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The Dynamics of Strategic Capability

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Abstract

The strategic capability concept and its integration into the strategic planning process in international business have not been sufficiently explored as its conflicting definitions indicate. Moreover international managers may not be aware of the need for strategic capability because, the strategic capability paradigm for international business has not been sufficiently conceptualized and explored. Therefore this paper reviews how the business environment influences strategic capability, explains the elements of strategic capability, how strategic capability is integrated into the strategic planning, and gives some suggestions for future research on the strategic capability paradigm as it pertains to international businesses.

Keywords: Strategic Capability, Business Environment, Strategy

1. Introduction

Every business in order to survive and thrive in a competitive business environment needs to possess a certain level of strategic capability. The type of strategic capability that the company needs at a specific time is determined by the legitimizing forces and the threats/opportunities in the future business environment (Ansoff, 1984: 177).

Legitimizing forces are the factors that establish the purpose of the international business and the criteria for its success. These forces evolve from the external environment of the international business and involve: The determination of the key attributes measuring successes in the international business (Vogel, 1991); the determination of the aggressiveness of behavior pertaining to each key attribute (Grahame, 1991); the determination of the rules of the game for the international business organization (Farrell, 1991; Grahame, 1991); the determination of the driving forces; the power structure of the international business organization (Ansoff, 1979:130, 1984:139&146).

Threats and opportunities also evolve in the external environment of the international business and they impact the international business organization in both positive and negative ways. The sources of threats and opportunities for the international businesses vary tremendously. The threats and opportunities can originate from customers, suppliers, competitors, government, and many other sources. Even a change in the weather can be a tremendous source of threats and opportunities as international business farmers and managers of smaller oil distributors know very well. For example, a warmer than usual winter in the northern parts of U.S. and Europe will substantially influence the demand for crude oil, causing swings in the volume of business for the many international oil companies and variation in oil prices.

The frequent changes in the threats and opportunities create environmental uncertainties that international business managers may have difficulty adjusting because they lack the capability to successfully identify new opportunities, detect and interpret problem areas and issues, and implement strategic responses. In a given business environment an appropriate and competent strategic capability is a key basis for such an effective strategic response (Ansoff, 1979:95; Hambrick, 1982). This view was reinforced by Lawrence and Lorsch who reviewed the relevant literature and presented a now classic study synthesising the relationships among these variables emphasizing that the sequence being the business environment as the independent variable determining the conditions of the dependent variables strategic capability and strategy into a contingency theory of organisations emphasising the '…goodness of fit with the various environmental variables and the predispositions of members.' (Lawrence and Lorsch, 1967:209) The success of the organisation is determined by this fit.

Although the contingency theory's concept of a fit among the business environment, strategic capability, and strategy have been well accepted in the strategic management literature (Ansoff, 1979: 95; 1984:14; Burns & Stalker, 1961; Thomson, 1967; Lawrence and Lorsch, 1967:185; Lorsch and Lawrence, 1972:38; Collins, 2001:41), this perspective has been criticized and debated since the early days of strategic management discipline. For an example, Chandler

(1962:15) put forward the evidence that a change in strategy was initiated by changing marketing environment of a business and that the new strategy must be followed by appropriate change in the internal configuration of the organisation that is its strategic capability and this perspective of the sequence has been supported by other leading strategic management scholars (Rumelt, 1974; Miles & Snow, 1978:3; Miles & Snow, 1986; Drucker, 1974:445).

