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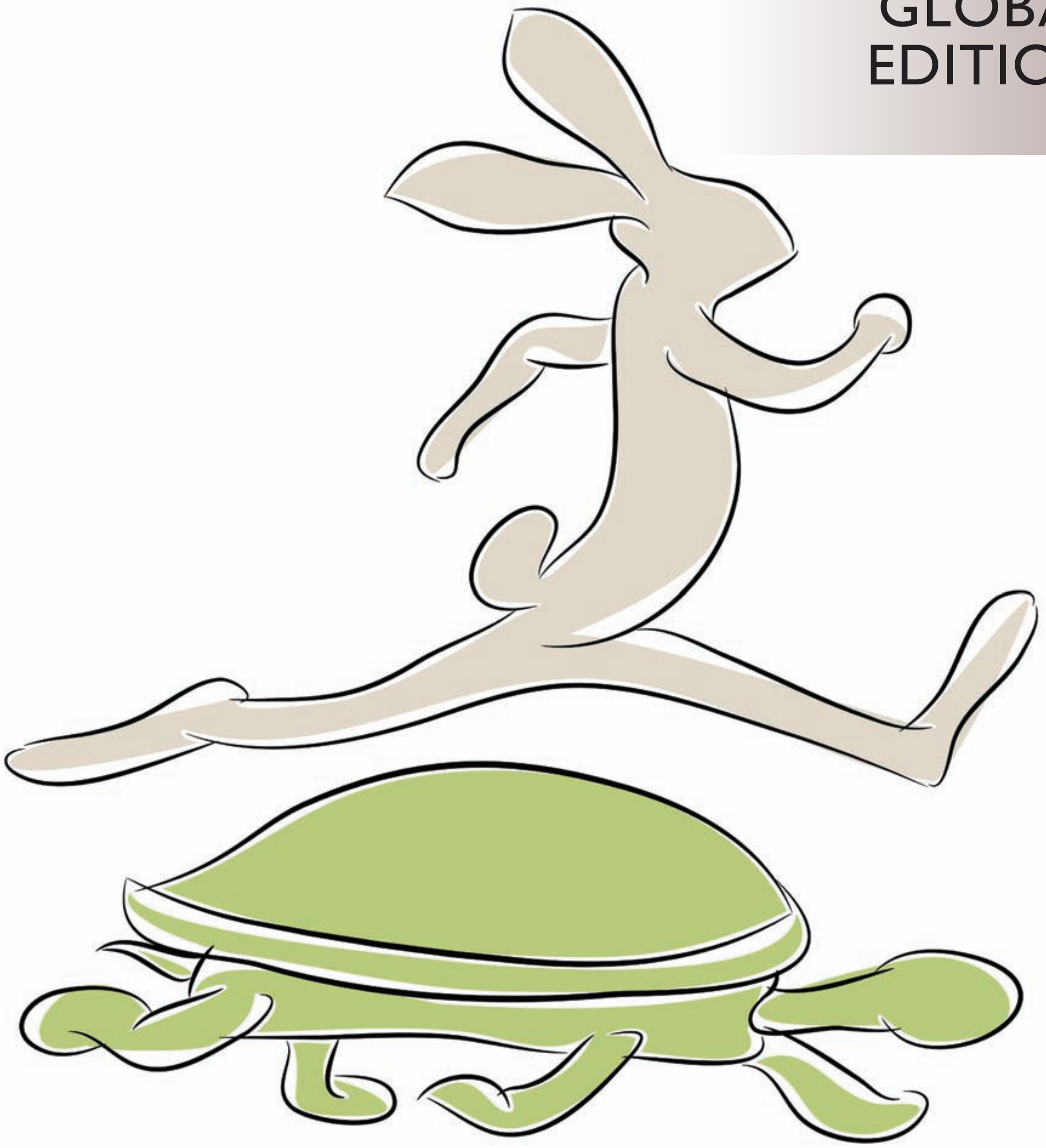

Strategic Management and Competitive Advantage

Concepts and Cases

FIFTH EDITION

Jay B. Barney • William S. Hesterly

ALWAYS LEARNING

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What's Out?

Models, concepts, and topics that don't pass a simple test:
"Does this help students analyze cases and real business situations?"

What's In?

"**VRIO**" – an integrative framework (see next page for details).

- Broad enough to apply in analyzing a variety of cases and real business settings.
- Simple enough to understand and teach.

The Results?

