Strategic Management

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Competitive Force

A note from David and Whellan

Collecting and evaluating information on competitors is essential for successful strategy formulation. Identifying major competitors is not always easy because many firms have divisions that compete in different industries. Many multidivisional firms do not provide sales and profit information on a divisional basis for competitive reasons. Also, privately held firms do not publish any financial or marketing information. Addressing questions about competitors such as those presented in Table below is important in performing an external audit.

Key Questions About Competitors

1. What are the major competitors' strengths?
2. What are the major competitors' weaknesses?
3. What are the major competitors' objectives and strategies?
4. How will the major competitors most likely respond to current economic, social, cultural, demographic, environmental, political, governmental, legal, technological, and competitive trends affecting our industry?
5. How vulnerable are the major competitors to our alternative company strategies?
6. How vulnerable are our alternative strategies to successful counterattack by our major competitors?
7. How are our products or services positioned relative to major competitors?
8. To what extent are new firms entering and old firms leaving this industry?
9. What key factors have resulted in our present competitive position in this industry?
10. How have the sales and profit rankings of major competitors in the industry changed over recent years? Why have these rankings changed that way?
11. What is the nature of supplier and distributor relationships in this industry?
12. To what extent could substitute products or services be a threat to competitors in this industry?

Competition in virtually all industries can be described as intense—and sometimes as cutthroat. For example, Walgreens and CVS pharmacies are located generally across the street from each other and battle each other every day on price and customer service. Most automobile dealerships also are located close to each other. Dollar General, based in Goodlettsville, Tennessee, and Family Dollar, based in Matthews, North Carolina, compete intensely on price to attract customers. Best Buy dropped prices wherever possible to finally put Circuit City totally out of business.

Seven characteristics describe the most competitive companies:

1. Market share matters; the 90th share point isn't as important as the 91st, and nothing is more dangerous than falling to 89.
2. Understand and remember precisely what business you are in.
3. Whether it's broke or not, fix it—make it better; not just products, but the whole company, if necessary.
4. Innovate or evaporate; particularly in technology-driven businesses, nothing quite recedes like success.
5. Acquisition is essential to growth; the most successful purchases are in niches that add a technology or a related market.
6. People make a difference; tired of hearing it? Too bad.
7. There is no substitute for quality and no greater threat than failing to be cost-competitive on a global basis.

Competitive Intelligence Programs

What is competitive intelligence? Competitive intelligence (CI), as formally defined by the Society of Competitive Intelligence Professionals (SCIP), is a systematic and ethical process for gathering and analyzing information about the competition's activities and general business trends to further a business's own goals (SCIP Web site).

Good competitive intelligence in business, as in the military, is one of the keys to success. The more information and knowledge a firm can obtain about its competitors, the more likely it is that it can formulate and implement effective strategies. Major competitors' weaknesses can represent external opportunities; major competitors' strengths may represent key threats.

In April 2009, Starwood Hotels & Resorts Worldwide sued Hilton Hotels Corp. for allegedly stealing more than 100,000 confidential electronic and paper documents containing "Starwood's most competitively sensitive information." The complaint alleges that two Starwood executives, Ross Klein and Amar Lalvani, resigned from Starwood to join Hilton and took this information with them. The legal complaint says, "This is the clearest imaginable case of corporate espionage, theft of trade secrets, unfair competition and computer fraud." In addition to monetary awards, Starwood is seeking to force Hilton to cancel the rollout of the Denizen hotel chain. Hilton is owned by Blackstone Group.

Hiring top executives from rival firms is also a way companies obtain competitive intelligence. Just two days after Facebook's COO, Owen Van Natta, left the company in 2009, he accepted the CEO job at MySpace, replacing then CEO and cofounder Chris DeWolfe. Van Natta had previously also been Facebook's COO, chief revenue officer, and vice president of operations. The MySpace appointment now pits CEO Van Natta against his old boss at Facebook, CEO Mark Zuckerberg. Facebook passed MySpace in visitors worldwide in 2008 and is closing in on leadership in the United States. Both firms are fierce rivals in the Internet social-networking business.

A recent article in the Wall Street Journal detailed how computer spies recently broke into the Pentagon's $300 billion Joint Strike fighter project, one of the costliest weapons programs ever. This intrusion and similar episodes of late have confirmed that any information a firm has available to anyone within the firm online may be at risk of being copied and/or siphoned away by adversaries or rival firms. A recent Pentagon report says the Chinese military in particular has made "steady progress" in developing online-warfare techniques, but rival firms in many industries have expert computer engineers who may be capable of similar unethical/unlawful tactics.

Many U.S. executives grew up in times when U.S. firms dominated foreign competitors so much that gathering competitive intelligence did not seem worth the effort. Too many of these executives still cling to these attitudes—to the detriment of their organizations today. Even most MBA programs do not offer a course in competitive and business intelligence, thus reinforcing this attitude. As a consequence, three strong misperceptions about business intelligence prevail among U.S. executives today:

1. Running an intelligence program requires lots of people, computers, and other resources.
2. Collecting intelligence about competitors violates antitrust laws; business intelligence equals espionage.
3. Intelligence gathering is an unethical business practice.

Any discussions with a competitor about price, market, or geography intentions could violate antitrust statutes. However, this fact must not lure a firm into underestimating the need for and benefits of systematically collecting information about competitors for Strategic Planning purposes. The Internet has become an excellent medium for gathering competitive intelligence. Information gathering from employees, managers, suppliers, distributors, customers, creditors, and consultants also can make the difference between having superior or just average intelligence and overall competitiveness.