Although, there are some conceptual differences and debate among strategic management theorists on the sequence of the fit among the environment, strategy, and strategic capability (Chandler, 1962:15; Rumelt, 1974; Miles & Snow, 1978:3; Miles & Snow, 1986; Drucker, 1974:445) visa versa the opinion that the fit should be among the business environment, the strategic capability, and strategy (Ansoff, 1984:14; Burns & Stalker, 1961; Thomson, 1967; Lawrence and Lorsch, 1967:185; Lorsch and Lawrence, 1972:38; Collins, 2001:41) and some authors have called for stretching strategy beyond existing strategic capability in anticipation- or creation of future environmental development (Hamel & Prahalad, 1994:146; Kim & Mauborgne, 2005:7). The basic conceptualisation of a relationship among the three variables was accepted as early as 1940's (Drucker, 1946: 37; Penrose, 1957:14-19). The fundamental premise in this argument is that the firm should respond to legitimizing forces, opportunities, and threats in the international business environment to build the appropriate strategic capability that in turn creates the strategies necessary for the firm to survive and prosper as implied by the contingency theory (Lawrence and Lorsh, 1967). Albeit the heated debate on their sequence as indicated Minzberg's (1990) paradoxical criticism of the strategic management prescriptive schools' of thought grounding on the contingency theory's perspective which shows the extent of the dilemma in the strategic management literature on the subject as so eloquently pointed out by Ansoff (1991). Figure 1 illustrates the relationships discussed above.

Many issues surface on close examination of this perspective of strategic capability and its relationships with strategy and the international business environments. First the perspective is reactive in nature meaning that the capabilities and strategy are reactive to existing or anticipated future environments. Second, the perspective ignores the role of visionary strategic individuals such as Henry Ford, Bill Gates, and Henry Lee and their roles in strategy formulation. Third the perspective ignores their roles in business environment creation. Fourth the perspective ignores the role of luck in business (Porter, 1990). Therefore a consideration for environmental creation needs to be considered which is done next.

2. Creating a Business Environment

The preceding discussion is focused on the hypotheses that the firm is an environment serving organization meaning that there are needs that rise in the business environment and that the firms respond to these needs by producing products or services that are needed by the customers. Much of the managerial writing has been addressing this view of the world and management ideas such as "customer is the king" and "the customer is always right" (e.g. Peters and Waterman 1982) are all based on this philosophy. However, compelling evidence can be observed in the market place for a different logic where firms create the business environment instead of serving it. Many of the most successful companies of the late 20th century based their business concept on creating a new business environment and needs. Examples of products and companies following this philosophy of business environment creation abound. Who would have claimed in the early 1980s that we "needed" the internet, mobile phones with cameras, satellite navigation system to find our way home, mutual fund based pension plans, and corn chips and salsa? Still some of the most successful companies of the era such as Yahoo, Fidelity, and Pepsi created these needs. This perspective effectively changes the sequence of the relationships among the strategy, strategic capability, and the international business environment to an amalgamation of the classic Chandlerian (1962) perspective of strategy coming before structure. The relationships are illustrated in figure 2.

The two approaches in conceptualizing the relationships among strategy, strategic capability, and the business environment and their sequence appear contradictory and call for explanation of the controversy, which leads to the concept of strategy and strategic capability equilibrium and business environmental shifts discussed next.

3. Strategy-Strategic Capability Equilibrium and Business Environmental Shifts

Where there is equilibrium between the strategy and strategic capability the performance of the organization is optimized for a particular business environment (Ansoff, 1984). The question is if there is a natural progression from the new business environment to Ansoff's conceptualization of the business environment containing legitimizing forces and threats/opportunities? The answer is most plausibly no. The transformation should be viewed a shift to another business environmental equilibrium rather than a progression because of the drastic difference between the two business environments. The new business environment may demand a completely different scientific and technological foundation, completely different manufacturing system, and often different distribution and marketing system. Thus a shift in business environment requires a new equilibrium between strategy and strategic capability. The relationship is illustrated in figure 3.

In support of the concept of business environmental shifts on the observer the changes in data storage devises such as

3.5" diskettes, CDs, and MP3s. The business environment in these memory storage devises did not progress from one of these to another. The devises represent a complete shift in the storage devises' business environment to a new equilibrium. To contrast, a progressive increase in the memory storage capacity of the 3.5" diskettes, CDs and MP3s would represent a movement along the curve on figure 3. Thus be a natural progression. In order to shed light on the dilemma of which comes first the business environment, strategy, or strategic capability, the concept of strategic capability needs further exploration.

