Introduction to the Special Issue Honoring Richard Rumelt:
The Foundations for Understanding Fundamental Issues in Strategy

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INTRODUCTION

Richard Rumelt should be heralded not just because of his publications and scholarly contributions to the field of strategy but also because of his style and ability and willingness to find answers to complex problems. He combines the pragmatism of the engineer with the “bright guy” approach to management issues. This has allowed him to generate both incisive analyses of specific cases and important theoretical findings of general relevance.

He is perhaps the last and the best of a set of scholars that came out of the Harvard Business School tradition of seeing problems as they are, not as we would like them to be. He is a master at digging in until he finds “good” strategies. This may be due in part to his time as a student of Joe Bower, who seems to take a similar approach. It’s a research strategy (and a consulting strategy) that, when done well, results in great insights.

The papers in this issue demonstrate how important Rumelt’s work has been to the field’s development. His work always focuses on fundamental issues to business strategy: diversification, strategy, and structure; competitive heterogeneity; how competitors differ; how profits endure; why firms struggle to adapt; where will entrepreneurship emerge?

This special issue includes a biographical interview and five papers. Each paper uses one of Rumelt’s publications as a starting point (see Table 1). The authors begin with historical context and the immediate impact of Rumelt’s ideas. Next, the resultant streams of literature are traced. Then, considering the papers’ long-term influence each author explains important future directions. The issue begins with Anne Marie Knott’s interview with Rumelt. We then present the papers in the order of the focal-paper’s publication date.
This introduction gives an overview of the papers. We discuss Rumelt’s contributions. In particular, how essential Rumelt has been to defining and addressing strategy’s fundamental issues (see Rumelt, Schendel and Teece, 1994). Strategic Management Review uses these issues as its foundation and guideposts: (1) How do firms behave? (2) Why are firms different? (3) What is the function of, or value added by, headquarters? And (4) What determines success or failure in international competition?

<table>
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<tr>
<th>Fundamental Issues in Strategy &amp; Related Questions</th>
<th>Starting points for the SI Papers</th>
<th>Special Issue Papers</th>
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**Why are firms different?**
- What effects matter more?
- What explains competitive heterogeneity?

|--------------------------|-----------------------------------------------------------------------------------------------|---------------------------------------------------------------------|

**How do firms behave?**
**Why are firms different?**
- What impedes adjustment?
- How can firms transform?

|-----------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------|

**THE SPECIAL ISSUE PAPERS**

Kathryn Rudi Harrigan’s article, “Issues Revisited From Rumelt’s (1974) ‘Strategy, Structure And Economic Performance’” leads off with an excellent account of research on corporate strategy, informed by its roots. Rumelt (1974) combined historical and economic methods to examine how strategy and structure influenced corporate performance. Harrigan details Rumelt’s book, work that emerged soon after, and describes the very broad influence of this book across numerous fields of study. With this backdrop, Harrigan shifts attention to the current state of corporate strategy research. Here, she discusses overlooked issues firms with mature businesses face. Using current examples, she reviews the numerous approaches to diversification and their performance implications.

Diversification was perhaps the first fundamental issue in the field of business strategy. In the years following the second world war, companies across the industrialized world shifted from being highly focused to being highly diversified (often in seemingly unrelated businesses). Empirical work largely considered diversification as a single linear attribute. Strong conclusions were hard to come by. Expanding on Wrigley, Rumelt used archival, historical, and economic measures to describe different strategies, structures, and
performance. This fine-grained method led a rich, far more nuanced discussion of diversification. The detail and depth of his analysis resulted in a number of core issues that continue to be discussed and expanded on today by scholars of corporate strategy.

In Harrigan’s words, Rumelt “combined his measures of corporate strategy and organizational structure with financial evidence of firms’ performance, the field of strategic management received an important research contribution that subsequently legitimized scholarship therein…. *Strategy, Structure and Economic Performance*, was the first rigorous study of diversification that combined these salient concepts.”