Firms need an effective competitive intelligence (CI) program. The three basic objectives of a CI program are (1) to provide a general understanding of an industry and its competitors, (2) to identify areas in which competitors are vulnerable and to assess the impact strategic actions would have on competitors, and (3) to identify potential moves that a competitor might make that would endanger a firm's position in the market. Competitive information is equally applicable for strategy formulation, implementation, and evaluation decisions. An effective CI program allows all areas of a firm to access consistent and verifiable information in making decisions. All members of an organizationfrom the chief executive officer to custodians—are valuable intelligence agents and should feel themselves to be a part of the CI process. Special characteristics of a successful CI program include flexibility, usefulness, timeliness, and cross-functional cooperation.

The increasing emphasis on competitive analysis in the United States is evidenced by corporations putting this function on their organizational charts under job titles such as Director of Competitive Analysis, Competitive Strategy Manager, Director of Information Services, or Associate Director of Competitive Assessment. The responsibilities of a director of competitive analysis include planning, collecting data, analyzing data, facilitating the process of gathering and analyzing data, disseminating intelligence on a timely basis, researching special issues, and recognizing what information is important and who needs to know. Competitive intelligence is not corporate espionage because 95 percent of the information a company needs to make strategic decisions is available and accessible to the public. Sources of competitive information include trade journals, want ads, newspaper articles, and government filings, as well as customers, suppliers, distributors, competitors themselves, and the Internet.

Unethical tactics such as bribery, wiretapping, and computer break-ins should never be used to obtain information. Marriott and Motorola—two U.S. companies that do a particularly good job of gathering competitive intelligence—agree that all the information you could wish for can be collected without resorting to unethical tactics. They keep their intelligence staffs small, usually under five people, and spend less than $200,000 per year on gathering competitive intelligence.
Unilever recently sued Procter & Gamble (P&G) over that company's corporate-espionage activities to obtain the secrets of its Unilever hair-care business. After spending $3 million to establish a team to find out about competitors in the domestic hair-care industry, P&G allegedly took roughly 80 documents from garbage bins outside Unilever's Chicago offices. P&G produces Pantene and Head & Shoulders shampoos; Unilever has hair-care brands such as ThermaSilk, Suave, Salon Selectives, and Finesse. Similarly, Oracle Corp. recently admitted that detectives it hired paid janitors to go through Microsoft Corp.'s garbage, looking for evidence to use in court.

Much external environmental scanning is done on an informal and individual basis. Information is obtained from a variety of sources—suppliers, customers, industry publications, employees, industry experts, industry conferences, and the Internet. For example, scientists and engineers working in a firm's R&D lab can learn about new products and competitors' ideas at professional meetings; someone from the purchasing department, speaking with supplier-representatives' personnel, may also uncover valuable bits of information about a competitor. A study of product innovation found that 77% of all product innovations in scientific instruments and 67% in semiconductors and printed circuit boards were initiated by the customer in the form of inquiries and complaints. In these industries, the sales force and service departments must be especially vigilant.

A recent survey of global executives by McKinsey & Company found that the single factor contributing most to the increasing competitive intensity in their industries was the improved capabilities of competitors. Yet, without competitive intelligence, companies run the risk of flying blind in the marketplace. In a 2008 survey of global executives, the majority revealed that their companies typically learned about a competitor's price change or significant innovation too late to respond before it was introduced into the market. According to work by Ryall, firms can have competitive advantages simply because their rivals have erroneous beliefs about them. This is why competitive intelligence has become an important part of environmental scanning in most companies.

Competitive intelligence is a formal program of gathering information on a company's competitors. Often called business intelligence, it is one of the fastest growing fields within strategic management. Research indicates that there is a strong association between corporate performance and competitive intelligence activities. 68 According to a survey of competitive intelligence professionals, the primary reasons for practicing competitive intelligence are to build industry awareness (90.6%), support the strategic planning process (79.2%), develop new products

(73.6%), and create new marketing strategies and tactics. As early as the 1990s, 78% of large U.S. corporations conducted competitive intelligence activities. In about a third of the firms, the competitive/business intelligence function is housed in its own unit, with the remainder being housed within marketing, strategic planning, information services, business development (merger & acquisitions), product development, or other units. According to a 2007 survey of 141 large American corporations, spending on competitive intelligence activities was rising from $1 billion in 2007 to $10 billion by 2012. At General Mills, for example, all employees have been trained to recognize and tap sources of competitive information. Janitors no longer simply place orders with suppliers of cleaning materials; they also ask about relevant practices at competing firms!

Source of Competitive Intellegence

Most corporations use outside organizations to provide them with environmental data. Firms such as A. C. Nielsen Co. provide subscribers with bimonthly data on brand share, retail prices, percentages of stores stocking an item, and percentages of stock-out stores. Strategists can use this data to spot regional and national trends as well as to assess market share. Information on market conditions, government regulations, industry competitors, and new products can be bought from "information brokers" such as Market Research.com (Findex), LexisNexis (company and country analyses), and Finsbury Data Services. Company and industry profiles are generally available from the Hoover's Web site, at www.hoovers.com. Many business corporations have established their own in-house libraries and computerized information systems to deal with the growing mass of available information.

The Internet has changed the way strategists engage in environmental scanning. It provides the quickest means to obtain data on almost any subject. Although the scope and quality of Internet information is increasing geometrically, it is also littered with "noise," misinformation, and utter nonsense. For example, a number of corporate Web sites are sending unwanted guests to specially constructed bogus Web sites. Unlike the library, the Internet lacks the tight bibliographic control standards that exist in the print world. There is no ISBN or Dewey Decimal System to identify, search, and retrieve a document. Many Web documents lack the name of the author and the date of publication. A Web page providing useful information may be accessible on the Web one day and gone the next. Unhappy ex-employees, far-out environmentalists, and prank-prone hackers create "blog" Web sites to attack and discredit an otherwise reputable corporation. Rumors with no basis in fact are spread via chat rooms and personal Web sites. This creates a serious problem for researchers. How can one evaluate the information found on the Internet?

