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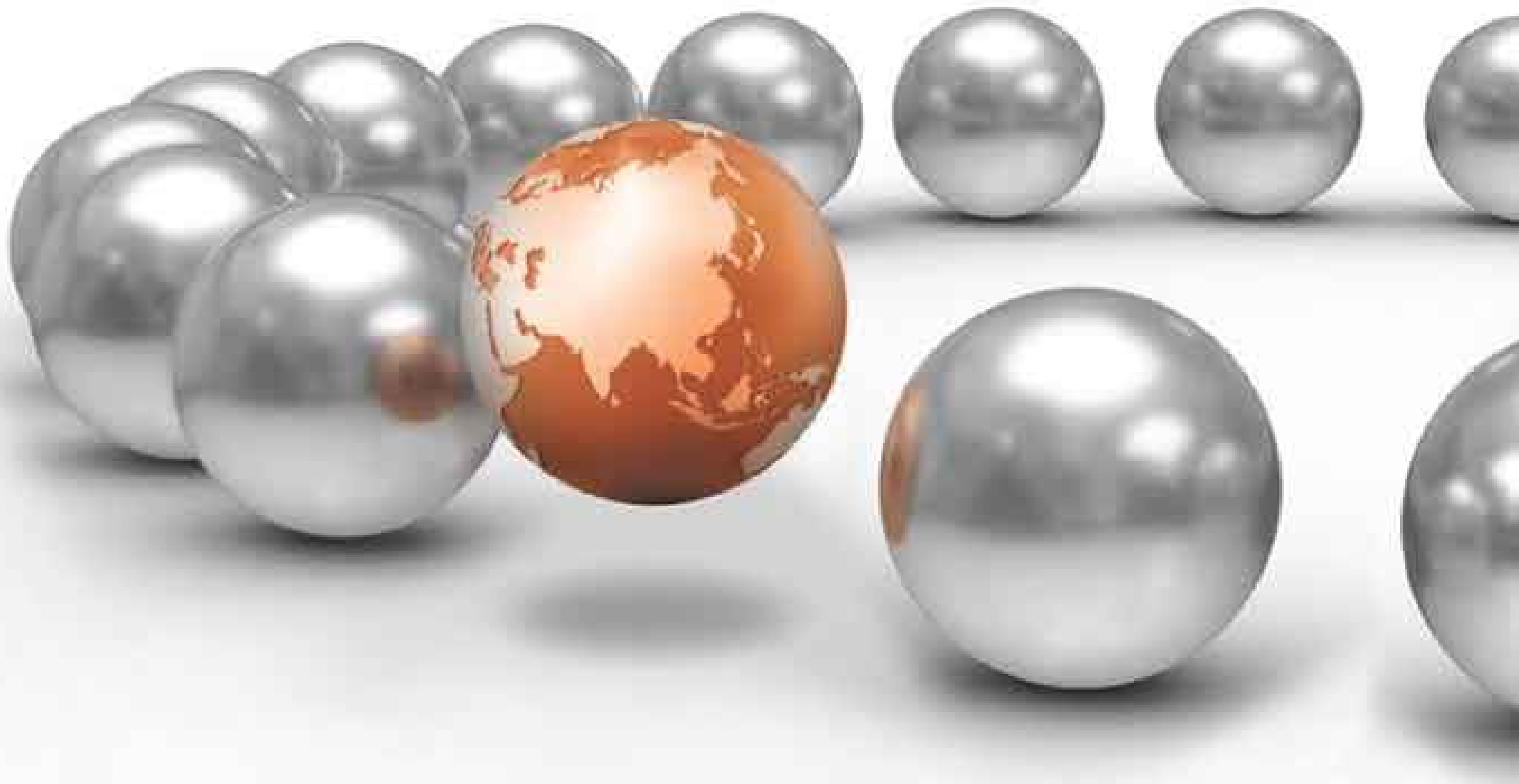

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SECOND EDITION

Strategic Management

Frank T. Rothaermel
Georgia Institute of Technology

McGraw Hill Education

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DEDICATION

To my eternal family for their love, support, and sacrifice:
Kelleyn, Harris, Winston, Roman, and Adelaide

—**FRANK T. ROTHAERMEL**

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MINICASES AND FULL-LENGTH CASES

MINICASES

FULL-LENGTH CASES

(All available through McGraw-Hill Create, www.McGrawHillCreate.com/Rothaermel)

FULL-LENGTH CASES MARKED WITH A ➽ WERE AUTHORED OR CO-AUTHORED SPECIFICALLY FOR THIS BOOK BY FRANK T. ROTHAERMEL.

CONTENTS

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CHAPTERCASES AND STRATEGY HIGHLIGHTS

CHAPTERCASES /

STRATEGY HIGHLIGHTS /

ABOUT THE AUTHOR

Frank T. Rothaermel

Georgia Institute of Technology

FRANK T. ROTHAERMEL (PHD) is a professor of strategic management and holds the Russell and Nancy McDonough Chair in the Scheller College of Business at the Georgia Institute of Technology. Frank is also an Alfred P. Sloan Industry Studies Fellow. He received a National Science Foundation (NSF) CAREER award, which "is a Foundation-wide activity that offers the National Science Foundation's most prestigious awards in support of . . . those teacher-scholars who most effectively integrate research and education" (NSF CAREER Award description). Frank is also the area coordinator for Strategic Management.

Frank's research interests lie in the areas of strategy, innovation, and entrepreneurship. To inform his research, he has conducted extensive field work and executive training with leading corporations such as Amgen, Daimler, Eli Lilly, Equifax, GE Energy, GE Healthcare, Hyundai Heavy Industries (South Korea), Kimberly-Clark, Microsoft, McKesson, NCR, Turner (TBS), among others. *BusinessWeek* named Frank one of Georgia Tech's Prominent Faculty in its national survey of business schools. The Kauffman Foundation views Frank as one of the world's 75 thought leaders in entrepreneurship and innovation.

Frank has published some 30 articles in leading academic journals such as the *Academy of Management Journal, Academy of Management Review, Organization Science, Strategic Management Journal,* and elsewhere. Some of his academic articles are highly cited. Frank currently serves (or served) on the editorial boards of the *Academy of Management Journal, Academy of Management Review, Organization Science, Strategic Management Journal,* and *Strategic Organization.* Frank regularly translates his research findings for wider audiences in articles in *Forbes, MIT Sloan Management Review, The Wall Street Journal,* and elsewhere.

He has received several recognitions for his research, including the Sloan Industry Studies Best Paper Award, the Academy of Management Newman Award, the Strategic Management Society Conference Best Paper Prize, the DRUID Conference Best Paper Award, and the Israel Strategy Conference Best Paper Prize. He is also the inaugural recipient of the Byars Faculty Excellence Award.

Frank has a wide range of teaching experience, including at the Georgia Institute of Technology, Georgetown University, ICN Business School (France), Michigan State University, Politecnico di Milano (Italy), St. Gallen University (Switzerland), and the University of Washington. He received numerous teaching awards for excellence in the classroom.

Frank holds a PhD degree in strategic management from the University of Washington, an MBA from the Marriott School of Management at Brigham Young University, and an M.Sc. (Diplom-Volkswirt) in economics from University of Duisburg, Germany. He was a visiting professor at the University of St. Gallen, Switzerland, and an Erasmus Scholar at Sheffield Hallam University, UK. Frank is a member of the Academy of Management, the Industry Studies Association (Founding Member), and the Strategic Management Society.

VISIT THE AUTHOR AT: www.ftrStrategy.com

PREFACE

The market responded very positively to the first edition, and I'm grateful for that strong vote of confidence. In this second edition, I built upon the unique strengths of this text and continue to improve it based on hundreds of insightful reviews and important feedback from professors, students, and professionals. The vision for this text is to provide students with core concepts, frameworks, and analysis techniques in strategy that will integrate their functional course offerings and help them become managers who make well-reasoned strategic decisions. It is a research-based strategy text for the issues that managers face in a globalized and turbulent 21st century, blending theory, empirical research, and practical applications in a student-accessible form.

The competition in the strategy textbook market can be separated into two overarching categories: traditional strategy books, which are the first-generation texts (from the 1980s); and more recent, research-based strategy books, which are the second-generation texts (from the 1990s). This new text is different—a third-generation strategy text, positioned to compete successfully with the primary first- and second-generation incumbents. The third-generation approach you will find here combines the student accessibility and application-oriented frameworks found in first-generation texts with the strategy research in the second-generation texts.

This text synthesizes and integrates theory, empirical research, and practical applications in a unique combination of rigor and relevance. With a single strong voice, the chapters weave together classic and cutting-edge theory with in-chapter cases and strategy highlights, to demonstrate how companies gain and sustain competitive advantage. The strategic intent for the book is to combine quality and value with user-friendliness.

In particular, the content of this product is based on the principles discussed next, each of which provides a value-added dimension for instructors or students, or both.

- ***Synthesis and integration of rigorous and relevant strategy material.*** For example, the text includes strategy material that has stood the test of time (such as the resource-based view and Porter's five forces model) as well as up-to-date strategy material and current research (such as the dynamic capabilities perspective and the triple bottom line).

