UNDERMINING COMPETITORS

It is almost axiomatic that strategy is about beating competitors. Much of the language—competitive advantage, deterring new rivals, first-mover advantage, etc.—hints at this adversarial perspective. Many popular books play to analogies of military strategy with a sense of almost war-like behavior, discussing both the strategic brilliance and leadership of great historic figures.[23] It is important not to push this analogy too far, however, since military strategy is dominated by geographical considerations that have no useful counterpart in most business situations. Also, warfare most often involves just two sides in a conflict whereas competitive industries usually concern several rivals.

Chapter 2 explained how a long-established view of strategy focuses on the impact that competitive forces have on industry profitability. Those forces include not just current, direct competitors, but customers' buying power, suppliers' control of key inputs, and pressure from substitute products and new competitors.

The competitive fragmentation of an industry is changed by the entry of new firms and the exit of others, and has powerful effects on prices, costs and profitability.

Firms can try to manipulate those forces to improve competitive conditions in various ways. Two of these aims are:

1. encouraging current competitors to leave the industry
2. deterring possible new entrants from starting up in the industry.

Many jurisdictions include regulations that forbid "anti-competitive" behavior, such as contract terms that restrict customers' freedom of choice, or cutting prices below cost to drive rivals out of business and deter new entrants. Nevertheless, there is much scope to make life difficult for competitors in ways that are not illegal. These can be understood by considering an industry-level picture of how competitive conditions change over time.

In Figure 5.27, the left-hand column displays the fragmentation of an industry by showing how its total revenue is accounted for by stacking up the revenue of each competitor. The industry's growth is attracting new competitors. In the scenario on the left, our own business grows little, both because those new entrants absorb the industry's growth and because we are less successful than some of the original competitors in driving our own growth. The implications of the competitive-forces view are, first, that these changes make it harder to sustain prices and second, that cost efficiency improvements are competed away by still greater pressure on prices.

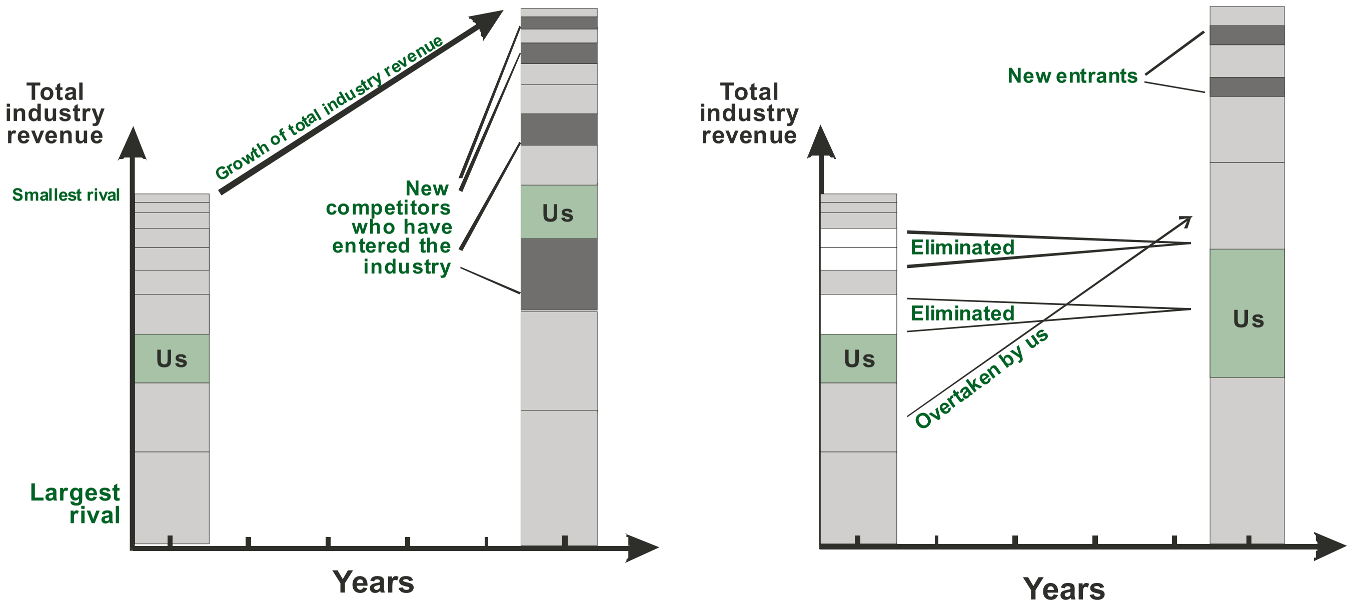

Figure 5.27: Alternative dynamics of the competitive structure of a growing market.

