

Understanding Competition

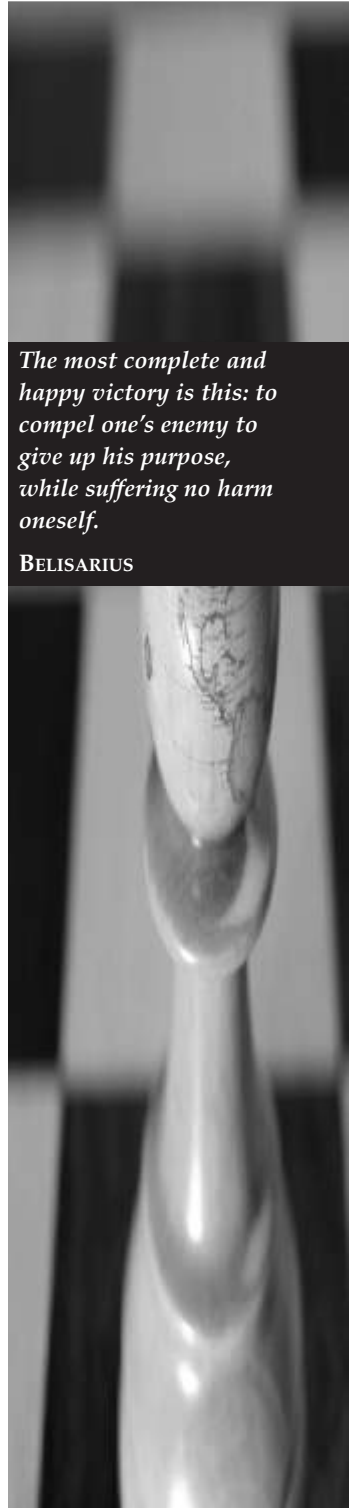
In a free market economy, each company tries to outperform its competitors. A competitor is a rival. A company must know, therefore, how it stands up against each competitor with regard to “arms and ammunition”—skill in maneuvering opportunities, preparedness in reacting to threats, and so on. To obtain adequate knowledge about the competition, a company needs an excellent intelligence network.

Typically, whenever one talks about competition, emphasis is placed on price, quality of product, delivery time, and other marketing variables. For the purposes of strategy development, however, one needs to go far beyond these marketing tactics. Simply knowing that a competitor has been lowering prices, for example, is not sufficient. Over and above that, one must know how much flexibility the competitor has in further reducing the price. Implicit here is the need for information about the competitor’s cost structure.

This chapter begins by examining the meaning of competition. The theory of competition is reviewed, and a scheme for classifying competitors is advanced. Various sources of competitive intelligence are mentioned, and models for understanding competitive behavior are discussed. Finally, the impact of competition in formulating marketing strategy is analyzed.

MEANING OF COMPETITION

The term *competition* defies definition because the view of competition held by different groups (e.g., lawyers, economists, government officials, and businesspeople) varies. Most firms define competition in crude, simplistic, and unrealistic terms. Some firms fail to identify the true sources of competition; others underestimate the capabilities and reactions of their competitors. When the business climate is stable, a shallow outlook toward the competition might work, but in the current environment, business strategies must be competitively oriented.



The most complete and happy victory is this: to compel one's enemy to give up his purpose, while suffering no harm oneself.

BELISARIUS

*Natural and
Strategic
Competition*

A useful way to define competition is to differentiate between natural and strategic competition. **Natural competition** refers to the survival of the fittest in a given environment. It is an evolutionary process that weeds out the weaker of two rivals. Applied to the business world, it means that no two firms doing business across the board the same way in the same market can coexist forever. To survive, each firm must have something uniquely superior to the other.

Natural competition is an extension of the biological phenomenon of Darwinian natural selection. Characteristically, this type of competition—evolution by adaptation—occurs by trial and error; is wildly opportunistic day to day; pursues growth for its own sake; and is very conservative, because growth from successful trials must prevail over death (i.e., bankruptcy) by random mistake.

Strategic competition is the studied deployment of resources based on a high degree of insight into the systematic cause and effect in the business ecological system. It tries to leave nothing to chance. Strategic competition is a new phenomenon in the business world that may well have the same impact upon business productivity that the industrial revolution had upon individual productivity. Strategic competition requires (a) an adequate amount of information about the situation, (b) development of a framework to understand the dynamic interactive system, (c) postponement of current consumption to provide investment capital, (d) commitment to invest major resources to an irreversible outcome, and (e) an ability to predict the output consequences even with incomplete knowledge of inputs. The following are the basic elements of strategic competition:

- The ability to understand competitive interaction as a complete dynamic system that includes the interaction of competitors, customers, money, people, and resources.
- The ability to use this understanding to predict the consequences of a given intervention in the system and how that intervention will result in new patterns of equilibrium.
- The availability of uncommitted resources that can be dedicated to different uses and purposes in the present even though the dedication is permanent and the benefits will be deferred.
- The ability to predict risk and return with sufficient accuracy and confidence to justify the commitment of such resources.
- The willingness to deliberately act to make the commitment.

Japan's emergence as a major industrial power over a short span of time illustrates the practical application of strategic competition.

The differences between Japan and the U.S. deserve some comparative analysis. There are lessons to be learned. These two leading industrial powers came from different directions, developed different methods, and followed different strategies.

Japan is a small group of islands whose total land area is smaller than a number of our 50 states. The U.S., by comparison, is a vast land.

Japan is mountainous with very little arable land. The U.S. is the world's largest and most fertile agricultural area in a single country.

Japan has virtually no energy or natural resources. The U.S. is richly endowed with energy, minerals, and other vital resources.

Japan has one of the oldest, most homogenous, most stable cultures. For 2,000 years or more, there was virtually no immigration, no dilution of culture, or any foreign invasion. The U.S. has been a melting pot of immigrants from many cultures and many languages over one-tenth the time span. For most of its history, the U.S. has been an agrarian society and a frontier society.

The Japanese developed a high order of skill in living together in cooperation over many centuries. Americans developed a frontier mentality of self-reliance and individuality.

The evolution of the U.S. into a vast industrial society was a classic example of natural competition in a rich environment with no constraints or artificial barriers.

This option was not open to Japan. It had been in self-imposed isolation from the rest of the world for several hundred years until Commodore Perry sailed into Tokyo harbor and forced the signing of a navigation and trade treaty. Japan had been unaware of the industrial revolution already well underway in the West. It decided to compete in that world. But it had no resources.

To rise above a medieval economy, Japan had to obtain foreign materials. To obtain foreign materials, it had to buy them. To buy abroad required foreign exchange. To obtain foreign exchange, exports were required. Exports became Japan's lifeline. But effective exports meant the maximum value added, first with minimum material and then with minimum direct labor. Eventually this led Japan from labor intensive to capital intensive and then to technology intensive businesses. Japan was forced to develop strategic business competition as part of national policy.¹

THEORY OF COMPETITION

Competition is basic to the free enterprise system. It is involved in all observable phenomena of the market—the prices at which products are exchanged, the kinds and qualities of products produced, the quantities exchanged, the methods of distribution employed, and the emphasis placed on promotion. Over many decades, economists have contributed to the theory of competition. A well-recognized body of theoretical knowledge about competition has emerged and can be grouped broadly into two categories: (a) economic theory and (b) industrial organization perspective. These and certain other hypotheses on competition from the viewpoint of businesspeople will now be introduced.

Economic Theory of Competition

Economists have worked with many different models of competition. Still central to much of their work is the model of *perfect competition*, which is based on the premise that, when a large number of buyers and sellers in the market are dealing in homogeneous products, there is complete freedom to enter or exit the market and everyone has complete and accurate knowledge about everyone else.

Industrial Organization Perspective

The essence of the industrial organization (IO) perspective is that a firm's position in the marketplace depends critically on the characteristics of the industry environment in which it competes. The industry environment comprises structure, conduct, and performance. Structure refers to the economic and technical perspectives of the industry in the context in which firms compete. It includes (a) concentration in the industry (i.e., the number and size distribution of firms), (b) barriers to entry

in the industry, and (c) product differentiation among the offerings of different firms that make up the industry. Conduct, which is essentially strategy, refers to firms' behavior in such matters as pricing, advertising, and distribution. Performance includes social performance, measured in terms of allocative efficiency (profitability), technical efficiency (cost minimization), and innovativeness.

Following the IO thesis, the structure of each industry vis-à-vis concentration, product differentiation, and entry barriers varies. Structure plays an important role in the competitive behavior of different firms in the market.

Businesspeople must be continually aware of the structure of the markets they are presently in or of those they seek to enter. Their appraisal of their present and future competitive posture will be influenced substantially by the size and concentration of existing firms as well as by the extent of product differentiation and the presence or absence of significant barriers to entry.

If a manager has already introduced the firm's products into a market, the existence of certain structural features may provide the manager with a degree of insulation from the intrusion of firms not presently in that market. The absence, or relative unimportance, of one or more entry barriers, for example, supplies the manager with insights into the direction from which potential competition might come. Conversely, the presence or absence of entry barriers indicates the relative degree of effort required and the success that might be enjoyed if the manager attempted to enter a specific market. In short, a fundamental purpose of marketing strategy involves the building of entry barriers to protect present markets and the overcoming of existing entry barriers around markets that have an attractive potential.²

Business Viewpoint

From the businessperson's perspective, **competition** refers to rivalry among firms operating in a market to fill the same customer need. The businessperson's major interest is to keep the market to himself or herself by adopting appropriate strategies. How and why competition occurs, its intensity, and what escape routes are feasible have not been conceptualized.³ In other words, there does not exist a theory of competition from the business viewpoint.