In “A Dynamic Strategic Theory of The Firm”, Hoopes and Madsen, discuss how Rumelt (1984) challenged the received view and shaped an agenda for the study of strategy. The article defines the conditions under which uncertainty and isolating mechanisms (including causal ambiguity) can lead to persistent heterogeneity. Uncertainty before investing in a production function gives rise to heterogeneity in investment choices. *Ex post*, uncertainty interacts with causal ambiguity and other isolating mechanisms, contributing to uncertain imitability and persistent differences in profitability. As Rumelt (1984) illustrates, these dynamics yield a range of results consistent with firm behavior and provide interesting prescriptions for the strategic firm.

Rumelt’s goal was to model the dynamics of Schumpeterian competition. His approach emphasized entrepreneurship and competitive heterogeneity as both are missing from the neoclassical economics view of the firm and industrial organization economics. The concepts in combination form a theory of strategy based on uncertainty and isolating mechanisms. Heterogeneity occurs because firms differ in how they *use* their resource bundles in response to opportunities that arise from endogenous or exogenous change. The
theory is inherently dynamic. The potency of isolating mechanisms may shift over time due to competitor behavior or unexpected events. An important prescription consistent with firm behavior: Opportunities may require firms to commit in spite of uncertainty.

Notably, the price of the resource (as determined by its market) needn’t reflect how its value to different firms can vary. Heterogeneity can obtain from variance in resources. But, also from firm-specific complementarities. This paper and its companion piece, Lippman and Rumelt (1982), had a profound influence on the field of strategy. Along with Rumelt (1991) these papers demonstrated the importance of managerial decision making beyond industry selection.

Against this background, Hoopes and Madsen take stock of what we know and do not know about the isolating mechanism concept and identify unexplored themes. The authors conclude by identifying some of the offspring research streams and scholarly work associated with Rumelt’s strategic theory of the firm.

Next, we shift to David Teece’s “Homage To Richard Rumelt: What Does A “Strategic Dynamics” Theory Of The Firm Look Like?” The beauty of Rumelt’s body of work is that each article or chapter takes on fundamental questions and thus, offers a distinctive new way of thinking. A careful read of his work also reveals significant connections among concepts, models and implications. Against this backdrop of core questions and contributions, Teece critiques and integrates several of Rumelt’s ideas into a systems model of dynamic capabilities.

As a step in building the systems model, Teece situates Rumelt’s work in context – showcasing how his studies in the 1980s have “become touchstones in strategic management.” For instance, “resource heterogeneity is an endogenous creation of economic
actors” (Rumelt, 1984: 561) and “top management’s job is ‘to adjust and renew these resources and relationships as time, competition and change erode their value’ ” (Rumelt, 1984: 558). The second quote is an early definition of the dynamic capabilities concept. Teece points out that Rumelt “had advanced many elements of the dynamic capabilities framework long before others.” Rumelt’s studies in the 1980s also “put him ahead of the now-influential resource based view of the firm which was taking shape at the time”.

A common thread in among this group of studies is the role of entrepreneurial activity and entrepreneurial rents. In Teece’s words, Rumelt’s 1987 article (Theory, Strategy and Entrepreneurship) “unpacked the idea of economic rent” and “provided a detailed analysis of the nature of entrepreneurial rents and a compelling description of the entrepreneurial process in large organizations.” Teece’s systems model integrates contributions from Rumelt’s early work and his subsequent work on the core elements of “good strategy” (strategy kernel) with Teece’s own work on the core categories of dynamic capabilities (you will have to read the paper to see the elegant alignment of concepts).

Teece also summarizes tradeoffs among different theories of the firm. This framing motivates a call for synthesizing the field’s cumulative knowledge to complement and advance Rumelt’s original strategic theory of the firm. Teece ends with: Rumelt is “the thought leader in the field – strategy’s strategist.”

