

Robert A. Pitts

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3e

# Strategic Management

*Building and Sustaining  
Competitive Advantage*

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**Building *and* Sustaining  
Competitive Advantage**

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## Strategic Management: Building and Sustaining Competitive Advantage, 3/e

Robert A. Pitts and David Lei

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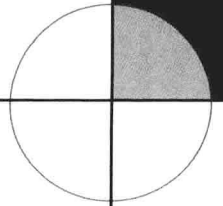
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# Preface

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*Strategic Management: Building and Sustaining Competitive Advantage*, Third Edition, is designed as a text for the core classes taught as part of the strategic management or business policy component for majors in business. It should also prove useful to managers and professionals who wish to update or refine their knowledge of some vital issues in strategy through self-study.

As was the case with the first two editions, the objective of this book is to encourage the reader to develop an appreciation for and ability to understand the major drivers of strategy in organizations. There is no question that business organizations of all sizes must prepare for an increasingly complex future. Companies must deal with a variety of strategic, technological, and organizational issues on a daily basis, including such hot-button issues as corporate restructuring, mergers and acquisitions, global competition, rapid technological change, new methods to create value, strategic alliances, the emergence of new types of competitors, the rapid proliferation of the Internet, and the growing challenges of creating and serving new markets anywhere. All these forces work together to redefine the economic and competitive landscape of not only the United States but also the entire world. Despite the numerous strategic challenges posed by these developments, they also represent opportunities for companies of all sizes in all industries to create new sources of competitive advantage that will enable them to participate in and even shape how industries evolve in the times ahead. On the other hand, these same challenges also threaten to erode the long-held competitive advantages of companies that are either slow to react or unable to mount an effective response. Consequently, to survive and prosper in this new millennium, the need to *build and sustain competitive advantage* will be greater than ever. Every chapter in this book was written with a competitive advantage perspective in mind. We believe that even if a large number of readers were not to pursue a career in management per se, knowledge of how organizations conceive, formulate, implement, and adjust their strategies would assist the reader in gaining a stronger appreciation for some of the key issues, trade-offs, and decisions that managers must face. Thus, our central focus on competitive advantage provides the rationale driving every aspect of our book—from its organization and style to the selection and integration of concepts and illustrative examples.

## The Organizational Architecture

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Although the instructional approach of the first two editions has been retained, several major changes have been made in both coverage and organization. The field of strategic management is becoming a richer topic of study as we speak. Companies are continuing to innovate breakthrough products, services, technologies, and markets at ever-faster rates. They are planning and organizing their activities using new methods, techniques, and modes of operation. At the same time, their actions challenge researchers and teachers to become not only more keenly aware of these developments, but also more adept in explaining them in the classroom. We recognize and welcome this opportunity to bring forth a discussion of both the traditional and newly emerging characteristics that define our vibrant competitive environment.

One of our most significant changes in coverage is the enhanced focus on how the Internet is beginning to play a major role in shaping how industries evolve and how firms think about competing in this rapidly moving arena. Certainly, we dedicate much more attention to this topic to recognize the tremendous expansion of the Internet across every industry in the past few years. In our view, it is imperative that students and practitioners of business begin to understand the impact of the Internet, as well as its limitations, on how firms formulate and implement their strategies. Over time, the Internet, like many other technological advances, will be taken for granted and used as another means to boost productivity, to enhance communications, and to reach out to new customers. Thus, we

present a new chapter (Chapter 5) to discuss how the Internet and the broader notion of e-business are beginning to reconfigure the way firms are creating and delivering value in many different industries. Likewise, the reorganization of many of our chapters also serves to recognize the growing importance of this topic.

Throughout the entire book, we incorporate additional and more detailed material related to such cutting-edge topics as flexible mass customization, outsourcing, new product development methods, building virtual sources of advantage, the economic concept of network effects, harnessing disruptive technologies, change management, the notion of “co-opetition,” network versus network competition, the rise and management of virtual organizations, and the emergence of modularity as a new principle of both product and organization design. All of these developments are redefining the way that companies build, sustain, and renew their individual sources of competitive advantage.

