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Competitive Strategies

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This reading contains links to online interactive illustrations and video, denoted by the icons above. To access these exercises, you will need a broadband Internet connection. Verify that your browser meets the minimum technical requirements by visiting <http://hbsp.harvard.edu/tech-specs>.

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1 INTRODUCTION

“Have you been Scroogled?” Between November 2012 and 2014, this provocative advertising tagline encouraged consumers to stop and consider something that had become habitual for many: using Google to search the web. The ads claimed that Google was amassing a repository of its users’ search data and selling it to advertisers, who would then use it to manipulate consumers into buying things they didn’t need. The campaign sent consumers to a website where they could learn about Google’s business practices and purchase T-shirts and mugs emblazoned with the tagline. The final seconds of the ads revealed their sponsor—Microsoft, which offers Bing, an alternative search product. In a savvy stroke of negative campaigning, the ads concluded with a call to action that hit squarely at Google’s revealed weakness: “For honest search results, try Bing.”

Negative campaigning has leaked out of the realm of politics and into the arena of marketing. The Scroogled campaign’s frontal attack and negative tone were designed to capture attention, generate publicity, and shake consumers out of their habitual Googling stupor long enough to consider Bing as an alternative.

With Scroogled, Microsoft went head-to-head with a formidable competitor. Google counted among the world’s leading brands, beloved and trusted by its customers, whereas Bing hadn’t gained much traction since entering the market in 2009. Google commands a 67% market share, compared with Bing’s 18%, and in brand favorability polls, Bing trailed Google by 45%.¹ Bing is the quintessential underdog brand, while Google comes across as a monopolist. But it does appear that the \$10 million Scroogled campaign accomplished its goal. In one study, 53% of consumers who viewed one of the ads indicated they would consider Bing or seek more information about Google’s business practices.²

Bare-knuckled battles like this one play out every day in the marketplace. Small, nimble challengers take on entrenched market leaders. Dominant players squash young upstarts. Bitter rivals push each other to make bad decisions, leading to vicious contests with few winners. But sometimes companies stand the best chance of surviving if they resist getting pulled into no-win conflicts—and look for opportunities to deploy moves characterized by cooperation that yield outcomes that benefit all players.

This Core Reading illuminates the dynamics of companies in competition and offers a process for planning and executing marketing strategies to compete in a rapidly changing marketplace. Its goal is to arm managers with the information they need to make marketing decisions that take into account their competitors’ likely responses. The reading explains how to assess the opportunities and

challenges of competing, as well as how to choose “games” (competitive contexts) that offer the best potential for enhancing a company’s profitability. It discusses how managers can change the opportunities the marketplace presents to them by alleviating restrictive competitive forces and by competing in ways that are more conducive to growth. The reading concludes by considering how consumers respond to marketplace competition and how companies can frame the competitive games they play to their advantage through savvy brand positioning and marketing communications.

2 ESSENTIAL READING

2.1 Competitive Dynamics in Marketing

Marketplace competition is complex. Organizations of all types have an end goal. For-profit companies may want to win market share or enhance shareholder returns, whereas nonprofit organizations may seek to fulfill a mission such as improving quality of life for specific social groups or protecting the environment. For all players, the stakes are high—firms invest considerable financial and human resources to launch products or services, and many fail to recoup those investments. As they compete, organizations have to deal with entrenched systems and structures and follow rules governing a wide range of decisions, which determine how they can set their prices or which channel partners they can access. These “rules of the game” put serious constraints on the moves a firm can make.