  It also includes *student-accessible coverage* of strategic management research. It draws on articles published in the leading academic journals (for instance, *Strategic Management Journal, Academy of Management Journal/Review, Organization Science, Management Science, Journal of Management,* and so on). Although academic theory and empirical research form the foundation of the text, I also have integrated insights from leading practitioner outlets (such as *Harvard Business Review, Sloan Management Review, California Management Review*) to enhance the application of concepts. To weave in current examples and developments, I draw on *The Wall Street Journal, Bloomberg Businessweek, Fortune, Forbes,* and others. In sum, theory is brought to life via the embedded examples within each framework and concept.
- ***The comprehensive yet concise presentation of core concepts, frameworks, and techniques.*** Although comprehensive, the text does not include every single idea ever introduced to the strategy field. Many students don't read the assigned readings in their strategy textbooks because the books contain *too much* information, presented in a disjointed fashion. Many strategy books read more like a literature review, without addressing *what* the research findings mean and *why* they are important for managers. This jumble prevents students from seeing the bigger strategic picture. They may see the trees, but they fail to see the forest. In contrast, this text will be an *enjoyable*

read for students—clear, concise, and filled with examples from companies today's students know—while at the same time providing the content and value-add that instructors expect. *It has one vision and one voice!*

- ***Combination of traditional and contemporary chapters.*** As a review of the chapter-contents listing will demonstrate, the text includes the traditional chapters needed in the core strategy course. In addition, it includes three contemporary *standalone chapters* that reviewers and users have identified as providing additional value:
  - Chapter 2, "Strategic Leadership: Managing the Strategy Process," discusses the roles of leaders in setting strategy within three different models: top-down planning, scenario planning, and strategy as planned emergence. This chapter allows for a thorough discussion of the role of vision, mission, and values; customer versus product-oriented missions; the combination of intended and emergent strategies; and the importance of long-term success in anchoring a firm in ethical values.
  - Chapter 5, "Competitive Advantage, Firm Performance, and Business Models," neatly ends the analysis section of the book by providing five approaches to measuring firm performance and assessing competitive advantage. It looks at three traditional approaches to measure performance (accounting profitability, economic value creation, and shareholder value creation) and at two holistic approaches (the balanced scorecard and the triple bottom line). Instructors can easily cover as many of the approaches as desired for their course and its goals. A new addition is the detailed discussion of business models. Putting strategy into action through innovative business models is becoming more and more important across all types of industries.
  - Chapter 7, *Innovation and Strategic Entrepreneurship,* addresses the important topics of innovation and strategic entrepreneurship as aspects of business strategy. Driven by Schumpeter's "perennial gale of creative destruction," competition seems more heated than ever, with innovation playing a key role in gaining and sustaining competitive advantage. This chapter addresses various aspects of innovation, beginning with the industry life cycle (ILC) and the modes of competition and business-level strategies at various stages in the life cycle. Given the importance of different customer preferences at different stages of the ILC, it introduces the crossing-the-chasm framework and illustrates it with an application to the smartphone industry. Using tools and concepts of strategic management, it explores four types of innovation, social entrepreneurship, and the Internet as a disruptive force. This chapter especially will engage students and provide much food for thought in their jobs and careers.
- ***Up-to-date examples and discussion of current topics within a global context.*** Having spoken to hundreds of students around the world, I want to minimize the frustration they express in seeing the same, out-of-date examples in so many of their (generic and boiler-plate) business-school textbooks. The book has been written for today's students to reflect the turbulence and dynamism that they will face as managers. I have drawn on up-to-date examples to illustrate how companies apply strategy concepts in today's business world. Although this text contains a standalone chapter on *Global Strategy,* examples throughout the book reflect the global nature of competition and the importance of emerging economies such as the BRIC countries and highlights non-U.S. competitors such as Lenovo, Siemens, the Tata Group, and BYD in globalized industries.

  Each chapter contains two *Strategy Highlight* boxes. These in-chapter examples apply a specific concept to a specific company. They are right-sized for maximum student appeal—long enough to contain valuable insights, and short enough to encourage student reading. For a list of the Strategy Highlight companies and topics, see page xiii.

I also have drawn topics and examples from recent and seminal business bestsellers, such as *The Black Swan; Built to Last; Co-opetition; Crossing the Chasm; Good Strategy, Bad Strategy; Good to Great; Great by Choice; How the Mighty Fall; In the Plex; Innovator's Dilemma (and Solution); Innovator's DNA; Lean In; Playing to Win; Predictably Irrational; Steve Jobs; The Long Tail; The Wide Lens; Wisdom of the Crowds; World 3.0; and Why Smart Executives Fail;* among others. I have included these ideas to expose students to topics that today's managers talk about. Being conversant with these concepts from business bestsellers will help today's students interview better and effortlessly join the discourse in the corporate world.

- ***Use of the AFI strategy framework.*** The book demonstrates that "less is more" through a focused presentation of the relevant strategy content using *A*nalysis, *F*ormulation, and *I*mplementation as a guiding framework. This model (see Exhibit 1.5 on page 18) integrates process schools of strategy (based on organization theory, psychology, and sociology) with content schools of strategy (based on economics). Process and content can be viewed as the "yin and yang" of strategy. Current strategy textbooks typically favor one or the other but do not integrate them, which leads to an unbalanced and incomplete treatment of strategic management. The AFI strategy strives for beauty through balance, which is lacking in most current strategy texts on the market. The model also emphasizes that gaining and sustaining competitive advantage is accomplished in an iterative and recursive fashion. The framework offers a repository for theoretical strategy knowledge that is well translated for student consumption, and it provides a toolkit for practicing managers.
- ***High-quality cases, well integrated with textbook chapters.*** Cases are a fundamental ingredient in teaching strategy. My interactions with colleagues, reviewers, and focus group participants in the course of writing and developing chapters indicate varying instructor needs for top-notch, up-to-date cases that are well-integrated with the content presented. Within this text itself are two types of cases:
  - **ChapterCases** begin and end each chapter, framing the chapter topic and content. The case at the beginning of the chapter highlights a strategic issue that a well-known company faced and relates that company to a concept to be taught in the chapter. The end of each chapter returns to the ChapterCase, in a recapitulation of the case titled "Consider This. . .". Here, we ask students to reconsider the case, applying concepts and information presented in the chapter, along with additional information about the focus company.
  - 20 **MiniCases,** (following Chapter 12), all based on original research, provide a decision scenario that a company's manager might face. With suggested links to related chapters, they offer dynamic opportunities to apply strategy concepts by assigning them as add-ons to chapters, either as individual assignments or as group work, or by using them for class discussion.

  I have taken pride in authoring *all* of the ChapterCases and MiniCases. This additional touch allows quality control and ensures that chapter content and cases use one voice and are closely interconnected. Both types of case materials come with sets of questions to stimulate class discussion or provide guidance for written assignments. The instructor resources offer sample answers that apply chapter content to the cases.
- In addition to these in-text cases, 24 **full-length Cases,** authored or co-authored by me specifically to accompany this textbook, are available through McGraw-Hill's

custom-publishing *Create*™ program. Full-length cases NEW to the second edition address strategic issues at Facebook, McDonald's, BlackBerry, and Amazon. Among the others, the cases about BetterWorldBooks, Tesla Motors, Numenta, Best Buy, and Apple have been updated and revised for the new edition. Also available are three full-length cases—about Microsoft, Tropical Salvage, and the movie industry—authored by other strategic-management instructors. Robust case teaching notes and financial data are available for all full-length cases accessed through Create.

- ***Direct applications of strategy to careers and lives*.** The examples in the book discuss products and services from companies with which students are familiar, such as Facebook, Starbucks, Apple, and Zipcar. Use of such examples aids in making strategy relevant to students' lives and helps them internalize strategy concepts and frameworks.

This edition also provides a stronger focus on practice/applications. Each chapter now closes with a section titled *Implications for the Strategist* that highlights practical implications of the concepts and frameworks discussed and allows the student to build a cumulative toolkit in strategic management. It bridges the gap to practical application and makes the reader more confident in using the tools presented.

In addition, at the end of each chapter's homework materials is an innovative text feature, titled *my*Strategy, which personalizes strategy concepts through direct application of the chapter topic to students' lives. Questions asked in these sections include: *What is your positioning strategy in the job market? How will you differentiate yourself, and at what cost?* and *How much is an MBA worth to you?* Such questions encourage students to think through strategic issues related to their budding careers. You may choose to make this feature a regular part of the course, or you may prefer to let students explore these items outside of the regular coursework. Either way, the *my*Strategy feature demonstrates opportunities to personalize strategy as students plan or enhance careers following completion of the strategy course and their degrees.

For details about changes made in the second edition, see the list that follows.

What's New in the Second Edition

I have revised and updated the second edition in the following ways, many of which were inspired by conversations and feedback from users and reviewers of the first edition.

CHANGES MADE THROUGHOUT

- ChapterCases and Strategy Highlights throughout have been either completely revised and updated or are new, as detailed in the following chapter-by-chapter entries.
- All major text examples have been updated or are new, with more in-depth discussion.
- More global coverage is included throughout, with a stronger China focus (both on the country as well as its global competitors).
- Additional coverage and discussion of more diverse strategic leaders has been included.
- Chapters now consistently contain two Strategy Highlight features per chapter.
- Chapters now contain a stronger practice/application focus throughout. Each chapter now closes with a section discussing practical *Implications for the Strategist.*
- Following Chapter 12 are 20 MiniCases—13 are brand-new MiniCases, many of which focus on China and Chinese companies competing in the West, and the remaining 7 are updated from the first edition.

- Four brand-new full-length Cases (Facebook, McDonald's, BlackBerry, and Amazon) are available through McGraw-Hill Create (including financial data in e-format for analysis available through McGraw-Hill Connect).
- There is continued focus on providing a streamlined presentation by dropping some material when adding new content. This focus results in a fast-paced, reader-friendly text.