Apart from these salient changes, we retain the chapter sequence of the two previous editions. Yet, every chapter has been thoroughly updated to include some of the most recent, compelling, and revealing examples of firm-based strategies in action (up to the time of this printing). At the same time, we also introduce and present some of the latest theoretical concepts and frameworks that are widely discussed and researched in the strategic management/business policy field. This balanced approach allows us to ensure that we can maintain our powerful applications-driven focus with a solid grounding in research.

Part 1 examines the issue of *building competitive advantage*. Chapters 1 through 6 analyze the particular steps involved in identifying and building upon a firm's strengths and distinctive competencies to create sources of competitive advantage. We examine how firms across different industries formulate strategies that enable them to build on their strengths and distinctive capabilities to compete more effectively. Traditional ways of competing are less likely to be successful in the future as customers demand a higher level of product/service customization faster and at lower cost. Thus, many of the trade-offs associated with conventionally derived, generic competitive strategies may no longer be tenable over time. Instead, firms will need to compete along all three dimensions of value creation: low cost, high quality, and speed to market. Many firms have already recognized this likely development and, in response, have begun formulating alternative strategies based on mass customization, flexibility, and new ways to reach customers. As mentioned before, a completely new chapter on the Internet highlights some of the challenges and opportunities this new technological medium presents to both new and established firms. We also consider the development of other types of technologies that enable all firms to become more responsive to their customers' needs while planting the seeds for future competitiveness.

Part 2 focuses on *extending competitive advantage*. Chapters 7 through 9 examine the key roles of corporate strategy, global strategy, and strategic alliances in leveraging the firm's resources to deepen and reinforce its sources of competitive advantage. In particular, we bring forth additional research ideas from many fertile areas of the academic literature, including the resource-based approach to corporate strategy. This approach reveals how firms can use their distinctive capabilities and skills to leverage themselves into new arenas. Diversification and global expansion into new markets are not the only challenges and issues we cover; many companies are also actively restructuring and realigning their businesses to sharpen their competitive focus and to unlock latent sources of strategic and financial value. Thus, we also examine what firms need to consider when undertaking different forms of corporate restructuring (e.g., cost reduction programs, corporate spin-offs) to promote this value creation focus. The chapter on strategic alliances brings forth new material based on research and practice as well. For example, many firms find themselves developing strategic alliances with partner companies where they simultaneously collaborate and compete. Likewise, entire industries (e.g., automotive, airlines, software, telecommunications) appear to be regrouping into larger networks of firms that compete with other similarly organized networks. Allying and partnering with other firms will almost certainly become taken for granted as a normal part of strategic behavior.

Part 3 addresses the critical issue of *organizing for competitive advantage*. Chapter 10 deals with organizational structure, with a special emphasis on how alternative organization designs promote the simultaneous development of distinctive capabilities with speed and fast responsiveness to customers' changing needs. Chapter 11 explains the concept of the vir-



tual organization in great detail. Traditional approaches to organization design have come under extreme scrutiny in recent years, as senior management in all industries begins to experiment and deploy new forms of network-based, horizontal organizational structures. We examine the critical success factors that managers must consider when they organize their firm's value-adding activities on a virtual basis. No less important, Chapter 11 also covers such vital topics as reward systems, performance evaluation criteria, and especially corporate culture. In particular, we focus extensively on how a firm's reward system and corporate culture can serve as a double-edged sword that can simultaneously promote and inhibit the implementation of new strategies. This is an especially important issue for firms that need to become adept and nimble as they respond to fast-changing industries and the rise of new competitors.

Part 4 deals with issues that revolve around *sustaining and renewing sources of competitive advantage*. The three chapters of this section explore vital issues that are the underpinnings of managing and sustaining growth, being receptive to new technologies and ideas, and maintaining profitability. Chapter 12 deals specifically with such issues as managing interrelationships among the firm's businesses to provide enduring sources of corporate-wide synergy, while balancing the need for fast responsiveness to changes in the competitive environment. The growth of multipoint competition, technological convergence among industries, and the simultaneous need for rapid adaptation to new environmental developments create a high level of organizational tension between coordination and autonomy. Chapter 13 deals extensively with the broader issue of how best to understand and implement strategic change. In particular, the increasingly popular notion of building learning organizations that utilize and enact upon change to create new forms of distinctive competencies will become paramount for firms in many industries facing hypercompetitive environments. In Chapter 14, we examine a host of new and leading-edge management practices that enable firms to reinvent themselves in the wake of faster environmental change. Topics such as corporate reengineering, flexible manufacturing systems, Internet-based technologies, and even newer forms of organization design are analyzed.

