



“VALUE. RARITY. IMITABILITY. ORGANIZATION.”

What Is It?

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

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

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

What’s the Benefit of the VRIO Framework?

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

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

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

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

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



EDITION

6

STRATEGIC MANAGEMENT AND COMPETITIVE ADVANTAGE

Concepts and Cases

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Dedication

This book is dedicated to my wife, Kim, and our 11 grandchildren: Isaac, Dylanie, Audrey, Chloe, Lucas, Royal, Lincoln, Nolan, Theo, Cade, and Townes. They help me remember that no success can compensate for failure in the home.

—*Jay B. Barney*

This book is dedicated to my wife Denise and my soon to be 14 grandchildren: Ellie, Owen, Emerson, Cade, Elizabeth, Amelia, Eden, Asher, Lydia, Scarlett, Charlotte, Amos, and Claire.

—*William S. Hesterly*

Brief Contents



Part 1: THE TOOLS OF STRATEGIC ANALYSIS

- CHAPTER 1** What Is Strategy and the Strategic Management Process? 2
 - CHAPTER 2** Evaluating a Firm's External Environment 26
 - CHAPTER 3** Evaluating a Firm's Internal Capabilities 62
- End-of-Part 1 Cases PC 1-1



Part 2: BUSINESS-LEVEL STRATEGIES

- CHAPTER 4** Cost Leadership 96
 - CHAPTER 5** Product Differentiation 124
 - CHAPTER 6** Flexibility and Real Options 154
 - CHAPTER 7** Collusion 178
- End-of-Part 2 Cases PC 2-1



Part 3: CORPORATE STRATEGIES

- CHAPTER 8** Vertical Integration 202
 - CHAPTER 9** Corporate Diversification 228
 - CHAPTER 10** Organizing to Implement Corporate Diversification 256
 - CHAPTER 11** Strategic Alliances 282
 - CHAPTER 12** Mergers and Acquisitions 308
- End-of-Part 3 Cases PC 3-1



- Appendix: Analyzing Cases and Preparing for Class Discussions 339
- Glossary 344
- Company Index 352
- Name Index 355
- Subject Index 359

Contents



Part 1: THE TOOLS OF STRATEGIC ANALYSIS



CHAPTER 1 What Is Strategy and the Strategic Management Process? 2

Go, Pokémon Go 2

Strategy and the Strategic Management Process 4

Defining Strategy 4

The Strategic Management Process 5

What is Competitive Advantage? 8

Research Made Relevant: How Sustainable Are Competitive Advantages? 10

The Strategic Management Process, Revisited 10

Measuring Competitive Advantage 11

Accounting Measures of Competitive Advantage 11

Strategy in Depth: The Business Model Canvas 12

Economic Measures of Competitive Advantage 16

Ethics and Strategy: Stockholders Versus Stakeholders 18

The Relationship Between Economic and Accounting Performance Measures 19

Emergent Versus Intended Strategies 19

Why you Need to Know About Strategy 20

Summary 22

Challenge Questions 23

Problem Set 23

End Notes 25

CHAPTER 2 Evaluating a Firm's External Environment 26

How Attractive is the Music Streaming Industry? 26

Understanding a Firm's General Environment 28

The Structure-Conduct-Performance Model of Firm Performance 32

Ethics and Strategy: Is a Firm Gaining a Competitive Advantage Good for Society? 32

A Model of Environmental Threats 34

Threat from New Competition 34

Strategy in Depth: Environmental Threats and the S-C-P Model 35

Another Environmental Force: Complements 45

Industry Structure and Environmental Opportunities 46

Research Made Relevant: The Impact of Industry and Firm Characteristics on Firm Performance 47

Strategy in Depth: Network and Empty Core Industries 48

Opportunities in Fragmented Industries: Consolidation 49

Opportunities in Emerging Industries: First-Mover Advantages 50

Opportunities in Mature Industries: Product Refinement, Service, and Process Innovation 52

Opportunities in Declining Industries: Leadership, Niche, Harvest, and Divestment 54

Summary 57

Challenge Questions 58

Problem Set 59

End Notes 60

CHAPTER 3 Evaluating a Firm's Internal Capabilities 62*When a Noun Becomes a Verb* 62**The Resource-Based View of the Firm** 64