In recent years, however, Henderson has developed the theory of strategic competition discussed above. Some of the hypotheses on which his theory rests derive from military warfare:

- Competitors who persist and survive have a unique advantage over all others. If they did not have this advantage, then others would crowd them out of the market.
- If competitors are different and coexist, then each must have a distinct advantage over the other. Such an advantage can only exist if differences in a competitor's characteristics match differences in the environment that give those characteristics their relative value.
- Any change in the environment changes the factor weighting of environmental characteristics and, therefore, shifts the boundaries of competitive equilibrium and "competitive segments." Competitors who adapt best or fastest gain an advantage from change in the environment.⁴

Henderson presents an interesting new way of looking at the marketplace: as a battleground where opposing forces (competitors) devise ways (strategies) to

outperform each other. Some of his hypotheses can be readily observed, tested, and validated and could lead to a general theory of business competition. However, many of his interlocking hypotheses must still be revised and tested.

CLASSIFYING COMPETITORS

A business may face competition from various sources either within or outside its industry. Competition may come from essentially similar products or from substitutes. The competitor may be a small firm or a large multinational corporation. To gain an adequate perspective on the competition, a firm needs to identify all current and potential sources of competition.

Competition is triggered when different industries try to serve the same customer needs and demands. For example, a customer's entertainment needs may be filled by television, sports, publishing, or travel. New industries may also enter the arena to satisfy entertainment needs. In the early 1980s, for example, the computer industry entered the entertainment field with video games.

Different industries position themselves to serve different customer demands—existing, latent, and incipient. **Existing demand** occurs when a product is bought to satisfy a recognized need. An example is Swatch Watch to determine time. **Latent demand** refers to a situation where a particular need has been recognized, but no products have yet been offered to satisfy the need. Sony tapped the latent demand through Walkman for the attraction of “music on the move.” **Incipient demand** occurs when certain trends lead to the emergence of a need of which the customer is not yet aware. A product that makes it feasible to read books while sleeping would illustrate the incipient demand.

A competitor may be an existing firm or a new entrant. The new entrant may enter the market with a product developed through research and development or through acquisition. For example, Texas Instruments entered the educational toy business through research and development that led to the manufacture of their Speak and Spell product. Philip Morris entered the beer market by acquiring Miller Brewing Company.

Often an industry competes by producing different product lines. General Foods Corporation, for example, offers ground, regular instant, freeze-dried, decaffeinated, and “international” coffee to the coffee market. Product lines can be grouped into three categories: a me-too product, an improved product, or a breakthrough product. A **me-too product** is similar to current offerings. One of many brands currently available in the market, it offers no special advantage over competing products. An **improved product** is one that, while not unique, is generally superior to many existing brands. A **breakthrough product** is an innovation and is usually technical in nature. The digital watch and the color television set were once breakthrough products.

In the watch business, companies have traditionally competed by offering me-too products. Occasionally, a competitor comes out with an improved product, as Seiko did in the 1970s by introducing quartz watches. Quartz watches were a little fancier and supposedly more accurate than other watches. Texas

Instruments, however, entered the watch business via a breakthrough product, the digital watch.

Finally, the scope of a competing firm's activities may be limited or extensive. For example, General Mills may not worry if a regional chain of Italian eateries is established to compete against its Olive Garden chain of Italian restaurants. However, if McDonald's were to start offering Italian food, General Mills would be concerned at the entry of such a strong and seasoned competitor.

Exhibit 4-1 illustrates various sources of competition available to fulfill the liquid requirements of the human body. Let us analyze the competition here for a company that maintains an interest in this field. Currently, the thrust of the market is to satisfy existing demand. An example of a product to satisfy latent demand would be a liquid that promises weight loss; a liquid to prevent aging would be an example of a product to satisfy incipient demand.

The industries that currently offer products to quench customer thirst are the liquor, beer, wine, soft drink, milk, coffee, tea, drinking water, and fruit juice industries. A relatively new entrant is mineral and sparkling water. Looking just at the soft drink industry, assuming that this is the field that most interests our company, we see that the majority of competitors offer me-too products (e.g., regular cola, diet cola, lemonade, and other fruit-based drinks). However, caffeine-free cola has been introduced by two major competitors, Coca-Cola Company and PepsiCo. There has been a breakthrough in the form of low-calorie, caffeine-free drinks. A beverage containing a day's nutritional requirements is feasible in the future.

The companies that currently compete in the regular cola market are Coca-Cola, PepsiCo, Seven-Up, Dr. Pepper, and a few others. Among these, however, the first two have a major share of the cola market. Among new industry entrants, General Foods Corporation and Nestle Company are likely candidates (an assumption). The two principal competitors, Coca-Cola Company and PepsiCo, are large multinational, multibusiness firms. This is the competitive arena where our company will have to fight if it enters the soft drink business.

INTENSITY, OR DEGREE, OF COMPETITION

The degree of competition in a market depends on the moves and countermoves of various firms active in the market. It usually starts with one firm trying to achieve a favorable position by pursuing appropriate strategies. Because what is good for one firm may be harmful to rival firms, rival firms respond with counter strategies to protect their interests.

Intense competitive activity may or may not be injurious to the industry as a whole. For example, while a price war may result in lower profits for all members of an industry, an advertising battle may increase demand and actually be mutually beneficial. Exhibit 4-2 lists the factors that affect the intensity of competition in the marketplace. In a given situation, a combination of factors determines the degree of competition.

EXHIBIT 4-1
Source of Competition

Customer Need: Liquid for the Body	
Existing need	Thirst
Latent need	Liquid to reduce weight
Incipient need	Liquid to prevent aging
Industry Competition (How Can I Quench My Thirst?)	
Existing industries	Hard liquor
	Beer
	Wine
	Soft drink
	Milk
	Coffee
	Tea
New industry	Water
	Mineral water
Product Line Competition (What Form of Product Do I Want?)	
Me-too products	Regular cola
	Diet cola
	Lemonade
	Fruit-based drink
Improved product	Caffeine-free cola
Breakthrough product	Diet and caffeine-free cola providing full nutrition
Organizational Competition (What Brand Do I Want?)	
<i>Type of Firm</i>	
Existing firms	Coca-Cola
	PepsiCo
	Seven-Up
	Dr. Pepper
New entrants	General Foods
	Nestle
<i>Scope of Business</i>	
Geographic	Regional, national, multinational
Product/market	Single versus multiproduct industry

**Opportunity
Potential**

A promising market is likely to attract firms seeking to capitalize on an available opportunity. As the number of firms interested in sharing the pie increases, the degree of rivalry increases. Take, for example, the home computer market. In the early 1980s, everyone from mighty IBM to such unknowns in the field as Timex Watch Company wanted a piece of the personal computer pie. As firms started

EXHIBIT 4-2
Factors Contributing to Competitive Rivalry

Opportunity potential
 Ease of entry
 Nature of product
 Exit barriers
 Homogeneity of market
 Industry structure or competitive position of firms
 Commitment to the industry
 Feasibility of technological innovations
 Scale economies
 Economic climate
 Diversity of firms

jockeying for position, the intensity of competition increased manifold. A number of firms, for example, Texas Instruments and Atari, were forced to quit the market. At the same time, new competitors such as Dell and Compaq entered the market, undermining even IBM.

<i>Ease of Entry</i>	When entry into an industry is relatively easy, many firms, including some marginal ones, are attracted to it. The long-standing, committed members of the industry, however, do not want “outsiders” to break into their territory. Therefore, existing firms discourage potential entrants by adopting strategies that enhance competition.
<i>Nature of Product</i>	When the products offered by different competitors are perceived by customers to be more or less similar, firms are forced into price and, to a lesser degree, service competition. In such situations, competition can be really severe.
<i>Exit Barriers</i>	For a variety of reasons, it may be difficult for a firm to get out of a particular business. Possible reasons include the relationship of the business to other businesses of the firm, high investment in assets for which there may not be an advantageous alternative use, high cost of discharging commitments (e.g., fixed labor contracts and future purchasing agreements), top management’s emotional attachment to the business, and government regulations prohibiting exit (e.g., the legal requirement that a utility must serve all customers).
<i>Homogeneity of the Market</i>	When the entire market represents one large homogeneous unit, the intensity of competition is much greater than when the market is segmented. Even if the product sold is a commodity, segmentation of the market is possible. It is possible, for example, to identify frequent buyers of the commodity as one segment; and occasional buyers as another. But if a market is not suited to segmentation, firms must compete to serve it homogeneously, thus intensifying competition.