Sample extract form Competitive Strategy Dynamics, (c) Kim Warren, (c). Pub John Wiley & Sons ISBN 978-0-470-06067-4

Average profitability therefore suffers, and we suffer more from this process than others who develop more successfully. Importantly, there is no assumption that either new entrants or the original competitors are positively profitable at all. Indeed, the first situation illustrated in Figure 5.27 could well result in many firms, or even the industry as a whole, being unprofitable for many years. From this scenario arises the suggestion that we, as original participants in the industry, would benefit if we could "deter" new entrants.

The scenario on the right depicts the same overall industry growth, but this time with fewer new entrants. In addition, some of the original competitors have exited the industry, leaving more space for us and the remaining firms to grow. Not only has this benefited our growth, but it (1) reduces the tendency amongst the smaller number of firms to compete away prices and margins in a desperate attempt to capture increasing sales; and (2) enables remaining firms to extract efficiency savings more quickly. Finally, we have been more successful in developing our own business and overtaken the previous number two competitor.

This has an important implication for competitive strategy, namely that it is valuable to select and act against *specific* competitors, rather than trying simply to be better than everyone across the market. The latter approach has several disadvantages.

- Taking on all competitors at once can be very costly. Any effort that is spread across the entire market has to be of a commensurate scale, so trying to underprice, outmarket, outsell, and outservice all competitors will inevitably incur considerable cost.
- Efforts dissipated across the whole industry will likely have less impact than efforts focused on specific parts of the market or against specific competitors.
- Such industry-wide competitive efforts will attract retaliation from all competitors, risking great damage to our own business.
- Our efforts will be highly visible, exacerbating the very competitive conditions that make it difficult to sustain profitability, for example by triggering price wars, escalating advertising commitments or starting a war for talent.

Taken together, these considerations mean that such indiscriminate competitive efforts simply don't work, or else take so long and at such great cost that the business pursuing them suffers along with all the others.

Selecting specific competitors to attack is more advisable than indiscriminate efforts, even to the extent of seeking their total elimination.

To select the most promising competitor to attack and identify how to do so requires a deep understanding of individual rivals. In their efforts to cut out unnecessary overheads, many companies lack the resources to build up even the most basic competitor intelligence. Given the value potentially at stake from even modest progress against rivals, this is a false economy.

A range of methods is available for competitor appraisal.[24] These involve assessing their strengths and weaknesses in some way—comparable to parts of the SWOT approach from Chapter 2 that management might use to assess its own business. Most such competitor analysis frameworks are qualitative and high-level, and quite inadequate for designing and implementing specific competitive campaigns. A more rigorous approach builds on two principles:

1. A competitor operating in our own industry will likely have both a similar set of resources and a similar architecture for organizing them to ourselves. Competitors may differ in which exact segments they serve, which exact set of products and services they offer, and so on, but the elements will be largely the same. Even where they differ (e.g. outsourcing certain activities that we do ourselves) many of the remaining parts of their resource system will be similar to our own.
2. Like us, a competitor will have a range of "quality" for each of its resources—larger and smaller customers, products that perform well and not so well, stronger and weaker sales people, and so on.

If we can understands how our own business performs, we should be able to evaluate the performance of any competitor—and therein lies the opportunity to damage that performance at little risk to ourselves.

To illustrate how this can be done, consider the real case of a mid-scale, mid-market restaurant chain, developing fast in a promising market, but number two to a long-established market leader. Although operating only 120 restaurants compared with the leader's 300+, it was generating nearly as much profit, due to a recent history of finding great locations and developing better products than the leader. With a good understanding of the profit contribution profile of its own restaurants, it was able to estimate the equivalent profile for the competitor (Figure 5.28).

Making this estimation of the competitor's performance was especially easy in this case—without resorting to illegal espionage! The profit of a restaurant is simply given by the revenue that comes from customer numbers and prices, minus its costs, which are dominated by numbers of staff and the ownership cost of the real estate. Prices are on the menu, customers can be counted, and their typical meal purchases can be observed. Staff numbers can be counted, and the costs of real estate are in the public domain. The resulting estimation was not exact, but close enough to know roughly how much profit was coming from each of the competitor's units.

