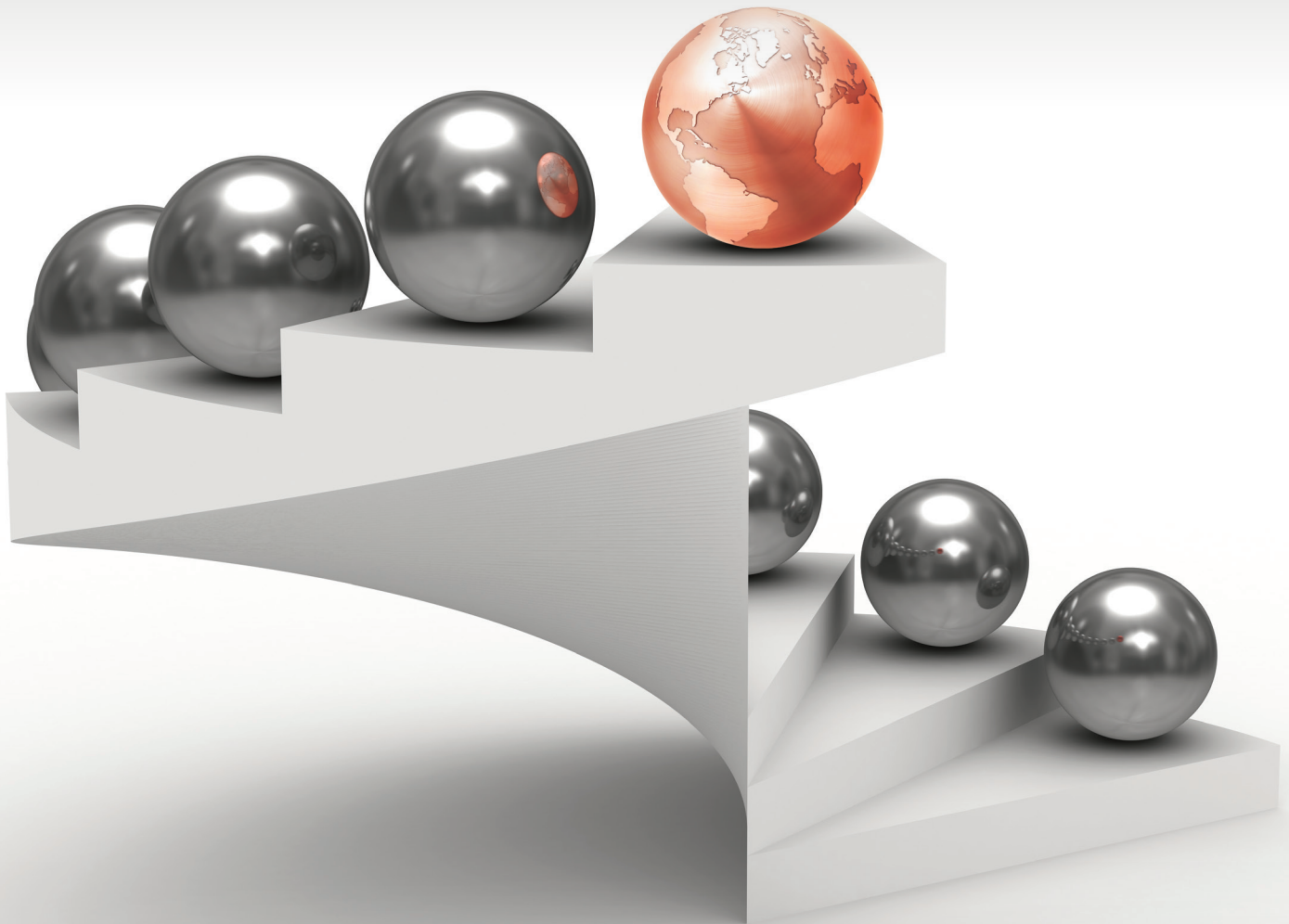


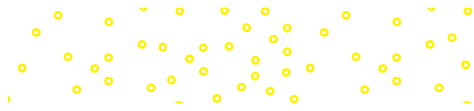
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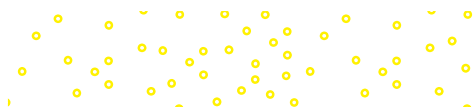
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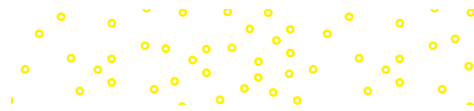


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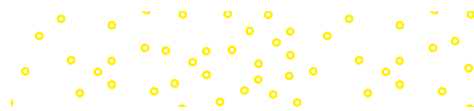
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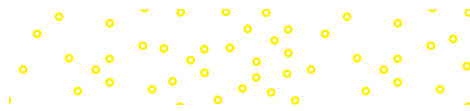
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**Frank T. Rothaermel**

Georgia Institute of Technology





## STRATEGIC MANAGEMENT

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ISBN 978-1-266-19186-2

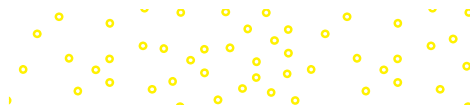
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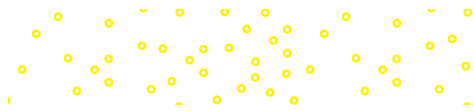
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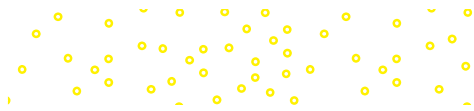
## DEDICATION

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

—Frank T. Rothaermel

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# CONTENTS IN BRIEF

---

---

## PART ONE / ANALYSIS 2

---

- CHAPTER 1 What Is Strategy? 4
- CHAPTER 2 Strategic Leadership: Managing the Strategy Process 32
- CHAPTER 3 External Analysis: Industry Structure, Competitive Forces, and Strategic Groups 80
- CHAPTER 4 Internal Analysis: Resources, Capabilities, and Core Competencies 128
- CHAPTER 5 Shared Value and Competitive Advantage 168

---

## PART TWO / FORMULATION 206

---

- CHAPTER 6 Business Strategy: Differentiation, Cost Leadership, and Blue Oceans 208
- CHAPTER 7 Business Strategy: Innovation, Entrepreneurship, and Platforms 244
- CHAPTER 8 Corporate Strategy: Vertical Integration and Diversification 294
- CHAPTER 9 Corporate Strategy: Strategic Alliances, Mergers, and Acquisitions 342
- CHAPTER 10 Global Strategy: Competing Around the World 374

---

## PART THREE / IMPLEMENTATION 414

---

- CHAPTER 11 Organizational Design: Structure, Culture, and Control 416
- CHAPTER 12 Corporate Governance, Business Ethics, and Business Models 460

---

## PART FOUR / MINICASES 493

---

### HOW TO CONDUCT A CASE ANALYSIS 494

Twelve MiniCases are included.

---

## PART FIVE / FULL-LENGTH CASES

Twelve full-length cases with auto-graded exercises are included in *Connect*.

All of Frank T. Rothaermel's full-length cases are available through McGraw Hill Create: [www.mcgrawhillcreate.com/rothaermel](http://www.mcgrawhillcreate.com/rothaermel)



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# MINICASES & FULL-LENGTH CASES

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## MINICASES /

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The twelve MiniCases correspond to their respective chapter number. These MiniCases are also available in *Connect*, with accompanying auto-graded exercises.

- 1 Whitney Wolfe Herd's Dating Strategy: From Tinder to Bumble
- 2 Microsoft: Satya Nadella hits Refresh
- 3 Robinhood: Democratizing Investing or Robbing Investors?
- 4 Dr. Dre's Core Competency: Coolness Factor
- 5 Sustaining Shared Value: The Rise and Fall of Toms Shoes
- 6 Warby Parker's Blue Ocean Strategy
- 7 Platform Strategy: How PayPal Solved the Chicken-or-Egg Problem
- 8 GE: Corporate Strategy Gone Bad
- 9 LVMH Acquires Tiffany: The American Jeweler Learns How to Speak French
- 10 Hollywood Goes Global
- 11 Chick-fil-A's Structure, Culture, and Control
- 12 Purdue Pharma and the Opioid Addiction Crisis

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|---------------|-----------------|
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| 2 Airbnb *    | 8 Uber >>       |
| 3 Rivian >>   | 9 Disney *      |
| 4 Starbucks * | 10 Netflix *    |
| 5 Best Buy *  | 11 McDonald's * |
| 6 Apple *     | 12 Nike         |

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## PRIOR EDITION CASES /

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Fifteen additional cases are included in *Connect*, in a standalone ebook. This combination of classic and contemporary cases provides even more options for instructors and students.