<i>Industry Structure</i>	When the number of firms active in a market is large, there is a good chance that one of the firms may aggressively seek an advantageous position. Such aggression leads to intense competitive activity as firms retaliate. On the other hand, if only a few firms constitute an industry, there is usually little doubt about industry leadership. In situations where there is a clear industry leader, care is often taken not to irritate the leader since a resulting fight could be very costly.
<i>Commitment to the Industry</i>	When a firm has wholeheartedly committed itself to a business, it will do everything to hang on, even becoming a maverick that fearlessly makes moves without worrying about the impact on either the industry or its own resources. Polaroid Corporation, for example, with its strong commitment to instant photography, must maintain its position in the field at any cost. Another example is Gillette's commitment to the shaving business. Such an attachment to an industry enhances competitive activity.
<i>Feasibility of Technological Innovations</i>	In industries where technological innovations are frequent, each firm likes to do its best to cash in while the technology lasts, thus triggering greater competitive activity.
<i>Scale Economies</i>	<p>Where economies realizable through large-scale operations are substantial, a firm will do all it can to achieve scale economies. Attempts to capture scale economies may lead a firm to aggressively compete for market share, escalating pressures on other firms. A similar situation occurs when a business's fixed costs are high and the firm must spread them over a large volume. If capacity can only be added in large increments, the resulting excess capacity will also intensify competition.</p> <p>Consider the airlines industry. Northwest Airlines commands 73% of the traffic at Detroit Metropolitan Wayne County Airport, and it wants to keep it that way by discouraging competitors. For example, a few years back, an upstart Spirit Airlines entered the Detroit-Philadelphia market with one-way fare of \$49, while Northwest's average one-way fare was more than \$170. Northwest soon slashed its fares to Philadelphia to \$49 on virtually all seats at all times, and added 30% more seats. A few months later, Spirit abandoned the route and Northwest raised its fare to more than \$220.⁵</p>
<i>Economic Climate</i>	During depressed economic conditions and otherwise slow growth, competition is much more volatile as each firm tries to make the best of a bad situation.
<i>Diversity of Firms</i>	Firms active in a field over a long period come to acquire a kind of industry standard of behavior. But new participants invading an industry do not necessarily like to play the old game. Forsaking industry patterns, newcomers may have different strategic perspectives and may be willing to go to any lengths to achieve their goals. The Miller Brewing Company's unconventional marketing practices are a case in point. Miller, nurtured and guided by its parent, Philip Morris, segmented the market by introducing a light beer to an industry that had hitherto

considered beer a commodity-type product. When different cultures meet in the marketplace, competition can be fierce.

COMPETITIVE INTELLIGENCE

Competitive intelligence is the publicly available information on competitors, current and potential, that serves as an important input in formulating marketing strategy. No general would order an army to march without first fully knowing the enemy's position and intentions. Likewise, before deciding which competitive moves to make, a firm must be aware of the perspectives of its competitors. Competitive intelligence includes information beyond industry statistics and trade gossip. It involves close observation of competitors to learn what they do best and why and where they are weak. No self-respecting business admits to not doing an adequate job of scanning the competitive environment, but what sets the outstanding companies apart from the merely self-respecting ones is that they watch their competition in such depth and with such dedication that, as a marketing executive once remarked to the author, "The information on competitive moves reaches them before even the management of the competing company learns about it."

Three types of competitive intelligence may be distinguished: defensive, passive, and offensive intelligence. **Defensive intelligence**, as the name suggests, is gathered to avoid being caught off-balance. A deliberate attempt is made to gather information on the competition in a structured fashion and to keep track of moves that are relevant to the firm's business. **Passive intelligence** is ad hoc information gathered for a specific decision. A company may, for example, seek information on a competitor's sales compensation plan when devising its own compensation plan. Finally, **offensive intelligence** is undertaken to identify new opportunities. From a strategic perspective, offensive intelligence is the most relevant.

Strategic Usefulness of Competitive Intelligence

Such information as how competitors make, test, distribute, price, and promote their products can go a long way in developing a viable marketing strategy. The Ford Motor Company, for example, has an ongoing program for tearing down competitors' products to learn about their cost structure. Exhibit 4-3 summarizes the process followed at Ford. This competitive knowledge has helped Ford in its strategic moves in Europe. For example, from regularly tearing down the Leyland Mini (a small truck), the company concluded that (a) Leyland was not making money on the Mini at its current price and (b) Ford should not enter the small truck market at current price levels. Based on these conclusions, Ford was able to arrive at a firm strategic decision not to assemble a "Mini."

The following example compares two companies that decided to enter the automatic dishwasher market at about the same time. One of the companies ignored the competition, floundered, and eventually abandoned the field; the other did a superior job of learning from the competition and came out on top. When the CEO of the first company, a British company, learned from his marketing department about the market growth potential for dishwashers and about current competitors' shares, he lost no time setting out to develop a suitable machine.

EXHIBIT 4-3***Ford Motor Company's Competitive Product Tear-Down Process***

1. **Purchase the product.** The high cost of product teardown, particularly for a carmaker, gives some indication of the value successful competitors place on the knowledge they gain.
 2. **Tear the product down—literally.** First, every removable component is unscrewed or unbolted; the rivets are undone; finally, individual spot welds are broken.
 3. **Reverse-engineer the product.** While the competitor's car is being dismantled, detailed drawings of parts are made and parts lists are assembled, together with analyses of the production processes that were evidently involved.
 4. **Build up costs.** Parts are costed out in terms of make-or-buy, the variety of parts used in a single product, and the extent of common assemblies across model ranges. Among the important facts to be established in a product teardown, obviously, are the number and variety of components and the number of assembly operations. The costs of the processes are then built up from both direct labor requirements and overheads (often vital to an understanding of competitor cost structures).
 5. **Establish economies of scale.** Once individual cost elements are known, they can be put together with the volume of cars produced by the competitor and the total number of people employed to develop some fairly reliable guides to the competitor's economies of scale. Having done this, Ford can calculate model-run lengths and volumes needed to achieve, first, break even and then profit.
-

Source: Robin Leaf, "How to Pick Up Tips from Your Competitors," *Director* (February 1978): 60.

Finding little useful information available on dishwasher design, the director of research and development decided to begin by investigating the basic mechanics of the dishwashing process. Accordingly, she set up a series of pilot projects to evaluate the cleaning performance of different jet configurations, the merits of alternative washing-arm designs, and the varying results obtained with different types and quantities of detergent on different washing loads. At the end of a year she had amassed a great deal of useful knowledge. She also had a pilot machine running that cleaned dishes well and a design concept for a production version. But considerable development work was still needed before the prototype could be declared a satisfactory basis for manufacture.

To complicate matters, management had neglected to establish effective linkages among the company's three main functions—marketing, technology, and production. So it was not until the technologists had produced the prototype and design concepts that marketing and production began asking for revisions and suggesting new ideas, further delaying the development of a marketable product.

So much for the first company, with its fairly typical traditional response to market opportunities. The second company, which happened to be Japanese, started with the same marketing intelligence but responded in a very different fashion.

First, it bought three units of every available competitive dishwasher. Next, management formed four special teams: (a) a product test group of marketing and technical staff, (b) a design team of technologists and production people, (c)

a distribution team of marketing and production staff, and (d) a field team of production staff.

The product test group was given one of each competitive model and asked to evaluate performance: dishwashing effectiveness, ease of use, and reliability (frequency and cause of breakdown). The remaining two units of each competitive model were given to the design team, who stripped down one of each pair to determine the number and variety of parts, the cost of each part, and the ease of assembly. The remaining units were stripped down to “life-test” each component, to identify design improvements and potential sources of supply, and to develop a comprehensive picture of each competitor’s technology. Meanwhile, the distribution team was evaluating each competitor’s sales and distribution system (numbers of outlets, product availability, and service offered), and the field team was investigating competitors’ factories and evaluating their production facilities in terms of cost of labor, cost of supplies, and plant productivity.

All this investigating took a little less than a year. At the end of that time, the Japanese still knew a lot less about the physics and chemistry of dishwashing than their British rivals, but the knowledge developed by their business teams had put them far ahead. In two more months they had designed a product that outperformed the best of the competition, yet would cost 30 percent less to build, based on a preproduction prototype and production process design. They also had a marketing plan for introducing the new dishwasher to the Japanese domestic market before taking it overseas. This plan positioned the product relative to the competition and defined distribution system requirements in terms of stocking and service levels needed to meet the expected production rate. Finally, the Japanese had prepared detailed plans for building a new factory, establishing supply contracts, and training the labor force.

The denouement of this story is what one might expect: The competitive Japanese manufacturer brought its new product to market two years ahead of the more traditionally minded British manufacturer and achieved its planned market share 10 weeks later. The traditional company steadily lost money and eventually dropped out of the market.

As the above anecdote shows, competitive analysis has three major objectives:

1. It allows you to understand your position of comparative advantage and your competitors’ positions of comparative advantage.
2. It allows you to understand your competitors’ strategies—past, present, and as they are likely to be in the future.
3. It is a key criterion of strategy selection, the element that makes your strategies come alive in the real world.

*Gathering
Competitive
Intelligence*

Knowledge about the competition may be gained by raising the following questions. To answer each question requires systematic probing and data gathering on different aspects of competition.

- Who is the competition? now? five years from now?
- What are the strategies, objectives, and goals of each major competitor?

- How important is a specific market to each competitor and what is the level of its commitment?
- What are the relative strengths and limitations of each competitor?
- What weaknesses make competitors vulnerable?
- What changes are competitors likely to make in their future strategies?
- So what? What will be the effects of all competitors' strategies, on the industry, the market, and our strategy?

Essentially, knowledge about competitors comprise their size, growth, and profitability, the image and positioning of their brands, objectives and commitments, strengths and weaknesses, current and past strategies, cost structure, exit barriers limiting their ability to withdraw, and organization style and culture.

The following procedure may be adopted to gather competitive intelligence:

1. **Recognize key competitors in market segments in which the company is active.** Presumably a product will be positioned to serve one or more market segments. In each segment there may be different competitors to reckon with; an attempt should be made to recognize all important competitors in each segment. If the number of competitors is excessive, it is sufficient to limit consideration to the first three competitors. Each competitor should be briefly profiled to indicate total corporate proportion.
2. **Analyze the performance record of each competitor.** The performance of a competitor can be measured with reference to a number of criteria. As far as marketing is concerned, sales growth, market share, and profitability are the important measures of success. Thus, a review of each competitor's sales growth, market share, and profitability for the past several years is desirable. In addition, any ad hoc reasons that bear upon a competitor's performance should be noted. For example, a competitor may have lined up some business, in the nature of a windfall from Kuwait, without making any strategic moves to secure the business. Similar missteps that may limit performance should be duly pointed out. Occasionally a competitor may intentionally pad results to reflect good performance at year end. Such tactics should be noted, too. Rothschild advises the following:

To make it really useful, you must probe how each participant keeps its books and records its profits. Some companies stress earnings; others report their condition in such a way as to delay the payment of taxes; still other bookkeep to increase cash availability.

