

THIRD EDITION

Strategic Management



Frank T. Rothaermel

Georgia Institute of Technology





STRATEGIC MANAGEMENT, THIRD EDITION

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DEDICATION

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

—FRANK T. ROTHARMEL

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FRANK T. ROTHAE RMEL (PH.D.) is a professor of strategy, 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. He has received several recognitions for his research, including the Sloan Industry Studies Best Paper Award, the Academy of Management Newman Award, the Strategic Management Society Conference Best Paper Prize, the DRUID Conference Best Paper Award, and the Israel Strategy Conference Best Paper Prize.

Thomson Reuters identified Frank as one of the “world’s most influential scientific minds” for having published in the top 1% of citation-based journal articles. He was listed among the top-100 scholars for his more than decade-long impact in both economics and business. *Businessweek* named Frank one of Georgia Tech’s Prominent Faculty in their national survey of business schools. The Kauffman Foundation views Frank as one of the world’s 75 thought leaders in entrepreneurship and innovation.

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 regularly translates his research findings for wider audiences in articles in *Forbes*, *MIT Sloan Management Review*, *Wall Street Journal*, and elsewhere.

Frank has a wide range of executive education experience, including teaching in programs at 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 institute-wide Georgia Power Professor of Excellence award. When launched (in 2012), Frank’s *Strategic Management* textbook received the McGraw-Hill 1st Edition of the Year Award in Business & Economics.

Frank holds a PhD degree in strategic management from the University of Washington; a MBA from the Marriott School of Management at Brigham Young University; and a M.Sc. (Diplom-Volkswirt) in economics from the University of Duisburg-Essen, Germany. Frank completed training in the case teaching method at the Harvard Business School. He was a visiting professor at the University of St. Gallen, Switzerland, and an Erasmus Scholar at Sheffield Hallam University, UK.



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Strategic Management is a research- and application-based strategy text that covers issues facing managers in a globalized and turbulent 21st century.

When the first edition published, the market response was overwhelmingly enthusiastic, and I was grateful for the strong vote of confidence. When the second edition published, the enthusiasm was even greater; I remain ever grateful for the sustained support. In this third edition, I build upon the unique strengths of the text and continue to add improvements based upon hundreds of insightful reviews and important feedback from professors, students, and professionals.

The strategy textbook market has long been separated into two overarching categories: traditional, application-based and research-based. Traditional, application-based strategy books represent the first-generation texts whose first editions were published in the 1980s. The research-based strategy books represent the second-generation texts whose first editions were published in the 1990s. This text represents a new category of strategy textbook—a third-generation text that *combines* the student accessible, application-oriented framework of the first-generation texts with the research-based framework of the second-generation texts. It integrates core concepts, frameworks, and analysis techniques in strategy with functional course offerings; it also aims to help students become managers capable of making well-reasoned strategic decisions.

To facilitate an enjoyable and refreshing reading experience that enhances learning, I synthesize and integrate theory, 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 theory to life via examples that cover products and services from companies with which students are familiar, such as Facebook, Google, Starbucks, Apple, and Uber. Use of such examples aids in making strategy relevant to students’ lives and helps them internalize strategy concepts and frameworks.

The hallmark features of this text continue to be:

- Use of 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 it is important*.

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

- Comprehensive but concise presentation of core concepts, frameworks, and techniques.
- Combination of traditional and contemporary strategy concepts.
- Up-to-date examples and discussion of current topics within a global context.
- Stand-alone chapter on competitive advantage, including a focus on *triple bottom line* and sustainability.
- Direct applications of strategy to careers and lives (including the popular *myStrategy* modules at the end of each chapter).
- Inclusion of *Strategy Term Project* (end-of-chapter) and interactive *Running Case* on HP (in Connect).
- Industry-leading digital delivery options and adaptive learning systems (Create, SmartBook, LearnSmart, and Connect)
- High-quality **Cases**, well integrated with textbook chapters and standardized, high-quality teaching notes; there are two types of cases:
 - **ChapterCases** begin and end each chapter, framing the chapter topic and content.
 - 28 **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 pride in authoring all of the ChapterCases, Strategy Highlights, and MiniCases. This additional touch allows quality control and ensures that chapter content and cases use one voice and are closely interconnected. Both types of case materials come with sets of questions to stimulate class discussion or provide guidance for written assignments. The instructor resources offer sample answers that apply chapter content to the cases.