In “On the Matter of How Much Industry Matters,” Haifeng Wang and Russell Coff give a deep and detailed review of the literature following Rumelt (1991). Rumelt began this work in the mid-1970s (see Knott, 2022, in this special issue). In a 1982 working paper, Rumelt found that firm effects were three to four times larger than industry effects.
Rumelt’s objective was to examine performance variance within industries, across industries, and across corporate ownership. At the time, most economists assumed industries were homogeneous. Rumelt used data like Schmalensee and published his findings in 1991. As Wang and Coff’s review shows, the general pattern of results observed in 1982–that the firm effect accounts for more of the variance in performance among firms than the industry effect–has been consistently replicated across a range of datasets and industries (with few exceptions).

Wang and Coff’s critical review showcases the important conversation that followed. Methods, data, and implications expanded greatly. Subsequent work unbundled the firm (corporate and business unit) effect (e.g., cohorts, CEO, patent stocks, etc.) to gain a stronger understanding of what matters more. Other work examined how the macroeconomic context, industry events (such as shocks), and temporal dynamics influence performance variance. It is not too surprising that a wider range of data sets, time periods, and contexts have resulted in numerous insights. For example, several studies find that industry, corporate and business unit effects (or firm effects) vary over time whereas others show that the effects differ pre and post a shock to an industry (you have to read the paper to see how). Another important category of work looks at more subtle dependent variables than the firm, industry, and corporate measures Rumelt used.

When this work started, one of Rumelt’s central goals was to demonstrate that management matters and close competitors differ. The literature goes far beyond Rumelt’s original paper. Studies use a variety of methods, different types of data, and tease apart a wide range of issues, from broad to fine grained. This body of work is surely as important as any in the field of strategy (and yet initial reviewers rejected it as not meriting
publication, for more, see the interview). They also are noteworthy in how long they have endured. Wang and Coff offer excellent commentary on this interesting discussion. Their paper is an important contribution to a fundamental issue in business strategy.

In her article, “Strategic Transformation and the Problem of Inertia,” Connie Helfat revisits the question of: Why are organizations resistant to change? In the afterword to Rumelt, Teece and Schendel’s (1994) edited volume, *The Fundamental Issues in Strategy*, the authors state that the most “enduring sources of competitive advantage seem to have more to do with organization than with product-market moves.” Bundled under the headline of “a question we missed”, the authors indicated that inertia is something that impedes adopting “good practice” and thus, is instrumental to understanding competitive positioning. At the time, Rumelt was developing his work on inertia and its relationships to strategic transformation.

In the late 1980s and in the 1990s, scholars tended to associate the dark side of inertia with the complexity that emerges as organizations grow large in size and age (Hannan and Freeman, 1984; Haveman, 1993). As Helfat (2022) shows, Rumelt’s (1995) work on inertia unbundled this complexity to identify five categories of behavioral and organizational design frictions that underlie inertia. Further, he explored each friction in depth, generating a comprehensive list of the sources of organizational inertia. First, we lacked such a detailed analysis of the sources of inertia and several sources have yet to be empirically examined. Second, the focus on behavioral aspects, organizational design features, and their interactions as sources of inertia was quite prescient. Today, the various concepts such as cognition underlying perceptions and interactions among individuals and
the organization are key to the behavioral view of strategy and work on the micro-foundations of capabilities.

How can firms overcome inertia? As Helfat details, Rumelt’s model of strategic transformation “proposed a sequence of changes in capabilities, coordination and incentives that would be required for firms to successfully renew themselves.” Her discussion highlights several contributions of Rumelt’s work. For one, Rumelt recognized the that a hierarchy of competencies (skills or capabilities) exists within firms and that higher order or macro-routines are necessary for fundamental or novel change. Such macro-routines are now commonly known as dynamic capabilities whereas lower level routines are viewed as ordinary capabilities.¹ Second, he used a coordination model, in part, to illustrate an ordering of skill development and argued that some lower level skills or capabilities must be changed and routinized before coordination skills can be applied to transform an organization. In the second half of the paper, Helfat deftly integrates Rumelt’s conceptualization of inertia and strategic transformation with work on corporate renewal. In so doing, she highlights multiple opportunities for future theoretical and empirical analysis. In Helfat’s words “relatively little research has brought together capabilities, organization design, and strategic transformation as Rumelt did.”

