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Dr. Syed Akhter is Professor of Marketing, Emeritus, at Marquette University
Dr. Barney Pacheco is a Marketing Lecturer in the Department of Management Studies at The University of the West Indies, St. Augustine.

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Brief Contents

Contents

Preface

In today's highly complex, quick-paced global economy, managers need to know and understand their customers, competitors, intermediaries, suppliers, regulators, and the environmental forces shaping the competitive environment. Such knowledge and understanding are crucial for developing and executing marketing strategies that create a good fit between what customers need and expect and what the firm delivers. Case studies of firms such as Apple, Amazon, Walmart, Zara, and Ikea underscore a key lesson about achieving success. Success is not a random event but the outcome of carefully crafted and executed strategies.

Competitive pressures are coming not only from firms in developed economies, but also from firms in developing and emerging economies. Furthermore, with the shrinking knowledge gap among managers from different economies, there is a corresponding increase in the competitive pressure on marketers to plan for success and to think of innovative ways to satisfy customer needs and wants. The global competitive environment has changed significantly and so too have the roles of marketing professionals in shaping the future of their organizations. In achieving organizational goals and succeeding in this marketplace, strategic marketing management is playing a significant role.

Focusing on marketing strategy, this revised edition integrates theoretical and conceptual developments in marketing, consumer psychology, industrial organization, and strategic management and is intended for undergraduate classes on marketing management, strategic marketing, or strategic marketing management, generally taught as an elective or capstone course. The book is also suitable for graduate level marketing classes or in classes based on simulations that focus on strategy.

The goals of the book are twofold: first, to enhance students' knowledge of why strategies are developed, how strategies should be developed, what type of strategies are appropriate for different market conditions, and how strategies achieve a sustainable competitive advantage in the marketplace; second, to help students understand how beliefs and knowledge about markets and the micro and macro environments shape the development of strategies and to prepare them to become effective and ethical decision makers.

The book assumes that students have taken a course in marketing. They are, therefore, expected to be familiar with the basic marketing concepts and with the four marketing mix variables—product, price, place, and promotion. The book adds value by taking students into the strategic domain of marketing where they will learn about strategic thinking and strategy developments and execution and the reasons behind developing and executing strategies, and the consequences of employing strategies.

This revised edition adds many key features that professors and students will find valuable. This new edition:

- presents a comprehensive view of strategic thinking, strategy development, and strategy execution
- takes an integrated approach to strategic marketing management and illustrates strategic marketing management concepts with examples and case studies
- builds a sound foundation for discussing strategic marketing concepts and their applications to achieve a sustainable competitive advantage
- provides in-depth treatment of the idea that successful marketing strategies are built on understanding the external environment and internal competencies

- explores and explains pedagogical and practical strategic marketing issues
- reinforces the significance of a consumer-centric approach to making strategic marketing decisions
- provides wide geographic perspective to prepare students for decision making in a complex, interdependent, and integrated world
- includes a new chapter on digital marketing and builds on the prior editions by adding new concepts, topics, and examples
- keeps a similar layout to previous editions to facilitate transition to the new edition
- adds twelve new end-of-chapter cases focusing on new business models, technological developments, and marketing strategies
- revised PowerPoint lecture slides and a test bank formatted for the major LMS platforms

The book is designed for a semester-long course on strategic marketing. It consists of twelve chapters. The first two chapters are foundational and cover the concepts of strategy, strategic marketing management, and strategic planning. These two chapters take an interdisciplinary approach, drawing from different disciplines to clarify marketing concepts and managerial practices.

Chapters three through six focus on the analytical dimension of strategic marketing management. The assumption is that strategies should evolve from the analysis of internal organizational situation and external market developments. Chapter three, thus, deals with issues related to consumer analysis; chapter four deals with competitor analysis; chapter five deals with external environment analysis; and chapter six deals with internal situation analysis.

Chapters seven through eleven deal specifically with strategy. The goals of these chapters are to provide a comprehensive view of the key functions of marketing such as segmenting, targeting, and positioning and to discuss strategies associated with the marketing mix. Chapter seven, for example, covers issues related to segmenting, targeting, and positioning; chapter eight covers the marketing mix strategies and offensive and defensive marketing strategies; chapter nine covers strategies related to new, growth, and mature markets; chapter ten covers local, regional, and global marketing strategies; and chapter eleven covers digital marketing strategies.

Chapter twelve, the last chapter of the book, highlights the significance of taking an ethical approach to decision-making. It discusses the different ethical frameworks, highlighting both the complexity and relevancy of ethical decision-making in marketing.

In this new edition, we have added twelve end-of-chapter cases written by Dr. Barney Pacheco. Dr. Pacheco is a Marketing Lecturer in the Department of Management Studies at The University of the West Indies, St. Augustine. The twelve cases come with teaching notes. These cases will provide students in-depth understanding of marketing issues and will prepare them to become strategic decision makers. In analyzing and discussing these cases, students will be able to apply marketing theories and concepts they have learned. While case analysis and discussion will take students through the different stages of problem solving, it will also achieve another significant goal, that of enhancing self-knowledge. Students will learn how they define marketing problems, how they analyze these problems, and how they arrive at decisions, and what they will need to do to become better decision makers.

Competitive Analysis

CHAPTER 4

Source: ESB Professional/Shutterstock.

World trade means competition from anywhere; advancing technology encourages cross-industry competition. Consequently, strategic planning must consider who our future competitors will be, not only who is here today.
—Eric Allison, Uber

Learning Objectives

- Learn about the significance of competitive intelligence in strategic marketing.
- Focus on competitive developments and their effects on marketing decisions.
- Differentiate between the different models of competition.
- Examine the different methods and procedures for identifying competitors.
- Learn about different aspects of competitors.

Chapter Outline

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Toys 'R' Us, a name synonymous with toys, opened its first store in 1957, went public in 1978, and in 2004 announced that it was getting out of the toy business. Although it did not surprise industry analysts, the announcement was ironic, considering that the company had revolutionized the toy industry by competing on price and assortment. It achieved the dominant position in the toy market in the late 1980s and early 1990s, having driven competitors like Child World and Kiddie City into bankruptcies and liquidation. The announcement resulted from Toys 'R' Us loss of market share in the U.S. retail toy market, from 25% in the late 1980s to about 15% in 2004, and a decline in operating profit, from over $400 million in 1999 to slightly over $100 million in 2003. The change in the competitive position of Toys 'R' Us was due to several strategic developments. First, just as Toys 'R' Us changed the competitive scenario in the 1980s with low price and large assortment, discount retailers, such as Wal-Mart and Target, did the same in the 1990s and gained market share. Second, consumer tastes changed, with children showing greater preference for electronic toys that the discounters carried. Third, the discounters changed their value proposition, focusing on low price and selection. These developments changed the competitive positions of firms, improving the position of discounters and worsening that of specialty stores.[1] In 2005, Toys 'R' Us was acquired by KKR & Co., Bain Capital Partners LLC, and Vornado Realty Trust.[2] In 2010, Toys 'R' Us registered for an initial public offering and in 2013 withdrew the registration due to declining sales. In 2018, Toys 'R' Us filed for bankruptcy, telling its employees that it will liquidate and close or sell all of its 800 US stores.[3]

Competitive Analysis

The above example illustrates the importance of understanding the competitive landscape for formulating strategies that are aligned with changing market conditions. Marketing strategies are designed to elicit positive responses from consumers by presenting them a value proposition that they find irresistible. When consumers decide to buy a product, they make a choice from the different competing alternatives available to them (see the purchasing decision process in Chapter 3). Their choice of an alternative shows which firm was successful in the marketplace. As the choices made by consumers follow a comparison of competing alternatives, managers need to know what the competing alternatives are and how consumers evaluate and perceive them.

As the product alternatives available to consumers have increased, the importance of adopting market orientation for making strategic marketing decisions has also increased. One of the elements of market orientation is competitor orientation (see Chapter 2), which directs managerial attention to the marketplace where different products compete and where competitors, customers, and environmental factors interact to create market opportunities and threats. The interactions of different forces in the marketplace create a dynamic competitive environment where changes can occur quickly and unexpectedly. Managers can understand this dynamic environment by conducting a competitive analysis, which examines the changes in the competitive environment resulting from (1) socioeconomic, political, and technological developments, and (2) strategies and strategic positions of competitors in the marketplace.

