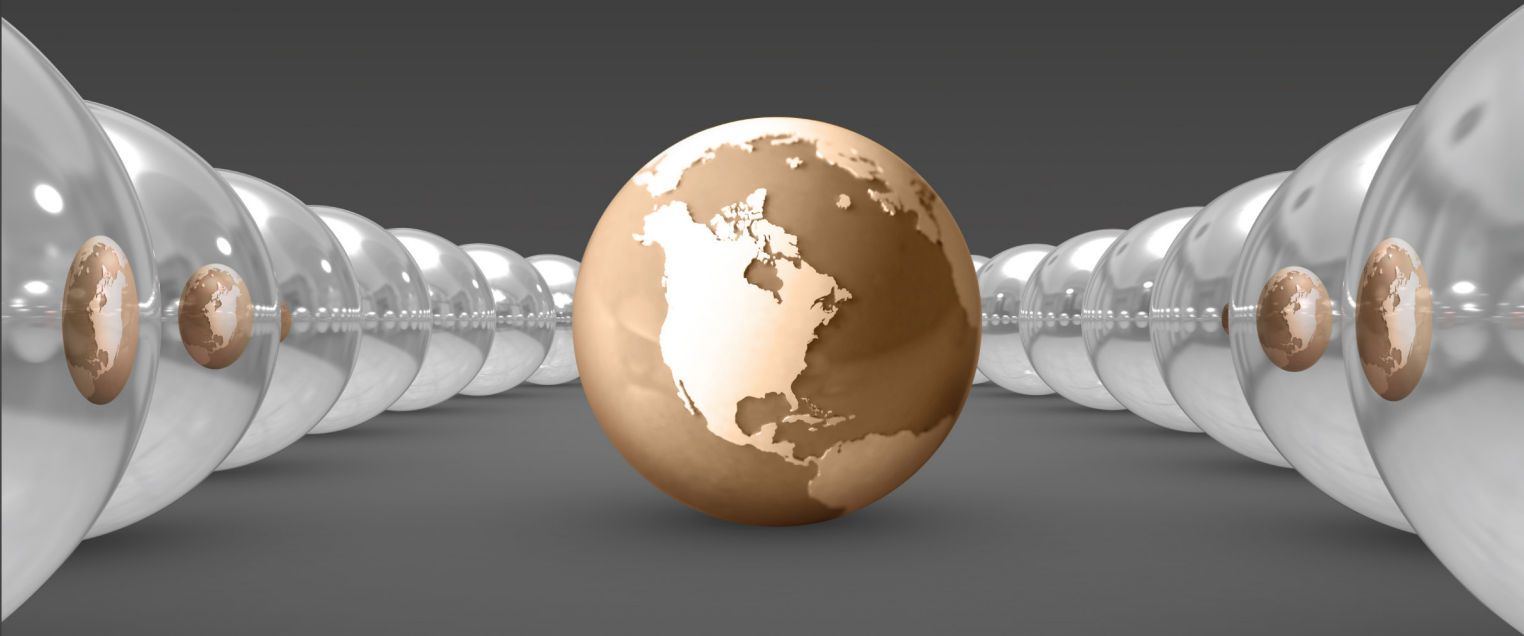


INSTRUCTOR'S EDITION | NOT FOR RESALE

# STRATEGIC MANAGEMENT *4e*



**Mc  
Graw  
Hill**  
Education

FRANK T. ROTHARMEL

FOURTH EDITION

# Strategic Management

Mc  
Graw  
Hill  
Education



FOURTH EDITION

---

# Strategic Management

---



**Frank T. Rothaermel**

Georgia Institute of Technology





## STRATEGIC MANAGEMENT, FOURTH EDITION

Published by McGraw-Hill Education, 2 Penn Plaza, New York, NY 10121. Copyright © 2019 by McGraw-Hill Education. All rights reserved. Printed in the United States of America. Previous editions © 2017, 2015, and 2013. No part of this publication may be reproduced or distributed in any form or by any means, or stored in a database or retrieval system, without the prior written consent of McGraw-Hill Education, including, but not limited to, in any network or other electronic storage or transmission, or broadcast for distance learning.

Some ancillaries, including electronic and print components, may not be available to customers outside the United States.

This book is printed on acid-free paper.

1 2 3 4 5 6 7 8 9 LWI 21 20 19 18

### Bound:

ISBN 978-1-259-92762-1 (student edition)

MHID 1-259-92762-8 (student edition)

ISBN 978-1-260-14192-4 (instructor edition)

MHID 1-260-14192-6 (instructor edition)

### Looseleaf:

ISBN 978-1-260-14186-3

MHID 1-260-14186-1

Product Developers: *Lai T. Moy*

Executive Marketing Manager: *Debbie Clare*

Content Project Managers: *Mary E. Powers (Core), Keri Johnson (Assessment)*

Buyer: *Susan K. Culbertson*

Design: *Matt Diamond*

Content Licensing Specialists: *Brianna Kirschbaum*

Cover Image: (leadership concept on white background): ©*ISerg/iStock/Getty Images RF; (globe):*

©*sankai/iStock/Getty Images RF*

Compositor: *SPi Global*

All credits appearing on page or at the end of the book are considered to be an extension of the copyright page.

### Library of Congress Cataloging-in-Publication Data

Names: Rothaermel, Frank T., author.

Title: Strategic management: concepts / Frank T. Rothaermel, Georgia Institute of Technology.

Description: Fourth Edition. | Dubuque: McGraw-Hill Education, 2018. |

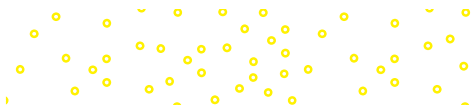
Revised edition of the author's *Strategic management*, [2017]

Identifiers: LCCN 2017049706 | ISBN 9781259927621 (paperback)

Subjects: LCSH: Strategic planning. | Management. | BISAC: BUSINESS & ECONOMICS / Management.

Classification: LCC HD30.28 .R6646 2018 | DDC 658.4/012—dc23 LC record available at <https://lccn.loc.gov/2017049706>

The Internet addresses listed in the text were accurate at the time of publication. The inclusion of a website does not indicate an endorsement by the authors or McGraw-Hill Education, and McGraw-Hill Education does not guarantee the accuracy of the information presented at these sites.



---

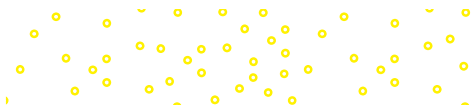
## DEDICATION

---

To my eternal family for their love, support, and sacrifice: Kelley, Harris, Winston, Roman, Adelaide, Avery, and Ivy.

—FRANK T. ROTHARMEL

---





---

# CONTENTS IN BRIEF

---

---

## **PART ONE / ANALYSIS 2**

---

- CHAPTER 1** What Is Strategy? 4
- CHAPTER 2** Strategic Leadership: Managing the Strategy Process 30
- CHAPTER 3** External Analysis: Industry Structure, Competitive Forces, and Strategic Groups 64
- CHAPTER 4** Internal Analysis: Resources, Capabilities, and Core Competencies 106
- CHAPTER 5** Competitive Advantage, Firm Performance, and Business Models 144

---

## **PART TWO / FORMULATION 180**

---

- CHAPTER 6** Business Strategy: Differentiation, Cost Leadership, and Blue Oceans 182
- CHAPTER 7** Business Strategy: Innovation, Entrepreneurship, and Platforms 218
- CHAPTER 8** Corporate Strategy: Vertical Integration and Diversification 264
- CHAPTER 9** Corporate Strategy: Strategic Alliances, Mergers, and Acquisitions 308
- CHAPTER 10** Global Strategy: Competing Around the World 338

---

## **PART THREE / IMPLEMENTATION 376**

---

- CHAPTER 11** Organizational Design: Structure, Culture, and Control 378
- CHAPTER 12** Corporate Governance and Business Ethics 418

---

## **PART FOUR / MINICASES 447**

---

---

### **HOW TO CONDUCT A CASE ANALYSIS 528**

---

---

## **PART FIVE / FULL-LENGTH CASES** Available through McGraw-Hill Create [www.McGrawHillCreate.com/Rothaermel](http://www.McGrawHillCreate.com/Rothaermel)

---



---

# MINICASES & FULL-LENGTH CASES

---

---

## MINICASES /

---

- 1 Michael Phelps: The Role of Strategy in Olympics and Business 448
- 2 PepsiCo's Indra Nooyi: Performance with Purpose 450
- 3 Yahoo: From Internet Darling to Fire Sale 453
- 4 How the Strategy Process Killed Innovation at Microsoft 456
- 5 Apple: The iPhone Turns 10, so What's Next? 459
- 6 Nike's Core Competency: The Risky Business of Creating Heroes 463
- 7 Dynamic Capabilities at IBM 466
- 8 Starbucks after Schultz: How to Sustain a Competitive Advantage? 470
- 9 Business Model Innovation: How Dollar Shave Club Disrupted Gillette 474
- 10 Competing on Business Models: Google vs. Microsoft 476
- 11 Can Amazon Trim the Fat at Whole Foods? 481
- 12 LEGO's Turnaround: Brick by Brick 484
- 13 Cirque du Soleil: Searching for a New Blue Ocean 488
- 14 Wikipedia: Disrupting the Encyclopedia Business 491
- 15 Disney: Building Billion-Dollar Franchises 494
- 16 Hollywood Goes Global 498
- 17 Samsung Electronics: Burned by Success? 503
- 18 Does GM's Future Lie in China? 509
- 19 Flipkart vs. Amazon in India: Who's Winning? 512
- 20 Alibaba—China's Ecommerce Giant: Challenging Amazon? 516
- 21 HP's Boardroom Drama and Divorce 520
- 22 UBS: A Pattern of Ethics Scandals 524

---

## FULL-LENGTH CASES /

---

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

Uber Technologies\*

Starbucks Corporation\*

Netflix, Inc.\*

Walmart\*

The Walt Disney Company\*

Tesla, Inc. >>

Apple Inc. >>

Amazon.com, Inc. >>

Best Buy Co., Inc. >>

Facebook, Inc. >>

McDonald's Corporation >>

Alphabet's Google >>

Delta Air Lines, Inc. >>

UPS in India >>

The Movie Exhibition Industry >>+

Space X\* +

Kickstarter: Using Crowdfunding to Launch a New Board Game +

Better World Books and the Triple Bottom Line

General Electric after GE Capital

IBM at the Crossroads

Merck & Co., Inc.