Some companies choose to use industrial espionage or other intelligence-gathering techniques to get their information straight from their competitors. According to a survey by the American Society for Industrial Security, PricewaterhouseCoopers, and the United States Chamber of Commerce, Fortune 1000 companies lost an estimated $59 billion in one year alone due to the theft of trade secrets. 74 By using current or former competitors' employees and private contractors, some firms attempt to steal trade secrets, technology, business plans, and pricing strategies. For example, Avon Products hired private investigators to retrieve from a public dumpster documents (some of them shredded) that Mary Kay Corporation had thrown away. Oracle Corporation also hired detectives to obtain the trash of a think tank that had defended the pricing practices of its rival Microsoft. Studies reveal that 32% of the trash typically found next to copy machines contains confidential company data, in addition to personal data (29%) and gossip (39%). 75 Even P&G, which defends itself like a fortress from information leaks, is vulnerable. A competitor was able to learn the precise launch date of a concentrated laundry detergent in Europe when one of its people visited the factory where machinery was being made. Simply asking a few questions about what a certain machine did, whom it was for, and when it would be delivered was all that was necessary.

Some of the firms providing investigatory services are Kroll Inc. with 4,000 employees in 25 countries, Fairfax, Security Outsourcing Solutions, Trident Group, and Diligence Inc. 76 Trident, for example, specializes in helping American companies enter the Russian market and is a U.S.-based corporate intelligence firm founded and managed by former veterans of Russian intelligence services, like the KGB.

To combat the increasing theft of company secrets, the United States government passed the Economic Espionage Act in 1996. The law makes it illegal (with fines up to $5 million and 10 years in jail) to steal any material that a business has taken "reasonable efforts" to keep secret and that derives its value from not being known. 78 The Society of Competitive Intelligence Professionals (www.scip.org) urges strategists to stay within the law and to act ethically when searching for information. The society states that illegal activities are foolish because the vast majority of worthwhile competitive intelligence is available publicly via annual reports, Web sites, and libraries. Unfortunately, a number of firms hire "kites," consultants with questionable reputations, who do what is necessary to get information when the selected methods do not meet SPIC ethical standards or are illegal. This allows the company that initiated the action to deny that it did anything wrong.

Monitoring Competitors for Strategic Planning

The primary activity of a competitive intelligence unit is to monitor competitors—organizations that offer same, similar, or substitutable products or services in the business area in which a particular company operates. To understand a competitor, it is important to answer the following 10 questions:

1. Why do your competitors exist? Do they exist to make profits or just to support another unit?
2. Where do they add customer value—higher quality, lower price, excellent credit terms, or better service?
3. Which of your customers are the competitors most interested in? Are they cherry-picking your best customers, picking the ones you don't want, or going after all of them?
4. What is their cost base and liquidity? How much cash do they have? How do they get their supplies?
5. Are they less exposed with their suppliers than your firm? Are their suppliers better than yours?
6. What do they intend to do in the future? Do they have a strategic plan to target your market segments? How committed are they to growth? Are there any succession issues?
7. How will their activity affect your strategies? Should you adjust your plans and operations?
8. How much better than your competitor do you need to be in order to win customers? Do either of you have a competitive advantage in the marketplace?

9. Will new competitors or new ways of doing things appear over the next few years? Who is a potential new entrant?
10. If you were a customer, would you choose your product over those offered by your competitors? What irritates your current customers? What competitors solve these particular customer complaints?

To answer these and other questions, competitive intelligence professionals utilize a number of analytical techniques. In addition to the previously discussed SWOT analysis, Michael Porter's industry forces analysis, and strategic group analysis, some of these techniques are Porter's four-corner exercise, Treacy and Wiersema's value disciplines, Gilad's blind spot analysis, and war gaming.

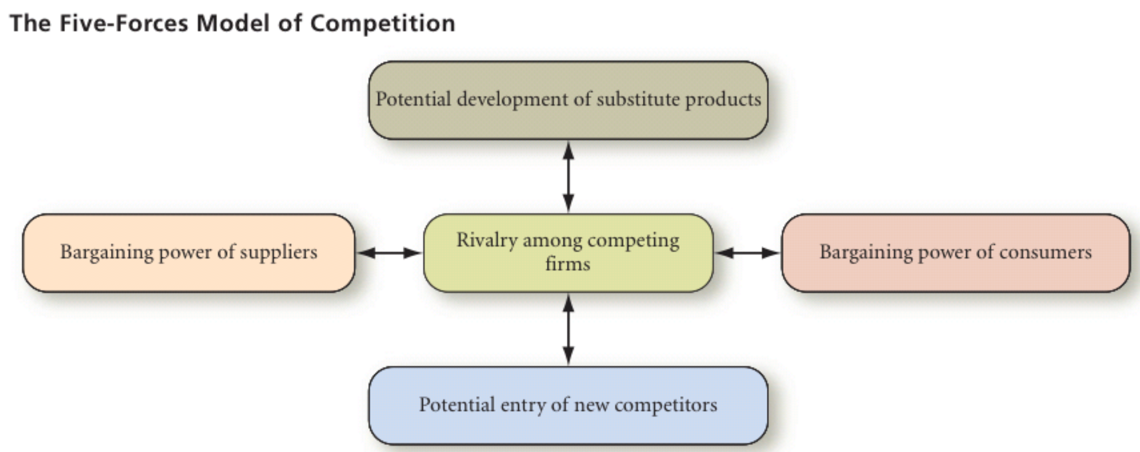
Done right, competitive intelligence is a key input to strategic planning. Avnet Inc., one of the world's largest distributors of electronic components, uses competitive intelligence in its growth by acquisition strategy.

