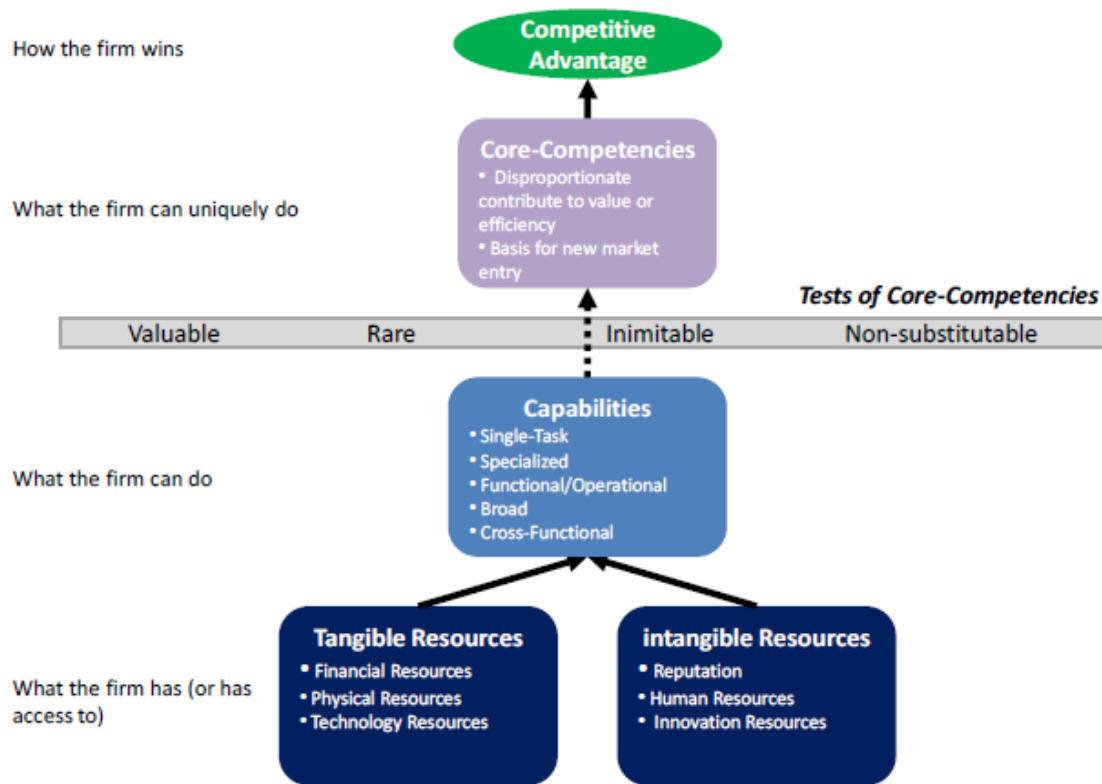# CORE COMPETENCIES

Key Points

- Core competencies are capabilities that have developed to the point where they provide competitive advantage for an organization.
- Core competencies help organizations access key markets and deliver value to end customers.
- The assumption that every organization has a core competence is not correct; there are specific criteria or tests that help determine if capabilities are in fact core competencies.

Main Thoughts

A core competence is a capability that has developed to the point where it has become a source of competitive advantage for an organization. Core competencies are not easy to develop nor can they be readily imitated. Organizations that have strong core competencies—such as Honda in engine manufacturing and Proctor & Gamble in brand management—are difficult to compete with. In these examples, it's easy to see how the core competencies form the nucleus of each company's respective strategy.

Figure 1: Pathway to Competitive Advantage—Core Competencies

Identifying Base Capabilities/Competencies - The starting point for identifying core competencies stems from an understanding of an organization's base capabilities (or base competencies). Identifying and documenting core capabilities by functional area is a good starting point. Another way to capture capabilities is by using Porter's Value Chain analysis. However, cataloging base capabilities and dubbing those that seem important to the organization's success does not make them core competencies. Core competencies are only those capabilities those that meet the following four tests:

Valuable - A capability must be valuable, specifically, it must contribute to value for customers. It must also help an organization capitalize on opportunities while mitigating threats in the external environment.

Rare - A capability must be rare. If every organization in an industry possessed identical capabilities, there would be no way to earn returns greater than those of competitors. Competitive advantage comes from doing things other organizations cannot.