Grok: Action Intelligence for Fast Data

Make or Break at RIM: Launching BlackBerry 10

---

\* NEW TO THE FOURTH EDITION >> REVISED AND UPDATED FOR THE FOURTH EDITION + THIRD-PARTY CASE





---

# CHAPTERCASES & STRATEGY HIGHLIGHTS

---

---

## CHAPTERCASES /

---

- 1** Tesla's Secret Strategy 5
- 2** Sheryl Sandberg: Leaning in at Facebook 31
- 3** Airbnb: Disrupting the Hotel Industry 65
- 4** Dr. Dre's Core Competency: Coolness Factor 107
- 5** The Quest for Competitive Advantage: Apple vs. Microsoft 145
- 6** JetBlue Airways: Finding a New Blue Ocean? 183
- 7** Netflix: Disrupting the TV Industry 219
- 8** Amazon.com: To Infinity and Beyond 265
- 9** Little Lyft Gets Big Alliance Partners 309
- 10** Sweden's IKEA: The World's Most Profitable Retailer 339
- 11** Zappos: Of Happiness and Holacracy 379
- 12** Uber: Most Ethically Challenged Tech Company? 419

---

## STRATEGY HIGHLIGHTS /

---

- 1.1** Teach for America: How Wendy Kopp Inspires Future Leaders 12
- 1.2** Merck: Reconfirming Its Core Values 18
- 2.1** Starbucks CEO: "It's Not What We Do" 44
- 2.2** BP "Grossly Negligent" in Gulf of Mexico Disaster 55
- 3.1** BlackBerry's Bust 71
- 3.2** The Five Forces in the Airline Industry 75
- 4.1** Applying VRIO: The Rise and Fall of Groupon 119
- 4.2** When Will P&G Play to Win Again? 125
- 5.1** Interface: The World's First Sustainable Company 165
- 5.2** Threadless: Leveraging Crowdsourcing to Design Cool T-Shirts 166
- 6.1** Dr. Shetty: "The Henry Ford of Heart Surgery" 200
- 6.2** How JCPenney Sailed Deeper into the Red Ocean 208
- 7.1** Standards Battle: Which Automotive Technology Will Win? 230
- 7.2** GE's Innovation Mantra: Disrupt Yourself! 248
- 8.1** Is Coke Becoming a Monster? 276
- 8.2** The Tata Group: Integration at the Corporate Level 289
- 9.1** How Tesla Used Alliances Strategically 315
- 9.2** Kraft's Specialty: Hostile Takeovers 326
- 10.1** The Gulf Airlines Are Landing in the United States 347
- 10.2** Walmart Retreats from Germany, and Lidl Invades the United States 351
- 11.1** W.L. Gore & Associates: Informality and Innovation 386
- 11.2** Sony vs. Apple: Whatever Happened to Sony? 400
- 12.1** GE's Board of Directors 430
- 12.2** Why the Mild Response to Goldman Sachs and Securities Fraud? 435

# CONTENTS

## PART ONE / ANALYSIS 2

### CHAPTER 1

WHAT IS STRATEGY? 4

#### CHAPTERCASE 1

Tesla's Secret Strategy 5

1.1 What Strategy Is: Gaining and Sustaining Competitive Advantage 6

*What Is Competitive Advantage? 8*

1.2 Vision, Mission, and Values 11

*Vision 11*

*Mission 13*

*Values 17*

1.3 The AFI Strategy Framework 19

1.4 Implications for Strategic Leaders 20

CHAPTERCASE 1 / Consider This... 21

### CHAPTER 2

STRATEGIC LEADERSHIP: MANAGING THE STRATEGY PROCESS 30

#### CHAPTERCASE 2

Sheryl Sandberg: Leaning in at Facebook 31

2.1 Strategic Leadership 32

*What Do Strategic Leaders Do? 33*

*How Do You Become a Strategic Leader? 33*

*The Strategy Process Across Levels: Corporate, Business, and Functional Managers 36*

2.2 The Strategic Management Process 38

*Top-Down Strategic Planning 38*

*Scenario Planning 39*

*Strategy as Planned Emergence: Top-Down and Bottom-Up 41*

2.3 Stakeholders and Competitive Advantage 47

*Stakeholder Strategy 48*

*Stakeholder Impact Analysis 50*

2.4 Implications for Strategic Leaders 55

CHAPTERCASE 2 / Consider This... 56

### CHAPTER 3

EXTERNAL ANALYSIS: INDUSTRY STRUCTURE, COMPETITIVE FORCES, AND STRATEGIC GROUPS 64

#### CHAPTERCASE 3

Airbnb: Disrupting the Hotel Industry 65

3.1 The PESTEL Framework 67

*Political Factors 68*

*Economic Factors 68*

*Sociocultural Factors 70*

*Technological Factors 70*

*Ecological Factors 70*

*Legal Factors 72*

3.2 Industry Structure and Firm Strategy: The Five Forces Model 73

*Industry vs. Firm Effects In Determining Firm*

*Performance 73*

*Competition In the Five Forces Model 74*

*The Threat of Entry 76*

*The Power of Suppliers 79*

*The Power of Buyers 80*

*The Threat of Substitutes 82*

*Rivalry Among Existing Competitors 83*

*A Sixth Force: The Strategic Role of Complements 88*

3.3 Changes over Time: Entry Choices and Industry Dynamics 90

*Entry Choices 90*

*Industry Dynamics 92*

3.4 Performance Differences within the Same Industry: Strategic Groups 93

*The Strategic Group Model 93*

*Mobility Barriers 95*

3.5 Implications for Strategic Leaders 96

CHAPTERCASE 3 / Consider This... 97

### CHAPTER 4

INTERNAL ANALYSIS: RESOURCES, CAPABILITIES, AND CORE COMPETENCIES 106

#### CHAPTERCASE 4

Dr. Dre's Core Competency: Coolness Factor 107

- 4.1 Core Competencies 110
- 4.2 The Resource-Based View 113
  - Two Critical Assumptions* 114
  - The Vrio Framework* 115
  - Isolating Mechanisms: How to Sustain A Competitive Advantage* 120
- 4.3 The Dynamic Capabilities Perspective 124
- 4.4 The Value Chain and Strategic Activity Systems 128
  - The Value Chain* 128
  - Strategic Activity Systems* 130
- 4.5 Implications for Strategic Leaders 133
  - Using Swot Analysis to Generate Insights From External and Internal Analysis* 134

**CHAPTERCASE 4 / Consider This... 135**

**CHAPTER 5**

COMPETITIVE ADVANTAGE, FIRM PERFORMANCE, AND BUSINESS MODELS 144

**CHAPTERCASE 5 /**

The Quest for Competitive Advantage: Apple vs. Microsoft 145

- 5.1 Competitive Advantage and Firm Performance 146
  - Accounting Profitability* 146
  - Shareholder Value Creation* 153
  - Economic Value Creation* 155
  - The Balanced Scorecard* 161
  - The Triple Bottom Line* 164
- 5.2 Business Models: Putting Strategy into Action 165
  - The Why, What, Who, and How of Business Models Framework* 167
  - Popular Business Models* 168
  - Dynamic Nature of Business Models* 170
- 5.3 Implications for Strategic Leaders 171

**CHAPTERCASE 5 / Consider This... 172**

**PART TWO / FORMULATION 180**

**CHAPTER 6**

BUSINESS STRATEGY: DIFFERENTIATION, COST LEADERSHIP, AND BLUE OCEANS 182

**CHAPTERCASE 6 /**

JetBlue Airways: Finding a New Blue Ocean? 183

- 6.1 Business-Level Strategy: How to Compete for Advantage 185
  - Strategic Position* 186
  - Generic Business Strategies* 186
- 6.2 Differentiation Strategy: Understanding Value Drivers 188
  - Product Features* 191
  - Customer Service* 191
  - Complements* 191
- 6.3 Cost-Leadership Strategy: Understanding Cost Drivers 192
  - Cost of Input Factors* 194
  - Economies of Scale* 194
  - Learning Curve* 196
  - Experience Curve* 199

6.4 Business-Level Strategy and the Five Forces: Benefits and Risks 201

- Differentiation Strategy: Benefits and Risks* 201
- Cost-Leadership Strategy: Benefits and Risks* 203

6.5 Blue Ocean Strategy: Combining Differentiation and Cost Leadership 204

- Value Innovation* 205
- Blue Ocean Strategy Gone Bad: "Stuck In the Middle"* 207

6.6 Implications for Strategic Leaders 210

**CHAPTERCASE 6 / Consider This... 211**

**CHAPTER 7**

BUSINESS STRATEGY: INNOVATION, ENTREPRENEURSHIP, AND PLATFORMS 218

**CHAPTERCASE 7 /**

Netflix: Disrupting the TV Industry 219

- 7.1 Competition Driven by Innovation 221
  - The Innovation Process* 222
- 7.2 Strategic and Social Entrepreneurship 225
- 7.3 Innovation and the Industry Life Cycle 227
  - Introduction Stage* 228
  - Growth Stage* 230
  - Shakeout Stage* 233
  - Maturity Stage* 234
  - Decline Stage* 234
  - Crossing the Chasm* 235
- 7.4 Types of Innovation 242
  - Incremental vs. Radical Innovation* 243
  - Architectural vs. Disruptive Innovation* 245
- 7.5 Platform Strategy 249
  - The Platform vs. Pipeline Business Models* 249
  - The Platform Ecosystem* 250