Provides students with the tools they need to do strategic analysis.
Nothing more. Nothing less.

VRIO

“**V**ALUE. **R**ARITY. **I**MITABILITY. **O**RGANIZATION.”

What Is It?

This book is not just a list of concepts, models, and theories. It is the first undergraduate textbook to introduce a **theory-based, multi-chapter organizing framework** to add additional structure to the field of strategic management.

“VRIO” is a mechanism that integrates two existing theoretical frameworks: the positioning perspective and the resource-based view. It is the primary tool for accomplishing internal analysis. It stands for four questions one must ask about a resource or capability to determine its competitive potential:

1. **The Question of Value:** Does a resource enable a firm to exploit an environmental opportunity, and/or neutralize an environmental threat?
2. **The Question of Rarity:** Is a resource currently controlled by only a small number of competing firms?
3. **The Question of Imitability:** Do firms without a resource face a cost disadvantage in obtaining or developing it?
4. **The Question of Organization:** Are a firm’s other policies and procedures organized to support the exploitation of its valuable, rare, and costly-to-imitate resources?

What’s the Benefit of the VRIO Framework?

The VRIO framework is the organizational foundation of the text. **It creates a decision-making framework for students** to use in analyzing case and business situations.

Students tend to view concepts, models, and theories (in all of their coursework) as fragmented and disconnected. Strategy is no exception. This view encourages rote memorization, not real understanding. VRIO, by serving as a consistent framework, connects ideas together. This encourages real understanding, not memorization.

This understanding enables students to better analyze business cases and situations—the goal of the course.

The VRIO framework makes it possible to discuss the formulation and implementation of a strategy simultaneously, within each chapter.

Because the VRIO framework provides a simple integrative structure, we are actually able to address issues in this book that are largely ignored elsewhere—including discussions of vertical integration, outsourcing, real options logic, and mergers and acquisitions, to name just a few.

Edition

5

Strategic Management *and* Competitive Advantage

Concepts and Cases

Global Edition

Jay B. Barney

t he University of Utah

William S. Hesterly

t he University of Utah

PEARSON

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This book is dedicated to my family: my wife, Kim; our children, Lindsay, Kristian, and Erin, and their spouses; and, most of all, our nine grandchildren, Isaac, Dylanie, Audrey, Chloe, Lucas, Royal, Lincoln, Nolan, and Theo. They all help me remember that no success could compensate for failure in the home.

Jay B. Barney
Salt Lake City, Utah

This book is for my family who has taught me life's greatest lessons about what matters most. To my wife, Denise; my daughters, sons, and their spouses: Lindsay, Matt, Jessica, John, Alex, Brittany, Austin, Julia, Ian, and Drew.; and my grandchildren, Ellie, Owen, Emerson, Cade, Elizabeth, Amelia, Eden, Asher, Lydia, and Scarlett.

William Hesterly
Salt Lake City, Utah

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Part 2: BUSINESS-LEVEL STRATEGIES

Part 3: CORPORATE STRATEGIES

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Preface

The first thing you will notice as you look through this edition of our book is that it continues to be much shorter than most textbooks on strategic management. There is not the usual "later edition" increase in number of pages and bulk. We're strong proponents of the philosophy that, often, less is more. The general tendency is for textbooks to get longer and longer as authors make sure that their books leave out nothing that is in other books. We take a different approach. Our guiding principle in deciding what to include is: "Does this concept help students analyze cases and real business situations?" For many concepts we considered, the answer is no. But, where the answer is yes, the concept is in the book.

New to This Edition

This edition includes many new chapter-opening cases, including:

- Chapter 1: A case on the video app "Angry Birds"
- Chapter 2: A case on the music streaming industry
- Chapter 3: A case on how Google keeps going
- Chapter 8: A case on Berkshire-Hathaway's corporate strategy
- Chapter 9: A case on the alliance between Apple and Samsung
- Chapter 10: A case on Google's acquisition strategy
- Chapter 11: A case on the infant formula business in China

All the other opening cases have been reused and updated, along with all the examples throughout the book.

Two newer topics in the field have also been included in this edition of the book: the business model canvas (in Chapter 1) and blue ocean strategies (in Chapter 5).