What Are Resources and Capabilities? 64

Critical Assumptions of the Resource-Based View 65

Strategy in Depth: Ricardian Economics and the Resource-Based View 66**The VRIO Framework** 67

The Question of Value 68

Ethics and Strategy: Externalities and the Broader Consequences of Profit Maximization 69

The Question of Rarity 71

The Question of Imitability 73

The Question of Organization 77

Research Made Relevant: Strategic Human Resource Management Research 78**Applying the VRIO Framework** 80

Applying the VRIO Framework to Southwest Airlines 81

Southwest's People-Management and Competitive Advantage 82

Imitation and Competitive Dynamics in an Industry 83

Not Responding to Another Firm's Competitive Advantage 84

Changing Tactics in Response to Another Firm's Competitive Advantage 84

Changing Strategies in Response to Another Firm's Competitive Advantage 85

Implications of the Resource-Based View 86

Where Does the Responsibility for Competitive Advantage in a Firm Reside? 86

Competitive Parity and Competitive Advantage 88

Difficult-to-Implement Strategies 88

Socially Complex Resources 89

The Role of Organization 89

Summary 90

Challenge Questions 91

Problem Set 92

End Notes 93

End-of-Part 1 Cases**Case 1-1:** Can SodaStream Disrupt the Carbonated Soft Drink Market? PC 1-1**Case 1-2:** True Religion Jeans: Flash in the Pants or Enduring Brand? PC 1-11**Case 1-3:** Walmart Stores, Inc. PC 1-26**Case 1-4:** Harlequin Enterprises: The Mira Decision PC 1-39**Part 2: BUSINESS-LEVEL STRATEGIES****CHAPTER 4** Cost Leadership 96*Fashion Eyeglasses—At a Fraction of the Price* 96**What is Business-Level Strategy?** 98**What is Cost Leadership?** 98

Sources of Cost Advantages 98

Strategy in Depth: Determining the Optimal Level of Production in an Industry 102*Research Made Relevant: How Valuable Is Market Share—Really?* 106*Ethics and Strategy: The Race to the Bottom* 108**The Value of Cost Leadership** 109

Cost Leadership and Environmental Threats 109

Strategy in Depth: The Economics of Cost Leadership 110**Cost Leadership and Sustained Competitive Advantage** 111

The Rarity of Sources of Cost Advantage 112

The Imitability of Sources of Cost Advantage 113

Organizing to Implement Cost Leadership 117
 Organizational Structure in Implementing Cost Leadership 117

Summary 120
 Challenge Questions 121
 Problem Set 122
 End Notes 123

CHAPTER 5 Product Differentiation 124

Who Is Victoria, and What Is Her Secret? 124
What is Product Differentiation? 126
 Bases of Product Differentiation 127
Research Made Relevant: Discovering the Bases of Product Differentiation 129
 Product Differentiation and Creativity 132
The Value of Product Differentiation 133
 Product Differentiation and Environmental Threats 133
Strategy in Depth: The Economics of Product Differentiation 134
 Product Differentiation and Environmental Opportunities 135
Ethics and Strategy: Product Claims and the Ethical Dilemmas in Health Care 136
Product Differentiation and Sustained Competitive Advantage 137
 Rare Bases for Product Differentiation 137
 The Imitability of Product Differentiation 137

Organizing to Implement Product Differentiation 143
 Organizational Structure and Implementing Product Differentiation 143
 Management Controls and Implementing Product Differentiation 144
Strategy in Depth: Going in Search of Blue Oceans 145
 Compensation Policies and Implementing Product Differentiation Strategies 147
Can Firms Implement Product Differentiation and Cost Leadership Simultaneously? 148
 No: These Strategies Cannot Be Implemented Simultaneously 148
 Yes: These Strategies Can Be Implemented Simultaneously 149
Summary 150
 Challenge Questions 151
 Problem Set 152
 End Notes 153

CHAPTER 6 Flexibility and Real Options 154

Why Is Netflix called Netflix? 154
What is Strategic Flexibility? 156
 Types of Flexibility 156
The Value of Strategic Flexibility 158
 Incorporating Risk in Strategic Decision Making 159
 Limitations of Risk Based Decision Making Under Uncertainty 159
 Valuing Flexibility 160
Strategy in Depth: The Black-Scholes Model for Valuing Financial Options 161
Research Made Relevant: The Value of Real Options Thinking 169