## 7.6 Implications for Strategic Leaders 254

### CHAPTERCASE 7 / Consider This... 254

## CHAPTER 8

CORPORATE STRATEGY: VERTICAL INTEGRATION AND DIVERSIFICATION 264

### CHAPTERCASE 8 /

Amazon.com: To Infinity and Beyond 265

### 8.1 What Is Corporate Strategy? 268

*Why Firms Need to Grow* 268

*Three Dimensions of Corporate Strategy* 269

### 8.2 The Boundaries of the Firm 271

*Firms vs. Markets: Make or Buy?* 272

*Alternatives on the Make-or-Buy Continuum* 274

### 8.3 Vertical Integration along the Industry Value Chain 278

*Types of Vertical Integration* 279

*Benefits and Risks of Vertical Integration* 281

*When Does Vertical Integration Make Sense?* 283

*Alternatives to Vertical Integration* 284

### 8.4 Corporate Diversification: Expanding Beyond a Single Market 285

*Types of Corporate Diversification* 287

*Leveraging Core Competencies for Corporate*

*Diversification* 291

*Corporate Diversification and Firm Performance* 293

### 8.5 Implications for Strategic Leaders 297

### CHAPTERCASE 8 / Consider This... 298

## CHAPTER 9

CORPORATE STRATEGY: STRATEGIC ALLIANCES, MERGERS, AND ACQUISITIONS 308

### CHAPTERCASE 9 /

Little Lyft Gets Big Alliance Partners 309

### 9.1 How Firms Achieve Growth 310

*The Build-Borrow-Buy Framework* 310

### 9.2 Strategic Alliances 313

*Why Do Firms Enter Strategic Alliances?* 314

*Governing Strategic Alliances* 317

*Alliance Management Capability* 320

### 9.3 Mergers and Acquisitions 323

*Why Do Firms Merge With Competitors?* 323

*Why Do Firms Acquire Other Firms?* 325

*M&A and Competitive Advantage* 327

## 9.4 Implications for Strategic Leaders 329

### CHAPTERCASE 9 / Consider This... 330

## CHAPTER 10

GLOBAL STRATEGY: COMPETING AROUND THE WORLD 338

### CHAPTERCASE 10 /

Sweden's IKEA: The World's Most Profitable Retailer 339

### 10.1 What Is Globalization? 342

*Stages of Globalization* 343

*State of Globalization* 344

### 10.2 Going Global: Why? 346

*Advantages of Going Global* 346

*Disadvantages of Going Global* 350

### 10.3 Going Global: Where and How? 353

*Where In the World to Compete? The Cage Distance Framework* 353

*How Do MNEs Enter Foreign Markets?* 357

### 10.4 Cost Reductions vs. Local Responsiveness: The Integration-Responsiveness Framework 358

*International Strategy* 359

*Multidomestic Strategy* 360

*Global-Standardization Strategy* 360

*Transnational Strategy* 361

### 10.5 National Competitive Advantage: World Leadership in Specific Industries 362

*Porter's Diamond Framework* 364

### 10.6 Implications for Strategic Leaders 366

### CHAPTERCASE 10 / Consider This... 367

## PART THREE / IMPLEMENTATION 376

## CHAPTER 11

ORGANIZATIONAL DESIGN: STRUCTURE, CULTURE, AND CONTROL 378

### CHAPTERCASE 11 /

Zappos: Of Happiness and Holacracy 379

### 11.1 Organizational Design and Competitive Advantage 381

*Organizational Inertia: The Failure of Established Firms* 382

*Organizational Structure* 384

*Mechanistic vs. Organic Organizations* 385

**11.2 Strategy and Structure 387**

*Simple Structure 387*

*Functional Structure 388*

*Multidivisional Structure 390*

*Matrix Structure 394*

**11.3 Organizing for Innovation 398**

**11.4 Organizational Culture: Values, Norms, and**

**Artifacts 401**

*Where Do Organizational Cultures Come From? 403*

*How Does Organizational Culture Change? 404*

*Organizational Culture and Competitive Advantage 405*

**11.5 Strategic Control-and-Reward Systems 407**

*Input Controls 408*

*Output Controls 408*

**11.6 Implications for Strategic Leaders 409**

**CHAPTERCASE 11 / Consider This... 410**

**CHAPTER 12**

CORPORATE GOVERNANCE AND BUSINESS

ETHICS **418**

**CHAPTERCASE 12 /**

Uber: Most Ethically Challenged Tech Company? 419

**12.1 The Shared Value Creation Framework 421**

*Public Stock Companies and Shareholder Capitalism 421*

*Creating Shared Value 423*

**12.2 Corporate Governance 425**

*Agency Theory 426*

*The Board of Directors 428*

*Other Governance Mechanisms 430*

**12.3 Strategy and Business Ethics 433**

*Bad Apples vs. Bad Barrels 434*

**12.4 Implications for Strategic Leaders 437**

**CHAPTERCASE 12 / Consider This... 438**

**PART FOUR / MINICASES 447**

**PART FIVE / FULL-LENGTH CASES**

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

Company Index 539

Name Index 545

Subject Index 547

---

# ABOUT THE AUTHOR

---

## Frank T. Rothaermel

Georgia Institute of Technology

**FRANK T. ROTHAE RMEL (PH.D.)** is a Professor of Strategy & Innovation, holds the Russell and Nancy McDonough Chair in the Scheller College of Business at the Georgia Institute of Technology (GT), and is 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’s research interests lie in the areas of strategy, innovation, and entrepreneurship. Frank has published over 30 articles in leading academic journals such as the *Strategic Management Journal*, *Organization Science*, *Academy of Management Journal*, *Academy of Management Review*, and elsewhere. Based on having published papers in the top 1 percent based on citations, *Thomson Reuters* identified Frank as one of the “world’s most influential scientific minds.” He is listed among the top-100 scholars based on impact over more than a decade in both economics and business. *Bloomberg 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 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, the Israel Strategy Conference Best Paper Prize, and is the inaugural recipient of the Byars Faculty Excellence Award. Frank currently serves (or served) on the editorial boards of the *Strategic Management Journal*, *Organization Science*, *Academy of Management Journal*, *Academy of Management Review*, and *Strategic Organization*.

Frank regularly translates his research findings for wider audiences in articles in the *MIT Sloan Management Review*, *The Wall Street Journal*, *Forbes*, and elsewhere. To inform his research Frank 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), UPS, among others.

Frank has a wide range of executive education experience, including teaching in programs at GE Management Development Institute (Crotonville, NY), Georgia Institute of Technology, Georgetown University, ICN Business School (France), Politecnico di Milano (Italy), St. Gallen University (Switzerland), and the University of Washington. He received numerous teaching awards for excellence in the classroom including the GT-wide Georgia Power Professor of Excellence award.

When launched in 2012, Frank’s *Strategic Management* text received the McGraw-Hill 1st Edition of the Year Award in Business & Economics. His *Strategic Management* text has been translated into Mandarin, Korean, and Greek. Several of his case studies are Most Popular among the cases distributed by Harvard Business Publishing.

Frank held visiting professorships at the EBS University of Business and Law (Germany), Singapore Management University (Tommie Goh Professorship), and the University of St. Gallen (Switzerland). He is a member of the Academy of Management and the Strategic Management Society.

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 is Diplom-Volkswirt (M.Sc. equivalent) in economics from the University of Duisburg-Essen, Germany. Frank completed training in the case teaching method at the Harvard Business School.



©Tony Benner

**VISIT THE AUTHOR AT:** <http://ftrStrategy.com/>



The market for strategy texts can be broadly separated into two overarching categories: traditional, application-based and research-based. Traditional, application-based strategy books represent the first-generation texts with first editions published in the 1980s. The research-based strategy books represent the second-generation texts with first editions published in the 1990s. I wrote this book to address a needed new category—a third generation of strategy text that *combines* into one the student-accessible, application-oriented frameworks of the first-generation texts with the research-based frameworks of the second-generation texts.

The market response to this unique approach to teaching and studying strategy was overwhelmingly enthusiastic. Enthusiasm and support increased with each subsequent edition. I'm truly grateful for the sustained support.

To facilitate an enjoyable and refreshing reading experience that enhances student learning and retention, I synthesize and integrate strategy frameworks, empirical research, and practical applications with current real-world examples. This approach and emphasis on real-world examples offers students a learning experience that uniquely combines rigor and relevance. As Dr. John Medina of the University of Washington's School of Medicine and life long researcher on how the mind organizes information explains:

How does one communicate meaning in such a fashion that learning is improved? A simple trick involves the liberal use of relevant real-world examples, thus peppering main learning points with meaningful experiences. . . . Numerous studies show this works. . . . The greater the number of examples . . . the more likely the students were to remember the information. It's best to use real-world situations familiar to the learner. . . . Examples work because they take advantage of the brain's natural predilection for pattern matching. Information is more readily processed if it can be immediately associated with information already present in the brain. We compare the two inputs, looking for similarities and differences as we encode the new information. Providing examples is the cognitive equivalent of adding more handles to the door. [The more handles one creates at the moment of learning, the more likely the information can be accessed at a later date.] Providing examples makes the information more elaborative, more complex, better encoded, and therefore better learned.\*

*Strategic Management* brings conceptual frameworks to life via examples that cover products and services from companies with which students are familiar, such as Facebook, Google, Tesla, Starbucks, Apple, McDonald's, Disney, Airbnb, and Uber. Liberal use of such examples aids in making strategy relevant to students' lives and helps them internalize strategy concepts and frameworks. Integrating current examples with modern strategy thinking, I prepare students with the foundation they need to understand how companies gain and sustain competitive advantage. I also develop students' skills to become successful leaders capable of making well-reasoned strategic decisions in a globalized and turbulent 21st century.

I'm pleased to introduce the new 4<sup>th</sup> edition of *Strategic Management*. My distinctive approach to teaching and transmitting strategy not only offers students a unique learning experience that combines theory and practice, but also provides tight linkages between concepts and cases. In this new 4<sup>th</sup> edition, I build upon the unique strengths of this product, and continue to add improvements based upon hundreds of insightful reviews and

\*Source: Medina, J. (2014). *Brain Rules: 12 Principles for Surviving and Thriving at Work, Home, and School* (pp. 139–140). (Seattle: Pear Press).

important feedback from professors, students, and working professionals. The hallmark features of this text continue to be:

- Student engagement via practical and relevant application of strategy concepts using a holistic *Analysis, Formulation, and Implementation (AFI) Strategy Framework*.
- Synthesis and integration of empirical research and practical applications combined with relevant strategy material to focus on “*What is important?*” for the student and “*Why is it important?*”
- Emphasis on diversity by featuring a wide range of strategic leaders from different backgrounds and fields, not just in business, but also in entertainment, professional sports, and so forth.
- Coverage of an array of firms, including for-profit public (*Fortune 100*) companies, but also private companies (including startups) as well as non profit organizations. All of them need a good strategy!
- Global perspective, with a focus on competing around the world, featuring many leading companies from Asia, Europe, and Latin America, as well as the United States. I was fortunate to study, live, and work across the globe, and I attempt to bring this cosmopolitan perspective to bear in this text.
- Direct personal applications of strategy concepts to careers and lives to help internalize the content (including the popular myStrategy modules at the end of each chapter).
- Industry-leading digital delivery option (Create), adaptive learning system (Smart-Book), and online assignment and assessment system (Connect).
- Standalone module on *How to Conduct a Case Analysis*.
- High-quality **Cases**, well integrated with text chapters and standardized, high-quality teaching notes; there are two types of cases that come with this text:
  - 12 **ChapterCases** begin and end each chapter, framing the chapter topic and content.
  - 22 **MiniCases** (Part 4 of the book), all based on original research, provide dynamic opportunities for students 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 great pride in authoring all 12 ChapterCases, Strategy Highlights (2 per chapter, for a total of 24), and 22 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, 23 **full-length Cases**, with 20 of them (that is almost 90 percent!) authored or co-authored by me specifically to accompany this textbook, are available through McGraw-Hill’s custom-publishing Create™ program ([www.McGrawHill-Create.com/Rothaermel](http://www.McGrawHill-Create.com/Rothaermel)). Full-length cases NEW to the 4th edition are:

- Uber
- Netflix
- Starbucks
- Disney
- Walmart
- SpaceX



Popular cases about Apple, Amazon, Facebook, McDonald's, Tesla, and Best Buy among several others are significantly updated and revised. Robust and structurally updated case teaching notes are also available and accessible through Create; financial data for these cases may be accessed from the Instructor Resource Center in the Connect Library.