Market Commonality and Resource Similarity

By definition, competitors are firms that offer similar products and services in the same market. Markets can be geographic or product areas or segments. For example, in the insurance industry the markets are broken down into commercial/consumer, health/life, or Europe/Asia. Researchers use the terms market commonality and resource similarity to study rivalry among competitors. Market commonality can be defined as the number and significance of markets that a firm competes in with rivals. Resource similarity is the extent to which the type and amount of a firm's internal resources are comparable to a rival. One way to analyze competitiveness between two or among several firms is to investigate market commonality and resource similarity issues while looking for areas of potential competitive advantage along each firm's value chain.

Competitive Analysis: Porter's Five-Forces Model

As illustrated in Figure below, Porter's Five-Forces Model of competitive analysis is a widely used approach for developing strategies in many industries. The intensity of competition among firms varies widely across industries.



According to Porter, the nature of competitiveness in a given industry can be viewed as a composite of five forces:

1. Rivalry among competing firms
2. Potential entry of new competitors
3. Potential development of substitute products
4. Bargaining power of suppliers
5. Bargaining power of consumers

The following three steps for using Porter's Five-Forces Model can indicate whether competition in a given industry is such that the firm can make an acceptable profit:

1. Identify key aspects or elements of each competitive force that impact the firm.
2. Evaluate how strong and important each element is for the firm.
3. Decide whether the collective strength of the elements is worth the firm entering or staying in the industry.

Rivalry Among Competing Firms

Rivalry among competing firms is usually the most powerful of the five competitive forces. The strategies pursued by one firm can be successful only to the extent that they provide competitive advantage over the strategies pursued by rival firms. Changes in strategy by one firm may be met with retaliatory countermoves, such as lowering prices, enhancing quality, adding features, providing services, extending warranties, and increasing advertising.

Free-flowing information on the Internet is driving down prices and inflation worldwide. The Internet, coupled with the common currency in Europe, enables consumers to make price comparisons easily across countries. Just for a moment, consider the implications for car dealers who used to know everything about a new car's pricing, while you, the consumer, knew very little. You could bargain, but being in the dark, you rarely could win. Now you can shop online in a few hours at every dealership within 500 miles to find the best price and terms. So you, the consumer, can win. This is true in many, if not most, business-to-consumer and business-to-business sales transactions today.

The intensity of rivalry among competing firms tends to increase as the number of competitors increases, as competitors become more equal in size and capability, as demand for the industry's products declines, and as price cutting becomes common. Rivalry also increases when consumers can switch brands easily; when barriers to leaving the market are high; when fixed costs are high; when the product is perishable; when consumer demand is growing slowly or declines such that rivals have excess capacity and/or inventory; when the products being sold are commodities (not easily differentiated such as gasoline); when rival firms are diverse in strategies, origins, and culture; and when mergers and acquisitions are common in the industry. As rivalry among competing firms intensifies, industry profits decline, in some cases to the point where an industry becomes inherently unattractive. When rival firms sense weakness, typically they will intensify both marketing and production efforts to capitalize on the "opportunity." Table below summarizes conditions that cause high rivalry among competing firms.

TABLE 3-11 Conditions That Cause High Rivalry Among Competing Firms

1. High number of competing firms
2. Similar size of firms competing
3. Similar capability of firms competing
4. Falling demand for the industry's products
5. Falling product/service prices in the industry
6. When consumers can switch brands easily
7. When barriers to leaving the market are high
8. When barriers to entering the market are low
9. When fixed costs are high among firms competing
10. When the product is perishable
11. When rivals have excess capacity
12. When consumer demand is falling
13. When rivals have excess inventory
14. When rivals sell similar products/services
15. When mergers are common in the industry

Potential Entry of New Competitors

Whenever new firms can easily enter a particular industry, the intensity of competitiveness among firms increases. Barriers to entry, however, can include the need to gain economies of scale quickly, the need to gain technology and specialized know-how, the lack of experience, strong customer loyalty, strong brand preferences, large capital requirements, lack of adequate distribution channels, government regulatory policies, tariffs, lack of access to raw materials, possession of patents, undesirable locations, counterattack by entrenched firms, and potential saturation of the market.

Despite numerous barriers to entry, new firms sometimes enter industries with higher-quality products, lower prices, and substantial marketing resources. The strategist's job, therefore, is to identify potential new firms entering the market, to monitor the new rival firms' strategies, to counterattack as needed, and to capitalize on existing strengths and opportunities. When the threat of new firms entering the market is strong, incumbent firms generally fortify their positions and take actions to deter new entrants, such as lowering prices, extending warranties, adding features, or offering financing specials.

Potential Development of Substitute Products

In many industries, firms are in close competition with producers of substitute products in other industries. Examples are plastic container producers competing with glass, paperboard, and aluminum can producers, and acetaminophen manufacturers competing with other manufacturers of pain and headache remedies. The presence of substitute products puts a ceiling on the price that can be charged before consumers will switch to the substitute product. Price ceilings equate to profit ceilings and more intense competition among rivals. Producers of eyeglasses and contact lenses, for example, face increasing competitive pressures from laser eye surgery. Producers of sugar face similar pressures from artificial sweeteners. Newspapers and magazines face substitute-product competitive pressures from the Internet and 24-hour cable television. The magnitude of competitive pressure derived from development of substitute products is generally evidenced by rivals' plans for expanding production capacity, as well as by their sales and profit growth numbers.