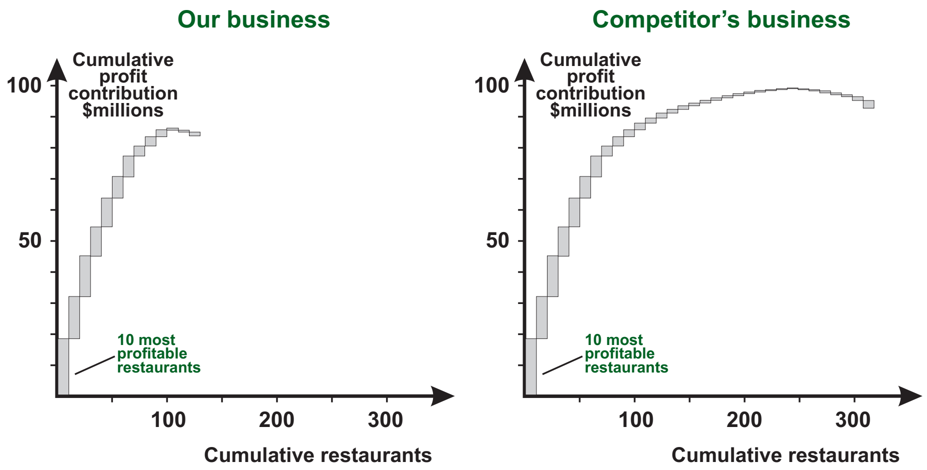

Figure 5.28: Comparable profit contribution curves for two mid-market restaurant chains.

Armed with this information, selecting the point of attack was relatively simple. Trying to damage their most profitable units would be difficult—they were clearly popular with their local consumers, were operated well, and received plenty of attention from headquarters' management. Any attack on these would certainly have been noticed, and vigorously defended.

Attacking unprofitable units was pointless, as the competitor would not be concerned or damaged by their loss. The appropriate targets were the restaurants contributing profits in the mid-range. A random selection of these moderately profitable units consisted of individual locations that were geographically dispersed and supervised by different regional managers within the competitor's management structure. Consequently, attacks on this random selection were not noticed, provided that the tactics were subtle. So what should those tactics be, bearing in mind that they are *local*; that is, conducted by specific units in our business against neighbouring units of the competitor?

- Most importantly, the tactics should *not* be led by price cuts. Price reductions significant enough to be noticed by customers hit profit margins hard. They must also be promoted to consumers if they are to work, which would make them highly visible to the competitor.
- Promotions that offer extra value for customers are less costly, and more difficult to retaliate against. Those promotions were not blanketed across the locality served by each of the attacker's units, but were selectively targeted at specific neighbourhoods from which the competing restaurant drew its customers.

- The next principle is to address every item on consumers' value curve—service quality, the environment and product quality. The local tactics therefore included ensuring that restaurants were oversupplied with staff, that the best food preparation staff were deployed and that the quality and maintenance of the customer environment were as good as possible.
- Finally, the units leading the attack were allocated the best unit managers—those who were most skilled at motivating staff, at ensuring high quality of product and service, and at befriending customers.

Taken together, these tactics took away a substantial proportion of the revenue from the competitor's units that were targeted, at which point their own policies started to act against them. With lower revenue, their management tried to sustain profits by cutting costs, especially staffing levels, which further damaged consumers' experience. With the targeted restaurants becoming rather quiet, they became increasingly unappealing and lost still more consumers. Eventually, the targeted units moved into losses or marginal profits, following which they were neglected by management until they were closed.

Repeating these tactics across a selection of mid-profit outlets inflicted disproportionate damage to the competitor's overall profits. In Figure 5.29, eliminating the profitability of just 11 units hits the competitor's profits by 12%, a process that could be accomplished in as little as six months. Repeating this principle over 2–3 years, dealing in all with 70–80 of the competitor's units did such damage that they started to experience further problems.

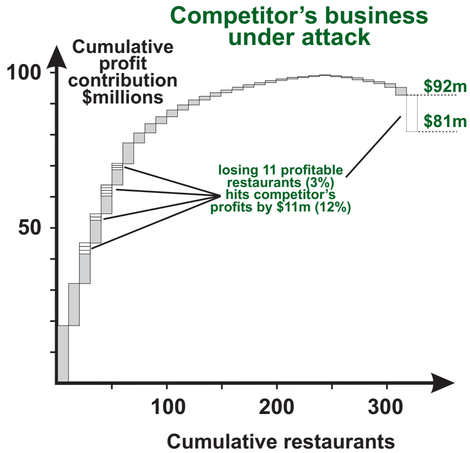

Figure 5.29: Targeting selected units does disproportionate damage to a restaurant competitor's profits.

- The pressure to sustain profits drove them into system-wide policies that did further damage, such as price discounting and cuts in staffing, marketing budgets, product development and maintenance, all of which undermined critical resources in their strategic architecture.
- The competitor's management started to lose motivation and commitment, and many left for better opportunities—often with the attacker!
- The confidence of investors was damaged—in this particular case, the business was one of several similar operations operated by the competitor's corporate owners—so requests for capital were turned down, making it impossible for the rival to match the high quality new units that we were being added to the aggressor's business.

In this case, the competitor left the industry after just a few years of the competitive strategy being implemented, selling most of its remaining viable restaurants to the one-time number two, who was left with a dominant position.