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# CHAPTERCASES & STRATEGY HIGHLIGHTS

---

## CHAPTERCASES /

---

- 1 Tesla: The Trillion-Dollar Tech Titan 5
- 2 Facebook Becomes Meta 33
- 3 Airbnb's Pandemic Pivot 81
- 4 Five Guys' Core Competency: "Make the Best Burger. Don't Worry about Cost." 129
- 5 Patagonia: A Pioneer in Creating Shared Value 169
- 6 JetBlue Airways: En Route to a New Blue Ocean? 209
- 7 Netflix: No Longer a Disruptor? 245
- 8 Amazon's Corporate Strategy 295
- 9 Little Lyft Gets Big Alliance Partners and Beats Uber in Going Public 343
- 10 IKEA: The World's Most Profitable Retailer 375
- 11 "A" Is for Alphabet and "G" Is for Google 417
- 12 Theranos: Bad Blood 461

## STRATEGY HIGHLIGHTS /

---

- 1.1 Twitter Needs a Strategy 10
- 1.2 Merck's Stakeholder Strategy 21
- 2.1 Teach for America: Inspiring Future Leaders 46
- 2.2 Starbucks CEO: "It's Not What We Do" 60
- 3.1 Blockbuster's Bust 88
- 3.2 From League of Legends to Fortnite: The Rise of Esports 114
- 4.1 Yeti's Core Competency: Making Quality Cool 134
- 4.2 Applying VRIO: The Rise and Fall of Groupon 145
- 5.1 BlackRock's \$10 Trillion of Shared Value 178
- 5.2 PepsiCo's Indra Nooyi: Performance with Purpose 195
- 6.1 Dr. Shetty: "The Henry Ford of Heart Surgery" 226
- 6.2 How JCPenney Sailed into a Red Ocean 235
- 7.1 Standards Battle: Which Automotive Technology Will Win? 261
- 7.2 How to Compete with Amazon.com? Easy: Use Shopify 279
- 8.1 The Equity Alliance between Coca-Cola and Monster: A Troubled Engagement? 308
- 8.2 P&G's Diversification Strategy: Turning the Tide? 326
- 9.1 How Tesla Used Alliances Strategically 350
- 9.2 Kraft Heinz: From Specializing in Hostile Takeovers to Eating Humble Pie 362
- 10.1 Walmart Retreats from Germany, and German Ultra-Low-Cost Grocers Invade the United States 388
- 10.2 *Squid Game*: Netflix's Transnational Strategy 400
- 11.1 Zappos: Of Holacracy and (Not Much) Happiness 435
- 11.2 Sony vs. Apple: Whatever Happened to Sony? 442
- 12.1 VW's Dieselgate: School of Hard NOx 473
- 12.2 Business Model Innovation: How Dollar Shave Club Disrupted Gillette 482



---

# CONTENTS

---

## **PART ONE / ANALYSIS 2**

---

### **CHAPTER 1**

WHAT IS STRATEGY? 4

#### **CHAPTERCASE 1 / Part I**

Tesla: The Trillion-Dollar Tech Titan 5

1.1 What Strategy Is: Gaining and Sustaining Competitive Advantage 7

*Crafting and Implementing Strategy at Tesla 7*

*What is Competitive Advantage? 12*

1.2 Stakeholder Strategy and Competitive Advantage 15

*Value Creation 15*

*Stakeholder Impact Analysis 17*

1.3 The Analysis, Formulation, Implementation (AFI) Strategy Framework 22

*Key Topics and Questions of the AFI*

*Strategy Framework 23*

1.4 Implications for Strategic Leaders 24

#### **CHAPTERCASE 1 / Part II 25**

### **CHAPTER 2**

STRATEGIC LEADERSHIP: MANAGING THE STRATEGY PROCESS 32

#### **CHAPTERCASE 2 / Part I**

Facebook Becomes Meta 33

2.1 Strategic Leadership 34

*What Do Strategic Leaders Do? 35*

*Strategic Leadership at Meta's Facebook 37*

*How Do You Become a Strategic Leader? 38*

*The Strategy Process Across Levels: Corporate, Business, and Functional Leaders 41*

2.2 Vision, Mission, and Values 43

*A Purpose-Driven Vision 44*

*Mission 51*

*Values 51*

2.3 The Strategic Management Process 52

*Top-Down Strategic Planning 53*

*Scenario Planning 54*

*Strategy as Planned Emergence: Top Down and Bottom Up 57*

2.4 Strategic Decision Making 63

*Strategic Inflection Points 63*

*Two Distinct Modes of Decision Making 65*

*Cognitive Biases and Decision Making 66*

*How to Improve Strategic Decision Making 70*

2.5 Implications for Strategic Leaders 71

#### **CHAPTERCASE 2 / Part II 72**

### **CHAPTER 3**

EXTERNAL ANALYSIS: INDUSTRY STRUCTURE, COMPETITIVE FORCES, AND STRATEGIC GROUPS 80

#### **CHAPTERCASE 3 / Part I**

Airbnb's Pandemic Pivot 81

3.1 The PESTEL Framework 83

*Political Factors 83*

*Economic Factors 84*

*Sociocultural Factors 86*

*Technological Factors 87*

*Ecological Factors 89*

*Legal Factors 89*

3.2 Industry Structure and Firm Strategy: The Five Forces Model 90

*Industry vs. Firm Effects In Determining Firm*

*Performance 90*

*Competition in the Five Forces Model 91*

*The Threat of Entry 92*

*The Power of Suppliers 97*

*The Power of Buyers 98*

*The Threat of Substitutes 99*

*Rivalry Among Existing Competitors 100*

*Applying the Five Forces Model to*

*the U.S. Airline Industry 107*

*A Sixth Force: The Strategic Role of Complements 109*

3.3 Changes over Time: Entry Choices and Industry Dynamics 110

*Entry Choices 110*

*Industry Dynamics 112*

3.4 Performance Differences within the Same Industry: Strategic Groups 116

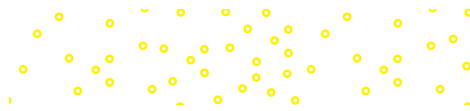
*The Strategic Group Model 117*

*Mobility Barriers 118*

*Strategic Group Dynamics 119*

3.5 Implications for Strategic Leaders 120

#### **CHAPTERCASE 3 / Part II 121**



**CHAPTER 4**

INTERNAL ANALYSIS: RESOURCES, CAPABILITIES, AND CORE COMPETENCIES 128

**CHAPTERCASE 4 / Part I**

Five Guys' Core Competency: "Make the Best Burger. Don't Worry about Cost." 129

4.1 From External to Internal Analysis 131

4.2 Core Competencies 132

*Leveraging Core Competencies Requires Focus on What to Do and What Not to Do* 132

*Resources and Capabilities* 137

4.3 The Resource-Based View 138

*Resource Heterogeneity and Resource Immobility* 140

*The VRIO Framework* 141

*Isolating Mechanisms: How to Sustain a Competitive Advantage* 146

4.4 The Dynamic Capabilities Perspective 151

*Core Rigidities* 151

*Dynamic Capabilities* 152

*Resource Stocks and Resource Flows* 152

4.5 The Firm Value Chain and Strategic Activity Systems 154

*Firm Value Chain* 154

*Strategic Activity Systems* 157

4.6 Implications for Strategic Leaders 160

*Using Swot Analysis to Generate Insights From External and Internal Analysis* 160

**CHAPTERCASE 4 / Part II** 162

**CHAPTER 5**

SHARED VALUE AND COMPETITIVE ADVANTAGE 168

**CHAPTERCASE 5 / Part I**

Patagonia: A Pioneer in Creating Shared Value 169

5.1 From Corporate Social Responsibility to Creating Shared Value 171

*Shareholder Capitalism* 172

*Shareholder Capitalism in Crisis?* 174

*Stakeholder Capitalism and Shared Value* 175

5.2 Competitive Advantage 181

*Accounting Metrics* 181

*Shareholder Value Creation* 183

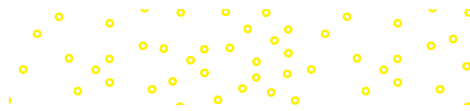
*Economic Value Creation* 186

*The Balanced Scorecard* 192

*The Triple Bottom Line* 195

5.3 Implications for Strategic Leaders 197

**CHAPTERCASE 5 / Part II** 199



**PART TWO / FORMULATION 206**

**CHAPTER 6**

BUSINESS STRATEGY: DIFFERENTIATION, COST LEADERSHIP, AND BLUE OCEANS 208

**CHAPTERCASE 6 / Part I**

JetBlue Airways: En Route to a New Blue Ocean? 209

6.1 Business-Level Strategy: How to Compete for Advantage 211

*Strategic Position* 212

*Generic Business Strategies* 212

6.2 Differentiation Strategy: Understanding Value Drivers 214

*Product Features* 217

*Customer Service* 217

*Complements* 217

6.3 Cost-Leadership Strategy: Understanding Cost Drivers 218

*Cost of Input Factors* 220

*Economies of Scale* 220

*Learning Curve* 223

*Experience Curve* 227

6.4 Business-Level Strategy and the Five Forces: Benefits and Risks 228

*Differentiation Strategy: Benefits and Risks* 228

*Cost-Leadership Strategy: Benefits and Risks* 230

6.5 Blue Ocean Strategy: Combining Differentiation and Cost Leadership 231

*Value Innovation* 232

*Blue Ocean Strategy Gone Bad: "Stuck in the Middle"* 234

6.6 Implications for Strategic Leaders 238

**CHAPTERCASE 6 / Part II** 239

**CHAPTER 7**

BUSINESS STRATEGY: INNOVATION, ENTREPRENEURSHIP, AND PLATFORMS 244

**CHAPTERCASE 7 / Part I**

Netflix: No Longer a Disruptor? 245

7.1 Competition Driven by Innovation 246

*Netflix's Continued Innovation* 247

*The Speed of Innovation* 247

*The Innovation Process* 249

*The Four Industrial Revolutions* 251

**7.2 Strategic and Social Entrepreneurship 254****7.3 Innovation and the Industry Life Cycle 257***Introduction Stage 259**Growth Stage 260**Shakeout Stage 264**Maturity Stage 265**Decline Stage 265**Crossing the Chasm 266***7.4 Types of Innovation 274***Incremental vs. Radical Innovation 274**Architectural vs. Disruptive Innovation 276***7.5 Platform Strategy 281***The Platform vs. Pipeline Business Models 281**The Platform Ecosystem 283***7.6 Implications for Strategic Leaders 286****CHAPTERCASE 7 / Part II 287****CHAPTER 8**

