

The Critical Assessment of the Resource-Based View of Strategic Management: The Source of Heterogeneity of the Firm

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Abstract

The objective of this paper is to incorporate the entrepreneurial view point into the framework of the resource-based view of strategic management. We firstly attempt to make a brief survey of the conceptual framework of the RBV, and formulize it in a static sense by contrasting it with the competitive forces approach. Secondly, we conduct a critical assessment of the RBV from a dynamic point of view. The concept of entrepreneur's ability is distilled by this assessment, and the objective of corporate strategy is clarified as well. Finally, we suggest a new perspective of the RBV by amending it from an entrepreneurial viewpoint.

Keywords:

resource-based view, entrepreneurship, disequilibrium, capability, strategic management

INTRODUCTION

“The pivot on which everything turns”.

(J. A. Schumpeter)

Although the resource-based view (RBV) has emerged as one of the substantial theories of strategic management, it is said that it has overlooked the role of entrepreneurial strategies and entrepreneurial abilities as one of the crucial sources of the competitive advantage of a firm. Even today, when entrepreneurship research is in demand, most economic research, and consequently much of strategic management research, views entrepreneurship as the “specter which haunts economic model”. (Baumol, 1997: 17)

The main objective of this paper is to amend the RBV of strategic management from a dynamic point of view, in order to make up its insufficiency. Many scholars have attempted to investigate into the mechanism of sustainable competitive advantage of a firm through the RBV with original concepts such as ‘core competence’ (e.g., Hamel & Praharad, 1994), ‘dynamic capability’ (e.g., Teece, Pisano & Shuen, 1997) ‘VRIO framework’ (Barney, 2002), ‘capability lifecycle’ (Helfat & Peteraf, 2003), and ‘routine and skills’ (e.g., Nelson & Winter, 1982), however, little work in RBV has been made to grasp the role of entrepreneurship as the crucial source of competitive advantage, despite the abilities of the entrepreneur are undoubtedly the principal human resource possessed by a firm (see Alvarez & Barney, 2000 for an exception). This paper attempts to incorporate the theory of entrepreneurship into the RBV of strategic management, while critically dealing with the RBV from an entrepreneurial viewpoint.

The paper is divided into three parts. First, a brief survey is given of the conceptual framework of the RBV. It is helpful for us to grasp the characteristics of its framework by contrasting it with the competitive forces approach (CFA) presented by Porter (1980) because it is said that the CFA explores the source of sustainable competitive advantage in the external environment of the firm (i.e., attractiveness of industry where they are located), while the RBV pays attention to the internal resources of the firm (i.e., the heterogeneous resources that a firm possesses). Second, we clarify the objectives of corporate strategy through a critical

assessment of the RBV from both a static and a dynamic point of view. Barney's fundamental concept of the RBV is examined. Third, we suggest a new perspective of the RBV by amending it from an entrepreneurial viewpoint.

I. STRATEGY AND EXTERNAL ENVIRONMENT OF A FIRM

Traditional research on strategic management suggests that firms need to seek a strategic fit between the external environment, for example opportunities and threats, and internal resources, for example strengths and weaknesses (e.g., Andrews, 1967; Itami, 1987). However, considerable emphasis has usually been given to a firm's competitive environment and its competitive position (Das & Teng, 2000). Considering the source of sustainable competitive advantage of a firm, it is widely accepted that the dominant viewpoint in the strategic management theory throughout the 1980s was the CFA presented by Porter (1980). His conceptual framework was mainly based on the structure-conduct-performance paradigm of the theory of industrial organization (Bain, 1959; Mason, 1949). It is no exaggeration to say that Porter (1980) specifically brings a concept of 'competition' for the first time in strategic management theory.¹⁾ The most innovative part of his work in this field is that he constructs a consistent framework for thought so as to examine concrete questions like "how will a firm able to get a competitive advantage over its competitors?"

In the CFA, the industrial structure strongly influences the rules of competition, as well as the strategies potentially available to the firms belonging to that industry. Therefore the strategic issue for a firm seems to concern their competitive positioning in the industry. They seek a favor-

1) Broadly speaking, the strategic management theory before 1980s (pre-Porter period), which used to be called 'business policy', had not been a body of theory with a consistent viewpoint yet. Its object was mainly to argue the management of the diversified firm. Hence, it was generally dealing with such an argument like, "to which business should we give the priority to allocate our resources?" or "from which business should we withdraw our resources?" In this stage, the strategy was no more than the 'citing list of procedures' because the object of strategy went no further than merely arguing the analytical technique: growth matrix, effect of experience curve, product portfolio management, policy decision tree and so on, and the flowchart of its application which is needed when the strategy has been drawing up. For instance, Hoffer and Schendel (1978), gave a comprehensive survey of past studies on the subject. They compile variety of analytical techniques and the flowchart of its application is indicated in their work. It is not thoroughly explained, however, why the process ought to be followed by such a flowchart.

able position in order to gain a monopoly rent (Teece, 1984), while avoiding involvement in competition or moderating competitive pressures by influencing industry structure and their competitors' behavior. To help the firm find such a positioning in the industry, Porter (1980) advanced a 'five-force model'. This consists of five industry-level forces: i.e., entry barriers, threat of substitution, bargaining power of supplier, bargaining power of buyer and rivalry among industry incumbents, which determine the inherent profit potential of an industry or sub-segment of it.

