Chapter 7

The Competitive Analysis

©GETTY IMAGES/PHOTODISC

Objectives

7-1 Explain competitive impact.

7-2 Discuss the role of competition in private enterprise.

7-3 Explain Porter's Five-Forces Model of Competition.

7-4 Explain direct and indirect competition.

7-5 Determine the geographic distribution of potential customers.

7-6 Conduct a competitive analysis.

7-7 Discuss the importance of competitive intelligence to entrepreneurial success.

THE IMPACT OF COMPETITION

New businesses need new customers. Opening a store or service is only one step toward future success. Real success occurs only if you attract customers—many customers.

Where are these customers currently shopping? Entrepreneurs must be able to answer that question, as well as many others. After all, they start out with no customers at all. Everyone who wants to buy products similar to theirs is buying from other, already established businesses. The only way to get customers, then, is to convince them to stop purchasing from those other businesses. To do that, entrepreneurs must have as much information about the competition as possible.

Competition, when used in a business sense, means a rivalry between companies that sell similar products or services. If you are to survive in the business world, you will have to get to know your competition. You must have **competitive impact**, which means the ability to effectively compete with other businesses.

Competition grows out of the fact that, in a country such as ours, consumers have freedom of choice. They can spend their money anywhere they please. They make the decision to spend their money in your store or down the street at another store that is in competition with yours.

Because there is freedom of choice in spending, you as a businessperson must be as competitive as possible. Your store must be of the highest quality and your merchandise of the type consumers demand. These positive attributes must then be combined with prices that are lower than or at least equal to those of your competitor.

Every day that the doors of your business are open to the public, you must strive to develop better products and better ways to serve your customers. If you do not, your competition will. At the same time, you have to keep an eye on your competitors and what they are doing. You cannot allow them to get a competitive edge on you. Once they do, your customers will become their customers.

COMPETITION AND PRIVATE ENTERPRISE

Competition is a very necessary part of private enterprise. If a private enterprise system is to serve the people efficiently, there must be competition among those who produce the products and among those who sell them. That competition is created by the following factors.

Similar Products and Services

©GETTY IMAGES/PHOTODISC

Competitors offer similar products or services for sale. Take sporting goods as an example. The owner of any one sporting goods store must consider all other sporting goods stores as competition for customers.

Multiple Buyers and Sellers

If there is to be competition within an economic system, there must be many buyers and many sellers. When these conditions exist in a market, no individual or business can exert undue pressure. For example, if there were only one sporting goods store in town, that store's owner could charge whatever price he or she wanted for the products. Local customers would have no choice but to pay the price or travel out of town to shop. Likewise, if there were only one buyer, the buyer could exert undue pressure on the seller to give price concessions. Multiple buyers and multiple sellers ensure competition by offering choices. Choices, in turn, help keep prices at fair levels.

Freedom to Enter or Exit Business

Competition in private enterprise means that a new business can start at any time. It also means that a company or an individual can stop doing business at any time. This freedom is what gives private enterprise its strength. Because new people are entering the marketplace on a regular basis and others are leaving, competition is assured.

The Guarantee of Fair Competition

Competition is a critical component of private enterprise, but private enterprise can be effective only if fair competition is guaranteed. The United States government, along with many state governments, has taken steps to ensure fairness in competition. Through the enactment of certain laws and the creation of the Federal Trade Commission (FTC), the U.S. Congress has undertaken to create an environment in which entrepreneurs can receive fair treatment from competitors, no matter how small or large their companies are.

Three laws that protect competition are the Sherman Antitrust Act, the Clayton Act, and the Robinson-Patman Act. Collectively, these laws help prevent monopolies. A **monopoly** is a business environment in which a single company, by controlling a specific supply of products or services, sets prices, prevents other businesses from entering the market, and controls the available supply of the product or service. Because these practices are anti-competitive, the government does not approve of them. The only monopolies the government allows are those in industries in which the product or service offered necessitates one supplier. This is often the case with local utilities.

The laws and the regulatory agency described below help protect fair competition in the United States.

Sherman Antitrust Act This act, passed in 1890, makes any business deal illegal that unreasonably restricts trade or commerce among states. It outlaws **price fixing**, the agreement between competitors to establish and maintain prices for their goods and services, a practice that leaves customers with few price choices. The act also makes owners or directors of a violating business guilty of a crime. Even though this law is over a hundred years old, it is one of the laws most often invoked today. At any given time, there are major cases in the U.S. courts based on the Sherman Antitrust Act.

Clayton Act This 1914 legislation is a follow-up to the Sherman Antitrust Act and provides additional powers for dealing with companies involved in illegal deals. Specifically, it prohibits businesses from acquiring companies that would create a monopoly environment and reduce competition. It also makes **tying agreements** illegal. In a tying agreement, a customer must buy one type of product before he or she can buy another type from the same seller. As an example, an automotive wholesaler agrees to sell an auto parts retailer hard-to-find vintage car parts, in return for which the retailer buys all his tires from the wholesaler as well.

Robinson-Patman Act This act extended the Clayton Act in 1936 by outlawing **price discrimination**, the practice of charging different prices to different customers for the same goods. It also outlaws mergers in which large companies acquire all the stock of competing companies.

Federal Trade Commission The FTC is a regulatory agency that was established to enforce and monitor these laws. It ensures fair competition among businesses, encourages free trade, carefully reviews business mergers and acquisitions to prevent monopolies from forming, and regulates advertising so that it is not deceptive. (See Chapter 4.)