Competitive analysis an integral component of strategic planning and decision-making that attempts to gain a better understanding of competitors' resources, capabilities, and strategies.

Competitive analysis is an integral component of strategic planning and decision making. The analysis attempts to gain a better understanding of competitors' resources, capabilities, and strategies.[4] Firms need to know where they stand against their competitors in the marketplace and how consumers perceive their competitors' value offerings.

Competitive analysis is conducted with the goal of obtaining relevant and timely information to help managers make strategic marketing decisions and achieve marketing and financial goals. Strategic marketing decisions about how to segment a market, which segments to target, how to position products, how much to charge for them, how to distribute them, how to communicate with customers, and which medium to use to deliver the messages should all be guided by the results of competitive analysis. Henderson highlights the importance of competitive analysis and notes that "the success of any marketing strategy depends on the strength of the competitive analysis on which it is based."[5]

In the next section, we discuss some of the major changes in the business environment and their effects on the competitive environment. We then cover the different aspects of competitive analysis: competitive intelligence gathering, models of competition, the five forces model of industry profitability, and identifying and understanding competitors.

Competitive Developments

In industry after industry, the competitive environment has undergone a major shift. Not only are the players different, but the products and services they bring to the market are also different. Consider the case of electronics. Sony has been a dominant player in this industry, producing a wide range of products from televisions to camcorders to laptops. However, its market position was challenged by South Korean firms such as Samsung and LG Electronics, who entered the market at the lower end of price points. And now, Chinese firms such as Haier Group and TCL have entered the market and are competing with established Japanese and South Korean firms with similar strategies that South Korean firms initially employed to gain consumer acceptance—offering low priced products with comparable quality.

Competitive developments, similar to those in the electronics industry, have also transformed the automobile industry. American and European firms were the dominant players until the middle of the 20th century. In the early 1960s, Japan's Toyota and Honda entered the global competitive arena. After Toyota and Honda, South Korea's Hyundai, Kia, and Daewoo entered the global market in the 1980s. Now China, as a major emerging economy, has also entered the automobile market. Along with China, two other emerging economies, Brazil and India, also see a future in the automobile industry. The entry of these firms in the automobile market, along with the entry of Tesla, a manufacturer of electric vehicles, has increased competitive pressures on the traditional players in Europe and the U.S. and forced them to review the sustainability of the competitive advantages they gained over the years. These developments indicate that the forces shaping the competitive environment are not only local but also global. And to gain a better perspective on the forces shaping the competitive environment, managers need to study the global supply drivers.

Supply Drivers and Competitor Behavior

Supply drivers the developments that influence the value-creating activities of firms.

Supply drivers refer to the developments that influence the value-creating activities of firms. The drivers affect how firms develop and manufacture products, where they manufacture products, how they take these products to the markets, and how they compete in the marketplace. In putting the marketing offerings together, a thoughtful consideration of the supply drivers that shape the competitive environment is necessary. A good understanding of supply drivers helps managers take proactive strategic decisions that improve their competitive positions in the marketplace. We will discuss three major supply drivers in the following section: globalization, cost pressure, and innovation.

Globalization

The rapid expansion of business activities is the result of several factors. Among them are international trade and investment policies of governments, developments in telecommunication and transportation technologies, and market expansion strategies of firms from both developed and developing economies. Not only multinationals but also small and medium-sized enterprises have expanded their business beyond the national borders to

Globalization the integration of the global economy.

satisfy needs and wants of consumers and achieve and strengthen their competitive positions. The term commonly used to characterize these developments is **globalization**. Although the term has varied meanings, it has come to signify the worldwide participation of firms in business activities and the global focus of production, distribution, and marketing of goods and services. Peng[6] defines globalization as "the close integration of countries and peoples of the world," and Rundh[7] views it as a "shift toward a more integrated and interdependent world economy." In both these definitions the theme of integration is present. Thus, globalization can simply be defined as the integration of the global economy.

Globalization has expanded the scope of markets and brought the role of strategic marketing management into a sharper focus. Firms no longer have to confine business and marketing activities to their domestic borders. McDonalds, for example, has successfully expanded its operations internationally to take advantage of the growing market opportunities. It now earns more than half of its revenues from international markets. While globalization has allowed US firms to take advantage of international market opportunities, it has also made them vulnerable to competitive attacks in their domestic markets. General Motors (GM), once the largest manufacturer of automobiles, found itself in less than a desirable situation in its domestic market because of competitive pressures due to globalization. It declared bankruptcy in June 2009 and in November 2010 went public again with an initial public offering (IPO).

Globalization is having a profound impact on the competitive positions of multinationals as they enter foreign markets and share business and technical knowledge with local firms. Consider this. European and Japanese firms entered the Chinese market and partnered and shared the technology with local Chinese firms to build the rail transit system. These junior Chinese partners adopted and improved upon the technology that was shared with them and are now effectively competing against established multinationals, such as Kawasaki Heavy Industries Ltd., Siemens AG, Alstom SA, and Bombardier Inc. In the growing global market for super-fast train systems, the Chinese firms are now selling trains that are faster and more advanced than their rivals in the developed economies.[8]

Cost Pressure

Cost management the concerted effort to reduce cost.

Cost management is the concerted effort to reduce cost. It is now a major concern of businesses. Cost management is critical because it plays a key role in setting the price of products. Firms cannot expect to survive and grow if the prices they charge for products are below the costs incurred to produce and market them. Price should be higher than cost to earn a profit. For firms to stay price competitive, they need to achieve cost efficiency by improving the input-output ratio. If firms can produce the same output with less input, or more output with the same input, they achieve cost efficiency. As competitive pressures have increased due to globalization, the search for cost efficiency has led firms to explore different production options including offshoring and outsourcing.

Offshoring shifting production to a country where the cost of production is lower.

Outsourcing contracting production and customer service to firms that can produce at a lower cost.

Offshoring refers to shifting production to a country where the cost of production is lower. Firms shut the production plant in one country and begin production in another to achieve a cost advantage. **Outsourcing** refers to contracting production and customer service to firms that can perform these tasks at a lower cost. China, India, Vietnam, and other Asian countries have become attractive destinations for offshoring and outsourcing activities. Nike, the leading athletic footwear company based in the U.S., outsources most of its production to countries in Asia such as China, Indonesia, Vietnam, and Thailand to reduce cost and increase profit. Similarly, Briggs and Stratton, a small engine company in Milwaukee, now produces some of its engines in China. Firms are finding themselves under immense competitive pressure to achieve cost efficiency. Cost containment will remain an important supply driver.

Innovation

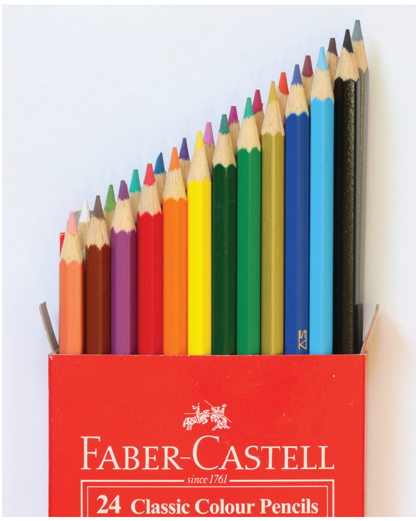
Product innovation gives the firm a competitive edge in the marketplace. Recent competitive developments reveal two important aspects of innovation. First, innovation is no longer the exclusive domain of established firms in the developed economies. Second, the pace of innovation has accelerated significantly. The new sources of innovation are large and mid-sized firms in the developing economies of Asia and Latin America. In Asia, for example, some of the firms, such as Taiwan's BenQ, that started as designers and builders of finished products for other companies have now entered the market with their own brands. These firms, known as **Original Design Manufacturers (ODM)**, are investing heavily in research and development to hasten the launch of new and innovative products. Samsung of South Korea, which started out as an ODM, now a global player and a rival of Sony of Japan and Apple of USA, is an inspiring example to these new Asian ODMs.[9] Firms in developing economies have acquired technological and management know-how and skills and are now launching their own innovative products to compete in the global markets. The major outcome of this development is an increase in competitive pressures in the markets of emerging and developed economies. And as these ODMs give consumers product choices that are value based, that is, competitively priced innovative products, competition will continue to become more intense.