This edition features several new and updated cases, including:

- You Say You Want a Revolution: Soda Stream International
- True Religion Jeans: Will Going Private Help It Regain Its Congregation?
- Walmart: Walmart Stores, Inc., in 2013
- Air Asia X: Can the Low Cost Model Go Long Haul?
- RyanAir—The Low Fares Airline: Whither Now?
- Papa John's International, Inc.
- e-Bay's Outsourcing Strategy
- National Hockey League Enterprises Canada: A Retail Proposal
- Starbucks: An Alex Poole Strategy Case
- Rayovac Corporation: International Growth and Diversification Through Acquisitions

VRIO Framework and Other Hallmark Features

One thing that has not changed in this edition is that we continue to have a point of view about the field of strategic management. In planning for this book, we recalled our own educational experience and the textbooks that did and didn't work for us then. Those few that stood out as the best did not merely cover all of the different topics in a field of study. They provided a framework that we could carry around in our heads, and they helped us to see what we were studying as an integrated whole rather than a disjointed sequence of loosely related subjects. This text continues to be integrated around the VRIO framework. As those of you familiar with the resource-based theory of strategy recognize, the VRIO framework addresses the central questions around gaining and sustaining competitive advantage. After it is introduced in Chapter 3, the VRIO logic of competitive advantage is applied in every chapter. It is simple enough to understand and teach yet broad enough to apply to a wide variety of cases and business settings.

Our consistent use of the VRIO framework does not mean that any of the concepts fundamental to a strategy course are missing. We still have all of the core ideas and theories that are essential to a strategy course. Ideas such as the study of environmental threats, value chain analysis, generic strategies, and corporate strategy are all in the book. Because the VRIO framework provides a single integrative structure, we are able to address issues in this book that are largely ignored elsewhere—including discussions of vertical integration, outsourcing, real options logic, and mergers and acquisitions, to name just a few.

We also have designed flexibility into the book. Each chapter has four short sections that present specific issues in more depth. These sections allow instructors to adapt the book to the particular needs of their students. "Strategy in Depth" examines the intellectual foundations that are behind the way managers think about and practice strategy today. "Strategy in the Emerging Enterprise" presents examples of strategic challenges faced by new and emerging enterprises. "Ethics and Strategy" delves into some of the ethical dilemmas that managers face as they confront strategic decisions. "Research Made Relevant" includes recent research related to the topics in that chapter.

We have also included cases—including many new cases in this edition—that provide students an opportunity to apply the ideas they learn to business situations. The cases include a variety of contexts, such as entrepreneurial, service, manufacturing, and international settings. The power of the VRIO framework is that it applies across all of these settings. Applying the VRIO framework to many topics and cases throughout the book leads to real understanding instead of rote memorization. The end result is that students will find that they have the tools they need to do strategic analysis. Nothing more. Nothing less.

Supplements

At the Instructor Resource Center, at www.pearsonglobaleditions.com/Barney, instructors can download a variety of digital and presentation resources. Registration is simple and gives you immediate access to all of the available supplements. In case you ever need assistance, our dedicated technical support team is ready to help with the media supplements that accompany this text. Visit http://247.pearsoned.custhelp.com for answers to frequently asked questions and toll-free user support phone numbers.

The following supplements are available for download to adopting instructors:

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- Case Teaching Notes
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Videos

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Other Benefits

Element	Description	Benefit	Example
Chapter Opening Cases	We have chosen firms that are familiar to most students. Opening cases focus on whether or not Rovio Entertainment, Ltd.—maker of the popular video game "Angry Birds"—can sustain its success, how Ryanair has become the lowest cost airline in the world, how Victoria's Secret has differentiated its products, how ESPN has diversified its operations, and so forth.	By having cases tightly linked to the material, students can develop strategic analysis skills by studying firms familiar to them.	24–25
Full Length Cases	This book contains selective, part-ending cases that underscore the concepts in each part. This provides a tight link to the chapter concepts to reinforce understanding of recent research. These are 1) decision oriented, 2) recent, 3) student-recognized companies, and 4) cases where the data are only partly analyzed.	Provides a tight link to chapter concepts, facilitating students' ability to apply text ideas to case analysis.	PC 1–1–PC 1–10
Strategy in Depth	For professors and students interested in understanding the full intellectual underpinnings of the field, we have included an optional Strategy in Depth feature in every chapter. Knowledge in strategic management continues to evolve rapidly, in ways that are well beyond what is normally included in introductory texts.	Customize your course as desired to provide enrichment material for advanced students.	245
Research Made Relevant	The Research Made Relevant feature highlights very current research findings related to some of the strategic topics discussed in that chapter.	Shows students the evolving nature of strategy.	69
Challenge Questions	These might be of an ethical or moral nature, forcing students to apply concepts across chapters, apply concepts to themselves, or extend chapter ideas in creative ways.	Requires students to think critically.	147
Problem Set	Problem Set asks students to apply theories and tools from the chapter. These often require calculations. They can be thought of as homework assignments. If students struggle with these problems they might have trouble with the more complex cases. These problem sets are largely diagnostic in character.	Sharpens quantitative skills and provides a bridge between chapter material and case analysis.	179–180
Ethics and Strategy	Highlights some of the most important dilemmas faced by firms when creating and implementing strategies.	Helps students make better ethical decisions as managers.	230
Strategy in the Emerging Enterprise	A growing number of graduates work for small and medium-sized firms. This feature presents an extended example, in each chapter, of the unique strategic problems facing those employed in small and medium-sized firms.	This feature highlights the unique challenges of doing strategic analysis in emerging enterprises and small and medium-sized firms.	75