## What's New in the 4th Edition?

I have revised and updated the 4th edition in the following ways, many of which were inspired by conversations and feedback from the many users and reviewers of the prior editions.

### OVERVIEW OF MAJOR CHANGES IN 4E:

- New A-head section on “Changes over Time: Entry Choices and Industry Dynamics” in Chapter 3.
- New A-head section on “The Value Chain and Strategic Activity Systems” in Chapter 4.
- New A-head section “Platform Strategy” in Chapter 7.
- New A-head section “Organizing for Innovation” in Chapter 11 (closed and open innovation).
- All new or updated and revised ChapterCases (including: Tesla, Sheryl Sandberg at Facebook, Airbnb, Uber vs. Lyft, IKEA, and Zappos).
- All new or updated and revised StrategyHighlights (two per chapter).
- New or fully updated and revised MiniCases (four new, 18 revised and updated).
- Fully updated and revised full-length cases, including most popular cases such as Apple, McDonald's, Best Buy, Amazon, Facebook, Delta Air Lines, Alphabet's Google, etc.

In detail:

### CHAPTER 1

- New ChapterCase: “Tesla's Secret Strategy.”
- New Strategy Highlight: “Teach for America: How Wendy Kopp Inspires Future Leaders.”
- Improved chapter flow through moving the updated section on “Vision, Mission, and Values” into Chapter 1 (from Chapter 2).

### CHAPTER 2

- New ChapterCase: “Sheryl Sandberg: Leaning in at Facebook.”
- Improved chapter flow through moving the updated section on “Stakeholder Strategy” into Chapter 2 (from Chapter 1).

### CHAPTER 3

- New ChapterCase: “Airbnb: Disrupting the Hotel Industry.”
- New A-head section on “Changes over Time: Entry Choices and Industry Dynamics.”
- Improved chapter flow through moving the updated section on industry and firm effects into Chapter 3 (from Chapter 1).

## CHAPTER 4

- New A-head section on “The Value Chain and Strategic Activity Systems.”
- New Strategy Highlight: “When Will P&G Play to Win Again?”

## CHAPTER 5

- New section on “the Why, What, Who, and How of Business Models Framework.”
- Extended and updated discussion of business models to include new popular applications and examples, with a more in-depth discussion.
- Extended and updated discussion of competitive advantage and firm performance using the ongoing competition between Apple and Microsoft as an example throughout the chapter, including comparing the same two companies along different metrics and approaches to assess competitive advantage. Added a stronger dynamic element.

## CHAPTER 6

- New section on the learning curve concept applied to Tesla’s manufacturing process with real-world data and graphic illustration.

## CHAPTER 7

- New A-head section “Platform Strategy.”
- New Strategy Highlight “Standards Battle: Which Automotive Technology Will Win?”

## CHAPTER 8

- Updated and revised ChapterCase featuring Amazon’s corporate strategy through vertical integration and diversification.
- Updated and expanded section on parent-subsidiary relationship, featuring GM and (former) subsidiaries Opel and Vauxhall in Europe.

## CHAPTER 9

- New ChapterCase: “Little Lyft Gets Big Alliance Partners,” featuring the smaller ride-hailing competitor’s astute use of strategic alliances with strong partners such as GM and Alphabet’s Waymo to compete against Uber.
- New Strategy Highlight “How Tesla Used Alliances Strategically”.

## CHAPTER 10

- New section on “Globalization 3.1: Retrenchment?”
- Updated and revised ChapterCase: “Sweden’s IKEA: The World’s Most Profitable Retailer,” highlighting IKEA’s strategy on competing in both developed and emerging economies across the world.
- New Exhibit 10.4 juxtaposing: “Advantages and Disadvantages of International Expansion”.
- Updated and revised Strategy Highlight: “Walmart Retreats from Germany, and Lidl Invades the United States,” highlighting how disruptors of the German grocery industry (Aldi and Lidl) are challenging Walmart on its home turf.

## CHAPTER 11

- New A-head Section “Organizing for Innovation” (closed and open innovation).
- New Strategy Highlight: “Sony vs. Apple: Whatever Happened to Sony?”
- New Exhibit 11.11 juxtaposing: “Advantages and Disadvantages of Different Organizational Structures”.

## CHAPTER 12

- Updated and revised ChapterCase: “Uber: Most Ethically Challenged Tech Company?” including co-founder and long-time CEO Travis Kalanick’s forced resignation in the wake of several ethics scandals.
- Updated and revised Strategy Highlight: “Why the Mild Response to Goldman Sachs and Securities Fraud?”

## MINICASES

- Added four-new: Yahoo, IBM, Dollar Shave Club, and Disney.
- Updated and revised the most popular 18 MiniCases from the third edition.
- Stronger focus on non-U.S. firms, especially on global competitors from Asia and Europe.
- Stronger focus on U.S. companies competing in China and India, facing strong domestic competitors.

## FULL-LENGTH CASES

- All cases—including the new and revised cases plus all cases from the previous editions that were authored by Frank T. Rothaermel—are available through McGraw-Hill Create: <http://www.mcgrawhillcreate.com/Rothaermel>.
- Added five new, author-written full-length Cases: Netflix, Starbucks, Uber, Walmart, and Disney.
- Added one new, full-length Case: SpaceX by David R. King
- Revised and updated the most popular cases including: Amazon, Apple, Alphabet’s Google, Best Buy, Facebook, McDonald’s, Tesla, Delta Air Lines, and UPS in India, among others.
- Updated and revised the popular case “The Movie Exhibition Industry” by Steve Gove.
- Case Strategic Financial Analyses (SFAs) include financial data in e-format for analysis.

## CONNECT

**Connect**, McGraw-Hill’s online assignment and assessment system, offers a wealth of content for both students and instructors. Assignable activities include the following:

- **SmartBook**, one of the first fully adaptive and individualized study tools, provides students with a personalized learning experience, giving them the opportunity to practice and challenge their understanding of core strategy concepts. SmartBook has been extremely well received by strategy instructors across the globe. It allows the instructor to set up all assignments prior to the semester, to have them auto-released on pre-set dates, and to receive auto-graded progress reports for each student and the entire class. Students love SmartBook because they learn at their own pace, and it helps

them to study more efficiently by delivering an interactive reading experience through adaptive highlighting and review.

- **Interactive Application Exercises** (such as Whiteboard Animation video cases, MiniCase case analyses, click-and-drag activities, and new case exercises for Amazon, Apple, Tesla, McDonald's, Best Buy, and Facebook) that require students to apply key concepts and so to close the knowing and doing gap, while providing instant feedback for the student and progress tracking for the instructor.
- **Running case**, an activity that begins with a review of a specific company and its applied strategy using appropriate tools (e.g., PESTEL, Porter's five forces, VRIO, SWOT, and others). The analysis progresses from a broad perspective to the appropriate company-level perspective—i.e., from global to industry to strategic group to company and within a firm. Students will develop a complete strategy analysis for the company and consider several scenarios for improving the company's competitive advantage. The scenarios will include a financial analysis and justification and ultimately provide a specific recommendation. Connect provide a running case example for Hewlett-Packard (now HP Inc. and Hewlett Packard Enterprise).
- **Resources for financial analysis** (such as strategic financial ratios, templates for strategic financial analysis, and financial ratio reviews) that provide students with the tools they need to compare performance among firms and to refresh or extend their working knowledge of major financial measures in a strategic framework.

## CREATE

- **CREATE**, McGraw-Hill's custom-publishing tool, is where you access the full-length cases (and Teaching Notes) that accompany *Strategic Management* (<http://www.mcgrawhillcreate.com/Rothaermel>). You can create customized course packages in print and/or digital form at a competitive price point.
- Through CREATE, you will be able to select from 20 author-written cases and 3 instructor-written cases that go specifically with the new 4<sup>th</sup> edition, as well as cases from Harvard, Ivey Darden, NACRA, and much more! You can: Assemble your own course, selecting the chapters, cases (multiple different formats), and readings that will work best for you. Or choose from several ready-to-go, author-recommended complete course solutions, which include chapters, cases, and readings, pre-loaded in CREATE. Among the pre-loaded solutions, you'll find options for undergrad, MBA, accelerated, and other strategy courses.

## INSTRUCTOR RESOURCES

Located in the Connect Library under the **Instructor's Resources** tab, instructors will find tested and effective tools to support teaching:

- The updated and revised **Teacher's Resource Manual (TRM)** includes thorough coverage of each chapter, as well as guidance for integrating Connect—all in a single resource. Included in this newly combined TRM, which retains favorite features of the previous edition's Instructor's Manual, is the appropriate level of theory, framework, recent application or company examples, teaching tips, PowerPoint references, critical discussion topics, and answers to end-of-chapter exercises.
- The **PowerPoint (PPT)** slides, available in an accessible version for individuals with visual impairment, provide comprehensive lecture notes, video links, and company

examples not found in the textbook. Options include 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 objectives, Bloom's Taxonomy levels, and AACSB compliance requirements. Many questions are new, and especially written for the new 4th edition.
- The **Video Guide** includes video links 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.

---

## ACKNOWLEDGMENTS

---

Any list of acknowledgments will almost always be incomplete, but I would like to thank some special people without whom this text would not have been possible. First and foremost, my wife Kelleyn, and our children: Harris, Winston, Roman, Adelaide, Avery, and Ivy. Over the last few years, I have worked longer hours than when I was a graduate student to conduct the research and writing necessary for this text and accompanying case studies and other materials. I sincerely appreciate the sacrifice this has meant for my family.