CHAPTER 1

- New ChapterCase about Apple's rise and current challenges to sustain a competitive advantage.
- Draws on Rumelt's insightful book *Good Strategy, Bad Strategy* to more clearly delineate the concept of strategy.
- Sharpened the definitions of strategy and competitive advantage. Part of this involved removing the section on "strategy as a theory of how to compete."
- Moved all stakeholder material (from Chapter 12) into Chapter 1.
- Now includes an extensive discussion of stakeholder strategy and corporate social responsibility in Chapter 1, to provide the foundation for that concept throughout the chapters.
- Moved a revised section of "Formulating Strategy Across Levels" to Chapter 2.
- Moved discussion on business models to Chapter 5, where it could be expanded.
- New Strategy Highlight 1.1 discussing the difficulty JetBlue experienced in trying to combine two different competitive strategies (low cost and differentiation).
- New Strategy Highlight 1.2 about BP's 2010 Gulf Coast oil spill and systemic safety issues over the last decade.
- New discussion and ethical/social issues questions about stakeholder relationships.
- Two new small-group exercises (one on black swan events and the other about the dangers of unclear choice of strategy).

CHAPTER 2

- New ChapterCase, about Indra Yoori as a strategic leader.
- Tightened chapter by moving/deleting section on strategic intent, thereby more closely linking discussions of vision and mission.
- Added extended coverage of strategic leadership (previously in Chapter 12) into Chapter 2, to highlight the role of strategic leaders early on in the chapters.
- Added a revised and updated section on formulating strategy across business levels (from Chapter 1 in 1e), with more examples provided; leads into coverage of the strategic management and types of strategic planning.
- Emphasized the role of strategic leaders in shaping strategy formulation and the strategy process.
- New Strategy Highlight 2.1 on Merck's core values and the development of drugs to treat river blindness and the challenges with the Vioxx recall.
- Added new ethical/social issues question asking students to identify whether actual company vision/mission statements are customer- or product-oriented, or a combination.
- Added a new small-group exercise related to STEM (science, technology, engineering, and math) disciplines and U.S. competitiveness.

CHAPTER 3

- New ChapterCase about Tesla Motors and the U.S. automotive industry.
- Sharpened the PESTEL discussion by subsuming Political/Legal factors and updating examples.
- Added new Strategy Highlight 3.1 on the Eurozone crisis (in the PESTEL discussion).
- Significantly expanded discussion of Porter's five forces to allow for in-depth treatment with current example (including new Strategy Highlight 3.2 on the five forces in the airline industry).
- Added B-section titled "Competition in the Five Forces Model" to highlight two key assumptions in this model.
- Subsumed structure-conduct-performance (SCP) model under "Rivalry among Existing Competitors" following Porter's seminal work in *Competitive Strategy.*
- Expanded discussion of SWOT with application example.
- Added new C-heads under threat of entry: network effects, economies of scale, customer switching costs, capital requirements, advantages independent of size, government policy, and threat of retaliation.
- Expanded the section on rivalry among existing competitors: Moved the discussion of industry structure and types into this section (the fifth force), in the subsection on competitive industry structure.
- Added Exhibit 3.4, "The Five Forces Competitive Analysis Checklist."
- Added small-group exercise (ethical/social issues) asking students to propose new guidelines for helping Kraft promote food to children in a socially responsible way.

CHAPTER 4

- New ChapterCase 4: Nike's Core Competency: The Risky Business of Fairy Tales
- Changes in chapter sequence: (1) Moved the section on how to sustain a competitive advantage to precede the value chain *section.* (2) Also moved the section on dynamic capabilities to earlier in the chapter; now precedes the value chain analysis.
- In the value chain analysis section, provided examples for low-cost and differentiated value chain.
- New Strategy Highlight 4.1: Applying VRIO: The rise and fall of Groupon.
- Discussed Circuit City as an in-text example of what happens when not reinvesting, honing, and upgrading core competencies.
- Expanded discussion of SWOT and added analysis of McDonald's in the implications for the strategist section.
- Used a new example for path dependence—why the U.S. carpet industry is based in Georgia.
- Added *activities, capabilities, dynamic capabilities,* and *isolating mechanisms* as key terms.
- Sharpened definitions and treatment of differences among *resource, capability,* and *core competence* in both text and art.
- New discussion question asks students to conduct a value chain analysis for McDonald's and then analyze whether changes in its priorities affected its value chain.
- Small-Group Exercise 2 asks students to build on the Groupon Strategy Highlight in the chapter in ways that will build dynamic capabilities and make its competencies more difficult to imitate.

CHAPTER 5

- New ChapterCase, focusing on Apple vs. BlackBerry.
- Rearranged topics in first section (on firm performance), to put accounting profitability first, followed by shareholder value creation, and then economic value creation, balanced scorecard, and triple bottom line.
- Used Apple and BlackBerry data to analyze and compare profitability.
- Updated exhibits related to accounting profitability (e.g., stock market valuations of Amazon, Apple, Google, Microsoft, and Samsung; market capitalization of Apple).
- In shareholder value section, added key term *market capitalization*.
- Added section on corporate social responsibility, in triple bottom line section.
- Added section on business models (razor-razor blade; subscription-based; pay as you go; freemium).
- In the business models section, added a detailed discussion of business model innovation, an in-text example about Zipcar, and a Strategy Highlight about Threadless.
- Revised the economic value creation discussion to focus on two companies, with the same costs but slightly different strategies. Added two new exhibits showing economic value creation for two different firms (situations)—Exhibits 5.5 and 5.6.
- New discussion question related to the Threadless Strategy Highlight.
- Added a new small-group exercise asking students to prepare a presentation in support of the triple-bottom-line approach.

CHAPTER 6

- New ChapterCase, about recent strategic initiatives at P&G that were intended to help strengthen its competitive position, including bringing back A. G. Lafley.
- New Strategy Highlight 6.1 on Whole Foods (was the ChapterCase in 1e).
- Revised integration strategy example uses stores (Nordstrom, Target, Walmart) rather than cosmetics companies.
- Moved discussion of integration strategy at the corporate level to Chapter 8.
- Added new heading for stuck in the middle (“Integration Strategy ‘Gone Bad’”) and used JCPenney as a text example.
- Moved discussion of mass customization into the section on integrated strategy.
- Clarified Exhibit 6.6 on effects of learning and experience.
- Reconceptualized the exhibit on value and cost drivers (now Exhibit 6.10).
- Changed ethical/social issue questions about scale of production and learning curves to a discussion question.
- Added a new ethical/social issue question relating to Whole Foods’ business strategy and healthy foods.

CHAPTER 7

- Updated ChapterCase about Wikipedia.
- New section on the innovation process, introducing the “four I’s”—idea, invention, innovation, imitation.
- Expanded section on entrepreneurship, including corporate and social entrepreneurship.
- Expanded the discussion of the industry life cycle section, including a subsection on the “shakeout stage.”

- Added a new application of the industry life cycle to the smartphone industry in emerging and developed economies.
- Added Geoffrey Moore's "crossing the chasm" framework (unique to this text), including a text example of the application of this model to innovation in the smartphone industry.
- Added a subsection, including exhibits, on closed versus open innovation.
- Updated the discussion on accelerating technological change and moved the exhibit (from Chapter 1 in 1e).
- Clarified the text and retitled the exhibit on product and process innovation and the emergence of an industry standard, to make clear that this concept applies throughout the entire industry life cycle.
- New key terms added: *first-mover advantages, invention, patent, crossing the chasm, innovation ecosystem, organizational inertia, Pareto principle, closed innovation, open innovation.*
- Added a discussion question asking students to think about the effect of the Internet on retailing and how retailers might respond.
- Added a discussion question asking students to explore stories about *low-tech* innovations.
- Added a small-group exercise related to P&G's Connect + Develop open innovation system.

CHAPTER 8

- In the discussion of transaction cost economics, clarified the discussion on economies of scale and economies of scope. Also, changed discussion of the *scope of the firm* to the *boundaries of the firm.*
- Added new Exhibit 8.1 showing internal and external transaction costs, to aid students in understanding this somewhat abstract but critical concept in corporate strategy.
- Moved discussion of integration strategy at the corporate level to this chapter, where it now appears as Strategy Highlight 8.2 on the Tata Group, a multinational conglomerate.
- Added Exhibit 8.12 on dynamic corporate strategy, contrasting Nike and adidas.
- In Exhibit 8.2, added "Transaction-specific investments" in the Advantages/Firm box.
- Deleted all references to *horizontal integration.*
- Added as key terms *internal transaction costs, external transaction costs, core competence-market matrix,* and *strategic alliances.*
- Expanded Discussion Question 2 to apply it to Delta's vertical integration decision.
- Expanded Ethical/Social Issues Question 1 to ask students how firms can outsource HR management systems but continue to show their commitment to employees.

CHAPTER 9

- New ChapterCase about Disney and its serial acquisitions of Pixar, Marvel, and Lucas Films. Expanded and updated the discussion of M&A and its strategic alliances.
- Moved discussion of principal–agent problems to first in the list of reasons for mergers.
- Added discussion of *real-options perspective* into the section on strategic alliances.
- Added discussion of the new build-borrow-or-buy framework (Capron and Mitchell), with accompanying exhibit, in the *Implications for the Strategist* section.

- Added examples of serial acquisitions (e.g., Google bought YouTube; Google bought Waze to pre-empt Apple and FB; Google acquired Motorola's cell phone unit to be able to integrate hardware with software; Facebook bought Instagram; Yahoo bought Tumblr).
- Added as key terms: *co-opetition, build-borrow-or-buy framework.*
- Added discussion question about expected failure rates when merging with competitors as opposed to acquiring smaller companies.
- Added new ethical/social issues question about IKEA's strategic use of nonequity alliances and stakeholder partnerships.
- Added a new small-group exercise about the wave of consolidations in the U.S. office furniture-manufacturing industry located primarily in Michigan.
- Revised the second small-group exercise about social media usage in 2012 by the Fortune Global 100 companies.

