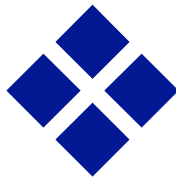

Chapter 7.
Your Competitor Radar

Chance favors the prepared mind.

- Louis Pasteur

The purpose of the competitive radar is to understand the intentions of your competitors and the forces shaping them.

Who is Your Competition?

This might seem like a strange question. How can anybody be in business and not know who the competitors are? Actually, it is a trick question. Of course we know who our competitors are, in the sense of the other businesses who contend with us for the customer's trade. But consider carefully that there may be other options open to your prospective customers for satisfying their requirements by means other than buying what you and your rivals sell. Those avenues are also your competition.

***Case in point*:** some years ago, executives of a cruise line operating in the Caribbean began exploring the issues related to growth of the business. The available customer data at that time showed that only four percent of the American public had ever taken a cruise of any kind. Everybody knew about cruises from the romantic literature, movies, and especially the popular television series "Love Boat." But in fact, very few people had actually participated in the experience behind the fantasy. It was also well known that most non-cruisers held various apprehensions about the experience — seasickness, boredom, formality and ceremony, and of course prices. However, almost all of the company's advertising and promotion was oriented toward the pleasures of cruising that would only be known to experienced customers.

It became clear during the review of the data and the marketing strategy that the real competition was not the rival cruise lines. The real competition was the set of other options available to the customers for spending their vacation funds. Rather than fighting the other companies for market share when the entire market represented

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only a four percent share of the total vacation market, it made more sense to fight for a much larger slice of a much larger pie. The strategy shifted to promoting cruises as attractive alternatives to other vacation options.

Case in point: with the remarkable popularity of the Internet and Web-based stock trading, the old established brokers — the "wirehouses" as veteran brokers call them — came under threat from discount brokerages. Of course, it's correct to say that the on-line brokers are the new competitors to the full-service brokers. But in the larger view, it also makes sense to say that the customers themselves have become competitors to the wirehouses. Once a person figures out how to execute a trade by going to a Web site, and decides that the personal advice and support he or she had been getting from a broker did not justify the fees being charged, this person becomes a new kind of customer.

Case in point: in the world of digital technology, many firms worry less about being knocked off by other firms that offer products similar to theirs, and more about alternative ways to create the value they offer. In recent years, the search for an alternative to the Windows operating system has intensified as Microsoft has increasingly used its technical monopoly and brand power to squelch competitors. The Java programming language, combined with the Web page structure for managing information, is part of a combination that could represent a technological alternative to the Windows style of doing things.

Case in point: traditional music publishers see serious competition from Internet pirates, i.e. those who digitize commercial music and install it on Web sites for free access by anybody who wants it. This has raised some extremely difficult issues regarding intellectual property and the legality of much of what goes on in the Internet "culture." In this sense, the competitors are not other music companies, but people who can use low-cost digital technology to destroy part of the demand for the products.

The point of this discussion is that, before you get to the sophisticated techniques of competitor intelligence, market share analysis, and competitive comparisons, it makes sense to identify clearly the competitive forces you are actually facing. In this respect, we can define a competitor as any entity that offers options to your customers which can diminish the appeal of the options you offer.

This may involve some very creative thinking and far-reaching associations, but it can be very important to establishing a clear understanding of your strategic prospects.

The Enemy of Your Enemy Might or Might Not Be Your Friend

In today's increasingly chaotic and fluid competitive environment, it's becoming more and more difficult to tell the difference between enemies and allies. In one situation, a particular firm might be your ally or competitive partner. In another it might be your customer. In another it might be your supplier. And in still another it might be your

competitor.

Travel agencies in recent years, particularly in America, have discovered that the airlines they thought were their business partners have become their determined enemies. In 1995 Delta Airlines, followed within days by United Airlines and American Airlines, announced caps, or ceiling amounts, on commissions paid to agencies for selling their tickets. Whereas airlines had for many years paid commissions to agencies of about ten percent of the ticket price, they announced that no domestic commission would exceed $25 for a one-way ticket or $50 for a round-trip ticket, no matter what the price. Since studies showed that the typical agency incurred costs of about $21 per ticket issued, this move virtually crippled an already profitless industry.

With the introduction of so-called “ticketless travel,” i.e. simple confirmations without any ticket documents, airlines saw the prospect of further reducing their selling costs and attracting the customers directly to them. A series of further reductions in commissions and restrictions on the most profitable tickets put thousands of agencies out of business. However, many agencies were still bound to multi-year contracts for the use of the electronic reservation systems, such as United’s Apollo and American’s Sabre, which were owned by the same airline companies supplying the tickets.

Some of the largest companies that sell branded consumer products such as clothing, perfume, cosmetics, and sporting gear have been experimenting with direct sales to consumers over the Internet. This may turn out to be a ticket to disaster, especially for firms that have no experience or infrastructure for direct selling. Levi Strauss, for example, began offering its full line of jeans and related clothing items over its Web site, to the dismay of retailers who carried their products. Some retailers anticipated that the company might offer better prices over the Internet than customers could get in their stores, especially since the Internet has become fiercely price competitive, in many cases amounting to a digital going-out-of-business sale.

Apple Computer began promoting its new iMac product over the Internet, making many loyal retailers very uncomfortable. It and many other firms have tried hard to put a positive face on the moves, assuring retailers that they are not really competitors. Increasingly, however, this will be a difficult sell, and many suppliers may find that the additional costs associated with selling direct to the public, combined with less than spectacular sales and animosity from retailers cause them to rethink the policy.