Competitive pressures arising from substitute products increase as the relative price of substitute products declines and as consumers' switching costs decrease. The competitive strength of substitute products is best measured by the inroads into the market share those products obtain, as well as those firms' plans for increased capacity and market penetration.

Bargaining Power of Suppliers

The bargaining power of suppliers affects the intensity of competition in an industry, especially when there is a large number of suppliers, when there are only a few good substitute raw materials, or when the cost of switching raw materials is especially costly. It is often in the best interest of both suppliers and producers to assist each other with reasonable prices, improved quality, development of new services, just-in-time deliveries, and reduced inventory costs, thus enhancing long-term profitability for all concerned.

Firms may pursue a backward integration strategy to gain control or ownership of suppliers. This strategy is especially effective when suppliers are unreliable, too costly, or not capable of meeting a firm's needs on a consistent basis. Firms generally can negotiate more favorable terms with suppliers when backward integration is a commonly used strategy among rival firms in an industry.

However, in many industries it is more economical to use outside suppliers of component parts than to self-manufacture the items. This is true, for example, in the outdoor power equipment industry where producers of lawn mowers, rotary tillers, leaf blowers, and edgers such as Murray generally obtain their small engines from outside manufacturers such as Briggs & Stratton who specialize in such engines and have huge economies of scale.

In more and more industries, sellers are forging strategic partnerships with select suppliers in efforts to (1) reduce inventory and logistics costs (e.g., through just-in-time deliveries); (2) speed the availability of next-generation components; (3) enhance the quality of the parts and components being supplied and reduce defect rates; and (4) squeeze out important cost savings for both themselves and their suppliers.

Bargaining Power of Consumers

When customers are concentrated or large or buy in volume, their bargaining power represents a major force affecting the intensity of competition in an industry. Rival firms may offer extended warranties or special services to gain customer loyalty whenever the bargaining power of consumers is substantial. Bargaining power of consumers also is higher when the products being purchased are standard or undifferentiated. When this is the case, consumers often can negotiate selling price, warranty coverage, and accessory packages to a greater extent.

The bargaining power of consumers can be the most important force affecting competitive advantage. Consumers gain increasing bargaining power under the following circumstances:

1. If they can inexpensively switch to competing brands or substitutes
2. If they are particularly important to the seller
3. If sellers are struggling in the face of falling consumer demand
4. If they are informed about sellers' products, prices, and costs
5. If they have discretion in whether and when they purchase the product

Sources of External Information

A wealth of strategic information is available to organizations from both published and unpublished sources. Unpublished sources include customer surveys, market research, speeches at professional and shareholders' meetings, television programs, interviews, and conversations with stakeholders. Published sources of strategic information include periodicals, journals, reports, government documents, abstracts, books, directories, newspapers, and manuals. The Internet has made it easier for firms to gather, assimilate, and evaluate information.

There are many excellent Web sites for gathering strategic information, but six that the author uses routinely are listed here:

1. http://marketwatch.multexinvestor.com
2. http://moneycentral.msn.com
3. http://finance.yahoo.com
4. www.clearstation.com
5. https://us.etrade.com/e/t/invest/markets
6. www.hoovers.com

Most college libraries subscribe to Standard & Poor's (S&P's) Industry Surveys. These documents are exceptionally up-to-date and give valuable information about many different industries. Each report is authored by a Standard & Poor's industry research analyst and includes the following sections:

1. Current Environment
2. Industry Trends
3. How the Industry Operates
4. Key Industry Ratios and Statistics
5. How to Analyze a Company
6. Glossary of Industry Terms
7. Additional Industry Information
8. References
9. Comparative Company Financial Analysis

Forecasting Tools and Techniques

Forecasts are educated assumptions about future trends and events. Forecasting is a complex activity because of factors such as technological innovation, cultural changes, new products, improved services, stronger competitors, shifts in government priorities, changing social values, unstable economic conditions, and unforeseen events. Managers often must rely on published forecasts to effectively identify key external opportunities and threats.

A sense of the future permeates all action and underlies every decision a person makes. People eat expecting to be satisfied and nourished in the future. People sleep assuming that in the future they will feel rested. They invest energy, money, and time because they believe their efforts will be rewarded in the future. They build highways assuming that automobiles and trucks will need them in the future. Parents educate children on the basis of forecasts that they will need certain skills, attitudes, and knowledge when they grow up. The truth is we all make implicit forecasts throughout our daily lives. The question, therefore, is not whether we should forecast but rather how we can best forecast to enable us to move beyond our ordinarily unarticulated assumptions about the future. Can we obtain information and then make educated assumptions (forecasts) to better guide our current decisions to achieve a more desirable future state of affairs? We should go into the future with our eyes and our minds open, rather than stumble into the future with our eyes closed.

Many publications and sources on the Internet forecast external variables. Several published examples include Industry Week's "Trends and Forecasts," BusinessWeek's "Investment Outlook," and Standard & Poor's Industry Survey. The reputation and continued success of these publications depend partly on accurate forecasts, so published sources of information can offer excellent projections. An especially good Web site for industry forecasts is finance.yahoo.com. Just insert a firm's stock symbol and go from there.

Sometimes organizations must develop their own projections. Most organizations forecast (project) their own revenues and profits annually. Organizations sometimes forecast market share or customer loyalty in local areas. Because forecasting is so important in strategic management and because the ability to forecast (in contrast to the ability to use a forecast) is essential, selected forecasting tools are examined further here.

Forecasting tools can be broadly categorized into two groups: quantitative techniques and qualitative techniques. Quantitative forecasts are most appropriate when historical data are available and when the relationships among key variables are expected to remain the same in the future. Linear regression, for example, is based on the assumption that the future will be just like the past—which, of course, it never is. As historical relationships become less stable, quantitative forecasts become less accurate.

