which cannot be used cannot be a resource of that firm. It is the internal controllable resources which are semi-deterministic in nature, in that although managed changes to inputs can be undertaken the market-place impact of them is probabilistic in nature.

3) The audit cannot simply follow a sequential function-by-function approach. The process should be informed by the insights gained from the value chain analysis, and resources and assets, although perhaps residing in particular functions, must be understood in terms of their synergistic, rather than isolated, potential for value creation.

4) Concepts such as "competences" or 'capabilities" are not particularly helpful if they are principally judgmental and rhetorical in nature and tend to be simply inferential descriptions of what may have worked in the past following *ex post facto* rationalization of phenomena. It is important to avoid such casual, and perhaps seductive, assertions of the causation of success.

5) To be of value the resource audit ought to be forward-looking, since whatever has produced past success cannot be assumed to do so in the future. Consequently the identification and evaluation of internal resources cannot be done in isolation from an insight into strategic aspirations; it must be driven by a view of the future, not an assessment of the past. Thus the internal audit of the company cannot be done in isolation from the assessment of the company's external environmental situation. It

follows that the internal resource audit becomes a search for the organic responsiveness of the firm rather than solely a search for the presence or absence of specific resources defined *a priori*. That would represent a molecular approach to strategic analysis and in no way considers the matter of the dynamic combination of resources.

Proceeding from these premises the following principles are proposed to frame an effective approach to internal resource audit.

## 2.1. Principle of Fitness

The idea of fitness relates to the ability of the firm to maintain and win business in its served markets. Two contributing factors would be sought here. The first is the possession of the necessary tangible and intangible assets required to achieve strategic objectives. By necessary it is meant that these assets will have been defined and identified by managers as a consequence of a rational process of analysis and design. Thus they will be definite in nature and not simply in the form of assumed strengths of the organization emerging from a retrospective appraisal of the firm's performance hitherto.

The second factor of importance in this connection will be the extent to which the firm can respond to intelligence and stimuli without the need to overcome structural inhihibitors to action. The biological analogy is with the body's autonomic systems which function and provide life support in an "unthinking" way. In essence the fit firm will respond autonomically to opportunities and threats. Clearly here organizational design, policies, procedures, and the general working style of the firm will be of central importance. Any artificial barriers to rapid assimilation of information and internal communications will undermine the fitness of the firm and render it less competitive than it might otherwise have been. Consequently it is suggested that an appropriate range of factors for ascertaining and achieving fitness might include the explicit definition of the key assets and resources without which strategic objectives cannot be achieved, derived from the use of tried and tested analytical methods for the identification of critical success factors. This would be augmented by an explicit, itemized, and phased plan for the acquisition of the key strategic assets identified. The design of the organization with the principal emphasis on facilitation of learning from experience, and the formulation and maintenance of internal policies and procedures specifically designed to ensure that the firm embraces and exploits new knowledge would be another important focus of strategic management attention. At the level of organizational detail the design of information and control systems and the removal throughout the firm of all organizational barriers to communications would be an integral part of the strategic plan of the firm. This would cover structure, design, customs, conventions, traditions, hierarchies, and so on, since all of these can introduce rigidities and inertia into the firm. These features are, in fact, part of a rounded strategy.

The intention of attending to this range of issues would be the achievement of an optimum balance between the firm's learning and action mechanisms, with the benefit that strategic response becomes a reflex action rather than an exercise in guarded and suspicious introspection, as may be the case for many businesses which lack the self-confidence to respond quickly to developments.

## 2.2. Principle of Alertness

Allied to the fitness of the firm is its alertness. Once again, this will be a feature of design, whether formal or informal, and will relate to the processes of intelligence acquisition and the organic capacity of the firm to learn both through the processing of externally sourced information and through the continuous review of internal conditions and developments. The essential requirement is to make maximum effective use of all intelligence and the following points will be of particular importance in this connection the information system of the firm would be designed and organized to receive signals from both internal and external sources, furthermore, the screening of information should be conducted to minimize the interference of "noise". Once acquired and screened information would need to be disseminated within the firm as quickly and widely as possible. This entails that there should be no vertical or horizontal barriers to the free exchange of information within the firm. The firm would look for every opportunity to learn and should have no reservations about questioning established ideas or views or changing direction and it should ensure that it develops a strong, retentive corporate memory so that its experiences are recorded and appraised for the learning potential they can offer.

These issues are all capable of a design approach, but achieving these conditions might be difficult for many firms since it may involve a considerable effort to overcome traditional views about organizational life and hierarchical structures. It will require novel ways of looking at the world and a constant willingness to learn and re-learn, jettisoning when necessary ideas and values which may have worked well in the past and to which many people have a degree of attachment. Internal controllable variables are deterministic in nature, but external developments are not, they are invariably stochastic. But good managers will recognize that it is possible to create controllable internal systems to improve the firm's external environment assessment and decision-making in the face of the uncontrollable variables. Failing to do these things would impair the alertness of the firm and in turn degrade its fitness.