CHAPTER 10

- Updated the ChapterCase with new data about the global appeal of Hollywood movies especially in regard to China.
- Revised the discussion of the integration-responsiveness framework to use more traditional terminology: international strategy, multidomestic strategy, global-standardization strategy, transnational strategy.
- Changed discussion of the stages of globalization from a Strategy Highlight box to text.
- Added discussion of Ghemawat's *World 3.0* framework.
- Clarified discussion of the disadvantages of expanding internationally.
- Added the CAGE (cultural, administrative, geographic, and economic) distance framework by Ghemawat (unique to this strategy text), with an accompanying exhibit.
- Streamlined coverage of Hofstede's national culture model.
- Added MTV as an example of an ineffective global-standardization strategy: started with global strategy, moved to multidomestic, now moving to transnational strategy.
- Added new Exhibit 10.6 to show dynamic strategic positioning for MTV Music Channel.
- Added as key terms: *CAGE distance framework, multidomestic strategy.*
- Added Discussion Question 3 about Ghemawat argument that the world isn't "flat" but is "semi-globalized."
- Added a new Ethical/Social Issues section question asking students to predict the persistence of Globalization 3.0 and to project what Globalization 4.0 might look like.
- Added Small-Group Exercise 1 about employment changes as U.S. companies become more globalized.
- Added new *my*Strategy feature about a personal strategy for building the three components of a global mind-set.

CHAPTER 11

- Introduced new model of how to assess strategic initiatives in regard to time horizon and resources required.
- Expanded discussion of SWOT implementation with application example (McDonald's) in the "Implications for the Strategist" section.
- Added and discussed key term: *core rigidity.*
- Added new Discussion Question 2 asking students to describe the values, norms, and artifacts of an organization with which they are familiar.

- Added new Ethical/Social Issues section question about organization culture and sports teams.
- Added a new small-group exercise asking students to think about how a university might apply the ROWE theory.

CHAPTER 12

- New ChapterCase on the continuing boardroom soap opera at Hewlett-Packard (highlighting how much HP deviated from its celebrated HP Way, shown in Exhibit 12.1).
- Strengthened the focus on the board of directors as a key corporate governance mechanism.
- Expanded the discussion of corporate governance and moved it to earlier in the chapter. Expansion includes more on agency theory (with related exhibit), adverse selection, moral hazard.
- Integrated discussion (and related exhibit) of a survey about attitudes toward corporate social responsibility across the globe.
- Added new discussion of Porter's shared value creation framework (unique to this text).
- Added current examples: Galleon Group's founder, Raj Rajaratnam; Carl Icahn's attempted LBO of Dell; Fabrice Tourre of Goldman Sachs.
- Added as key terms: *shared value creation framework, adverse selection, moral hazard, leveraged buyout.*
- Added new Strategy Highlight 12.2 on securities fraud by Fabrice Tourre at Goldman Sachs, and the resulting revision to Goldman's code of conduct.
- Moved section on strategic leadership to Chapter 2.
- Moved stakeholder impact analysis to Chapter 1.
- Moved discussion of corporate social responsibility to Chapters 1 and 5.
- Added new discussion question about the Business Roundtable's recommendation that the CEO not also serve as chairman of the board.
- Added new discussion question about how Nike might apply the shared value creation framework to global economic and social needs.
- Revised questions related to Small-Group Exercise 2 about the female and minority participation on corporate boards.

MINICASES

- Added 13 brand-new MiniCases, many of which focus on China and Chinese companies competing in the West.
- Updated seven MiniCases from the first edition.

FULL-LENGTH CASES

- Added four brand-new, full-length Cases: Facebook, McDonald's, BlackBerry, and Amazon.
- Revised and updated: BetterWorldBooks, Tesla Motors, Numenta, Best Buy, and Apple.
- **All cases**—including the new and revised cases plus all cases from the first edition that were authored by Frank Rothaermel—**are available through McGraw-Hill Create.** Cases include financial data in e-format for analysis.

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  - The **Instructors Manual (IM)** includes thorough coverage of each chapter. New in this edition, we offer two versions of the IM, for newer and experienced faculty. Included in both versions are the appropriate level of theory, recent application or company examples, teaching tips, PowerPoint references, critical discussion topics, and answers to end-of-chapter exercises.
  - The **PowerPoint (PPT)** slides provide comprehensive lecture notes, video links, and company examples not found in the textbook. There will be instructor media-enhanced slides as well as notes with outside application examples.
  - The **Test Bank** includes 100–150 questions per chapter, in a range of formats and with a greater-than-usual number of comprehension, critical-thinking, and application (or scenario-based) questions. It's tagged by learning objective, Bloom's Taxonomy levels, and AACSB compliance requirements.
  - **Links to videos** that relate to concepts from chapters. The video links include sources such as Big Think, Stanford University's Entrepreneurship Corner, *The McKinsey Quarterly,* ABC, BBC, CBS, CNN, ITN/Reuters, MSNBC, NBC, PBS, and YouTube.
- The **Online Learning Center (OLC),** located at www.mhhe.com/ftrStrategy2e, offers resources for both instructors and students:
  - At the **instructors' portion** of the OLC, which is password-protected, instructors can access all of the teaching resources described earlier, a Case Matrix relating cases to concepts within the chapters, and comprehensive Case Teaching Notes, including case financial analysis.
  - At the **students' portion** of the OLC, students can take chapter quizzes to review concepts and click on links to videos that relate back to concepts covered in the chapter and/or cases.

Frank Rothaermel was closely involved in developed all ancillaries, to ensure full integration with the strategy content in the text.

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Each chapter in the book begins with a list of numbered learning objectives, which appear throughout the chapter as well as in the end-of-chapter assignments. Every Test Bank question for *Strategic Management* maps to a specific chapter learning objective in the textbook. Each Test Bank question also identifies topic area, level of difficulty, Bloom's Taxonomy level, and AACSB skill area. You can use our Test Bank software, *EZ Test* and *EZ Test Online,* or *Connect Management* to easily search for learning objectives that directly relate to the learning objectives for your course. You can then use the reporting features of *EZ Test* to aggregate student results in a similar fashion, making the collection and presentation of Assurance of Learning data simple and easy.

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Acknowledgments

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I have long yearned to write a text that shows students and managers how exciting strategic management can be, but that at the same time presents the recent developments in the field, including the rigor upon which concepts and frameworks are now built, to make better strategic decisions in a turbulent and dynamic world. I'm fortunate that I had the support of many people to make this vision become a reality, and I'm truly grateful.

Frank T. Rothaermel
Georgia Institute of Technology

Web: http://ftrStrategy.com
Strategy Blog: http://www.facebook.com/ftrStrategy
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THANK YOU . . .

This book has gone through McGraw-Hill Education's thorough development process. Over the course of several years, the project has benefited from numerous developmental focus groups and symposiums, from hundreds of reviews from reviewers across the country, and from beta-testing of the first-edition manuscript on a variety of campuses. The author and McGraw-Hill wish to thank the following people who shared their insights, constructive criticisms, and valuable suggestions throughout the development of this project. Your contributions have improved this product.

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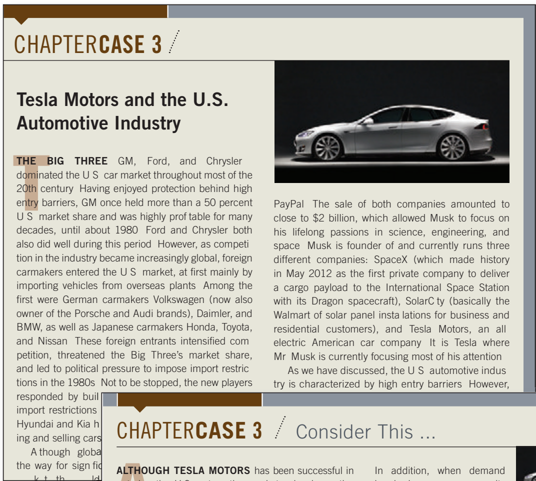


CHAPTER**CASE 3** /

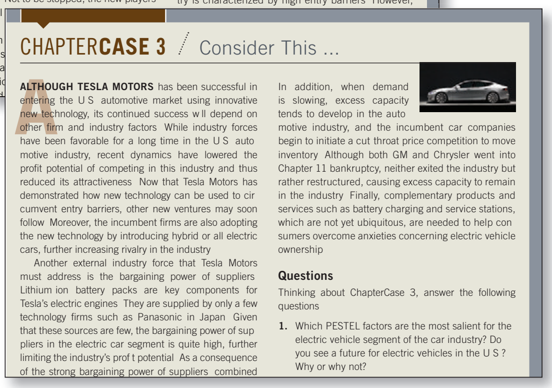
Tesla Motors and the U.S. Automotive Industry

THE BIG THREE GM, Ford, and Chrysler dominated the U S car market throughout most of the 20th century Having enjoyed protection behind high entry barriers, GM once held more than a 50 percent U S market share and was highly prof table for many decades, until about 1980 Ford and Chrysler both also did well during this period However, as competi tion in the industry became increasingly global, foreign carmakers entered the U S market, at first mainly by importing vehicles from overseas plants Among the first were German carmakers Volkswagen (now also owner of the Porsche and Audi brands), Daimler, and BMW, as well as Japanese carmakers Honda, Toyota, and Nissan These foreign entrants intensified com petition, threatened the Big Three's market share, and led to political pressure to impose import restric tions in the 1980s Not to be stopped, the new players responded by buil import restrictions Hyundai and Kia h ing and selling cars

A though globa the way for sign fic

PayPal The sale of both companies amounted to close to $2 billion, which allowed Musk to focus on his lifelong passions in science, engineering, and space Musk is founder of and currently runs three different companies: SpaceX (which made history in May 2012 as the first private company to deliver a cargo payload to the International Space Station with its Dragon spacecraft), SolarC ty (basically the Walmart of solar panel insta lations for business and residential customers), and Tesla Motors, an all electric American car company It is Tesla where Mr Musk is currently focusing most of his attention

As we have discussed, the U S automotive indus try is characterized by high entry barriers However,



CHAPTER**CASE 3** / Consider This ...