¹ In the late 1980s and early 1990s, work and debates were emerging on the notion of a hierarchy of capabilities. For instance, Collis (1994) referred to higher order capabilities and raised concerns about an infinite regress in attempts to explain competitive advantage. While Teece, Pisano and Shuen’s study of dynamic capabilities was published in SMJ in 1997, the working version was available in 1993 and assigned doctoral reading within the Strategy and Organization Department at UCLA.
CONCLUSION

Rumelt’s work shaped the field of strategy. The special issue papers revisit the core ideas and initiate a dialogue for new directions. Collectively, his work has spawned decades and has refined our understanding of strategy and its dynamics (see Appendix 1). In Rumelt’s words:

“Uncertain imitability is a theory explaining the origin and persistence of interfirm differences in efficiency.” “…the case of uncertain imitability is distinguishable from monopoly or collusive oligopoly by the observed dispersion of profit rates among extant firms.” Lippman and Rumelt (1982: 436).

“a firms’ strategy may be explained in terms of the unexpected events that created (or will create) potential rents together with the isolating mechanisms that (will) act to preserve them. If either element of the explanation is missing, the analysis is inadequate.” Rumelt (1984:142)

“…the most important sources of economic rents are business-specific; industry membership is a much less important source…”Rumelt (1991: 167).

“The overwhelming evidence is that organizations possess considerable inertia, yet strategy content models, including the resource-based view of the firm, tend to sidestep this issue. A complete “strategic theory of the firm” must deal squarely with the issue of inertia.” (Rumelt, 1995 :23)

“…building blocks of the neoclassical theory of the firm are fragile.” “The payments perspective also puts simple rents in the forefront, recognizing that wealth consists of payments to scarce resources.” Lippman and Rumelt (2003a: 925)

“Most of the resources of critical interest to the strategist are unpriced. Strategists must create, deploy, combine, manage, and exchange such resources without the help of market prices.” Lippman and Rumelt (2003b: 1070)

Rumelt deftly manages the tension between managerial relevance and academic rigor. He has a unique skill for making academic solutions tangible to managers. For example, as Wang and Coff note, his work on “what matters” continues to influence

Rumelt’s work spans a wide range of methods. Almost always examining fundamental issues. Avoiding incrementalism. Always with an eye on practice. He has a masterful way of using history and concepts external to business as tool for framing ideas. An example is what rock climbers label as the most challenging part of a boulder – the crux. In his recent book, *The Crux: How Leaders Become Strategists* (2022), he states that the “art of strategy is defining a crux that can be mastered and in seeing or designing a way through it.”

**EPILOG BY DAVID TEECE**

As the chapters in this special issue attest, the Rumeltian method has led to some major methodological and theoretical advances. Although Dick has not published as much as some might have wished, his contributions have been vital, and his influence has spread further through the students he’s influenced over his decades teaching strategy at UCLA, including Kathleen Conner (1986), Julia Liebeskind (1990), Jennifer Bethel (1990), Anne Marie Knott (1994), David Hoopes (1995), Carl Voigt (1996), Robert Piret (1996), Belen Villalonga (2001), and Fan Xia (2007).

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² Rumelt, R.P. 2003c. “What in the World is Competitive Advantage?” Policy working paper 2003-105, UCLA. This work also was presented at the Strategic Management Society’s annual conference.
I had the good fortune to collaborate with him in the early 1990s on corporate coherence (Teece, Rumelt, Dosi, and Winter, 1994) and the fundamental issues of strategy (Teece, Rumelt, and Schendel, 1994). His practical insights and deep knowledge are distinctly his own. It is past time for the tribute he’s receiving here.

Early on, Dick and I had animated discussions on Michael Porter’s Five Forces (Porter, 1980) and the role of complementary assets. These exchanges shaped my own thinking a great deal. I gained a lot from them as I was not a “member” of the field of strategic management at the time.