## 2.3. Principle of Durability

A firm requires durability to survive and prosper in a changing world. We may think of durability as a measure of the firm's stamina for the long haul. This is not a point-in-time condition but an extended capacity to develop continuously. The principal focus of this consideration will be the firm's reserves of strength. This would mean a concentration on the firm's ability to renew and develop its key assets and resources, not the least of which will be a constant flow of management and other human talent to exploit and direct resources towards the achievement of the corporate purpose. Consequently that purpose itself is an aspect of durability as it imbues the firm with a direction for its efforts and a means of avoiding distractions and blind alleys. To this end a number of points are important to note. There ought to be a systematic and continuous review of the firm's key strategic assets to ensure that they are maintained and where necessary developed and modified. The financial resources of the firm should be focused primarily on these key strategic assets. The continuous monitoring, development, and acquisition of management talent will be axiomatic in ensuring the firm's stamina. The explicitly stated purpose of the firm should provide the decision rules for cases where difficult choices have to be made between strategic options and competing claims on strategic asset allocation. In this connection an understanding of the purpose of the firm will have to be disseminated throughout the organization to all levels to ensure that all employees are aware of the nature of their own contribution to strategic success, in terms of their own professional language and work. Special care would need to be taken to ensure that the high-level objectives of the firm's corporate and business strategy are translated into appropriate functional level language to enable delivery of strategy in the competitive market.

Once again the issues identified here are all susceptible of a design approach. Attention to these issues will improve the chances of a firm achieving longevity. The essential notion is the conditioning of the firm with a long-term level of competitiveness in view. The principal focus is not just the creation of successful products now but the capacity to continuously develop and introduce new products over time. The firm may have very little idea of what products the market may require in ten years but it must ensure that it has the potential and survivability to be there in ten years providing the products whose market need will have manifested itself in the intervening period.

## 2.4. Principle of Innovation

In considering this question the two factors of primary interest are the firm's human capital and its powers of imagination. Together these two factors will govern the level of the firm's creativity. As innovation is a creative act only human intelligence allied with imagination can produce it. With a view to a firm's long-term competitiveness clearly the diligence with which it acquires talent and the provision of an internal environment which promotes creativity will be critical determinants. The following considerations will be of relevance to these issues. The firm's human resourcing policies will need to be strategically focused rather than simply determined in isolation at the functional level, thus ensuring recruitment and development activities reflect strategic objectives. As a corollary, the firm's human resourcing funds should be focused on strategy-determined staffing needs and managers should be adept at re-allocating key human resources in changing conditions to optimize their value creation. A heavy emphasis would be laid on executive succession plans and policies for developing and retaining strategically important people. The firm's reward systems ought to be designed with creativity and innovative initiatives in mind and a cultural predisposition to challenging norms of thinking and behaviour should be designed into the firm's organization and be reflected in the firm's choice of strategic performance measurements.

All of these considerations can be rationally addressed through purposeful planning and organizational design. It would be wrong to believe that creativity can simply emerge from a relatively unstructured organizational setting. The search here is for purposeful freedom and initiative, and not simply a form of organizational libertarianism, where anything goes. It should be noted that much of what has been observed here about innovation will be closely related to the observations above about the alertness of the firm and the need to embed the information systems to gather intelligence and the removal of organizational barriers to communication.

## 2.5. Principle of Adaptability

The last principle to address relates to the capacity of the firm to adapt itself to changes in the environmental forces which impact upon it. The analogy here is clearly with the biological need to adapt to survive. Once again, appropriate information processing will be a clear imperative in this connection, but it must be combined with a propensity within the firm to accept and embrace changed conditions as a matter of course. The firm's information collection, processing, interpretation, and dissemination systems should be designed with strategic objectives in mind; the systems would serve the strategy and not vice versa and consequently would be changed when business objectives change. Performance control feedback systems would be based upon clear and calibrated strategic success factor measurements; both quantitative and qualitative. The adaptable firm would need to be willing to change its organization structure as its strategic objectives change and all structural and procedural rigidities within the firm's organization should be removed. The firm should ensure that it possesses the necessary professional change management skills and processes for overcoming fear, conservatism, turf-wars, and other forms of resistance to change which would otherwise promote strategic inertia

To meet the requirement to cover all these issues the firm will clearly focus on the continuous design and re-design of its strategic information systems and the need to engineer mutability into its organizational structure and behaviour. The essential objective is to produce an organization which has an organic relationship with its environment and where internal processes are designed to be adaptive as a matter of course rather than as a matter of exception. Failure to do this effectively may result in a firm which is defensive-minded and sees the environment in adversarial terms rather than as a source of opportunities for growth and renewal.

## 3. Discussion

It is not suggested that these five principles be seen as a series of sequential considerations. Good managers will be considering all five in parallel and contemporaneously. The five questions will probably not in practice be separable and the measures required in response to each will blend with the others. Thus the implementation of the actions required to ensure each of the five conditions will be complex and reflexive and require considerable thought and planning. This process itself will become a high-level organizational competence underlying and vitalizing the firm's long-term competitiveness. In considering the overall contribution of the five determinants above, we might re-state the five questions and summarize as **Table 2**.