These measurements are important because they may affect the company's ability to procure financing and attract people as well as influence stockholders' and investors' satisfaction with current management.⁶

3. **Study how satisfied each competitor appears to be with its performance.** Refer to each competitor's objective(s) for the product. If results are in concert with the expectations of the firm's management and stakeholders, the competitor will be satisfied. A satisfied competitor is most likely to follow its current successful strategy. On the other hand, if results are at odds with management expectations, the competitor is most likely to come out with a new strategy.
4. **Probe each competitor's marketing strategy.** The strategy of each competitor can be inferred from game plans (i.e., different moves in the area of product, price, promotion, and distribution) that are pursued to achieve objectives.

Information on game plans is available partly from published stories on the competitor and partly from the salespeople in contact with the competitor's customers and salespeople.

To clarify the point, consider a competitor in the small appliances business who spends heavily for consumer advertising and sells products mainly through discount stores. From this brief description, it is safe to conclude that, as a matter of strategy, the competitor wants to establish the brand in the mass market through discounters. In other words, the competitor is trying to reach customers who want to buy a reputable brand at discount prices and hopes to make money by creating a large sales base.

5. **Analyze current and future resources and competencies of each competitor.** In order to study a competitor's resources and competencies, first designate broad areas of concern: facilities and equipment, personnel skills, organizational capabilities, and management capabilities, for example. Refer to the checklist in Exhibit 4-4. Each area may then be examined with reference to different functional areas (general management, finance, research and development, operations, and especially marketing). In the area of finance, the availability of a large credit line would be listed as a strength under management capabilities. Owning a warehouse and refrigerated trucks is a marketing strength listed under facilities and equipment. A checklist should be developed to specifically pinpoint those strengths that a competitor can use to pursue goals against your firm as well as other firms in the market. Simultaneously, areas in which competitors look particularly vulnerable should also be noted. The purpose here is not to get involved in a ritualistic, detailed account of each competitor but to demarcate those aspects of a competitor's resources and competencies that may account for a substantial difference in performance.
6. **Predict the future marketing strategy of each competitor.** The above competitive analysis provides enough information to make predictions about future strategic directions that each competitor may pursue. Predictions, however, must be made qualitatively, using management consensus. The use of management consensus as the basic means for developing forecasts is based on the presumption that, by virtue of their experience in gauging market trends, executives should be able to make some credible predictions about each competitor's behavior in the future. A senior member of the marketing research staff may be assigned the task of soliciting executive opinions and consolidating the information into specific predictions on the moves competitors are likely to make.
7. **Assess the impact of competitive strategy on the company's product/market.** The delphi technique, examined in Chapter 12, can be used to specify the impact of competitive strategy. The impact should be analyzed by a senior marketing personnel, using competitive information and personal experiences on the job as a basis. Thereafter, the consensus of a larger group of executives can be obtained on the impact analysis performed previously.

Sources of Competitive Information

Essentially, three sources of competitive intelligence can be distinguished: (a) what competitors say about themselves, (b) what others say about them, and (c) what employees of the firm engaged in competitive analysis have observed and learned about competitors. Information from the first two sources, as shown in Exhibit 4-5, is available through public documents, trade associations, government, and

EXHIBIT 4-4

Source of Economic Leverage in the Business System

	<i>Facilities and Equipment</i>	<i>Personnel Skills</i>	<i>Organizational Capabilities</i>	<i>Management Capabilities</i>
1. General Mgmt.				
2. Finance				Large credit line
3. R&D				
4. Operations				
5. Marketing	Warehousing	Door-to-door selling	Direct sales	Industrial marketing
	Retail outlets	Retail selling	Distributor chain	Customer purchasing
	Sales offices	Wholesale selling	Retail chain	Department of Defense marketing
	Service offices	Direct industry selling	Consumer service organization	State and municipality marketing
	Transportation equipment	Department of Defense selling	Industrial service organization	Well-informed and receptive management
	Training facilities for sales staff	Cross-industry selling	Department of Defense product support	Large customer base
	Data processing equipment	Applications engineering	Inventory distribution and control	Decentralized control
		Advertising	Ability to make quick response to customer requirements	Favorable public image
		Sales promotion	Ability to adapt to sociopolitical upheavals in the marketplace	Future orientation
		Servicing	Loyal set of customers	Ethical standards
		Contract administration	Cordial relations with media and channels	
		Sales analysis	Flexibility in all phases of corporate life	
		Data analysis	Consumer financing	
		Forecasting	Discount policy	
		Computer modeling	Teamwork	
		Product planning	Product quality	
		Background of people		
		Corporate culture		

EXHIBIT 4-5
Sources of Competitive Intelligence

	<i>Public</i>	<i>Trade Professionals</i>	<i>Government</i>	<i>Investors</i>
What competitors say about themselves	<ul style="list-style-type: none"> • Advertising • Promotional materials • Press releases • Speeches • Books • Articles • Personnel changes • Want ads 	<ul style="list-style-type: none"> • Manuals • Technical papers • Licenses • Patents • Courses • Seminars 	<ul style="list-style-type: none"> • SEC reports • FIC • Testimony • Lawsuits • Antitrust 	<ul style="list-style-type: none"> • Annual meetings • Annual reports • Prospectors • Stock/bond issues
What others say about them	<ul style="list-style-type: none"> • Books • Articles • Case studies • Consultants • Newspaper reporters • Environmental groups • Consumer groups • "Who's Who" • Recruiting firms 	<ul style="list-style-type: none"> • Suppliers/vendors • Trade press • Industry study • Customers • Subcontractors 	<ul style="list-style-type: none"> • Lawsuits • Antitrust • State/federal agencies • National plans • Government programs 	<ul style="list-style-type: none"> • Security analyst reports • Industry studies • Credit reports

investors. Take, for example, information from government sources. Under the Freedom of Information Act, a great amount of information can be obtained at low cost.

As far as information from its own sources is concerned, the company should develop a structured program to gather competitive information. First, a tear-down program like Ford's (Exhibit 4-3) may be undertaken. Second, salespeople may be trained to carefully gather and provide information on the competition, using such sources as customers, distributors, dealers, and former salespeople. Third, senior marketing people should be encouraged to call on customers and speak to them in depth. These contacts should provide valuable information on competitors' products and services. Fourth, other people in the company who happen to have some knowledge of competitors should be encouraged to channel this information to an appropriate office.

Information gathering on the competition has grown dramatically in recent years. Almost all large companies designate someone specially to seek competitive intelligence. A *Fortune* article has identified more than 20 techniques to keep tabs on the competition. These techniques, summarized below, fall into seven groups. Virtually all of them can be legally used to gain competitive insights,

although some may involve questionable ethics. A responsible company should carefully review each technique before using it to avoid practices that might be considered illegal or unethical.

1. Gathering information from recruits and employees of competing companies.

Firms can collect data about their competitors through interviews with new recruits or by speaking with employees of competing companies. According to the *Fortune* article:

When they interview students for jobs, some companies pay special attention to those who have worked for competitors, even temporarily. Job seekers are eager to impress and often have not been warned about divulging what is proprietary. They sometimes volunteer valuable information. . . . Several companies now send teams of highly trained technicians instead of personnel executives to recruit on campus.

Companies send engineers to conferences and trade shows to question competitors' technical people. Often conversations start innocently—just a few fellow technicians discussing processes and problems . . . [yet competitors'] engineers and scientists often brag about surmounting technical challenges, in the process divulging sensitive information.

Companies sometimes advertise and hold interviews for jobs that don't exist in order to entice competitors' employees to spill the beans. . . . Often applicants have toiled in obscurity or feel that their careers have stalled. They're dying to impress somebody.

In probably the hoariest tactic in corporate intelligence gathering, companies hire key executives from competitors to find out what they know.

- 2. Gathering information from competitors' customers.** Some customers may give out information on competitors' products. For example, a while back Gillette told a large Canadian account the date on which it planned to begin selling its new Good News disposable razor in the United States. The Canadian distributor promptly called Bic about Gillette's impending product launch. Bic put on a crash program and was able to start selling its razor shortly after Gillette introduced its own.
- 3. Gathering information by infiltrating customers' business operations.** Companies may provide their engineers free of charge to customers. The close, cooperative relationship that engineers on loan cultivate with the customer's staff often enables them to learn what new products competitors are pitching.
- 4. Gathering information from published materials and public documents.** What may seem insignificant, a help wanted ad, for example, may provide information about a competitor's intentions or planned strategies. The types of people sought in help wanted ads can indicate something about a competitor's technological thrusts and new product development. Government agencies are another good source of information.
- 5. Gathering information from government agencies under the Freedom of Information Act.** Some companies hire others to get this information more discreetly.
- 6. Gathering information by observing competitors or by analyzing physical evidence.** Companies can get to know competitors better by buying their products or by examining other physical evidence. Companies increasingly buy competitors' products and take them apart to determine costs of production and even manufacturing methods.

In the absence of better information on market share and the volume of product being shipped, companies have measured the rust on the rails of railroad sidings to their competitors' plants and have counted tractor-trailers leaving loading bays.

7. **Gathering information from competitors' garbage.** Some firms actually purchase such garbage. Once it has left a competitor's premises, refuse is legally considered abandoned property. Although some companies shred paper generated by their design labs, they often neglect to shred almost-as-revealing refuse from marketing and public relations departments.⁷

*Organization for
Competitive
Intelligence*

Competitive, or business, intelligence is a powerful new management tool that enhances a corporation's ability to succeed in today's highly competitive global markets. It provides early warning intelligence and a framework for better understanding and countering competitors' initiatives. Competitive activities can be monitored in-house or assigned to an outside firm. A recent study indicates that over 500 U.S. firms are involved or interested in running their own competitive intelligence activities.⁸ Usually, companies depend partly on their own people and partly on external help to scan the competitive environment.