The Georgia Institute of Technology provided a conducive, intellectual environment and superb institutional support to make this project possible. I thank Russell and Nancy McDonough for generously funding the endowed chair that I am honored to hold. I'm grateful for Dean Maryam Alavi and Senior Associate Dean Peter Thompson for providing the exceptional leadership that allows faculty to fully focus on research, teaching, and service. I have been at Georgia Tech for 15 years, and could not have had better colleagues—all of whom are not only great scholars but also fine individuals whom I'm fortunate to have as friends: Marco Ceccagnoli, Annamaria Conti, Jonathan Giuliano, Stuart Graham, Matt Higgins, David Ku, John McIntyre, Alex Oettl, Pian Shu, Eunhee Sohn, and Laurina Zhang. We have a terrific group of current and former PhD students, many of whom had a positive influence on this project, including Shanti Agung (Drexel University), Drew Hess (Washington and Lee University), Kostas Grigoriou (McKinsey), Congshan Li, Jaiswal Mayank (Rider University), Nicola McCarthy, German Retana (INCAE Business School, Costa Rica), Maria Roche, Briana Sell Stenard (Mercer University), Jose Urbina, Carrie Yang (University of Chicago), and Wei Zhang (Singapore Management University).

I was also fortunate to work with McGraw-Hill, and the best editorial and marketing team in the industry: Michael Ablassmeir (director), Susan Gouijnstook (managing director), Lai T. Moy (senior product developer), Debbie Clare (executive marketing manager), Mary E. Powers and Keri Johnson (content project managers), Matt Diamond (senior designer), and Haley Burmeister (editorial coordinator). Bill Teague, content development editor, worked tirelessly and carefully on the fourth edition manuscript. I'm also indebted to Ann Torbert and Karyn Lu for invaluable editorial guidance on prior editions.

I'm more than grateful to the contributions of great colleagues on various resources that accompany this new edition of *Strategic Management*:

- Heidi Bertels (College of Staten Island, CUNY) on the Test Bank and *SmartBook*
- John Burr (Purdue University) on the *Video Guide*
- Melissa Francisco (University of Central Florida) on the accessible *PowerPoint Presentations*
- Anne Fuller (California State University, Sacramento), on *Connect*, *Teacher's Resource Manual*, and *End-of-Chapter Material*
- David R. King (Florida State University) on select *Full-length Cases* and *Full-length Case Teaching Notes*
- Chandran Mylvaganam (Northwood University) on the *MiniCase Teaching Notes*  
Shawn Riley (Kutztown University) for his expert reviews on the *Case Exercises*, *Case SFAs*, and *MiniCase Case Analyses*

I'd also like to thank the students at Georgia Tech, in the undergraduate and full-time day MBA, and the evening and executive MBA programs, as well as the executive MBA students from the ICN Business School in Nancy, France, on whom the materials were beta-tested. Their feedback helped fine-tune the content and delivery.

Last, but certainly not least, I wish to thank the reviewers and focus group attendees who shared their expertise with us, from the very beginning when we developed the prospectus to the final teaching and learning package that you hold in your hands. The reviewers have given us the greatest gift of all—the gift of time! These very special people are listed starting on page xxii.

Frank T. Rothaermel  
*Georgia Institute of Technology*

Web: [ftrStrategy.com](http://ftrStrategy.com)  
Email: [frank@ftrStrategy.com](mailto:frank@ftrStrategy.com)

# 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 as well as market reviews of the of subsequent editions 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.

## REVIEWERS AND SYMPOSIUM ATTENDEES

Joshua R. Aaron <i>East Carolina University</i>	Bindu Arya <i>University of Missouri, St. Louis</i>	Geoff Bell <i>University of Minnesota, Duluth</i>
Moses Acquah <i>University of North Carolina, Greensboro</i>	Elton Scifres <i>Stephen F. Austin State University</i>	Bruce W. Bellner <i>The Ohio State University</i>
Garry Adams <i>Auburn University</i>	Seung Bach <i>California State University, Sacramento</i>	Heidi Bertels <i>City University of New York, Staten Island</i>
M. David Albritton <i>Northern Arizona University</i>	Jeffery Bailey <i>University of Idaho</i>	Lorenzo Bizzi <i>California State University, Fullerton</i>
Benjamin N. Alexander <i>California Polytechnic State University</i>	David Baker <i>Kent State University</i>	Tim Blumentritt <i>Kennesaw State University</i>
Brent B. Allred <i>The College of William &amp; Mary</i>	LaKami T. Baker <i>Auburn University</i>	William C. Bogner <i>Georgia State University</i>
Semiramis Amirpour <i>University of Texas, El Paso</i>	Dennis R. Balch <i>University of North Alabama</i>	David S. Boss <i>Ohio University</i>
Cory J. Angert <i>University of Houston-Downtown</i>	Edward R. Balotsky <i>Saint Joseph's University</i>	Michael Bowen <i>University of South Florida</i>
Melissa Appleyard <i>Portland State University</i>	Kevin Banning <i>Auburn University, Montgomery</i>	Nathan A. Bragaw <i>Louisiana State University</i>
Jorge A. Arevalo <i>William Paterson University</i>	Jeff Barden <i>Oregon State University</i>	Dorothy Brawley <i>Kennesaw State University</i>
Asli Arikan <i>Kent State University</i>	James W. Barrow <i>Suffolk University</i>	Wm. David Brice <i>California State University, Dominguez Hills</i>
Marne Arthaud-Day <i>Kansas State University</i>	Patricia Beckenholdt <i>University of Maryland University College</i>	Michael G. Brizek <i>South Carolina State University</i>



James W. Bronson <i>University of Wisconsin, Whitewater</i>	Betty S. Coffey <i>Appalachian State University</i>	Mohinder Dugal <i>Western Connecticut State University</i>
Jill A. Brown <i>Bentley University</i>	Anne N. Cohen <i>University of Minnesota</i>	Arthur J. Duhaime III <i>Nichols College</i>
Barry Bunn <i>Valencia College</i>	Brian Connelly <i>Auburn University</i>	David Duhon <i>University of Southern Mississippi</i>
Richard A. L. Caldarola <i>Troy University</i>	W. J. Conwell <i>University of Texas at El Paso</i>	Danielle Dunne <i>Fordham University</i>
Janice F. Cervený <i>Florida Atlantic University</i>	Rick Corum <i>Liberty University</i>	Supradeep Dutta <i>State University of New York, Buffalo</i>
Clint Chadwick <i>University of Alabama, Huntsville</i>	Cynthia S. Cycyota <i>United States Air Force Academy</i>	Loretta S. Duus <i>Midlands Technical College</i>
Kenneth H. Chadwick <i>Nicholls State University</i>	Derrick E. D'Souza <i>University of North Texas</i>	Jason Scott Earl <i>Brigham Young University Hawaii</i>
Jay P. Chandran, <i>Northwood University</i>	Parthiban David <i>American University</i>	Andrew G. Earle <i>University of New Hampshire</i>
Jianhong Chen <i>University of New Hampshire</i>	Samuel DeMarie <i>Iowa State University</i>	Helen Eckmann <i>Brandman University</i>
Tianxu Chen <i>Oakland University</i>	Irem Demirkan <i>Northeastern University</i>	Linda F. Edelman <i>Bentley University</i>
Yi-Yu Chen <i>New Jersey City University</i>	Geoffrey Desa <i>San Francisco State University</i>	Alan Ellstrand <i>University of Arkansas, Fayetteville</i>
Steve Childers <i>Radford University</i>	Edward Desmarais <i>Salem State University</i>	David Epstein <i>University of Houston Downtown</i>
Sanjib Chowdhury <i>Eastern Michigan University</i>	Michael E. Dobbs <i>Eastern Illinois University</i>	Michael M. Fathi <i>Georgia Southwestern State University</i>
Valerie L. Christian <i>Sacred Heart University</i>	Mark Dobeck <i>Cleveland State University</i>	Kevin Fertig <i>University of Illinois at Urbana, Champaign</i>
Brent Clark <i>University of South Dakota</i>	Darla Domke-Damonte <i>Coastal Carolina University</i>	James Fiet <i>University of Louisville</i>
Timothy S. Clark <i>Northern Arizona University</i>	Stephen A. Drew <i>Florida Gulf Coast University</i>	
John Clarry <i>Rutgers University</i>		



Robert S. Fleming <i>Rowan University</i>	Sanjay Goel <i>University of Minnesota Duluth</i>	Theodore T. Herbert <i>Rollins College</i>
Daniel Forbes <i>University of Minnesota</i>	Steve Gove <i>University of Vermont</i>	Kurt Herrmann <i>Brigham Young University</i>
Isaac Fox <i>University of Minnesota</i>	Patrick Greek <i>Macomb Community College</i>	Ken Hess <i>Metropolitan State University</i>
Susan Fox-Wolfgramm <i>Hawaii Pacific University</i>	Shirley A. Green <i>Indian River State College</i>	Scott Hicks <i>Liberty University</i>
William Foxx <i>Troy University</i>	Regina A. Greenwood <i>Nova Southeastern University</i>	Glenn Hoetker <i>Arizona State University</i>
Charla S. Fraley <i>Columbus State Community College</i>	Robert D. Gulbro <i>Athens State University</i>	Phyllis Holland <i>Valdosta State University</i>
W.A. Franke <i>Northern Arizona University</i>	Michael Gunderson <i>University of Florida</i>	R. Michael Holmes, Jr. <i>Florida State University</i>
Steven A. Frankforter <i>Winthrop University</i>	Craig Gustin <i>American InterContinental University</i>	Stephen V. Horner <i>Arkansas State University</i>
Anne W. Fuller <i>California State University, Sacramento</i>	Stephen F. Hallam <i>University of Akron</i>	George Hruby <i>Cleveland State University</i>
Venessa Funches <i>Auburn University, Montgomery</i>	Marcia McLure Hardy, <i>Northwestern State University, Louisiana</i>	Tammy Huffman <i>Utah Valley University</i>
Jeffrey Furman <i>Boston University</i>	Ahma Hassan <i>Morehead State University</i>	Tobias M. Huning <i>Columbus State University</i>
Scott Gallagher <i>James Madison University</i>	Scott D. Hayward <i>Elon University/ Appalachian State University</i>	Tammy G. Hunt <i>University of North Carolina Wilmington</i>
David L. Gartenberg <i>Seattle University</i>	Jon Timothy Heames <i>West Virginia University</i>	Ana Elisa Iglesias <i>University of Wisconsin, La Crosse</i>
John E. Gentner <i>University of Dayton</i>	Richard A. Heiens <i>University of South Carolina, Aiken</i>	Syeda Noorein Inamdar <i>The Chinese University of Hong Kong</i>
Jim Glasgow <i>Villanova University</i>	Duane Helleloid <i>University of North Dakota</i>	John G. Irwin <i>Troy University</i>
Eric Glymph <i>Virginia Commonwealth University</i>	Kurt A. Heppard <i>United States Air Force Academy</i>	Carol K. Jacobson <i>Purdue University</i>
Devi R. Gnyawali <i>Virginia Tech</i>		Sean Jasso <i>University of California, Riverside</i>