Just as it’s important to understand your competition, it’s also important to understand the circumstances that may be driving competition in your line of business. Before we apply the fancy techniques of competitive analysis, we have to be sure we know who the players are and how the game is really being played.

Which Companies Will Dominate? Ask Your Broker

One person who may be able to help you make sense of the picture on your

competitor radar is one you might never think to ask: your stockbroker. What does a stockbroker know about business fundamentals? Plenty, if he or she is highly trained in valuing firms listed on the major exchanges.

Robert Frazier, an economic consultant and registered professional financial adviser, says:

> ***"Expert brokers and analysts have to make dispassionate judgments about the business prospects of industrial firms every day, in every industry. We do it by looking at the firm's position in its competitive arena and then evaluating its earnings prospects based on what's likely to happen over the next six months, twelve months, and out three to five years."***

According to Frazier, a few key parameters can tell most of the story about each of the competing firms in a particular sector. Management's know-how, by the way, is not at the top of his list, although it does appear. Frazier's comparative model for business success includes the following variables:

1. ***Working capital and free cash flow*.** Generally speaking, the firm with the deepest pockets will win most of its battles. It can outspend its competitors on R&D, brand building, advertising and promotion, capacity growth, and acquisition of other firms. It can also usually drive prices, at least temporarily, by underpricing its rivals and sustaining lower profit margins for longer periods. A crowded market may be a good opportunity for a well-capitalized firm to enter if it contains many small to mid-sized competitors. This has been well demonstrated by firms such as Wal-Mart, which has soaked up demand in almost all rural and suburban areas it has entered, putting many smaller retailers out of business.

2. ***Low operating costs*.** Low levels of debt and consequently low costs of capital, streamlined operations, minimum organizational waste, low labor costs and high productivity, good deals with suppliers, and efficient use of information technology give a firm greater freedom to deploy resources. A cost-efficient firm can withstand price wars more effectively than others, and it can use its working capital and free cash flow better to sponsor growth. Microsoft, for example, sells products composed of almost pure information. The costs of software packaging and associated materials are almost negligible. With little capital tied up in plant or equipment, high free cash flow, and few competitive pressures, it enjoys virtual immunity to price competition.

3. ***Brand power*.** For the top few players in each sector, brand power is almost the whole game. If you're not one of the few brand leaders, you must adopt a whole different set of competitive priorities, because you can't bark as loud as the biggest dogs in the neighborhood. Coca-Cola Corporation spends over $800 million per year on advertising to keep its position as the world's most widely recognized brand. Procter & Gamble invests heavily in maintaining its army of consumer brands. Nestle

Incorporated has managed to keep its Nescafe brand in strong position for many years, in second place behind Coke as the most widely recognized beverage.

4. ***Market growth potential.*** The best-managed firm can't magically create demand in a situation where the causes of that demand are disappearing. There's no substitute for a strong product in a growing market. Intel has ridden a steady wave of demand for its microchips for several decades. Cisco profits from the powerful growth of Internet traffic, creating demand for its servers and data networking equipment. Nokia, the fast-growing Finnish maker of cellular phones, benefits from worldwide demand for mobile communications.

5. ***Customer access.*** Contact with the customers, or those who sell to the customers, is crucial to growth in revenue and earnings. If you can't get your products onto the shelves or otherwise in front of the customers, you can't sell them. The dominant players who have the biggest presence in the distribution channel, or who can afford to get their message to the customers, will tend to edge out their competitors. Customers can't buy what they don't know about. Procter & Gamble enjoys almost unchallenged elbow room on supermarket shelves for its range of consumer products. Frito-Lay Incorporated dominates the packaged snack foods industry, with ready access to store shelves. Consulting giant Andersen Consulting, with its thousands of consultants in constant daily contact with client companies, has almost unlimited opportunities to grow its base of business, while small consulting companies have to fight for every possible client opportunity.

6. ***Competitive density and capacity.*** The sheer number of suppliers and the capacity they bring to the marketplace will affect the profit opportunities for all players, and particularly the weaker firms. In a fast-growing marketplace where capacity hasn't caught up with demand, opportunities and options are more wide open. In a crowded marketplace with too many suppliers or too much capacity, the competitors fall into destructive price wars that decimate the weakest players and erode the profits of the stronger ones. The world car market, for example, has become grotesquely overcrowded in recent years, with Asian conglomerates building more factories and launching ever more unsuccessful models. The semiconductor business also suffers from boom-bust cycles, superimposed on a generally rising curve of world demand. DeBeers, the South African diamond marketing giant, has single-handedly controlled the world diamond market for years by *limiting* the flow of diamonds to the retail channel, thereby keeping diamonds unnaturally scarce and prices high.

7. ***Unique competitive advantage.*** Any special situation, such as a unique geographic location, ownership of a patent, ownership of critical information, dominance of a very specialized niche, control of a wildly popular consumer product, or any similar factor that only your firm has, can give you a special form of leverage over your competitors. This may also include a product or service with unique appeal. A fad toy, when it's hot, is a remarkable thing to see. A best-selling book or a wildly popular movie gives its owner a big dividend on the investment. A brand that stands alone, such as a Rolex, Waterford Crystal, Mercedes Benz, or Disneyland creates a

special advantage that competitors or imitators cannot copy.