©GETTY IMAGES/PHOTODISC

FUN FACTS

According to a leading online source for small business statistics, there are over 24 million business entities in the U.S. filing income tax returns, but nearly 60 percent reported annual receipts of less than $25,000.

FIVE-FORCES MODEL OF COMPETITION

When it comes to the analysis of competition, Harvard Business School Professor Michael Porter's body of work is the acknowledged standard. In his research, Porter identifies five forces that drive competitive activity:

1. Intensity of rivalry among existing competitors
2. Threat of entry by new competitors
3. Pressure from substitute products
4. Bargaining power of suppliers
5. Bargaining power of buyers

Any entrepreneur contemplating entering a new industry should examine these forces. Current entrepreneurs can benefit from a similar analysis as they struggle to stay competitive in markets where they already operate.

Another essential point entrepreneurs should keep in mind is the direct relationship between competition and profit. With increased competition often comes deep discounting of prices, increased advertising expenses, and other activities that negatively impact profit margins.

The level of competition is often the deciding factor in whether or not to enter a particular industry. Just as important, competition often drives an entrepreneur to leave an industry.

Rivalry Among Existing Competitors

Professor Porter typically identifies rivalry among competitors as the strongest of the competitive forces. He identifies nine specific areas of rivalry.

1. *Rivalry intensifies as the number of competitors increases and as competitors become more equal in size and capability.* In an industry with few competitors, competition is minimized. As the number of competitors increases, so does the level of competition. What does this mean for an entrepreneur thinking of starting a new business? It means you should investigate the industry carefully and determine how many potential competitors exist in the geographic market of your proposed business. Based on the number, estimate the level of competition.
2. *Rivalry is usually stronger when demand for the product is growing slowly.* In a mature industry, competitive rivalry is stronger because the market size is fairly well established. In a growing industry, competitive rivalry is less intense because new customers are easier to find. Aspiring entrepreneurs should seek out growth industries in which competition is not likely to be as aggressive toward new entrants.

©GETTY IMAGES/PHOTODISC

3. *Rivalry is more intense when industry conditions tempt competitors to use price cuts or other competitive weapons to boost unit volume.* When business conditions put pressure on companies to sell more product units to protect cash flow, they are more inclined to use price as a competitive weapon. If you enter a business driven by the need for large unit sales, evaluate your company's economic health and the nature of your product to determine the best time to enter the market.
4. *Rivalry is stronger when the cost to customers of switching brands is low.* If a customer is using a $50,000 piece of equipment, the cost to switch brands would be very high. If, on the other hand, the customer is using a $10 item, the cost to switch would be very low. The price of the products you sell will be a very important variable in the potential competitive environment.
5. *Rivalry is stronger when one or more competitors is dissatisfied with its market position and launches moves to bolster its standing at the expense of rivals.* A large competitor may seek to enhance its position in the market by using aggressive competitive tactics. If you are considering entry into such a market, take into account the already heightened level of competitiveness.
6. *Rivalry increases in proportion to the size of the payoff from a successful strategic move.* If a strategic move such as a new product introduction results in a rapid increase in market share, the competition to make that move is very high. Obviously, in an industry where the payoff for a new product is very high, the risks of entry are also very high.


©GETTY IMAGES/PHOTODISC

7. *Rivalry tends to be more vigorous when it costs more to get out of a business than to stay in and compete.* If an entrepreneur has several million dollars invested in a business, the cost of closing that business would be extremely high. Consequently, such a businessperson is inclined to stay in the business even though the profit margin is low. It is better than losing millions of dollars. You should carefully examine the costs of starting the proposed business. The higher the initial costs, the harder it is to exit the business later.
8. *Rivalry becomes more volatile and unpredictable when competitors are more diverse in terms of their strategies, personalities, corporate priorities, resources, and countries of origin.* The more diverse the group, the harder it is to predict competitive response. Gather as much competitive intelligence as possible on all your major competitors. You can never know enough about those with whom you compete.
9. *Rivalry increases when strong companies outside the industry acquire weak firms in the industry and launch aggressive, well-funded moves to transform their newly acquired businesses into major market contenders.* Competition grows more intense when larger companies enter the industry by purchasing small, already existing companies and transforming them into major competitors. You should understand that if the industry is attractive to you, it might also be attractive to a large company wishing to expand its offerings.

Threat of Entry by New Competitors

Whether you are already doing business in an industry or merely contemplating such a move, you should give careful consideration to a couple of factors. First, what are the barriers to entering the new market? Second, what will be the reaction to your new company by businesses already actively operating there?

Barriers to Entry The first barrier to entry is often the question "How big do I have to be to enter the business and be successful?" For example, take an entrepreneur who is thinking about opening a sporting goods store in a small metropolitan area. She wants to offer hunting, fishing, camping, and other lines to make her store a comprehensive, broadly based option for local customers. She will need enough money to successfully compete with two large, well-established national sporting goods chains already in business in the area. The barriers she faces are the size of building required to house the store and the large amount of start-up cash she will need to stock it. The size of the store alone may be a big enough barrier to keep her from entering the business.

©GETTY IMAGES/PHOTODISC

Another barrier to entrepreneurs may be the technology or specialized skills necessary to enter a particular business. Are any special technologies or training necessary for success in the business? Are they available and affordable? Do patents control any critical part of the business? If so, are the necessary patents available? Trade skills necessary for success may be carefully guarded secrets.