The general conclusion that can be drawn from this example is that:

It is often possible and valuable to understands the quality profile of competitors' businesses as the basis for focused attack.

Not all situations make it so simple for management to develop focused competitive tactics. More commonly, it is necessary to learn about the competitor's source of profitability from customers, rather than from distribution outlets as in the restaurant case.

The business banking division of a major bank did not know which competitors were making how much profit from which customers. However, the bank knew from its own experience the likely value of the banking services for any customer of any size in any sector. It could then make a reasonable estimate of the profit a competitor might be receiving from a similar customer of a similar size in the same sector. From this initial estimate, management could make adjustments if they had reason to believe for example that the competitor made better margins or had some cost disadvantage. The bank's customer-relationship managers were also able, over a period, to approach customers with whom they did not deal and find out which bank provided its services.

Other considerations in such targeted competitive strategies include:

- *Choosing which competitor offers the best target.* Small rivals are not necessarily easy to take on, and in any case may offer little benefit from being defeated. On the other hand, bigger stronger competitors can have powerful resources to defend with or retaliate. Often it can be best to choose a mid-ranking rival, but the key criteria should be (1) that their defeat offers a significant improvement to competitive conditions overall and (2) that a tactical campaign can be devised that is feasible and minimizes the risk of retaliation. In another restaurant industry case, a new competitor tried taking on McDonalds in an important country market. They were destroyed in just 18 months by very similar tactics to those described above—the only difference being that all their units were attacked at once. The original plan was never feasible, and a waste of time and money.

- *Deciding whether to be open or covert about the attack.* In the restaurant case, secrecy was important because, had the competitor been aware of the plan, it could have looked out for those units that were under attack and responded locally with sufficient effort to prevent the loss of business. With the covert and seemingly random scatter of attacks it simply appeared that once-successful units were gradually failing for no apparent cause other than generally disappointing performance in the market. In the business banking case, it was also important that the plan not be disclosed, because the target of the attack was of comparable size and power to the attacker. In other cases, it can be appropriate to be open about the attack if it helps the competitor decide early on to admit defeat and withdraw.
- *Choosing which resources to use as the basis for a competitive attack.* The quality curve can sometimes be constructed, for example, for the profit contribution a competitor enjoys from the individual products in its product range. The attack can then focus on products that are weak, even though they contribute significantly to the competitor's performance—perhaps a product that is becoming obsolete or that is poorly supported. In the car industry, US manufacturers have repeatedly been picked off by European and Japanese producers who offered superior models in product segments that were seen as secondary, such as compact cars, performance saloons and hybrid vehicles. The result was, as management pundit Tom Peters has remarked, that the US auto industry has been "nibbled to death," piece by piece over four decades.
- *Deciding on the effort to devote to deterring new entrants.* At the time of the warfare described above in the restaurant market, several would-be competitors had announced development plans that in total would have added over 700 new units in the market over five years. These plans were encouraged by the market's growth, and by the winning company's very success. Had that number of units actually been opened, virtually all of those competitors would have

lost money and failed, and done considerable damage to the eventual victor. Too many firms thought that running restaurant chains was easy, not understanding the complexity of product development, staff training, operating procedures, sourcing and logistics, and real-estate development. Open communications were used, such as industry magazines and conferences, to clarify the difficulty of building a successful business and demonstrate just how powerful was the winner's system of resources. The implicit message was "Sure, we are successful, but do not for a minute imagine you can match us—and be sure that we will destroy you if you try!" On reflection, many of the would-be entrants decided that the challenge looked just too difficult, and abandoned their plans. Less than half of the announced new units were ever opened.

It is worth emphasizing once more that:

It is vital in competitive battles to observe legal prohibitions on anticompetitive behavior.

Competition regulators in general believe that larger numbers of competitors inevitably improve conditions for customers by driving down prices and driving up quality and service.[25] Whilst this is debatable—the pressure to drive down prices can make it impossible for competitors to invest in improved products and service quality, and with large numbers of small competitors it is impossible for any to obtain the benefits of scale and learning that drive down costs—it does mean that regulators strongly favor removal of entry barriers and disapprove of attacks on specific competitors. Nevertheless, there is much that can be done without falling foul of such legal constraints. There is nothing illegal about a company choosing where to direct its sales effort, which products to promote or how to allocate its customer support.

INCORPORATING ATTRIBUTE ANALYSIS IN STRATEGY DEVELOPMENT

Chapter 4 showed a number of examples of generic architectures for firms in certain industries—for example, fast-moving consumer products, airlines, vehicle manufacturers, professional firms, insurance companies and media companies. All these architectures have the advantage of capturing, on a single page, the