Strategic Flexibility and Sustained Competitive Advantage 172
 Rare and Costly-to-Imitate Flexibility 172
Organizing to Implement Strategic Flexibility 173
Ethics and Strategy Feature: Treating Employees as Flexible Assets 174
Summary 175
 Challenge Questions 175
 Problem Set 176
 End Notes 177

CHAPTER 7 Collusion 178

A Gas Station Conundrum 178

What is Collusion? 180

Ethics and Strategy Feature: The Ethics of Collusion 181

The Value of Collusion 182

Colluding to Reduce the Threat of New Competitors 182

Colluding to Reduce the Threat of Current Competitors 183

Strategy in Depth: How Colluding Firms Generate Economic Profits 183

Colluding to Reduce Other Competitive Threats 184

Collusion and Sustained Competitive Advantage 184

Ways Firms Can Cheat on Collusive Agreements 185

Explicit and Tacit Collusion 189

Industry Attributes and the Threat of Cheating 189

Research Made Relevant: Sending Signals to Maintain Collusion 190

Rarity and Costly to Imitate Collusion Strategies 196

Organizing to Implement Tacit Collusion 197

Organizational Efficiency 197

Organizational Self-Discipline 198

Summary 198

Challenge Questions 199

Problem Set 199

End Notes 200

End-of-Part 2 Cases

Case 2-1: McDonald’s: Comeback in the U.S. Burger Market? PC 2-1

Case 2-2: The Levi’s Personal Pair Proposal PC 2-7

Case 2-3: Papa John’s International, Inc.: Growth Challenges PC 2-17

Case 2-4: Ryanair—The Low Fares Airline PC 2-24

Case 2-5: Torrey Nano, Inc. PC 2-48

Case 2-6: Collusion in Major League Baseball PC 2-52

Part 3: CORPORATE STRATEGIES



CHAPTER 8 Vertical Integration 202

Outsourcing Research 202

What Is Corporate Strategy? 204

What Is Vertical Integration? 204

The Value of Vertical Integration 205

Strategy in Depth: Measuring Vertical Integration 206

Vertical Integration and the Threat of Opportunism 207

Vertical Integration and Firm Capabilities 209

Vertical Integration and Flexibility 210

Applying the Theories to the Management of Call Centers 212

Research Made Relevant: Empirical Tests of Theories of Vertical Integration 212

Integrating Different Theories of Vertical Integration 214

Vertical Integration and Sustained Competitive Advantage 215

The Rarity of Vertical Integration 215

Ethics and Strategy: The Ethics of Outsourcing 216

The Imitability of Vertical Integration 217

Organizing to Implement Vertical Integration 218

Organizational Structure and Implementing Vertical Integration 218

Management Controls and Implementing Vertical Integration 219

Compensation in Implementing Vertical Integration Strategies 221

Summary 223

Challenge Questions 224

Problem Set 225

End Notes 226

CHAPTER 9 Corporate Diversification 228

The Worldwide Leader 228

What is Corporate Diversification? 230

Types of Corporate Diversification 231

Limited Corporate Diversification 231

Related Corporate Diversification 232

Unrelated Corporate Diversification 233

The Value of Corporate Diversification 233

What Are Valuable Economies of Scope? 233

Research Made Relevant: How Valuable Are Economies of Scope? 234

Can Equity Holders Realize These Economies of Scope on Their Own? 247

Ethics and Strategy: Globalization and the Threat of the Multinational Firm 248

Corporate Diversification and Sustained Competitive Advantage 249

The Rarity of Diversification 249

Strategy in Depth: Risk-Reducing Diversification and a Firm's Other Stakeholders 249