ALTHOUGH TESLA MOTORS has been successful in entering the U S automotive market using innovative new technology, its continued success w ll depend on other firm and industry factors While industry forces have been favorable for a long time in the U S auto motive industry, recent dynamics have lowered the profit potential of competing in this industry and thus reduced its attractiveness Now that Tesla Motors has demonstrated how new technology can be used to cir cumvent entry barriers, other new ventures may soon follow Moreover, the incumbent firms are also adopting the new technology by introducing hybrid or all electric cars, further increasing rivalry in the industry

Another external industry force that Tesla Motors must address is the bargaining power of suppliers Lithium ion battery packs are key components for Tesla's electric engines They are supplied by only a few technology firms such as Panasonic in Japan Given that these sources are few, the bargaining power of sup pliers in the electric car segment is quite high, further limiting the industry's prof t potential As a consequence of the strong bargaining power of suppliers combined

In addition, when demand is slowing, excess capacity tends to develop in the auto motive industry, and the incumbent car companies begin to initiate a cut throat price competition to move inventory Although both GM and Chrysler went into Chapter 11 bankruptcy, neither exited the industry but rather restructured, causing excess capacity to remain in the industry Finally, complementary products and services such as battery charging and service stations, which are not yet ubiquitous, are needed to help con sumers overcome anxieties concerning electric vehicle ownership

Questions

Thinking about ChapterCase 3, answer the following questions

1. Which PESTEL factors are the most salient for the electric vehicle segment of the car industry? Do you see a future for electric vehicles in the U S ? Why or why not?

ChapterCases bookend the chapter topic and focus on companies and industries of interest to students. The opening statement lays out a situation or issue that the chapter will address. The "**Consider This…**" section at the end of the chapter introduces additional information, plus concepts and information from the chapter to extend and complete the ChapterCase example. Questions in the "Consider This…" section are good jumping-off points for class discussion.

Twenty **MiniCases**, with suggested links to related chapters, follow Chapter 12. These short cases focus on a decision scenario that a company's manager might face. They offer dynamic opportunities to apply strategy concepts by assigning them as add-ons to chapters, either as individual assignments or as group work, or by using them for class discussion. In this second edition, half of the MiniCases focus on global companies.

Mini**Case** 10 /

From Good to Great to Gone: The Rise and Fall of Circuit City

IN THE 1990S Circuit City was the largest and most successful consumer electronics retai er in the Un ted States Indeed Circuit City was so successful it was included as one of only 11 companies featured in Jim Coll ns' bestseller *Good to Great* To qualify for th s august group of h gh performers a company had to attain "extraordinary results averaging cumula tive stock returns 6 9 times the general market in the 15 years following their transition points "[1] Indeed Circuit City was *the best performing* company on Collins' good to great list ou performing the stock market 18 5 t mes during the 1982 1997 period

How did Circuit City become so successful? The company was able to build and refine a set of core competencies that enabled it to create a higher eco nomic value than its competitors In particular Circuit City created world class competenc es in effic ent and effective logist cs exper ise It deployed sophis i cated point of sale and inventory racking technology supported by IT investments hat enabled the firm to connect the flow of information among geographi cally dispersed s ores Th s expertise in turn a lowed deta led tracking of customer preferences and enabled Circuit City to respond quickly to changing rends The company also relied on highly motiva ed we l trained sales personnel to provide superior service and thus build and maintain customer loyalty These core competencies enabled Circuit City to implement a "4S business model" service se ection sav ngs and satisfaction that it applied to big t cket consumer electronics with an unmatched degree of consistency throughout the United States

Perhaps even more mportant during the company's high performance run many capable competi ors were unable to replicate C rcuit C ty's core competen cies Further underscor ng Circuit City's superior per formance s the fact as Jim Collins described it hat "if you had to choose between $1 inves ed in Circuit City or $1 inves ed in General Electric on the day that the legendary Jack Welch took over GE in 1981 and he d [that investment] to January 1 2000 you would have been better off with Circuit C ty by [a factor of]

SOURCE http //www wired com/gadge lab/2009 03/ci cuit city st/

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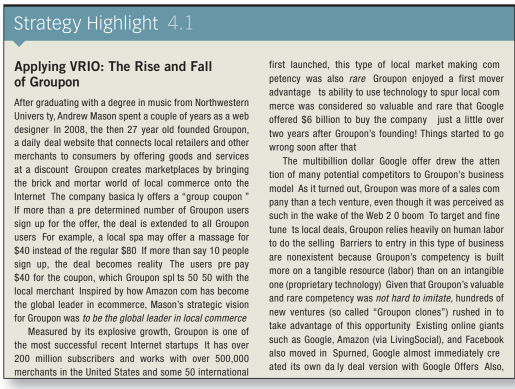
Get Them **Thinking** . . .



Strategy Highlight 4.1

Applying VRIO: The Rise and Fall of Groupon

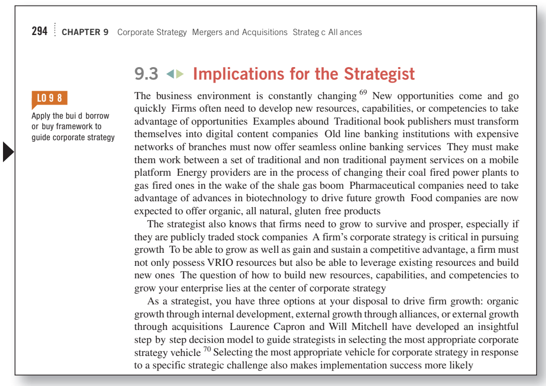
After graduating with a degree in music from Northwestern Univers ty, Andrew Mason spent a couple of years as a web designer In 2008, the then 27 year old founded Groupon, a daily deal website that connects local retailers and other merchants to consumers by offering goods and services at a discount Groupon creates marketplaces by bringing the brick and mortar world of local commerce onto the Internet The company basica ly offers a "group coupon " If more than a pre determined number of Groupon users sign up for the offer, the deal is extended to all Groupon users For example, a local spa may offer a massage for $40 instead of the regular $80 If more than say 10 people sign up, the deal becomes reality The users pre pay $40 for the coupon, which Groupon spl ts 50 50 with the local merchant Inspired by how Amazon com has become the global leader in ecommerce, Mason's strategic vision for Groupon was *to be the global leader in local commerce*

Measured by its explosive growth, Groupon is one of the most successful recent Internet startups It has over 200 million subscribers and works with over 500,000 merchants in the United States and some 50 international first launched, this type of local market making competency was also *rare* Groupon enjoyed a first mover advantage ts ability to use technology to spur local commerce was considered so valuable and rare that Google offered $6 billion to buy the company just a little over two years after Groupon's founding! Things started to go wrong soon after that

The multibillion dollar Google offer drew the attention of many potential competitors to Groupon's business model As it turned out, Groupon was more of a sales company than a tech venture, even though it was perceived as such in the wake of the Web 2 0 boom To target and fine tune ts local deals, Groupon relies heavily on human labor to do the selling Barriers to entry in this type of business are nonexistent because Groupon's competency is built more on a tangible resource (labor) than on an intangible one (proprietary technology) Given that Groupon's valuable and rare competency was *not hard to imitate*, hundreds of new ventures (so called "Groupon clones") rushed in to take advantage of this opportunity Existing online giants such as Google, Amazon (via LivingSocial), and Facebook also moved in Spurned, Google almost immediately created its own da ly deal version with Google Offers Also,

Strategy Highlight boxes apply a specific concept to a specific company. Two per chapter, they are long enough to contain valuable insights, yet short enough to encourage student reading.

NEW in this edition, **Implications for the Strategist** sections present practical implications of the concepts and frameworks discussed in the chapter. They enable the student to build a cumulative toolkit in strategic management that bridges the gap between theory and practice.



294 | CHAPTER 9 Corporate Strategy Mergers and Acquisitions Strateg c All ances

9.3 Implications for the Strategist

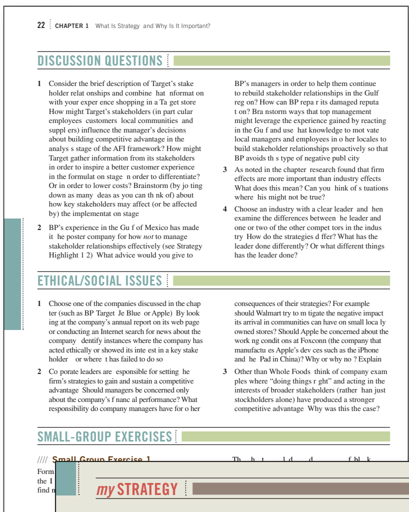
LO 9 8

Apply the bui d borrow or buy framework to guide corporate strategy

The business environment is constantly changing[69] New opportunities come and go quickly Firms often need to develop new resources, capabilities, or competencies to take advantage of opportunities Examples abound Traditional book publishers must transform themselves into digital content companies Old line banking institutions with expensive networks of branches must now offer seamless online banking services They must make them work between a set of traditional and non traditional payment services on a mobile platform Energy providers are in the process of changing their coal fired power plants to gas fired ones in the wake of the shale gas boom Pharmaceutical companies need to take advantage of advances in biotechnology to drive future growth Food companies are now expected to offer organic, all natural, gluten free products

The strategist also knows that firms need to grow to survive and prosper, especially if they are publicly traded stock companies A firm's corporate strategy is critical in pursuing growth To be able to grow as well as gain and sustain a competitive advantage, a firm must not only possess VRIO resources but also be able to leverage existing resources and build new ones The question of how to build new resources, capabilities, and competencies to grow your enterprise lies at the center of corporate strategy

As a strategist, you have three options at your disposal to drive firm growth: organic growth through internal development, external growth through alliances, or external growth through acquisitions Laurence Capron and Will Mitchell have developed an insightful step by step decision model to guide strategists in selecting the most appropriate corporate strategy vehicle[70] Selecting the most appropriate vehicle for corporate strategy in response to a specific strategic challenge also makes implementation success more likely



22 | CHAPTER 1 What Is Strategy and Why Is It Important?