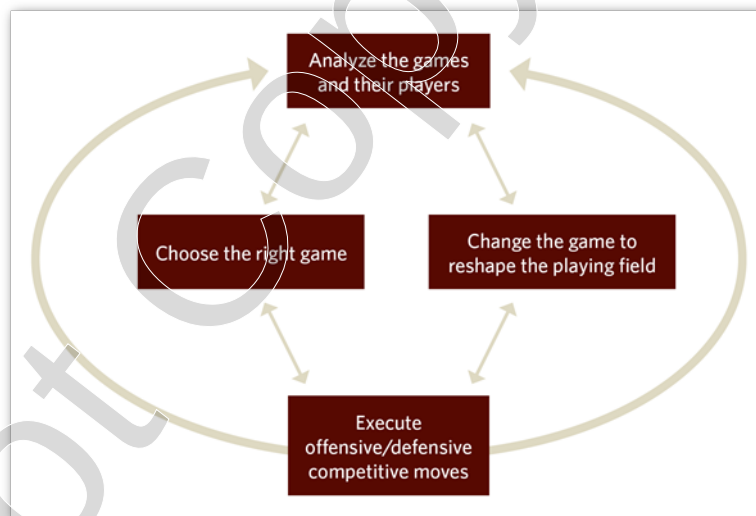
To compete in today’s marketplace, companies also have to operate in an increasingly complicated arena. Minor changes in strategy often lead to major consequences that no one expected. Hindsight proves largely useless because conditions change so quickly, and seeing beyond the next few moves is critical. As players learn from painful experience and adapt to shifting conditions, they evolve—as does the game itself.

Moreover, players bring different knowledge, skills, and experience to the game, and how they play shapes the outcomes. Some companies make moves that are based on emotions or instinct, relying on their past experiences to provide guidance and deftly changing their marketing strategies as the game evolves. Others take a seemingly safer, pragmatic approach, calculating probabilities and choosing moves that promise the highest potential payoff at each decision point. Still others play hardball, seeking to win at any cost.

Playing smart requires not only awareness of a company's distinctive resources and capabilities, but also deep intelligence about its opponents. Yet all too many managers approach marketing strategy with a single-minded focus on their own actions. That's dangerous—because competition is a dynamic game. To understand whether a strategy will succeed, managers must imagine themselves in their opponents' heads and play out all potential cascading actions and reactions.

The best players understand the game being played and have the flexibility to marshal resources and deploy strategies that put them in a position to win. They continuously monitor, learn from, and adapt to changing conditions, and they possess the confidence and bravado to challenge the game's structure and rules to uncover new opportunities to capture value. **Exhibit 1** depicts a dynamic process model for managing marketplace competition. We'll explore each part of this model in subsequent sections of this reading.

EXHIBIT 1 A Dynamic Process Model for Managing Marketplace Competition



The most talented marketing strategists excel at two things: choosing where to play, and figuring out how to win on their selected playing field. Hear more about these two choices in Video 1. In the process model shown in Exhibit 1, the choice of where to play (that is, which competitive context will be appropriate for the company) is informed by a thorough analysis of a firm's business model, its competitors, and the game's landscape, including what the firm and its competitors bring to the table, as well as the opportunities and constraints of the competitive context. Ideally, "the right game" will be one in which the resources and capabilities that the firm brings to bear are superior to those brought by the competition and are well aligned with what customers value. Once managers have chosen the right game, they execute offensive and defensive moves in the

marketplace, while simultaneously observing and analyzing rivals' moves. These actions either reinforce the existing game or reshape the playing field in ways that create new advantages for one or more competitors.



VIDEO 1 The Two Choices to Make in Strategy



Scan this QR code, click the icon, or use this link to access the video: bit.ly/hbsp2uo4CM

The dynamism of this process model suggests that to succeed, managers must not only play the right game but must also play the game right.

2.2 Analyzing the Games and Their Players

2.2.1 Taking Stock of the Marketing Arsenal

When crafting competitive strategy, most marketing managers start by analyzing data about their competitors. It's better to look inward first, however. A company's own marketing resources and capabilities represent the competitive weaponry a company has in its arsenal and present a picture of the firm's strengths and weaknesses. *Resources* are the hard and soft assets a company owns, such as its product designs and performance, brands, retail establishments, and customer relationships. *Capabilities* (also referred to as competencies) are activities that the firm performs proficiently and that are valued in the marketplace, such as managing customer relationships, providing customer service, and enticing customers with inbound marketing communications.