No forecast is perfect, and some forecasts are even wildly inaccurate. This fact accents the need for strategists to devote sufficient time and effort to study the underlying bases for published forecasts and to develop internal forecasts of their own. Key external opportunities and threats can be effectively identified only through good forecasts. Accurate forecasts can provide major competitive advantages for organizations. Forecasts are vital to the strategic-management process and to the success of organizations.

Making Assumptions

Planning would be impossible without assumptions. McConkey defines assumptions as the "best present estimates of the impact of major external factors, over which the manager has little if any control, but which may exert a significant impact on performance or the ability to achieve desired results." Strategists are faced with countless variables and imponderables that can be neither controlled nor predicted with 100 percent accuracy. Wild guesses should never be made in formulating strategies, but reasonable assumptions based on available information must always be made.

By identifying future occurrences that could have a major effect on the firm and by making reasonable assumptions about those factors, strategists can carry the strategic-management process forward. Assumptions are needed only for future trends and events that are most likely to have a significant effect on the company's business. Based on the best information at the time, assumptions serve as checkpoints on the validity of strategies. If future occurrences deviate significantly from assumptions, strategists know that corrective actions may be needed. Without reasonable assumptions, the strategy-formulation process could not proceed effectively. Firms that have the best information generally make the most accurate assumptions, which can lead to major competitive advantages.

Industry Evolution

Over time, most industries evolve through a series of stages from growth through maturity to eventual decline. The strength of each of the six forces mentioned earlier varies according to the stage of industry evolution. The industry life cycle is useful for explaining and predicting trends among the six forces that drive industry competition. For example, when an industry is new, people often buy the product, regardless of price, because it fulfills a unique need. This usually occurs in a fragmented industry—where no firm has large market share, and each firm serves only a small piece of the total market in competition with others (for example, cleaning services). As new competitors enter the industry, prices drop as a result of competition. Companies use the experience curve and economies of scale to reduce costs faster than the competition. Companies integrate to reduce costs even further by acquiring their suppliers and distributors. Competitors try to differentiate their products from one another's in order to avoid the fierce price competition common to a maturing industry.

By the time an industry enters maturity, products tend to become more like commodities. This is now a consolidated industry—dominated by a few large firms, each of which struggles to differentiate its products from those of the competition. As buyers become more sophisticated over time, purchasing decisions are based on better information. Price becomes a dominant concern, given a minimum level of quality and features, and profit margins decline. The automobile, petroleum, and major home appliance industries are examples of mature, consolidated industries each controlled by a few large competitors. In the case of the United States major home appliance industry, the industry changed from being a fragmented industry (pure competition) composed of hundreds of appliance manufacturers in the industry's early years to a consolidated industry (mature oligopoly) composed of three companies controlling over 90% of United States appliance sales. A similar consolidation is occurring now in European major home appliances.

As an industry moves through maturity toward possible decline, its products' growth rate of sales slows and may even begin to decrease. To the extent that exit barriers are low, firms begin converting their facilities to alternate uses or sell them to other firms. The industry tends to consolidate around fewer but larger competitors. The tobacco industry is an example of an industry currently in decline.

Categorizing International Industries

According to Porter, world industries vary on a continuum from multidomestic to global. Multidomestic industries are specific to each country or group of countries. This type of international industry is a collection of essentially domestic industries, such as retailing and insurance. The activities in a subsidiary of a multinational corporation (MNC) in this type of industry are essentially independent of the activities of the MNC's subsidiaries in other countries. Within each country, it has a manufacturing facility to produce goods for sale within that country. The MNC is thus able to tailor its products or services to the very specific needs of consumers in a particular country or group of countries having similar societal environments.

Global industries, in contrast, operate worldwide, with MNCs making only small adjustments for country-specific circumstances. In a global industry an MNC's activities in one country are significantly affected by its activities in other countries. MNCs in global industries produce products or services in various locations throughout the world and sell them, making only minor adjustments for specific country requirements. Examples of global industries are commercial aircraft, television sets, semiconductors, copiers, automobiles, watches, and tires. The largest industrial corporations in the world in terms of sales revenue are, for the most part, MNCs operating in global industries.

The factors that tend to determine whether an industry will be primarily multidomestic or primarily global are:

1. Pressure for coordination within the MNCs operating in that industry
2. Pressure for local responsiveness on the part of individual country markets

To the extent that the pressure for coordination is strong and the pressure for local responsiveness is weak for MNCs within a particular industry, that industry will tend to become global. In contrast, when the pressure for local responsiveness is strong and the pressure for coordination is weak for multinational corporations in an industry, that industry will tend to be multidomestic. Between these two extremes lie a number of industries with varying characteristics of both multidomestic and global industries. These are regional industries, in which MNCs primarily coordinate their activities within regions, such as the Americas or Asia. The major home appliance industry is a current example of a regional industry becoming a global industry. Japanese appliance makers, for example, are major competitors in Asia, but only minor players in Europe or America. The dynamic tension between the pressure for coordination and the pressure for local responsiveness is contained in the phrase, "Think globally but act locally."

International Risk Assessment

Some firms develop elaborate information networks and computerized systems to evaluate and rank investment risks. Small companies may hire outside consultants, such as Boston's Arthur D. Little Inc., to provide political-risk assessments. Among the many systems that exist to assess political and economic risks are the Business Environment Risk Index, the Economist Intelligence Unit, and Frost and Sullivan's World Political Risk Forecasts. The Economist Intelligence Unit, for example, provides a constant flow of analysis and forecasts on more than 200 countries and eight key industries. Regardless of the source of data, a firm must develop its own method of assessing risk. It must decide on its most important risk factors and then assign weights to each.