However, a series of empirical surveys have failed to support the link between industrial structure and the performance of a firm. Some studies show the variance in firm performance between industries is substantially less than that within industries (e.g., Jacobson, 1988; Hansen & Wernerfelt, 1989; Rumelt, 1991). Others also identify systematic and significant performance differences among firms which belong to the same strategic group within an industry (Cool & Schendel, 1988). Research has suggested that the internal resources of a firm rather than the external environment around the firm are possibly the primary source of performance differences among firms. This result is bringing a growing number of researchers to the RBV of strategic management to explain the differences by focusing their attention on resource heterogeneity in an industry and the source of sustainable competitive advantage of the firms.²⁾

II. STRATEGY AND INTERNAL RESOURCES OF A FIRM

Since the mid 1980s, the RBV has emerged as one of the substantial theories of strategic management (Barney, 1986a; Rumelt, 1984;

2) According to Teece, *et al.* (1997: 514), an entry decision process of the CFA looks roughly as follows: "(1) pick an industry (based on its 'structural attractiveness'); (2) choose an entry strategy based on conjectures about competitors' rational strategies; (3) if not already possessed, acquire or otherwise obtain the requisite assets to compete in the market." From this perspective the process of identifying and developing the requisite assets is not particularly problematic. The process involves nothing more than choosing rationally among a well-defined set of investment alternatives. If assets are not already owned, they can be bought. On the contrary, the RBV assumes resource endorsement of a firm cannot equibrate through factor input markets. The entry decision process of the RBV is as follows: "(1) identify your firm's unique resources; (2) decide in which markets those resources can earn the highest rents; and (3) decide whether the rents from those assets and most effectively utilized by (a) integrating into related market(s), (b) selling the relevant intermediate output to related firms, or (c) selling the assets themselves to a firm in related businesses."

Wernerfelt, 1984), even though it is said that the RBV does not presently appear to meet the empirical content criterion required of a theoretical system (Bacharach, 1989; Hunt, 1991; McKelvey, 1997; Priem & Butler, 2001a,b). The increased attention to firms' resources by researchers has seemed to be beneficial in helping to clarify the potential contributions of resources to competitive advantage, as well as to introduce strategy scholars to a number of useful descriptive theories from industrial organization economics (e.g., Alchian & Demsetz, 1972, on 'teamwork' production, or DeVany & Saving, 1983, on price as a signal of quality), and furthermore to alleviate a previous analytical overemphasis on the opportunities and threats that arise from the product side (Priem & Butler, 2001a).

The RBV suggests that the resources possessed by a firm are the primary determinants of its performance, and these may contribute to a sustainable competitive advantage of the firm (e.g., Hoffer & Schendel, 1978; Wernerfelt, 1984). According to Barney (1991), the concept of resources includes all assets, capabilities, organizational processes, firm attributes, information, knowledge, etc. controlled by a firm that enable the firm to conceive of and implement strategies that improve its efficiency and effectiveness (Barney, 1991; Daft, 1983).

In the early stage of the RBV, the main concern was to identify the characteristics of resources that are not subject to imitation by competitors. If the resources possessed by a firm can easily be replicated by competitors, even though the resources are the source of competitive advantage of the firm, then the advantage will not last long. Dierickx & Cool (1989a) describe how the sustainability of a firm's asset position hinges on how easily its resources can be substituted or imitated, and imitability is linked to the characteristics of the asset accumulation process: i.e., time compression diseconomies, asset mass efficiencies, inter-connectedness, asset erosion and casual ambiguity. In the same way, several other characteristics have been explored such as unique historical conditions, causal ambiguity (Reed & DeFillippi, 1990), social complexity, isolating mechanism and so on (Barney, 1991; Lippman & Rumelt, 1982; Rumelt, 1984).

III. CAPABILITY AS A SOURCE OF THE HETEROGENEITY

Let us develop the concept of resources a little further. For instance, Grant (1991) notes the distinction between resources and capability as follows:

Resources are inputs into the production process...[they] include items of capital equipment, skills of individual employees, patents, brand names, finance, and so on. But, on their own, few resources are productive. Productive activity requires the cooperation and coordination of teams of resources. A capability is the capacity for a team of resources to perform some task or activity. (Grant, 1991: 118-19)

In the same manner, Amit & Schoemaker (1993) define resources as stocks of available factors that are owned or controlled by the firm, which are converted into final products or services. Capabilities, in contrast, refer to a firm's capacity to deploy resources, usually in combination, using organizational processes, to produce a desired effect.³⁾ Hence, the presence of capability enables resources to begin to be utilized, and the potential for the creation of output arises. While resources are the source of a firm's capabilities, capabilities are the main source of its competitive advantage (Grant, 1991). The important point of this approach compared to the early stage of RBV is that, for the sake of gaining a sustainable competitive advantage, capability is regarded as more important than resources *per se*, and this implies that the firm-specific way of cooperation and coordination of resources causes the heterogeneity among firms in an industry.⁴⁾

This thought can be theoretically traced back to Penrose's (1959) work. According to her work, firm development is an evolutionary and cumulative process of resource learning, in which increased knowledge of the firm resources both helps create options for further expansion and increase absorptive capacity. Therefore, a major focus of her work lies in the application of resources.

She regards a firm as more than an administrative unit, it is also a collection of productive resources which including both physical and

3) Stalk, *et al.* (1992) draw a distinction between a capability and a competence as follows: competencies and capabilities represent two different but complementary dimensions of an emerging paradigm for corporate strategy. Both concepts emphasize 'behavioral' aspects of strategy in contrast to the traditional structural model. But whereas core competence emphasizes technological and production expertises at specific points along the value chain, capabilities are more broadly based, encompassing the entire value chain. In this respect, capabilities are visible to the customer in a way that core competencies rarely are (Stalk, *et. al.*, 1992: 66).