3.1 Strategic Capability

Ansoff (1979:72) made some of the earlier contributions to the concept of strategic capability where he analyzed it in terms of general management capability and competence, logistical competence, strategic capacity and discussed their dynamics. While Ansoff's work broke new ground on the subject, certain questions still remain unanswered. For example, the distinction between individual competence and organizational competence is blurred, the transformation process from individual competence to organizational competence is not explained, and further development of the concepts was needed.

Other management scholars (Prahalad and Hamel, 1990; Hamel and Prahalad, 1994) picked up the ball and warned of the dangers of ignoring the importance of core competencies and emphasized the need to managing them like portfolios of products and assets. They defined core competencies as "the collective learning in the organization" (1990:82) and they don't differentiate between core competencies and core capabilities (1994:203). Moreover their conceptualization and examples are limited to technologies and products (Hamel and Prahalad, 1993). In the wake of their work a number of writers on the subject have attempted to make a distinction between the two. For example, Stalk, Evan, and Shulman (1992) consider core capability applicable to the whole value chain but core competence limited to functional areas within the firm.

Prahalad and Hamel (1990:83&84) claim core competencies can be identified in terms of access to market, customer benefits, difficulty in imitation, and think that a list of 20 to 30 capabilities is too extensive and core competencies should be limited to five or six. However in 1994:203, they revised their previous positions and extended the list of capabilities to 40 or 50 and the core competencies to fifteen. Moreover they provide useful distinctions among meta-competencies, core competencies, and constituent skills and realize that in order to make the concept of capability operational the company needs to inventory the capabilities in the firm to the level of each individual's personal skills. This recognition should be applauded. Anything else is an anomaly in times when a pair of shoelaces is inventoried in a hypermarket. Why should not a firm keep a detailed inventory of its most valuable assets? In addition to the problem of agreement on how core capabilities are defined, the identification of their elements beyond broad abstraction is lacking in the literature. This is in spite of the devotion of whole issues of management journals to the subject.

Consequently, building on the above contributions on strategic capability a different perspective is taken on its definition: as the ability to change the organization and create business environments. A capability is strategic if it results in change or has the potential to. Certainly we are seeking a positive change for the organization. From this perspective strategic capability can be analyzed in terms of strategic- resources, competence, capacity, quality, and the mobility of these factors. Furthermore an attempt is made to identify tangible components of strategic capability in relation to these factors.

3.1.1 Strategic Resources

Strategic resources can be changed from one form to another fast. Cash and cash equivalents and the ability to raise capital through equity or debt are the most important strategic resource for an international business.

Traditionally defined resources such as machines, factories, human resources, and intellectual capital (Johnson, Scholes, and Whittington, 2005:118) are unlikely to be able to change fast and can be acquired on the market if the money is available. Therefore they should not be considered strategic resources leading to competitive advantage. Obsolete machines and factories are liabilities not strategic assets, retraining employees takes long and is expensive, and filing cabinets full of patents that have never materialized are just scrap paper not strategic resources.

In the current international business environment virtually every part of the production value chain can be purchased, built, or subcontracted.

Jobs can be outsourced and intellectual property such as relevant patents or designs can be purchased or the companies owning them can be acquired like the recent acquisition spree by Chinese companies has indicated. In search of resources, distribution networks, and talent Chinese companies have been scooping up giants such as the IBM PC division by Lenovo, France's Thomson TV manufacturer by TCL Corporation, and Korea's Ssangyong trucks by Shoanghai Automotive Industry Corporation (Roberts et. al. 2004).

In the current international business environment companies like Lenovo can purchase the IBM's PC division to give Lenovo access to the marketing, logistics, and knowledge resources Lenovo needs. China Minmetal bid for Canada's

Noranda is an attempt to purchase resources for cash. Even oil reserves are no longer strategic resources as they can be purchased on the market as the CNOOC Ltd's $18.5 billion bid for UNOCAL indicates. The question is if products/services can be considered strategic resources? The answer lies in the products ability to change and mutate into other products. Arm & Hammer baking soda has mutated from being a food additive into refrigerator cleaner, carpet cleaner, air freshener, laundry additive, and toothpaste. A case for and against the argument can be made. The question is if the product's success can be attributed to its ability to change or in strategic competence.