Within the organization, competitive information should be acquired both at the corporate level and at the SBU level. At the corporate level, competitive intelligence is concerned with competitors' investment strengths and priorities. At the SBU level, the major interest is in marketing strategy, that is, product, pricing, distribution, and promotion strategies that a competitor is likely to pursue. The true payoff of competitive intelligence comes from the SBU review.

Organizationally, the competitive intelligence task can be assigned to an SBU strategic planner, to a marketing person within the SBU who may be a marketing research or a product/market manager, or to a staff person. Whoever is given the task of gathering competitive intelligence should be allowed adequate time and money to do a thorough job.

As far as outside help is concerned, three main types of organizations may be hired to gather competitive information. First, many marketing research firms (e.g., A.C. Nielsen, Frost and Sullivan, SRI International, Predicasts) provide different types of competitive information, some on a regular basis and others on an ad hoc arrangement. Second, clipping services scan newspapers, financial journals, trade journals, and business publications for articles concerning designated competitors and make copies of relevant clippings for their clients. Third, different brokerage firms specialize in gathering information on various industries. Arrangements may be made with brokerage firms to have regular access to their information on a particular industry.

SEEKING COMPETITIVE ADVANTAGE

To outperform competitors and to grow despite them, a company must understand why competition prevails, why firms attack, and how firms respond. Insights into competitors' perspectives can be gained by undertaking two types of analysis: industry and comparative analysis. **Industry analysis** assesses the

attractiveness of a market based on its economic structure. **Comparative analysis** indicates how every firm in a particular market is likely to perform, given the structure of the industry.

Industry Analysis

Every industry has a few peculiar characteristics. These characteristics are bound by time and thus are subject to change. We may call them the dynamics of the industry. No matter how hard a company tries, if it fails to fit into the dynamics of the industry, ultimate success may be difficult to achieve.

An example of how the perspectives of an entire industry may change over time is provided by the cosmetics industry. The cosmetics business was traditionally run according to personal experience and judgment, by the seat-of-the-pants, so to speak, with ultimate dependence on the marketing genius of inventors. In the 1980s, a variety of pressures began to engulf the industry. The regulatory climate became tougher. Consumers have become more demanding and are fewer in number. Although the number of working women continues to rise, this increase has not offset another more significant demographic change: The population of teenagers—traditionally the heaviest and most experimental makeup users—has been declining. In 1995, there were 15 percent fewer 18- to 24-year-olds than in 1985. As a result, sales of cosmetics are projected to increase only about 2.5 percent per year to the year 2000. These shifts, along with unstable economic conditions and rising costs, have made profits smaller. In the 1980s, several pharmaceutical and packaged-goods companies, including Colgate-Palmolive Co., Eli Lilly and Co., Pfizer, and Schering Plough, acquired cosmetics companies. Among these, only Schering Plough, which makes the mass market Maybelline, has maintained a meaningful business. Colgate, which acquired Helena Rubenstein, sold the brand seven years later after it languished. At the start of the 1990s, the industry began to change again. New mass marketers Procter & Gamble and Unilever entered the arena, bringing with them their great experience producing mundane products such as soap and toilet paper, sparking disdain in the glamorous cosmetics trade. However, the mammoth marketing clout of these giant packaged-goods companies also sparked fear. Procter & Gamble bought Noxell Corporation, producer of Cover Girl and Clarion makeup, making it the top marketer of cosmetics in mass market outlets. Unilever acquired Faberge and Elizabeth Arden.⁹

These changes made competition in the industry fierce. Although capital investment in the industry is small, inventory and distribution costs are extremely high, partly because of the number of shades and textures required in each product line. For example, nail polish and lipstick must be available in more than 50 different shades.

The cosmetics industry has gone through a tremendous change since the 1980s. In those days, success in the industry depended on having a glamorous product. As has been observed, Revlon was manufacturing lipstick in its factories, but it was selling beautiful lips. Today, however, success rests on such nuts-and-bolts matters as sharp positioning to serve a neatly defined segment and securing distribution to achieve specific objectives in sales, profit, and market

share.¹⁰ Basic inventory and financial controls, budgeting, and planning are now utilized to the fullest extent to cut costs and waste: “In contrast to the glitzy, intuitive world of cosmetics, Unilever and P&G are the habitats of organization men in grey-flannel suits. Both companies rely on extensive market research.”¹¹ This type of shift in direction and style in an industry has important ramifications for marketing strategy.

The dynamics of an industry may be understood by considering the following factors:

1. Scope of competitors’ businesses (i.e., location and number of industries).
2. New entrants in the industry.
3. Other current and potential offerings that appear to serve similar functions or satisfy the same need.
4. Industry’s ability to raise capital, attract people, avoid government probing, and compete effectively for consumer dollars.
5. Industry’s current practices (price setting, warranties, distribution structure, after-sales service, etc.).
6. Trends in volume, costs, prices, and return on investment, compared with other industries.
7. Industry profit economics (the key factors determining profits: volume, materials, labor, capital investment, market penetration, and dealer strength).
8. Ease of entry into the industry, including capital investment.
9. Relationship between current and future demand and manufacturing capacity and its probable effects on prices and profits.
10. Effect of integration, both forward and backward.
11. Effect of cyclical swings in the relationship between supply and demand.

To formulate marketing strategy, a company should determine the relevance of each of these factors in its industry and the position it occupies with respect to competitors. An attempt should be made to highlight the dynamics of the company in the industry environment.

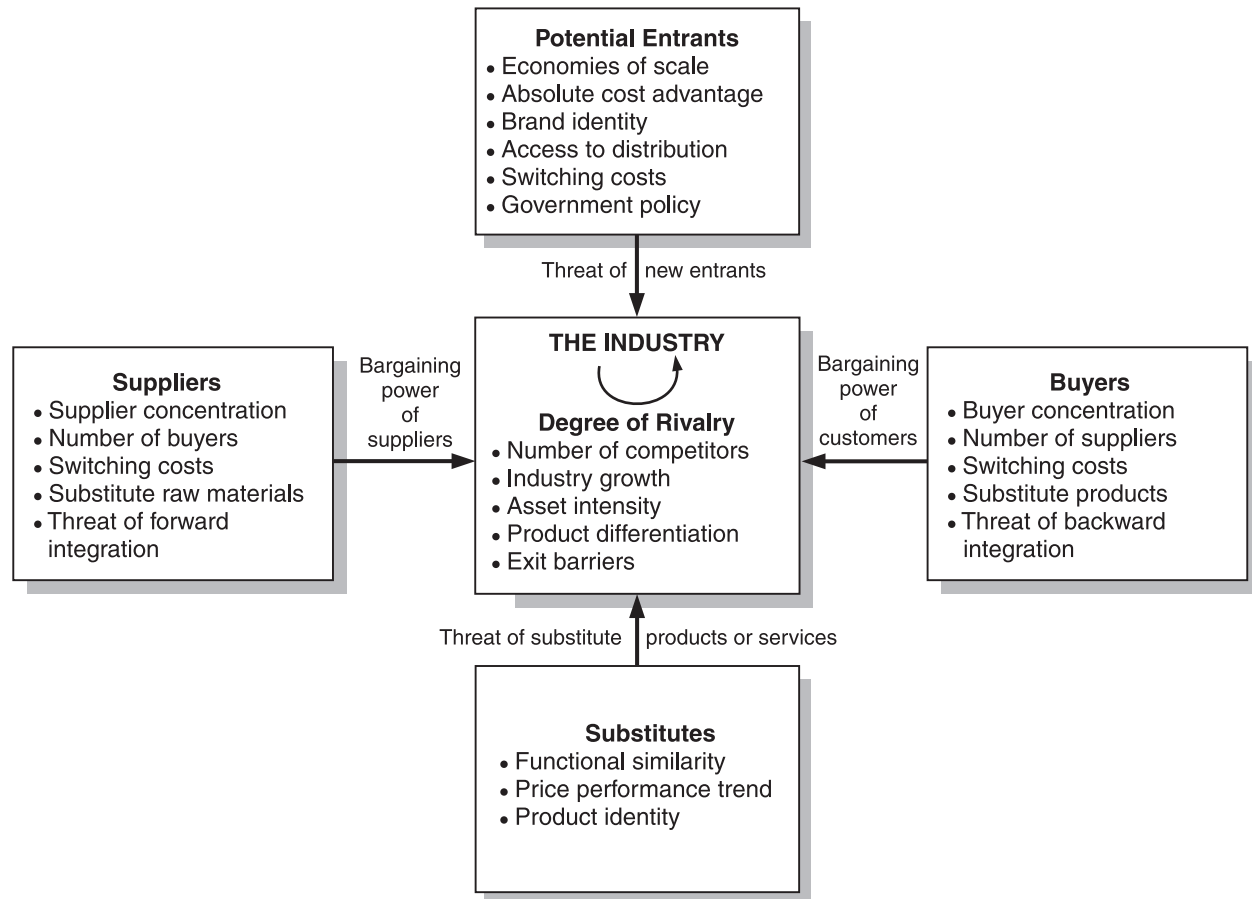
*Porter’s Model of
Industry Structure
Analysis*

Conceptual framework for industry analysis has been provided by Porter. He developed a five-factor model for industry analysis, as shown in Exhibit 4-6. The model identifies five key structural features that determine the strength of the competitive forces within an industry and hence industry profitability.