4) To deepen the concept of capability, Grant (1991) invokes the concept of 'organizational routine' from evolutionary theory (e.g., Nelson, 1991). He views capability as a routine or a number of interacting routines, and organization as a huge network of routines.

human resources. According to Penrose, it is never ‘resources’ *per se* that are the ‘inputs’ in the production process, but only the ‘services’ that the resource can render, that is:

“The services yielded by resources are a function of the way in which they are used?exactly the same resources when used for different purposes or in different ways and in combination with different types of or amounts of other resources provide a different service or set of services. The important distinction between resources and services is not their relative durability; rather it lies in the fact that resources consists of a bundle of potential services and can, for the most part, be define independently of their use, while services cannot be so defined, the very word ‘service’ implying a function, an activity...it is largely in this distinction that we find the source of the uniqueness of each individual firm” (1959: 25).⁵⁾

The result of this is that the concept of ‘capability’ is the capacity of a firm to convert resources they possess into the ‘service’. The good services might be produced by either ‘good resources’ or ‘average capability’/ ‘average resources’ or ‘good capability’, if capability were a type of ‘score’ of capability, particular to each firm (e.g., good firms have a high ‘capability score’). The difference, or possibly the uniqueness, of a firm largely comes from these capabilities.

IV. VULNERABILITY OF THE RBV

After having made a brief survey of the conceptual framework of the RBV by contrasting it with the CFA, we now attempt to clarify the objective of corporate strategy through a critical assessment of the RBV. Barney’s (1991) conceptual framework of the RBV has been used⁶⁾, because

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- 5) Foss (2005) notes that while the RBV is Penrosian in its emphasis on firm-level heterogeneity, most of Penrose’s basic themes æ flexibility in an uncertain world, organizational learning as an evolutionary discovery process, path-dependency, the vision of the management team, entrepreneurship, firm differences being traceable to the efficiency with which resources are applied rather than to resources themselves, etc. æ seem to lie outside the orbit of the RBV, at least as its conceptual framework is clearly related to Demsetz’s (1973) competitive equilibrium model.
- 6) Referring to the SWOT framework, Barney defines resources as being *valuable* when they help seizing an opportunity in the firm’s environment or when they help neutralizing some threat in that environment, or at least shielding the firm against the threat. By resources

as Priem & Butler (2001a) remark, many RBV proponents either paraphrase his statements or simply cite his articles (i.e., Barney, 1991), without an augmented definition (e.g., Bates & Flynn, 1995; Brush & Artz, 1999; Lits, 1996; Powel, 1992a, b; Rindova & Fombrun, 1999; Yeoh & Roth, 1999), and operate under his framework in their conceptual and empirical work.⁷⁾ Barney's (1991) remarks on the conditions that a firm produces competitive advantage⁸⁾ may be paraphrased as follows:

- (a) resources must be valuable.
- (b) resources must be rare.

Two points should be noted here regarding to the attributes of the competitive advantage of a firm. Firstly, Barney's concept of 'valuable' is an ambiguous criterion to measure the competitive advantage of a firm. Whether the resource is valuable or not should be measured by its profitability, and thus it ought to take the form of an economic asset regardless of how tangible or intangible it is. The value of any resource should be measured by the discounted value of the expected future income stream that can be attributed to it.⁹⁾

In the RBV the valuable attribute of a firm is taken as given. The

being *rare*, Barney seems to have a simple counting sense (as distinct from an economic sense) in mind. Firms that control valuable and rare resources possess a competitive advantage and will be able to obtain a competitive advantage. If furthermore the relevant resources are *non-imitable* and *non-substitutable* a sustainable competitive advantage may be obtained. The non-imitability (or more correctly: "costly-to-imitate") condition directs attention to whether (or, at which cost) competitor firms can acquire or accumulate resources with attributes and levels of attributes similar to some desired resource which produces a competitive advantage. The non-substitutability (or, "costly-to-substitute") condition directs attention to whether (or, at which cost) competitor firms can access (different) resources that will allow them to implement the same strategies as some successful firm. According to Foss (2005), it is also these two criteria that allows Barney to define sustainable competitive advantage in terms of situations in which all attempts by competitor firms at imitating or substituting a successful firm have ceased. Thus, he notes that sustainable competitive advantage is a property of an equilibrium.

- 7) Priem and Butler investigate whether the RBV arguments regarding competitive advantage meet the generally accepted criteria for classifying a set of statements as a theory, See Priem & Butler (2001a, b) and also Barney's counter-argument (Barney, 2001).
- 8) With regard to the sustainability, he notes the resource must be imperfectly imitable, and cannot be strategically equivalent substitutes for this resource.
- 9) This kind of argument has been well discussed in the theory of multinational corporations (i.e., an argumentation between OLI paradigm theorists and Internalization theorists regarding the handling of ownership advantage of a firm). See, e.g., Casson (1987).

planning and investment necessary to build up such resources are exogenous in this framework.¹⁰⁾ This means there is the fear that the RBV will overstate the profitability of firms exploiting these resources, because they ignore the cost of acquisition and accumulation. Therefore it is impossible for the RBV to explain why firms invest in such a valuable resource rather than in other type of resources (i.e., Barney is conducting a cross sectional analysis of what the firms currently has, he is not discussing what they would need to do to obtain more or different resources in the future. Barney focuses here on content while other RBV authors have focused on process. He is not trying to explain “why firms invest”, he is trying to explain what firms have accumulated as of a specific point in time. However, other RBV researchers have considered “why” and “how”).