Marketing resources and capabilities constitute important building blocks in a firm's *business model*—a framework that captures the way a company creates value in the marketplace, the resources and capabilities that enable it to deliver that value to customers, and the financial engine and profit formula that help it capture some of that value in the form of profits. Successful companies build a stable of marketing resources and capabilities that support their business model and that are ideally distinctive from and superior to those of competitors.

Exhibit 2 lists common marketing resources and capabilities and the forms of value they provide.

EXHIBIT 2 Marketing Resources and Capabilities

Resources	Value
Customer relationships	Existing customers generate current and future profits for the company.
CRM database	Customer data help companies effectively and efficiently market to their target customers and build enduring relationships with the most profitable ones.
Brand equity	Strong brands are assets that help companies garner a premium price.
Distribution channel relationships	Strong relationships with channel partners help companies distribute their offerings to customers and can limit competitors' access to the marketplace.
Retail stores and e-commerce websites	Brick-and-mortar and virtual spaces allow companies to deliver their offerings to customers.
Patents and trademarks	Legal protections prevent or discourage competitors from copying and selling innovators' products and brands.
Marketing communications creative platform	The right brand positioning communicated with a strong creative vision and delivered through the right media can generate demand for a firm's offerings.
Marketing communications and media budget	Media spending can help companies capture a dominant share of voice.

Capabilities	Value
Market sensing	Anticipating and recognizing market forces and trends help companies craft plans for the future.
Customer relationship management	Managing customer relationships well can reduce customer-acquisition costs and help companies maximize existing customers' profitability.
Brand management	Strong brand builders enhance the asset value of their company's brands and ensure that all its marketing actions further enhance brand equity.
Channel relationship management	Strong relationships with distribution channel partners reduce channel conflict that can drive down profitability.
Product and service design and R&D	Superior design and research-and-development expertise can generate new products and services that deliver value to customers and the company.
Market research	Comprehensive research helps companies better understand their customers, enabling more effective and efficient marketing.
Marketing communications	The ability to craft compelling messages and deliver them effectively to consumers lets companies extract maximum value from their media budget.
Pricing flexibility and expertise	The ability to adjust prices to capitalize on differences in customers' willingness to pay can increase a company's profits.

To analyze their company's marketing resources and capabilities, managers can explore the following questions:

- How highly do our customers value this resource or capability? Why is it important, and what value does it deliver to our customers?
- How good are our resources and how strong are our capabilities compared to customers' expectations?
- How important is this resource or capability to our success? How does it help us extract value from our customer relationships? How does it help us increase our revenue or reduce our costs?
- How well do we support this resource or capability? Do we have the right level of financial and human resources behind it?
- How well protected is this resource or capability? Do we have patents, trademarks, intellectual property rights, or proprietary processes that prevent or discourage others from using or copying it?
- What can trump this resource or capability? What would make it obsolete?

2.2.2 Mapping the Competitive Landscape

To map the competitive landscape, a company identifies and analyzes firms that compete with it by delivering a similar product to consumers or an alternative solution to meet consumers' needs. It's critical to assess not only existing competitors but also possible new competitors that could arise in the future. In fact, anticipating tomorrow's competitors today can be the difference between being surprised and being prepared to compete the instant a new rival appears on the scene.

To analyze the competitive landscape, companies can use a tool called **strategic group mapping**: managers visually represent the competitive field by constructing a topological map identifying **strategic clusters**—groups of industry rivals that share similar characteristics, such as products, target markets, price points, quality levels, and points of differentiation. (See *Core Reading: Brand Positioning* [HBP No. 8197] for a discussion of a similar tool, *perceptual mapping*.)

Through strategic group mapping, marketing managers can:

- Identify their closest competitors—those mimicking their company's strategies and posing the biggest threat
- Identify future contenders by illuminating competitors in adjacent strategic groups that might easily shift closer to the firm's strategic group
- Analyze barriers limiting movement among groups to anticipate future competitors

- Identify untapped opportunities—ones where competition is slim—that may be fertile for expansion, particularly if those opportunities have the potential to serve unmet consumer needs

To build a useful strategic group map, a manager should gather input from customers—especially regarding how they consider, purchase, use, and switch among products and brands. Such input helps managers create a comprehensive picture of the competitive field. After all, customers’ perceptions of their options, along with their consumption behaviors, reveal much more about who a firm’s competitors are than a marketing manager’s internal analysis does.