As shown in this model, the degree of rivalry among different firms is a function of the number of competitors, industry growth, asset intensity, product differentiation, and exit barriers. Among these variables, the number of competitors and industry growth are the most influential. Further, industries with high fixed costs tend to be more competitive because competing firms are forced to cut price to enable them to operate at capacity. Differentiation, both real and perceived, among competing offerings, however, lessens rivalry. Finally, difficulty of exit from an industry intensifies competition.

Threat of entry into the industry by new firms is likely to enhance competition. Several barriers, however, make it difficult to enter an industry. Two cost-related entry barriers are economies of scale and absolute cost advantage. Economies of

EXHIBIT 4-6
Porter's Model of Industry Competition



Source: Michael E. Porter, "Industry Structure and Competitive Strategy: Keys to Profitability," *Financial Analysis Journal* (July–August 1980): 33.

scale require potential entrants either to establish high levels of production or to accept a cost disadvantage. Absolute cost advantage is enjoyed by firms with proprietary technology or favorable access to raw materials and by firms with production experience. In addition, high capital requirements, high switching costs (i.e., the cost to a buyer of changing suppliers), product differentiation, limited access to distribution channels, and government policy can act as entry barriers.

A substitute product that serves essentially the same function as an industry product is another source of competition. Since a substitute places a ceiling on the price that firms can charge, it affects industry potential. The threat posed by a

substitute also depends on its long-term price/performance trend relative to the industry's product.

Bargaining power of buyers refers to the ability of the industry's customers to force the industry to reduce prices or increase features, thus bidding away profits. Buyers gain power when they have choices—when their needs can be met by a substitute product or by the same product offered by another supplier. In addition, high buyer concentration, the threat of backward integration, and low switching costs add to buyer power.

Bargaining power of suppliers is the degree to which suppliers of the industry's raw materials have the ability to force the industry to accept higher prices or reduced service, thus affecting profits. The factors influencing supplier power are the same as those influencing buyer power. In this case, however, industry members act as buyers.

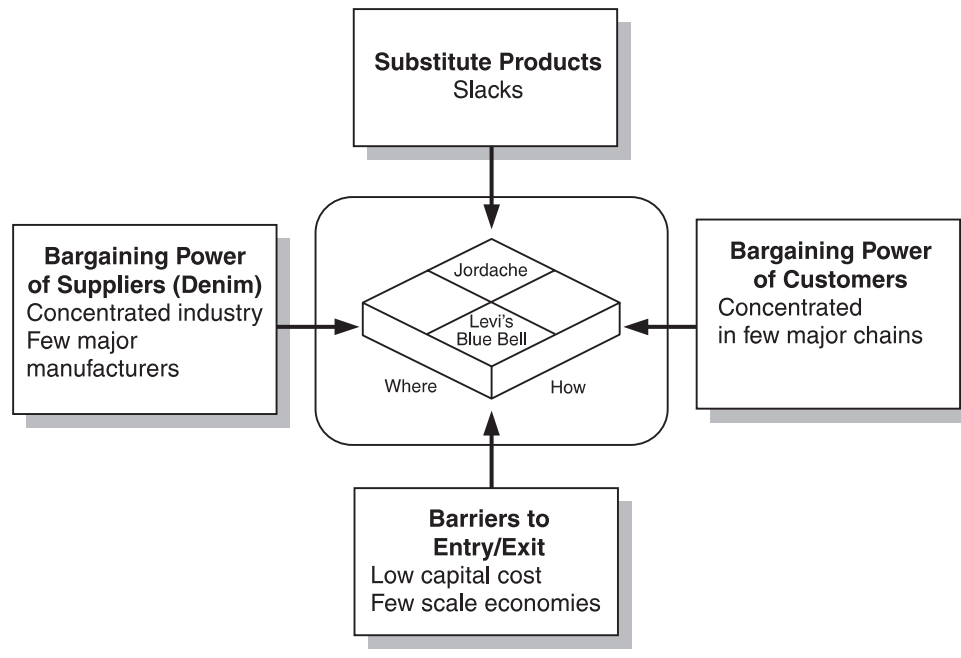
These five forces of competition interact to determine the attractiveness of an industry. The strongest forces become the dominant factors in determining industry profitability and the focal points of strategy formulation, as the following example of the network television industry illustrates. Government regulations, which limited the number of networks to three, have had a great influence on the profile of the industry. This impenetrable entry barrier created weak buyers (advertisers), weak suppliers (writers, actors, etc.), and a very profitable industry. However, several exogenous events are now influencing the power of buyers and suppliers. Suppliers have gained power with the advent of cable television because the number of customers to whom artists can offer their services has increased rapidly. In addition, as cable television firms reduce the size of the network market, advertisers may find substitute advertising media more cost-effective. In conclusion, while the industry is still very attractive and profitable, the changes in its structure imply that future profitability may be reduced.

A firm should first diagnose the forces affecting competition in its industry and their underlying causes and then identify its own strengths and weaknesses relative to the industry. Only then should a firm formulate its strategy, which amounts to taking offensive or defensive action in order to achieve a secure position against each of the five competitive forces.¹² According to Porter, this involves

- Positioning the firm so that its capabilities provide the best defense against the existing array of competitive forces.
- Influencing the balance of forces through strategic moves, thereby improving the firm's relative position.
- Anticipating shifts in the factors underlying the forces and responding to them, hopefully exploiting change by choosing a strategy appropriate to the new competitive balance before rivals recognize it.¹³

Take, for example, the U.S. blue jeans industry. In the 1970s most firms except for Levi Strauss and Blue Bell, maker of Wrangler Jeans, took low profits. The situation can be explained with reference to industry structure (see Exhibit 4-7). The extremely low entry barriers allowed almost 100 small jeans manufacturers to join the competitive ranks; all that was needed to enter the industry was

EXHIBIT 4-7
Structure of Blue Jeans Industry



Source: Ennlus E. Bergsma, "In Strategic Phase, Line Management Needs Business's Research, Not Market Research," *Marketing News* (21 January 1983): 22.

some equipment, an empty warehouse, and some relatively low-skilled labor. All such firms competed on price.

Further, these small firms had little control over raw materials pricing. The production of denim is in the hands of about four major textile companies. No one small blue jeans manufacturer was important enough to affect supplier prices or output; consequently, jeans makers had to take the price of denim or leave it. Suppliers of denim had strong bargaining power. Store buyers also were in a strong bargaining position. Most of the jeans sold in the United States were handled by relatively few buyers in major store chains. As a result, a small manufacturer basically had to sell at the price the buyers wanted to pay, or the buyers could easily find someone else who would sell at their price.

But then along came Jordache. Creating designer jeans with heavy up-front advertising, Jordache designed a new way to compete that changed industry forces. First, it significantly lowered the bargaining power of its customers (i.e., store buyers) by creating strong consumer preference. The buyer had to meet Jordache's price rather than the other way around. Second, emphasis on the designer's name created significant entry barriers. In summary, Jordache formulated a strategy that

neutralized many of the structural forces surrounding the industry and gave itself a competitive advantage.

Comparative Analysis

Comparative analysis examines the specific advantages of competitors within a given market. Two types of comparative advantage may be distinguished: structural and response. **Structural advantages** are those advantages built into the business. For example, a manufacturing plant in Indonesia may, because of low labor costs, have a built-in advantage over another firm. **Responsive advantages** refer to positions of comparative advantage that have accrued to a business over time as a result of certain decisions. This type of advantage is based on leveraging the strategic phenomena at work in the business.

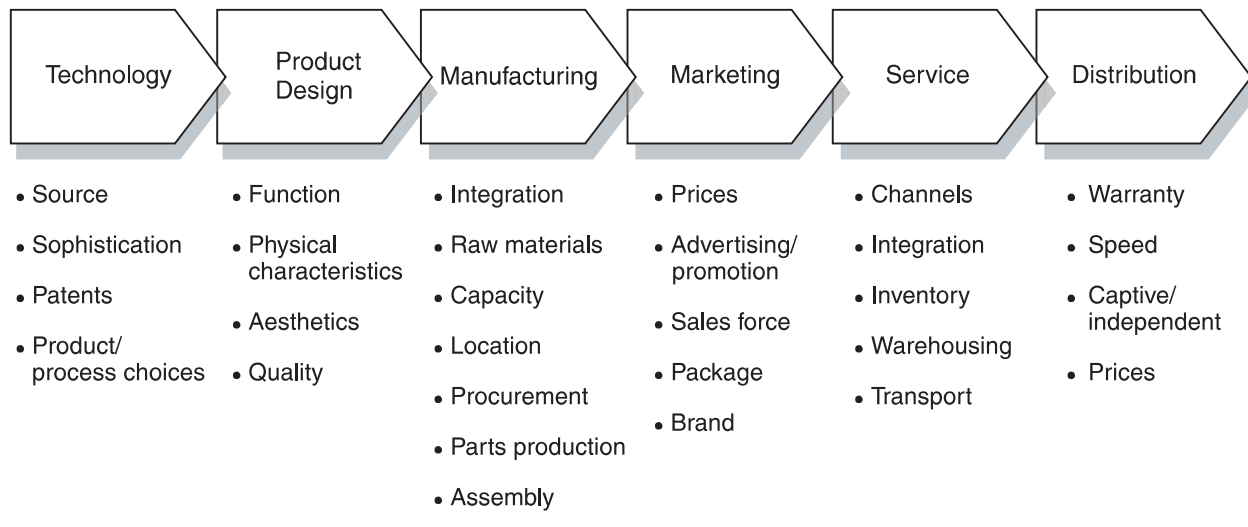
Every business is a unique mixture of strategic phenomena. For example, in the soft drink industry a unit of investment in advertising may lead to a unit of market share. In contrast, the highest-volume producer in the electronics industry is usually the lowest-cost producer. In industrial product businesses, up to a point, sales and distribution costs tend to decline as the density of sales coverage (the number of salespeople in the field) increases. Beyond this optimum point, costs tend to rise dramatically. However, cost is only one way of achieving a competitive advantage. A firm may explore issues beyond cost to score over competition. For example, a company may find that distribution through authorized dealers gives it competitive leverage. Another company may find product differentiation strategically more desirable.