DISCUSSION QUESTIONS

1 Consider the brief description of Target's stakeholder relat onships and combine hat nformat on with your exper ence shopping in a Ta get store How might Target's stakeholders (in part cular employees customers local communities and suppl ers) influence the manager's decisions about building competitive advantage in the analys s stage of the AFI framework? How might Target gather information from its stakeholders in order to inspire a better customer experience in the formulat on stage n order to differentiate? Or in order to lower costs? Brainstorm (by jo ting down as many deas as you can th nk of) about how key stakeholders may affect (or be affected by) the implementat on stage

2 BP's experience in the Gu f of Mexico has made it he poster company for how *not* to manage stakeholder relationships effectively (see Strategy Highlight 1 2) What advice would you give to BP's managers in order to help them continue to rebuild stakeholder relationships in the Gulf reg on? How can BP repa r its damaged reputat on? Bra nstorm ways that top management might leverage the experience gained by reacting in the Gu f and use hat knowledge to mot vate local managers and employees in o her locales to build stakeholder relationships proactively so that BP avoids th s type of negative publ city

3 As noted in the chapter research found that firm effects are more important than industry effects What does this mean? Can you hink of s tuations where his might not be true?

4 Choose an industry with a clear leader and hen examine the differences between he leader and one or two of the other compet tors in the indus try How do the strategies d ffer? What has the leader done differently? Or what different things has the leader done?

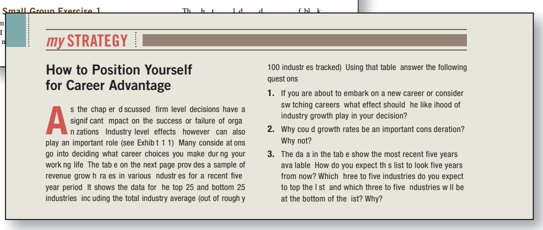
ETHICAL/SOCIAL ISSUES

1 Choose one of the companies discussed in the chapter (such as BP Target Je Blue or Apple) By looking at the company's annual report on its web page or conducting an Internet search for news about the company dentify instances where the company has acted ethically or showed its inte est in a key stakeholder or where t has failed to do so

2 Co porate leaders are esponsible for setting he firm's strategies to gain and sustain a competitive advantage Should managers be concerned only about the company's f nanc al performance? What responsibility do company managers have for o her consequences of their strategies? For example should Walmart try to m tigate the negative impact its arrival in communities can have on small loca ly owned stores? Should Apple be concerned about the work ng condit ons at Foxconn (the company that manufactu es Apple's dev ces such as the iPhone and he Pad in China)? Why or why no ? Explain

3 Other than Whole Foods think of company examples where "doing things r ght" and acting in the interests of broader stakeholders (rather han just stockholders alone) have produced a stronger competitive advantage Why was this the case?

SMALL-GROUP EXERCISES



my STRATEGY

How to Position Yourself for Career Advantage

As the chap er d scussed firm level decisions have a signif cant mpact on the success or failure of orga n zations Industry level effects however can also play an important role (see Exhib t 1 1) Many conside at ons go into deciding what career choices you make dur ng your work ng life The tab e on the next page prov des a sample of revenue grow h ra es in various ndustr es for a recent five year period It shows the data for he top 25 and bottom 25 industries inc uding the total industry average (out of rough y 100 industr es tracked) Using that table answer the following quest ons

1. If you are about to embark on a new career or consider sw tching careers what effect should he like ihood of industry growth play in your decision?

2. Why cou d growth rates be an important cons deration? Why not?

3. The da a in the tab e show the most recent five years ava lable How do you expect th s list to look five years from now? Which hree to five industries do you expect to top the l st and which three to five ndustries w ll be at the bottom of the ist? Why?

A variety of end-of-chapter features meet varying course needs:

- **Take-Away Concepts** (chapter summaries) and **Key Terms** help students review important content.
- **Discussion Questions, Social/Ethical Issues,** and **Small-Group Exercises** have been updated to more closely link chapter concepts and provide newly updated examples and applications.
- The **Strategy Term Project** provides an extended, "hands-on" project, divided across chapters into a series of focused, targeted tasks.
- The ***my*Strategy** feature shows students how to internalize and apply strategy concepts to their lives and careers.

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Available for Rothaermel, 2e, Connect is an integrated technology solution that increases student engagement and comprehension, automates assignment delivery and grading, and through a variety of reports monitors whether learning objectives are met. Connect Strategic Management provides a wide array of tools and content to improve student performance.

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Distinguishing what students know from what they don't, and honing in on concepts they are most likely to forget, LearnSmart continuously adapts to each student's needs by building an individual learning path so students study smarter and retain more knowledge.

Smartbook™

Fueled by LearnSmart—SmartBook is the first and only adaptive reading experience available today.

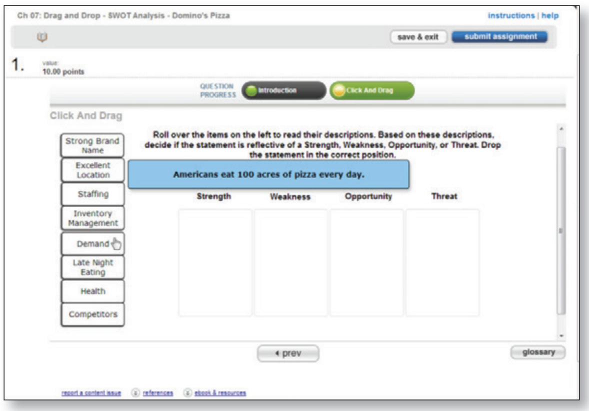
Assessing what a student knows or doesn't know, and focusing on the concepts the student is likely to forget, SmartBook personalizes content for each student in a continuously adapting reading experience. Reading is no longer a passive and linear experience, but an engaging and dynamic one, through which students are more likely to master and retain important concepts, coming to class better prepared. Valuable reports provide instructors insight as to how students are progressing through textbook content, which is useful for shaping in-class time and assessments.

As a result of the adaptive reading experience found in SmartBook, students are more likely to retain knowledge, stay in class, and get better grades. This revolutionary technology is available only from McGraw-Hill Education and for hundreds of course areas as part of the LearnSmart Advantage series.

CONNECT FEATURES

Running Case

Students will begin by reviewing a specific company and the company's applied strategy using appropriate tools (e.g., PESTEL, Porter's Five Forces, VRIO, SWOT, and others). The analysis will progress from a broad global view, to an industry view, to a strategic group view, and then focus on the company itself, moving from a broad perspective to the appropriate company-level perspective. Students will develop a strategic analysis for the company and consider several scenarios for the company to improve its competitive advantage. The scenarios will include a financial analysis and justification and ultimately provide a specific recommendation.



Interactive Applications

Interactive Applications offer a variety of automatically graded exercises that require students to **apply** key concepts. Whether the assignment includes a *drag and drop, video case, timeline/sequencing,* or *case analysis*, these applications provide instant feedback and progress tracking for students, and detailed results for the instructor.

Resources for Analysis

Resources for student analysis of industries, companies, and strategies include:

- **Templates for strategic financial analysis** and a **How to do a case analysis guide**, complete with financial ratios used to compare performance between firms.
- A **financial review activity**—for students who wish to *refresh* or *extend* their working knowledge of major financial measures in a strategic framework.

Connect Instructor's Manual

New to this edition is a guidebook to walk instructors through the various Connect content available with 2e. It comes complete with general Connect recommendations, screen shots of interactive applications to reference for use with chapters, and suggested follow-up activities.

PART 1

Strategy Analysis

The AFI Strategy Framework

Chapter 1

What Is Strategy, and Why Is It Important?

Chapter Outline

Learning Objectives

After studying this chapter, you should be able to:

LO 1-1 Explain the role of strategy in a firm's quest for competitive advantage.

LO 1-2 Define competitive advantage, sustainable competitive advantage, competitive disadvantage, and competitive parity.

LO 1-3 Differentiate the roles of firm effects and industry effects in determining firm performance.

LO 1-4 Evaluate the relationship between stakeholder strategy and sustainable competitive advantage.

LO 1-5 Conduct a stakeholder impact analysis.

CHAPTERCASE 1

Apple: Once the World's Most Valuable Company

ON AUGUST 20, 2012, Apple's stock market valuation reached $623 billion, making it the most valuable public company of all time.[1] A mere 15 years earlier, Apple would likely have gone bankrupt if archrival Microsoft (which enjoyed the same position with a valuation of $615 billion in December 1999) had not invested $150 million in Apple. How did Apple become so successful?

Apple became the world's most successful company due to a powerful competitive strategy. That strategy, conceptualized by co-founder Steve Jobs, combines innovation in products, services, and business models. From near-bankruptcy in 1997, Apple's revitalization really took off in the fall of 2001 when it introduced the iPod, a portable digital music player. Eighteen months later, Apple soared even higher when it opened the online store iTunes, quickly followed by its first retail stores. Apple's stores now earn the highest sales per square foot of any retail outlets, including luxury stores such as Tiffany & Co. jewelry or LVMH, purveyor of fine handbags and other luxury goods.

Apple didn't stop there. In 2007, the company revolutionized the smartphone market with the introduction of the iPhone. Just three years later, Apple created the tablet computer industry by introducing the iPad, thus beginning to reshape the publishing and media industries. Further, for each of its iPod, iPhone, and iPad lines of businesses, Apple followed up with incremental product innovations extending each product category. By combining tremendous brain power, intellectual property, and iconic brand value, Apple has enjoyed dramatic increases in revenues. More traditional firms such as Exxon Mobil and GE—each at one time the world's most valuable company—can now only dream of such results.