If you have no experience in the planned business, how long will it take you to get up to speed? The wrong answer can be a significant barrier to business success.

Brand loyalty—the consumer's preference for familiar, well-established brands—is an important entrance barrier facing many new entrepreneurs. The difficulty of penetrating and diffusing brand loyalty is one of the tenets of marketing theory. Barriers to switching brands include not only psychological issues but also real costs. What will be the cost in real dollars for potential customers to switch to your brand? Is it a reasonable expectation that they will do so? If it is, does your start-up budget allow for the promotional expenses necessary to overcome brand loyalty?

Then there are the start-up expenses associated with buildings, equipment, and supplies necessary for successful entry into the industry. Do you have to construct a building from the ground up and then equip it with costly machinery? If you do, how long will it take before the new business starts to generate revenue? Does your start-up budget allow for these initial expenditures?

Access to product and/or equipment vendors is another factor to assess. Will the vendors do business with you? Often, fear of losing a major client who happens to be your competitor may cause hesitation on a vendor's part. Difficult access to the necessary equipment, parts, and inventory may prove a formidable barrier to entering the industry.

Competitive Reaction How will firms already doing business in the industry react to a new start-up? Take the previous example of the entrepreneur planning to open a sporting goods store in a market in which two well-established national chains are already operating. Will they ignore the new entrant as an insignificant competitor, or will they wage all-out war? Their reaction will probably be driven by the overall health of the industry and its potential for growth.

If there is little potential for growth in the sporting goods market and the retail pie will simply be divided among more players, some sort of retail war is inevitable. If the market is still growing and entrance of another competitor is not as critical, minor price competition may be the only reaction.

Will the competitors put pressure on their vendors not to sell to the new business? Will they create promotional campaigns aimed at solidifying brand loyalty? Will they send secret shoppers into the new business? The answer to all these questions is probably yes. Will the competitors go so far as to break the law? No, but they will no doubt go as far as the law allows.

Beware of the competition's reaction to your new business. Your competitors will learn about the start-up when you make your business plan available to bankers, vendors, and potential customers. Some of these individuals will likely mention your plan to the competition. It is very important to try to predict competitive reaction; it is even more important to plan for it.

Small Business Technology

The starting point for entrepreneurs doing a competitive analysis should be the Internet. If, for instance, you are starting a small winery in Grand Junction, Colorado, and want to check out the competition, you would simply type “Grand Junction Colorado wineries” into an Internet search engine. One of the first search options offered would take you to a page that links you to a list of the 14 wineries in the area. Further links take you to the wineries’ web sites, which provide a great deal of useful competitive information.

Pressure from Substitute Products

Are substitute products readily available in a sufficient quantity and at a price that might cause your potential customers to switch? In 2004, the price of natural gas for home heating was very high. The cost of electricity was considerably lower. Entrepreneurs selling natural gas heaters soon realized the competitive pressure created by an abundant supply of electric heaters. Their only real salvation was the high cost of switching. To switch from natural gas to electric heat, customers had to invest in electric heaters or even convert their furnaces. Obviously, this would be very expensive.

If substitute products are available for the products you are planning to sell, how do you plan to deal with them? The danger from substitute products should be addressed during the business planning process.

What about the danger from substitute distribution channels? Again, consider the entrepreneur planning to open a retail sporting goods store. Her intent is to open a bricks-and-mortar store—in other words, a traditional retail store in a local shopping center or other convenient location. She is planning her business around the competition from other similar businesses. What if her potential customers are planning to use a substitute approach to purchasing sporting goods? What if they intend to shop at one of the large online sporting goods retailers? Again, this kind of potential substitution should be included in the planning process. Issues such as cost of switching, quality of substitutes, and availability should be researched as well.

Bargaining Power of Suppliers

The power of suppliers to the desired industry is another factor to evaluate. Are the suppliers in a position to withhold supplies of needed products? Can they extort a higher price because supply is either limited or closely controlled?

Take diamonds, for instance. For many years one European company closely controlled the supply of diamonds. Dealers wanting a supply of high-quality stones dealt with the company or one of a few designated wholesalers. The suppliers wielded considerable power over the industry. Even though the supply of diamonds has opened up over the past few years, suppliers are still a major competitive consideration.

©GETTY IMAGES/PHOTODISC

You should question and investigate the availability of raw materials, inventory, and supplies for your planned business. What can interrupt the flow of these items? If the flow is interrupted, what are the alternatives?

If the bargaining power of suppliers is a major consideration for the new business, you must plan accordingly. Lack of sales is not the only thing that kills businesses; lack of necessary supplies or raw materials can be just as deadly.

The Global ENTREPRENEUR

So you're starting a new business with an international component. Maybe the company is totally internationally based. How can you conduct a competitive analysis?

There are numerous resources for the international entrepreneur. The secret is knowing where to look. As with a domestic venture, the Internet is a good place to start. You'll need to make a few adjustments in your strategy, however.

First, you'll need to use a search engine that can provide country-specific Internet sites related to your new business. One such site is Search Engines Worldwide®, a list of global and local search engines sorted by country. If you are interested in doing business in Australia, for instance, you'll find 60 Australian search engines at this site.

Another great place to start is the U.S. Department of State. It offers a series of publications called *Background Notes* that contain information on all countries with which the U.S. has relations. They include facts on each country's land, people, history, government, political conditions, economy, and relations with other countries and the U.S. The *Notes* are updated regularly and are available free on the Internet to entrepreneurs needing timely information on an international market.