2.2.3 Defining the Competition

Identifying a firm’s competitors can be challenging. Many managers take an overly narrow perspective, identifying as rivals only those companies that sell the same offering to the same customers. Looking for competitors only within one’s own industry leads to what marketing scholar Theodore Levitt called “marketing myopia.”³ By broadening their perspective from a particular product or service category to the greater consumer need being served, managers can identify potential adversaries whose products or services meet the same need even if they look decidedly different. For instance, consumers’ need for transportation can be met by numerous products and services. For a company that makes cars, competitors include not only other automotive manufacturers but also public transportation services, taxi and car-rental services, and even bicycles. Adopting the customers’ perspective helps managers identify all potential substitutes. Learn more about Levitt’s notion of marketing myopia in **Video 2**.



VIDEO 2 Marketing Myopia



Scan this QR code, click the icon, or use this link to access the video: bit.ly/hbsp2utt6As

Sometimes competitors come from decidedly unexpected directions and take surprising forms. Clayton Christensen identified an especially dangerous type of competitor that he called disruptors—companies that enter the fray with low-end, simple offerings that don’t strike **incumbents** as threatening. The incumbents ignore them because they’re more concerned about newcomers that sell products or services that deliver higher performance than their own. So they keep trying to make next-generation products that are bigger and better than their predecessors. Meanwhile, the disruptors are quietly attracting customers previously unserved by the mainstream offerings. After gaining a foothold in the industry, disruptors gradually improve their offerings’ performance—capturing larger swaths of consumers and eventually taking over mainstream market segments, as can be seen in the sidebar “Disrupting Photography.”

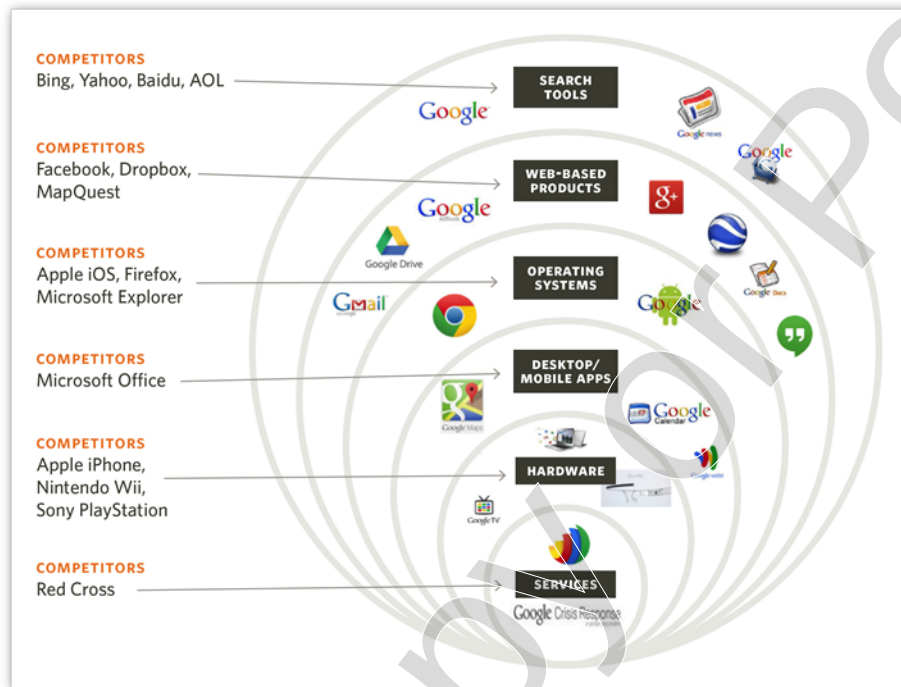
Disrupting Photography

The business landscape is littered with companies that failed to anticipate and respond effectively to **disruptive innovations**. Kodak is a case in point. The company entered bankruptcy after failing to take seriously the threat presented by digital photography. Surprisingly, the technology that enables digital photography was invented at Kodak, but managers who saw it as inferior to film photography shelved it. Fearing that Kodak would cannibalize its own high-margin film business if it launched the inferior technology, Kodak let Nikon, Sony, and Canon enter the market. Today, digital photography accounts for the vast majority of all pictures taken.