## Instructional Approach

Within this organizational framework, our coverage of strategic management utilizes a variety of approaches to examine the topic of competitive advantage. To maintain continuity with the expanding research in the field, we have based our presentation and discussion of key concepts on a thorough review of the theoretical and empirical literature from strategic management. To maintain relevancy and applicability for managerial practitioners, we illustrate our presentation with numerous "strategic snapshots" and examples of organizations operating within a variety of different industries. Wherever possible, we use up-to-date, real-world examples to demonstrate how organizations from multiple settings deal with the many complex issues surrounding competitive advantage. Numerous industries (e.g., financial services, consumer packaged goods, telecommunications, airlines, retailing, electronics, computers, restaurants, automotive, entertainment, software, multimedia) that are either on the leading edge of change or facing many of these strategic challenges are examined in detail.

## Key Content Features of This Text

In keeping with the spirit of competitive advantage, our book provides a distinctive edge to our customers and users. Within the context of our advantage-driven focus, seven key themes are addressed and reinforced throughout the book:

- Distinctive competence
- Quality
- The Internet
- Globalization

- Managing change
- Innovation
- Ethics

Distinctive competence represents a key pillar of competitive advantage and forms the backdrop for every chapter of the book. We discuss the concept of distinctive competence in great detail. Organizations can thrive only to the extent that they perform some activity(ies) better than their competitors. *In the long term, a firm is only as profitable as it is distinctive. Likewise, a strategy is only as useful as it is distinctive.* Identifying and building those special resources, capabilities, and skills that make a firm special, and even unique, form the basis for competitive advantage. Achieving and maintaining distinctiveness thus becomes a key, ongoing task facing every manager and employee within a firm.

Quality is another vital ingredient of competitive advantage that is reinforced in many places throughout the text. Although numerous firms began implementing total quality management (TQM) efforts during the 1980s, these efforts have met with mixed success, even to this day. To sustain competitive advantage, building quality products alone is insufficient. Firms also need to build and support quality-oriented cultures, thinking, and management practices in all of their organizational activities. In addition, firms need to practice continuous improvement so that they are able to constantly reach for higher levels of excellence. As we enter the new millennium, the ability of firms to produce high-quality products, services, and organizational processes will become a given, as all firms are expected to be competitive in this dimension. Yet, building quality products *and* processes remains an ongoing journey.

There is little doubt that the Internet has become a real driver of technological change in almost every industry. The Internet has given rise to a number of unprecedented business opportunities, such as the growth of digital media, new forms of entertainment, new channels of retailing, the convergence of telecommunications with computer networks, and on-line services that enable customers to access voice, video, data, and other services at decreasing cost over time. At the same time, firms are using the power of the Internet to redesign their organizations to take advantage of the technology's real-time information power and data to stay on top of environmental developments, while simultaneously enhancing internal organizational communications and coordination. Many companies are using the Internet to build newer sources of virtual advantage.

Many of the world's national markets are becoming more uniform, and opportunities to enter new markets are increasing. Globalization is becoming a permanent force in every person and every organization's life. Despite recent economic recessions both at home and abroad, customers around the globe are becoming savvier and possess more discretionary buying power. As a result, we will all be living in a "global village" in which a growing range of consumer and industrial products/services will be continuously redefined, tailored, and customized to each person's tastes and preferences. Globalization, however, requires firms to deal with a host of unfamiliar elements, including customers in distant locations, governments pursuing different agendas, and competitors possessing unusual capabilities. Globalization also brings with it the rise of very different competitors, many of them backed by home governments and industrial policies that may drastically alter the competitive environment.