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Obviously, a book like this is not written in isolation. We owe a debt of gratitude to all those at Pearson who have supported its development. In particular, we want to thank Stephanie Wall, Editor-in-Chief; Dan Tylman, Acquisitions Editor; Sarah Holle, Program Manager; Erin Gardner, Marketing Manager; Judy Leale, Project Manager Team Lead; and Karalyn Holland, Senior Project Manager.

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WiLLia M S. HESt Er LY

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Part

1 THE TOOLS OF STRATEGIC ANALYSIS

chapter

1 What Is Strategy and the Strategic Management Process?

Learning Objectives *After reading this chapter, you should be able to:*

1. Define strategy.
2. Describe the strategic management process.
3. Define competitive advantage and explain its relationship to economic value creation.
4. Describe two different measures of competitive advantage.
5. Explain the difference between emergent and intended strategies.
6. Discuss the importance of understanding a firm's strategy even if you are not a senior manager in a firm.

Why are these Birds So angry?

Rarely can the beginning on an entire industry be traced to a single event on a specific day. But this is the case with the smart phone applications industry.

On June 29, 2007, Apple first introduced the iPhone. A central feature of the iPhone was that it would be able to run a wide variety of applications, or "apps." And, most importantly for the evolution of the apps industry, Apple decided that while it would evaluate and distribute these applications—through the online Apple App Store—it would not develop them. Instead, Apple would "crowd source" most applications from outside developers.

And, thus, the smart phone applications industry began. By April 24, 2009, iPhone users had downloaded more than 1 billion apps from the Apple App Store. During 2012, more than 45.6 billion smart phone apps were downloaded from all sources, generating revenues in excess of $25 billion. Projections suggest double-digit growth in this industry for at least another five years.

Of course, much has changed since 2007. For example, Apple now has six competitors for its Apple App Store, including Amazon App Store, Google Play Store, BlackBerry World, and Windows Phone Store. Some of these stores distribute apps for non-Apple phone operating systems developed by Google (Android), BlackBerry, and Windows. But all of these distributors have adopted Apple's original model for developing applications: mostly outsource it to independent development companies.

These development companies fall into four categories: (1) Internet companies—including Google—who have developed smart phone versions of popular Internet sites—including, for example, YouTube and Google Maps; (2) traditional video game companies—including Sega—who have developed smart phone versions of popular video games—including, for example, Sonic Dash; (3) diversified media companies—including Disney—who have built apps featuring characters and stories developed in their far-flung media operations—including, for example, Monster's University; and (4) companies who have been formed to develop entirely new apps.

There are, of course, literally thousands—maybe hundreds of thousands—of this last type of app development firm. The proliferation of these firms—sometimes no more than one person with an idea—has led to a proliferation of apps across all smart phone platforms. Currently, there are 1.5 million downloadable apps available on both the Apple App Store and Google Play Store.

Among these thousands of independent developers, a few have been unusually successful. None exemplifies this "rag to riches" dynamic more than Rovio, an app development company headquartered outside Helsinki, Finland. Rovio is best known for an amazingly simple game involving enraged avians—yes, Angry Birds.

The challenge facing Rovio, and all these successful independent app developers, is: Can they go beyond developing a single "killer app," or will they be "one-hit wonders?" Rovio is trying to avoid this fate by leveraging the Angry Birds franchise into a series of related apps—Angry Birds Star Wars, Bad Piggies; by developing apps that build on new characters—The Croods; by diversifying into related non-app businesses—Angry Birds Toons; and by licensing Angry Birds characters to toy manufactures—including Mattel.