8. ***One-time opportunities or circumstantial wildcards.*** The break-up of the former Soviet Union, the fall of the Berlin Wall, the handover of Hong Kong to mainland China, the release of a blockbuster product such as the impotence pill Viagra, the Y2K software bug, or any other significant and singular event can present special opportunities to firms that might be in a position to capitalize on them. This may also include a major scandal that wrecks the public image of one of the competitors in a sector, loss of a significant lawsuit, the death of a CEO, the fall from grace of a celebrity who has endorsed a certain firm's products, or any of a countless number of unpredictable events could drastically change the economic prospects of one or more competitors.

9. ***Executive leadership.*** A strong CEO, supported by a talented and well-integrated leadership team, and armed with a sound strategic plan, can make the most of all other advantages that might be presented by the business environment. Legendary leaders such as General Electric's Jack Welch, Asea Brown Boveri's Percy Barnevik, Microsoft's Bill Gates, and Intel's Andy Grove have become almost synonymous with their firms in the minds of their customers, competitors, and investors.

10. ***Organizational culture & structure.*** In some cases the firm's culture and values are uniquely appropriate to the mission it has undertaken. Or, its particular organizational structure might support the mission much better than the types of structures being used by competitors. Morale, teamwork, and a sense of destiny can play a big part in accomplishing the mission and staying true to the strategic direction. Competitors who are malorganized or afflicted with stressed cultures will make less effective use of the knowledge and talent of their people. Apple Computer Company started with a frenetic, "we can do anything" blue-jeans culture, but gradually lost its spirit and its best people as it drifted deeper and deeper into its strategic dilemma. IBM's corporate culture has, at times, served as a major asset and at other times, a handicap. Some analysts credit 3M Corporation's flexible, product-driven structure with the firm's capacity to bring a mind-boggling flow of new products to market.

A basic part of your competitor radar picture should be an objective comparison of your firm with the primary and secondary competitors in your sector against these critical predictive parameters. How would your stockbroker evaluate your firm and its competitors? Which of you would he or she recommend most enthusiastically as a sound investment?

Consolidation: the David & Goliath Scenario

In 1910 there were 300 automobile firms operating in the US. Today, there are three successful ones.

One of the more unnerving trends in many industries, intensifying from the 1980s onward, is the ever-increasing consolidation caused by mergers and acquisitions.

While companies have been buying and selling one another for many years, the increasingly competitive environment in almost all sectors has led to a condition of too many firms chasing too few customers. By Darwinian selection, a few grow to dominance and the rest tend to die off or get eaten up.

Economists point to the phenomenon of *increasing returns*, or the principle of *self-reinforcing advantage* among the dominant players in any sector. When one or more firms manage to gain a competitive edge early in the development of an industry, they tend to be able to increase that advantage little by little over time, until they are significantly stronger than the rest. At some point, the competitive advantage begins to accelerate, and the dominant firms become stronger and stronger at the expense of those who do not enjoy the advantages of size and capital strength.

For example, the mega-store can usually offer the customers better overall value than the smaller store, in terms of a wider range of merchandise, discount prices, and frequent sales or promotions. In recent years, the so-called “category killer” stores in America such as Blockbuster Video, Bookstar, and Circuit City, as well as mass discounters such as Price-Costco, have won customers away from smaller competitors with the ability to stock in depth and offer deep discounts. The traditional “personal service” appeal is difficult to sell in the face of more products and lower prices. Increasingly, consumers face the choice of “all service” or “no service,” and when the price is lower, most of them vote with their wallets. Small is no longer beautiful, at least to the typical consumer.

This size dominance is analogous to the “alpha male” in a troop of monkeys or a band of gorillas, who manages to maintain and reinforce his dominance over the other males and his privileges with the females for a very long time. Often the only change in the alpha male position comes when the current leader dies or grows so old that a younger male can successfully challenge him.

The “alpha competitor” may gain that status in any number of ways, such as being first in the marketplace, having a far superior product, having more money to spend, or perhaps just by benefiting from a major blunder on the part of a key competitor. Whatever the initial reason, as the alpha leader typically becomes more and more successful, it gains a self-reinforcing advantage. If the lead firm doesn’t stumble or run into unforeseen problems, it can ultimately outspend its competitors and buy market share, customer access, and production capacity. It can advertise more heavily to build and reinforce its brand power, which in turn adds to its increasing advantage. Some analysts contend that Apple Computer lost its position as the potential alpha firm in the PC business when Steve Jobs took his eye off the ball by picking a fight with IBM and missing the real threat from Microsoft’s Windows until too late.

Coca-Cola has been the alpha company in its sector for many years. Kodak enjoyed a similar position in its category. IBM certainly did so for many years. In recent times, Intel has dominated the computer chip business, with ever-increasing technological advantages, brand power, and market share. Microsoft has similarly dominated the

market for PC operating systems for over 5 years. The fact that the shares of both Coca-Cola and Microsoft have long traded well above the nominal prices justified by their profits shows that investors have decided that they have virtually no competition, for all practical purposes.

This “David and Goliath” scenario — the steady consolidation and aggregation of competitors and the movement toward the existence of a few giants surrounded by a number of smaller and weaker firms — seems to be an almost inexorable trend in a wide range of industries. As the larger firms have continued to consolidate over the past 10 years or so, most of them seem to have lost interest in the customer experience and concentrated almost solely on issues of structure and capital strength. The result seems to be an increasing perception of the part of many customers that, the larger the firm, the more it takes its customers for granted, and the less it is inclined to pay attention to delivering superior customer value. This may work to the advantage of smaller or mid-sized firms, if they can move to capitalize on it.