Original Design Manufacturers (ODM) large and mid-sized firms in the developing economies that started as designers and builders of finished products for other companies but have now entered the market with their own brands.

The pace of innovation has increased in today's global economy. Firms need to innovate quickly and continually, if they do not want others to beat them to the market with new, innovative products. Richard D'Aveni[10] argues that the period during which firms are able to sustain their competitive advantages from innovation is shrinking. That is, the advantages from innovation do not last very long. He characterizes this as a hypercompetitive environment and recommends that firms should take initiative to disrupt their own existing sources of advantages and create new ones to stay competitive. In short, firms must now innovate to stay ahead of competition.

Take the case of the pencil, a common product that many insist has been perfect for well over a century. As the computer age arrived with a keyboard, a mouse, and a screen, it was generally believed that the days of a pencil were numbered. Many thought that it would soon be driven to oblivion. However, Faber-Castell, a pencil manufacturer since 1761, has taken this common, familiar product and increased sales through innovation. The company's track record for innovation dates back to 1839, when it introduced the hexagonal pencil, the first of its kind designed to stay on flat surfaces instead of rolling off. More recent innovations include the manufacturing of pencils with water-based paints to make them safer for children who chew on them and introducing a triangular-shaped pencil that is ergonomically designed for children. Faber-Castell's success is based on the desire to increase the performance of their product to meet the needs of customers through innovation. When they look at this product, they think that there still is room for further refinement.[11]

Just as Faber-Castell focused on refining pencils to meet customer needs without turning them into a high-tech product, Liverscribe took the common pen and turned it into a twenty-first century technology. It built the Echo smartpen. The Echo pen writes like any other, unless a specially designed paper is used, in which case the writing is digitally preserved and can be transferred to a computer using a USB cord. The uploaded handwritten notes appear exactly as they did on the page. The Echo can make sound recordings as well. For both Faber–Castell and Liverscribe, the secret to meeting the changing needs of their target markets is innovation. For the former the target markets are students in the classroom, for the latter they are tech savvy consumers, doctors, executives, and academics in need of saving handwritten documents into a digital format.[12]



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Although the advantages from innovations are many, they are, however, short lived. Competitors can either improve upon the innovations or introduce path-breaking innovations of their own. Firms, therefore, cannot expect to live off of their innovations for long. The strategic imperative is that they need to keep their innovation efforts rolling. Consider the case of Nokia. When Nokia dominated the cell phone industry, European leaders hailed the company as a high-tech success story for the continent. It was often used as an example of how to succeed in a competitive global market. Nokia, however, lost its edge over time. How it did this is an interesting case study from which valuable marketing lessons can be drawn. First, Nokia worried more about maintaining market share than creating innovative products that excited customers. Second, the company failed to capitalize on the environmental changes taking place, especially changes in how consumers were using cell phones, not only for making calls but also for emailing and social networking. Third, its location in Finland isolated it from the movers and shakers of the industry and deprived it of innovative ideas.[13] What happened to Nokia was neither unique nor surprising. A key lesson in Nokia's story is that firms that are doing well now should not assume that they will continue to do well in the future. The competitive positions of firms change, although for many firms the change may be slow and gradual.

Competitive Intelligence

Competitive intelligence insights about competitors that marketers derive from primary and secondary data.

The development of result-enhancing marketing strategies presupposes the use of competitive intelligence. **Competitive intelligence** refers to insights about competitors that marketers derive from primary and secondary data.[14] Although managers can make decisions without having to rely on competitive intelligence, such decisions will not match the effectiveness of decisions that are based on relevant and timely intelligence. The effectiveness of strategic marketing decisions is based on the understanding of the competitive environment.

Marketing managers gain competitive advantages by understanding the strategic orientations and behaviors of their competitors. The advantages are further enhanced when they understand how the marketing mix strategies of competitors influence consumers' response in the marketplace. Competitive intelligence contributes to this understanding by collecting, organizing, analyzing, and disseminating meaningful information to managers. It formalizes and systematizes the process of data collection about the competitive environment and competitors. The objective of competitive intelligence is to help managers become better decision makers by providing them with timely and relevant data.[15] The competitive intelligence system can be organized around five critical questions: what to collect, how to collect, from where to collect, how to analyze, and how to disseminate.

What Data to Collect

The answer to the question what data to collect comes from the questions that managers need answered. Managers need to know not only what data they need but also why they need them. Data collection on competitive intelligence begins with questions about competitors and the reasons for asking these questions. To answer questions that guide strategic decision making, firms collect competitive data at both the industry and firm levels. Industry-level data is collected to determine the attractiveness and profitability of

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the industry. Michael Porter has developed a five forces model to analyze industry which can be used to collect industry-related data. Porter's five forces model, discussed later in the chapter, focuses on the threat of new entrants, threat of substitutes, bargaining power of buyers, bargaining power of suppliers, and intensity of rivalry.

At the firm level, managers need to identify the type of data they need on their key competitors. The different types of firm-related data that are useful for understanding competitors are as follows:

- how are the key competitors satisfying the needs and wants of target markets
- what are their value offerings
- how have the key competitors positioned their offerings
- what are their competitive advantages
- what is the market share of each product
- what are competitors' plans for introducing new products
- how much do they spend on research and development, and
- which markets are they betting on and from which markets are they retreating

The data on the above questions are analyzed and interpreted to develop competitors' strategic profiles. Competitor profiles are useful because they indicate what competitors do, how they do it, why they do it, and what they achieve. The profiles help managers understand the relative position of competitors with respect to different marketing metrics, such as market share, consumer satisfaction, brand equity, and consumer loyalty.

How to Collect Data

There are two types of data, primary and secondary data. **Primary data** is data that the firms collect themselves, and **secondary data** is data that others have collected. Primary data is collected in three major ways: surveys, experiments, and focus groups. In surveys, the firm develops an instrument such as a questionnaire to collect data. Survey data is collected either by mail or phone or on the Internet. In experiments, data is collected in a controlled environment, where it is possible to evaluate the effects of a specific stimulus, such as the effects of new packaging on the perception of the product. In focus groups, data is collected from a small group of a representative sample, using either a structured or an unstructured approach. In a structured approach, the focus group moderator has a set of specific questions on which responses are solicited. In an unstructured approach, the format is open-ended and the focus group moderator is allowed to introduce new questions.

Primary data data that the firms collect themselves.

Secondary data data that others have collected.

Where to Collect Data

Firms can collect secondary data from different sources (see **Table 4.1** for some of the major sources of data). These sources can be divided into four groups. In the first group

TABLE 4.1 Sources of Data

• Government • U.S. Department of Commerce • U.S. Census Bureau • U.S. Securities and Exchange Commission • U.S. Patent Database • U.S. Department of Labor	• Universities • Research Reports • Articles • Case Analyses
• Business • Dun & Bradstreet • Hoovers • A.C. Nielsen • Standard & Poors	• Periodicals • Harvard Business Review • Journal of Business Strategy • Journal of Marketing • Wall Street Journal • Business Week

are the different governmental agencies that publish data on the environment, economy, industry, publicly held companies, and consumers. In the second group are private research and consulting firms, such as AC Nielsen, Euromonitor, and McKinsey and Company, which collect data and publish reports on markets, brands, and consumers. These reports can be purchased. In the third group are universities that conduct research and publish articles, case studies, and reports on businesses. These publications not only have data but also provide insights into the workings of markets and firms. In the fourth group are the business periodicals such as Harvard Business Review and Business Week that cover issues related to the economy, industry, firms, and consumers. In addition to these four sources, data can also be obtained from press releases and regulatory filings of firms and interviews of executives.

Data collection is a costly and challenging enterprise. In today's information age, large amounts of data are available at different sources on different topics. However, the question for managers is not how much data is available, but what are the relevant data for decision making and how they can be accessed. The four criteria for judging the efficacy of the data search process are: efficiency, accuracy, comprehensiveness, and timeliness.[16]

- Efficiency refers to the cost incurred in terms of time, money, and human resources to obtain competitive data.
- Accuracy refers to the validity of data obtained.
- Comprehensiveness refers to the extent to which relevant data is collected.
- Timeliness refers to the usefulness of data for decision making.