In addition to these in-text cases, 21 full-length cases, authored or co-authored by me specifically to accompany this textbook, are available through McGraw-Hill's custom-publishing *Create*[™] program (www.McGrawHillCreate.com/Rothaermel). Full-length cases **New** to the third edition are: Delta, General Electric, and Google. Popular cases about Apple, Amazon.com, IBM, Facebook, McDonald's, Tesla Motors, and Better World Books among several others are significantly updated and revised. Robust and standardized case teaching notes are also available and accessible through Create; financial data for these cases may be accessed from the Instructor Resource site on Connect.

What's New in the Third Edition?

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

OVERVIEW OF IMPORTANT CHANGES IN 3E:

- New section on blue ocean strategy (Chapter 6), with application examples and strategy canvas.
- More global coverage included throughout, with a stronger Asian focus both on the continent as well as its global competitors.
- Stronger focus on sustainable business.
- Increased the total number of MiniCases to 28 (15 brand new, 13 revised).
- New, completely revised, or updated ChapterCases and Strategy Highlights.

- Stronger integration and expanded discussion of ChapterCases throughout.
- Increased emphasis on practice and applications of strategy concepts and frameworks.
- Updated or new firm, product, and service examples to afford more in-depth discussion.
- Enhanced graphic design and rendering of exhibits throughout entire text.

In detail:

CHAPTER 1

- New ChapterCase about Twitter's rise and current challenges.
- New Strategy Highlight 1.1 discussing Threadless and its use of crowdsourcing to help produce better products and maintain competitive advantage.
- Updated Strategy Highlight 1.2 about BP's Gulf Coast oil spill and systemic safety issues over the last decade.

CHAPTER 2

- New ChapterCase about Yahoo's CEO Marissa Mayer and the attempted turnaround under her leadership.
- Created new and stand-alone sections on each vision, mission, and values.
- Updated Strategy Highlight 2.1 on Merck's core values and the development of drugs to treat river blindness and the challenges with the Vioxx recall.
- Added a new table comparing and contrasting top-down strategic planning, scenario planning, and strategy as planned emergence (brief descriptions, pros and cons, where best used); see Exhibit 2.9.
- Added new sections to expand discussion of autonomous actions, serendipity, and resource allocation process as part of strategy as planned emergence.
- Added new ethical/social issues question focusing on Merck's responsibility to meet the needs of both its customers and its shareholders.

CHAPTER 3

- Updated ChapterCase about Tesla Motors and the U.S. automotive industry.
- Separate discussion of political and legal factors in the PESTEL framework.
- Sharpened the discussion of PESTEL framework overall.
- New Strategy Highlight 3.1: "BlackBerry's Bust."
- Updated the discussion of competition in the U.S. domestic airline industry throughout the chapter, and in Strategy Highlight 3.2: "The Five Forces in the Airline Industry."

CHAPTER 4

- New ChapterCase about Dr. Dre, and multi-billion-dollar Apple acquisition of Beats Electronics.
- Fresh examples of core competencies and their applications.
- Interlocution of the concept of *Core Rigidities*.
- Expanded discussion on dynamic capabilities, including new Strategy Highlight 4.2: "Dynamic Capabilities at IBM."

- Included new Exhibit 4.6 showing IBM’s successful transition throughout several technological discontinuities over the last 125 years.
- Sharpened discussion of SWOT, including moving (an updated version of) the SWOT application to McDonald’s in the Instructor Manual.

CHAPTER 5

- New ChapterCase, focusing on Apple vs. Microsoft and their quest for competitive advantage over time.
- Extended discussion of Apple and Microsoft (turnaround under new CEO Satya Nadella) throughout the chapter.
- Sharpened discussion of competitive advantage and firm performance.
- Expanded discussion of business models to include new popular applications and examples, with a more in-depth discussion.
- New Strategy Highlight 5.2 on Airbnb and its novel business model.

CHAPTER 6

- New ChapterCase about JetBlue and how its straddling of different strategy positions led to being “Stuck in the Middle” and a competitive disadvantage.
- New section on Blue Ocean Strategy.
- Application of the Blue Ocean Strategy canvas to the U.S. domestic airline industry.
- Discussion of the *Eliminate-Reduce-Raise-Create* framework from Blue Ocean Strategy and application to IKEA.
- New Strategy Highlight 6.1: “Dr. Shetty: The Henry Ford of Heart Surgery,” focusing on cost reductions in healthcare.
- New Strategy Highlight 6.2: “How JCPenney Sailed into the Red Ocean.”
- Dropped the section “The Dynamics of Competitive Positioning”
- New *myStrategy* module, comparing and contrasting low-cost and differentiated workplaces.