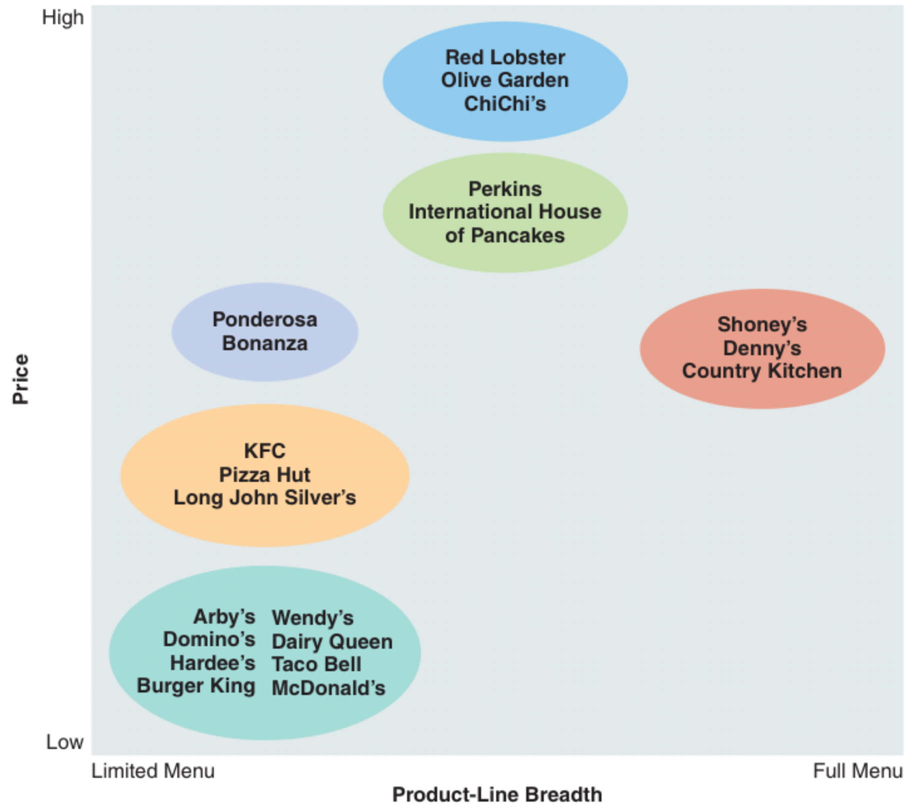
Strategic Groups

A strategic group is a set of business units or firms that "pursue similar strategies with similar resources." Categorizing firms in any one industry into a set of strategic groups is very useful as a way of better understanding the competitive environment. Research shows that some strategic groups in the same industry are more profitable than others. Because a corporation's structure and culture tend to reflect the kinds of strategies it follows, companies or business units belonging to a particular strategic group within the same industry tend to be strong rivals and tend to be more similar to each other than to competitors in other strategic groups within the same industry.

For example, although McDonald's and Olive Garden are a part of the same industry, the restaurant industry, they have different missions, objectives, and strategies, and thus they belong to different strategic groups. They generally have very little in common and pay little attention to each other when planning competitive actions. Burger King and Hardee's, however, have a great deal in common with McDonald's in terms of their similar strategy of producing a high volume of low-priced meals targeted for sale to the average family. Consequently, they are strong rivals and are organized to operate similarly.

Strategic groups in a particular industry can be mapped by plotting the market positions of industry competitors on a two-dimensional graph, using two strategic variables as the vertical and horizontal axes (See Figure below):

Mapping Strategic Groups in the U.S. Restaurant Chain Industry



1. Select two broad characteristics, such as price and menu, that differentiate the companies in an industry from one another.
2. Plot the firms, using these two characteristics as the dimensions.
3. Draw a circle around those companies that are closest to one another as one strategic group, varying the size of the circle in proportion to the group's share of total industry sales. (You could also name each strategic group in the restaurant industry with an identifying title, such as quick fast food or buffet-style service.)

Other dimensions, such as quality, service, location, or degree of vertical integration, could also be used in additional graphs of the restaurant industry to gain a better understanding of how the various firms in the industry compete. Keep in mind, however, that the two dimensions should not be highly correlated; otherwise, the circles on the map will simply lie along the diagonal, providing very little new information other than the obvious.

Strategic Types

In analyzing the level of competitive intensity within a particular industry or strategic group, it is useful to characterize the various competitors for predictive purposes. A strategic type is a category of firms based on a common strategic orientation and a combination of structure, culture, and processes consistent with that strategy. According to Miles and Snow, competing firms within a single industry can be categorized into one of four basic types on the basis of their general strategic orientation. This distinction helps explain why companies facing similar situations behave differently and why they continue to do so over long periods of time. These general types have the following characteristics:

1. Defenders are companies with a limited product line that focus on improving the efficiency of their existing operations. This cost orientation makes them unlikely to innovate in new areas. With its emphasis on efficiency, Lincoln Electric is an example of a defender.
2. Prospectors are companies with fairly broad product lines that focus on product innovation and market opportunities. This sales orientation makes them somewhat inefficient. They tend to emphasize creativity over efficiency. Rubbermaid's emphasis on new product development makes it an example of a prospector.
3. Analyzers are corporations that operate in at least two different product-market areas, one stable and one variable. In the stable areas, efficiency is emphasized. In the variable areas, innovation is emphasized. Multidivisional firms, such as IBM and Procter & Gamble, which operate in multiple industries, tend to be analyzers.
4. Reactors are corporations that lack a consistent strategy-structure-culture relationship. Their (often ineffective) responses to environmental pressures tend to be piecemeal strategic changes. Most major U.S. airlines have recently tended to be reactors—given the way they have been forced to respond to new entrants such as Southwest and JetBlue.