Both the sources of data and methods of data collection give rise to ethical and legal considerations. In today's business environment, information is a precious source of competitive advantage. As such, firms may be tempted to employ means that cross ethical boundaries. Recognizing that this temptation is there, firms need to set high standards for gathering data and prohibit unethical and illegal practices. Unethical and illegal practices may yield short-term benefits, but in the long run they have corrosive effects on the morale and performance of the organization.

How to Analyze Data

Primary and secondary data can be analyzed in many different ways. In addition to the procedures ranging from frequency analysis to contingency analysis to analysis of variance to multiple regression analysis, there are other powerful statistical techniques for analyzing primary and secondary data. In particular, the choice of a statistical procedure should be determined by the type of answers that managers seek. Marketing managers may need to know how pricing or promotion strategies of competitors are affecting market outcomes such as sales, market share, and consumer satisfaction. Analysis of variance or regression analysis can be used to answer this question. Perceptual maps can be used to determine how competitive offerings compare to those of the firm in the consumers' mind. A variety of statistical tools is available for analyzing data and understanding developments in the marketplace. What is important is that the analysis of data should result in specific strategic recommendations for the managers that they can consider and implement. The goal of analysis is to help managers make the strategic decisions.

How to Disseminate Findings

With the advent of the Intranet, Extranet, and Internet, firms can disseminate information effectively and efficiently to different locations. However, for disseminating strategic information, the use of the Intranet is recommended because its use is limited to designated, password-authorized users. Several questions need to be answered before developing a system for disseminating information. Who needs the information? What type of information do they need? Why do they need the information? When do they need the information? Where do they need the information? In developing the information

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disseminating system, the concept of just-in-time is highly relevant. That is, people who need the information should have access to the information when they need it and where they need it. The timely dissemination of strategic information can be a valuable source of competitive advantage.

Models of Competition

After the failure of the regulated economy in the Soviet Union, the market-based economy emerged as the most successful model of economic system. In a market-based economy, firms decide what to produce, how to produce, when to produce, and for whom to produce. However, in a market-based economy, firms are not allowed unfettered power over business and marketing decisions. Governments regulate business activities, and the extent to which they regulate the competitive environment determines the constraints that are imposed on marketing decision making. The regulatory environment and the type of decisions that firms can take shape the nature of competition between firms, which can be defined as rivalry between firms for customers. The intensity of rivalry is captured in the different models of competition such as perfect competition, monopoly, oligopoly, and monopolistic competition. The salient features of each competitive model are described below.

Perfect Competition

Perfect competition is a theoretical construct that presents an idealized picture of a market. In a perfectly competitive market there are numerous sellers and buyers, none of them large enough to exercise market power. The products sold in the market are not differentiated, thus buyers do not show a preference for a specific seller. The sellers accept the going price as their own price, as they are not large enough to influence market price. They are thus **price takers**. Both buyers and sellers have perfect knowledge of the market, which precludes either from taking advantage of exclusive information. There are no entry or exit barriers and firms do not collude or form alliances to change market positions. Although these competitive conditions are seldom met in the marketplace, the idea of perfect competition serves as a valuable benchmark for judging the other models of competition.

Price takers when sellers accept the going price as their own price because they are not large enough to influence market price.

Monopoly

Monopoly is at the other end of the competitive continuum. Unlike the large number of sellers in a perfectly competitive market, there is only one seller in the market, a monopolist. Buyers thus have to buy the product from the monopolist if they wish to satisfy their needs. The product that a monopolist sells does not have close substitutes, which gives it considerable market power in setting the price. It uses this market power to become a **price maker**. A price maker is the firm that sets the price.

Price maker the firm that sets the price.

In a monopoly the entry barriers are high. The most effective barriers result from patent and copyright laws. For example, upon the approval of a patent, the patent laws grant exclusive rights to the firm to sell its products for a specified period of time. Similarly, the copyright laws give an author exclusive rights over her work by making it illegal for others to print and sell the work without the author's permission. A monopoly can also result from exclusive control over the supply of raw materials. The most famous example is that of De Beers, the South African diamond company. Although the company does not have 100 percent of either the market share or the supply of diamonds, it comes close to being a monopolist because of the market power it enjoys. An entry barrier in a monopoly can also arise from economies of scale as the firm entering the market has to be very large and have a large market share to be an efficient competitor.

Oligopoly

Oligopoly is positioned between perfect competition and monopoly. Unlike in a perfectly competitive market in which there are many sellers and in a monopoly in which there is only one seller, in an oligopoly there are only few sellers. A two-seller oligopoly is known as a duopoly. The products that oligopolists sell are similar and are considered close substitutes. Buyers do not have perfect knowledge of the different offerings in the marketplace. And the market is considered imperfect in the sense that the firms are not price takers. Each firm sets its own price, knowing that competitors will likely respond to its pricing or other marketing strategies. In an oligopolistic environment, firms seek to gain a competitive advantage by forming alliances with others. These alliances can either be equity or non-equity based. Equity-based alliances are based on shared ownerships, which can be in either equal or unequal percentages. Non-equity based alliances are based on agreements between firms to share resources such as information, personnel, or technology. A firm in oligopoly may also be able to create significant product difference entry barriers.

Monopolistic Competition

Monopolistic competition can be considered a hybrid of perfect competition and monopoly. In monopolistic competition, there are many firms competing in the marketplace, with each firm trying to achieve a monopoly position through product differentiation. However, as product differences are small and the number of firms is large, the market becomes very competitive. The firms in monopolistic competition are price makers, that is, they set their own price. Although there are no entry or exit barriers, firms try to erect barriers by creating favorable brand image, increasing consumer satisfaction, and exercising power over the distribution channel. Given the large number of firms in the marketplace, the likelihood of alliances, either equity or non-equity, does not appear to be very high.

Porter's Five Forces Model of Competition and Profitability

Performance varies by industry. Some industries are more profitable than others. The pharmaceuticals industry, for example, achieved a higher rate of return on capital than, say, the metals industry. Performance variations exist not only between firms within an industry, but also between industries. The analysis at the industry level provides useful insights about the incumbents (competitors within an industry), especially their strategies and market positions. Porter developed the **five forces model** for analyzing industry profitability.[17] In Porter's model, the profitability of an industry is determined by the following five forces: threat of new entrants, threat of substitutes, bargaining power of buyers, bargaining power of suppliers, and competition from established rivals (see **Figure 4.1**).

Five forces model analyzing industry profitability and competition by understanding the threat of new entrants, threat of substitutes, bargaining power of buyers, bargaining power of suppliers, and competition from established rivals.

Threat of New Entrants

Firms generally do not want competitors to enter their markets. They therefore take different types of strategic decisions to create entry barriers. The stronger these barriers are the less the threats of a new entrant. In analyzing an industry, managers can look at the entry barriers that existing firms have created. First, if existing firms have achieved cost efficiencies, it will allow them to lower the price of products and reduce per-unit profit. Low per-unit profit can reduce the incentive for a new firm to enter the market. Second,

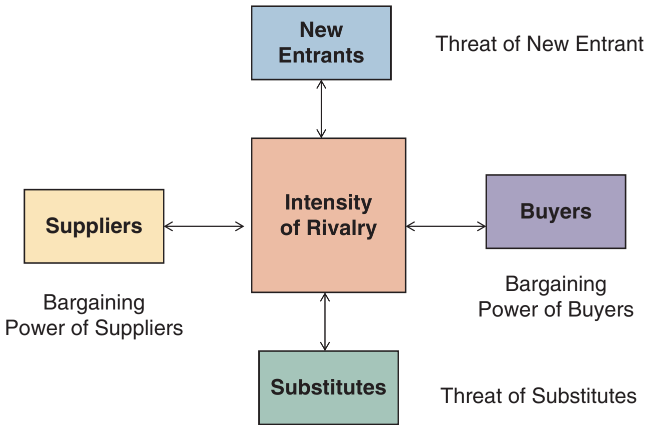

FIGURE 4.1 **The Five Forces Model**
Source: Based on Michael E. Porter, 1980, *Competitive Strategy: Techniques for Analyzing Industry Competitors*, The Free Press, New York, NY.

firms can create entry barriers by increasing brand equity. High brand equity increases loyalty among existing consumers and encourages repeat purchases, which can increase the cost for a new comer to convince these consumers to switch to a new brand. Third, if existing firms have developed strong relationships with distribution channels, access to shelf space in retail chains might not be easy to obtain for a new firm. The lack of shelf space at retail chains will force the new firm to use different distribution options to reach customers, which can result in increasing cost and making it less competitive. This can reduce the incentive to enter the market.