CHAPTER 7

- New ChapterCase on Netflix and the disruption in the TV industry.
- Coverage of innovation process expanded with a stronger focus on how to manage innovation.
- More in-depth coverage of product and process innovation over the entire industry life cycle, including revision of Exhibit 7.6 “Product and Process Innovation throughout an Industry Life Cycle.”
- Revision of Exhibit 7.9 “Features and Strategic Implications of the Industry Life Cycle.”
- New Strategy Highlight 7.1: “How Dollar Shave Club Is Disrupting Gillette.”
- Dropped the section “The Internet as Disruptive Force: The Long Tail.”
- Revised the *myStrategy* module and end-of-chapter section around debate on whether college adds to potential success of entrepreneurs.

CHAPTER 8

- New ChapterCase on how Amazon.com diversified over time to become the “Everything Store,” including a detailed exhibit showing Amazon.com’s key strategic initiatives and stock market valuation from the idea of in 1994 to 2015 (Exhibit 8.1).

- New section titled, “Why Firms Need to Grow.”
- New Strategy Highlight 8.1 “Is Coke Becoming a Monster?”
- More in-depth discussion of Exhibit 8.4 “Alternatives on the Make-or-Buy Continuum” in the text.
- New subsection on “When Does Vertical Integration Make Sense?”
- Revised section of “Types of Corporate Diversification” to sharpen discussion and provide graphic support as Rumelt’s framework categorizing different types of diversification is developed (Exhibit 8.8).
- Expanded discussion to clarify more fully the sources of value creation and costs of vertical integration and diversification (Exhibit 8.11).

CHAPTER 9

- Revised and updated ChapterCases focusing on Disney’s attempt to build billion-dollar franchises, with strategic alliances, and mergers and acquisitions as critical to corporate strategy execution.
- Changed macro structure of chapter by moving the Build-Borrow-Buy Framework upfront to guide and frame the discussion corporate strategy execution using.
- Discussion of strategic alliances before mergers and acquisitions.
- Included a new section entitled “How Firms Achieve Growth.”
- New Strategy Highlight 9.1 “IBM and Apple: From Big Brother to Big Alliance Partner.”
- Revised to *myStrategy* module to sharpen the discussion of network strategy in terms of career management.

CHAPTER 10

- New ChapterCase on IKEA, with a focus on the question whether the Swedish furniture retailer’s success is sustainable while competing globally.
- Reorganization of section “What Is Globalization” into two subsections, focusing on the stage and state of globalization respectively.
- New Strategy Highlight 10.1 “The Gulf Airlines Are Landing in the United States.”

CHAPTER 11

- Revised and updated ChapterCase “Zappos: From Happiness to Holacracy.”
- Included discussion on Holacracy as new organization structure.
- Expanded discussion with detailed visual support of section “Organizational Inertia: The Failure of Established Firms.”
- New Strategy Highlight 11.1 “The Premature Death of a Google-like Search Engine at Microsoft.”
- Dropped section on using SWOT analysis for strategy implementation.

CHAPTER 12

- New ChapterCase on Uber and its ethical lapses.
- Strong integration of Uber ChapterCase throughout the body of the chapter.
- Updated Strategy Highlight 12.1 “GE’s Board of Directors,” including discussion chairperson—CEO duality in the body of the chapter.
- Updated Strategy Highlight 12.2 “Did Goldman Sachs and the Fabulous Fab Commit Securities Fraud?”

MINICASES

- Added 15 brand-new MiniCases.
- Updated 13 MiniCases from second edition.
- Stronger focus on non-U.S. firms, especially on global competitors from Asia.
- Stronger focus on competing in China and India, facing strong domestic competitors.