In addition, if the firms want to realize their competitive advantage or maximize their profit from the resources they possess, they have to take into account of the demand-side characteristics that influence on the final price of their output. The values of resources are determined by demand-side characteristics, and those are also exogenous to the RBV model (Priem & Butler, 2001a, b). We never have *a priori* information on the competitive advantage among firms that will result in super-normal profit, on the contrary, we know *a posteriori* the existence of the competitive advantage by virtue of the existence of super-normal profit. After all, the emphasis is on how to sustain such a valuable resource over the long term without adequate appreciation of its economic value. Therefore it is open to criticism that the RBV contains a theory of sustainability but not a theory of competitive advantage (Priem & Butler, 2001b).

Secondly, the concept of a ‘rare’ resource does not necessarily ensure the competitive advantage of the firm, even if that resource generates a large ‘rent’ due to its relative scarcity. Rents are the prices of services yielded by resources (Lewin & Phelan, 2002). In this phase rent is noth-

10) According to Petaraf (1993: 180), “Firms with superior resources will earn rents... It may be understood most clearly by assuming that firms with superior firms with superior resources have low average costs than other firms”. We understand that superior resources may earn Ricardian type of rents, however in order to analyze the source of firm sustainable competitive advantage over rivalry, we should put not a ‘rent’ but a ‘profitability’ in question. And we cannot understand her ground why ‘superior resources’ go to ‘a low cost position’ (1993: 180). Superior resources must have accompanied a lot of investment until then due to its superiority, even though which is such an intangible assets as ‘organizational culture (i.e., Barney, 1986b), thus we cannot necessarily to say ‘firms with superior firms with superior resources have low average costs than other firms’.

ing more than the rental price of the service of the resource whether it is rare or not. After remunerating all the factors of production, no profit has been left to the firm (Demsetz, 1973; Barney, 1986a; Rumelt, 1987). If there is a firm gaining profit from the resource, it is simply that the firm squeezes some part of the rent from the owner of the resources.

Many RBV researchers identify the concept of ‘rent’ (e.g., Mahoney & Pandian, 1992; Petaraf, 1993; Rumelt, 1987), that is expressed in various forms, i.e., Ricardian rent, Marshallian rent, Paretian rent, and quasi-rent, as those, which accrue from the relative differentiation of resources a firm control (We have to bear in mind the fact that rent will be paid even though all of land is homogeneous or even if the land is not fertile. Rent is not paid due to the relative difference of the land’s fertility but by the fact that land is merely scarce (Lewin & Phelan, 2002). The difference in fertility reflects in the difference in rental rates, however, the rental rate is nothing to do with the profitability of a firm. The owner of any resources just asks for the rents: i.e., wage, rent, and interest, according to its rate). They consider the concept of ‘competition’ as the states that firms compete in factors of production markets over the relative advantage of the resources they acquire or accumulate, rather than compete in final-product markets over the price of their products and services.

However, from the static point of view, all of the relative advantages of these resources ought to be compensated for their owner. And the source of competitive advantage of the firm remains only by their monopoly rent. In this case alone, a firm would be able to gain super-normal profit at the cost of social welfare. It follows from what has been said, that the RBV contains the conditions of sustainability, but it does not fulfill the conditions for acquiring and realizing a competitive advantage.¹¹⁾

11) According to Foss (2005), Barney (1991) singles out two necessary “primitives” that must obtain for SCA to exist, namely heterogeneity and immobility, however, the relation between these two “primitives” and the four other conditions of sustainable competitive advantage (i.e., resources being rare, valuable, costly to imitate and costly to substitute) is not made clear. The implication of Barney’s discussion is that the four latter are collectively sufficient for SCA, and if they (all) obtain, heterogeneity and immobility also obtain. However, the four conditions are not all necessary, whereas immobility and heterogeneity are. In other words, possessing resources that are rare, valuable, costly to imitate and costly to substitute is not the only way to gain and sustain competitive advantages, as long as the relevant ways conform to the criteria of resources being immobile and heterogeneous. This, however, is not clarified in Barney’s paper.

V. THE RBV'S FORTE

Given that the RBV is nothing more than an indication of the condition for competitive firms to sustain their advantage, how can we investigate the academic value in the RBV in terms of explaining the source of the competitive advantage of a firm? By examining Barney's (1986a, 2001) research, we see that he might recognize the existence of super-normal profit and the source of competitive advantage besides valuable and rare resources. The 'strategic factor market imperfection' is the key concept for finding the academic value in the RBV.

The strategic factor markets are developed when a firm requires the acquisition of resources in order to implement its strategy (Barney, 1986a). These markets are where firms buy and sell the resources necessary to implement their strategies (Barney, 1986a; Hirshleifer, 1980). Hence the economic performance of the firms depends not only on the returns from their strategies but also on the cost of buying the resources from these markets to implement those strategies. And the costs of those resources are determined by the characteristics of the factor markets.

