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## INERTIA AND TRANSFORMATION

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In this article I argue that strategy scholars have incorrectly borrowed from economists the assumption of organizational plasticity. Particularly in large firms, inertia, rather than plasticity, is the norm. Unfortunately, there can be no simple theory of inertia as its causes are multiple and varied. After sketching out the shapes of the most important sources of inertia, I turn to the problem of overcoming inertia—the question of organizational transformation. Starting with a simple model of organizational capabilities as existing on two levels (unit-based and rooted in coordination among units), I draw some preliminary conclusions about the shape of organizational transformation. In particular, I focus on the interplay between incentive intensity and coordinative capacity and argue that most transformations move through a sequence of phases in which coordinative capacity is first dramatically reduced and then rebuilt along new lines.

### Introduction

Roughly fifteen years ago the field of business and corporate strategy began to incorporate economic reasoning into its research program.

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The first step was the adoption of traditional industrial organization economics, with its emphasis on barriers to entry and collusive reductions in rivalry (Porter 1980). Subsequently, strategy researchers developed what is now called the resource-based view of the firm.<sup>2</sup> This theory sees firms as collections of resources and sees performance differences as largely reflecting differences in resource quality. Whereas traditional industrial organization saw high profits as stemming from collusive reductions in competition or strategies of entry deterrence, the resource-based view sees high profits as the rents accruing to specialized and difficult-to-replicate or non-imitable resources.

Thus, today strategy researchers work with a complex amalgam of economic and quasi-economic reasoning. We envision the firm as striving to maximize value, but also see it as working with factors of production that are far from mobile, as dealing with ambiguous production functions, and as possessing or controlling collections of tacit knowledge and externally held attributions (reputation) that evolve over time in response to investment, activity and imitation.

It is useful to note that this new view has not been developed by "applying" economics to strategy. Rather, it has been accomplished by carefully identifying the assumptions within received economic models that prevented or ruled out strategic phenomena, and by then analyzing the situations created by altered assumptions. In particular, a central dogma of neoclassical microtheory, especially that part associated with traditional industrial organization, was the basic homogeneity of firms within industries (but for scale). Differences in performance were thus attributed to differences in scale or its collective equivalent, concentration. By contrast, the resource-based view has as its central dogma the heterogeneity of firms induced by heterogeneous resources.

The power behind this research stream has, in large measure, come from the clarity and strength of the theory (neoclassical microeconomics) which it attacks. In fact, the neoclassical model maintained such a grip on the minds of economists that they often spoke of its failures as "market failures," as if it were somehow the responsibility of reality to live up to theory rather than the theorist's responsibility to describe reality.

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<sup>2</sup>Early contributions were made by Lippman and Rumelt (1982), Teece (1982), Wernerfelt (1984), Rumelt (1984), Porter (1985) (who made the "activity" the central element of his revised view), and Barney (1986). Reviews of the topic are provided by Conner (1991) and Grant (1991).