The Imitability of Diversification 251

Summary 252

Challenge Questions 253

Problem Set 253

End Notes 254

CHAPTER 10 Organizing to Implement Corporate Diversification 256

Is It Soup Yet? 256

Organizational Structure and Implementing Corporate Diversification 258

The Board of Directors 259

Strategy in Depth: Agency Conflicts Between Managers and Equity Holders 261

Research Made Relevant: The Effectiveness of Boards of Directors 262

Institutional Owners 263

The Senior Executive 264

Corporate Staff 265

Division General Manager 267

Shared Activity Managers 268

Management Controls and Implementing Corporate Diversification 270

Evaluating Divisional Performance 270

Allocating Corporate Capital 273

Transferring Intermediate Products 274

Compensation Policies and Implementing Corporate Diversification 277

Ethics and Strategy: Do CEOs Get Paid Too Much? 278

Summary 278

Challenge Questions 279

Problem Set 279

End Notes 281

CHAPTER 11 Strategic Alliances 282

Alliances Between Chinese and U.S. Firms 282

What is a Strategic Alliance? 284

How do Strategic Alliances Create Value? 285

Strategic Alliance Opportunities 285

Strategy in Depth: Winning Learning Races 287

Research Made Relevant: Do Strategic Alliances Facilitate Tacit Collusion? 290

Alliance Threats: Incentives to Cheat on Strategic Alliances 292

Adverse Selection 293

Moral Hazard 293

Holdup 294

Ethics and Strategy: When It Comes to Alliances, Do "Cheaters Never Prosper"? 295

Strategic Alliances and Sustained Competitive Advantage 296

The Rarity of Strategic Alliances 296

The Imitability of Strategic Alliances 297

Organizing to Implement Strategic Alliances 300

Explicit Contracts and Legal Sanctions 300

Equity Investments 301

Firm Reputations 302

Joint Ventures 303

Trust 304

Summary 304

Challenge Questions 305

Problem Set 305

End Notes 306

CHAPTER 12 Mergers and Acquisitions 308

The Travails of Technology Acquisitions 308
Ethics and Strategy: Is Greed Good? 310

What Are Mergers and Acquisitions? 311

The Value of Mergers and Acquisitions 312

Mergers and Acquisitions: No Economies of Scope 312

Mergers and Acquisitions: When Economies of Scope Exist 313

Returns to Mergers and Acquisitions: Research Results 317

Strategy in Depth: Evaluating the Performance Effects of Acquisitions 317

Why Are There So Many Mergers and Acquisitions? 318

Mergers and Acquisitions and Sustained Competitive Advantage 321

Valuable, Rare, and Private Economies of Scope 321

Valuable, Rare, and Costly-to-Imitate Economies of Scope 322

Unexpected Valuable Economies of Scope Between Bidding and Target Firms 323

Implications for Bidding Firm Managers 324

Implications for Target Firm Managers 328

Research Made Relevant: The Wealth Effects of Management Responses to Takeover Attempts 329

Organizing to Implement a Merger or Acquisition 332

Post-Merger Integration and Implementing a Diversification Strategy 332

Special Challenges in Post-Merger Integration 333

Summary 335

Challenge Questions 335

Problem Set 336

End Notes 337

End-of-Part 3 Cases

Case 3-1: National Hockey League Enterprises Canada: A Retail Proposal PC 3-1

Case 3-2: Starbucks: An Alex Poole Strategy Case PC 3-6

Case 3-3: Rayovac Corporation: International Growth and Diversification Through Acquisitions PC 3-19

Case 3-4: Aegis Analytical Corporation's Strategic Alliances PC 3-31

Case 3-5: Activision's Crush on Mobile Gaming PC 3-41

Appendix: Analyzing Cases and Preparing for Class Discussions 339

Glossary 344

Company Index 352

Name Index 355

Subject Index 359

Preface



NEW TO THIS EDITION

What Should Be Included in a Strategic Management Text?

A very interesting question. Some books seem to think that the answer to this question is: Everything. And so, they get longer and longer each edition. Nothing dropped, plenty added.

We have taken a very different approach:

- Topics that are now covered more completely in non-strategic management texts are dropped.
- Models or frameworks that have proved to be theoretically unsound or empirically not substantiated are dropped.
- Strategic management models that provide important insights that have emerged over the last few years are added.

The result of all these changes is that the sixth edition of our text is just about the same length as the first edition, although the content of the sixth edition is dramatically different than all prior editions.

What Have We Dropped

Two elements have most obviously been dropped from this edition. In both cases, this decision was made, not because these are unimportant topics, but rather, because they are so important that non-strategic management text books have been written to address them.