When it comes to evaluating the picture on your competitor radar screen, it makes a big difference whether your firm is the alpha male of the business or not. If you are one of the handful of firms large enough and blessed with sufficient capital to win most of the customers, your competitor radar should be focused on identifying possible threats to that dominance, including fundamental shifts or changes in the structure of the market, which might nullify all or part of your advantage.

If you’re one of the “others” in the sector, your competitor radar should be focused on exploiting any weaknesses or gaps in the value offered the customers by the alpha firms, and finding ways to distinguish your firm in the minds of the customers. If you can’t compete on the basis of raw economic power, then you’ll have to do it by making yourself more attractive to certain specific customers in specific ways.

Is There a Merger in Your Future?

Worldwide merger activity in 1997, measured in the value of corporate assets acquired, set a new record of over one trillion dollars. By the end of 1998, it had topped $2.2 trillion. The worldwide stock of available capital, together with astronomical share prices on US exchanges, led to unprecedented levels of asset concentration.

Not all mergers make sense, either strategically or economically, and not all of them produce positive results. Some firms get caught up in the “growth psychosis,” seeking sheer asset growth at the expense of market logic. On average, less than half of corporate mergers ultimately increase the value of the assets of the shareholders of the acquiring firm. Growth for the sake of growth is the ideology of the cancer cell, not the successful enterprise.

On the other hand, some mergers are important enough to cause fundamental changes in the way an industry operates. Others make sense but do not reshape the

landscape in any permanent way. Each combination needs to be understood in its own context.

If you operate in a business sector in which mergers and acquisitions are increasing, or likely to increase, it's important to understand how consolidation can affect your possibilities, and indeed whether acquiring other firms or being acquired makes sense for your business. To understand how mergers can influence your business, it is important to understand why they happen.

A person has to read news reports in the popular press and business magazines with a degree of skepticism when it comes to the announcement of corporate mergers. It seems to be the style for newsmakers to report each new mega-merger with all the drama of a moon landing, and to hint at great new powers for the merging companies while hinting at grave consequences for all other competitors who will presumably be "left behind" in the new order of business.

Most merger stories suffer from an excess of drama and a shortage of information about exactly why the merger is such a good idea and exactly how it will benefit the shareholders of the combined firms. Indeed, it often seems that newswriters all have the same standard merger-story template stored in their word processors, and they simply have to insert the names of the merging companies, their share values and market capitalization, and a few references to the business sector involved. After that, it's basically a matter of admiring the merging companies and scaring the hell out of the others.

When AT&T and Telecommunications Incorporated (TCI), the cable-TV company, decided to merge, various news reports heralded the plan as a brilliant strategic move that would "send competitors scrambling to find partners, or risk being left out." Presumably the merger would put AT&T into the cable-TV business, or put TCI into the local telephone business, or put both companies into the Internet business. The prize was supposed to be the Internet cable-access market, in which consumers could connect to the Internet through TCI's local cable systems, and AT&T would carry their messages over its existing long-lines structure. However, little was said about the need to sell special equipment (cable modems) to subscribers, and massively upgrade the cable infrastructure for two-way transmission. Without the questionable Internet rationale, the merger would be a simple combination of balance sheets.

When Citibank and Travelers Group announced plans to merge, many news reports immediately predicted the inevitable demise of most of the smaller and mid-sized banks in the US, presumably because of some obvious advantage created by the sheer combination of capital assets. In particular, it was presumed that the two companies could easily cross-sell their financial products to each others' customers. That may turn out to be true, but simply bolting together two financial firms does not automatically confer the divine right of greater market dominance. It has to be earned. In Europe, for instance, a new wave of consumer privacy laws may very well put fences around the various business units within financial firms, preventing them from sharing customer data across market areas without customer permission. While

privacy issues tend to get lip service in the US, European governments take them much more seriously.

If you want to understand how a merger in a particular industry might affect the future of your firm, you'll need a more precise thinking process than that offered by the Goliath-watching journalists. If you understand the basic logic of mergers, you can substitute your own judgment for the vagueness and drama of the news reports, and decide for yourself what the merger's effects will likely be and how soon, if at all, your business might experience them.

Let's review the major kinds of mergers in terms of their reasons, or the logic behind them. Here is a quick catalog of the most common merger motives, ranging from the questionable to the defensible:

1. ***Vanity mergers.*** Two CEOs get together and play "big business." There may be little or no market synergy, brand logic, economic leverage, or added value for the shareholders. A number of big corporate mergers in the 1970s and 1980s were more about vanity than value. AT&T in particular gobbled up a computer company and a cellular telephone company, announcing that it had become the "global solutions company." It later split up again, spinning off its R&D arm, Lucent, as well, and went back to concentrating on the long distance telephone business that built it. A variation on the vanity merger is the copycat merger, put together to answer a presumed threat from other companies that have merged, whether it makes good strategic sense or not.

2. ***Balance sheet mergers.*** Some mergers, and many acquisitions, are simply combinations of resources with little or no added value or synergy. Depending on the prices paid and the market values of the stock involved, shareholders may experience them as ranging from value-losing to value-added. But after the commotion, many consolidated balance sheets show just about the same asset picture as the simple sum of the two parts. Reporters sometimes tout these mergers as clever moves or inevitable consolidations, and knowingly explain how the merger gives the acquiring firm new product lines, access to new markets, and greater competitive power. In many cases, the simple sum of the parts is still the sum of the parts.

One part of the operation may include a business sector the parent was not previously engaged in, but market share, revenue, and earnings from that sector have not changed just because the two balance sheets were bolted together. Ford Motor Company's purchase of the Jaguar operation did not put Ford in the luxury car market, except by name association. Its later bid for Volvo's car operation showed the same "one plus one equals two" arithmetic.