As environmental change accelerates in future years, a firm's ability to respond to change will become an increasingly vital ingredient to competitive advantage. Sources of competitive advantage developed in one time period may rapidly become obsolete as new technologies, competitors, and customer needs change overnight. However, previous investments in core competencies and skills may actually erect their own barriers to learning new technologies and skills. How companies can sustain their strategies and growth paths into the future remains an ongoing strategic and organizational challenge that pervades our book. We provide a thorough examination of the kinds of responses that firms will be increasingly called upon to make, the problems they may confront when attempting to achieve effective response, and approaches for dealing with such problems.

Throughout our book, we place a great emphasis on understanding how firms across many industries innovate products, services, and value-creating processes to build and sustain advantage. In many industries, firms are beginning to realize that they need to create

new products and services faster and more efficiently to preempt what future competitors might bring to the marketplace. Competing on time is considered an essential building block of an effective strategy in every industry. This innovation-driven theme pervades every chapter in our book by focusing on how the latest developments in computer technology, service operations, lean production, flexible manufacturing, and Internet-driven distribution systems are compelling firms to become more nimble and agile in implementing and redesigning their strategies. At the same time, firms must become increasingly vigilant of new, “disruptive technologies” that could fundamentally alter the value chain and the value proposition they offer to their customers. This text provides many examples of how firms have introduced new product and service offerings across the telecommunications, financial services, restaurant, retailing, transportation, health care, manufacturing, consumer electronics, software, entertainment, and multimedia industries.

Society has long imposed censure on firms that fail to meet minimum standards of ethical behavior. However, societal expectations are increasing and will continue to do so in future years. Behavior that conforms to high ethical standards will therefore be increasingly rewarded and indeed necessary for competitive survival. Managers cannot make decisions about their firms’ strategies in a vacuum. The needs of different stakeholders (e.g., shareholders, employees, communities) must be evaluated and considered when formulating and implementing strategies. Thus, we provide a broad coverage of different types of ethical dilemmas that are likely to surface in every organization as strategic managers wrestle with the issues we discuss.

## New to This Edition

In our quest to ensure that instructors, students, and other readers receive an outstanding coverage of the major issues defining strategic management, we have attempted to capture and present many of the most recent economic, technological, organizational, and regulatory developments that have transpired in the business world since the publication of our previous second edition. Certainly, any instructor in strategic management knows that new developments from every industry occur daily—many of which will have a lasting impact on the competitive environment. Yet, we believe that some key emerging and evolving concepts are significant enough to warrant more intensive coverage in this third edition. *Strategic Management*, Third Edition, discusses and examines a number of major ideas that are becoming focal points for how companies are realigning their strategies and organizations. Among these are the following:

- Internet-driven strategies and business models
- The potential sources of virtual advantage when competing in the marketplace, as well as the marketplace
- The increasingly popular notion of modularity in product and organization design
- The economic concept of network effects
- The growth and application of knowledge webs
- The rise of simultaneous cooperation and competition, described by some researchers as “co-opetition”
- Network versus network forms of competition
- The need to understand, monitor, and respond to competence-changing or disruptive technologies
- Management practices of virtual organizations
- The critical link between reward systems and strategy
- How corporate culture and dominant mindsets give rise to both strength and inertia
- Additional research findings and changes in how companies deal with the generic strategies of differentiation, low-cost leadership, and focus
- The continued search for coherent corporate strategies based on inimitable resources



We believe that our balanced pedagogical approach of providing a strong applications focus, combined with a thorough review of the theoretical and empirical academic literature (continuously revised and improved from our two previous editions), will help the reader understand many of these evolving concepts in a succinct and direct manner.