CORPORATE STRATEGY: VERTICAL INTEGRATION AND DIVERSIFICATION 294

**CHAPTERCASE 8 / Part I**

Amazon's Corporate Strategy 295

**8.1 What Is Corporate Strategy? 298***Why Firms Need to Grow 299**Three Dimensions of Corporate Strategy 300***8.2 The Boundaries of the Firm 302***Firms vs. Markets: Make or Buy? 303**The Make-or-Buy Continuum 306***8.3 Vertical Integration along the Industry Value Chain 310***Types of Vertical Integration 312**Benefits and Risks of Vertical Integration 315**When Does Vertical Integration Make Sense? 317**Alternatives to Vertical Integration 318***8.4 Corporate Diversification:****Expanding Beyond a Single Market 319***Types of Corporate Diversification 321**Core Competencies and Corporate**Diversification 323**Corporate Diversification and Firm Performance 328***8.5 Implications for Strategic Leaders 333****CHAPTERCASE 8 / Part II 333****CHAPTER 9**

CORPORATE STRATEGY: STRATEGIC ALLIANCES, MERGERS, AND ACQUISITIONS 342

**CHAPTERCASE 9 / Part I**

Little Lyft Gets Big Alliance Partners and Beats Uber in Going Public 343

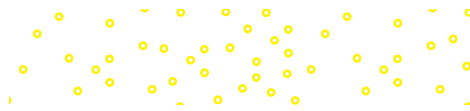
**9.1 How Firms Achieve Growth 345***The Build-Borrow-Buy Framework 345***9.2 Strategic Alliances 348***Why Do Firms Enter Strategic Alliances? 349**Governing Strategic Alliances 353**Alliance Management Capability 356***9.3 Mergers and Acquisitions 358***Why Do Firms Merge with Competitors? 359**Why Do Firms Acquire Other Firms? 361**M&A and Competitive Advantage 364***9.4 Implications for Strategic Leaders 366****CHAPTERCASE 9 / Part II 367****CHAPTER 10**

GLOBAL STRATEGY: COMPETING AROUND THE WORLD 374

**CHAPTERCASE 10 / Part I**

IKEA: The World's Most Profitable Retailer 375

**10.1 What Is Globalization? 377***Stages of Globalization 379**State of Globalization 381***10.2 Competing Globally: Why? 384***Advantages of Competing Globally 385**Disadvantages of Competing Globally 387***10.3 Competing Globally: Where and How? 391***Where in the World to Compete? The CAGE Distance**Framework 391**How Do MNEs Enter Foreign Markets? 395***10.4 Cost Reductions vs. Local Responsiveness 396***International Strategy 397**Multidomestic Strategy 398**Global-Standardization Strategy 398**Transnational Strategy 399***10.5 National Competitive Advantage: World Leadership in Specific Industries 404***Porter's Diamond Framework 404***10.6 Implications for Strategic Leaders 406****CHAPTERCASE 10 / Part II 407**



---

## **PART THREE / IMPLEMENTATION 414**

---

### **CHAPTER 11**

ORGANIZATIONAL DESIGN: STRUCTURE, CULTURE,  
AND CONTROL 416

#### **CHAPTERCASE 11 / Part I**

“A” Is for Alphabet and “G” Is for Google 417

11.1 Organizational Design and Competitive  
Advantage 420

*Organizational Inertia: The Failure  
of Established Firms* 421

*Organizational Structure* 424

*Mechanistic vs. Organic Organizations* 426

11.2 Strategy and Structure 428

*Simple Structure* 428

*Functional Structure* 429

*Multidivisional Structure* 432

*Matrix Structure* 436

11.3 Organizing for Innovation 440

11.4 Organizational Culture: Values, Norms, and  
Artifacts 444

*Where Do Organizational Cultures Come From?* 447

*How Does Organizational Culture Change?* 448

*Organizational Culture and Competitive Advantage* 449

11.5 Strategic Control-and-Reward Systems 450

*Input Controls* 451

*Output Controls* 451

11.6 Implications for Strategic Leaders 452

**CHAPTERCASE 11 / Part II 453**

### **CHAPTER 12**

CORPORATE GOVERNANCE, BUSINESS ETHICS, AND  
BUSINESS MODELS 460

#### **CHAPTERCASE 12 / Part I**

Theranos: Bad Blood 461

12.1 Corporate Governance 463

*Agency Theory* 465

*The Board of Directors* 466

*Other Governance Mechanisms* 468

12.2 Strategy and Business Ethics 471

*Bad Apples vs. Bad Barrels* 474

12.3 Business Models: Strategy in Action 476

*The Business Model Framework* 476

*Popular Business Models* 478

*Dynamic Nature of Business Models* 480

*Business Model Innovation* 481

12.4 Implications for Strategic Leaders 486

**CHAPTERCASE 12 / Part II 487**

---

## **PART FOUR / MINICASES 493**

---

HOW TO CONDUCT A CASE ANALYSIS 494

---

## **PART FIVE / FULL-LENGTH CASES**

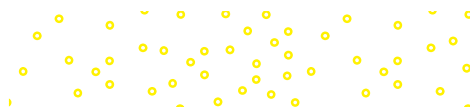
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**Company Index CI-1**

**Name Index NI-1**

**Subject Index SI-1**



# ABOUT THE AUTHOR

## Frank T. Rothaermel

Georgia Institute of Technology

**Frank T. Rothaermel, Ph.D.**, is a Professor of Strategy and 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 “offers the National Science Foundation’s most prestigious awards in support of those teacher-scholars who most effectively integrate research and education.”<sup>1</sup> *Bloomberg Businessweek* named Frank one of Georgia Tech’s Prominent Faculty, while *Poets & Quants* selected Frank as one of the “Favorite Business School Professors Teaching MBAs.” He received the Theory-to-Practice Award from the Vienna Strategy Forum at the Vienna University of Economics and Business.

Frank is the author of a leading textbook—*Strategic Management* (6th edition, 2023), with translations into Greek, Korean, Mandarin, and Spanish. When launched, Frank’s textbook won the McGraw Hill 1st Edition Award of the Year in Business and Economics. The 4th edition won the McGraw Hill Product of the Year Award in Business and Economics. Frank also authored over 50 case studies distributed by McGraw Hill Create ([www.mcgrawhillcreate.com/rothaermel](http://www.mcgrawhillcreate.com/rothaermel)) and Harvard Business Publishing (HBP), with 23 achieving “bestseller” status among the cases distributed by HBP.

Frank’s research interests lie in strategy, innovation, and entrepreneurship; he has published over 35 articles in leading academic journals such as the *Strategic Management Journal*, *Organization Science*, *Academy of Management Journal*, *Academy of Management Review*, and elsewhere. Using published papers in the top 1% based on citations, Thomson Reuters identified Frank as one of the “world’s most influential scientific minds” and listed him among the top 100 scholars based on impact over more than a decade in economics and business. He is among the world’s top 2% most-cited researchers, according to research conducted by the Meta-Research Innovation Center at Stanford University.

Frank has a wide range of executive education experience, including teaching in programs at GE Management Development Institute (Crotonville, New York), 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. To inform his research, Frank has conducted extensive fieldwork and executive training with a wide range of companies such as Amgen, Daimler, Eli Lilly, Equifax, GE Energy, GE Healthcare, Hyundai Heavy Industries (South Korea), Kimberly-Clark, Microsoft, McKesson, NCR, Turner (TBS), and UPS, among others.

Frank held visiting professorships at 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 American Economic Association, the Academy of Management, and the Strategic Management Society.

Frank holds a Ph.D. 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.



Courtesy of Kelley Rothaermel

1. NSF CAREER Award description.

# PREFACE

I'm pleased to introduce the new 6th edition of *Strategic Management*. Since January 2020, when the 5th edition published, the world has changed dramatically:

- The Covid-19 pandemic led to millions of deaths across the world. Governments shut down entire economies for periods of time. Working from home became the new normal. Governments spent trillions of dollars in fiscal stimuli and relief while central banks added substantial monetary expansions. Combined with disrupted supply chains, double-digit inflation not seen in decades ensued.
- The George Floyd killing (in 2020) sparked mass protests, leading to societies worldwide confronting a history of racial injustices.
- Russia invaded Ukraine, resulting in a significant supply-side shock to post-Covid economies still recovering, contributing to inflation, food shortages, and surges in oil, gas, and other commodity prices.
- Disenchantment with the economic system led to a shift from shareholder capitalism to stakeholder capitalism, with an emphasis on creating shared value.