Consider the competitive strategy of various viruses like AIDS and the Swine Flue virus H1N1, the problem in fighting such viruses is that they are constantly changing so every time scientist come up with an antidote, the virus has already changed and mutated to another form rendering the antidote useless. Would it be fantastic to be able to develop a product that constantly mutates into new products nullifying all efforts by competitors to produce compatible products? Some of the top fashion designers stay on top by doing exactly that, by the time competitors produce copies and imitations of the top fashion labels, the fashion designers are already out with the next design rendering the competitor's products "old fashion". Kester (1984) provided some empirical evidence for the value of growth strategies which can lead to multiple "mutations" into new products or even product lines and concluded that the key value driver in the stock price of companies was the ability of managers to invest their cash into opportunities which have the ability to hatch- or mutate into new growth business. Again, the question is if the product's success can be attributed to its ability to change or in the strategic competence of the designers and if so then can't designers and product lines be bought? Therefore, this discussion shows that the only resource remaining strategic is cash and the ability to raise it. And this perspective has been supported by those criticizing the resource based view of the firms such as Eisenhardt and Martin (2000).

3.1.2 Strategic Competence

The strategic competence of an international business can be analyzed in terms of two categories. The first category is individual competence such as the skills, knowledge, experiences, and aspirations of the strategic managers, key management, scientific, and technical personnel as well as other internal stakeholders. The second category is the organizational competence such as formal management systems, structure, scientific and technical competence, organizational culture, organization's logistical competence in respect to the various functions such as marketing and finance, and technologies (Ansoff, 1979:76; 1984:184; Lynch, 2003).

Individual Competence. The first category is individual competence such as the skills, knowledge, experiences, and aspirations of the strategic managers, key management, scientific, and technical personnel as well as other internal stakeholders. (Ansoff, 1979:76; 1984:184; Lynch, 2003).

Strategic managers are the people who influence the strategic behavior leading to success or failure of the international business. The influences they have on the international business are affected by: The strategic manager's courage, talent, skills, strategic culture, ambitions, risk propensity, tenacity, perseverance, and cheerfulness under adverse conditions and stress; the power the strategic managers have; the constraints on the freedom of behavior they and the international business experiences; the recognition and rewards given to the role of the strategic manager in the international business; the match between the strategic manager's personality and the role the manager is assigned in the international business (Ansoff, 1979:210; Nutt, 1989; van de Mer and Jacques, 1989).

The role of the strategic manager is to insure the success and survival of the international business, and this role becomes more demanding when the international business is in a turbulent business environment where the business strategies of the past are obsolete and the strategic manager's entrepreneurial spirit becomes critical. This importance of strategic managers is evident in U.S. industries having experienced an increase in the turbulence level in their business environments.

The revolutionary changes in the hospital industry in the San Francisco Bay area have put many of the smaller hospitals out of business. However, some strategic managers had tremendous impact on the strategic evolution of many of the smaller hospitals, and they were able to save them from following the bandwagon to bankruptcy. The success of these smaller hospitals was contributed to the effective responses of their strategic managers (Meyer, Brooks, and Goes, 1990).

In the banking industry, strategic managers at smaller commercial banks were the key sources of effective responses to the changes caused by the deregulation of the banking industry in the 1980s (Ballarin, 1986). In the telecommunication industry, strategic managers of smaller telecommunication businesses played a very important role in developing effective responses to tremendous changes in their business environments due to deregulation of the industry (Astley and Fombrum, 1983).