In the fall of 2012, investors' expectations of Apple's future growth potential in burgeoning industries such as the mobile Internet, TV, and other media propelled its share price to over $700. Some analysts contend that Apple may become the first $1 trillion company on the planet. What will it take to achieve that? To do so, Apple must continue to find new industries to revolutionize, while at the same time increase its global market penetration in emerging economies such as China and India.[2]

After reading this chapter, you will find more about this case, along with related questions, on page 19.

WHY WAS APPLE so successful? Why did Microsoft's once superior market valuation evaporate? Why did Apple's competitors such as Sony, Dell, Hewlett-Packard (HP), Nokia, and BlackBerry struggle? What must Apple do to sustain its competitive advantage, especially in light of strong performances by competitors such as Google, Amazon, and Samsung? For that matter, why is any company successful? What enables some firms to gain and then sustain their competitive advantage over time? Why do once-great firms fail? How can a firm's managers influence performance? These are the big questions that define strategic management. Answering these questions requires integrating the knowledge you've obtained in your studies of various business disciplines to understand what leads to superior performance.

strategic management An integrative management field that combines analysis, formulation, and implementation in the quest for competitive advantage.

Strategic management is the integrative management field that combines *analysis, formulation,* and *implementation* in the quest for competitive advantage. Mastery of strategic management enables you to view a firm in its entirety. It also enables you to think like a general manager to help position your firm for superior performance. The *AFI strategy framework* (shown on page 1) embodies this view of strategic management.

In this chapter, we lay the groundwork for the study of strategic management. We'll introduce some foundational ideas about strategy and competitive advantage and then consider the role of business in society. Next, we take a closer look at the components of the AFI framework and provide an overview of the entire strategic management process. We conclude this introductory chapter, as we do with all others in this text, with a section entitled *Implications for the Strategist.* Herein, we provide practical applications and considerations of the material developed in the chapter. Let's begin the exciting journey to understand strategic management and competitive advantage.

1.1 What Strategy Is: Gaining and Sustaining Competitive Advantage

LO 1-1

Explain the role of strategy in a firm's quest for competitive advantage.

strategy The set of goal-directed actions a firm takes to gain and sustain superior performance relative to competitors.

Strategy is a set of goal-directed actions a firm takes to gain and sustain superior performance *relative* to competitors.[3] To achieve superior performance, companies compete for resources: New ventures compete for financial and human capital. Existing companies compete for profitable growth. Charities compete for donations, and social networks compete for members. In any competitive situation, a *good strategy* enables a firm to achieve superior performance.

A *good strategy* consists of three elements:[4]

1. A *diagnosis* of the competitive challenge. This element is accomplished through strategy *analysis* of the firm's external and internal environments (Part 1 of the AFI framework).
2. A *guiding policy* to address the competitive challenge. This element is accomplished through strategy *formulation,* resulting in the firm's corporate, business, and functional strategies (Part 2 of the AFI framework).
3. A *set of coherent actions* to implement the firm's guiding policy. This element is accomplished through strategy *implementation* (Part 3 of the AFI framework).

Let's revisit ChapterCase 1 and see how these three elements manifest themselves in a good strategy.

THE COMPETITIVE CHALLENGE. First, consider the diagnosis of the competitive challenge. ChapterCase 1 briefly traces Apple's renewal from the year 2001, when it hit upon the product and business-model innovations of the iPod/iTunes combination. Prior to that, Apple was merely a niche player in the desktop-computing industry, and struggling financially. Steve Jobs turned the sinking company around by focusing on only two computer models (one laptop and one desktop) in each of two market segments (the professional market and the consumer market) as opposed to dozens of non-differentiated products within each segment. This streamlining of its product lineup enhanced Apple's strategic focus. Even so, the outlook for Apple was grim. Jobs believed that Apple, with less than 5 percent market share, could not win in the personal computer industry where desktops and laptops had become commoditized gray boxes. In that world, Microsoft, Intel, and Dell were the star performers. Jobs needed to create the "next big thing."[5]

A GUIDING POLICY. Next, let's consider the guiding policy. In this case, Apple shifted its competitive focus away from personal computers to mobile devices. In doing so, Apple disrupted several industries through its product and business-model innovations. Simply put, a *business model* explains how the firm intends to make money. Combining hardware (i.e., the iPod) with a complementary service product (i.e., the iTunes Store) enabled Apple to devise a new business model. Users could now download individual songs legally (at 99 cents) rather than buying an entire CD or downloading the songs illegally using Napster and other file-sharing services. The availability of the iTunes Store drove sales of iPods. Along with rising sales for the new iPod and iTunes products, demand rose for iMacs. The new products helped disrupt the existing personal computer market, because people wanted to manage their music and photos on a computer that worked seamlessly with their mobile devices. The success of the iPod/iTunes business model innovation was then leveraged to develop and launch the iPhone and the iPad.

COHERENT ACTIONS. Finally, Apple implemented its guiding policy with a set of coherent actions. Apple's coherent actions took a two-pronged approach: First, it streamlined its product lineup through a simple rule[6]—"we will make only one laptop and one desktop model for each of the two markets we serve, professional and consumer." Second, it disrupted the industry status quo through a potent combination of product and business model innovations, executed at planned intervals. These actions allowed Apple to create a string of temporary competitive advantages. Taken together, this string of temporary competitive advantages enabled the company to sustain its superior performance over a number of years.

A good strategy is more than a mere goal or a company slogan. First, a good strategy defines the competitive challenges facing an organization through a critical and honest assessment of the status quo. Second, a good strategy provides an overarching approach (policy) on how to deal with the competitive challenges identified. Last, a good strategy requires effective implementation through a coherent set of actions.

LO 1-2

Define competitive advantage, sustainable competitive advantage, competitive disadvantage, and competitive parity.

WHAT IS COMPETITIVE ADVANTAGE?

Competitive advantage is always *relative,* not absolute. To assess competitive advantage, we compare firm performance to a *benchmark*—that is, either the performance of other firms in the same industry or an industry average. A firm that achieves superior performance relative to other competitors in the same industry or the industry average has a **competitive advantage.**[7] Apple, for instance, has achieved a competitive advantage over Google, Samsung, Nokia, and BlackBerry in the smartphone industry and over Microsoft, Amazon, Samsung, and HP in the tablet computer industry. A firm that is able to outperform its competitors or the industry average over a prolonged period of time has a **sustainable competitive advantage.**

competitive advantage Superior performance relative to other competitors in the same industry or the industry average.

sustainable competitive advantage Outperforming competitors or the industry average over a prolonged period of time.

However, past performance is no guarantee of future performance. As noted in ChapterCase 1, Microsoft was once the most valuable company in the world, but has struggled to keep up with Apple. Microsoft, as well as Google, Samsung, Amazon, and others, is working hard to neutralize Apple's competitive advantage. Amazon's Kindle line of tablets and

Microsoft's Surface tablet computer compete against Apple's iPad. The question is whether Apple can continue to maintain a competitive advantage in the face of increasingly strong competition and rapidly changing industry environments. We provide an update on the ChapterCase in the *"Consider This . . ."* section at the end of this chapter.

competitive disadvantage Underperformance relative to other competitors in the same industry or the industry average.

competitive parity Performance of two or more firms at the same level.

If a firm underperforms its rivals or the industry average, it has a **competitive disadvantage.** For example, a 15 percent return on invested capital may sound like superior firm performance. In the energy industry, though, where the average return on invested capital is often above 20 percent, such a return puts a firm at a competitive disadvantage. In contrast, if a firm's return on invested capital is 2 percent in a declining industry such as newspaper publishing, where the industry average has been negative (–5 percent) for the last few years, then the firm has a competitive advantage. Should two or more firms perform at the same level, they have **competitive parity.** In Chapter 5, we'll discuss in greater depth how to evaluate and assess competitive advantage and firm performance.

To gain a competitive advantage, a firm needs to provide either goods or services consumers value more highly than those of its competitors, or goods or services similar to the competitors' at a lower price.[8] The rewards of superior value creation and capture are profitability and market share. Steve Jobs wanted to "put a ding in the universe"—making a difference by delivering products and services people love. Mark Zuckerberg built Facebook to make the world more open and connected. Google co-founders Larry Page and Sergey Brin were motivated to create a better search engine in order to make the world's information universally accessible. For Jobs, Zuckerberg, Page, Brin, and numerous other entrepreneurs and businesspeople, creating shareholder value and making money is the *consequence* of filling a need and providing a product, service, or experience consumers wanted, at a price they could afford. The important point here is that strategy is about creating superior value, while containing the cost to create it. Managers achieve this combination of value and cost through *strategic positioning.* That is, they stake out a unique position within an industry that allows the firm to provide value to customers, while controlling costs. The greater the difference between value creation and cost, the greater the firm's *economic contribution* and the more likely it will gain competitive advantage.

Strategic positioning requires *trade-offs,* however. As a low-cost retailer, Walmart has a clear strategic profile and serves a specific market segment. Upscale retailer Nordstrom's has also built a clear strategic profile by providing superior customer service to a specific market segment (luxury). Although these companies are in the same industry, their customer segments overlap very little, and they are not direct competitors. That is because Walmart and Nordstrom's each has chosen a distinct but different strategic position. The managers make conscious trade-offs that enable each company to strive for competitive advantage in the retail industry, using different competitive strategies: leadership versus differentiation. In regard to the customer service dimension, Walmart provides acceptable service by low-skill employees in a big-box retail outlet offering "everyday low prices," while Nordstrom's provides a superior customer experience by professional sales people in a luxury setting. A clear strategic profile—in terms of product differentiation, cost, and customer service—allows each retailer to meet specific customer needs. Competition focuses on creating value for customers (through lower prices or better service and selection, in this example) rather than destroying rivals. Even though Walmart and Nordstrom's compete in the same industry, both can win if they achieve a clear strategic position through a well-executed competitive strategy.