Not only are we all affected by these significant events, but they also profoundly impact how strategic leaders run companies. As such, these dramatic events have a direct bearing on *Strategic Management*. I discuss these black swan events in detail and derive implications for strategy and competitive advantage. For instance, Chapter 5 has an entirely new focus by framing the discussion of competitive advantage in light of the shift toward creating shared value for all stakeholders.

## What's New in the Sixth Edition?

I have revised and updated the new edition in the following ways, many of which were inspired by current events, recent developments in strategic management, and conversations and feedback from the many users, reviewers, and students of the prior editions.

## OVERVIEW OF MAJOR CHANGES IN THE SIXTH EDITION

- The implications of the Covid-19 pandemic, the racial-justice movement, and the disenchantment with the capitalist system permeate the new 6th edition and capture the momentum toward stakeholder strategy to create shared value.

### **New Chapter:**

- Chapter 5 has an entirely new focus by framing the discussion of competitive advantage in light of the shift toward creating shared value for all stakeholders, reflected in the new chapter title, "Shared Value and Competitive Advantage"

### **New ChapterCases:**

- "Facebook becomes Meta" (Chapter 2)
- "Patagonia: A Pioneer in Creating Shared Value" (Chapter 5)

### **New Sections:**

- "The Red Queen Effect in Business Competition" in Chapter 1, "What Is Strategy?"
- "Strategic Leadership at Meta's Facebook" in Chapter 2, "Strategic Leadership"
- "A Purpose-Driven Mission and Strategic Intent" in Chapter 2, "Strategic Leadership"

- “Strategic Leadership and the Future of Work” in Chapter 2, “Strategic Leadership”
- “Strategic Inflection Points” in Chapter 2, “Strategic Leadership”
- “Strategic Group Dynamics” in Chapter 3, “External Analysis: Industry Structure, Competitive Forces, and Strategic Groups”
- “The Four Industrial Revolutions” in Chapter 7, “Business Strategy: Innovation, Entrepreneurship, and Platforms”
- “Not All Industry Value Chain Stages Are Equally Profitable” in Chapter 8, “Corporate Strategy: Vertical Integration and Diversification”
- “Systemic Rivalry and Techno Cold War” in Chapter 10, “Global Strategy: Competing Around the World”
- “The Ambidextrous Organization: Balancing Trade-Offs” in Chapter 11, “Organizational Design: Structure, Culture, and Control”

#### **New Exhibits:**

- “The Interplay between Purpose-Driven Vision, Strategic Intent, and Core Competencies” in Chapter 2, “Strategic Leadership”
- “Strategic Inflection Point” in Chapter 2, “Strategic Leadership”
- “Strategic Groups and Mobility Barriers in U.S. Domestic Airline Industry, Including the Emergence of the Ultra-Low-Cost Strategic Subgroup” in Chapter 3, “External Analysis: Industry Structure, Competitive Forces, and Strategic Groups”
- “Four Industrial Revolutions from the 1780s to 2020s” in Chapter 7, “Business Strategy: Innovation, Entrepreneurship, and Platforms”
- “The Three Dimensions of Corporate-Level Strategy: Vertical Integration, Horizontal Diversification, and Geographic Scope” in Chapter 8, “Corporate Strategy: Vertical Integration and Diversification”
- “The Smiley Curve: Differential Profit Potential along the Industry Value Chain” in Chapter 8, “Corporate Strategy: Vertical Integration and Diversification”
- “The Short Head and the Long Tail” in Chapter 12, “Corporate Governance, Business Ethics, and Business Models”

#### **Improvements to Content Flow:**

- “Business Models: Strategy in Action” is now in Chapter 12, “Corporate Governance, Business Ethics, and Business Models,” to reflect the role of business models in strategy implementation
- All new or updated and revised **Strategy Highlights** (two per chapter).

#### **Cases:**

- Nine (!) new out of 12 **MiniCases**, featuring successes and failures. Companies featured in the new MiniCases: Chick-fil-A, Dr. Dre (Beats Electronics), Microsoft, Purdue Pharma, Robinhood, Tiffany and LVMH, Tinder and Bumble, Toms Shoes, and Warby Parker.
  - All other MiniCases are revised and updated.
  - One MiniCase per chapter, tightly integrated with learning objectives.
  - Detailed and high-quality teaching notes are available in the **Connect Library**.
- Three new **full-length Cases**: Rivian, Peloton, and Uber
  - All other cases, including the most popular ones, such as Apple, Best Buy, Disney, McDonald’s, Starbucks, and Tesla, are revised and updated.
    - Detailed and updated case teaching notes are available in the **Connect Library**.



## IN DETAIL

### CHAPTER 1

- A stronger emphasis on “Stakeholder Strategy and Competitive Advantage”
- New Section: “The Red Queen Effect in Business Competition”
- Revised and updated:
  - ChapterCase: “Tesla: The Trillion-Dollar Tech Titan”
  - Section: “Crafting and Implementing Strategy at Tesla”
  - Strategy Highlight: “Twitter Needs a Strategy?”

### CHAPTER 2

- New ChapterCase: “Facebook Becomes Meta”
- New Sections:
  - “Strategic Leadership at Meta’s Facebook”
  - “A Purpose-Driven Mission and Strategic Intent”
  - “Strategic Leadership and the Future of Work”
  - “Strategic Inflection Points”
- Revised and updated Strategy Highlight: “Teach for America: Inspiring Future Leaders”

### CHAPTER 3

- Revised and updated:
  - ChapterCase: “Airbnb: Disrupting the Hotel Industry”
  - Strategy Highlight: “From League of Legends to Fortnite: The Rise of ESports”
- New Section:
  - “Strategic Group Dynamics”

### CHAPTER 4

- Revised and updated ChapterCase: “Five Guys’ Core Competency: ‘Make the Best Burger, Don’t Worry about Cost.’”
- New Strategy Highlight: “Yeti’s Core Competency: Making Quality Cool”

### CHAPTER 5

- New ChapterCase: “Patagonia: A Pioneer in Creating Shared Value”
- New A-head Section: “From Corporate Social Responsibility to Creating Shared Value”
- New Sections:
  - “Shareholder Capitalism”
  - “Shareholder Capitalism in Crisis?”
  - “Creating Shared Value”
- New Strategy Highlight: “BlackRock’s \$10 Trillion of Shared Value”

### CHAPTER 6

- Revised and updated ChapterCase: “JetBlue Airways: En Route to a New Blue Ocean?”
- New Strategy Highlight: “How JC Penney Sailed into a Red Ocean”

## CHAPTER 7

- Revised and updated ChapterCase: “Netflix: No Longer a Disruptor?”
- New Section: “The Four Industrial Revolutions”
- New Strategy Highlight: “How to Compete with Amazon.com? Easy: Use Shopify”
- Revised and updated Strategy Highlight: “Standards Battle: Which Automotive Technology Will Win?”

## CHAPTER 8

- Revised and updated ChapterCase: “Amazon’s Corporate Strategy”
- New Section: “Not All Industry Value Chain Stages Are Equally Profitable”
- Revised and updated Strategy Highlights:
  - “The Equity Alliance between Coca-Cola and Monster: A Troubled Engagement?”
  - “P&G Diversification Strategy: Turning the Tide?”

## CHAPTER 9

- Revised and updated ChapterCase: “Little Lyft Gets Big Alliance Partners and Beats Uber in Going Public”
- Revised and updated Strategy Highlight: “Kraft Heinz: From Specializing in Hostile Takeovers to Eating Humble Pie”

## CHAPTER 10

- Revised and updated ChapterCase: “IKEA: The World’s Most Profitable Retailer”
- New Section: “Systemic Rivalry and Techno Cold War”
- New Strategy Highlight: “Squid Game: Netflix’s Transnational Strategy”
- Revised and updated Strategy Highlight: “Walmart Retreats from Germany, and German Ultra-Low-Cost Grocers Invade the United States”
- Revised and updated section “Cost Reductions vs. Local Responsiveness,” where the “Integration-Responsiveness Framework” is now the “Cost-Responsiveness Framework”

## CHAPTER 11

- Revised and updated ChapterCase: “‘A’ is for Alphabet and ‘G’ is for Google”
- New Section: “The Ambidextrous Organization: Balancing Trade-Offs”
- Revised and updated Strategy Highlights:
  - “Zappos: Of Holacracy and (Not Much) Happiness”
  - “Sony vs. Apple: Whatever Happened to Sony?”

## CHAPTER 12

- Revised and updated ChapterCase: “Theranos: Bad Blood”
- New A-head Section: “Business Models: Strategy in Action”
- New Section: “The Long Tail and Business Model Innovation”
- New Strategy Highlight: “Business Model Innovation: How Dollar Shave Club Disrupted Gillette”

## PEDAGOGY

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 text to address a needed new category—the third generation of strategy content 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 continues to be overwhelmingly enthusiastic.