As I mentioned, Dick’s publication output, while impressive, has been relatively limited. An unfortunate consequence is that, while highly cited, his work doesn’t amount to a structure others can build on, nothing that one can refer to as the Rumeltian model. His work is more about a process of inquiry leading to trenchant observations. While this is important and useful for teaching and consulting, it also leaves us wanting something more comprehensive. In my main contribution to this issue, I try to flesh out what I think Dick’s recorded comments about strategic dynamics suggest he has in mind. Perhaps he will still reveal how he really sees all the pieces of the competitiveness puzzle coming together.

The problem with the Rumeltian case-specific approach is that you have to be as clever as Dick to get full purchase from it. A framework, on the other hand, provides more guidance. Clearly there is room for both approaches, and Dick has many times proven the value associated with his style. In the meantime, he has left a steep mountain to climb for those who wish to follow, with his classic publications and his recent overviews of strategy serving as critical signposts along the way.
APPENDIX 1. List of Rumelt’s Publications

Books, Edited Volumes and Journal Special Issues


Journal Publications


Rumelt, RP. 1981b. How Important is Industry in Explaining Firm Profitability, working paper, Graduate School of Management, University of California, Los Angeles.


**REFERENCES**


Table 2. Implications, Key Insights, and Related Work

<table>
<thead>
<tr>
<th>Implications for a Normative Theory from Rumelt (1984:142-143)</th>
<th>Key Insights</th>
<th>Examples of Related Research Streams and/or Offsprings</th>
<th>Examples†</th>
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</table>
| 1. The opportunities for strategic change occur infrequently, and their timing is largely beyond the control of management. The chance to substantially improve one’s competitive position does not arise out of pricing or advertising tactics, but the recognition of change in some underlying factor. | 1. Tactics do not make a decision strategic or increase the likelihood of superior performance.  
2. Opportunities for change are infrequent and it is more substantive change that matters.  
3. Improving one’s competitive position requires understanding the origins of change. | • What makes a decision strategic?  
• Strategic theory of the firm  
• Entrepreneurial discovery and creation | • Good Strategy/Bad Strategy (Rumelt, 2011)  
• What makes a decision strategic? (Leiblein, Reuer & Zenger, 2019)  
• Theory of the Firm (KBV, RBV, TCE, Behavioral, etc.)  
• Inertia & Transformation (Rumelt, 1995)  
• Discovery & Creation; Profiting from Innovation (Teece, 1986, 2006); Entrep. Theories (Alvarez & Barney, 2007)  
• Exploitation/Exploration (March, 1991) |
| 2. Unexpected events may change the distribution of sales and profits within an industry, acting as windfall gains and losses to incumbents. It is vital that management recognize and take full advantage of these events. The routine component of strategy formulation is the constant search for ways in which the firm’s unique resources can be redeployed in changing circumstances. | 1. Shocks and unexpected events: upset the established industry structure, alter the strength of isolating mechanisms, and disrupt the persistence of superior profit.  
2. The potency of isolating mechanisms changes over time.  
3. Uncertainty creates opportunities. Managers should frame shocks as opportunities.  
4. Search for how resources can be redeployed is a routine part of strategy development. | • Firm Evolution, Industry Evolution and Profit  
• Persistence; Quantifying the duration of advantage  
• Variance Decomposition Studies  
• The Resource-based View  
• Shocks and Adjustment (institutional, technological, economic, market based)  
• Isolating mechanisms  
• Competitive Dynamics and Inertia  
• First mover advantage, first mover disadvantage and the role of luck.  
• Search | • Strategy in a 'structural break’ (Rumelt, 2008); Strategy Dynamics (Ghemawat & Cassiman, 2007)  
• Persistence of Shocks to Profitability (McGahan & Porter, 1999); Persistence, Cohort Effects, & Temporary Advantage (Madsen & Walker, 2017); Persistence: Temporary or Sustained (Wiggins & Ruefi, 2002)  
• How much does industry matter? (Rumelt, 1991); How much does industry matter, really? (McGahan & |
such situations it is usually unclear what the eventual structure of the industry will be. Firms that are lucky or insightful enough to make early commitments to what turns out to be defensible positions can be stunningly successful.