3. ***Fire sale mergers.*** When adverse economic conditions drive the stock price of an otherwise successful company to unreasonably low levels, the firm may become a target for a takeover. In a hostile move, another company may simply acquire the stock by tender offer on the sharemarkets. In a friendly takeover, or at least one not completely hostile, the troubled firm may agree to an acquisition for the benefit of its

shareholders. Its executives will try to negotiate a takeover price that values the shares higher than they are currently fetching on the market. If the buying firm's shares happen to be highly valued on the sharemarkets, it may be able to acquire the other firm without having to borrow funds for the purchase, or even putting up any cash all, by trading its own shares for the shares of the firm to be acquired. Fire sale mergers that have no other accompanying advantages can sometimes turn into long-term disappointments once the price distortions work themselves out.

4. ***"Crown jewel" mergers.*** Sometimes a desirable product, technology, or brand is embedded in a company that otherwise would not interest the acquiring firm. The purpose of the merger is to acquire the prize asset, and once the deal is made the buyer simply disassembles the acquired firm and sells off or closes those operations it doesn't want. Several of the most venerable of the old book publishing firms in New York were torn apart in this process of asset stripping, as mega-firms like Viacom bought them and resold their "imprints," i.e. publishing programs with well-known brand names and established customer bases.

5. ***Extermination mergers.*** These are also called "clean-up" mergers or "pest-control" mergers. Sometimes a dominant firm buys off a budding competitor in order to keep the competitive picture clean and simple. A large player may acquire a number of smaller players in its market in order to clean up the marketplace and reduce the noise caused by too many competing brands. With the competing brands out of the way, it becomes easier and more economical to build customer acceptance of the surviving brand. Some analysts contend that a number of Microsoft's acquisitions of start-up software companies and Internet operators have the effect of stalling the development of alternative technologies that might gain wider support and eventually threaten the dominance of its Windows operating system.

6. ***Capacity mergers.*** When a company is well-positioned for growth, such as a firm like Home Depot, which sells tools, supplies, and materials for do-it-yourself homeowners and small construction firms, it needs to move into new geographic areas and add capacity in an orderly way. In that scenario, it often makes sense to buy up existing firms that would otherwise be competitors. Instead of adding more local capacity and facing competition, it simply acquires the needed new resources. This approach tends to work well only when the existing resources fit the business model, or can be transformed to align with it.

7. ***Synergy mergers.*** More mergers have been justified on the basis of presumed strategic or economic synergy than any other reason, but few measure up to the claims. News reporters tend to take it for granted that important synergies are part of every merger, and many of them can find synergies that require especially good eyesight to perceive. A synergy merger is one in which the capabilities of the two firms combine in such a way as to create advantages such as increasing revenue opportunities for one or both, leveraging assets belonging to one on behalf of the other, increasing customer access for one or both, building brand power, or creating customer value not offered by either alone.

For example, two computer retailers with regional market dominance might merge to create a single mega-brand, with the possibility of national reach and national brand power. Truly synergistic mergers tend to offer the greatest threat to competitors because they can change the rules for competition, or at least change the competitive priorities. Compaq Computer Corporation's acquisition of Digital Equipment Corporation promised significant synergy, because it brought together DEC's highly successful computer services capability with Compaq's strong product line.

8. ***Efficiency mergers.*** The most obviously justifiable mergers are those which reduce overcapacity in a crowded marketplace and create a single firm with the same total revenues and lower costs. This is often the case when competing banks with similar service areas merge. Instead of fighting tooth and nail for the same customers, with two sets of branch banks facing one another across every street corner, the result is one set of branches serving the same number of customers at vastly lower costs. In addition, the combined operation can make use of one infrastructure, one marketing process, one advertising message, and one brand image.

When oil giants Exxon and Mobil announced plans to merge, at a time of historically low oil prices, their immediate focus was to reduce overall costs at the same level of combined revenues. Mergers which reduce capacity do not necessarily threaten other competitors in and of themselves. However, when merged firms enjoy unusual cost advantages, or become economically huge in terms of working capital and free cash flow, they can usually outspend their competitors on R&D, advertising, brand positioning, and expansion of product lines. In that case, the merger is not only beneficial for the shareholders of the firms involved, but a definite threat to their competitors.

Space does not permit a discussion of other significant aspects of merger impacts such as government regulatory actions, stock market valuations, and financing methods. However, from the standpoint of simple competitive effects, it is advisable to study the prospects for consolidation in your business sector very carefully. Merging could make sense for your firm under certain circumstances. And whether it does or not, the potential for mergers and acquisitions among your competitors can have a significant effect on your growth options. There is no need to panic every time a merger is announced, but it makes good sense to understand the effects of consolidation on the competitive dynamics of your particular business environment.

Branding: the Endless Battle for Mindshare

Few companies devote enough attention, energy, and resources to building and maintaining their brands, i.e. the psychological identity of their product in the mind of the customers. Aside from the super-brand companies that have achieved worldwide "top of mind" recognition, many others seem to think of brands as basic necessities of business but not as powerful competitive weapons.

Yet it is abundantly clear, everywhere you look, that brand recognition, once achieved, brings with it a host of advantages large and small. Brand awareness causes biases, both unconscious and overt, in customer buying habits. It makes selling easier. The existence of a few powerful brands in a particular sector usually forms a *de facto* barrier to entry by new competitors. In retailing, where shelf space is constantly allocated according to earning potential, branded products that create their own natural "demand pull" will always have the advantage over lesser known products. In services, where perceived competence, trust, and reliability are often crucial, buyers tend to gravitate to known and trusted names.