Threat of Substitutes

In analyzing the industry, managers need to know if there are substitutes that can replace the industry's products. Products that have no viable substitutes can command high prices in the market, especially when competition among established firms in the industry is weak. Thus, the profitability of an industry diminishes when the threat of substitutes increases. Let's take the example of the steel industry. In the production of many products such as automobiles, electronics, or household appliances, plastic and aluminum can now be substituted for steel. Firms that use steel to produce these products can look at these substitutes to judge their viability and suitability. The decision to substitute plastic or aluminum for steel will depend on the cost-benefit ratio. If firms gain from the use of substitutes and are also able to reduce cost, they will most likely make the switch. In this case, plastic and aluminum will be a threat to the steel industry.

Bargaining Power of Buyers

The increasing bargaining power of buyers can reduce the attractiveness of the industry from which they buy. This happens if there are few buyers who buy from a relatively large number of suppliers. The few buyers that are there would end up increasing their bargaining power because the large number of suppliers would be competing with each other for buyers' patronage. Furthermore, when the components or parts that suppliers sell are not patented or do not have proprietary components, the power of buyers increases.

Bargaining Power of Suppliers

Just like buyers, suppliers can also exercise market power and reduce the attractiveness of the industry to which they supply their parts or components. If there are few firms that supply to a large number of buyers, the suppliers will enjoy considerable market power. Furthermore, if these suppliers are supplying components and parts that are patented or whose production requires specialized knowledge that only they possess, they will be able to charge high price. Such market power will increase suppliers' profitability and reduce the profitability of the industry to which they are the suppliers.

Intensity of Rivalry

The intensity of rivalry between firms increases if there are more of them competing in the same market space for the same group of customers. Rivalry between firms is also intensified if the industry suffers from overcapacity. As each firm has an incentive to reduce cost by increasing production and improving its price competitiveness, the strategy may result in the oversupply of products in the market. Such a strategy would generate price competition, which will adversely impact profitability. Rivalry also becomes intense when the market is in a growth stage. In a growing market, firms try to increase and consolidate their market share, which intensifies competition among firms.

The five forces model provides a multidimensional view of competition and profitability. The model allows managers to examine the existing competitors in a market and see how their strategies have enabled them to achieve competitive advantages. The five forces model can be used to explain the competitive situation of a firm in an industry and why its profitability situation is better or worse than the industry's average. While the model is useful, it has been criticized because it takes a retrospective view. It shows what has happened and why. It does not show how a firm can develop specific strategies to improve its market position. Notwithstanding this drawback, the five forces framework is a significant development for understanding the competitive situation within a specific industry.

Identifying Competitors

Who are the competitors? This may look like an easy question to answer, but Theodore Levitt[18] showed the danger of identifying competitors incorrectly. In his now-famous article, *Marketing Myopia,* Levitt warned against identifying competitors too narrowly. The tunnel vision that results from the myopic view blinds managers to developments at the periphery that can later threaten their market position. Take the case of a brick and mortar retailer. If it takes a narrow view of competition that includes only other brick and mortar store retailers, it will preclude from consideration the competitive threats arising from online retailers. The danger of incorrectly identifying competitors is that it not only leaves the firm vulnerable to current threats but also to threats that can potentially arise in the future from sources that it has not considered.

Firms need to know their competitors, both at the firm level and the product level. Firms within an industry compete for customers with each other and are therefore considered competitors. Proctor & Gamble (P&G) and Colgate-Palmolive, two of the leading consumer products companies, are competitors. Products and brands also compete with each other. Crest toothpaste of P&G and Colgate toothpaste of Colgate-Palmolive are competitors. Managers therefore need to understand their competitors at both levels. Identifying competition at the firm level helps managers understand the strengths and weaknesses of their competitors. Identifying competition at the product and brand level helps managers understand the appeals of competing offerings to consumers. This would help managers make decisions about which new products to develop, which new attributes to add to a product, how much price to charge for a product, or how to position or reposition brands. We cover three approaches to identifying competitors: business classification systems for identifying firm level competitors, consumer decision hierarchy, and perceptual map for identifying product and brand level competitors.

North American Industry Classification System a valuable source of data for identifying firms that compete in the same product categories.

Business Classifications

Although managers do not find it difficult to identify their major competitors, a more rigorous approach is needed to get a comprehensive sense of firm level competition. The examination of the **North American Industry Classification System (NAICS**—pronounced "nakes") is

TABLE 4.2 **North American Industry Classification Systems**

First two-digits:	Sector	51	Information
Third digit:	Sub-Sector	515	Broadcasting (except Internet)
Fourth digit:	Industry Group	5151	Radio and Television Broadcasting
Fifth digit:	NAICS Industry	51511	Radio Broadcasting
Sixth digit:	U.S. Industry	515111 515112	Radio Networks Radio Stations

a valuable source of data for identifying firms that compete in the same product categories. NAICS, developed by the U.S., Canada, and Mexico, replaces the decades-old Standard Industrial Classification (SIC) system. NAICS identifies more industries than the SIC and provides data on key economic indicators such as number of establishments, employment, annual payroll, output per hour, retail sales, manufacturers' shipments, and service industry receipts.[19]

NAICS is organized as a hierarchy (see **Table 4.2** for the six-digit codes for the information industry).[20] The first two digits designate a major economic sector, such as the information sector. The third digit designates an economic sub-sector such as broadcasting, except Internet. The fourth digit designates an industry group, such as radio and television broadcasting. The fifth digit designates the specific NAICS industry, such as radio broadcasting. The sixth digit identifies subdivisions of NAICS industries that accommodate user needs in individual countries. For example, the sixth digit in the U.S. industry will identify radio networks or radio stations.

Although the Census Bureau collects the names and addresses of companies associated with the NAICS codes, it does not release them. Title 13 of the United States Code protects the confidentiality of the information provided by companies. However, there are private research firms that, for a fee, provide both SIC and NAICS codes for specific companies. Some of the companies that provide such data are Dun & Bradstreet, Standard & Poor's, Moody's Investors Service, and Hoovers. Such data can be useful for identifying competitors in similar lines of business.

NAICS data can be used to determine the N-firm concentration ratio, which is a measure of the relative power of a group of firms in an industry. The popular ratio is the four-firm concentration ratio, the CR4, which shows the combined market share of the four largest firms in an industry. Although the CR4 is quite popular, other ratios can also be calculated from the data, such as a three-firm or a five-firm concentration ratio, depending on the need of managers. A higher ratio suggests a consolidated industry, that is, few firms exercising a large amount of market power, and a lower ratio suggests a fragmented industry, that is, a large number of firms with a small amount of market power. Another method of measuring concentration is the Herfindahl index. The index equals the sum of the squared market shares of the firms in the industry. Thus, in an industry where a monopolist holds 100% of the market share, the index would be $(100^2 * 1) = 10{,}000$. On the other hand, in an industry with 5 firms whose market shares are as follows: Firm A 30%, Firm B 25%, Firm C 20%, Firm D 15% and Firm E 10%, the index would be $(30^2*1 + 25^2*1 + 20^{2*}*1 + 15^2 *1 + 10^2 *1) = 2250$. A decrease in the index suggests an increase in competition and a decrease in market power, whereas an increase in the index suggests the opposite, a decrease in competition and an increase in market power.[21]

Consumer Decision Hierarchy

In the consumer decision hierarchy approach to identifying product and brand level competition, the underlying premise is that consumers define competitors by the choices they