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. I also move iteratively between strategy concepts and real-world examples. This unique approach offers students a learning experience that combines rigor and relevance. As John Medina of the University of Washington’s School of Medicine and lifelong 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.<sup>2</sup>

*Strategic Management* brings conceptual frameworks to life via examples that cover products and services from companies with which students are familiar, such as Airbnb, Apple, Amazon, Chick-fil-A, Disney, Five Guys, IKEA, JetBlue, Lyft and Uber, Meta (Facebook), Netflix, Nike, Patagonia, Peloton, Robinhood, Rivian, Starbucks, Tinder and Bumble, Tesla, Toms Shoes, Warby Parker, and Yeti. 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 turbulent 21st century.

My distinctive approach to teaching strategy offers students a unique learning experience that combines theory and practice and provides tight linkages between concepts and cases. In this new 6th edition, I build upon the unique strengths of this product and continue to add improvements based upon hundreds of insightful reviews and 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**.

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

- *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?*”
- *Strong emphasis on diversity, equity, and inclusion (DEI)* 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 a wide array of organizations*, including for-profit public companies, private firms (including startups), and nonprofit 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, Latin America, and North America. I was fortunate to study, live, and work across the globe, and I attempt to bring this cosmopolitan perspective to bear in this text.
- *Industry-leading digital delivery option (Create)*, *adaptive learning system (SmartBook)*, *activity-based applications (ABAs or mini sims in Connect)*, and other *online assignment and assessment tools (Connect)*.
- *Best-in-class Teaching Resources*.
- *A standalone module on How to Conduct a Case Analysis*.
- *High-quality Cases*, well integrated with text chapters and standardized, *high-quality and detailed teaching notes*; there are three types of cases that come with this text:
  - **12 ChapterCases** begin and end each chapter, framing the chapter topic and content. Each ChapterCase has thought-provoking questions tailored to the specific chapter content to stimulate in-class discussions.
  - **12 MiniCases** in Part 4 of the book, with one MiniCase specifically matched to each chapter with accompanying discussion questions. All of the cases are based on original research, provide dynamic opportunities for students to apply strategy concepts by assigning them in conjunction with specific chapters, and can be used in various ways (as individual assignments, group work, and in class).
  - **27 full-length Cases** by Frank T. Rothaermel are included free of charge for students in **6th edition Connect**: 12 are new or fully updated; 15 are from previous editions.
- **Over 50 full-length Cases** by Frank T. Rothaermel are available through McGraw Hill Create ([www.mcgrawhillcreate.com/rothaermel](http://www.mcgrawhillcreate.com/rothaermel)).

I have taken great pride in authoring this text’s case materials (some with co-authors). This additional touch is a differentiating feature from other offerings on the market and allows for strict quality control and seamless integration with chapter content. All case materials come with sets of questions to stimulate class discussion and provide guidance for written assignments. High-quality case teaching notes that more fully integrate content and cases are available to instructors in the **Connect Library** (Instructor Resources).

## CONTENT DELIVERY

**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, allowing them to practice and challenge their understanding of core strategy concepts. It allows the instructor to set up all assignments before the semester, have them auto-released on preset dates, and 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.

- **Application-Based Activities (ABAs)** are highly interactive mini simulations that challenge students to use problem-solving skills and apply their knowledge to realistic scenarios. Students are placed in specific roles in which they are required to apply multiple concepts and make data-informed decisions. They progress from understanding basic concepts to analyzing complex scenarios and solving problems.
- **Application Exercises** including animated video cases and on-location video cases, Mini-Case case analyses, interactive exercises, and new case exercises for all 12 full-length cases are available in Connect and require students to apply key concepts, thereby closing the knowing and doing gap, while providing instant feedback for the student and progress tracking for the instructor.
- **New Student Primer**, available in Connect, contains direct personal applications of strategy concepts to students' careers and lives, helping them to internalize the content. Included in the new Student Primer are the popular and completely revised myStrategy modules for each chapter, as well as Financial Ratio Reviews, which give students the opportunity to further hone their financial analysis skills. These review exercises cover each type of financial ratio (activity, leverage, liquidity, market, and profitability). As such, they provide students with a solid foundation for effective case analysis.

## INSTRUCTOR RESOURCES

The **Instructor Resources** located in **Connect** provide the following teaching tools, all of which have been tested and updated with this edition:

- The **Teacher's Resource Manual (TRM)** includes thorough coverage of each chapter and 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, additional company examples not found in the textbook, teaching tips, PowerPoint references, critical discussion topics, answers to ChapterCase discussion questions, and a variety of exercises. In addition, all end-of-chapter discussion questions are now located in the TRM.
- The **PowerPoint (PPT)** slide decks, available in an accessible version for individuals with visual impairment, provide comprehensive lecture notes, video links, and additional company examples not found in the textbook. Options include instructor media-enhanced slides as well as notes with outside application examples. All slides can be edited by individual instructors to suit their needs.
- The **Test Bank** includes 100 to 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. Each question is tagged to learning objectives, Bloom's taxonomy levels, and AACSB compliance requirements. Many questions are new and written especially for this new edition.
- The **Video Guide** includes video links that relate to concepts from every chapter. The guide includes links to a wide range of sources, from Big Think to Stanford University's Entrepreneurship Corner; The McKinsey Quarterly to BBC and YouTube.

## CREATE

- **Create**, McGraw Hill's custom-publishing tool, is where you access additional full-length cases (and Teaching Notes) beyond those included complimentary in Connect 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 all author-written cases as well as instructor-written cases that match specifically with the new 6th edition. Create also contains cases from Harvard, Ivey, Darden, NACRA, and much more! You can assemble your own course, selecting the chapters, cases (multiple 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, preloaded in Create. Among the preloaded solutions, you'll find options for undergraduate, MBA, accelerated, and other strategy courses.

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# ACKNOWLEDGMENTS

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Any list of acknowledgments will always be incomplete, but I would like to thank some special people without whom this product 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 provides 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 I am honored to hold. I'm grateful to Dean Maryam Alavi and Senior Associate Deans Jonathan Clarke and Soumen Ghosh for providing the exceptional leadership that allows faculty to focus on research, teaching, and service. I would like to thank my colleagues at Georgia Tech—all of whom are not only great scholars but also fine individuals whom I'm fortunate to have as friends: Marco Caccagnoli, Anne Fuller, Jonathan Giuliano, Stuart Graham, David Ku, Ashlee Li, Astrid Marioni, John McIntyre, Alex Oettl, Aleksandra Rebeka, Eunhee Sohn, and Peter Thompson.

I'm also fortunate to work with a great team at McGraw Hill: Michael Ablassmeir (director), Anne Ehrenworth (senior product developer), Debbie Clare (executive marketing manager), Sherry Kane and Bruce Gin (senior content project managers), and Sarah Flynn (senior content licensing specialist). Steve Rigolosi contributed as a superb content development editor on the 6th edition manuscript. I'm grateful for the excellent research assistance provided by Veronica Bian, Melissa Francisco, Megan Gamble, and Duncan Siebert.

I'm thankful for the contributions of great colleagues on various resources that accompany this new edition of *Strategic Management*:

- John Burr (Purdue University) on the *Video Guide*.
- Meredith Peabody (Northern Arizona University) and Carla Flores (Ball State University) on the revision of Connect, including the *Interactive Exercises*, *MiniCase Exercises*, and *Case Exercises*.
- Orhun Guldiken (Florida International University) on the accessible *PowerPoint* slide decks.
- Jennifer Sexton (Mississippi State University) on the *Teacher Resource Manual*.

Last but certainly not least, I wish to thank the reviewers and focus group attendees who shared their expertise with us, from the beginning when we developed the prospectus to the new teaching and learning package 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 below.

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# THANK YOU . . .

