

**EXECUTIVE SUMMARY**  
**THE CORE COMPETENCE OF THE CORPORATION**  
**Prahalad & Hamel**

1. Then and Now

- a. A diversified corporation used to be able to simply point business units at particular end product markets and admonish them to be world leaders.
- b. With market boundaries changing ever more quickly, targets are elusive and capture is at best temporary.
- c. 2 alternative concepts: A portfolio of businesses vs a portfolio of competencies.

2. NEC vs GTE -- an excellent contrast

a. NEC

- i. In early 70s, articulated strategic intent to exploit the convergence of computing and communications.
- ii. Success, management reckoned, would hinge on acquiring competencies, particularly in semiconductors.
- iii. Constituted a "C&C Committee" of top managers to oversee development of core products and competencies.
- iv. Put in place coordination groups and committees that cut across the interests of individual businesses.
- v. Shifted enormous resources to strengthen its position in components and central processors.
- vi. By using collaborative arrangements to multiply internal resources, they were able to accumulate a broad array of core competencies.
- vii. Carefully ID'd three interrelated streams of technological and market evolution.
- viii. Reasoned computing, communications, and components businesses would so overlap that it would be very hard distinguish among them, and there would be enormous opportunities for a company that had built the competencies needed to serve all three markets.
- ix. Determined that semiconductors would be the company's most important "core product."
- x. Entered into myriad strategic alliances--over 100 as of 1987--aimed at building competencies rapidly and at low cost.
- xi. Almost all their collaborations were oriented toward technology access.
- xii. Director of Research quote: "From an investment standpoint, it was much quicker and cheaper to use foreign technology. There wasn't a need for us to develop new ideas."

b. GTE

- i. No such clarity of strategic intent and strategic architecture appeared to exist at GTE.
- ii. No commonly accepted view of which competencies would be required to compete in the information technology industry was communicated widely.
- iii. While significant staff work was done to identify key technologies, senior line managers continued to act as if they were managing independent business units.
- iv. Decentralization made it difficult to concentrate on core competencies.

- v. Instead, individual business units became increasingly dependent on outsiders for critical skills, and collaboration became a route to staged exits.

### 3. Core competence -- The roots of competitive advantage

- a. In the short run, a company's competitiveness derives from the price/performance attributes of current products.
- b. In the long run, competitiveness derives from the ability to build, at lower cost and more speedily than competitors, the core competencies that spawn unanticipated products.
- c. Real sources of advantage are to be found in management's ability to consolidate corporate-wide technologies and production skills into competencies that empower individual business to adapt quickly to changing opportunities.
- d. Senior executives who claim that they cannot build core competencies either because they feel the autonomy of business units is sacrosanct or because their feet are held to the quarterly budget fire should think again.
- e. The diversified corporation is a large tree. The trunk and major limbs are core products, the smaller branches are business units, the leaves, flowers, and fruit are end products. The root system that provides nourishment, sustenance, and stability is the core competence.
- f. You can miss the strength of a competitor by looking only at their end products.
- g. Core competencies are the collective learning in the organization, especially how to coordinate diverse production skills and integrate multiple streams of technologies.
- h. If core competence is about harmonizing streams of technology, it is also about the organization of work and the delivery of value.
- i. Core competence is communication, involvement, and a deep commitment to working across organizational boundaries. It involves many levels of people and all functions.
- j. Core competence does not diminish with use. Unlike physical assets, which deteriorate over time, competencies are enhanced as they are applied and shared.
- k. Core competencies need to be nurtured and protected, as knowledge fades if it is not used.
- l. Competencies are the glue that binds existing businesses and also the engine for new business development.
- m. There are major companies that have had the potential to build core competencies but failed because of an inability to conceive of the company as anything other than a collection of discreet businesses.
- n. Management trapped in the SBU mind-set almost inevitably finds its individual businesses dependent on external sources for critical component (which are physical embodiments of core competencies).

### 4. How not to think about core competence -- challenges posed to Western Managers

- a. In the core competencies underlying them, disparate businesses become coherent.
- b. Unlike the battle for global brand dominance, which is visible in the world's broadcast and print media, the battle to build world-class competencies is invisible to people who aren't deliberately looking for it.
- c. Top management often tracks cost and quality of competitor products, yet how many managers untangle the web of alliances their competitors may have constructed to acquire competencies at low cost?