## Our Distinctive Edge

Of the fourteen chapters in our book, nine are especially distinctive, containing material that we emphasize when compared with other strategic management texts. Examples include the following:

### **Chapter 4: Opportunities for Distinction: Building Competitive Advantage**

- Understanding the trade-offs among various competitive strategies
- Developing new competitive strategies based on mass customization
- The rise of product design modularity and its impact on fast response
- Competing to understand and to create new market segments
- Life cycle dynamics and its impact on different forms of competitive advantage

### **Chapter 5: Competing on the 'Net: Building Virtual Advantage**

- How the Internet is transforming the way we compete
- The different types of Internet-based business platforms
- How business-to-business differs from business-to-consumer platforms
- Economic characteristics of Internet-based competition
- The concepts of network effects, disintermediation, and value chain compression

### **Chapter 6: Shifts in Competitive Advantage: Responding to Environmental Change**

- How change affects a firm's distinctive competence
- Competence-changing and disruptive technologies
- Rise of new Internet-driven and alternative distribution channels
- Changes in related or neighboring industries
- Strategies and responses designed to accommodate change

### **Chapter 7: Corporate Strategy: Leveraging Resources to Extend Advantage**

- Revisiting the resource-based view of corporate strategy
- Competence-based focus that forms the pillar of synergy
- Key tests for diversification success
- Corporate restructuring and the rise of spin-offs to unlock value

### **Chapter 9: Strategic Alliances: Teaming and Allying for Advantage**

- Types of strategic alliances
- Competence-based competition and learning
- Multipartner consortia arrangements
- Network versus network competition
- The rise of "co-opetition"
- Alliance benefits/costs/risks
- Japanese *keiretsu*/Korean *chaebols*
- Using alliances to deskill competitors

### **Chapter 11: Attaining Integration for Advantage**

- The rise of hybrid network organizations
- Key characteristics of virtual organizations
- Management practices in virtual organizations
- The impact of reward systems on strategy implementation
- Performance evaluation and its impact on strategy
- Corporate cultures and strategy implementation
- The double-edged characteristic of corporate cultures
- How dominant approaches give rise to dominant mind-sets

## Chapter 12: Balancing Cooperation and Autonomy: Managing Interrelationships

Synergy and corporate-wide competitive advantage  
 Technological convergence  
 Multipoint competition  
 Factors promoting high levels of interunit cooperation  
 Factors promoting the need for greater autonomy  
 New developments in technology “fusion”

## Chapter 13: Managing Strategic Change: Building Learning Organizations

The concept of a learning organization  
 Management practices of learning organizations  
 Organization designs to promote learning  
 Implementing strategic change  
 Avoiding corporate ossification and competitive decline  
 Steps to promote change in static and “dinosaur” organizations

## Chapter 14: Redefining Advantage

Building quality cultures  
 Continuous improvement  
 Understanding and managing advanced, flexible manufacturing  
 New approaches to product development and commercialization  
 Reengineering and business process redesign  
 Internet-driven supply chain management and manufacturing systems  
 The continued growth of horizontal, networked organizations

# Learning-Based Features of This Text

To maximize the learning value of this text, we have organized each chapter using a common format that introduces and reinforces key strategic management concepts and terms. Each chapter includes the following organizational features:

- **Learning objectives.** At the beginning of every chapter, a series of learning objectives helps readers identify key points and ideas. These objectives provide a step-by-step process that guides the reader through the chapter's material.
- **Opening Strategic Snapshots.** Each chapter begins with an opening mini-case(s), known as strategic snapshots. These are designed to introduce the different environmental settings, strategies, and actions that relate to an issue surrounding competitive advantage. We use companies from a variety of different industry settings, including Boeing, Cisco Systems, Coca-Cola, Eastman Kodak, Kellogg, 3M, Nordstrom, IBM, Ford Motor Company, Tyco International, and Sony. The purpose of these cases is to show how a specific company applies the concepts and principles presented in that chapter, providing a useful bridge between real-world practices and the concepts discussed throughout the book.
- **Key terms.** Key ideas and terms that are vital to understanding strategic management are boldfaced throughout the book and defined in the margins. A glossary at the end of the text provides a review and handy summary of these terms and definitions.
- **Chapter summary.** Each chapter ends with a summary that is directly linked to the learning objectives. These summaries are presented in a bullet-point format to reinforce key concepts, tools, and ideas discussed in the chapter.
- **Exercises and discussion questions.** At the end of most chapters, students are encouraged to think about what they have learned through the use of discussion questions, exercises, and even the Internet to see how companies are competing in today's fast-changing environment. Internet exercises are easily identified by a logo that appears next to the exercise.