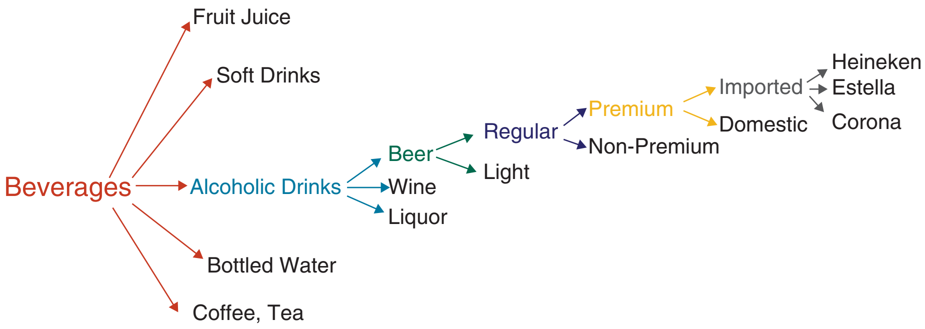

FIGURE 4.2 Consumer Decision Hierarchy

make in the marketplace. If, for example, consumers consider the market offerings of a group of firms to be a part of their specific choice set, then this group and their brands will constitute the competitive set. From a marketing perspective, this approach is the direct application of the consumer orientation—looking at the exchange relationships from the viewpoint of consumers. Consider this. You are in the market to buy a pair of tennis shoes and the only brands you are willing to consider are Nike, Adidas, and K-Swiss. Your decision to include only these three brands into your choice set identifies the three brands as competitors. These are the brands that will compete for your patronage. If there are a whole lot of people who think like you about these brands and who can be grouped together into a viable segment, then the competitive set has been determined.

Consumers can select from a variety of product and brand options to satisfy their needs and wants. These options can be represented as a decision hierarchy, leading from the general product categories to specific brands (see **Figure 4.2**). When consumers move outward from the base of the decision hierarchy to the final choice of a brand, they face a new competitive set at each stage. In Figure 4.2 the base of the hierarchy shows that the product under consideration is beverages. At this stage consumers have to make a choice among the different types of beverages, such as fruit juices, soft drinks, alcoholic drinks, bottled water, and coffee and tea. Let's assume that consumers choose alcoholic beverages at this stage. This choice forces another decision on consumers, what type of alcoholic beverage—beer, wine, or hard liquor. If, say, beer is chosen, another decision presses on, should it be regular beer or low-calorie (light) beer. If a regular beer is chosen, there is yet another decision to be made, a choice between premium and non-premium beer, both of which can be either imported or domestic. And finally, let's say, if imported, premium beer is chosen, which brands of beer?

The consumer decision hierarchy shows the different levels of the product and brand competitive set. A firm concentrating on competitors near the base (product categories) would end up with a broad definition of the market and a large set of competitors. On the other hand, a firm concentrating on the outermost branch will come up with a narrow definition of the market and a small set of competitors. A broad view of competition will lack the focus that is needed to compete at the local level. And a narrow view will lose sight of developments at the margin that can alter the future of the competitive environment. Managers, therefore, need to take both the broad and the narrow views of competition. The combined perspective will prepare firms to be vigilant to macro and micro developments that may affect their market performance.[22]

Perceptual Map

Perceptual map a graphical tool for identifying product or brand level competition; shows the relative positions of products or brands on different dimensions in consumers' mind.

A **perceptual map** is a graphical tool for identifying product or brand level competition. The map shows the relative positions of products or brands on different dimensions in consumers' mind. Although a three-dimensional perceptual map can be drawn, both its construction and interpretation can be cumbersome. Therefore, marketers show preference for a two-dimensional perceptual map. In constructing a perceptual map, marketers need

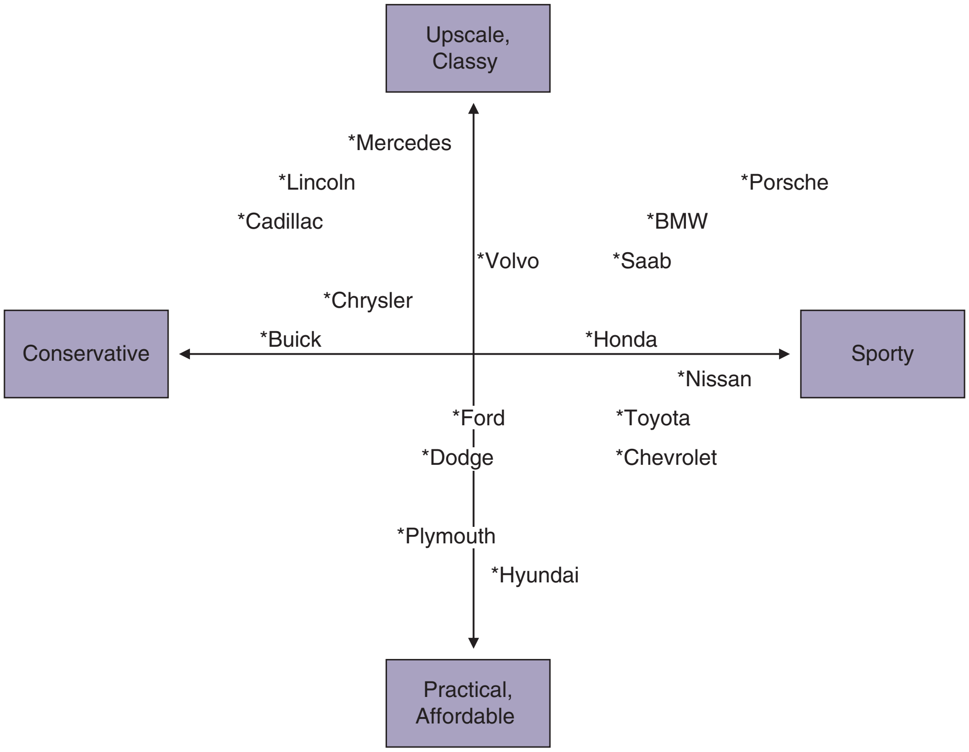

FIGURE 4.3 Perceptual Map
Source: Based on Alexander Hiam and Charles D. Schewe, 1992, *The Portable MBA in Marketing,* John Wiley & Sons.

to use the dimensions that are relevant to consumers. The dimensions are the attributes that consumers consider important in evaluating products and making a purchase decision. Based on the relative ratings of the competing products on different attributes, a perceptual map that shows the positioning of the products is developed. The distance between the different products on the map is interpreted as measures of psychological similarities. The closer the products are on the map the more similar they are in the consumers' mind.

Marketers determine the competitive set by examining the clusters of products on a perceptual map. For example, with reference to automobiles, the perceptual map in **Figure 4.3** shows several clusters with each cluster representing a specific consumer market segment. In the northwest quadrant, Lincoln and Cadillac are grouped as upscale, classy and conservative; and in the southeast quadrant, Toyota and Nissan are grouped as sporty, practical, and affordable. Each cluster represents a market segment. And the different brands in each cluster represent a specific set of competitors. The blank spaces in the map can be seen as opportunities for introducing new brands, under the assumption that there is a sizable, profitable, and reachable segment of consumers whose needs and wants are not being met currently. Different statistical techniques can be used to construct perceptual maps, such as cluster analysis, discriminant analysis, factor analysis, and multidimensional scaling.

Understanding Competitors

Competitors are rivals who fight for the patronage of the same group of consumers. Although firms should try to understand all their competitors, they should focus more on understanding their key competitors. Key competitors are those whose actions have a significant impact on the firm's performance. For example, Unilever would consider Proctor & Gamble and Nestle as key competitors. And Nike would consider Adidas a key competitor. Identifying the key competitors and learning about them allow firms to derive many benefits. First, it puts them in an advantageous position to develop and execute

Competitors rivals who fight for the patronage of the same group of consumers.