Another interesting site is the Central Intelligence Agency (CIA) site called *The World Factbook.* It offers a staggering array of information about countries of interest to entrepreneurs. Under the heading "Economy — Overview" for each country, it describes the type of economy, the degree of market orientation, the level of economic development, the most important natural resources, and the unique areas of specialization. It also characterizes major economic events and policy changes in the most recent 12 months and often includes a statement about one or two future macroeconomic trends. The site is a good resource for an overall perspective of a country's business climate.

A competitive analysis is probably more critical to the future success of an internationally based business than to that of a domestic company. If you grew up in America, you are familiar with the culture, laws, and other idiosyncratic aspects of doing business here. How could you possibly know about doing business in another country without extensive research? Do your homework! Competitive surprises in another country may not be much fun.

Think Critically

Pick a country of personal interest to you. Using the Internet, log on to the CIA site. Prepare a brief overview of the country that would be useful to an entrepreneur considering doing business there.

Bargaining Power of Buyers

Just as you should carefully research the power of suppliers to the desired industry, you should also investigate the power of buyers. If, for example, you are starting a business to manufacture computer chips, are there a few large buyers that control the industry? If so, are they in a position to exert undue price and/or quality pressure on the new company?

What should the entrepreneur look for in relation to buyers? The first thing is probably the number of buyers. If there are so many they cannot all be identified, they may not be a major concern. If there are a lot of buyers but only two or three major ones, that may be a concern if those major buyers control a majority percentage of the market.

Quantifying buyers/customers is always an important planning activity. How do you plan for an industry in which buyers have a great deal of bargaining power? Look at the availability of substitute products and the cost of switching. Analyze potential buyers carefully. The problem is not always their reluctance to buy your product. Rather, it may be the pressure they can bring to bear on the way you do business.

TYPES OF COMPETITION

Every business that sells sporting goods of any kind is a potential competitor for a new retail sporting goods store. Not all the businesses are the same, though. Some compete more directly than others. As entrepreneurs analyze their competition, they must first consider into which classification the competing firms fall—direct or indirect competition.

Direct Competition

Direct competition refers to businesses that derive the majority of their profits from the sale of products or services that are the same as or similar to those sold by another business. A good way to start an analysis of direct competition is by looking in the Yellow Pages of the telephone book for other stores that deal in the same product you are planning to sell.


©GETTY IMAGES/PHOTODISC

Another method of identifying direct competition is to contact the local chamber of commerce. A quick review of its membership list should identify organizations that will be direct competition. Many communities have planning departments that compile annual data books in which the communities are divided into shopping zones and the number and types of retailers in each zone are listed.

Yet another valuable way to scope out the competition is by conducting a physical check of the geographic market. A good way to do this is to drive through all retail centers within the competitive area to see if there are other competitors you have not already identified. The check should also include walking through any enclosed malls.

The number of direct competitors you identify and their behavior in the marketplace will ultimately have a profound effect on the new business. It is important to evaluate your findings and try to determine the reputation of your competitors. For example, you should address these questions: "What are they doing that appeals to customers? What could I do better? What have I seen that I want to avoid?"

Indirect Competition

Indirect competition is competition from businesses that derive only a small percentage of their profits from the sale of products or services that are the same as or similar to those sold by another business. If a small entrepreneurial business sells sweatshirts, for example, its indirect competitors might be Wal-Mart, Kmart, Target, and other large general-merchandise retailers.

If you have lived in the area for some time, identifying indirect competition should not be too difficult. You should take time, however, to include all businesses that fall into this category.

Indirect competition can often prove to be the most dangerous kind. For a business like a sweatshirt store, indirect competition will almost always come from a large national chain, which usually has more capital than a small business and is capable of purchasing in much greater quantities. Because the large chain does not have to rely simply on the one product line, it can choose to deal only in those items that produce the greatest profit. It can carry as few or as many of an item as it desires.

Small business owners do not have that option. Not only can they not be as selective, they cannot buy in as large a quantity, either. To attract and keep customers, the sweatshirt store owner must try to satisfy all customer needs for athletic apparel and merchandise. In addition to high-profit items, the store owner must also carry items that are in demand even though they produce much lower profits.

Just as the number and behavior of direct competitors have a profound effect on the new business, so do the number and behavior of indirect competitors. Assess your findings about indirect competitors and try to determine their reputations and roles in the marketplace.

GEOGRAPHIC CUSTOMER DISTRIBUTION

As entrepreneurs begin the process of formally getting to know the competition for the planned business, they need to be concerned with geography—not geography in the sense of the world but in the sense of customers. Getting to know customers is a critical ingredient in the success formula for your new company. Where do your potential customers live? How far will they travel to do business with you?

To determine the geographic distribution of potential customers, get a map of the area in which your business will be located. Mark the probable location of the business. You have likely not chosen the exact location yet, but you probably have a good idea of the general neighborhood.

Next, mark the areas on the map in all directions that represent the farthest distance customers will likely be willing to travel to do business with you. Then draw a circle that includes all the communities in which your potential customers live.

If the business is a small retail store, the circle may be relatively small and cover only a portion of the city. If, on the other hand, the intended business is a production facility with widely based appeal, the circle might include one or more states. It could even cover entire regions of the country.