- The “Strategy in the Emerging Enterprise” feature in each chapter has been dropped. As entrepreneurship teaching has become more important, these topics have been receiving enhanced coverage in entrepreneurship texts.
- The “International Strategies” chapter has been dropped. Again, this is not because international strategy is unimportant. Rather, it is so important that entire texts are dedicated to this topic.

What Has Been Added

By dropping these two topics, we were able to add two new chapters to this edition, while keeping the length of the book more or less the same.

- **Chapter Six: Flexibility and Real Options.** This chapter summarizes the latest theoretical and empirical work on the value of strategic flexibility. It describes the settings under which flexibility will create value, and how that value can be estimated.

CHAPTER

6

Flexibility and Real Options

LEARNING OBJECTIVES

After reading this chapter, you should be able to:

- 6.1 Define strategic flexibility and real options.
- 6.2 Specify the conditions under which strategic flexibility and real options will be valuable for firms.
- 6.3 Identify when strategic flexibility and real options can be a source of sustained competitive advantage.
- 6.4 Identify the organizational challenges associated with implementing strategic flexibility and a real options strategy.

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Why Is Netflix called Netflix?

For the first ten years of its existence, everyone had one question about Netflix: Why was Netflix called Netflix? Everyone got the “flix” part of the name—“flix” was slang for movies, and from its founding in 1997, Netflix was in the movie distribution business. Its business model was to take orders for DVD rentals online and then fulfill those orders by delivering DVDs to consumers through the mail. But the “net” had nothing to do with how Netflix distributed its DVDs. A better name for Netflix might have been “Mailflix” or “Letterflix.”

In fact, Netflix was very successful at this DVD by mail distribution model. By 2000, it was challenging the leader in the DVD rental business—Blockbuster. Blockbuster had retail stores that consumers would visit to rent DVDs. They would also have to return these DVDs to the same store. Having DVDs delivered through the mail eliminated these two trips and, except for delays while rented DVDs were sent through the mail, was infinitely more convenient than renting DVDs at retail stores.

In the late 1990s, Blockbuster had tried to duplicate Netflix’s DVD distribution model. It failed. Apparently, the fulfillment logistics in the DVDs by mail business—though perfected by Netflix—were very difficult for Blockbuster to imitate. Rather than trying to duplicate Netflix, in 2000 Blockbuster tried to buy Netflix for \$50 million. The founders of Netflix—Reed Hastings and Marc Randolph—declined the offer. Instead, Netflix continued its operations in the DVD rental business, continuously exceeded

xiii

LEARNING OBJECTIVES

After reading this chapter, you should be able to:

- 7.1 Define explicit and tacit collusion and explain why collusion is typically inconsistent with social welfare in an economy.
- 7.2 Describe how collusion can create economic profits.
- 7.3 Describe different ways that collusive agreements can fall apart, and how it is possible to use the attributes of an industry to anticipate how sustainable these agreements are likely to be.
- 7.4 Describe two unique challenges associated with organizing to implement a collusion strategy.

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A Gas Station Conundrum

Consider the following scenario. Think of it as a chance to apply all the theories and frameworks discussed in this text so far.

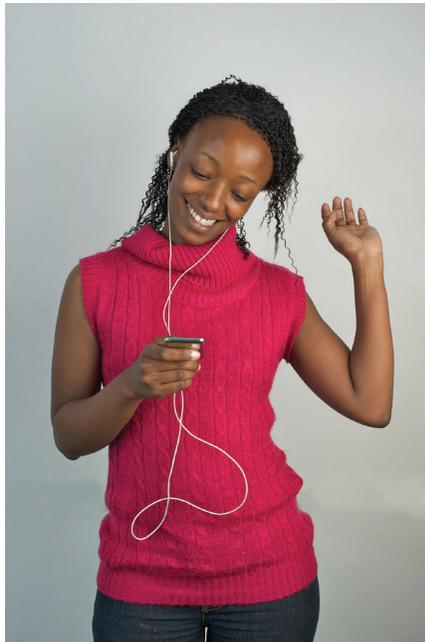
You own and operate a gas station on a busy street corner in your town. There are other gas stations in your city, but they are located over ten miles away. You sell a well-respected brand of gasoline, one that is supported by a national advertising