- d. In how many Western boardrooms is there an explicit, shared understanding of the competencies the company must build for leadership?
  - e. How many senior executives discuss the crucial distinction between competitive strategy at the SBU level and competitive strategy at the level of an entire company?
  - f. Cultivating core competence does not mean outspending rivals on R&D or sharing costs between SBUs.
  - g. Building core competence is more ambitious and different than integrating vertically. (Of course, decisions about competencies do provide a logic for vertical integration, though.)
5. Identifying core competencies -- and losing them
- a. Three tests can be applied to ID core competencies in a company:
    - i. A core competence provides potential access to a wide variety of markets. (e.g. Competence in display systems opens up to TVs, calculators, monitors, auto dashboards.)
    - ii. A core competence should make a significant contribution to the perceived customer benefits of the end products. (e.g. Honda's engines fit this bill.)
    - iii. A core competence should be difficult for competitors to imitate. And it will be difficult if it is a complex harmonization of individual technologies and production skills.
  - b. Few companies are likely to build world leadership in more than 5-6 fundamental competencies. A company that compiles a list of 20-30 capabilities has probably not produced a list of core competencies.
  - c. It is probably good discipline to generate a list of this sort and to see the aggregate capabilities as building blocks. This tends to prompt search for licensing deals/alliances to fill in missing pieces at low cost.
  - d. Companies that judge competitiveness, their own and their competitors', primarily in terms of the price/performance of end products are courting the erosion of core competencies--or making too little effort to enhance them.
  - e. Embedded skills that give rise to next generation competitive products cannot be "rented in" by outsourcing and OEM supply relationships.
  - f. In Prahalad's view--too many companies have unwittingly surrendered core competencies when they cut investment in what they mistakenly thought were just "cost centers" in favor of outside suppliers.
  - g. Two clear lessons to consider.
    - i. First, the costs of losing a core competence can be only partly calculated in advance. The baby may be thrown out with the bath water in divestment decisions.
    - ii. Second, since core competencies are built through a process of continuous improvement and enhancement that can span a decade or longer, a company that has failed to invest in core competence building will find it very difficult to enter an emerging market, unless of course, it will be content simply to serve as a distribution channel.
6. From core competencies to core products
- a. 3 different planes on which battles for global (or any business) leadership are waged: core competence, core products, and end products.

- b. Core products - the physical embodiment of one or more core competencies.
- c. Core products - the components or subassemblies that actually contribute to the value of the end products.
- d. Thinking in terms of core products forces a company to distinguish between brand share it achieves in end product markets and manufacturing share it achieves in any particular core product.
- e. To sustain leadership in chosen core competence areas, strongest companies seek to maximize their world-manufacturing share in core products.
- f. Control over core products is critical for several reasons:
  - i. Manufacture of core products for a wide variety of external (and internal) customers yields revenue and market feedback that, at least partly, determines the pace at which core competencies can be enhanced and extended.
  - ii. By focusing on competence and embedding it in core products, businesses can build up advantages in component markets first and have them leveraged off their superior products to move downstream to build brand share. And they are not likely to remain low cost suppliers forever. As their reputation for brand leadership is consolidated, they may well gain price leadership.
  - iii. A dominant position in core products allows a company to shape the evolution of applications and end markets.
  - iv. As a company multiplies the number of application arenas for its core products, it can consistently reduce the cost, time, and risk in new product development. In short, well-targeted core products can lead to economies of scale and scope.

#### 7. The tyranny of the SBU

- a. Old prescriptions have toxic side effects. The need for new prescriptions is most obvious in companies organized exclusively according to the logic of SBUs.
- b. A diversified corporation obviously has a portfolio of businesses and of products; but we must also learn to think in terms of a portfolio of core competencies as well.
- c. US companies don't lack technical resources to build competencies, but top management often lacks the vision to build them and the administrative means for assembling resources spread across multiple businesses.
- d. It is important for a company to know whether it is winning or losing on each of the 3 planes of competition – core competence, core products, or end products. It can be difficult to measure, as market share doesn't always indicate sustainability of a position (e.g.--if you are relying on others core competence, rather than your own to build an end product position, you could be in quick sand.)
- e. The primacy of the SBU -- an organizational dogma for a generation -- is now clearly an anachronism. The SBU prism (in many companies) means that only one plane of the global competitive battle, the battle to put competitive products on the shelf today, is visible to top management. What are the costs of this distortion??!!
- f. Under investment in developing core competencies and core products
  - i. When a corporation sees itself primarily as a collection of SBUs, no single unit may feel responsible for maintaining a viable position in core products nor be able to justify investment req'd to build leadership in some core competence.