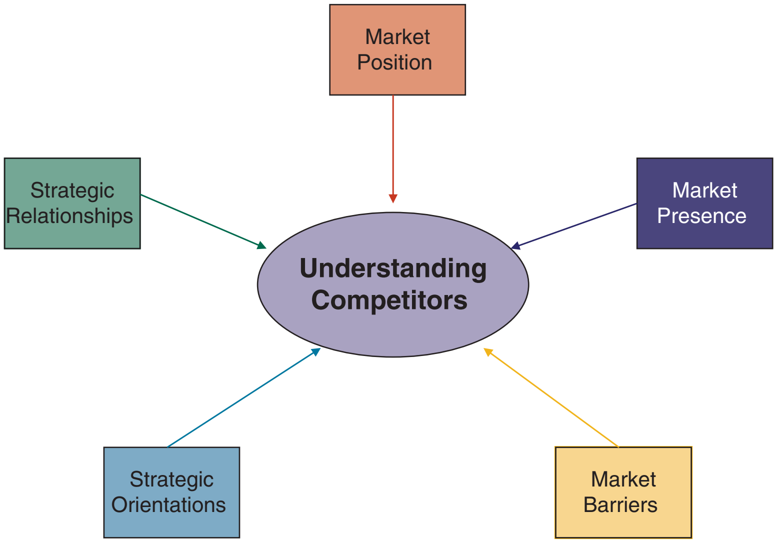

FIGURE 4.4 Understanding Competitors

marketing strategies. Second, it prepares them to anticipate how their competitors might respond to their strategic and tactical initiatives. Third, it allows them to compare their own strengths and weaknesses against those of their key competitors. And, fourth, it helps them determine the competencies they need to develop to gain a sustainable competitive advantage. **Figure 4.4** shows the different factors that help managers develop an understanding of their competitors. The factors are market position, market presence, market barriers, strategic orientation, and strategic relationships.

Market Position

In India, Pepsi has a higher market share than Coke. How this came about is an interesting study of strategic decisions and marketing strategy. In 1977 Coca-Cola pulled out of the Indian market because a new regulation would have required it to partner with a local firm and share its syrup formula. In 1988 PepsiCo entered the Indian market and formed a joint venture with two Indian companies. It then launched an aggressive advertising campaign to establish its brand image. To the Indian consumers, the word Pepsi soon became synonymous with carbonated soft drinks. Coke reentered the market in 1993 and found a well-entrenched competitor. For Coke, the strategic question then was how to reestablish its position in India. It adopted a multipronged marketing strategy that included acquiring local brands, introducing new brands, and launching a campaign to position Coke as the new soft drink. Coke promoted a simple slogan, "Thanda Matlab Coca Cola" which translates to "Cold Means Coke" in English. The intent was to link Coke with the word thanda, which means cold in Hindi, as Indians customarily ask their guests if they would like "thanda," meaning if they would like a cold soft drink.[23]

Market position determined by a firm's ratio of sales to total sales in a specific product market.

Firms continuously struggle to improve their market positions. The **market position** of a firm is determined by the ratio of sales to total sales in a specific product market. A high market share over a long period of time suggests that the firm has been able to achieve a good fit between what it offers and what the market expects. Changes in relative market positions result from the growth rate of sales of each competitor. The understanding of sales and growth rates is critical because it indicates how consumers are responding to the firm's and competitors' marketing strategies. In addition to sales and growth rates, firms also need to know about the profitability position of each competitor. Low profitability can hamper a competitor's effort to invest in new products and market development. On the other hand, high profitability allows competitors to diversify and strengthen their market positions. Toyota, for example, used its financial strength to enter the luxury car market and solidify its market position in the U.S.

Market Presence

Market presence refers to the geographical scope of markets where the firm conducts its business. A firm may choose to maintain only a national presence for strategic reasons. However, when it decides to go international, it has the option of expanding its presence either regionally or globally. The geographical expansion of market space gives firms the advantage of both scale and scope economies. A firm with a global presence, for example, will be able to achieve economies of scale because of the increased size of the market. A global presence will also allow it to achieve scope advantage such as using umbrella branding for different products. **Umbrella branding** refers to using the same brand name for different products. Unilever's Axe, an umbrella brand, is sold in more than sixty countries. The different products under the same brand name include Axe deodorant, Axe body wash, Axe daily fragrance, Axe hair styling, and Axe antiperspirant. A firm's presence in different country markets is also significant because it improves the ability to cross subsidize. **Cross subsidization** refers to the use of funds from one market to enter, maintain, or enhance presence in other markets. Firms therefore need to understand how their competitors have expanded their market presence and the advantages they have gained from such expansions.

Market presence the geographical scope of markets where the firm conducts its business.

Umbrella branding using the same brand name for different products.

Cross subsidization the use of funds from one market to enter, maintain, or enhance presence in other markets.

Market Barriers

In a perfectly competitive market, there are no **market barriers**. Firms are able to freely enter and exit the market. However, in the other models of competition, especially in oligopolistic competition, firms can create both entry and exit barriers. **Entry barriers** can be created by increasing production capacity, market share, product differentiation, and brand equity.[24] For example, investments in increased capacity can create entry barriers. Potential competitors will be discouraged from entering the market, knowing that the company with high capacity can increase supply and put a downward pressure on price. Price competition will lower the profit margin of would-be competitors, thus reducing the incentive to enter the market. Market entry barriers can also be created by firms with large market shares. A large market share signals the market power of the incumbents. Firms with large market share can make it costly for others to enter the market. Product differentiation can also act as an entry barrier. A highly differentiated product meets the specific needs of customers and increases loyalty among them, thus discouraging others from entering that market. Market entry barriers can also be created by increasing brand equity through advertising and product performance. Consumers' commitment to a brand increases brand equity, which gives the firm the ability to charge premium price and increase profit.

While entry barriers make it costly for new firms to enter a market, exit barriers make it costly for current firms to leave the market. **Exit barriers** can arise when firms make investments in specialized assets that have no other feasible use. As firms cannot use these assets for other purposes, they make exiting the market costly for the firm. Exit barriers can also result from psychological commitments of managers to a pet project. As time goes by, there may be further escalation of managerial commitments to the project, making it difficult for them to leave the market.

Market barriers obstacles resulting from competition in the marketplace that make market entry or market exit more difficulty or costly.

Entry barriers can be created by increasing production capacity, market share, product differentiation, and brand equity.

Exit barriers can arise when firms make investments in specialized assets that have no other feasible use.

Strategic Orientations

Strategic orientations are reflected in the strategies firms develop and implement. As strategies are designed to achieve specific outcomes, they reveal management's thinking about the market. Firms therefore need to understand the marketing mix strategies of competitors, especially those strategies that succeeded and the reasons behind their success and those that failed and the reasons behind their failure. The understanding of both sets of strategies is important because competitors are more likely to implement successful strategies in the future, while avoiding those that failed. Firms can understand the strategic orientations of competitors by asking a series of questions. What new products have

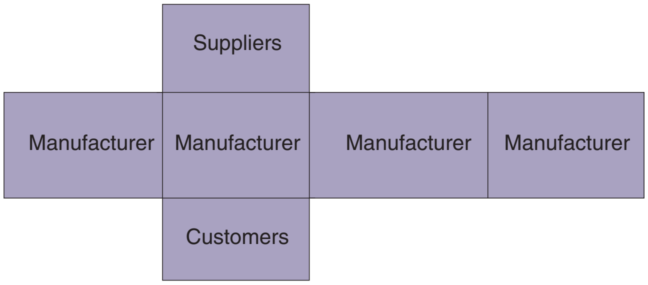

FIGURE 4.5 Competitors' Strategic Relationships

the competitors introduced and what products do they have in the development phase, what are the different price points on which they compete in different segments, what channels do they use to distribute products, and what media and message do they use to reach target markets?

Strategic Relationships

Firms not only compete but also collaborate with each other. In **Figure 4.5**, two types of collaboration are shown; one integrates vertical activities of the firm and the other integrates horizontal activities. **Vertical collaboration** involves collaboration with either the suppliers or customers or both. Vertical collaboration with suppliers and customers can give firms strategic advantages in managing their value chain activities. By ensuring that the supply of raw materials or components is timely, defect-free, and economical, firms can deliver quality products to customers and achieve a competitive advantage. **Horizontal collaboration** occurs between firms at the same level of the value chain, such as between suppliers or between manufacturers or between distributors. Collaboration can either be equity based or non-equity based. Managers need to understand what type of collaborative activities, if any, their competitors are engaged in because they can have an impact on the competitive position and profitability of firms.

Vertical collaboration collaboration with either the suppliers or customers or both.

Horizontal collaboration occurs between firms at the same level of the value chain, such as between suppliers, between manufacturers, or between distributors.