Inimitable - Organizations that enjoy high profit levels will quickly be imitated by other organizations wanting to enjoy the same. When capabilities can be easily imitated then they are not unique and will provide little in the way of competitive advantage.
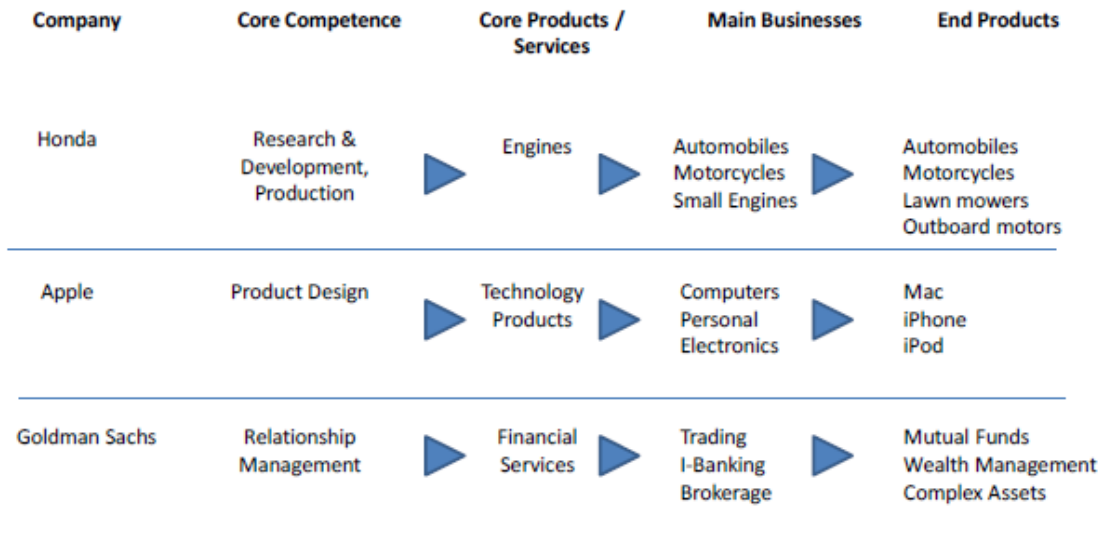
Non-Substitutable - Important capabilities cannot be substituted with other like capabilities. Stated another way, a different capability cannot be used instead of the capability being considered for purposes of this criteria. If substitution were possible the key capability would be limited in its contribution to competitive advantage.

When all four of the above tests are met a capability then becomes a core competency. More simply, when an organization has a capability that can create something of value for customers, that few, if any other organizations possess, that is difficult to imitative and has no viable substitutes then it has a core competency on its hands the kind which has the means to provide sustainable competitive advantage.

For Example:

The following diagram depicts how competencies are manifest in central product architecture, business units and then end products.

Figure 2: Core Competence Flow Diagram (adapted from Prahalad & Hamel, *Core Competence of the Corporation*, Harvard Business Review, 1990)

Company	Core Competence	Core Products / Services	Main Businesses	End Products
Honda	Research & Development, Production	Engines	Automobiles Motorcycles Small Engines	Automobiles Motorcycles Lawn mowers Outboard motors
Apple	Product Design	Technology Products	Computers Personal Electronics	Mac iPhone iPod
Goldman Sachs	Relationship Management	Financial Services	Trading I-Banking Brokerage	Mutual Funds Wealth Management Complex Assets

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Core competence is a misunderstood management concept. In strategy sessions, when the analysis is turned inward, managers are quick to identify many of what they refer to as their core competencies. What should be clear from the above discussion is that core competencies are hard to develop *if organizations are able to develop them at all*. More often than not, what managers call core competencies are really important capabilities; things that they do well but not so well that they are free from competitor imitation or substitution.

A better way to approach core competency understanding is to assume your organization doesn't have any. Using this approach, the four criteria then become true tests to determine if key capabilities are or could potentially become core competencies. This approach forces management teams to critically evaluate whether or not they have capabilities and processes that can serve as the basis for competitive advantage. But this approach is difficult to use in practice if for no other reason than management teams do not want to believe they have no basis for sustainable competitive advantage. While sobering, it's better to realize your competitive limitations before your competitors do.

For More Information

Magazines & Journals
Harvard Business Review
Journal of Business Strategy

Books

Grant, R. Contemporary Strategy Analysis, Blackwell Publishing, Malden, 2005.
Penrose, E., The Theory of the Growth of the Firm, Wiley, New York, 1959.
Dosi, G. et al, The Nature and Dynamics of Organizational Capabilities, Oxford University Press, London, 2001.

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