The circle on the map represents the geographic distribution of your potential customers. It also, to some extent, represents the geographic distribution of your future competition. Have you ever noticed that fast-food restaurants tend to come in clusters? That's because they have all determined where their potential customers live and work and how far they are likely to drive for a hamburger and a soft drink. This is just one illustration of the fact that once you have located the customers, you have probably located the competition as well.

COMPETITIVE ANALYSIS


©GETTY IMAGES/PHOTODISC

Now that you understand types of competition and geographic distribution, it is time to do a more detailed competitive analysis. A **competitive analysis** is defined as the identification and examination of the characteristics of a specific competing firm. A business-specific competitive analysis provides you with the information you need to pinpoint strengths and weaknesses, both yours and the competition's. This knowledge is essential for marketing success.

How do you know the names of your competitors? Every business providing the same product you plan to offer within the geographic distribution of potential customers is your competitor. As suggested earlier, check the Yellow Pages, look for advertisements, drive the geographic area if you can, talk to people, ask questions, and put together a list. You will need it to analyze your competition.

Analysis of Competitors Who Have Failed

Not only should all the identified direct and indirect competitors be analyzed, so should any that have recently gone out of business. Most of these would probably have fallen into the category of direct competitors. It is important to include them in your analysis so that you can benefit from their mistakes. But first you need to determine the reasons for these mistakes. A good analysis provides that information.

Table 7-1 is a form designed for analyzing competitors who have failed. List as many competitors that have gone out of business as possible, consulting chamber of commerce records, community data books, personal knowledge, Yellow Pages from previous years, and any other source of local business data.

After identifying failed competitors, try to determine why they failed. Casual conversations with existing competitors will often yield useful information. Most will probably have an opinion on why the business in question failed.

Some of the possible reasons for failure are listed in the table. They include poor management, undercapitalization, lack of knowledge about the business, and the competition's influence. If you can identify any trends among the failures, note those as well.

TABLE 7-1 REASONS FOR FAILURE

Names	Poor Management	Under-capitalization	Lack of Knowledge	Competition	Other
1.					
2.					
3.					
4.					
5.					
6.					
7.					
Trends					
1.					
2.					
3.					
4.					
5.					

Analysis of Direct and Indirect Competition

The next step is to look at both direct and indirect competition from an analytical perspective. Table 7-2 is a convenient way to record data from that analysis. Five factors should be analyzed: price, location, facility, competition type, and rank.

- **Price** In this sense, price refers to the price range into which each competitor's prices fall for products or services that are the same as or very similar to what your new business will offer. Based on your competitive analysis, indicate if the competition is in the high (H), middle (M), or low (L) range.
- **Location** The location of competitive businesses must be examined in comparison to the new business's anticipated location. Is the competition located in a better (B), worse (W), or about the same (S) quality location?
- **Facility** Facility refers to the actual buildings occupied by competitors. Compared to the new business's anticipated facility, is the competitor's facility better (B), worse (W), or about the same (S)?
- **Type of competition** Based on the previous information presented, determine if other businesses are direct (D) or indirect (I) competition.
- **Rank** The competitors should be ranked in terms of their degree of competitiveness. If there are 10 competitors, number 1 should be the strongest, number 10 the weakest.

TABLE 7-2 ANALYSIS OF THE COMPETITION

Names of Competitors	Price (H/M/L)	Location (B/W/S)	Facility (B/W/S)	Direct (D) or Indirect (I)	Rank (1 to 10)
1.					
2.					
3.					
4.					
5.					
6.					
7.					
8.					
9.					
10.					

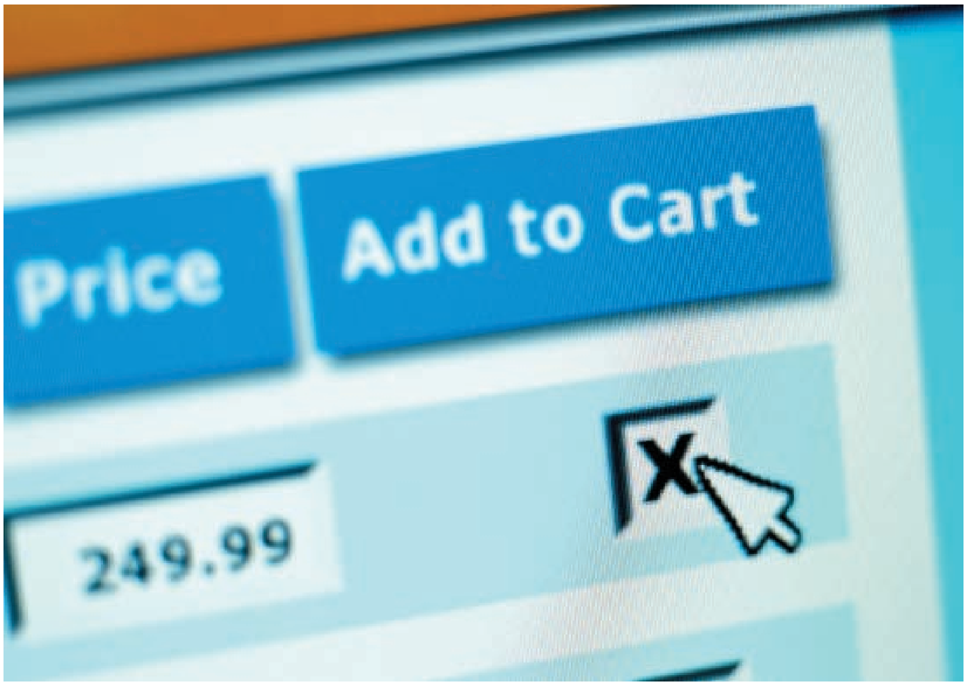
Table 7-3 is a form that takes the competitive analysis one step further. With this form you can use the information recorded in Table 7-2 to identify your strengths and weaknesses as compared to the competition's. First list two strengths, then two weaknesses. As you identify each weakness, try to determine how it might be overcome.