Of course, all the opening cases and examples used throughout the book have been updated or changed, as have the supporting cases and instructor’s manual. New opening cases include:

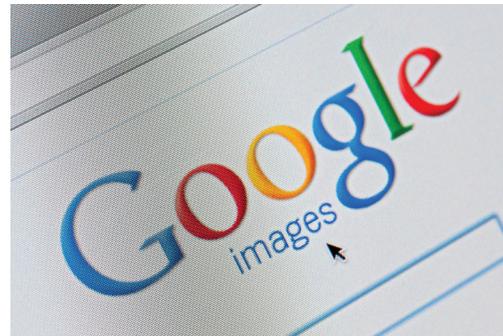
- “Go, Pokémon, Go” in Chapter One: This case discusses how the Pokémon altered reality game was created, and asks if this product will be a source of sustained competitive advantage.

- **Chapter Seven: Collusion.** This chapter explores the economic—and ethical—implications of explicit and tacit collusion. Even if a particular firm chooses to not engage in collusion, it must still understand this strategy and its economic consequences, because some of its competitors may choose this strategy.

These two chapters have all the teaching elements (Learning Objectives, Opening case, Research made Relevant feature, Strategy in Depth feature, Ethics and Strategy feature, Challenge Questions, and a Problem Set) and are supported by cases, just like the other chapters in the book. However, they explore important strategic options that receive less attention in other texts.



- “How Attractive is the Music Streaming Industry?” in Chapter Two: Music streaming services are very popular, but very few make money. Why is this the case, and what impact will this have on the strategies of these firms?
- “When a Noun Becomes a Verb” in Chapter Three: Why has Google gained a competitive advantage, and will they be able to sustain it?
- “Is it Soup Yet” in Chapter Ten: Alphabet has organized itself into a multi-divisional corporation, but will this help this company, and its operating divisions—including Google—grow and maintain their competitive advantage.



New supporting cases include: McDonald’s, Collusion in Major League Baseball, Torrey Nano (a fictional case), and Activision’s Crush on Mobile Gaming.

What Remains the Same

All the chapters in the book—beginning with Chapter Three—are still organized around the VRIO framework. Students at all levels continue to find this framework helpful in thinking about and applying what can be a very complex topic—strategic management.

We also continue to integrate the latest theory and empirical research into the text—but in a way that helps students apply these concepts in a real world setting. Consider just two examples:

“VRIO” – an integrative framework (see next page for details).

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

VRIO

VRIO

VRIO

VRIO

Research Made Relevant

Rita McGrath and Ian MacMillan argue that under conditions of uncertainty, managers should invest in a diversified range of projects that parallel many of the real options discussed in this chapter. These projects can be arrayed as in Figure 6.1.

In this figure, **technical uncertainty** refers to the extent to which managers understand the process by which a new product or service will be developed before that process is undertaken. Low technical uncertainty exists when managers know what kinds of skills and other



The Value of Real Options Thinking

resources they will need to develop a new product or service, the cost of acquiring these skills and resources, how to manage them effectively, and so forth. High technical uncertainty exists when managers do not know these things about a new product or service.

Market uncertainty, in Figure 6.1, refers to the extent to which managers understand how a new product or service will be received in the market. Low market uncertainty exists when managers know the price at which a product or service is likely to sell, the likely size

- The “Research Made Relevant” feature in Chapter Six’s discussion of flexibility and real options presents a simple—yet remarkably powerful—way of calculating the value of a firm’s strategic options

- The “Research Made Relevant” feature in Chapter Nine’s discussion of the value of economies of scope cites the most recent research—some published in 2017—about this important issue.

We have also kept our most popular supporting cases, including True Religion, Harlequin, Walmart, and Starbucks among others. With only a couple of exceptions, the revised cases are shorter. In shortening the cases, we have mostly cut out historical and other peripheral background material. Two of the new cases, Collusion in Major League Baseball and Torrey Nano, require students to apply concepts from the new chapters in the book on collusion and flexibility. As has been true of all of the editions, the vast majority of the cases deal with companies and industries that students will find familiar and, we hope, stimulating to analyze and discuss.

With the introduction on the chapters on strategic flexibility and real options (Chapter Six) and collusion (Chapter Seven), the book continues to include the most up to date conceptual and analytical material in the field of strategic management, while presenting that material in an accessible and applicable way.