Internal Stakeholder Aspirations. The aspirations of the internal stakeholders in the international business influence its effectiveness. They are individuals, groups, and organizations who have an interest in the actions of an international business organization, and who are able to influence it (Savate, et.al. 1991) such as employees, international business

managers, stockholders, and bondholders (Cornell, and Shapiro, 1987). The internal stakeholders influence the international business by their aspirations acting on the power structure of the international business (Ansoff, 1979:164; Savage, 1991)

The internal stakeholder aspirations can be analyzed in term of their attributes of performance, aggressiveness of behavior, and level of aspirations. The attributes of performance are the elements by which performance is measured by in the organization. In for profit business organization these attributes can be after tax profit, earning per share, market share, or growth. The aggressiveness of the stakeholders' behaviors is the attitude towards the attributes. The attitudes can be satisfying, or goal seeking, or maximizing. The level of aspirations is the thresholds or goals triggering operational or strategic action by the international business (Ansoff, 1979:107). The stakeholders' aspirations influence the international business in many ways. The capital structure, power structure, and the culture of the international business are strongly influenced by the aspirations of the stakeholders (Cornell and Shapiro, 1987; Barton, Hill, and Sundaram, (1989).

Individual scientific, logistical, and technical competence may be strategic in nature when specific highly talented and skilled personnel are employed by the organization. The challenge for the organization is to institutionalize the individual competences and turn them into organizational competence by systematically documenting and communicating the knowledge of the key scientific, logistical, and technical personnel to the rest of the organization.

Organizational Competence. Organizational competence is the collective accumulation of skills, knowledge, and experience of the organization's past and present employees. For example, many talented individuals and group of individuals have contributed their talent, skills, and experiences in creating the policy and procedure manuals for the McDonalds corporation and these manuals become the organizational competence of the corporation and will remain so even if the individuals leave it. The organizational competence can be analyzed in terms of the organization's esprit de corps, organizational culture, formal management systems, structure, scientific and technical competence, the organization's logistical competence in respect to the various functions such as marketing and finance, and technologies (Ansoff, 1979:76; 1984:184; Lynch, 2003).

Esprit de Corps is the state of the spirits of a person or group as exhibited by courage, confidence, cheerfulness, discipline, selflessness, dedication to a common goal, and willingness to perform assigned tasks. These elements of espirit de corp can all be assessed objectively.

Culture is a complex set of beliefs, assumptions, values, language, and symbols that define the way in which individuals in international business conduct their interactions with members of their firm and outside parties (Peters and Waterman, 1982; Fiol, 1991). The culture of the international business influences its performance, structure, and its stakeholders' aspirations.

The culture consists of many elements. The attitude towards change; whether it is friendly or hostile towards change. The propensity towards risk and risk taking, whether the organization avoids, tolerates or seeks risks. The time perspective towards problems; whether it is past, present, or future oriented. The action perspective; whether it has an internal operations or external environment orientation. The goals of the management and employees of the international business; whether they are focused on stability, efficiency, effectiveness, growth or innovation. The shared model of the world, which is the perception of the critical success factors shared by the international business Furthermore the culture is a change trigger; which means the activator of managerial response to events effecting the international business; whether it is crisis or unsatisfactory performance (Ansoff, 1984:211). The culture affects the performance of the international business. For instance, culture can lead to sustained competitive advantage (Porter, 1980), a strong employee and customer centered cultures lead to superior financial performance (Peters and Waterman, 1982), a culture that enables the firm to behave in ways that lead to high sales, low costs, high margins, is rare, and imperfectly imitable by competitor does contribute to sustained superior financial performance (Barney, l986b), and a culture based on commitment to and high involvement in the international business is critical for survival in the increasingly competitive business environment (Walton, 1992).

Hamel and Prahalad (1993:76) portrayed managerial culture as "the assumptions, premises, and accepted wisdom that bound or 'frame' a company's understanding of itself and its industry…" and consider these frames as the determinants of the firm's success or failure.

Consequently a successfully implemented change in philosophy and personnel policies towards such a culture gets the desired results in financial performance (James, 1991).

A change in culture is important when the structure of the organization is changed and new approaches to doing things are adopted. As demonstrated by Lee Iacocca who created an international business unit separate from the structure of the Chrysler organization to develop the new LH cars. He credited the successful launching of the new Chrysler LH cars to an international business like culture of the small team. The international businesses culture facilitated the change in the structure of the Chrysler organization and made the development of the new car possible in a record time

(Smith, 1992).