- Scott Johnson  
*Oklahoma State University*
- Mahesh P. Joshi  
*George Mason University*
- Jon Kalinowski  
*Minnesota State University, Mankato*
- Necmi Karagozoglu  
*California State University, Sacramento*
- Joy Karriker  
*East Carolina University*
- J. Kay Keels  
*Coastal Carolina University*
- Franz Kellermanns  
*University of North Carolina, Charlotte*
- Theodore A. Khoury  
*Portland State University*
- David King  
*Iowa State University*
- Brent Kinghorn  
*Missouri State University*
- Jerry Kopf  
*Radford University*
- Donald J. Kopka, Jr.  
*Towson University*
- Frank Kozak  
*Bowling Green State University*
- Mario Krenn  
*Louisiana State University*
- Bruce C. Kusch  
*Brigham Young University, Idaho*
- Melody Waller LaPreze  
*Missouri State University*
- K. Blaine Lawlor  
*University of West Florida*
- Marty Lawlor  
*Rochester Institute of Technology*
- John Lawrence  
*University of Idaho*
- Mariana J. Lebrn,  
*Towson University*
- Hun Lee  
*George Mason University*
- Jay Lee  
*California State University Sacramento*
- Mina Lee  
*Xavier University*
- Charles J. F. Leflar  
*University of Arkansas, Fayetteville*
- Jon Lehman  
*Vanderbilt University*
- David Leibsohn  
*California State University, Fullerton*
- Aristotle T. Lekacos  
*Stony Brook University*
- Jun Lin  
*State University of New York, New Paltz*
- Joseph Mahoney  
*University of Illinois at Urbana-Champaign*
- David Major  
*Indiana University*
- Paul Mallette  
*Colorado State University*
- Tatiana S. Manolova  
*Bentley University*
- Daniel B. Marin  
*Louisiana State University*
- Sarah Marsh  
*Northern Illinois University*
- Louis Martinette  
*University of Mary Washington*
- Anthony U. Martinez  
*San Francisco State University*
- Blake Mathias  
*Louisiana State University*
- Patricia Matuszek Troy  
*University, Montgomery*
- David McCalman  
*University of Central Arkansas*
- Jeffrey E. McGee  
*The University of Texas, Arlington*
- Jean McGuire  
*Louisiana State University*
- Rick McPherson  
*University of Washington*
- Michael Merenda  
*University of New Hampshire*
- John M. Mezas  
*University of Miami*
- Grant Miles  
*University of North Texas*
- Douglas R. Miller  
*University of North Carolina, Wilmington*
- Michael Miller  
*University of Illinois, Chicago*
- Elouise Mintz  
*Saint Louis University*
- Raza Mir  
*William Paterson University*

- |  |  |  |
|--|--|--|
| Kelly Mollica<br><i>University of Memphis</i>                      | Kevin J. O'Mara<br><i>Elon University</i>                          | JoDee Phillips<br><i>Kaplan University</i>                           |
| Mike Montalbano<br><i>Bentley University</i>                       | Kenny (Kyeungrae) Oh<br><i>University of Missouri, St. Louis</i>   | Michael W. Pitts<br><i>Virginia Commonwealth University</i>          |
| Debra L. Moody<br><i>Virginia Commonwealth University</i>          | Don Okhomina,<br><i>Fayetteville State University</i>              | Erin Pleggenkuhle-Miles<br><i>University of Nebraska-Omaha</i>       |
| Gwen Moore<br><i>University of Missouri, St. Louis</i>             | Eren Ozgen<br><i>Troy University-Dothan</i>                        | Robert Porter<br><i>University of Central Florida</i>                |
| James P. Morgan<br><i>Webster University, Fort Leonard Wood</i>    | Chris Papenhausen<br><i>University of Massachusetts, Dartmouth</i> | Richard A. Quinn<br><i>University of Central Florida</i>             |
| Richard T. Mpoyi<br><i>Middle Tennessee State University</i>       | James M. Pappas<br><i>Oklahoma State University</i>                | Vasudevan Ramanujam<br><i>Case Western Reserve University</i>        |
| John Mullane<br><i>Middle Tennessee State University</i>           | Audrey Parajon<br><i>Wilmington University</i>                     | Krishnan Ramaya<br><i>Pacific University</i>                         |
| Chandran Mylvaganam<br><i>Northwood University, Michigan</i>       | Dr. Audrey Parajon,<br><i>Wilmington University</i>                | Annette L. Ranft<br><i>University at Tennessee</i>                   |
| Louise Nemanich<br><i>Arizona State University</i>                 | Ronaldo Parente<br><i>Florida International University</i>         | Christopher R. Reutzell<br><i>Sam Houston State University</i>       |
| Don O. Neubaum<br><i>Oregon State University</i>                   | Srikanth Paruchuri<br><i>Pennsylvania State University</i>         | Gary B. Roberts<br><i>Kennesaw State University</i>                  |
| Charles Newman<br><i>University of Maryland University College</i> | Christine Cope Pence<br><i>University of California, Riverside</i> | Simon Rodan<br><i>San Jose State University</i>                      |
| Kuei-Hsien Niu<br><i>California State University, Sacramento</i>   | Luis A. Perez-Batres<br><i>Central Michigan University</i>         | Jessica R. Salmon<br><i>Rutgers University</i>                       |
| Jill Novak<br><i>Indian River State College</i>                    | Clifford R. Perry<br><i>Florida International University</i>       | Yassir M. Samra<br><i>Manhattan College</i>                          |
| Frank Novakowski<br><i>Davenport University</i>                    | Keith Perry<br><i>San Jose State University</i>                    | Michael D. Santoro<br><i>Lehigh University</i>                       |
| Jeffrey R. Nystrom<br><i>University of Colorado Denver</i>         | Antoaneta Petkova<br><i>San Francisco State University</i>         | Tim Schoenecker<br><i>Southern Illinois University, Edwardsville</i> |
|  |  | Elton Scifres<br><i>Stephen F. Austin State University</i>           |

- |   |  |  |
|---|--|--|
| Gary Scudder<br><i>Vanderbilt University</i>                                | James D. Spina<br><i>University of Maryland</i>                | Rashada Houston Turner<br><i>Florida A&amp;M University</i>                          |
| Wendell Seaborne<br><i>Franklin University</i>                              | Peter A. Stanwick<br><i>Auburn University</i>                  | Beverly B. Tyler<br><i>North Carolina State University</i>                           |
| Deborah Searcy<br><i>Florida Atlantic University</i>                        | Mark Starik<br><i>San Francisco State University</i>           | Isaiah O. Ugboro<br><i>North Carolina A&amp;T State University</i>                   |
| Russell Seidle<br><i>Suffolk University, Boston</i>                         | Warren Stone,<br><i>University of Arkansas at Little Rock.</i> | Barry VanderKelen<br><i>California Polytechnic State University, San Luis Obispo</i> |
| Jim Sena<br><i>California Polytechnic State University, San Luis Obispo</i> | Mohan Subramaniam<br><i>Boston College</i>                     | Jorge Walter<br><i>The George Washington University</i>                              |
| Anju Seth<br><i>Virginia Tech</i>   | Ram Subramanian<br><i>Montclair State University</i>           | Bruce Walters<br><i>Louisiana Tech University</i>                                    |
| Deepak Sethi<br><i>Old Dominion University</i>                              | James Anthony Swaim<br><i>Kennesaw State University</i>        | Jia Wang<br><i>California State University, Fresno</i>                               |
| Jennifer Sexton<br><i>West Virginia University</i>                          | Timothy Syfert<br><i>Grand Valley State University</i>         | David B. Wangrow<br><i>Marquette University</i>                                      |
| Ali Shahzad<br><i>James Madison University</i>                              | Carol M. Sánchez<br><i>Grand Valley State University</i>       | Andrew Ward<br><i>Lehigh University</i>  |
| Mark Sharfman<br><i>University of Oklahoma</i>                              | Jing'an Tang<br><i>Sacred Heart University</i>                 | Vincent Weaver<br><i>Greenville Technical College</i>                                |
| Thomas Shirley<br><i>San Jose State University</i>                          | Linda F. Tegarden<br><i>Virginia Tech</i>                      | Joel West<br><i>Claremont Graduate University</i>                                    |
| Eugene S. Simko<br><i>Monmouth University</i>                               | Robert Thompson<br><i>University of Texas, San Antonio</i>     | Laura Whitcomb<br><i>California State University, Los Angeles</i>                    |
| Faye A. Sisk<br><i>Mercer University, Atlanta</i>                           | Paul W. Thurston, Jr.<br><i>Siena College</i>                  | George O. White III<br><i>University of Michigan, Flint</i>                          |
| Lise Anne D. Slatten<br><i>University of Louisiana, Lafayette</i>           | Thuhang Tran<br><i>Middle Tennessee State University</i>       | Margaret White<br><i>Oklahoma State University</i>                                   |
| Alan D. Smith<br><i>Kent State University/Robert Morris University</i>      | Kim K. J. Tullis<br><i>University of Central Oklahoma</i>      |  |
| Garry D. Smith<br><i>Mississippi State University</i>                       |  |  |
| Ned Smith<br><i>University of Michigan</i>                                  |  |  |

Marta Szabo White  
*Georgia State University*

Carolyn Wiethoff  
*Indiana University*

Scott Williams  
*Wright State University*

James Winters  
*Portland State University*

Ross A. Wirth  
*Franklin University*

Cathy Coleman Wood  
*University of Tennessee*

Robert Chapman Wood  
*San Jose State University*

Beth Woodard  
*Belmont University*

Chuanyin Xie  
*The University of  
Tampa*

George Young,  
*Liberty University*

John Yudelson  
*California State University  
Northridge*

Michael J. Zhang  
*Sacred Heart University*

Zhe Zhang  
*Eastern Kentucky  
University*

Xia Zhao  
*California State University,  
Dominguez Hills*

Yanfeng Zheng  
*The University of  
Hong Kong*

Arvids A. Ziedonis  
*Boston University*



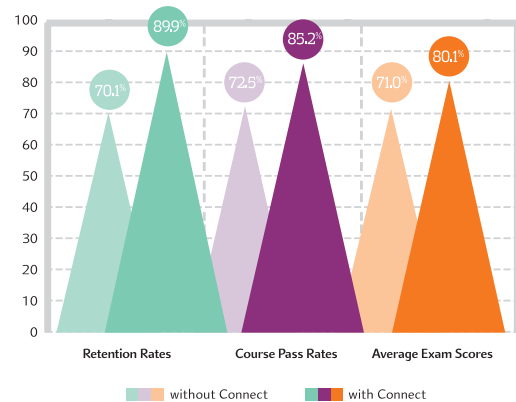
McGraw-Hill Connect® is a highly reliable, easy-to-use homework and learning management solution that utilizes learning science and award-winning adaptive tools to improve student results.