According to the principle of self-reinforcing advantage, brand power is a major engine of profit, either because the brand leader can out-price its lesser known competitors and thereby grow by volume, or because it can charge higher prices — sometimes known as the "brand tax" — and enjoy a better cost structure. At wholesale levels, the brand leader can usually demand better deals, or at least grant fewer concessions, to those who profit by moving its products.

Although a thorough discourse on branding is beyond the scope of this discussion, it is important that we consider the role of brands and brand strategies in evaluating the competitive arena in any business sector. And it is worthwhile to rekindle a proper sense of awe and respect for the power of brand psychology.

If your firm enjoys the position of one of the brand leaders in a certain industry or category, you have a certain set of priorities and imperatives with regard to deploying the power of the brand for competitive advantage. If you are a lesser-known player, or a new entrant to the field, you have an entirely different set of priorities. However, being small or unknown does not mean that you cannot use brand-building principles and techniques to your advantage. Every firm, in every sector of business, should devote strenuous efforts to achieving whatever measure of brand power is feasible in its circumstances.

Building brand power, or coping with competitors who have it, requires a clear understanding of what a brand is and what it is not. According to marketing consultant Al Ries, many brand-conscious companies proceed from faulty theories about how branding actually works. According to his book *The 22 Immutable Laws of Branding*, co-authored with Laura Ries:

> ***In the long run a brand is nothing more than a name. Don't confuse what makes a brand successful in the short term with what makes a brand successful in the long term.***
>
> ***In the short term, a brand needs a unique idea or concept to survive. It needs to be first in a new category. It needs to own a word in the mind. But in the long term, the unique idea or concept disappears. All that is left is the difference between your brand name and the brand names of your competitors.***

> ***Xerox was the first plain-paper copier. This unique idea built the powerful Xerox brand in the mind. But today all copiers are plain-paper copiers. The difference between brands is not in the product, but in the product names (italics supplied). Or rather the perception of the names.***[1]

This concept of a brand as a word seems so simple that it repels the mind. We are tempted to think of a brand as a complex idea, or a set of feelings on the part of the customer, or an over-arching corporate identity behind it. But the process of *brand-building* is really the process of teaching customers to associate a word or phrase with some new or unique value proposition; the process of *brand-exploitation* is the process of using the brand name as a shorthand message to break through the noise and clutter of a crowded marketplace.

Many executives tend to confuse their brand identities with their company identities. A brand, and the concept behind it, should be narrow rather than broad. In fact, according to Ries, the narrower the focus of the brand's meaning in the mind of the customer, the stronger the brand becomes. Conversely, the broader the message the brand is expected to carry, the weaker it becomes. To cite another example:

> ***Think Chevrolet. What immediately comes to mind? Having trouble? It's understandable.***
>
> ***Chevrolet is a large, small, cheap, expensive car ... or truck. When you put your brand name on everything, that name loses its power.***
>
> ***Chevrolet used to be the largest-selling automobile in America. In 1986, for example, the Chevrolet division of General Motors sold 1,718,839 cars. But trying to be all things to everyone undermined the power of the brand. Today Chevrolet sells less than a million cars per year and has fallen to second place in the market behind Ford.***[2]

Ries also attacks the tendency of marketers to squander brand power with approaches such as *line extensions* and *mega-branding*. A line extension is a variation of the brand, aimed at a portion of the market not included in the original brand's definition in the mind of the buyer. For example, Mercedes-Benz has recently moved down-market with a relatively low-priced model, which risks contradicting the original idea of the marque as representing expensive engineering and quality. Volvo has introduced a sporty variation, a positioning that is unrelated to the powerful brand image of safety and durability it has always enjoyed.

AT&T has struggled for years to persuade Americans that it's something more interesting than a long-distance telephone company; it's in the peculiar position of trying to shake off a powerful brand identity, conferred on it by generations of customers. American Express has introduced a bewildering variety of credit cards with names that take off from the original. Levi Strauss, the firm that made "Levi's"

synonymous with “blue jeans” has recently flirted with a wide range of fashions and styles that fuzz up the perception of a once-powerful brand name. The effect of line extensions, according to Ries, is to weaken the brand’s selling power in the long term, for the sake of stealing sales from other sectors in the short term.

Mega-branding usually involves promoting a popular brand to the status of an umbrella symbol, with component brands tucked under it like satellites under a mother ship. In many cases, the customer can no longer associate the brand name with the original value proposition, e.g. a specific car, beverage, or telephone service. The marketer then faces the awesome task of trying to re-educate a large number of consumers to accept a diverse set of associations with the recognized brand name. This is what General Motors tried to do with the Chevrolet brand, what American Express tried with the concept of the “American Express Card,” and what Disney has tried in recent years with its forays into broadcasting and even the Internet.

An important thing to remember in brand-building and brand-exploitation is the concept of *singularity*. There is a powerful tendency of the human mind to simplify and iconize complex ideas into simple symbols. A brand name is a *word* (or at most a simple phrase), one which evokes a specific, localized, self-centered idea of value in the mind of a prospective customer. Xerox means copier. Coca-Cola means soft drink. Volvo means a safe, durable, and dependable car. Waterford means fine crystal. Harley Davidson means motorcycles. Winchester means guns.

Logos and other visual symbols may help to signal the value proposition in the mind of the customer, but “in the end is the word.” For example, when you see the highly recognized black-and-yellow “K” symbol used by Kodak, you probably recognize it immediately, but a split second later, you probably hear your mind’s voice saying “Kodak.”