FULL-LENGTH CASES

- Added three brand-new, full-length Cases: Delta Air Lines, General Electric after GE Capital, and Google.
- Revised and updated: Amazon.com, Apple, Best Buy, Better World Books, Facebook, IBM, McDonald's, Merck, Tesla Motors, and Better World Books, among others.
- Also included is an updated version of the popular case “The Movie Exhibition Industry” by Steve Gove and Brett Matherne.
- **All cases**—including the new and revised cases plus all cases from the first and second editions that were authored by Frank T. Rothaermel—**are available through McGraw-Hill Create**: <http://www.mcgrawhillcreate.com/Rothaermel>.
- Cases include financial data in e-format for analysis.

Instructor Resources

Connect, McGraw-Hill's online assignment and assessment system, offers a wealth of content for both students and instructors. Students will find the following:

- **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. Students will develop a 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.
- **Interactive applications** (such as click-drag activities, video cases, and—new in this edition—case analyses for each of the MiniCases) that require students to *apply* key concepts; instant feedback and progress tracking are also available.
- **Resources for analysis** (such as financial ratios, templates for strategic financial analysis, and financial review activities) that provide students with the tools they need to compare performance between firms and to refresh or extend their working knowledge of major financial measures in a strategic framework.
- **LearnSmart and SmartBook**, which has been significantly improved for this edition to provide students with more opportunity to probe concepts at a higher level of thinking.

Under the **Instructor's Resources tab**, instructors will find tested and effective tools that enable automatic grading and student-progress tracking and reporting, and a trove of content to support teaching:

- The **Combined Instructor Manual (IM)** includes thorough coverage of each chapter, support for newer and experienced faculty, as well as guidance for integrating Connect—all in a single resource. Included in this newly combined IM is the appropriate level of theory, recent application or company examples, teaching tips, PowerPoint references, critical discussion topics, and answers to end-of-chapter exercises.

- The **PowerPoint (PPT)** slides provide comprehensive lecture notes, video links, and company examples not found in the textbook. There will be instructor media-enhanced slides as well as notes with outside application examples.
- The **Test Bank** includes 100–150 questions per chapter, in a range of formats and with a greater-than-usual number of comprehension, critical-thinking, and application (or scenario-based) questions. It's tagged by learning objectives, Bloom's Taxonomy levels, and AACSB compliance requirements.
- The **Video Guide** is new for this edition and 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.

CREATE, McGraw-Hill's custom-publishing program, is where you access the full-length cases that accompany *Strategic Management* (<http://www.mcgrawhillcreate.com/Rothaermel>). Through CREATE, you will be able to select from 20 author-written cases that go specifically with this textbook as well as cases from Harvard, Ivey Darden, NACRA, and much more! You can: *Assemble your own course*, selecting the chapters, cases, 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.

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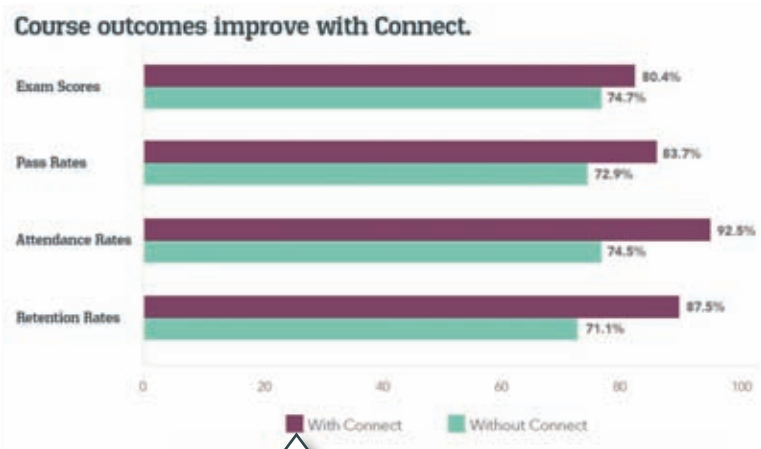
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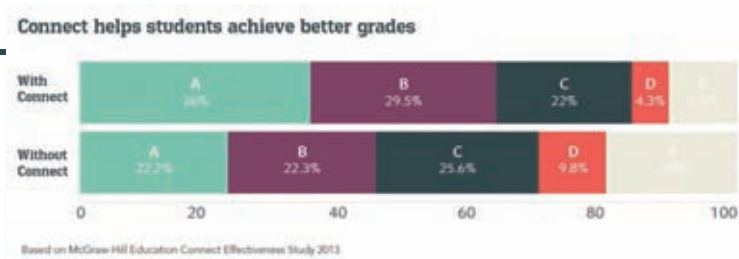
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