It is leading us that valuable and rare resources are not the source of competitive advantage or above normal return if the cost of acquiring or developing these resources equals the value they create when used to conceive of and implement a strategy. However, there is an implied possibility that the competitive advantage may come from the imperfections in strategic factor markets. Different firms in these markets will have different expectations about the future value of a strategy, which creates this imperfection (Barney, 1986a), and the owners of the firm also have different expectations about the future return of their resources (Barney, 2001). Therefore, different expectations toward the resources produce the possibility of a competitive advantage for a firm. This kind of competitive advantage, named 'economic rents' by Barney, reflect the creative and entrepreneurial ability of firms to discover how to generate value with their resources in ways that other firms and outside owners cannot anticipate (Barney, 1986a, 2001). Firms which intend to obtain a competitive advantage must be consistently better informed concerning the future value of these resources than other firms.¹²⁾

12) Peteraf (1993) argues that *ex ante limits to competition* is a condition for the existence and endurance of competitive advantage. Because of *ex ante* uncertainty about the future

Examining the Barney's concept of 'strategic factor market imperfection', we are able to interpret that the characteristics of 'competition' are not in the world of static states (equilibrium), but in the world of dynamic processes of change (disequilibrium). As mentioned above, no rents emerge in the world of static states. If the price of any resource reflects the discounted value of its expected future earnings, and if everyone shares the same correct expectations, then that price includes all correctly anticipated value components. It is nothing to say that *ex ante* values will turn out to be equal to *ex post* values. There will be no room for super-normal profit. Unless there is a difference between the *ex post* value of a venture and the *ex ante* cost of acquiring the necessary resources, the entrepreneurial rents are zero (Rumelt, 1987; Peteraf, 1993).

In a dynamic sense, such a situation cannot exist because a price of any resource does not reflect the discounted value of its expected future earnings, so everyone does not share the same correct expectations towards it and the price includes all correctly anticipated value components. The possibility of profit comes from *ex ante* uncertainty of the resource's certain (real) value, the probability of profit comes from *ex post* realization of its certain value. In this sense, the size of super-normal profit, thus the competitive advantage of a firm, depends on the difference between the *ex ante* cost of resources and the *ex post* value of them. This suggests that to acquire a competitive advantage is no more and no less than to obtain the entrepreneurial rents. The CA depends on how to exploit the factor markets disequilibrium, i.e., the firm's skill (accuracy) at perceiving the future value of resources. We may say that the academic values can be found in the RBV when we view it in a dynamic context.

value of the resources to be bought or developed today, only firms with entrepreneurial insight or luck make the right investment decisions and are rewarded by entrepreneurial rents (Barney, 1986; Wernerfelt & Montgomery, 1986). Also, *ex post limits to competition* (i.e., isolating mechanisms) protects the strategic assets and capabilities from being imitated. Isolating mechanisms allow a firm to sustain its competitive advantage. Isolating mechanisms Rumelt (1984: 568) such as casual ambiguity, specialized assets, switching and search costs, team-bodied skills, reputation and image and legal restrictions on entry are the reasons why markets fail. In the absence of isolating mechanisms and market imperfections, resources would be mobile, and no firm could achieve competitive advantage and positive returns (like in perfect competition). By pointing these mechanisms out, Rumelt (1984) highlights 'why firms exist' and then concentrates on 'why firms are heterogeneous'.

VI. ABILITY OF ENTREPRENEUR AS A SOURCE OF THE HETEROGENEITY

In the dynamic world, the heterogeneous perceptions are more important than the heterogeneous resources *per se* (Lewin, 2005; Lewin & Phelan, 2002). As a matter of course, such perception originates in the asymmetric information among firms. This drives us, logically, to the situation that the 'entrepreneurship' and also the ability to perceive market imperfection of information have to be incorporated into the RBV. How to best evade the market imperfection or how to make good use of that imperfection is very strategic decision made by a firm to gain a super-normal profit.¹³⁾ And of course, the one who will be in charge of this strategic task is an entrepreneur.¹⁴⁾

As an aside, even if it is logical to represent the entrepreneurship in the RBV, how can we recognize the relationship between the RBV and

13) Casson points out the relation between transaction cost theory and entrepreneur as follows: "Both theories agree upon the importance of 'market imperfections' and 'asymmetric information'. However, while transaction cost theory emphasizes that people with privileged information may profit by cheating others, the theory of entrepreneurship suggests that they will profit by speculating against them as well, by investing in projects that they would not wish to invest in themselves"(Casson, 2004). Needless to say, transaction cost theorists have been considering efficient governance mechanisms that could evade such a cheating cost (e.g., Coase, 1937; Williamson, 1975, 1979).

14) The introduction and immediate selection of the entrepreneur as an explanatory mechanism does not come as a natural step to some scholars, who criticize that there seems to be an alternative explanations as "why is the answer not group decision-making?" Casson (2004) clearly recognize this point. He stated: "Some business researchers ...claim that large firms are controlled by groups of entrepreneurs, rather than by a single entrepreneur. These propositions are only half-truths, however...there is nothing in the theory of entrepreneurship which limits a firm to having a single entrepreneur. Indeed, a successful entrepreneur is likely to grow his firm by developing entrepreneurial qualities amongst his employees. Decentralization to product divisions or national subsidiaries can empower the employees of a large firm to act in an entrepreneurial way. Nevertheless, the CEO will ultimately take responsibility for coordinating the decisions of these other entrepreneurs." However, as we examine some of eminent Japanese firm's decision-making process, which is characterized by a kind of group-decision making, it seems to us that the criticism is well justifiable. In fact, for example, there is collective selection mechanism in Toyota: new routine (e.g., multi-task job assignment along the process flow, task assignment for volume changes and productivity improvement, on-the-spot inspection by direct workers and so on), could not be adopted without the consent from the shop floor supervisors to the factory managers, and they even have a right, to some extent, to do screening them. This suggests that the entrepreneurship does not confine a firm to have a particular entrepreneur, but some group in a firm is capable of fulfilling its function as an entrepreneur. Therefore, we treat the entrepreneur as an entity, which takes a function of entrepreneurship, whichever it is a particular person (entrepreneur) or not.

entrepreneurship?¹⁵⁾ For recognizing this relationship, Casson (2004) helpfully points out that resource-based theory highlights the importance of human resources, as reflected in competencies and capabilities, to the performance of the firm (Teece & Pisano, 1994). The theory of entrepreneurship simply asserts that the abilities of the entrepreneur are the principal human resource possessed by the firm. Other resources, such as the capabilities of scientists and managers, derive from those of the entrepreneur, since it is the entrepreneur who has selected the people with these capabilities to work for the firm¹⁶⁾ (Casson, 2004).