A second important thing to remember is that it’s the customer who actually defines the brand, not the marketer. The brand perception is the association formed in the mind of the customer between a value proposition, such as discounted stock brokerage services, and a particular product entity, such as Charles Schwab. Brand psychology argues that Charles Schwab & Company is not the important entity in the mind of the value-conscious investor. To several million investors, “Schwab” means a particular experience of making investments and receiving information, not a company. Kodak is not a company — it’s a film. Coke is not a company — it’s a soft drink. McDonald’s is not a company — it’s a place to feed and amuse your kids cheaply. Confusing the brand perception with the identity of the company usually leads to mistakes in brand-exploitation.

The entertainment industry has had remarkable success with branding in movies. Disney, in particular, has perfected the art of branding a movie concept and marketing it as a total package. Popular children’s movies such as *The Lion King* serve as models for the process of extending the brand identity to collateral products such as videos, T-shirts, toys, posters, lunchboxes, and almost every kind of impulse purchase imaginable. Its marketing alliances with McDonald’s have given it

enormous market reach at virtually no cost, as children encounter buying opportunities in each of the more than 10,000 burger shops.

The phenomenal commercial success of the movie *Titanic* made the ship's name an icon and an instant brand. The film generated well over $3 billion in revenue. The video version sold over 60 million copies, setting a new record. All over the English-speaking world, advertisers were trying to link their products to the *Titanic* brand; magazines turned out a tide of stories about the legendary young actor Leonardo DiCaprio; and TV producers found a hungry audience for a host of shows based on shipboard romances and sea tragedies. Cruise lines saw demand for cruise vacations skyrocket. Even *Moby Dick* enjoyed TV re-runs.

A person can become a brand. This is particularly true of entertainers. Madonna is as much an economic entity as she is a person. The instant recognition of her name and the association of a set of social and cultural values to her role as a performer is the core concept of a "Madonna industry." Elvis Presley was, and still is, a legendary commercial brand. Mystery-horror writer Steven King has become a brand. Evidence for this is the fact that his name usually appears on the book cover in letters larger than those used for the title. Publishers fight for the privilege of paying millions of dollars to publish stories he hasn't even invented. The remarkable success of young golf star Tiger Woods made him an instant brand, with the commercial power to sell all sorts of products. His name itself is a perfect brand name.

A memorable name can be a natural asset. No US president has ever had an unpronouncable name. Would you go to see a movie starring an actor whose name is Marion Morrison? You have if you've ever seen a John Wayne film. Which is the more memorable name, Leonard Slye or Roy Rogers? You may not recognize Nathan Birnbaum as a famous comedian, but you probably know him by his stage name: George Burns. You may not recognize a comedian named Allen Konigsberg, but you may know him as Woody Allen. Your brand name is the stage name of your product.

One the biggest and most successful human brands of all time is the American basketball star Michael Jordan. His performances for the Chicago Bulls team increased attendance well above the levels enjoyed by competing teams, brought tourist revenue to Chicago, and increased the economic value of the team franchise to astronomical levels. The saddest people on the day he announced his retirement from the game, at the peak of his career at age 34, were the team owners and the army of business operators who had marketed Jordan merchandise. By some estimates Jordan, as a one-man brand, represented a $10 billion industry over the span of his career.

Curiously, however, Jordan's short stint as a professional baseball player was a commercial flop by any measure. His status as a legendary basketball player had virtually no carryover value in the minds of baseball fans. Few sport fans in America can even remember the name of the team he briefly joined, or what position he played.

A third key truth of branding, just illustrated, is that every brand has a certain range of meaning in the mind of the customer. Trying to stretch the marketing message beyond the limits of this *brand envelope* is to risk confusing the customer and undermining confidence in the brand.

Many entertainment celebrities have learned the hard way that celebrity status is very specific, and often not portable. A number of Hollywood figures have dabbled in businesses unrelated to their commercial identities, only to find themselves no more blessed than any other competitors in their chosen industries. Actors Bruce Willis, Demi Moore, Arnold Schwarzenegger, and others backed the extravagant Planet Hollywood restaurants, most of which lost money. Actor Tom Selleck and partners closed their Black Orchid restaurant in Honolulu, when it could not compete for the limited "carriage trade" clientele in the islands. Famed producer Steven Spielberg even tried his hand, with a deep-sea themed restaurant in Los Angeles named Dive!, which sank without a ripple.

Even within an industry such as entertainment, a brand envelope can be very narrowly defined. Mega-stars such as Sylvester Stallone and Arnold Shwarzenegger, and other type-cast adventure actors have failed spectacularly when they have tried to reach into other genres within the movie industry, especially comedy. Once moviegoing customers develop an iconic recognition of Sylvester Stallone or Steven Segal as a muscular, monosyllabic, one-man killing machine, they don't seem willing to think of him as funny.

Consumer research techniques can help you define the envelopes of various brands and compare customer perceptions of your brand with perceptions of those of your competitors. These techniques can apply just as well to a service firm as to the more conventional packaged goods products.

The technique of *semantic profiling*, for example, involves presenting a group of customers with a set of adjectives that could plausibly describe various aspects of the brand or brands under investigation. The customers participating in the research simply select the adjectives they think best apply to each of the competing brands or companies, for example "refreshing," "convenient," "friendly," "efficient," "economical," "trusted," or "exciting." By graphing the frequency scores of the various adjectives, one can draw a visual profile that uniquely describes the psychological envelope of the brand. By overlaying the profiles of competing brands, one can quickly discover gaps, disparities, inconsistencies, or key differences that can help to clarify, redefine, or reposition a brand against its competition.