Even now, a new disruption is shaking up the photography business. Cameras embedded in smartphones, initially dismissed as inferior substitutes for digital cameras, are gaining ground. Consumers love them because it's so easy to take pictures and upload them to social media sites. As smartphone manufacturers have continuously improved their cameras, the quality differential between a camera phone and a digital camera has shrunk. More and more consumers see no need to spend big on a digital camera when their mobile device does the job for them.

Who constitutes a firm's competitors can also shift as the company's business model changes. Google, for instance, started out as an online search platform, but when it expanded into other product and service categories, it soon came face-to-face with many new opponents. Today Google competes not only with Microsoft but also with rivals as diverse as Apple, Garmin, Facebook, and Nintendo. **Exhibit 3** reveals the complexity of Google's current competitive landscape.

EXHIBIT 3 Google's Competitive Landscape



2.2.4 Comparing Players' Marketplace Positions

Competitors occupy different positions in the marketplace. Some are **market leaders**, dominating their industries and enjoying large market shares. Some are **market challengers**, aggressively pursuing strategies to gain market share and unseat the market leader. Some are **market followers**, content to let others lead while they doggedly mimic rivals' innovations. Some are **market nichers**, delivering specialized products designed to serve small segments in the marketplace that competitors have ignored. **Exhibit 4** shows examples of competitors' marketplace positions in three product categories.

EXHIBIT 4 Examples of Marketplace Positions

	Hair Removal	Web Search	Fast-Food Restaurants
Market leader	Gillette	Google	McDonald's
Market challenger	Schick	Bing	Burger King
Market follower(s)	Bic	Yahoo	Wendy's, Hardees
Market nicher	Veet, Nair. While other competitors are fighting for the razor market, nichers like Veet and Nair compete for consumers' demand for alternative hair-removal solutions, such as waxing or chemical exfoliation.	Technorati. While most search engines search the entire web, nicher Technorati searches only user-generated content.	UFood. While most fast-food restaurants focus on quick, inexpensive service, UFood offers healthful fast food.

Understanding competitors' market positions gives managers valuable insight into each rival's focus and probable future strategies. Moreover, a competitor's market position illuminates its strengths and weaknesses as well as opportunities and threats. For example, many market leaders drive innovation, investing heavily in research and development (R&D) to stay ahead. Market challengers tend to channel the lion's share of their resources toward marketing, outspending others to gain a dominant **share of voice**. Market followers often launch me-too products that require minimal R&D or marketing investment, which lets them sell their offerings at lower price points. Market nichers steer clear of mainstream consumers to avoid attracting attention and retaliation from market leaders.

Market positions often change, so managers must also analyze the competitor dynamics. Which competitors are gaining and losing market share? Which have become more offensive, and which have shifted to defense? Answers to questions like these shed light on which competitors are actively mounting challenges and which are content to stay in the slipstream of others, following or drafting off of the ideas and momentum of the market leader. Dynamic analysis can also help managers anticipate rivals' future trajectories: Which nichers are gaining capabilities that could help them move outside their niche? Which followers are showing higher investments in R&D that indicate the intention to become a challenger? Which challengers are outspending the market leader to lay the groundwork for taking over a market?

Understanding market positions can also help managers plan their own strategies. Which market position does the firm want to occupy? Which resources and capabilities (e.g., deeper understanding of customers or

development of new technologies) will it have to acquire or strengthen to gain and hold that position?