Rovio has even begun crowd sourcing new app ideas that it can bring to market. Independent developers can pitch games and apps to Rovio online. Whether this effort will lead to the next generation of Rovio apps is not yet known.

What is known is that the smart phone applications industry—an industry that was created only in 2007—is likely to grow and evolve dramatically over the next few years. And firms as diverse as Google, Apple, Disney, Sega—and even Rovio—will have to evolve with it.

Sources: www.rovio.com accessed August 23, 2013; www.distimo.com accessed August 23, 2013; www.newrelic.com accessed August 23, 2013

Firms in the smart phone applications industry—whether they have entered this business from another media industry—like Google and Disney—or not—like Rovio—face classic strategic questions. How is this industry likely to evolve? What actions can be taken to change this evolution? How can firms gain advantages in this industry? How sustainable are these advantages?

The process by which these, and related, questions are answered is the strategic management process, and the answers that firms develop for these questions help determine a firm's strategy.

Strategy and the Strategic Management Process

Although most can agree that a firm's ability to survive and prosper depends on choosing and implementing a good strategy, there is less agreement about what a strategy is and even less agreement about what constitutes a good strategy. Indeed, there are almost as many different definitions of these concepts as there are books written about them.

Defining Strategy

In this book, a firm's **strategy** is defined as its theory about how to gain competitive advantages.[1] A good strategy is a strategy that actually generates such advantages. Disney's theory of how to gain a competitive advantage in the apps industry is to leverage characters from its movie business. Rovio's theory is to develop entirely new content for its apps.

Each of these theories—like all theories—is based on a set of assumptions and hypotheses about the way competition in this industry is likely to evolve and how that evolution can be exploited to earn a profit. The greater the extent to which these assumptions and hypotheses accurately reflect how competition in this industry actually evolves, the more likely it is that a firm will gain a competitive advantage from implementing its strategies. If these assumptions and hypotheses turn out not to be accurate, then a firm's strategies are not likely to be a source of competitive advantage.

But here is the challenge. It is usually very difficult to predict how competition in an industry will evolve, and so it is rarely possible to know for sure that a firm is choosing the right strategy. This is why a firm's strategy is almost always a theory: It's a firm's best bet about how competition is going to evolve and how that evolution can be exploited for competitive advantage.

The Strategic Management Process

Although it is usually difficult to know for sure that a firm is pursuing the best strategy, it is possible to reduce the likelihood that mistakes are being made. The best way to do this is for a firm to choose its strategy carefully and systematically and to follow the strategic management process. The **strategic management process** is a sequential set of analyses and choices that can increase the likelihood that a firm will choose a good strategy; that is, a strategy that generates competitive advantages. An example of the strategic management process is presented in Figure 1.1. Not surprisingly, this book is organized around this strategic management process.

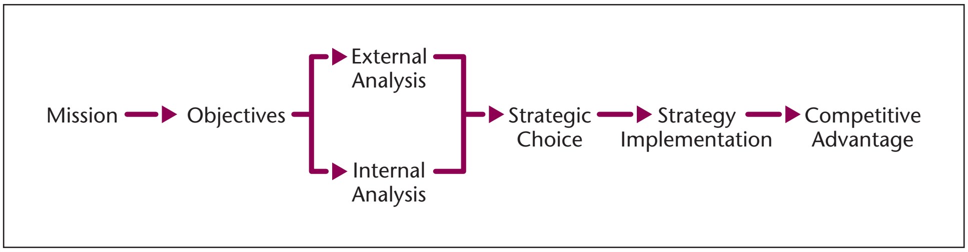

Figure 1.1 The Strategic Management Process

a Firm's Mission

The strategic management process begins when a firm defines its mission. A firm's **mission** is its long-term purpose. Missions define both what a firm aspires to be in the long run and what it wants to avoid in the meantime. Missions are often written down in the form of **mission statements**.

Some Missions May not affect Firm Performance. Most mission statements incorporate common elements. For example, many define the businesses within which a firm will operate—medical products for Johnson and Johnson; adhesives and substrates for 3M—or they can very simply state how a firm will compete in those businesses. Many even define the core values that a firm espouses.