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This text 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, hundreds of reviews from instructors across the country, beta-testing, and market reviews of subsequent editions on various campuses in the U.S. and across the world. 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 greatly improved this product:

Joshua R. Aaron  
*East Carolina University*

Joseph Aranyosi  
*University of Phoenix*

Moses Acquah  
*University of North Carolina,  
Greensboro*

Garry Adams  
*Auburn University*

M. David Albritton  
*Northern Arizona University*

Benjamin N. Alexander  
*California Polytechnic State  
University*

Brent B. Allred  
*Utah State University*

Semiramis Amirpour  
*University of Texas, El Paso*

Cory J. Angert  
*University of Houston-  
Downtown*

Melissa Appleyard  
*Portland State University*

Jorge A. Arevalo  
*William Paterson University*

Asli Arikan  
*Kent State University*

Mathias Arrfelt  
*Arizona State University*

Marne Arthaud-Day  
*Kansas State University*

Bindu Arya  
*University of Missouri,  
St. Louis*

Guclu Atinc  
*Texas A&M University,  
Commerce*

Seung Bach  
*California State University,  
Sacramento*

John Bade  
*Washington University,  
St. Louis*

Jeffery Bailey  
*University of Idaho*

David Baker  
*Kent State University*

LaKami T. Baker  
*Auburn University*

Dennis R. Balch  
*University of North Alabama*

Edward R. Balotsky  
*Saint Joseph's University*

Kevin Banning  
*Auburn University,  
Montgomery*

Jeff Barden  
*Oregon State University*

James W. Barrow  
*Suffolk University*

Patricia Beckenholdt  
*University of Maryland,  
University College*

Geoff Bell  
*University of Minnesota,  
Duluth*

Valerie Bell  
*Loyalist College, Canada*

Bruce W. Bellner  
*The Ohio State University*

Gregory Berezewski  
*Roosevelt University*

Heidi Bertels  
*City University of New York,  
Staten Island*

Lorenzo Bizzi  
*California State University,  
Fullerton*

Audrey M. Blume  
*Wilmington University*

Tim Blumentritt  
*Kennesaw State University*

William C. Bogner  
*Georgia State University*

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*Southern Illinois University,  
Edwardsville*

David S. Boss  
*Ohio University*

Michael Bowen  
*University of South Florida*

Nathan A. Bragaw  
*Louisiana State University*

Dorothy Brawley  
*Kennesaw State University*



Wm. David Brice  
*California State University,  
Dominguez Hills*

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*South Carolina State  
University*

James W. Bronson  
*University of Wisconsin,  
Whitewater*

Jill A. Brown  
*Bentley University*

Barry Bunn  
*Valencia College*

Richard A. L. Caldarola  
*Troy University*

Marco Ceccagnoli  
*Georgia Institute of  
Technology*

Janice F. Cervený  
*Florida Atlantic University*

Clint Chadwick  
*University of Alabama,  
Huntsville*

Kenneth H. Chadwick  
*Nicholls State University*

Heewon Chae  
*Arizona State University*

Kalyan Chakravaty  
*California State University,  
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Jay P. Chandran  
*Northwood University*

Jianhong Chen  
*University of New Hampshire*

Tianxu Chen  
*Oakland University*

Yi-Yu Chen  
*New Jersey City University*

Mike Cheng  
*Golden Gate University*

Steve Childers  
*Radford University*

Sanjib Chowdhury  
*Eastern Michigan University*

Valerie L. Christian  
*Sacred Heart University*

Brent Clark  
*University of South Dakota*

Timothy S. Clark  
*Northern Arizona University*

John Clarry  
*Rutgers University*

Betty S. Coffey  
*Appalachian State University*

Anne N. Cohen  
*University of Minnesota*

Jamie Collins  
*University of Canterbury*

Brian Connelly  
*Auburn University*

W. J. Conwell  
*University of Texas, El Paso*

Rick Corum  
*Liberty University*

Eva Lynn Cowell  
*University of Tennessee*

Cynthia S. Cycyota  
*United States Air Force  
Academy*

Derrick E. D'Souza  
*University of North Texas*

Joshua J. Daspit  
*Texas State University*

Parthiban David  
*American University*

Samuel DeMarie  
*Iowa State University*

Irem Demirkan  
*Northeastern University*

Geoffrey Desa  
*San Francisco State  
University*

Edward Desmarais  
*Salem State University*

Steven S. Dionne  
*Georgia State University*

Michael E. Dobbs  
*Eastern Illinois University*

Mark Dobeck  
*Cleveland State University*

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*Coastal Carolina University*

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University*

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Jason Scott Earl  
*Brigham Young University,  
Hawaii*

Andrew G. Earle  
*University of New Hampshire*

Helen Eckmann  
*Brandman University*

Linda F. Edelman  
*Bentley University*

Kimberly Ellis  
*Florida Atlantic University*

Alan Ellstrand  
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*University of Houston-  
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University*

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Champaign*

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*University of Louisville*

Robert S. Fleming  
*Rowan University*

Carla C. Flores  
*Ball State University*

Daniel Forbes  
*University of Minnesota*

Isaac Fox  
*University of Minnesota*

Susan Fox-Wolfgramm  
*Hawaii Pacific University*

William Foxx  
*Troy University*

Charla S. Fraley  
*Columbus State Community  
College*

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*Northern Arizona University*

Steven A. Frankforter  
*Winthrop University*

Anne W. Fuller  
*Georgia Institute of  
Technology*

Venessa Funches  
*Auburn University,  
Montgomery*

Jeffrey Furman  
*Boston University*

Nolan Gaffney  
*University of North Texas*

Scott Gallagher  
*James Madison University*

David L. Gartenberg  
*Seattle University*

John E. Gentner  
*University of Dayton*

Jim Glasgow  
*Villanova University*

Eric Glymph  
*Virginia Commonwealth  
University*

Devi R. Gnyawali  
*Virginia Tech*

Sanjay Goel  
*University of Minnesota,  
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Steve Gove  
*University of Vermont*

Patrick Greek  
*Macomb Community College*

Shirley A. Green  
*Indian River State College*

Regina A. Greenwood  
*Nova Southeastern University*

Christin Van Wyk Greiman  
*Northwood University*

Robert D. Gulbro  
*Athens State University*

Michael Gunderson  
*University of Florida*

Craig Gustin  
*American InterContinental  
University*

Stephen F. Hallam  
*University of Akron*

Dinesh Hasija  
*Augusta University*

Marcia McLure Hardy  
*Northwestern State  
University, Louisiana*

Darel Hargrove  
*Central Michigan University*

Ahma Hassan  
*Morehead State University*

Scott D. Hayward  
*Elon University*

Jon Timothy Heames  
*West Virginia University*

Richard A. Heiens  
*University of South Carolina,  
Aiken*

Duane Helleloid  
*University of North Dakota*

Kurt A. Heppard  
*United States Air Force  
Academy*

Theodore T. Herbert  
*Rollins College*

Kurt Herrmann  
*Brigham Young University*

Ken Hess  
*Metropolitan State University*

Scott Hicks  
*Liberty University*

Glenn Hoetker  
*The University of Melbourne*

Phyllis Holland  
*Valdosta State University*

R. Michael Holmes, Jr.  
*Florida State University*

Stephen V. Horner  
*Arkansas State University*

George Hruby  
*Cleveland State University*

Tammy Huffman  
*Utah Valley University*

Tobias M. Huning  
*University of North Florida*

- Tammy G. Hunt  
*University of North Carolina,  
Wilmington*
- Ana Elisa Iglesias  
*University of Wisconsin, La  
Crosse*
- Syeda Noorein Inamdar  
*The Chinese University of  
Hong Kong*
- John G. Irwin  
*Troy University*
- Carol K. Jacobson  
*Purdue University*
- Sean Jasso  
*University of California,  
Riverside*
- 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*
- Elko Klijn  
*Old Dominion 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. Lebron  
*Towson University*
- Hun Lee  
*George Mason University*
- Jay Lee  
*California State University,  
Sacramento*
- Mina Lee  
*Xavier University*
- Mingxiang Lee  
*Florida Atlantic 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*
- Eduardo V. Lopez  
*Belmont University*
- Joseph Mahoney  
*University of Illinois, Urbana-  
Champaign*
- David Major  
*University of Miami*
- 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*
- Charles Marvil  
*Georgia Southern University*
- Blake Mathias  
*Louisiana State University*
- Gita Mathur  
*San Jose State University*
- Patricia Matuszek  
*Troy University,  
Montgomery*
- David McCalman  
*University of Central  
Arkansas*
- James McCormack  
*Bentley University*
- Jeffrey E. McGee  
*The University of Texas,  
Arlington*