## Homework and Adaptive Learning

- Connect's assignments help students contextualize what they've learned through application, so they can better understand the material and think critically.
- Connect will create a personalized study path customized to individual student needs through SmartBook®.
- SmartBook helps students study more efficiently by delivering an interactive reading experience through adaptive highlighting and review.

Over **7 billion questions** have been answered, making McGraw-Hill Education products more intelligent, reliable, and precise.

Connect's Impact on Retention Rates, Pass Rates, and Average Exam Scores

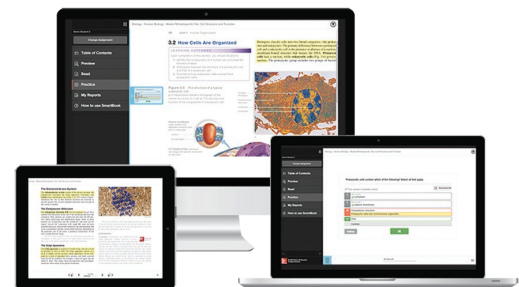


Using **Connect** improves retention rates by **19.8** percentage points, passing rates by **12.7** percentage points, and exam scores by **9.1** percentage points.

73% of instructors who use **Connect** require it; instructor satisfaction increases by 28 percentage points when **Connect** is required.

## Quality Content and Learning Resources

- Connect content is available to your class through a simple and intuitive interface.
- The Connect eBook makes it easy for students to access their study material on smartphones and tablets. They can study on the go and don't need internet access to use the eBook as a reference, with full functionality.
- Multimedia content such as videos, simulations, and games drive student engagement and critical thinking skills.

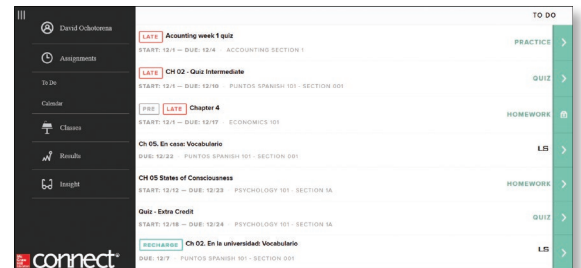


# Robust Analytics and Reporting

- Connect Insight® generates easy-to-read reports on individual students, the class as a whole, and on specific assignments.
- The Connect Insight dashboard delivers data on performance, study behavior, and effort. Instructors can quickly identify students who struggle and focus on material that the class has yet to master.
- Connect automatically grades assignments and quizzes, providing easy-to-read reports on individual and class performance.



©Hero Images/Getty Images RF



More students earn  
**As** and **Bs** when  
they use **Connect**.

## Trusted Service and Support

- Connect integrates with your LMS to provide single sign-on and automatic syncing of grades. Integration with Blackboard®, D2L®, and Canvas also provides automatic syncing of the course calendar and assignment-level linking.
- Connect offers comprehensive service, support, and training throughout every phase of your implementation.
- If you're looking for some guidance on how to use Connect, or want to learn tips and tricks from super users, you can find tutorials as you work. Our Digital Faculty Consultants and Student Ambassadors offer insight into how to achieve the results you want with Connect.

[www.mheducation.com/connect](http://www.mheducation.com/connect)



PART

# 1 Analysis

---

**CHAPTER 1** What Is Strategy?

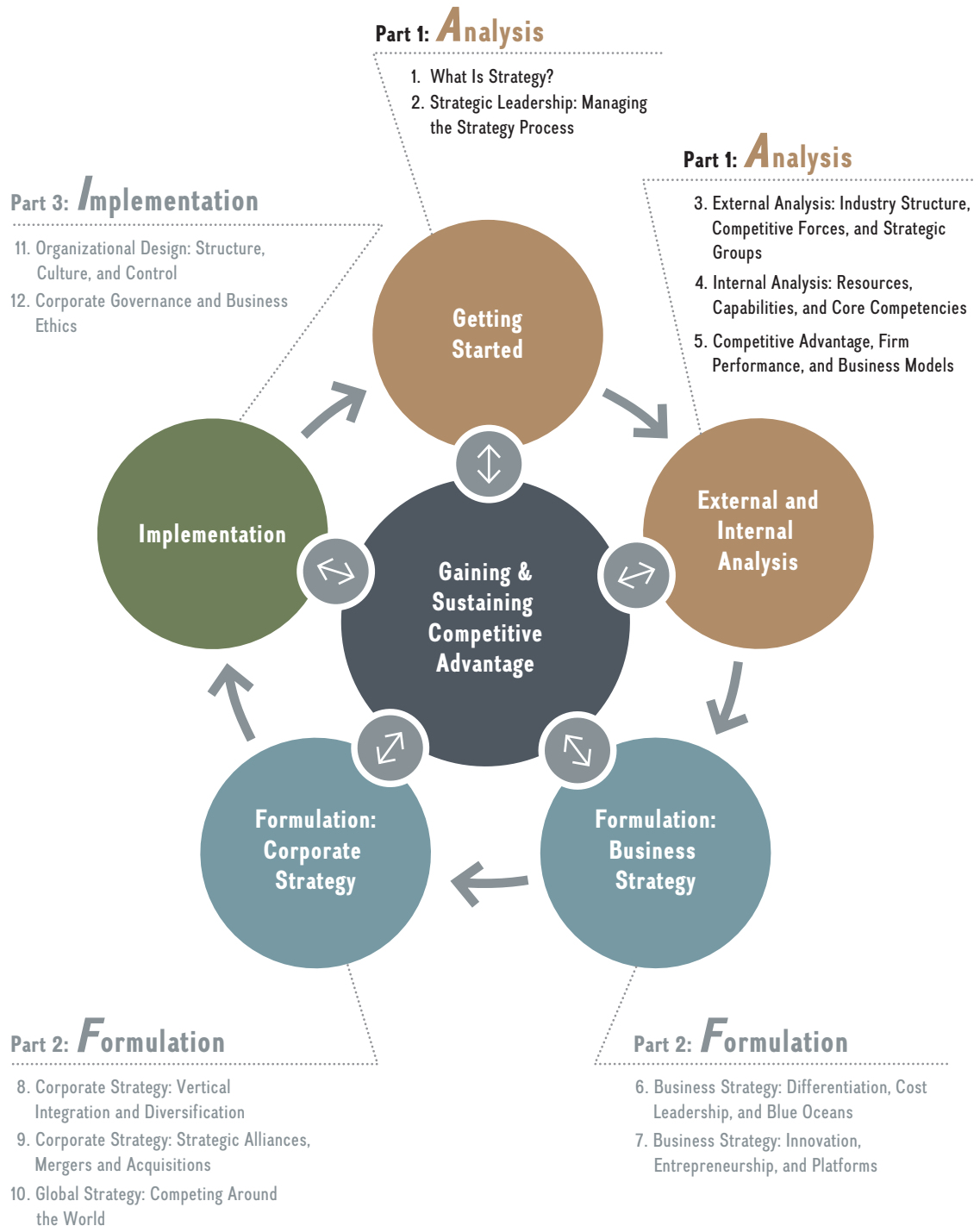
**CHAPTER 2** Strategic Leadership: Managing the Strategy Process

**CHAPTER 3** External Analysis: Industry Structure, Competitive Forces, and Strategic Groups

**CHAPTER 4** Internal Analysis: Resources, Capabilities, and Core Competencies

**CHAPTER 5** Competitive Advantage, Firm Performance, and Business Models

# The AFI Strategy Framework





# CHAPTER 1 What Is Strategy?

# 1

## Chapter Outline

- 1.1** What Strategy Is: Gaining and Sustaining Competitive Advantage  
*What Is Competitive Advantage?*
- 1.2** Vision, Mission, and Values  
*Vision*  
*Mission*  
*Values*
- 1.3** The AFI Strategy Framework
- 1.4** Implications for Strategic Leaders

## Learning Objectives

- 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** Describe the roles of vision, mission, and values in a firm's strategy.
- LO 1-4** Evaluate the strategic implications of product-oriented and customer-oriented vision statements.
- LO 1-5** Justify why anchoring a firm in ethical core values is essential for long-term success.
- LO 1-6** Explain the AFI strategy framework.

## Tesla's Secret Strategy

**IN 2017, TESLA INC.**—an American manufacturer of all-electric cars—boasted a market capitalization<sup>1</sup> of over \$60 billion, an appreciation of more than 1,400 percent over its initial public offering price in 2010. How can a California startup achieve a market valuation that exceeds that of GM, the largest car manufacturer in the world, making some 10 million vehicles a year? The answer: Tesla's Secret Strategy. In a blog entry on Tesla's website in the summer of 2006, Elon Musk, Tesla's co-founder and CEO, explained the startup's master plan:<sup>2</sup>

1. Build sports car.
2. Use that money to build an affordable car.
3. Use *that* money to build an even more affordable car.
4. While doing above, also provide zero-emission electric power generation options.
5. Don't tell anyone.

Let's see if Tesla stuck to its strategy. In 2008, Tesla introduced its first car: the Roadster, a \$110,000 sports coupe with faster acceleration than a Porsche or a Ferrari. Tesla's first vehicle

served as a prototype to demonstrate that electric vehicles can be more than mere golf carts. Tesla thus successfully completed Step 1 of the master plan.

In Step 2, after selling some 2,500 Roadsters, Tesla discontinued its production in 2012 to focus on its next car: the Model S, a four-door family sedan, with a base price of \$73,500 before tax credits. The line appeals to a somewhat larger market and thus allows for larger production runs to drive down unit costs. The Model S received an outstanding market reception. It was awarded not only the 2013 Motor Trend Car of the Year, but also

received the highest score of any car ever tested by Consumer Reports (99/100). Tesla manufactures the Model S in the Fremont, California, factory that it purchased from Toyota. By the end of 2016, it had sold some 125,000 of the Model S worldwide.