2.2.5 Understanding Competitive Advantage

Competing differently from rivals constitutes the heart of marketing strategy. A **competitive advantage** is *something a company does that has value for consumers and that competitors cannot match*. A **sustainable competitive advantage** is one that is likely to persist over time despite changing market and competitive conditions. Firms build competitive advantage by doing something *better than* other companies do, doing something that the others *don't* do, or doing what rivals *can't* do.

Firms generally compete on cost or differentiation. To compete on cost, they achieve the lowest costs (for example, by maximizing operational efficiencies) so they can offer consumers the lowest price. This strategy requires a ruthless approach to cost reduction. To compete on differentiation, companies develop offerings with unique and superior attributes or performance. This strategy may require considerable investment in R&D and marketing.

The size of a company's target audience also affects its approach to gaining competitive advantage. Some companies strive to serve a mass market. This approach requires scale and the right resources to broadly market and distribute a product or service to diverse audiences. Other companies deploy a niche strategy, which requires knowing a particular group of consumers so well that the firm can customize its products to meet their needs in a superior way.

To assess their company's competitive advantage, managers should determine what makes their products or services unique. Do the firm's offerings have a cost, product, or service advantage that sharply distinguishes them from others'? Does the company have marketing advantages, such as advertising efficiencies gained from a large market share or big marketing budgets? Does the company already have an established, strong brand? Does it have enduring relationships with customers and with key **complementors**? Does it boast superior R&D expertise to keep new products flowing through the development pipeline? Does it have employees who excel at delivering customer service?

To assess their company's competitive strengths, managers can also use weighted-attribute modeling to understand consumers' perceptions of how a firm's resources and capabilities stack up against those of the competition. Such analysis can yield additional insights useful for crafting competitive strategy. (See *Core Reading: Creating Customer Value* [HBP No. 8176], for more detail on how to conduct a competitive-strength assessment using this type of modeling.)

Exhibit 5 depicts a competitive-strength assessment of sport utility vehicles (SUVs). The assessment shows that, at the time of the survey, consumers viewed the Land Rover as having lower performance, aesthetics, comfort and convenience, and economic value than the Jeep Grand Cherokee or the Ford Explorer. Consumers consider all these characteristics to be important. When these attributes were added together and weighted according to their importance to consumers, the Land Rover had the lowest rating. The customers who were surveyed probably wouldn't buy it unless the company revamped its marketing efforts to address the perceived weaknesses.

EXHIBIT 5 SUV Competitive-Strength Assessment

Resource or Capability	Importance Weight	Land Rover Discovery		Jeep Grand Cherokee		Ford Explorer	
		Strength Rating	Weighted Score	Strength Rating	Weighted Score	Strength Rating	Weighted Score
Quality	0.20	7.4	1.48	7.2	1.44	7.4	1.48
Safety	0.20	7.6	1.52	7.4	1.48	7.4	1.48
Performance	0.15	6.4	0.96	7.2	1.08	7.1	1.07
Off-road capability	0.10	7.4	0.74	7.2	0.72	7.1	0.71
Aesthetics	0.10	6.5	0.65	7.5	0.75	7.5	0.75
Comfort and convenience	0.10	6.9	0.69	7.5	0.75	7.6	0.76
Economics	0.10	4.9	0.49	5.6	0.56	6.1	0.61
Status/image	0.05	6.9	0.35	7.4	0.37	6.8	0.34
Overall Rating (weighted)		6.88		7.15		7.20	

Note: Importance weights are estimated on the basis of customer rankings of attribute importance. Strength ratings are based on customer perceptions of major SUV brands as measured by Allison-Fisher, Inc., "Barometer of Automotive Awareness and Imagery Study," 1994.

Source: Adapted from Harvard Business School, "Land Rover North America, Inc.," HBS No. 596-036, by Susan Fournier. Copyright © 1995 by the President and Fellows of Harvard College; all rights reserved.

A competitive-strength assessment helps managers uncover their relative strengths and weaknesses versus their competitors' in the minds of consumers, and use the insights to strengthen their marketing strategies. But to compete effectively, firms must also get inside the heads of their competitors and clearly understand each rival's guiding mission, business model, market position, and marketing strategies. They must decipher the customer segments each competitor is targeting and the position each occupies in the minds of consumers. They also need to compare each rival's products, services, price points, distribution strategies, and marketing communications against their

own. Through such rigorous analysis, managers can identify areas of opportunity and anticipate competitors' likely responses to marketplace moves.