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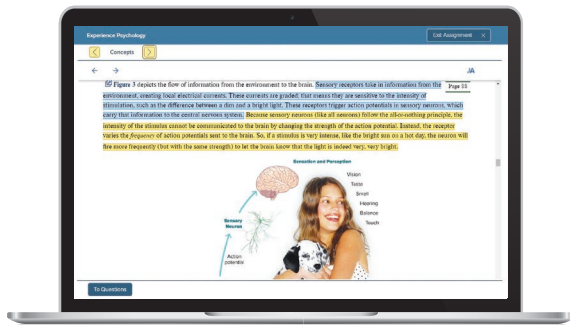
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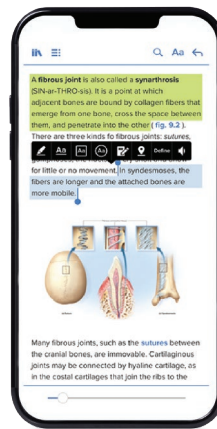
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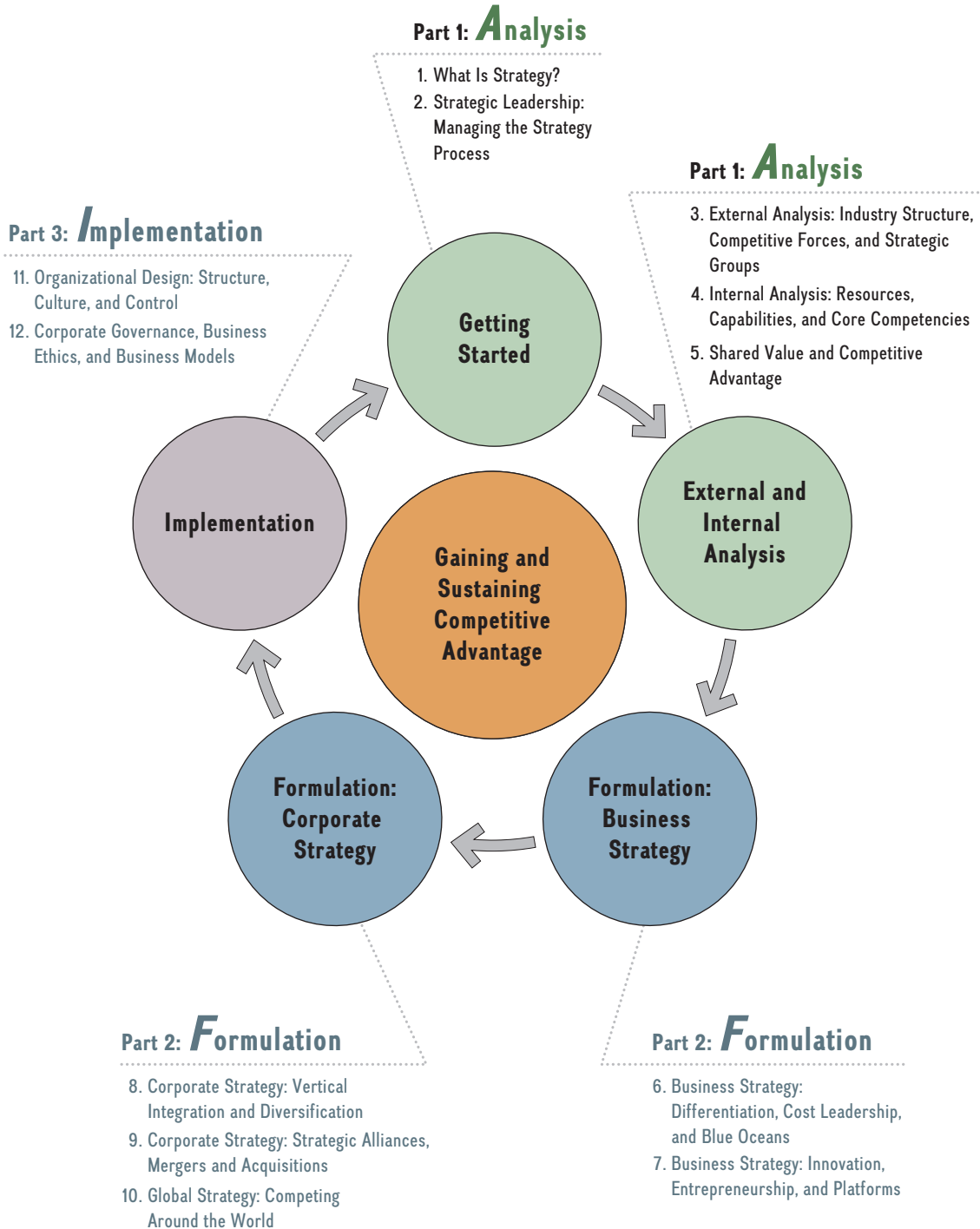
PART

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** Shared Value and Competitive Advantage

# The AFI Strategy Framework



# What Is Strategy?

## Chapter Outline

- 1.1** What Strategy Is: Gaining and Sustaining Competitive Advantage  
*Crafting and Implementing Strategy at Tesla*  
*What Is Competitive Advantage?*
- 1.2** Stakeholder Strategy and Competitive Advantage  
*Value Creation*  
*Stakeholder Impact Analysis*
- 1.3** The Analysis, Formulation, Implementation (AFI) Strategy Framework  
*Key Topics and Questions of 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** Assess the relationship between stakeholder strategy and sustainable competitive advantage.
- LO 1-4** Conduct a stakeholder impact analysis.
- LO 1-5** Apply the Analysis, Formulation, Implementation (AFI) Strategy Framework.

## Tesla: The Trillion-Dollar Tech Titan

Tesla, Inc., an American manufacturer of all-electric cars, had a market capitalization<sup>1</sup> of greater than \$1 trillion in 2022, an appreciation of 50,000% over its initial public offering in 2010. Only five other tech companies—Alphabet, Amazon, Apple, Meta Platforms (formerly Facebook), and Microsoft—are in the elite trillion-dollar club.<sup>2</sup> A mere 18 years after its founding, Tesla is the youngest company to reach this important milestone. Moreover, the Austin, Texas-based electric vehicle company is almost twice as valuable as five major car companies combined: Ford, GM, Stellantis (formerly Fiat Chrysler), Toyota, and Volkswagen (VW).

How did Tesla transform from a fledgling startup to a trillion-dollar tech titan? The answer: Tesla's strategy. In a 2006 blog entry, Elon Musk, Tesla's co-founder and chief executive officer (CEO), explained the startup's master plan:<sup>3</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.

Did Tesla stick 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. The Roadster served as a prototype to demonstrate that electric vehicles (EVs) can be more than mere golf carts. Tesla thus completed Step 1 of its master plan.

In Step 2, after selling 2,500 Roadsters, Tesla stopped producing them in 2012 to focus on its next car: the Model S, a four-door family sedan with an initial base price of \$73,500. The Model S, which appeals to a somewhat broader market and thus allows for larger production runs to drive down unit costs, received an outstanding market

reception. It was named the Motor Trend Car of the Year and received the highest score of any car ever tested by Consumer Reports (99/100). The refreshed Tesla Model S Plaid, introduced in 2022, is the world's fastest mass-production car; it accelerates from 0 mph to 60 mph in two seconds. Tesla has sold more than 300,000 Model S cars worldwide.

Tesla also completed Step 3 of its master plan. In 2016, it unveiled the Model 3, an all-electric compact luxury sedan with a starting price of \$35,000. Many people who wanted the new Model 3 stood in line overnight, eagerly waiting for Tesla stores to open so they could pay their \$1,000 deposit and secure a spot on the waiting list for a car they had never seen, let alone taken for a test drive. As a result of this consumer enthusiasm, Tesla received more than 500,000 preorders for the Model 3, for a total of \$500 million in interest-free loans. Despite Tesla's initial difficulties in scaling up production, Model 3 deliveries began in 2017. In 2019, Tesla launched the Model Y, a compact SUV with the entry version starting at \$39,000 (and a range of 230 miles) and the high-end performance version starting at \$60,000 (and a range of 280 miles).



Elon Musk introduced the Cybertruck in 2019, with mass production of the futuristic truck in 2023.

Frederic J. Brown/AFP/Getty Images

The two lower-priced Models 3 and Y were critical for Tesla to break into the mass market. In 2021, Tesla sold close to 1 million vehicles worldwide, with Models 3/Y accounting for 97% of sales. With upgrade options, the average selling price in 2021 was \$54,000 for the Model 3 and \$68,000 for the Model Y. Despite its higher price, the Model Y is the most popular Tesla vehicle globally, and Tesla continuously works on ramping up production volume to drive down costs further.

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 2016. The integration of Tesla and SolarCity, which resulted in the first fully integrated clean-tech energy company that combines solar power, power storage, and transportation, marks the completion of Step 4 in Tesla's master plan.

In 2016, 10 years after creating Tesla's initial master plan, Elon Musk unveiled the second part of his strategy to

continue the pursuit of Tesla’s vision “to accelerate the advent of sustainable energy.”<sup>4</sup> Again, CEO Musk detailed a set of stretch goals:

1. Create stunning solar roofs with seamlessly integrated battery storage.
2. Expand the EV product line to address all major segments.
3. Develop a self-driving capability that is 10 times safer than manual via massive fleet learning.
4. Enable your car to make money for you when you aren’t using it.

In the updated strategy, Step 1 leverages the integration of SolarCity. Tesla is now a fully integrated sustainable energy company, combining energy generation and storage. It provides energy generation via solar roofs that look like regular roofing shingles but last longer and cost less, all things considered. Tesla also offers its Powerwall to residential consumers, making it possible to store solar energy captured on the roof of their house for later use. Energy generation therefore becomes decentralized. Thanks to the Powerwall, consumers can generate and use energy without being dependent on a utility company and can sell their excess energy to utility providers. Indeed, consumers can generate enough energy to power not only their Tesla cars but also their entire house. Should there be a power outage in the

central utility grid, the Powerwall provides electricity to a home for one week.

In Step 2, Tesla is planning to expand the EV lineup to address all major market segments. Elon Musk excels in product development, and Tesla has introduced several new vehicles, including a futuristic pickup truck (the Cybertruck, with production in 2023) and a heavy-duty semitruck.

In Step 3, Tesla is developing its vehicles’ self-driving capabilities. The goal is to make self-driving vehicles 10 times safer than cars driven manually, thus increasing the demand for fully autonomous cars. Many industry observers expect commercial trucks to be the first fully autonomous vehicles, especially on interstate highways. Self-driving large trucks can be on the road 24/7 and need to stop only to recharge their batteries.