By this point you should have the information you need to understand your competition. If you do a good job, competitors should not be able to surprise you in the future.

TABLE 7-3 STRENGTHS AND WEAKNESSES OF MY PLANNED BUSINESS
Strengths 1. 2. 3. 4.
Weaknesses 1. *How will I overcome this?* 2. *How will I overcome this?* 3. *How will I overcome this?*

What if you are having trouble finding information about your major competitors? Are there other things you can do? Of course there are. The secret is to try to continually discover new sources of information. The following list offers several possibilities.

- **Yellow Pages** After you have identified a competitor, check the Yellow Pages in the local telephone book for an ad. Does the ad provide useful competitive information? If so, make a record of it.
- **Promotional Brochures** Do any of your competitors print and distribute brochures? If so, these usually contain a wealth of information about the business.
- **Promotional Advertisements** Paid promotional advertisements in print media, on the radio, and on TV are usually built around one or two major selling points your competitor feels are important. Pay careful attention and try to identify them.
- **Competitors' Customers** Have you run across potential customers for your business who are currently shopping at the competition? If so, ask them questions such as what they like and dislike about the competition and what it would take for you to win their business.
- **Competitors' Vendors** As you check out vendors for equipment, supplies, and inventory for the new business, ask them questions about the competition. Ask which business is the biggest, most profitable, best managed, and so on. Ask who they think your biggest competitors will be.
- **Trade Associations** If there are trade or business associations dealing with your specific business, join them if possible. That way you can get membership lists and other valuable information about the industry and who the major players are.



©GETTY IMAGES/PHOTODISC

- **Competitors' Web Sites** Companies often put things on their web pages that they never should. Check them out for things such as number of employees, major clients, employee resumes, future plans, and anything else that might be listed. You will find that good competitive sense is often sacrificed for ego, and poor decisions concerning what to put on the Web are the result.
- **Competitors' Employees** Depending on the size of your community, you may meet or already know one or more employees of some of the competitive businesses. If you do, ask them about their company. Why do they like working there? Is it a strong company? Who are some of the company's biggest clients? A word of caution: Do not try to deceive the people with whom you are talking. Tell them you are interested in getting into the business.
- **News Stories About Competitors** Keep a careful eye on the news media for stories about the competition. Again, sensitive competitive information sometimes slips out when a news story is being developed. Also, newspeople have a tendency to do in-depth background work on interviewees and include it in the story.
- **Shop the Competition** If the competitive business is the kind that encourages customers to walk in and wander around, take advantage of the opportunity to see them in action. Check out the physical facility, prices, customer service, and anything else you can think of.

COMPETITIVE INTELLIGENCE

Competitive analysis has achieved such a prominent place in business success that it has spawned a whole new industry. Today entrepreneurial ventures all over the world sell the service of gathering competitive intelligence. The industry is large enough to have its own professional association. SCIP, the Society of Competitive Intelligence Professionals, describes itself as an organization that is "serving professionals who are leveraging knowledge for competitive advantage."

Ethics for ENTREPRENEURS

Candice graduated from Colorado State University 10 years ago with a business degree in human resource management. For the first five years after college, she worked in the personnel department of a large computer manufacturing facility in Fort Collins, Colorado. The work was challenging and the pay was good, but with 60-hour workweeks, Candice had little time or energy to devote to other aspects of her life.

Candice progressed well in the company. She gained solid experience in all aspects of human resource management, especially hiring and benefits. Life was good, if somewhat boring and predictable.

Toward the end of her fifth year, the company decided to outsource the human resource management function. As Candice contemplated unemployment for the first time in her adult life, the phone rang. It was the manager of the company that had been awarded the outsourcing contract. He wanted to know if Candice was interested in working for them.

Fast-forward four years to the present. Candice has advanced to the level of manager of the outsource company. Realizing she is doing the lion's share of the work but receiving little of the profit, she is planning to strike out on her own. The title "entrepreneur" has a nice sound to it.

She has been working on a business plan that will lay the groundwork for her new company. It is now time to start on the competitive analysis. Candice faces an ethical dilemma. One of the major competitors for her venture will be the company she currently manages. How much company information can she ethically use?

Two years ago Candice's boss responded aggressively to the challenge of a new competitor. He cut prices to a bare minimum, pressured clients, and called in favors all over town. She knows she can expect the same treatment. Her advantage, in addition to being able to predict the competitive response, is that she is the one who has been working with clients. She is the face of the company around town. Plus, the owner has seemingly lost interest in the business.

Candice decides she would probably have the competitive advantage in any struggle that might arise when she opens her own company. She continues to work on her business plan.

Think Critically

1. Do you think it is ethical for Candice to use her personal knowledge of the company to compete against it?
2. Is there another way for Candice to work more for herself, yet not have to compete against her current employer?

Many entrepreneurs do not understand the concept of competitive intelligence and its importance to modern businesses. **Competitive intelligence (CI)** is a systematic and ethical program for gathering, analyzing, and managing external information that can affect a company's plans, decisions, and operations.