Meanwhile many organizations experience a gap between the manager's perception of the culture of the international business and its desired culture as determined by the business environment. Where such cultural gap exists it has a substantial impact on the international business profitability (Smead, 1991). A nation's culture severely affects the competitive advantage of nations through the cultural attitude towards technology adaptation. The effectiveness of technology transfer to international business is moderated by variations in culture and culture-based receptivity (Kedia and Bhagat, 1988).

Formal management systems are explicit formalized routines and procedures that guide and control the work of international businesses (Ansoff, 1984:256). The formal management systems are elements of most international business organizations and their affects on the performance of the organizations are positive. High performance has been related to effective formal information based routines and procedures for strategic decision making, budgeting systems, cost control systems, strategic and competitive scanning system (Mahmood and Soon, 1991), resource allocation systems, human resource management systems, project management systems (Robinson 1982), and performance evaluation and rewards systems (Simons, 1991).

The building blocks of formal management systems are: information input, control, budgeting, programming, planning and implementation (Ansoff, 1984:266; Porter, 1990). However the relationship between the formal management system and performance is a controversial one and researchers attempt to explain why some management systems improve performance in a particular international business and not in others. Two critical parts of the formal management system receiving much attention are the information technology systems, and the strategic and competitive scanning systems employed by the international business. The information technology system employed by the international business has a positive effect on the strategic effectiveness of an international business, and information technology is being used by U.S. organizations as strategic business tools and competitive assets (Mahmood and Soon, 1991). For an example, the SABRE reservation system at American Airlines was considered by its strategic managers to be a key strategic competence helping the airline to gain significant advantage in market share over its competitors in the early 1980s. The success of the system was contributed to the ease small travel agencies could adapt the system into their operation (Cash and Konsynski, 1985).

The strategic and competitive scanning system employed by an international business has positive effects on its strategic effectiveness, and strategic and competitive scanning systems can create sustainable competitive advantage (Kiernan, 1993; Zajac and Bazerman, 1991; Ghosal and Kim, 1986).

Formal structure is the pattern of relationships in tasks, authority, roles, and responsibility by which the international business does its work (Pfeffer, 1991). The formal structure in international businesses developed in the late 19th century and the early 20th century as a response to the demands of the industrial revolution. The first formal structure was the functional structure where task, authority, roles, and responsibility were patterned along functional lines. Since, international businesses have attempted to meet new demands on their responsiveness by developing new formal structures. Consequently, researchers have investigated the relationship between the environment and organizational structure, strategy, and performance.

Integrating Strategic Capability into the Strategic Planning Process

The strategic planning process must involve a phase where the need for strategic capability applicable for the future business environment is evaluated with the objective of matching the strategic capability to the future business environment the firm intents to create. Moreover the argument for the fit between the strategic capability and international business strategies is based on the observation that the implementation of strategies is contingent upon the responsiveness of the strategic capability (Chandler, 1962; Galbraith, 1977; Eglehoff, 1988).

The strategic capability analysis includes six analytical steps. The first step is to access the strategic budget of resources. The second step is to perform strategic competence analysis. The third step is to access the applicability of the strategic competence components to the needs of the firm. The forth step is to quantify the number of the strategic competence components listed above and access they are sufficient to the firm's need. The fifth step is to access the mobility of the strategic competence components. The sixth step is environmental analysis focusing on what new business environments can be created.

Albeit the importance of the strategic capability, empirical evidence solving the dilemma of the relationship and sequencing among strategy, strategic capability, and the business environment is scant with the rare exception of Collins (2001), who investigated the sequencing of strategy and strategic capability. His research found evidence for both approaches in successful firms but, Collins favored strategic capability before strategy in larger firms. However his research did not ascertain the role of the international business environment and if it was the fundamental basis for strategy and strategic capability formulation or if the two came first creating the business environment.