Summary

Competitive analysis is a critical ingredient in strategic decision making. Strategic decisions are guided by an understanding of competitive developments, such as cost pressure, innovation, and globalization. The more a firm knows about its competitors and the competitive environment, the more effective it will be in making strategic marketing decisions. Competitive intelligence is the art and science of gathering information on markets and competitors. Firms need to know what to collect, how to collect, from where to collect, how to analyze, and how to disseminate. As information is a critical source of competitive advantage, firms are sometimes tempted to engage in practices that can be considered unethical. A high ethical standard should be maintained in collecting and using information.

There are different models of competition that attempt to capture the market structure. The different competitive models are perfect competition, monopoly, duopoly, oligopoly, and monopolistic competition. Perfect competition is the ideal competitive structure in which neither the buyers not the sellers have market power. In contrast, other models have both. Duopoly refers to a market with only two sellers. In oligopoly there are more than two sellers with market power. In a monopoly there is only one seller. In monopolistic competition, each seller targets a specific segment where it wants to create a monopoly position through product differentiation. However, product differences are small and the market thus becomes very competitive.

At the industry level, Porter's five forces model provides insights into the competitive structure. The five forces that determine the profitability of the industry are buyer power, supplier power, threat of substitutes, threat of new entrants, and competitive intensity. Firms improve the effectiveness of their strategies by identifying and understanding their competitors. Firms can identify competitors by using business classification systems, consumer decision hierarchy, and perceptual maps. Firms can understand competitors by examining their market position, market presence, market barriers, strategic orientations, and strategic relationships.

Key Terms

Competitors, p. 79
Competitive analysis, p. 66
Competitive intelligence, p. 70
Cost management, p. 68
Cross subsidization, p. 81
Entry barriers, p. 81
Exit barriers, p. 81
Five forces model, p. 74
Globalization, p. 68
Horizontal collaboration, p. 82
Market barriers, p. 81
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Primary data, p. 71
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Supply drivers, p. 67
Umbrella branding, p. 81
Vertical collaboration, p. 82

Discussion Questions

1. Section 4-1 discussed the differences between primary and secondary sources of information. What costs and benefits do you think are associated with each type? Are there situations in which one type of source is superior to the other?
2. Section 4-3 outlined three models of competition. Can you provide an industry example for each model? What specific characteristics of each industry apply to the models?
3. Use Porter's five forces model to analyze the level of rivalry in the software industry and in the automobile industry. Which industry do you think is more attractive for a firm wanting to enter the market? See the web exercise below.

Further Reading

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Seena Sharp, *Competitive Intelligence Advantage: How to Minimize Risk, Avoid Surprises, and Grow Business in a Changing World*, John Wiley & Sons, 2009.

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Web Exercise

Go to the U.S. Census Bureau's NAICS list (http://www.census.gov/epcd/www/naics.html). Describe the hierarchy used for the transportation equipment manufacturing and the information industry sectors. For example, how is an economic sub-sector labeled differently from an industry group in each sector?

Notes

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CASE: Airbnb: Creating a Competitive Advantage

The idea for Airbnb originated in 2007 when Brian Chesky and Joe Gebbia decided to rent out some airbeds they had available in order to pay their rent. From those humble beginnings, the company has grown into a business that provides access to over 5 million unique places to stay and was valued at $31 billion in 2018.[1] The company's business model faces legal challenges, however, in large cities like New York, which seek to limit short-term private rentals where the host is not present.[2] This legal action threatened the company's ability to offer short-term rentals in some of its most lucrative urban markets and posed a dilemma for the founders who had to decide whether to defend or change their business model.

Company History

Initially, the founders decided to target conferences and festivals across America. The first major conference they targeted was the 2008 South by Southwest conference and they managed to attract about 40 listings. After observing the interactions between hosts and renters at that event, Airbnb tweaked the business model and began acting as an intermediary between the contracting parties and charged a service fee for facilitating payments. [3] At first the company required hosts to be present when guests rented the space which enhanced the quality of the lodging experience. As the company grew, this requirement was relaxed and a greater variety of listings was allowed. A turning point for the company came in 2009, when Airbnb became involved with Y Combinator—an investment fund and start-up advisory based in Silicon Valley. Y Combinator provided a network of outside investors and mentors and allowed Airbnb to focus on growing the business. After working with Airbnb for a few months, one of the Y Combinator mentors encouraged the founders to pursue slower organic growth by engaging in activities that were difficult to scale. He further suggested that the company focus on New York City, which was the market with the highest growth and where most of its customers were located.[4]

As part of their growth strategy, the company invested in activities that were sometimes expensive and did not scale easily, such as hiring professional photographers to train thousands of hosts in design principles so they could present their rentals in the most attractive light. Property owners were also encouraged to throw host parties that included persons currently staying with them as well as stay in touch with past renters. Videos of customer experiences were then posted by Airbnb on its website and social media accounts. Gradually, the company began developing a social network of loyal renters and hosts who connected over their shared Airbnb experiences and also provided feedback to the company on how the rental experience could be enhanced.[5] The rich insight derived from these forum discussions not only increased the odds of properties being rented but made it more difficult for competitors to copy the company's business model.

Competition

As the vacation rental industry grew, Airbnb found itself facing competition from three sources. The first category of competitors included companies attempting to clone the Airbnb business model. These copycat websites had a similar design to Airbnb and some even posted Airbnb listings on their website. Many of the imitator websites based in Europe falsely claimed to be affiliated with Airbnb and offered similar services but from a European perspective.[6]

Airbnb also faced competition from hotel aggregator sites such as Hotels.com whose deep pockets gave them the opportunity to offer attractive prices. Unlike Airbnb, these companies mainly catered to persons seeking to book a hotel room but also offered vacation packages that included airfare and rental cars. A third category of competitors comprised of well-funded sites such as Flipkey who targeted families and individuals looking for a more upscale vacation rental than typically offered by Airbnb.[7] These companies had grown exponentially by deploying an aggressive marketing campaign that allowed them to get instant brand recognition.

In response to the intensifying competition Airbnb adopted several strategies to defend its market position. To counter the threat of copycat websites, Airbnb initiated a campaign in 2011 to encourage customers to notify the company if they received an unsolicited invitation from an imitation website. Helping to expose copycat sites not only built customer loyalty but also strengthened the sense of community among Airbnb's customers. The company also improved its website to help prospective customers book rentals faster and invested heavily in enhancing the experience of its guests. In 2014 for instance, Airbnb partnered with a start-up called Vayable to offer renters guided tours of attractions in the neighborhood where they were staying.[8] Local businesses near the company's listings were also invited to join the Airbnb network and provide special deals to nearby renters.

To address the concerns of hosts that their properties might be vandalized by unruly guests, the company began providing insurance to hosts up to $1 million, backed by Lloyds of London and introduced a 24/7 helpline manned by customer service agents. Efforts were also made to obtain continuous feedback from hosts and guests about what they liked or disliked about their Airbnb experience. This detailed insight was used to tweak the website and business model. The net effect of these initiatives was an increase in the number of individuals willing to rent out their properties via Airbnb and greater confidence by renters in the quality of the experience they would have while staying at one of the company's listings.

Legal Challenges

As Airbnb grew, the company began allowing second-home and vacation rentals when hosts were not present during the rentals. This aspect of the company's business model brought it into conflict with regulations in New York City and other major markets which prohibited the short-term rental of residential rooms without the tenant being present. The hotel industry contended that Airbnb violated leases and evaded taxes which hotels and Bed & Breakfast were subjected to. They argued that this gave Airbnb an unfair competitive advantage and advocated that the company should be governed by the same set of regulations that applied to the hotel industry.[9]

Airbnb initially took a hardline stance in defending itself against these calls for regulation. Airbnb contended that it should not be subject to traditional hotel regulations and hotel taxes because it did not actually own the rented spaces and existed simply as an intermediary. The company also launched several campaigns to demonstrate how it was contributing to local communities and providing a much-needed source of income to cash strapped homeowners. Faced with pressure from local authorities and mounting negative publicity, in 2015 Airbnb changed its philosophy and agreed to collecting and remitting hotel taxes on behalf of their hosts and guests.[10]

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Assignment Questions

1. What is Airbnb’s business model?
2. What actions did Airbnb take after its inception that contributed to its success?
3. What are the major threats to Airbnb’s future success and how should the company address its legal challenges?