Research Made Relevant

In 1994, Lang and Stulz published a sensational article that suggested that, on average, when a firm began implementing a corporate diversification strategy, it destroyed about 25 percent of its market value. Lang and Stulz came to this conclusion by comparing the market performance of firms pursuing a corporate diversification strategy with portfolios of firms pursuing a limited diversification strategy. Taken together, the market performance of a portfolio of firms that were pursuing a limited diversification strategy was about 25 percent



How Valuable Are Economies of Scope?

higher than the market performance of a single diversified firm operating in all the businesses included in this portfolio. These results suggested that not only were economies of scope not valuable, but, on average, efforts to realize these economies destroyed economic value. Similar results were published by Comment and Jarrell using different measures of firm performance.

Not surprisingly, these results generated quite a stir. If Lang and Stulz were correct, then diversified firms—no matter what kind of

Solving Teaching and Learning Challenges

Some MBA and undergraduate business programs teach strategic management early in the curriculum, to give students a broad strategic perspective before they begin specializing in particular functional areas. Others teach strategic management later in the curriculum, after students have taken a deep dive into one or more functional areas.

Students in these different programs bring very different skill sets to the strategic management course. This book accommodates faculty and students in both kinds of programs.

Teaching in a “Strategy First” Curriculum

Faculty who teach in “strategy first” programs can emphasize the core text material in each chapter—and the associated cases—and de-emphasize the “Strategy in Depth” and “Research Made Relevant” features. This core material does not require much background in other business functions, and when it does, the required background is explained in detail. However, there is enough substance in this material to enable students to read and analyze the cases, and to apply strategic management ideas throughout their curriculum, and into their career choices.

Teaching in a “Strategy Last” Curriculum

Faculty who teach in “strategy last” programs can broaden their emphasis to include the “Strategy in Depth” and “Research Made Relevant” features. These features include most of the technical, economic, and mathematical discussions in the book—discussions that build directly on knowledge students should have received in their functional classes. These materials make it possible for students and faculty to go into much more analytical detail in discussing the cases, and help demonstrate how the ideas developed in other functional areas are relevant in strategic management.

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Developing Employability Skills

Students who take the strategic management course often ask—how can this course enhance my employability? This question is answered in Chapter One of this book.

The VRIO framework is not just a tool for analyzing sources of competitive advantage for firms, it can also be used by students to assess whether or not they have a competitive advantage in the labor market. Consider the following:

- Is a student's knowledge of how to discount a firm's cash flow likely to be a source of competitive advantage in the labor market? This skill is valuable, but—because every business student in the world learn this skill—it is not rare, and thus will only be a source of competitive parity for a student.
- Is a student's ability to derive projected cash flows and an appropriate discount rate from a deep understanding of a firm's strategy likely to be a source of competitive advantage in the labor market? This skill is also valuable, but—in my experience—it is more rare, and thus potentially a source of competitive advantage.
- Which is more likely to be a source of competitive advantage for a student in the labor market: The ability to recite the "Five P's" in marketing or the ability to leverage their unique work experiences—either in a full time job or an internship—with their education to analyze a firm's marketing strategy? The VRIO framework suggests the latter, not the former, approach will more likely be a source of competitive advantage.

Competing for a great job in the labor market is just another form of competition. Students who want to gain a competitive advantage in that market must build valuable, rare, and costly to imitate capabilities. As described in Chapter Three, these capabilities will typically need to be socially complex, path dependent, or causally ambiguous.

Put differently, this book is not just about corporate competitive advantage in the product market, it is also about a student's competitive advantage in the labor market.

Instructor Teaching Resources

At the Instructor Resource Center, www.pearsonhighered.com/irc, instructors can easily register to gain access to a variety of instructor resources available with this text in downloadable format. If assistance is needed, our dedicated technical support team is ready to

xviii Preface

help with the media supplements that accompany this text. Visit <https://support.pearson.com/getsupport> for answers to frequently asked questions and toll-free user support phone numbers.

This program comes with the following teaching resources.