In order to survive, any company, regardless of size, must be different in one of two dimensions. It must have lower costs than its direct head-to-head competitors, or it must have unique values for which its customers will pay more. Competitive distinctiveness is essential to survival. Competitive distinctiveness can be achieved in different ways: (a) by concentrating on particular market segments, (b) by offering products that differ from rather than mirror competing products, (c) by using alternative distribution channels and manufacturing processes, and (d) by employing selective pricing and fundamentally different cost structures. An analytical tool that may be used by a company seeking a position of competitive advantage/distinction is the business-system framework.

Examination of the business system operating in an industry is useful in analyzing competitors and in searching out innovative options for gaining a sustainable competitive advantage. The business-system framework enables a firm to discover the sources of greatest economic leverage, that is, stages in the system where it may build cost or investment barriers against competitors.¹⁴ The framework may also be used to analyze a competitor's costs and to gain insights into the sources of a competitor's current advantage in either cost or economic value to the customer.

Exhibit 4-8 depicts the business system of a manufacturing company. At each stage of the system—technology, product design, manufacturing, and so on—a company may have several options. These options are often interdependent. For example, product design will partially constrain the choice of raw materials. Likewise, the perspectives of physical distribution will affect manufacturing

EXHIBIT 4-8
Business System of a Manufacturing Company

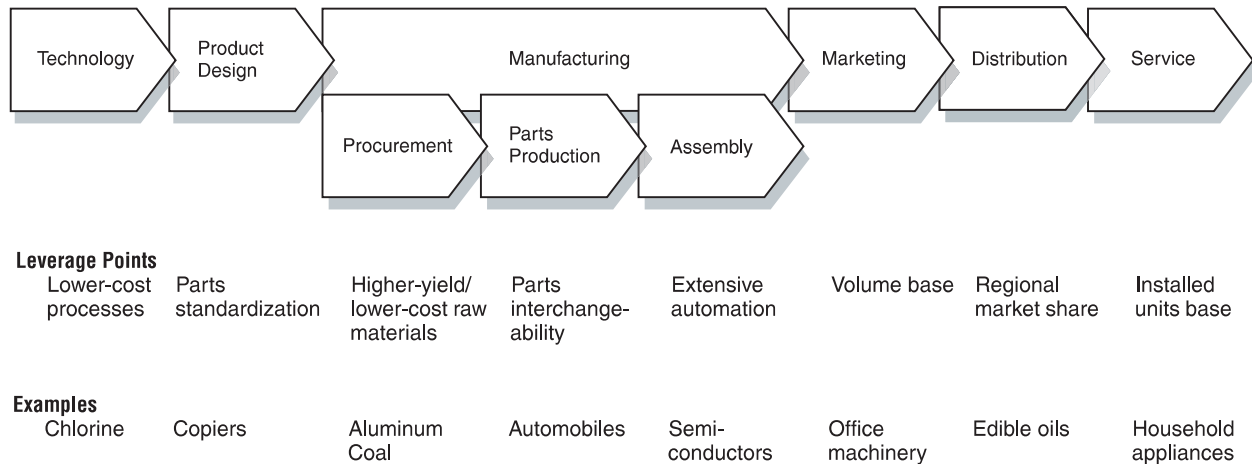


Source: Roberto Buaron, "New-Game Strategies," *The McKinsey Quarterly* (Spring 1981): 34. Reprinted by permission of the publisher. Also, "How to Win the Market-Share Game? Try Changing the Rules." Reprinted by permission of the publisher, from *Management Review* (January 1981) © 1981. American Management Association, New York. All rights reserved.

capacity and location and vice versa. At each stage, a variety of questions may be raised, the answers to which provide insights into the strategic alternatives a company may consider: How are we doing this now? How are our competitors doing it? What is better about their way? About ours? How else might it be done? How would these options affect our competitive position? If we change what we are doing at this stage, how would other stages be affected? Answers to these questions reveal the sources of leverage a business may employ to gain competitive advantage (see Exhibit 4-9).

The use of the business-system framework can be illustrated with reference to Savin Business Machines Corporation.¹⁵ In 1975, this company with revenues of \$63 million was a minor factor in the U.S. office copier market. The market was obviously dominated by Xerox, whose domestic copier revenues were approaching \$2 billion. At that time, Xerox accounted for almost 80 percent of plain-paper copiers in the United States. In November 1975, Savin introduced a plain-paper copier to serve customers who wanted low- and medium-speed machines (i.e., those producing fewer than 40 copies per minute). Two years later, Savin's annual revenues passed \$200 million; the company had captured 40 percent of all new units installed in the low-end plain-paper copier market in the United States. Savin managed to earn a 64 percent return on equity while maintaining a conservative 27 percent debt ratio. In early 1980s, its sales surpassed \$470 million, selling more copiers in the United States than any other company.¹⁶ Meanwhile

EXHIBIT 4-9
Sources of Economic Leverage in the Business System

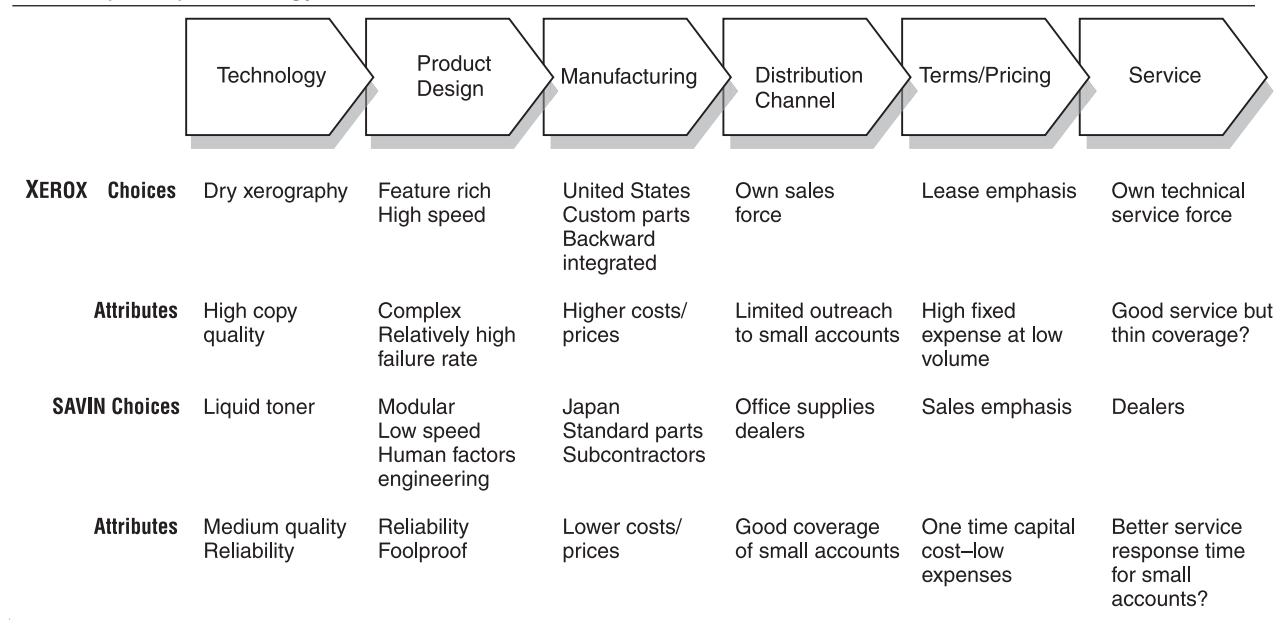


Source: Roberto Buaron, "New-Game Strategies," *The McKinsey Quarterly* (Spring 1981): 35. Reprinted by permission of the publisher. Also, "How to Win the Market-Share Game? Try Changing the Rules." Reprinted by permission of the publisher, from *Management Review* (January 1981) © 1981. American Management Association, New York. All rights reserved.

Xerox, which in 1974 had accounted for more than half of the low-end market, saw its share shrink to 10 percent in 1978. What reasons may be ascribed to Savin's success against mighty Xerox? Through careful analysis of the plain-paper copier business system, Savin combined various options at different stages of the system to develop a competitive advantage to successfully confront Xerox. As shown in Exhibit 4-10, by combining a different technology with different manufacturing, distribution, and service approaches, Savin was able to offer business customers, at some sacrifice in copy quality, a much cheaper machine. The option of installing several cheaper machines in key office locations in lieu of a single large, costly, centrally located unit proved attractive to many large customers.

At virtually every stage of the business system, Savin took a radically different approach. First, it used a low-cost technology that had been avoided by the industry because it produced a lower quality copy. Next, its product design was based on low-cost standardized parts available in volume from Japanese suppliers. Further, the company opted for low-cost assembly in Japan. These business-system innovations permitted Savin to offer a copier of comparable reliability and acceptable quality for half the price of Xerox's equivalent model. (Note: Starting from the mid-1980s, the Savin Corp. ran into all sorts of managerial problems. In 1993, it went into bankruptcy.)

EXHIBIT 4-10
Plain-Paper Copier Strategy: Xerox versus Savin



Source: Peter R. Sawers, "How to Apply Competitive Analysis to Strategic Planning," *Marketing News* (18 March 1983): 11. Reprinted by permission of the American Marketing Association.