Regardless of whether you are selling competitive intelligence as a service or conducting it for your own entrepreneurial use, CI is important. Consider the pace of business change. What was true yesterday may not be true tomorrow. Managing "by the seat of your pants" is no longer a viable option.


©GETTY IMAGES/PHOTODISC

Instinct and intuition are still important assets, but they must be applied to data gathered through intense competitive intelligence activities.

The price of bad business decisions is often business failure. This is especially true for the small business still in its infancy. Limited financial resources and restricted cash flow make every decision a critical juncture for the business owner.

The price is equally heavy for big business. Sam Walton, the founder of Wal-Mart, noted in his autobiography, *Made in America: My Story,* "One reason Sears fell so far off the pace is that they wouldn't admit for the longest time that Wal-Mart and Kmart were their real competition. They ignored both of us, and we blew right by them."

Ethics and Competitive Intelligence

Is competitive intelligence legal? Yes. With the information published on company web sites and the preponderance of written material available today, there is little competitive information that cannot be uncovered using legal, ethical means.

To help guide those gathering competitive intelligence, SCIP has published "Society's Code of Ethics," which "forbids breaching an employer's guidelines, breaking the law, or misrepresenting oneself." SCIP's guidelines for intelligence-gathering professionals are the following:

- To continually strive to increase respect and recognition for the profession at local, state, national, and international levels
- To pursue their duties with zeal and diligence while maintaining the highest degree of professionalism and avoiding all unethical practices
- To faithfully adhere to and abide by their own company's practices, objectives, and guidelines
- To comply with all applicable laws
- To accurately disclose all relevant information, including their identity and that of their organization, prior to all interviews
- To fully respect all requests for confidentiality of information
- To promote and encourage full compliance with these ethical standards within their company, with third-party contractors, and within the entire profession

FUN FACTS

Mattel's Barbie® and Ken® were a couple for 43 years. In 2004, the company's vice president of marketing said they were "breaking up." It seems nothing lasts forever. Competitors are probably trying to determine why. Do you think there is a competitive implication here?

Many firms dealing in CI have incorporated SCIP's code of ethics and made additions to it as well. Some examples follow.

1. Employees never lie when representing themselves.
2. They do not provide false or misleading information.
3. They do not try to confuse or deceive during interviews.
4. They never use threats or intimidation.
5. They do not deal in corporate espionage by stealing trade secrets.
6. They conduct all Internet research in a legal manner.
7. They do not offer money or special favors for information.
8. They do not install listening devices in competitors' businesses.
9. They do not record conversations without permission.

The Competitive Intelligence Industry

According to the Society of Competitive Intelligence, the market for business intelligence is worth about $2 billion a year worldwide. Services range from detailed investigations to clipping news articles. According to research in the late 1990s, 60 percent of all surveyed U.S. companies had a structured intelligence system.

Competitive intelligence is not just for big business, though. Entrepreneurs starting small businesses need it just as much. The major difference is that while big business may hire a CI firm to gather information, small businesses must educate themselves in CI procedures and perform the work themselves.

Regardless of your size, big company or small, to a large degree your success lies in knowing what your competition is doing. Business decision-making should be more of a science than an art. A big part of making it a science is having accurate data upon which to base decisions.

Analyze your competition carefully. You can be sure they are watching and analyzing you.

Chapter Review

Ship in a BOTTLE

Survey the Competition

One of the attractions of the ships-in-bottles business to Fred was the lack of competition. At first glance he believed he had the market pretty much to himself, but when he did some research he learned he was far from alone when he considered the tremendous amount of indirect competition and substitute products.

In the wholesale business, indirect competition came from the 50 plus wholesalers and manufacturers who were active in the quality specialty nautical product business. Although their products did not duplicate his, they were after the same target market that Fred was. Their presentations and sales of items such as ship models, kits, and nautical artifacts could quickly absorb the retail buyer's open to buy budget. During the trade show Fred often heard "Well, I'd be interested, but I've already gone over my purchase budget in ship models."

Fred started a list of the companies he'd heard the most about in order to design a competitive strategy. He would have to create arguments why a buyer should stock ships in bottles in addition to ship models and other related items. He would point out the advantages of ships in bottles in terms of uniqueness, space requirements, and sometimes price compared to large ship models. He would not pretend that the competition did not exist and would offer his product as one that complemented the other. The argument that a complete nautical gift display should offer ships in bottles as well as ship models, nautical instruments, kits, and other artifacts held considerable merit.

Fred also learned he should not dismiss the inexpensive souvenir competition. He worked on designing presentations that demonstrated that his product was distinctly different and served a different market.

The retail Internet market was filled with nautical gift sellers. Again, although they did not offer the same product, they were selling to the same market. Their web sites often advertised a complete selection of all nautical gifts, including one or two models of ships in bottles purchased from a souvenir wholesaler. Fred's new web site would address this potential competition by announcing boldly that he had the largest selection available in the U.S.

One area he felt confident about was that it was a very difficult market for new entrants. Building ships in bottles was a rare skill. It was practiced by some modeling experts, but few would turn it into a commercial business because of the lack of trained labor and the difficulty of acquiring parts. Some of Johann's relatives were trained in the craft, and he had a source for bottles and materials in the Philippines that was not known to many. In the past there had been competition, in particular another German manufacturer. However, he had left the market because of material supply problems and a lack of qualified help and returned to making customized models.