- ii. In the absence of a more comprehensive view imposed by corporate management, SBU managers will tend to under invest.
- iii. Managers in Western corporations, by and large, have failed to look across their various product divisions in an attempt to identify opportunities for coordinated initiatives.
- g. Imprisoned resources
  - i. As an SBU evolves, it develops unique competencies that are typically seen as the sole property of the business in which they grew up.
  - ii. A manager from another SBU who asks to borrow talented people is likely to get a cold rebuff. SBU managers are not only unwilling to lend their competence carriers but they may actually hide talent to prevent its redeployment in the pursuit of new opportunities.
  - iii. Western companies have traditionally had an advantage in the stock of skills they possess, but have been unable to reconfigure them quickly to respond to new opportunity.
  - iv. When competencies become imprisoned, the people who carry the competencies do not get assigned to the most exciting opportunities, and their skills begin to atrophy.
  - v. Only by fully leveraging core competencies can smaller companies afford to compete with industry giants.
  - vi. It is ironic that top management devotes so much attention to the capital budgeting process yet typically has no comparable mechanism for allocating the human skills that embody core competencies.
  - vii. Top managers are seldom able to look four or five levels down into the organization, ID the people who embody critical competencies, and move them across organizational boundaries.
- h. Bounded innovation
  - i. If core competencies aren't recognized, individual SBUs will pursue only those innovations that are close at hand -- marginal product line extensions or geographic expansions.
  - ii. Hybrid opportunities will emerge only when managers take off their blinders.
  - iii. Conceiving of the corporation in terms of core competencies widens the domain of innovation.

## 8. Developing strategic architecture

- a. Fragmentation of core competencies becomes inevitable when a diversified company's information systems, patterns of communication, career paths, managerial rewards, and processes of strategy development do not transcend SBU lines.
- b. Prahalad believes that senior management should spend a significant amount of time developing a corporate-wide strategic architecture that establishes objectives for competence building.
- c. A strategic architecture = a road map of the future that identifies which core competencies to build and their constituent technologies.
- d. Key question for senior management: How can a company make partnerships intelligently without a clear understanding of the core competencies it is trying to build and those it is attempting to prevent from being unintentionally transferred?

- e. To sink sufficiently strong core competence roots, a company must answer some fundamental questions:
    - i. How long can we preserve our competitiveness in this business if we do not control this particular core competence?
    - ii. How central is this core competence to perceived customer benefits?
    - iii. What future opportunities would be foreclosed if we were to lose this particular competence?
  - f. A strategic architecture:
    - i. Provides logic for product and market diversification.
    - ii. Should make resource allocation priorities transparent to the entire organization.
    - iii. Provides a template for allocation decisions by top management and helps lower level managers understand the logic of allocation priorities and disciplines senior management to maintain consistency.
    - iv. Yields a definition of the company and the markets it serves.
    - v. Is a tool for communicating with customers and other external constituents.
    - vi. Reveals the broad direction without giving away every step.
  - g. Two things critical for strategic architecture to come to life:
    - i. Consistency of resource allocation.
    - ii. Development of an administrative infrastructure that enables consistency of resource allocation.
  - h. The organizational results when a solidly supported strategic architecture comes to life:
    - i. A managerial culture of teamwork.
    - ii. A capacity to change.
    - iii. A willingness to share resources.
    - iv. A willingness to protect proprietary skills.
    - v. A willingness to think long term.
    - vi. Something that cannot be easily duplicated overnight by competitors!
9. Redeploying to exploit competencies
- a. Premise -- if core competencies are a company's critical resource and if top management must ensure that CCs aren't held hostage by a particular unit, it follows that SBU managers should bid for core competencies in the same way they bid for capital.
  - b. Once overarching competencies are ID'd by top management (with SBU help), they must ID the projects and people connected with them. (A thorough audit.)
  - c. This sends a clear message to middle managers: core competencies are corporate resources and may be re-allocated by corporate management. Individual businesses don't own the people. SBUs are entitled to the services of an individual so long as it can be demonstrated that their utilization is yielding the highest possible pay-off.
  - d. Progress enabling questions:
    - i. Reward systems - how can they be adjusted to support this thinking?
    - ii. How does senior management recognize the contribution of SBU managers who give up the talent?
    - iii. How does a corporation build into its thinking an allowance for a dip in performance from the unit that gives up the talent? Censure in times like this can cause serious damage.

- iv. How does a corporation wean its people of the sense that they "belong" to one unit?
1. Mid-career: assigning people to a series of cross-functional teams.
  2. Early-career: Carefully planned rotation systems.
  3. Horizons-type program that is continually updated - letting people know they are being tracked for future developmental purposes.
  4. Periodically bringing competence carriers from across the organization to compare notes and ideas.

10. The bottom line

- a. Core competencies are the wellspring of new business development and should constitute the focus for strategy at the corporate level.
- b. Only if a company is conceived of as a hierarchy of core competencies, core products, and market-focused business units, will it be fit to fight.
- c. In the final analysis--Top management adds value by enunciating the strategic architecture that guides the competence acquisition process.