Indeed, mission statements often contain so many common elements that some have questioned whether having a mission statement even creates value for a firm.[2] Moreover, even if a mission statement does say something unique about a company, if that mission statement does not influence behavior throughout an organization, it is unlikely to have much impact on a firm's actions. After all, while Enron was engaging in wide ranging acts of fraud[3], it had a mission statement that emphasized the importance of honesty and integrity.[4]

Some Missions can improve Firm Performance. Despite these caveats, research has identified some firms whose sense of purpose and mission permeates all that they do. These firms include, for example, 3M, IBM, Philip Morris, Wal-Mart, and Disney. Some of these **visionary firms**, or firms whose mission is central to all they do have enjoyed long periods of high performance.[5] From 1926 through 1995, an investment of $1 in one of these firms would have increased in value to $6,536. That same dollar invested in an average firm over this same time period would have been worth $415 in 1995.

These visionary firms earned substantially higher returns than average firms even though many of their mission statements suggest that profit maximizing, although an important corporate objective, is not their primary reason for existence. Rather, their primary reasons for existence are typically reflected in a widely held set of values and beliefs that inform day-to-day decision making. While, in other firms, managers may be tempted to sacrifice such values and beliefs to gain short-term advantages, in these special firms, the pressure for short-term performance is balanced by widespread commitment to values and beliefs that focus more on a firm's long-term performance.[6]

Of course, that these firms had performed well for many decades does not mean they will do so forever. Some previously identified visionary firms have stumbled more recently, including American Express, Ford, Hewlett-Packard, Motorola, and Sony. Some of these financial problems may be attributable to the fact that these formally mission-driven companies have lost focus on their mission.

Some Missions can hurt Firm Performance. Although some firms have used their missions to develop strategies that create significant competitive advantages, missions can hurt a firm's performance as well. For example, sometimes a firm's mission will be very inwardly focused and defined only with reference to the personal values and priorities of its founders or top managers, independent of whether those values and priorities are consistent with the economic realities facing a firm. Strategies derived from such missions are not likely to be a source of competitive advantage.

For example, Ben & Jerry's Ice Cream was founded in 1977 by Ben Cohen and Jerry Greenfield, both as a way to produce super-premium ice cream and as a way to create an organization based on the values of the 1960s' counterculture. This strong sense of mission led Ben & Jerry's to adopt some very unusual human resource and other policies. Among these policies, the company adopted a compensation system whereby the highest-paid firm employee could earn no more than five times the income of the lowest-paid firm employee. Later, this ratio was adjusted to seven to one. However, even at this level, such a compensation policy made it very difficult to acquire the senior management talent needed to ensure the growth and profitability of the firm without grossly overpaying the lowest-paid employees in the firm. When a new CEO was appointed to the firm in 1995, his $250,000 salary violated this compensation policy.

Indeed, though the frozen dessert market rapidly consolidated through the late 1990s, Ben & Jerry's Ice Cream remained an independent firm, partly because of Cohen's and Greenfield's commitment to maintaining the social values that their firm embodied. Lacking access to the broad distribution network and managerial talent that would have been available if Ben & Jerry's had merged with another firm, the company's growth and profitability lagged. Finally, in April 2000, Ben & Jerry's Ice Cream was acquired by Unilever. The 66 percent premium finally earned by Ben & Jerry's stockholders in April 2000 had been delayed for several years. In this sense, Cohen's and Greenfield's commitment to a set of personal values and priorities was at least partly inconsistent with the economic realities of the frozen dessert market in the United States.[7]

Obviously, because a firm's mission can help, hurt, or have no impact on its performance, missions by themselves do not necessarily lead a firm to choose and implement strategies that generate competitive advantages. Indeed, as suggested in Figure 1.1, while defining a firm's mission is an important step in the strategic management process, it is only the first step in that process.

Objectives

Whereas a firm's mission is a broad statement of its purpose and values, its **objectives** are specific measurable targets a firm can use to evaluate the extent to which it is realizing its mission. High-quality objectives are tightly connected to elements of a firm's mission and are relatively easy to measure and track over time. Low-quality objectives either do not exist or are not connected to elements of a firm's mission, are not quantitative, or are difficult to measure or difficult to track over time. Obviously, low-quality objectives cannot be used by management to evaluate how well a mission is being realized. Indeed, one indication that a firm is not that serious about realizing part of its mission statement is when there are no objectives, or only low-quality objectives, associated with that part of the mission.

external and internal analysis

The next two phases of the strategic management process—external analysis and internal analysis—occur more or less simultaneously. By conducting an