Supplements available to instructors at www.pearsonhighered.com/irc	Features of the Supplement
Case Teaching Notes authored by William Hesterly from the University of Utah	<ul style="list-style-type: none"> • Case-by-case summaries • Examples and activities not in the main book • Study questions • Teaching plans • Case analysis and discussion
Instructor’s Resource Manual authored by Ram Subramanian from the University of Florida	<ul style="list-style-type: none"> • Chapter-by-chapter summaries • Teaching points • Lecture guides for accompanying PowerPoint slides • Answers to challenge questions and problem sets in the book
PowerPoint Presentations authored by Ram Subramanian from the University of Florida	<ul style="list-style-type: none"> • Slides include graphs, tables, and equations from the textbook. • PowerPoints meet accessibility standards for students with disabilities. Features include, but not limited to: <ul style="list-style-type: none"> ▪ Keyboard and Screen Reader access ▪ Alternative text for images ▪ High color contrast between background and foreground colors
Test Bank authored by Ram Subramanian from the University of Florida	<p>Over 1000 true/false, multiple choice, short answer questions with these annotations:</p> <ul style="list-style-type: none"> • Difficulty level (1 for straight recall, 2 for some analysis, 3 for complex analysis) • Section number and name • Learning objective • Application type • AACSB learning standard (Ethical Understanding and Reasoning; Analytical Thinking; Information Technology; Diverse and Multicultural Work; Reflective Thinking; Application of Knowledge)
TestGen® Computerized Test Bank	<p>TestGen allows instructors to:</p> <ul style="list-style-type: none"> • Customize, save, and generate classroom tests • Edit, add, or delete questions from the Test Item Files • Analyze test results • Organize a database of tests and student results

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Most of Professor Barney's research focuses on how firms can gain and sustain competitive advantages. He has published over 100 articles in a variety of outlets, including the Harvard Business Review, the Sloan Management Review, the Strategic Management Journal, the Academy of Management Review, the Academy of Management Journal, and has published six books, including a novel titled *What*



WILLIAM S. HESTERLY

William Hesterly is the Associate Dean for Faculty and Research and the Dumke Family Presidential Chair of Strategic Management in the David Eccles School of Business, University of Utah. After studying at Louisiana State University, he received bachelors and master's degrees from Brigham Young University and a Ph.D. from the University of California, Los Angeles.

Professor Hesterly's research on organizational economics, vertical integration, organizational forms, and entrepreneurial networks has appeared in top journals including the

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Professor Barney has won several awards for his research and writing, including the Irwin Outstanding Educator Award for the Business Policy and Strategy Division of the Academy of Management, the Scholarly Contributions Award for the Academy of Management, and three honorary doctoral degrees—from Lund University (Sweden), the Copenhagen Business School (Denmark), and Universidad Pontificia Comillas (Spain). He has also been elected to the Academy of Management Fellows and the Strategic Management Society Fellows and has won teaching awards at UCLA, Texas A&M, and Ohio State.

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Professor Barney consults with companies and other organizations to help identify and leverage their sources of sustained competitive advantage. His over 50 clients have included Honeywell, Hewlett Packard, Texas Instruments, Koch Industries, Nationwide Insurance, Cardinal Health, and Columbus Public Schools.

Academy of Management Review, *Organization Science*, *Strategic Management Journal*, *Journal of Management*, and the *Journal of Economic Behavior and Organization*. His research has been mentioned on the front page of the *Wall Street Journal* and was featured prominently in Malcolm Gladwell's 2010 *New Yorker* article, "Talent Grab."

Professor Hesterly's research was recognized with the Western Academy of Management's Ascendant Scholar Award in 1999. Dr. Hesterly has also received best paper awards from the Western Academy of Management and the Academy of Management. Professor Hesterly has served on the editorial boards of *Strategic Organization*, *Organization Science* and the *Journal of Management*. He also served as the Senior Editor of *Long Range Planning*, the leading European journal in strategy.

Professor Hesterly has previously served as Associate Dean for Academic Affairs, Department Chair, and also as

XX

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Professor Hesterly has been recognized multiple times as the outstanding teacher in the MBA Program at the David Eccles School of Business and he has also been the recipient

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Professor Hesterly has served as a consultant to *Fortune* 500 firms in the electronic, office equipment, paper, telecommunications, energy, aerospace, and medical equipment industries. He has also consulted with smaller firms in several other industries. He has taught in a variety of executive programs, both in universities and corporations.