Besides his remarks on the relationship between entrepreneurship and the RBV, Casson made an important statement on the conceptual distinction of resources. As we formulated the relationship above, we made a distinction between resources and capability in accordance with the function of resources in general. In addition, here the concept of the ‘abilities of the entrepreneur’ is pulled out from the category of resources. It is supposed that the abilities of the entrepreneur is of particular importance when a firm needs to make decisions such as selecting people with the right capabilities to work for the firm, as these things require the entrepreneur’s vision and strategy. “The essence of coordination is decision-making” (Casson, 1997: 78).

The firm is therefore not only the unit to cooperate and coordinate resources, but also the one to specialize decision-making. Not all decisions are strategic and some decisions are matter of a routine, but routine pro-

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- 15) Current theories of corporate entrepreneurship stress the link between the Schumpeterian concept of entrepreneurship and the RBV of the firm (Gick, 2002). Following Burgelman (1983: 1353), strategic management needs to build on internal entrepreneurship, which allows the combination of new resources. According to Penrose (1959), however new opportunities inside firms stem from unused resources that exist in any stage of the development process of the firm. Seen from this perspective, firms are not much more than ‘productive opportunities’ and ‘possibilities for deploying resources that the firm’s entrepreneurs and managers can see and which they are willing and able to act on’ (Gick, 2002).
- 16) Casson’s definition of entrepreneur is as follows: “An entrepreneur is someone who specializes in taking judgmental decisions about the coordination of scarce resources” (1982: 23). Central to this definition is a notion of a judgmental decision. This, Casson defines as a decision “where different individuals, sharing the same objectives and acting under similar circumstances, would make different decisions” (1982: 24). They would make different decision because they have “different access to information, or different interpretation of it”. It follows from this definition that an entrepreneur will be a person whose judgment inevitably differs from the judgment of others. The reward, then, for an entrepreneur derives from backing his or her judgment and being proved right by subsequent events (Ricketts, 2002: 71).

cedures have to be designed, and this is often a strategic decision. When new threats or opportunities arise, procedures often need to be changed. The design of new procedures is an important aspect of the entrepreneurial response to a changing situation (Casson, 2003, 2004). Thus under some circumstances, the direction of resources and capabilities are not chosen without the abilities of an entrepreneur. Those are empowered by the entrepreneur's abilities. The abilities of the entrepreneur here is a super-ordinate concept to capability. Hence, the presence of the ability enables capability to be performed along the entrepreneur's vision or strategy, capability enables resources to begin to be utilized, and the potential for the creation of service arises. The main source of the competitive advantage is the abilities of the entrepreneur. While both invoking and amending the RBV from the entrepreneurial point of view, if we take the source of competitive advantage to be the creation of entrepreneurial rents¹⁷⁾, then one of the objectives of corporate strategy is defined as follow:

Strategy is the function of a firm to obtain an entrepreneurial rent by exploiting the factor markets disequilibrium (i.e., to maximize the difference between the *ex ante* values of inputs and the *ex post* values of outputs in a dynamic world) through firm-specific capabilities and resources which are directed by the abilities of an entrepreneur (originating from the heterogeneous perception of the entrepreneur). In other words, we may say that the ultimate attribute of the competitive advantage of the firm is the firm's skill (accuracy) at perceiving the future value of resources.

VII. ENTREPRENEURIAL ARBITRAGE AND INNOVATION

In the preceding section, we made a critical assessment of the RBV. It becomes clear that the RBV has its own traits and potential as an academ-

17) Some researchers (e.g., Kobayashi, 1999; Tokuda, 2000, 2004) define corporate strategy relevance to obtain rents as follow: the rent considered from the perspective of resource input, which is created as a consequence of the scarcity of itself, defined as 'Ricardian rent.' The other is rent comes from resource application, which is created by virtue of applying the resource more skillfully than competitor do, defined as 'quasi-rent'. In accordance with these definitions, if we take the goal of strategy to be the creation of a large rent, the role of strategy is to acquire and accumulate scarce resources, and then to use them skillfully. However, no one knows its value before any value is realized in a market after using it skillfully, and the value would be extracted only from its application, even though the resource is not scarce. Therefore the causal relationship between resource and its application is the other way around.

ic thought when we grasp it in a dynamic context. Now we have to explore how to exploit the factor markets disequilibrium in order to create the entrepreneurial rents. Here we will suggest two ways for the exploitation. One is ‘entrepreneurial arbitrage’ and the other is ‘entrepreneurial innovation’ (see Appendix). Both of them share a fundamental proposition: the existence of unexploited opportunities that no one exploits, while each of them has crucial distinction in terms of their perception toward the market process in which the entrepreneur performs their role.