Hoping for an even broader customer appeal, Tesla also introduced the Model X, a crossover between an SUV and a family van with futuristic falcon-wing doors for convenient access to second- and third-row seating. The \$100,000 starting sticker price of the Model X is quite steep, however; thus limiting mass-market appeal. Technical difficulties with its innovative doors delayed its launch until the fall of 2015.

Tesla has now reached Step 3 of its master plan. In 2017, Tesla delivered the company's newest car: the

Model 3, an all-electric compact luxury sedan, with a starting price of \$35,000. Tesla received some 375,000 preorders within three months of unveiling its model. Many of the want-to-be Tesla owners stood in line overnight, eagerly awaiting the opening of the Tesla stores to put down a \$1,000 deposit to secure a spot on the waiting list for the Model 3, a car they had never even seen, let alone taken for a



Tesla's Model X with falcon wing doors. ©Bloomberg/Getty Images

test drive. By the time Tesla delivered the first 30 cars of its new Model 3 (to Tesla employees for quality testing and appreciation of their hard work), the California car maker had received over 500,000 preorders. This customer enthusiasm amounted to \$500 million in interest-free loans for Tesla. The Model 3 was slated for delivery by late 2017. Tesla hoped to sell 500,000 total vehicles by the end of 2018. To accomplish this ambitious goal, Musk also promised that Tesla would increase its annual production from 50,000 in 2015 to 1 million vehicles a year by 2020.


Step 4 of Musk’s master plan for Tesla aims to provide zero-emission electric power generation options. To achieve this goal, Tesla acquired SolarCity, a solar energy company, for more than \$2 billion in the fall of 2016. This joining creates the world’s first fully integrated clean-tech energy company by combining solar power, power storage, and transportation. A successful integration of Tesla and

SolarCity, where Musk is also chairman and an early investor, would allow completion of Step 4 of Tesla’s master plan.

Step 5: “Don’t tell anyone”—thus the ChapterCase title “Tesla’s Secret Strategy.”<sup>3</sup>

---

You will learn more about Tesla by reading this chapter; related questions appear in “ChapterCase 1 / Consider This . . . .”

 **WHY IS TESLA SO SUCCESSFUL?** In contrast, the big-three U.S. automakers—Ford, GM, and Chrysler—struggled during the first decade of the 21st century, with both GM and Chrysler filing for bankruptcy protection.

If once-great firms can fail, why is any company successful? What enables some firms to gain and then sustain their competitive advantage over time? How can managers influence firm 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, and how you can help your organization achieve it.

**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 an organization such as a firm or a nonprofit outfit in its entirety. It also enables you to think like a general manager to help position your organization for superior performance. The *AFI strategy framework* embodies this view of strategic management. It will guide our exploration of strategic management through the course of your study.

In this chapter, we lay the groundwork for the study of strategic management. We’ll introduce foundational ideas about strategy and competitive advantage. We then move from thinking about why strategy is important to considering the role an organization’s vision, mission, and values play in its strategy. 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 titled *Implications for Strategic Leaders*. Here 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.

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

## 1.1 What Strategy Is: Gaining and Sustaining Competitive Advantage

**Strategy** is a set of goal-directed actions a firm takes to gain and sustain superior performance *relative* to competitors.<sup>4</sup> 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, universities compete for the best students and professors, sports teams compete for championships, while celebrities compete for media attention.

As highlighted in the ChapterCase, Tesla, a new entrant in the automotive industry, is competing with established U.S. companies such as GM, Ford, and Chrysler and also with foreign automakers Toyota, Honda, Mercedes, and BMW, among others, for customers. In any

### 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.

competitive situation, a **good strategy** enables a firm to achieve superior performance relative to its competitors. This leads to the question: What is a good strategy?

1. A *diagnosis* of the competitive challenge. This element is accomplished through *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 to see whether Tesla, Inc. is pursuing a good strategy. Tesla appears to be performing quite well when considering indicators such as stock appreciation, where it outperforms its competitors by a wide margin. The high appreciation of Tesla stock points to investors' expectations of future growth. By other measures, such as generating profits, Tesla underperforms compared to established car companies. Losses are common for startups early on, especially if the business requires large upfront investments such as building new factories, which Tesla was required to do. What we can say at this point is that Tesla seems to be starting with a promising strategy and is in the process of gaining a competitive advantage. But can Tesla sustain its advantage over time? Let's use the three elements of a good strategy to assess how Tesla CEO Elon Musk could turn an early lead into a sustainable competitive advantage.

**THE COMPETITIVE CHALLENGE.** A good strategy needs to start with a clear and critical diagnosis of the competitive challenge. Musk, Tesla's co-founder and CEO, describes himself as an "engineer and entrepreneur who builds and operates companies to solve environmental, social, and economic challenges."<sup>5</sup> Tesla was founded with the vision to "accelerate the world's transition to sustainable transport."<sup>6</sup>

To accomplish this mission, Tesla must build zero-emission electric vehicles that are attractive and affordable. Beyond achieving a competitive advantage for Tesla, Musk is working to set a new standard in automotive technology. He hopes that zero-emission electric vehicles will one day replace gasoline-powered cars.

Tesla's competitive challenge is sizable: To succeed it must manufacture attractive and affordable vehicles using its new technology, which will compete with traditional cars running on gasoline. It also needs the required infrastructure for electric vehicles, including a network of charging stations to overcome "range anxiety"<sup>7</sup> by consumers; many mass-market electric vehicles cannot drive as far on one charge as gasoline-powered cars can with a full tank of gas. Gas stations can be found pretty much on any corner in cities and every couple of miles on highways.<sup>8</sup>

**A GUIDING POLICY.** After the diagnosis of the competitive challenge, the firm needs to formulate an effective guiding policy in response. The formulated strategy needs to be consistent, often backed up with *strategic commitments* such as sizable investments or changes to an organization's incentive and reward system—big changes that cannot be easily reversed. Without consistency in a firm's guiding policy, employees become confused and cannot make effective day-to-day decisions that support the overall strategy. Without consistency in strategy, moreover, other stakeholders, including investors, also become frustrated.

To address the competitive challenge, Tesla's current guiding policy is to build a cost-competitive mass-market vehicle such as the new Model 3 (this is also Step 3 in Tesla's "Secret Strategy," as discussed in the ChapterCase). Tesla's formulated strategy is consistent with its mission and the competitive challenge identified. It also requires significant strategic commitments such as Tesla's \$5 billion investment in a new lithium-ion battery

**Good strategy** A strategy is good when it enables a firm to achieve superior performance. It consists of three elements: (1) a diagnosis of the competitive challenge; (2) a guiding policy to address the competitive challenge; and (3) a set of coherent actions to implement a firm's guiding policy.

plant in Nevada, the so-called Gigafactory. Batteries are the most critical component for electric vehicles. To accomplish this major undertaking, Tesla has partnered with Panasonic of Japan, a world leader in battery technology.

**COHERENT ACTIONS.** Finally, a clear guiding policy needs to be implemented with a set of coherent actions. Tesla appears to implement its formulated strategy with actions consistent with its diagnosis of the competitive challenge. To accomplish building a cost-competitive mass-market vehicle, Tesla must benefit from *economies of scale*, which are decreases in cost per vehicle as output increases. To reap these critical cost reductions, Tesla must ramp up its production volume. This is a huge challenge: Tesla aims to increase its production output by some 20 times, from 50,000 cars built in 2015 to 1 million cars per year by 2020. Tesla's retooling of its manufacturing facility in Fremont, California, to rely more heavily on cutting-edge robotics as well as its multibillion-dollar investment to secure an uninterrupted supply of lithium-ion batteries are examples of actions coherent with Tesla's formulated strategy. At the same time, Tesla is further building out its network of charging stations across the United States and globally. To fund this initiative, it announced that using the company's charging network will no longer be free for new Tesla owners.

To accomplish the lofty goal of making zero-emission electric motors the new standard in automotive technology (rather than gas-powered internal combustion engines), Tesla decided to make its proprietary technology available to the public. Musk's hope is that sharing Tesla's patents will expand the overall market size for electric vehicles as other manufacturers, such as BMW with its i3 line of vehicles, can employ Tesla's technology.

In review, to create a good strategy, three steps are crucial. 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 on how to deal with the competitive challenges identified. The approach needs to be communicated in policies that provide clear guidance for employees. Last, a good strategy requires effective implementation through a coherent set of actions.

## WHAT IS COMPETITIVE ADVANTAGE?

### LO 1-2

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

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**.<sup>9</sup> In terms of stock market valuation, Tesla has appreciated much more in recent years than GM, Ford, or Chrysler, and thus appears to have a competitive advantage, at least on this dimension.

A firm that is able to outperform its competitors or the industry average over a prolonged period has a **sustainable competitive advantage**. Apple, for example, has enjoyed a sustainable competitive advantage over Samsung in the smartphone industry for over a decade since its introduction of the iPhone in 2007. Other phone makers such as Microsoft (which purchased Nokia) and BlackBerry have all but exited the smartphone market, while new entrants such as Xiaomi and Huawei of China are trying to gain traction.

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

---

**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.

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



superior firm performance. In the consulting 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, like newspaper publishing, where the industry average has been negative (−5 percent) for the past 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. The rewards of superior value creation and capture are profitability and market share. Elon Musk is particularly motivated to address global warming, and thus formed Tesla to build electric vehicles with zero emissions. Sara Blakely, the founder and CEO of Spanx, the global leader in the shapewear industry, is motivated to change women's lives. Sam Walton was driven by offering lower prices than his competitors when creating Walmart, the world's largest retailer. For Musk, Blakely, Walton, 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, or by offering similar value at lower cost. Managers achieve these combinations 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 has also built a clear strategic profile by providing superior customer service to a higher end, luxury market segment. Although these companies are in the same industry, their customer segments overlap very little, and they are not direct competitors. Walmart and Nordstrom have each 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: cost 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 provides a superior customer experience by professional salespeople 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 compete in the same industry, both can win if they achieve a clear strategic position through a well-executed competitive strategy. Strategy, therefore, is not a zero-sum game.



Spanx founder and CEO Sara Blakely, a graduate of Florida State University, is the world's youngest female billionaire.

©ZUMA Press Inc/Alamy Stock Photo

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