Since clear strategic positioning requires trade-offs, strategy is as much about deciding what *not* to do, as it is about deciding what to do.[9] Because resources are limited, managers must carefully consider their strategic choices in the quest for competitive advantage. Trying to be everything to everybody will likely result in inferior performance.

Strategy Highlight 1.1

JetBlue: "*Stuck in the Middle*"?

Entrepreneur David Neeleman, at the age of 25, co-founded Morris Air, a charter air service that in 1993 was purchased by Southwest Airlines (SWA). Morris Air was a low-fare airline that pioneered many cost-saving practices that later became standard in the industry, such as e-ticketing. After working as an airline executive for SWA, Neeleman founded another airline, JetBlue Airways, in 1998. When Neeleman established JetBlue, his strategy was to provide air travel at even lower costs than SWA. At the same time, he wanted to offer better service and more amenities.

JetBlue copied and improved upon many of SWA's cost-reducing activities. For example, it started out by using just one type of airplane (the Airbus A320) to lower the costs of aircraft maintenance and pilot training. It also chose to fly point to point, directly connecting highly trafficked city pairs. In contrast, legacy airlines such as Delta, United, or American use a hub-and-spoke system; such systems connect many different locations via layovers at airport hubs. The point-to-point business model focuses on directly connecting fewer but more highly trafficked city pairs. The point-to-point system lowers costs by not offering baggage transfers and schedule coordination with other airlines. In addition, JetBlue flew longer distances and transported more passengers per flight than SWA, further driving down its costs. Initially, JetBlue enjoyed the lowest cost per available seat-mile (an important performance metric in the airline industry) in the United States.

At the same time, JetBlue also attempted to enhance its differential appeal by driving up its perceived value. Its intent was to combine high-touch (to enhance the customer experience) and high-tech (to drive down costs). Some of JetBlue's value-enhancing features included high-end 100-seat Embraer regional jets with leather seats, individual TV screens with popular movie and television programming, 100 channels of XM Satellite Radio, and free in-flight Wi-Fi capabilities, along with friendly and attentive on-board service and other amenities. Also, because one-third of customers prefer speaking to a live reservation agent, despite a highly functional website for reservations and other travel-related services, JetBlue decided to employ stay-at-home parents in the United States instead of following industry best practice by outsourcing its reservation system to India. The company suggests this "home sourcing" is more productive than outsourcing; it also says that customers' appreciation of the reservation experience more than makes up for the wage differential between the U.S. and India. To sum it up, JetBlue's "Customer Bill of Rights" declared its dedication to "bringing humanity back to air travel."

In early 2007, however, JetBlue's reputation for outstanding customer service took a major hit: Several flights were delayed due to a snowstorm in which the airline kept passengers on board the aircraft; some sat on the tarmac for up to nine hours. Many wondered whether JetBlue was losing its magic touch. In May 2007, David Neeleman left JetBlue. Ever the entrepreneur, he went on to found Azul, a Brazilian airline, in 2008. For JetBlue, trying to combine a cost-leadership position with a differentiation strategy has meant that despite enjoying some early years of competitive advantage, it is now struggling to maintain that advantage.[10]

Strategy Highlight 1.1 shows how JetBlue ran into trouble by trying to combine two different competitive strategies at the same time—a *cost-leadership* strategy, focused on low cost, and a *differentiation* strategy, focused on delivering unique features and service.

Although the idea of combining different business strategies seems appealing, it is actually quite difficult to execute an *integrated* cost-leadership *and* differentiation position.

Cost leadership and differentiation are distinct strategic positions. Pursuing them at the same time results in trade-offs that work against each other. For instance, higher perceived customer value (e.g., providing leather seats throughout the entire aircraft and free Wi-Fi) comes with higher costs. JetBlue continues to pursue an integration strategy today, attempting to be both a cost leader *and* differentiator. Many firms that attempt such an *integration strategy* end up being *stuck in the middle;* that is, the managers have failed to carve out a clear strategic position. In their attempt to be everything to everybody, these firms end up being neither a low-cost leader nor a differentiator. This common strategic failure contributed to JetBlue's competitive disadvantage in recent years.

The key to successful strategy is to combine a set of activities to stake out a *unique position* within an industry. Competitive advantage has to come from performing different activities or performing the same activities differently than rivals are doing. Ideally, these activities reinforce one another rather than create trade-offs. For instance, Walmart's strategic activities strengthen its position as cost leader: Big retail stores in rural locations, extremely high purchasing power, sophisticated IT systems, regional distribution centers, low corporate overhead, and low base wages and salaries combined with employee profit sharing reinforce each other, to maintain the company's cost leadership.

In addition, operational effectiveness, marketing skills, and other functional expertise all strengthen a unique strategic position. Those capabilities, though, do not substitute for competitive strategy. Competing to be similar but just a bit better than your competitor is likely to be a recipe for cut-throat competition and low profit potential. Let's take this idea to its extreme in a quick thought experiment: If all firms in the same industry pursued a low-cost position through application of competitive benchmarking, all firms would have identical cost structures. None could gain a competitive advantage. Everyone would be running faster, but nothing would change in terms of relative strategic positions. There would be little if any value creation for customers because companies would have no resources to invest in product and process improvements. Moreover, the least-efficient firms would be driven out, further reducing customer choice.

To gain a deeper understanding of what strategy is, it may be helpful to think about what strategy is *not.*[11] Be on the lookout for the following major hallmarks of what strategy is NOT:

1. *Grandiose statements are not strategy.* You may have heard firms say things like, "Our strategy is to win" or "We will be #1." Such statements of desire, on their own, are not strategy. They provide little managerial guidance and frequently fail to address the economic fundamentals. As we will discuss in the next chapter, an effective vision and mission *can* lay the foundation upon which to craft a good strategy. This foundation must be backed up by strategic actions that allow the firm to address a competitive challenge.
2. *A failure to face a competitive challenge is not strategy.* If the firm does not define a clear competitive challenge, managers have no way of assessing whether they are making progress in addressing it. Managers at the now-defunct video rental chain Blockbuster, for example, failed to address the competitive challenges posed by new players such as Netflix, Redbox, Amazon Prime, and Hulu.
3. *Operational effectiveness, competitive benchmarking, or other tactical tools are not strategy.* People casually refer to a host of different policies and initiatives as some sort of strategy: pricing strategy, Internet strategy, alliance strategy, operations strategy, IT strategy, brand strategy, marketing strategy, HR strategy, China strategy,

and so on. All these elements may be a *necessary* part of a firm's functional and global initiatives to support its competitive strategy, but these elements are *not sufficient* to achieve competitive advantage. In this text, though, we will reserve the term *strategy* for describing the firm's overall efforts to *gain and sustain competitive advantage.*

INDUSTRY VS. FIRM EFFECTS IN DETERMINING PERFORMANCE

Firm performance is determined primarily by two factors: industry and firm effects. **Industry effects** describe the underlying economic structure of the industry. They attribute firm performance to the industry in which the firm competes. The structure of an industry is determined by elements common to all industries such as entry and exit barriers, number and size of companies, and types of products and services offered. In a series of empirical studies, academic researchers have found that the industry a firm is in determines about 20 percent of a firm's profitability.[12] In Chapter 3, when studying external analysis, we'll gain a deeper understanding of an industry's underlying structure and how it affects firm performance.

Firm effects attribute firm performance to the actions managers take. In Chapter 4, we'll take a close look inside the firm to understand why firms within the same industry differ, and how differences among firms can lead to competitive advantage.

For now, the key point is that managers' actions tend to be more important in determining firm performance than the forces exerted on the firm by its external environment.[13] Empirical research studies indicate that a firm's strategy can explain up to 55 percent of its performance.[14] Exhibit 1.1 shows these findings.

Although a firm's industry environment is not quite as important as the firm's strategy within its industry, they jointly determine roughly 75 percent of overall firm performance. The remaining 25 percent is partly attributed to business cycles and other effects.

Competition—the ongoing struggle among firms to gain and sustain competitive advantage—does not take place in isolation. Managers therefore must understand the relationship between strategic management and the role of business in society, which we will turn to next.

LO 1-3

Differentiate the roles of firm effects and industry effects in determining firm performance.

industry effects Firm performance attributed to the structure of industry in which the firm competes.

firm effects Firm performance attributed to the actions managers take.

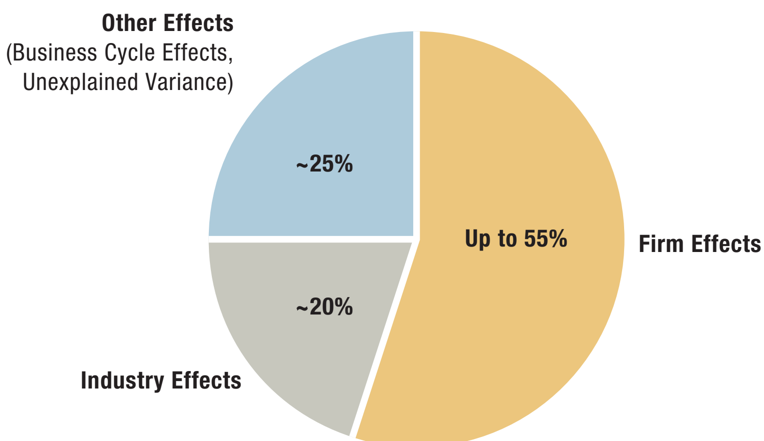


EXHIBIT 1.1

Industry, Firm, and Other Effects Explaining Superior Firm Performance