4. Conclusions and Further Research

Although there is a general consensus in the strategic management theory that the international business environment, strategy, and strategic capability are all crucial element in the strategic management of firms, there is no consensus on the sequencing of strategy and strategic capability on one side and the place of the international business environment in relation to the other two. Moreover the elements of strategic capability are poorly understood. Furthermore the empirical evidence for this theoretical work is limited. Although some empirical evidence have been provided for the elements and variables in strategic capability (e.g. Lenz 1980; Ulrich and Wiesema, 1987; Dutta, Bergen, Levy, Ritson, and Zbaracki 2002; and Oliver & Holzinger, 2008) the focus has mainly been on conceptual development and have provided scant or inconclusive empirical evidence for the sequence and relationships among strategy, strategic capability, and environment as well as the key variables therein. Consequently further research is needed on the strategy, strategic capability, and business environment concepts as they need to be developed into a paradigm by investigating the variables and elements that may belong in the strategy, strategic capability, and international business environment formulas presented above, their sequence, and how these can be integrated into the strategic planning process in international businesses need investigation as well. This research may include variables suggested by Walton (1992) which were: informal management systems, organizational knowledge, customer goodwill, front line employees, age, obsolescence, logistical competence, location and strategic deployment, luck and the ability to exploit it, attitude towards competitors, and strategic reserves or cash. The research of these elements and their integration into the strategic planning process would enhance the knowledge of international business organizations and give managers the necessary strategic tools they need to implement effective strategies in changing international business environments. Much of this research should be focused on how organizations build the strategic capability to create new business environments.

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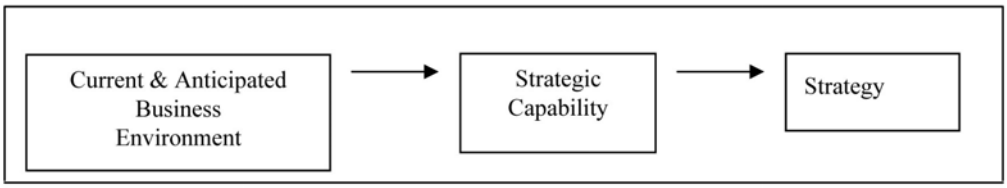

Figure 1. Ansoff's Perspective: Environment, Strategic Capability, and Strategy

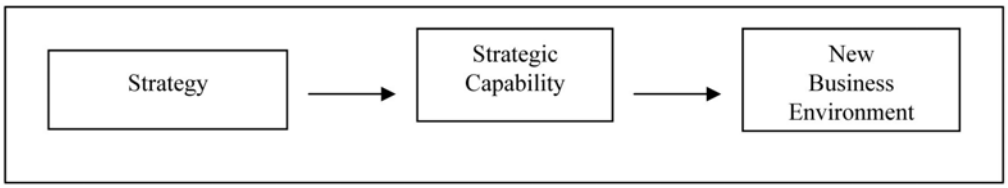

Figure 2. Chandler's Perspective: Strategy and Strategic Capability

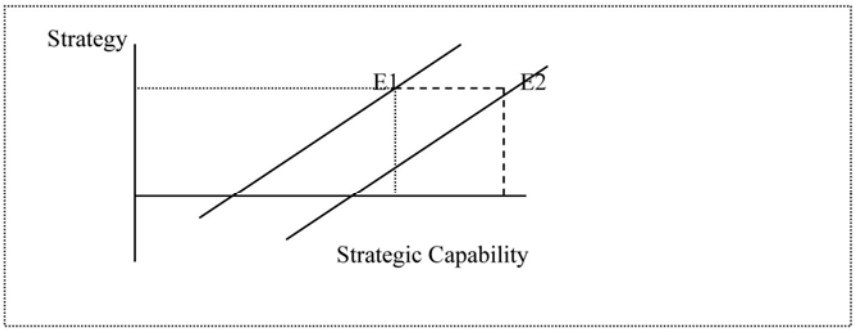

Figure 3. Strategy and Strategic Capability Equilibrium