It is proposed here that the answers to these five questions will provide the basis for judging the likelihood of the firm's long-term competitiveness. Fundamentally the proposition is that if these five questions can be answered affirmatively the firm will have done all it could from a rational managerial perspective to ensure it is in a competitive state. Of course, whether the firm is successful or not is ultimately for the market to decide.

One key implication of the approach to internal resource audit as proposed in the 'five question' method above is that it may well emerge that the capacity of the firm for purposeful strategic action may be not so much a function of what resources are in place, but, rather, of what barriers and constraints are absent from the firm's organizational arrangements. It may prove to be the case that barriers to communication, silo structures, fundamental policies and procedures, embedded values, and so on, will prove to be intangible liabilities which can vitiate any benefit the firm might have expected to derive from its strategic assets. If the purpose of an IRA is to identify the state of the firm's internal strategic condition and standing, then the identification of the liabilities may be of as much, if not more, importance than identifying the assets, since assets cannot be exploited if they are negated by other internal factors. To allow this to happen when the internal liabilities are identifiable would be a failure of strategic management. Furthermore, we can say that the purpose of an internal audit will be the identification of internal resources and liabilities together with an evaluation of their impact and significance. It is important for a firm that this process is continuous and routine, providing a basis for prospective planning towards strategic objectives. It is not uncommon that the identification of competences and capabilities frequently comes after success has occurred and *ex post facto* rationalization assigns that success on a judgmental basis to those identified competences and capabilities, even if a true analysis might produce a different explanation for the success the firm has experienced. It is, therefore, important to avoid such casual assertions of causality and a systematic and systemic internal resource audit procedure will be an important factor in this regard. Thus we are seeking in the IRA evidence that the firm is endowed with the capability to develop competitive advantage through time rather than simply identifying particular

**Table 2. The five key questions.**

| | |
|---|---|
| Fit | Is the firm in a fit condition to undertake the strategic tasks facing it and focused on the long-term success factors within its strategy? |
| Alert | Has the firm ensured it is attuned to its operating environment, both external and internal, and has it developed the necessary antennae and information processing and learning systems? |
| Durable | Can the firm last the pace over the long-term with evidence of stamina and the capacity for self-renewal? |
| Innovative | Is the firm designed and resourced to enable it to change its strategic directions and methods of achieving strategic objectives? |
| Adaptable | Has the firm structured and resourced itself to be creatively responsive to environmental changes? |

 

assets or intangible resources at a point in time. The IRA is thus a contribution to assessing long-term organic viability rather than a mechanistic listing of currently possessed resources in the fashion of compiling a strategic asset register. Whereas the RBV and the strategic management literature in general would appear to focus on strategic success as some form of competitive "winning" (or a measurable terminal outcome of some description) the underlying view of strategic success in this article is open-ended and recognizes that it will be different for each firm. Rather than seeking a common definition of strategic success the proposal here seeks a tractable approach to developing the organizational conditions and potential for optimizing the chances of success, however the managers of a particular firm may have defined that. Thus the approach here has been essentially management-focused rather than focused on general-theory and may be seen as an attempt to view the issues from the strategy-as-practice position. The framework of management tasks represented by the issues and challenges within each of the five questions posed depicts a systematic approach to "doing the right things", derived from first principles of sound management practice. The substance of the managerial task will be the constant conditioning of the firm in the face of a dynamic world. Consequently, given the suggested inadequacy of the RBV literature a more fruitful basis of conceiving of successful organization for competitive advantage might be the perspective of the market-process approach to management [42,43] with its emphasis upon the acquisition and use of information and the structuring of the firm to facilitate this and to ensure that the organizational arrangements of the firm, or hierarchy, [43] optimize the sensitivity of the firm to market conditions and dynamics. In other words the market and its dynamics is internalized and reflected in the organization's structure, behaviour and systems.

## 4. Conclusions

It has not been the purpose of this article to suggest any brand new managerial concepts or theory. What is suggested, however, is that it would be helpful if a range of well-established good practices of management technique, organizational design, and information systems management could be bundled by managers into a coherent and purposeful series of distinct, proceduralized, and accountable management responsibility areas. If this can be achieved then the result might be a firm whose, fitness, alertness, durability, innovativeness and adaptability are a set of interlinking, overlapping and harmonious properties facilitating the optimum exploitation of the potential for internal synergy and in consequence the achievement of a degree of strategic success in its markets. Product and market selection are ultimately acts of faith on the part of managers, but management, resource acquisition and deployment, and organization are matters of tried and tested knowledge and best-practice. Essentially the purpose of managers must be to produce a sentient organism which can negotiate the future and whatever it throws at it. This can only be done by creating an organization which is resilient and responsive and that consequently can achieve self-sustaining viability in an uncertain and unplannable environment. If this can be achieved with the method proposed herein that would represent a move towards providing the sounder, non-intuitive, basis of internal resource audit which Hax and Majluf were hoping for over a quarter of a century ago.

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