Fred did not consider the modeling experts competition, as they served an entirely different market.

A buyer looking to purchase an individual customized model for $1,500 and willing to wait six months for its completion was not part of Fred's target market. He was only too glad to pass along the names of professional modelers to inquirers.

continued

Think Critically

1. What other sources of information should Fred investigate to determine the strength and number of his competition?
2. Fred is very vulnerable to the bargaining power of his supplier. Johann could change distributors or decide to manage the U.S. market himself. What should Fred be doing to protect himself from this threat?

Summary

Knowledge of the competition is vital to all entrepreneurs if they are to survive in the business world. Competition and private enterprise are dependent on each other. Competition in the United States is created by the following factors: similar products and services, multiple buyers and sellers, freedom to enter or exit business, and the guarantee of fair competition. Fair competition is ensured by three acts of Congress: the Sherman Antitrust Act, the Clayton Act, and the Robinson-Patman Act. In addition, the Federal Trade Commission regulates business activities to prevent unfair competition.

When it comes to business competition, Harvard Business School Professor Michael Porter's body of work is the analytical standard. Porter identifies five forces that drive competitive activity:

1. Intensity of rivalry among existing competitors
2. Threat of entry by new competitors
3. Pressure from substitute products
4. Bargaining power of suppliers
5. Bargaining power of buyers

Any entrepreneur contemplating entry into a new industry should examine all these forces. Current entrepreneurs should also study these forces as they struggle to stay competitive in markets where they already operate.

There are two types of competition, direct and indirect. All competitors, whether direct or indirect, must be identified and analyzed. The geographic distribution of both customers and competitors is one of the first factors an aspiring entrepreneur should consider.

In the next step, specific competitors must be identified and a more detailed analysis begun. Businesses that have failed in the recent past must also be analyzed to determine why they failed and to look for any trends that may be useful for planning purposes.

The next step is to look at both direct and indirect competition from an analytical perspective. Current competitors must be analyzed in five areas: price, location, facility, type of competition, and rank. After competitors are analyzed, the information should be used to identify strengths and weaknesses of the new business.

Competitive analysis has become so essential that it has spawned a whole new industry. Today, entrepreneurial ventures all over the world sell the service of gathering competitive intelligence, or CI. Competitive intelligence is a systematic and ethical program for gathering, analyzing, and managing external information that can affect a company's plans, decisions, and operations. SCIP, the Society of Competitive Intelligence Professionals, has created guidelines for the conduct of CI professionals.

Chapter Review

A Case in POINT

"A GOOD JOB" FOR THE COMPETITION

Two weeks ago Benjamin Dinges opened his new business, a store called Sporting Life. It offers a full range of athletic equipment designed for weekend athletes.

Business has been very slow for Ben, and he is getting discouraged. The new business has not lived up to his expectations at all. In the beginning he thought that once he got enough money together to open the store, customers would automatically start coming in. He had put up the equity on his home as security, done the necessary work to get the rented facility ready, and chosen the right kind of merchandise.

A few customers had come in, but most left without buying anything. He had been so frustrated he'd asked several of them why they didn't buy. They told him they could get the same merchandise at a lower price from the competition. When he pressed them for names, they mentioned several. He had heard of only one of the competing stores.

Back in the planning stage, he had known there would be competition, but he didn't worry about it. "Just do a good job," he had told himself. "That's all it takes. Let the competition worry about me. I'm going to be the problem, not them."

Think Critically

1. If you were a friend of Ben's and he asked you for advice, what would you say to him at this point?
2. Do you think there is any chance of salvaging Ben's business? What is the biggest mistake he has made so far?
3. Do you think Ben gave himself good advice when he said, "Just do a good job"? Why or why not?

Vocabulary Builder

1. Clayton Act
2. competition
3. competitive analysis
4. competitive impact
5. competitive intelligence
6. direct competition
7. indirect competition
8. monopoly
9. price discrimination
10. price fixing
11. Robinson-Patman Act
12. Sherman Antitrust Act
13. tying agreements

Review the Concepts

14. What is competitive impact?
15. How does competition relate to private enterprise?
16. What is the difference between direct and indirect competition?

17. What is meant by geographic distribution of customers?
18. What is Porter's Five-Forces Model of Competition?
19. What does Porter mean when he says, "Rivalry is usually stronger when demand for the product is growing slowly"?
20. What does Porter mean by the bargaining power of suppliers?
21. Why is it important to analyze competitive strengths and weaknesses?
22. Define competitive intelligence.
23. Is competitive intelligence legal? Is it ethical?

Critical Thinking

24. Name the four factors that create competition in the U.S. Briefly explain each factor.
25. How does a monopoly eliminate competition?
26. What role do customers play in determining the geographic distribution of competition?
27. Why is it important to analyze competitors that have failed?
28. What are the five factors to consider when analyzing current competitors?

Project

Build Your Business Plan

As you continue the planning process for your new business, it is now time to take the information presented in this chapter and use it to get to know your competition. Complete the following steps in your business plan notebook.

1. Take a map of your area and put a star on the general site of your new business. With a marker, draw a circle around your anticipated geographic market area.
2. Using the Yellow Pages and other available resources, make a list of businesses that are potential competitors within the geographic market area.
3. Try to find out if businesses similar to yours have failed in the past year. List those businesses on a separate sheet of paper.
4. Now make your own copies of Tables 7-1, 7-2, and 7-3. Complete the tables as fully as you can.