Fully self-driving capabilities are required for Tesla to fulfill Step 4 of the new master plan: Turn your car into an income-generating asset. The idea is to offer an Uber-like service composed of Tesla vehicles but without drivers. On average, cars are in use for less than three hours a day. The idea is that your self-driving Tesla will be part of a shared vehicle fleet when you are not using it. This new business model drastically reduces the total cost of ownership of a Tesla vehicle. It also allows anyone to ride in a Tesla due to the sharing economy.<sup>5</sup>

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**Part II of this ChapterCase appears in Section 1.4.**



Why is Tesla so successful? In contrast to Tesla’s success, the big three U.S. automakers—Ford, GM, and Chrysler (now Stellantis)—struggled during the first decade of the 21st century, with both GM and Chrysler filing for bankruptcy protection.

*Why are some companies successful while others fail? And what, as a strategic leader, can you do about it?* 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 a firm or a nonprofit organization in its entirety. It also allows you to think like a general manager to help your organization achieve superior performance. The *AFI Strategy Framework* embodies this view of strategic management. It will guide our exploration of strategic management throughout this book.

In this chapter, we lay the groundwork for the study of strategic management. First, we introduce foundational ideas about strategy and competitive advantage. We move beyond thinking about competitive advantage solely as superior financial performance and

#### **strategic management**

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

introduce the concept of stakeholder strategy. Understanding stakeholder strategy allows us to appreciate the role of business in society more broadly. We then examine the components of the AFI framework and provide an overview of the entire strategic management process. We conclude this introductory chapter, as we conclude all other chapters in this text, with a section titled *Implications for Strategic Leaders*, which provides practical applications and considerations of the material developed in the chapter. Let's begin the exciting journey that ends with a deep understanding of strategic management and competitive advantage.

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

**Strategy** is a set of goal-directed and integrated actions a firm takes to gain and sustain superior performance *relative* to competitors.<sup>6</sup> Strategy is the outcome of the strategic management process. 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, and celebrities compete for endorsements. As highlighted in the ChapterCase, Tesla, a new entrant in the automotive industry, is competing for customers with established U.S. companies such as GM and Ford, and with foreign automakers Toyota, Honda, Nissan, Hyundai, VW, Audi, Porsche, Mercedes, and BMW, among others.

A **good strategy** enables a firm to achieve superior performance and sustainable competitive advantage relative to its competitors in any competitive situation. A good strategy consists of three key elements that make up the strategic management process:

1. A *diagnosis* to identify the competitive challenge. Diagnosis includes analyzing the firm's external and internal environments (Part 1 of the AFI framework: *Analysis*).
2. A *guiding policy* to address the competitive challenge through strategy formulation. The guiding policy lays the foundation to craft a firm's corporate, business, and functional strategies (Part 2 of the AFI framework: *Formulation*).
3. A set of *coherent actions* to implement the firm's guiding policy (Part 3 of the AFI framework: *Implementation*).

### CRAFTING AND IMPLEMENTING STRATEGY AT TESLA

Let's revisit ChapterCase 1 to see whether Tesla pursues a good strategy. Tesla is performing quite well in terms of indicators such as stock appreciation, where it outperforms its competitors by a wide margin. The appreciation of Tesla stock after its initial public offering (IPO) points to investors' expectations of future growth. By other measures, such as generating profits, Tesla underperforms compared to established car companies. Early on, startups expect losses, especially if the business requires significant upfront investments such as building new manufacturing facilities and retooling existing factories, which Tesla was required to do. Since 2020, Tesla has been generating positive and increasing net income. What we can say at this point is that Tesla seems to be starting with a promising strategy and is in the process of achieving superior performance relative to its competitors. But can Tesla sustain this outstanding performance over time? Let's use the three elements of a good strategy to explore this question.

#### LO 1-1

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

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

**good strategy** Enables a firm to achieve superior performance and sustainable competitive advantage relative to its competitors. It is the outcome of a strategic management process that 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.

**DIAGNOSIS OF THE COMPETITIVE CHALLENGE.** A good strategy needs to start with a precise and critical diagnosis of the competitive challenge. Elon 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>7</sup> Tesla was founded with the vision to "accelerate the world's transition to sustainable transport."<sup>8</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 hard 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 use its new technology to manufacture attractive and affordable vehicles, which will compete with cars running on gasoline. To overcome "range anxiety,"<sup>9</sup> Tesla has installed a charging station network. At this point, mass-market EVs cannot drive as far on one charge as gasoline-powered cars with a tank of gas. Gas stations are pretty much on every corner in cities and every couple of miles on highways.<sup>10</sup>

**A GUIDING POLICY.** After diagnosing the competitive challenge, strategic leaders must formulate an effective guiding policy in response. The developed strategy needs to be consistent over the long term, and it is often backed up with strategic commitments. A *strategic commitment*, for instance, is a sizable investment or a change to an organization's incentive and reward system. Strategic commitments (such as Tesla's Gigafactories) are significant investments resulting in fundamental changes to the organization's structure. In general, strategic commitments are significant changes that are difficult and costly to reverse.

Without consistency in a firm's guiding policy, it can create confusion among employees about which priorities to address. An inconsistent policy, therefore, negatively impacts effective day-to-day decisions that support the overall strategy. Moreover, other stakeholders, including investors and customers, become frustrated if the firm does not have a consistent and coherent strategy over time.

Tesla's guiding policy is to build cost-competitive mass-market vehicles such as Models 3/Y. Its formulated strategy is consistent with its mission and the competitive challenge identified. This strategy required significant strategic commitments, as demonstrated by Tesla's \$5 billion investment in a new lithium-ion battery plant in Nevada, the so-called Gigafactory or Giga Nevada. Batteries are the most critical component of electric vehicles. To build the battery manufacturing component of the Gigafactory, Tesla partnered with Panasonic of Japan, a world leader in battery technology.

To expand global production capacity rapidly and drive down costs, Tesla invested billions in several electric vehicle manufacturing plants across the globe. In 2019, it completed a production facility in Shanghai, China. Giga Shanghai is a vast factory, equal in size to the Tesla car manufacturing facility in Fremont, California, combined with its Gigafactory in Nevada. The goal is to produce batteries and cars on a large scale and in the same location. Large scale and co-location of critical tasks allow Tesla to further lower the price of Models 3/Y. The completion of Giga Shanghai in a record time of less than one year was a turning point for Tesla because the company was facing bankruptcy in 2018. The development and manufacturing costs of the luxury Models S/X were much higher than anticipated, leading to huge losses.

Giga Shanghai services the European market and the Chinese market, which is the largest electric vehicle market globally. The cost of Models 3/Y at Giga Shanghai is an estimated 40% lower than the costs when they are made in the United States, with no loss in quality. To further expand production capacity, in 2022 Tesla opened Giga Berlin, a \$7 billion factory, and Giga Texas (near Austin), a \$10 billion investment. Although such significant up-front investments frequently lead to early-year losses, they also represent a solid and credible commitment to becoming a viable competitor in the mass automobile market. Moreover, they deter entry by other potential newcomers to the EV industry.

**COHERENT ACTIONS.** Strategic leaders implement a guiding policy through coherent actions. Tesla's strategic leaders implement the formulated strategy with activities consistent with their diagnosis of the competitive challenge. To make a cost-competitive mass-market vehicle, Tesla must benefit from *economies of scale*, decreasing the cost per vehicle as output increases. To reap critical cost reductions, Tesla must ramp up its production volume. 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, exemplify actions coherent with Tesla's formulated strategy. So do its investments in Gigafactories in Austin, Berlin, and Shanghai.

Another set of coherent actions are those focused on Tesla's best-selling vehicles, Models 3/Y. In 2021, the EV maker doubled its production volume to close to 1 million cars compared to 2020. Thus, since 2015, Tesla has achieved a 20-fold increase in production volume from 50,000 cars built per year. Tesla's focus on Models 3/Y explains why they made up 97% of Tesla's vehicle deliveries in 2021. In addition, to ramp up production and drive down costs even further, Elon Musk announced, in 2022, that Tesla will not introduce any new vehicles for the time being. Moreover, he pushed back the mass production date for the much-anticipated Cybertruck to 2023.

At the same time, Tesla is expanding its network of charging stations across North America, Europe, and Asia. To fund this initiative and to avoid bottlenecks, Tesla announced that it will no longer provide new owners free use of the company's charging network. In addition, to accomplish the lofty goal of making zero-emission electric motors rather than internal combustion engines the new standard in automotive technology, Tesla decided to make some of its proprietary technology available to the public. Musk hopes that sharing Tesla's patents will expand the overall market size for electric vehicles as other manufacturers use Tesla's technology. This set of coherent actions shows that Tesla is dedicated to achieving its mission of accelerating the transition to sustainable transportation.

In review, to craft a good strategy, three steps are crucial in the strategic management process:

- A good strategy must define an organization's competitive challenge through a critical and honest assessment of the status quo.
- A good strategy provides a game plan for dealing with the competitive challenge identified. The firm needs a guiding policy that provides clear guidance for all employees.
- A good strategy requires effective implementation through a coherent and consistent set of actions.

Strategy Highlight 1.1 examines Twitter and asks whether the social media company has a strategy.