The former is the way to create the rents as a return to the entrepreneur’s alertness in the process of a new equilibrium (Choi, 1995; Gick, 2002; Hebert & Link, 1982). An entrepreneur gains a profit by means of adjusting the value differentiation of any factors in the existing market. For instance, if different price prevail in the same market, there is scope for profitable arbitrage between the two segments of the market. Or if the prices of inputs are out of line with the prices of outputs then there is scope for expanding the production of some products at the expense of others (Casson, 2003). Adjusting the differentiation of resource value more accurately and more quickly than other individuals is one of the main ways to exploit the disequilibrium.

In contrast, ‘entrepreneurial innovation’ is the way to create the rents as a return to an entrepreneur’s discovery of new combinations as disturbing a process of equilibrium (Choi, 1995; Gick, 2002; Hebert & Link, 1982). For instance, the entrepreneur conducts innovation which is manifested in the introduction of new products or products with new qualities, new production processes, new markets, the use of new raw materials and other intermediate products, and the formation of new organization (Schumpeter, 1934). Creating the differentiation of resource value proactively with other individuals is one of the main ways to exploit the disequilibrium. It goes without saying that the former is consistent with the thought of the Austrian school or Kirznerian¹⁸⁾ (e.g., Kirzner, 1985) and the latter is consistent with that of Schumpeterian¹⁹⁾ (Schumpeter, 1934).

18) According to Gick (2002), profit is a return to alertness; the alertness attribute Kirzner granted to the entrepreneur enables him to notice new chances to exploit. By doing so he contributes to the equilibration process of the market (Kirzner, 1973). In this way the Kirznerian entrepreneur is different from Schumpeter’s, who is pushing the economy away from equilibrium. Kirzner’s focus is on market equilibration in a given ends-means framework (Gick, 2002: 95).

19) Creative individuals – only a minority of them exists in a society where most individuals

Casson shows the distinction clearly as follows:

The Austrian market process is usually construed, in neoclassical terms, as asserting that markets are always out of equilibrium, and that entrepreneurial interventions tend to move markets towards equilibrium, without them ever reaching that state. This interpretation presumes, however, that the markets already exist: this is reflected in the reference to entrepreneurial activities as speculation or arbitrage—both of these activities which take place in established markets. Radical forms of market-making²⁰⁾ entrepreneurship, however, involve designing products or specifying services which did not previously exist, and for which there was therefore no market. In absence of the entrepreneur, therefore, it is not the case that markets would be merely out of equilibrium, as the Austrian view suggests, but that markets would not exist at all. (Casson, 2004)

As one of the most important entrepreneurial activities, Casson (2004) emphasizes the identification of changes in patterns of demand and creation of new markets by bringing together suppliers of inputs and consumers of outputs. We can paraphrase the market-making activity as an innovation to realize a future value system through the new combinations of resources in the present time and space, while the arbitration is merely exploiting the unexploited opportunities in the present existing market. It is not necessary for the purpose of this paper to enter into a detailed discussion on this distinction. It is enough to mention here only that there are two ways for exploiting the factor markets disequilibrium, i.e., adjusting the differentiation of resource value, and creating the differentiation of resource value.²¹⁾

do not recognize new possibilities – bring about discontinuous change. These individuals are called entrepreneur. Their main task is the carrying out of innovation. The entrepreneur plays a central role in this process of economic development; he is the 'exemplar of leadership in economic life' (Schumpeter, 1934).

- 20) Casson (2004) remarks that 'market-making' or 'creating new markets' is not the only form of entrepreneurial activity, but it is an important and often neglected one. We treat here the market-making activity as one of the disruptive or radical innovations, while most of innovation has incremental characteristics.
- 21) This paper advocates a single-directional relationship between the entrepreneur and resources, where competitive advantage is created because certain entrepreneurs can better assess the value of resources and profit from it. I realize that this relationship is

The relationship between entrepreneurship (arbitrage and innovation) and the valuation of resources is summarized in table 1 (*see below*). This table shows the correlation between firm A's and other firms' evaluation toward resources. If all the firms (or the potential participants) estimate or measure the value of any resource equally whether it is estimated accurately, overestimated or underestimated: i.e. they share the discounted value of the expected future income (or rent) stream that can be attributed to it, they cannot expect any competitive advantage at all (Even though they could accurately estimate the value of it, it is nothing to say that the factor market is competitive equilibrium).

Table 1; Source of competitive advantage in disequilibrium

		Firm (entrepreneur) A		
Other firms (entrepreneurs)	overestimate	overestimate Equilibrium (excess competition)	accurate Others buy the resource → disadvantage	Underestimate Others buy the resource → disadvantage
	accurate	A buy the resource → disadvantage	Equilibrium (competitive)	Others buy the resource → gain CA
	underestimate	A buy the resource → disadvantage	A buy the resource → gain CA	Equilibrium (no competition)

In a dynamic context, if firm A overestimates a strategy's return potential from the resource that is acquired in the market, the firm will probably sustain an economic loss in the long run. Thus, as a result, the

incomplete and static. Penrose (1959) describes the a dynamic, two-directional relationship between the entrepreneur and firm's resources, where (1) the resources managers worked with in the past influence what managers will imagine about new uses of resources and new directions for the firm and (2) subjective (unique) productive opportunities envisioned by managers will lead to heterogeneity in the services available from resources. Penrose notes that "There is a close relation between the various kinds of resources with which a firm works and the development of ideas, experience, and knowledge of its managers and entrepreneurs, and we have seen how changing experience and knowledge affect not only the productive services available from resources, but also "demand" as seen by the firm (1959: 85). So, the resource and capability endowments of the firm also determine what entrepreneurs or managers can imagine both about resource combinations among existing resources and about the value of external resources. Portraying the resource-management interactions as one directional makes it static and incomplete, and we have to take into account of this point for further studies.

firm gains the competitive disadvantage vis-à-vis the competitor of the firm gain the competitive advantage. In the same context, if firm A underestimates a strategy's return potential from the resource that is acquired in the market, the competitor of the firm gain the competitive advantage, if they estimate the value of the resources higher than the firm and acquire them at the price less than the accurate vale of it.