SUSTAINING COMPETITIVE ADVANTAGE

A good strategist seeks not only to "win the hill, but hold on to it." In other words, a business should not only seek competitive advantage but also sustain it over the long haul. Sustaining competitive advantage requires erecting barriers against the competition.

A barrier may be erected based on size in the targeted market, superior access to resources or customers, and restrictions on competitors' options. Scale economies, for example, may equip a firm with an unbeatable cost advantage that competitors cannot match. Preferred access to resources or to customers enables a company to secure a sustainable advantage if (a) the access is secured under better terms than competitors have and (b) the access can be maintained over the long run. Finally, a sustainable advantage can be gained if, for various reasons, competitors are restricted in their moves (e.g., pending antitrust action or given past investments or existing commitments).

In financial terms, barriers are based on competitive cost differentials or on price or service differentials. In all cases, a successful barrier returns higher margins than the competition earns. Further, a successful barrier must be sustainable

and, in a practical sense, unbreachable by the competition; that is, it must cost the competition more to surmount than it costs the protected competitor to defend.

The nature of the feasible barrier depends on the competitive economics of the business. A heavily advertised consumer product with a leading market share enjoys a significant cost barrier and perhaps a price-realization barrier against its competition. If a consumer product has, for example, twice the market share of its competition, it need spend only one-half the advertising dollar per unit to produce the same impact in the marketplace. It will always cost the competition more, per unit, to attack than it costs the leader to defend.

On the other hand, barriers cost money to erect and defend. The expense of the barrier may become an umbrella under which new forms of competition can grow. For example, while advertising is a barrier that protects a leading consumer brand from other branded competitors, the cost of maintaining the barrier is an umbrella under which a private-label product may hide and grow.

A wide product line, large sales and service forces, and systems capabilities are all examples of major barriers. Each of these has a cost to erect and maintain. Each is effective against smaller competitors who are attempting to copy the leader but have less volume over which to amortize barrier costs.

Each barrier, however, holds a protective umbrella over focused competitors. The competitor with a narrow product line faces fewer costs than the wide-line leader. The mail-order house may live under the umbrella of costs associated with the large sales and service force of the leader. The "cherry picker" may produce components compatible with the systems of the leader without bearing the systems engineering costs.

Exhibit 4-11 shows the relationship between barrier and umbrella strategies in sustaining competitive advantage. The best position in the system is high barrier and low umbrella. A product or business with a position strong enough that the costs of maintaining the barrier are, on a per unit basis, insignificant is in a high-barrier, low-umbrella position. The low-barrier, low-umbrella quadrant is, by definition, a commodity without high profitability.

Most interesting is the high-barrier, high-umbrella quadrant. The business is protected by the existence of the barrier. At the same time, it is at risk because the cost of supporting the barrier is high. Profitability may be high, but the risk of competitive erosion, too, may be substantial. The marketplace issue is the trade-off between consumer preferences for more service, quality, choice, or "image" and lower prices from more narrowly focused competitors.

These businesses face profound decisions. Making no change in direction means continual threats from focused competition. Yet any change in spending to lower the umbrella means changing the nature of the competitive protection; that is, eroding the barrier.

Successful marketing strategy requires being aware of the size of the umbrella and continually testing whether to maintain investment to preserve or heighten the barrier or to withdraw investment to "cash out" as the barrier erodes.

A sustainable advantage is meaningful in marketing strategy only when the following conditions are met: (a) customers perceive a consistent difference in

EXHIBIT 4-11
Strategies for Sustaining Competitive Advantage

		Umbrella	
		Low	High
Barrier	High	Protected	Specialty at Risk
	Low	Commodity	Dying

Source: Sandra O. Moose, "Barriers and Umbrellas," *Perspectives* (Boston: Boston Consulting Group, 1980). Reprinted by permission.

important attributes between the firm's product or service and those of its competitors, (b) the difference is the direct result of a capability gap between the firm and its competitors, and (c) both the difference in important attributes and the capability gap can be expected to endure over time.

To illustrate the point, consider competition between the Kellogg Co. and Quaker Oats Co. in the cereal market. Beginning in 1995, Kellogg could not maintain the barrier and the umbrella became too big. Quaker Oats (a relatively small fourth player in the industry) took advantage of this opportunity and introduced a line of bagged cereals that were cheaper versions of Kellogg's (the industry leader's) national brands. By skimping on packaging and marketing costs, Quaker could sell bagged products for about \$1 less than boxed counterparts. Since 1995, bagged cereals have skyrocketed from virtually nothing to account for 8% of all cereal packages sold in 1998.¹⁷ The difference that Kellogg counted on could not be maintained. The consumer did not care whether cereals are in a bag or box.

SUMMARY

Competition is a strategic factor that affects marketing strategy formulation. Traditionally, marketers have considered competition as one of the uncontrollable variables to be reckoned with in developing the marketing mix. It is only in the last few years that the focus of business strategy has shifted to the competition. It is becoming more and more evident that a chosen marketing strategy should be based on competitive advantage to achieve sustained business success. To implement such a perspective, resources should be concentrated in those areas of competitive activity that offer the best opportunity for continuing profitability and sound investment returns.

There are two very different forms of competition: natural and strategic. Natural competition implies survival of the fittest in a given environment. In business terms, it means firms compete from very similar strategic positions, relying on operating differences to separate the successful from the unsuccessful. With strategic competition, on the other hand, underlying strategy differences vis-à-vis market segments, product offerings, distribution channels, and manufacturing processes become paramount considerations.

Conceptually, competition may be examined from the viewpoint of economists, industrial organization theorists, and businesspeople. The major thrust of economic theories has centered on the model of perfect competition. Industrial organization emphasizes the industry environment (i.e., industry structure, conduct, and performance) as the key determinant of a firm's performance. A theoretical framework of competition from the viewpoint of the businessperson, other than the pioneering efforts of Bruce Henderson, hardly exists.

Firms compete to satisfy customer needs, which may be classified as existing, latent, or incipient. A firm may face competition from different sources, which may be categorized as industry competition, product line competition, or organizational competition. The intensity of competition is determined by a combination of factors.

A firm needs a competitive intelligence system to keep track of various facets of its rivals' businesses. The system should include proper data gathering and analysis of each major competitor's current and future perspectives. This chapter identified various sources of competitive information, including what competitors say about themselves, what others say about them, and what a firm's own people have observed. To gain competitive advantage, that is, to choose those product/market positions where victories are clearly attainable, two forms of analysis may be undertaken: industry analysis and comparative analysis. Porter's five-factor model is useful in industry analysis. Business-system framework can be gainfully employed for comparative analysis.

DISCUSSION QUESTIONS

1. Differentiate between natural and strategic competition. Give examples.
2. What are the basic elements of strategic competition? Are there any prerequisites to pursuing strategic competition?
3. How do economists approach competition? Does this approach suffice for businesspeople?
4. What is the industrial organization viewpoint of competition?
5. Identify, with examples, different sources of competition.
6. How does industry structure affect intensity of competition?
7. What are the major sources of competitive intelligence?
8. Briefly explain Porter's five-factor model of industry structure analysis.

NOTES

- ¹ Bruce D. Henderson, "New Strategies for the Global Competition," *A Special Commentary* (Boston: Boston Consulting Group, 1981): 5–6.
- ² Louis W. Stern and John R. Grabner, Jr., *Competition in the Marketplace* (Glenview, IL: Scott, Foresman and Company, 1970): 29.
- ³ See Michael E. Porter, *Competitive Strategy* (New York: The Free Press, 1980): Chapter 1. See also E. T. Grether, *Marketing and Public Policy* (Englewood Cliffs, NJ: Prentice-Hall, 1960): 25; and George Fisk, *Marketing Systems: An Introductory Analysis* (New York: Harper & Row, 1967): 622.
- ⁴ Bruce D. Henderson, "The Anatomy of Competition," *Journal of Marketing* (Spring 1983): 8–9.
- ⁵ Wendy Zellner, "How Northwest Gives Competition a Bad Name," *Business Week*, (16 March 1998): 34.
- ⁶ William E. Rothschild, *Putting It All Together* (New York: AMACOM, 1976): 85.
- ⁷ Steven Flax, "How to Snoop on Your Competitors," *Fortune* (14 May 1984): 29–33. Also see Richard Teitelbaum, "The New Race for Intelligence," *Fortune* (2 November 1992): 104.
- ⁸ Patrick Marren, "Business Intelligence: Inside Out?" *Outlook*, The Futures Group. (June 1996): 1.
- ⁹ "Unilever Is All Made Up with Everywhere to Go," *Business Week* (31 July 1989): 33–34. Also see "The Branding of Beauty," *The Economist*, (21 October 1995): 67.
- ¹⁰ "L'Oréal Aiming at High and Low Markets," *Fortune* (22 March 1993): 89.
- ¹¹ Kathleen Deveny and Alecia Swasy, "In Cosmetics, Marketing Cultures Clash," *The Wall Street Journal* (31 October 1989): B1.
- ¹² See George S. Day and Prakash Nedungadi, "Managerial Representations of Competitive Strategy," *Journal of Marketing* (April 1994): 31–44.
- ¹³ Michael E. Porter, "Note on the Structural Analysis of Industries," *Harvard Business School Case Service* (1975): 22.
- ¹⁴ Richard Normann and Rafael Ramirez, "From Value Chain to Value Constellation: Designing Interactive Strategy," *Harvard Business Review* (July–August 1993): 65–77.
- ¹⁵ Roberto Buaron, "New-Game Strategies," *McKinsey Quarterly* (Spring 1981): 24–40.
- ¹⁶ Tom Giordano, "From Riches to Rags," *The Hartford Courant* (12 December 1993): 61.
- ¹⁷ "Cereal-Box Killers Are on the Loose." *Business Week* (5 October 1998): 48.