The point of this discussion of brand psychology is simply that all business leaders, and particularly those who are not fortunate to enjoy the status of mega-brand owners, need to understand the dynamics of branding in their competitive environments, and to incorporate brand thinking into their competitive strategies.

A smaller player can work to create a new category or sub-category in which to plant a flag. By spotting the progressive weakening of a dominant brand, the smaller firm may

be able to take action to strengthen its own. And, in any case, the firm's leaders can map a competitive strategy that has a realistic chance of succeeding, based on a clear understanding of the marketing power structure in its industry.

The Struggle for Differentiation

If the David and Goliath scenario continues to become the model for competition in most industries, then the competitive strategies and priorities will be radically different for the two kinds of players. Goliaths have one set of strengths, weapons, and tactics, while Davids have a different set. In the simplest terms, your competitive radar screen will tend to show Goliaths as becoming ever more capital-oriented, cost-focused, and inclined toward standardizing the customer experience, with the Davids becoming ever more value oriented and focused on creating a different and preferable customer experience.

Review the recent developments in industries such as banking, insurance, brokerages, air travel, and telecommunications and you'll see a steady trend toward an emphasis on asset structure as the primary competitive weapon among the larger firms. The era of "customer service," at least for the larger dominant firms, seems to have faded. It may be fertile ground for the smaller and mid-sized firms, but they will have to do such a good job at it that they can offset some of the advantages of size and deep pockets.

Over the long run, notwithstanding the biblical story that favored David, the Goliaths tend to win. This is largely because they are financially able to offer the customers a bigger and better package of choices, at lower prices, or at least at lower costs, which gives them the self-reinforcing advantage previously discussed. When the Davids win, or at least survive and thrive by staying out from under the feet of the Goliaths, it is usually because they have created some kind of differentiation they can use to create sufficient customer preference to allow them to profit and grow.

Building and defending a niche can be a ticket to long-term success. Sotheby's, the famous 200 year-old auction house, is virtually without peer when it comes to moving the assets and artifacts of the rich and famous. Harrods, the quintessentially English department store, has used its commission as provider to the royal family as its badge of aristocracy for many years.

But the famous and legendary firms aren't the only ones who can take advantage of niche thinking. A surprising number of clever or unusual value concepts demonstrate that it's possible for the Davids to stay out from under the feet of the Goliaths.

***Case in point*:** a small British firm, AirFoyle, acquired an unusual airplane from the Ukrainian military forces, who could no longer make good use of it after the Cold War thawed. The craft, an Antonov 124, was an ultra-heavy lift cargo plane, one of a few created by the famous Antonov Design Bureau in its heyday. This flying monster has a hinged nose and tail section, both of which swing up to reveal a giant tunnel-like

cargo bay complete with overhead cranes. It can carry up to 150 tons of people, equipment, or machinery. For transporting certain kinds of objects, such as huge statues, monuments, rocket bodies, and things of awkward size and shape, it has no equal. The firm makes its plane available to clients all over the world who need to move difficult things, and who gladly pay its asking price for a service they can get nowhere else.

***Case in point*:** Shouldice Hospital in Toronto has established a worldwide reputation since 1945 as the best place to go for one particular kind of surgery: inguinal hernia repair, the only kind it offers. How can a hospital survive and thrive on a single surgical procedure? Its founder, Dr. Edward Earle Shouldice, distinguished himself by repairing hernias for young men who would otherwise be disqualified for military service in World War II. By the end of the war, his reputation was already well established. He and those who came after him concentrated on becoming the world's best practitioners of that one procedure. Shouldice is recognized throughout the world at the place to go for hernia repair.

***Case in point*:** how about a firm like 1-800-AUTOPSY? The steadily declining use of autopsies in America, and in most developed countries, has caused medical associations and other advocates to call for an increase in the practice. Autopsies, from the medical point of view, are useful in gathering medical statistics, discovering unknown disorders, evaluating the accuracy of medical diagnoses and treatments, training medical students, and detecting medical malpractice. Medical plans and managed care companies have steadily cut back on autopsies, so much so that in some cities the percentage of autopsies has fallen to one-fifth their number in 1960. In response to the American Medical Association's appeal for more autopsies, Mr. Vidal Herrera founded Autopsy/Post Services. Equipped with vans and mobile autopsy gear, he performs over 800 autopsies per year and plans to franchise his service in 72 American cities and 16 foreign countries.[3]

Of course, large firms can also benefit by concentrating intensely on differentiation. Companies such as Disney have created one-of-a-kind customer experiences that set them apart from their competitors, and indeed even put them into a category all their own. Nordstrom Corporation has given its department stores a special "signature" style of service and merchandising, which they have used to great competitive advantage.

The lesson in a nutshell is: if you're big and dominant in your sector, you can compete on the basis of asset strength, but if you're small you must be agile, well-focused, and differentiated in a way that creates customer preference and offsets the limitations of size. Some firms have been able to do both. Few can survive by doing neither.

Chapter Notes (7)

1. Ries, Al and Laura Ries. *The 22 Immutable Laws of Branding.* New York: HarperBusiness, 1998, page 74. Contact the authors through their Web site at ries.com.

2. Ries, Al and Laura Ries. *The 22 Immutable Laws of Branding.* New York: HarperBusiness, 1998, page 9.

3. “1-800-Autopsy,” *The Economist,* Jan 2nd, 1999, p 29.