Further more, firm A which perceives the new market opportunities may try to conduct an innovation by means of organizing the new resource combinations. In order to conducting the innovation, firm A may buy up some resources, including those of underestimated in the existing market (we could say this kind of situation as 'stagnant') but perceived those will be valuable in the future market (thus those undervalued resources are essentially 'unknown' or 'unvalued' before the innovation has been brought about: *see* the bottom right grid), and then re-deploys those resources to alternative uses. Thus the entrepreneurial innovation is an innovation to perceive (and then realize) a future value system through the new combinations of resources in present time and space.

If the firm A's perception will turn out to be correct, it will gain the competitive advantage. After seeing firm A has been successful, other firms will then tend to imitate firm A, which may be leading the resource market to be competitive, or excess competitive situation. The excess competitive situation makes some firms drop out of the market, because of their pessimistic perception of the market prospect. The situation may flow like a Schumpeterian business cycle.

CONCLUSION

To begin with, a brief survey was given on the conceptual framework of the RBV by contrast it with the CFA. The first point we examined was Barney's fundamental concept of the RBV. From a static point of view, we showed that his concept of 'valuable' and 'rare' resources does not fulfill the conditions for acquiring and realizing a competitive advantage. Because firstly, either the investment necessary to build up resources and the demand-side characteristics that ought to evaluate the value of these resources are exogenous to his framework. Secondly, after remunerating all the factors of production, no competitive advantage has been left to a firm whether the firm possesses 'rare' resources or not. All of the 'rare'

resources ought to be of value to their owner.

In contrast, from a dynamic point of view, we could find an implied possibility in his framework that the competitive advantage may come from ‘imperfections in the factors markets’. Different firms and different owners in these markets will have different expectations about the future value of those resources, which create this imperfection. Therefore, different perceptions toward resources produce the possibility of a competitive advantage. This indicates that the abilities of the entrepreneur lie in discovering how to generate the real economic value with their resources in ways that others cannot anticipate.

The second point considered was the relationship between resources, capabilities, and the abilities of the entrepreneur. We suggested that the main source of competitive advantage does not fall into the heterogeneity of resources and capabilities *per se*, but the heterogeneous perceptions of the entrepreneur. The abilities of the entrepreneur enable capabilities to be performed along the entrepreneur’s vision or strategy, capabilities enable resources to begin to be utilized, and the potential for the creation of output arises. By treating the relationship as such, we concluded that one of the objectives of corporate strategy is the function of a firm to obtain an entrepreneurial rent by exploiting the factor markets disequilibrium (i.e., to maximize the difference between *ex ante* values of inputs and *ex post* values of outputs in a dynamic world) through firm-specific capabilities and resources which are directed by the abilities of an entrepreneur (originating from the heterogeneous perception of the entrepreneur). And most important entrepreneurial abilities for gaining the competitive advantage is, nothing to say, the firm’s skill or accuracy at perceiving the future value of resources.

Finally, we suggest two ways for creating entrepreneurial rents, i.e., entrepreneurial arbitrage and entrepreneurial innovation. We concluded that the entrepreneurial innovation as an innovation to realize a future value system through the new combinations of resources in present time and space, while the arbitrage is merely exploiting the unexploited opportunities in the present existing market.

Although many scholars have contributed to identify the mechanism of sustainable competitive advantage of the firm by means of analyzing the RBV of strategic management, few scholars have paid attention to the role of the entrepreneurial strategic decision process or the entrepreneur-

ship as the source of competitive advantage. In order to deepen the understanding of the source of sustainable competitive advantage of a firm, we have to pay attention on not only to the *ex post* mechanisms in which a firm manage to assure the realization of certain value, but also to the *ex ante* mechanisms in which an entrepreneur attempt to exploit the differences in their perception toward uncertainty. This work has taken only the first step in that direction.

Appendix.

There are some similarities and differences between the Barney's (1986) concept of managerial foresights: i.e., accurate expectations and luck. The managerial foresight or the 'accurate expectations of return potential of the strategy' he noted is similar to one of our concepts, i.e., 'entrepreneurial arbitrage' (adjusting the value differentiation in the factor market). Namely, the firm could gain super-normal profits by exploiting the disequilibrium in the factor markets.

However, we treat the concept of 'luck' a little bit different from the Barney's understanding of it. I suppose that the 'luck' is the complementary element to the 'expectation' in the sense that the expectation of the entrepreneur will be accomplish accurately (so he gain the 'intended' super-normal profit) under the condition that any 'unexpected' environmental disturbance/volatility (e.g., unexpected increase in product price by the war) for the entrepreneur, luckily, never happen around the firm. On the other hand, if the entrepreneur unluckily confronts such an unexpected situation, the expectation will turn out to be the error from the expectation. As a result, the entrepreneur may sometimes gain the 'unintended' super-normal profit by chance when he has luck, and he may sometimes sustain a loss when he has no luck.

We may say that every firm have a probability to gain the 'unintended' super-normal profit in a short period by virtue of the 'luck', but only the firm which does have a better expectation rather than the competitors can gain the 'intended' super-normal profit if the environment luckily permit it. The luck discussion is well treated in the theory of entrepreneurship. See Knight (1921) one of the examples.

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