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<th>4.</th>
<th>A critical strategic question in a growth industry is the shape of the final equilibrium. When industry growth is rapid, profit rates are normally quite high, but reinvestment rates that are even higher work to produce net negative cash flows. If firms misjudged the strength of isolating mechanisms in the final equilibrium, the slowing of growth will bring profit rates to below normal rates; the industry will have functioned as a cash trap. Theory and empirical work on this issue have obvious normative value.</th>
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<tr>
<td>1.</td>
<td>What will a growing industry look like after it shakes out and/or matures?</td>
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<td>2.</td>
<td>Firms invest heavily as industry sales grow (and competition enters the industry). When shakeout occurs or if growth slows unexpectedly, over capacity leads to severe losses and exit.</td>
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<td>4.</td>
<td>Anticipating when growth slows and how severe a shakeout will be are critical to investment decisions and viability.</td>
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<tr>
<td>5.</td>
<td>Superior profits do not indicate good management.</td>
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| • | Resource renewal, recombination and redeployment |

| Strategic Responses to Shocks (Argyres, Mahoney, Nickerson, 2019). |
| Commitment – Persistence from linking and binding actions (Ghemawat, 1991) |
| FMA (Lieberman & Montgomery, 1988), FMD (Leiberman & Montgomery, 1998); FMA & Isolating Mechanisms (Suarez and Lanzollo, 2007) |
| Search (Levinthal, 1997; Ahuja & Katila, 2004) |

| 1. | Strategy over time; Industry Life Cycles & Evolution |
| 2. | Growth & Corporate Renewal |
| 3. | Inertia |
| 4. | Persistence of superior performing firms and poor performing firms in stable environments vs. rapidly shifting environments. |

| Industry Life Cycles: (Klepper and Graddy, 1990; Jovanovic & MacDonald (1994) |
| Industry Dynamics and Shakeout (Lenox, Rockart, & Lewin, 2007) |
| Tech Paradigms and Trajectories (Dosi, 1982) |
| Schumpeterian Competition & Technology Regimes (Winter, 1984) |
5. If opportunities for significant shifts in strategic position are infrequent, and if isolating mechanisms create defensible positions, it follows that many firms can ignore strategy for long periods of time and still appear profitable. As a corollary, high levels of profitability are not necessarily an indicator of good management. If a strategic position is strong enough, even fools can churn out good results, for a while.

6. In attractive industries, even weak firms can perform well.

6. Because strategic opportunities are by definition uncertain and connected to the possession of unique information or resources, strategy analysis must be situational. Just as there is no algorithm for creating wealth, strategic prescriptions that apply to broad classes of firms can only aid in avoiding mistakes, not in attaining advantage.

1. There is no rule for riches.
2. General prescriptions only help firms avoid mistakes.
3. Strategic analysis requires considering the internal and external conditions under which a firm is operating.

1. When ambiguity is high, speed is critical to protecting a firm’s position.
2. Good strategy is feasible under uncertainty. No situation is perfect and waiting until full information is available leads to missed opportunities.

5. Inertia (Miller and Chen 1994; Tripsas & Gavetti, 2000; Tripsas, 2009); Inertia and Transformation (Helfat, 2022, this volume)
6. Renewal (Huff, Huff & Thomas, 1992; Agarwal & Helfat, 2009)

6. Because isolating mechanisms act to protect the first successful mover, speed is critical despite (and, in fact, because of) high levels of ambiguity. Good strategy is not necessarily enacted with a high level of confidence, although general management may appear confident to spur action. If firms wait until the proper method of entering a market or producing a product is fully understood it will normally be too late to take advantage of the information.

7. Because isolating mechanisms act to protect the first successful mover, speed is critical despite (and, in fact, because of) high levels of ambiguity. Good strategy is not necessarily enacted with a high level of confidence, although general management may appear confident to spur action. If firms wait until the proper method of entering a market or producing a product is fully understood it will normally be too late to take advantage of the information.
Table 1 identifies related research streams and/or research spawned from Rumelt’s work and sample of articles associated with the streams.