- **Examples.** In addition to the opening cases, each chapter includes many up-to-date examples of how different organizations tackle a particular issue related to competitive advantage. These examples are designed to supplement the opening cases and to reinforce the reader's learning. A comprehensive company and subject index are provided at the end of the text to facilitate easy accessibility to the examples discussed throughout the book.

## The Package

### Instructor's Resource Guide with Test Bank

The *Instructor's Resource Guide with Test Bank* (ISBN 0-324-11690-X), written by Michael D. Ensley at the University of North Carolina, Charlotte, is much more than an instructor's guide. This all-in-one instructional resource has learning objectives, key terms and concepts, lecture notes, an overview of the chapter material, supplementary resources, and test questions for each chapter.

### PowerPoint Slides

A complete set of PowerPoint slides developed by John P. Orr at Cameron University supports each chapter. The slides include the chapter figures, additional figures, and text slides and are available for downloading from this book's Web site at <http://pitts.swcollege.com>.

### InfoTrac College Edition®

Each new copy of *Strategic Management* comes with a card entitling students to free access to InfoTrac College Edition, an on-line database—updated daily—of full-text articles from hundreds of scholarly and popular periodicals, including *Newsweek*, *Academy of Management Executive*, *Harvard Business Review*, *Fortune*, and the *Journal of Management*. Use InfoTrac to give your students the opportunity to build their research skills or point them to particular articles of your own choosing. To get started, go to <http://www.infotrac-college.com>.

### Web Site

Visit our Web site at <http://pitts.swcollege.com/> where you will find interactive quizzes, InfoTrac resources, PowerPoint slide presentations, and other valuable materials for both the instructor and student.

### Turner Learning/CNN Video: Management and Strategy

Available on VHS cassette, forty-five minutes of video segments from the Cable News Network (ISBN 0-324-17170-6) are free to adopters of *Strategic Management*, making it easy to bring the real world into the classroom and providing numerous opportunities to relate strategic management concepts to stories in the news. This videotape comes with a guide containing topic keys and other special pedagogical features to facilitate discussion.

## Other Resources

- **Global Corporate Management in the Marketplace: An Online Simulation in Business Strategy.** Developed by Ernest R. Cadotte, of the University of Tennessee, Knoxville, and Innovative Learning Solutions, Inc. In this Internet-based simulation (ISBN 0-324-16866-7), students team up to manage a new venture formed to spearhead the introduction of a new line of microcomputers into global competition. Along the way, they experience a full range of value chain decisions and learn what drives performance up or down. Comprehensive success criteria are presented to each team in the form of a "balanced scorecard." Excellent tutorials and help screens complete the picture. Learn more at <http://marketplace-simulation.com>.



- **Strategic Management in the Marketplace: An Online Simulation in Business Strategy.** Developed by Ernest R. Cadotte, of the University of Tennessee, Knoxville, and Innovative Learning Solutions, Inc., *Strategic Management in the Marketplace* (ISBN 0-324-16867-5) is a compact alternative to *Global Corporate Management*, with fewer decision periods to play through, fewer potential markets to explore, and fewer product lines to manage.
- **The Global Business Game: A Simulation in Strategic Management and International Business.** Developed by Joseph Wolfe, Professor Emeritus of the University of Tulsa, and Experiential Adventures LLC. This newly revised CD-ROM-based game (ISBN 0-324-16183-2) crosses over all areas of business, with dedicated chapters on marketing, operations management, and accounting/finance.
- **Strategize! Experiential Exercises in Strategic Management.** Written by Julie I. Siciliano, of Western New England College, and C. Gopinath, of Suffolk University. Constructed around seventeen unique action-oriented “Strategy Sessions,” *Strategize!* (ISBN 0-324-06653-8) presents a range of experiential exercises and projects for use in class or out. (An accompanying Instructor’s Manual is also available.)

## Acknowledgments

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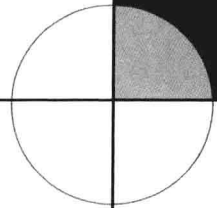
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