Dividing the competition into these four categories enables the strategic manager not only to monitor the effectiveness of certain strategic orientations, but also to develop scenarios of future industry developments (discussed later in this chapter).

Hypercompetition

Most industries today are facing an ever-increasing level of environmental uncertainty. They are becoming more complex and more dynamic. Industries that used to be multidomestic are becoming global. New flexible, aggressive, innovative competitors are moving into established markets to rapidly erode the advantages of large previously dominant firms. Distribution channels vary from country to country and are being altered daily through the use of sophisticated information systems. Closer relationships with suppliers are being forged to reduce costs, increase quality, and gain access to new technology. Companies learn to quickly imitate the successful strategies of market leaders, and it becomes harder to sustain any competitive advantage for very long. Consequently, the level of competitive intensity is increasing in most industries.

Richard D'Aveni contends that as this type of environmental turbulence reaches more industries, competition becomes hypercompetition. According to D'Aveni:

In hypercompetition the frequency, boldness, and aggressiveness of dynamic movement by the players accelerates to create a condition of constant disequilibrium and change. Market stability is threatened by short product life cycles, short product design cycles, new technologies, frequent entry by unexpected outsiders, repositioning by incumbents, and tactical redefinitions of market boundaries as diverse industries merge. In other words, environments escalate toward higher and higher levels of uncertainty, dynamism, heterogeneity of the players and hostility.

In hypercompetitive industries such as computers, competitive advantage comes from an upto-date knowledge of environmental trends and competitive activity coupled with a willingness to risk a current advantage for a possible new advantage. Companies must be willing to cannibalize their own products (that is, replace popular products before competitors do so) in order to sustain their competitive advantage.

Using Key Success Factors to Create an Industry Matrix

Within any industry there are usually certain variables—key success factors—that a company's management must understand in order to be successful. Key success factors are variables that can significantly affect the overall competitive positions of companies within any particular industry. They typically vary from industry to industry and are crucial to determining a company's ability to succeed within that industry. They are usually determined by the economic and technological characteristics of the industry and by the competitive weapons on which the firms in the industry have built their strategies. For example, in the major home appliance industry, a firm must achieve low costs, typically by building large manufacturing facilities dedicated to making multiple versions of one type of appliance, such as washing machines. Because 60% of major home appliances in the United States are sold through "power retailers" such as Sears and Best Buy, a firm must have a strong presence in the mass merchandiser distribution channel. It must offer a full line of appliances and provide a just-in-time delivery system to keep store inventory and ordering costs to a minimum. Because the consumer expects reliability and durability in an appliance, a firm must have excellent process R&D. Any appliance manufacturer that is unable to deal successfully with these key success factors will not survive long in the U.S. market.

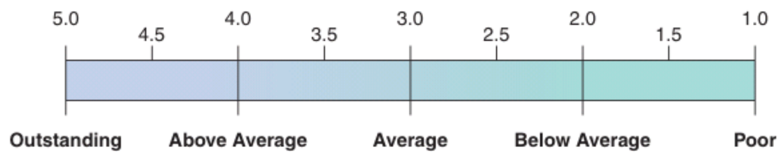
TABLE 4–4 Industry Matrix

Key Success Factors	Weight	Company A Rating	Company A Weighted Score	Company B Rating	Company B Weighted Score
1	2	3	4	5	6
Total	1.00				

SOURCE: T. L. Wheelen and J. D. Hunger, *Industry Matrix*. Copyright © 1997, 2001, and 2005 by Wheelen & Hunger Associates. Reprinted with permission.

An industry matrix summarizes the key success factors within a particular industry. As shown in Table above, the matrix gives a weight for each factor based on how important that factor is for success within the industry. The matrix also specifies how well various competitors in the industry are responding to each factor. To generate an industry matrix using two industry competitors (called A and B), complete the following steps for the industry being analyzed:

1. In Column 1 (Key Success Factors), list the 8 to 10 factors that appear to determine success in the industry.
2. In Column 2 (Weight), assign a weight to each factor, from 1.0 (Most Important) to 0.0 (Not Important) based on that factor's probable impact on the overall industry's current and future success. (All weights must sum to 1.0 regardless of the number of strategic factors.)
3. In Column 3 (Company A Rating), examine a particular company within the industry—for example, Company A. Assign a rating to each factor from 5 (Outstanding) to 1 (Poor) based on Company A's current response to that particular factor. Each rating is a judgment regarding how well that company is specifically dealing with each key success factor.
4. In Column 4 (Company A Weighted Score), multiply the weight in Column 2 for each factor by its rating in Column 3 to obtain that factor's weighted score for Company A.
5. In Column 5 (Company B Rating), examine a second company within the industry - in this case, Company B. Assign a rating to each key success factor from 5.0 (Outstanding) to 1.0 (Poor), based on Company B's current response to each particular factor.
6. In Column 6 (Company B Weighted Score), multiply the weight in Column 2 for each factor times its rating in Column 5 to obtain that factor's weighted score for Company B.
7. Finally, add the weighted scores for all the factors in Columns 4 and 6 to determine the total weighted scores for companies A and B. The total weighted score indicates how well each company is responding to current and expected key success factors in the industry's environment. Check to ensure that the total weighted score truly reflects the company's current performance in terms of profitability and market share. (An average company should have a total weighted score of 3.)



The industry matrix can be expanded to include all the major competitors within an industry through the addition of two additional columns for each additional competitor.