Competitive analysis involves understanding a competitor's current strategy and then extrapolating from its actions and investments to anticipate its future moves. By understanding the strategic trajectories that a competitor might take, managers can plan their own strategies for neutralizing any advantages that a rival might gain. Managers can map a competitor's potential trajectories and then assess the likelihood of the company's achieving a particular trajectory, given its current and future resources and capabilities. For an alternative view of competitive analysis, see the sidebar "Kill the Company."

Kill the Company

The consultant Lisa Bodell has developed a process that turns traditional competitive analysis upside down. Rather than asking her marketing manager clients to think about how they can beat the competition, Bodell asks them to consider how the competition can beat them. Through a series of what she calls "Kill the Company" exercises, she challenges them to put themselves in their competitors' heads and then think of ways to attack. She asks managers a simple question, "What would you do right now to put us out of business or render us obsolete?" Successfully killing your own company requires a deep understanding of your competitors' resources and capabilities, combined with an honest assessment of your own vulnerabilities. It illuminates competitive threats, both big and small, and helps managers identify ways to bolster their companies' defenses to protect against those threats.

Bodell also uses "Killer Queries" to spark competitive analysis, such as:

- What two things could our competitors do to make our products or services irrelevant?
- What three things could a competitor do for our customers that would make them leave us for that competitor?
- How low does our competitor's price need to get before we lose one-third of our customers?

Source: Lisa Bodell, *Kill the Company: End the Status Quo, Start an Innovation Revolution* (Brookline, MA: Bibliomotion, 2012).

2.3 Choosing the Right Game to Play

2.3.1 Analyzing the PARTS of the Game

“The essence of business success is making sure you’re playing the right game,” according to Adam Brandenburger and Barry Nalebuff, who have studied firms in competition across industries.⁴ But there are many different games to play in a marketplace, and marketing managers have to assess their attractiveness in terms of expected rewards and potential risks. Analyzing playing fields is critical to choosing the right game to play. Without this perspective, managers are flying blind as they plan and execute competitive strategies. The rules of a game determine the potential payoffs and penalties that players can win or incur by executing certain tactics.

Game theory provides a useful lens for analyzing a competitive game. **Game theory** comprises sets of concepts aimed at understanding the decision-making processes of individuals or firms in interactive situations of competition with complementary and conflicting interests. Game theorists use the acronym PARTS as a framework for analyzing games.⁵ The PARTS of a marketplace game include the following:

- *Players* are the companies that compete and the supporting actors who contribute to the game, such as suppliers, customers, complementors, and collaborators.
- *Added values* are the incentives and disincentives in the game that move competitors toward and away from actions. Added values determine the benefits and costs of playing the game.
- *Rules of engagement* are the laws, contracts, customs, and practices that guide players’ actions.
- *Tactics* constitute the possible actions each competitor has at its disposal, such as offensive or defensive moves.
- *Scope* represents the boundaries of play—for example, the market segment served or the customer need addressed.

Let’s take a closer look at some of these. As we saw in Section 2.2, the main players and the marketing resources and capabilities they bring to the playing field powerfully influence a firm’s ability to compete profitably in an industry. But supporting players often play a large role in determining a game’s attractiveness. Marketers frequently have to contend with strong, powerful collaborators, such as retailers, to deliver their products to market. Walmart, for example, is an invaluable yet formidable partner for most consumer-products companies. The largest retailer in the world, Walmart offers manufacturers dizzying access to consumers and can account for a large chunk of a

manufacturer's annual sales. In return for this access, Walmart demands rock-bottom prices as well as flawless customer service and logistics from its suppliers. As a result, some manufacturers find it difficult to make a healthy profit on their sales to Walmart.

Added values can also have a big influence on an industry's profitability. Take the grocery business. Food retailers often charge manufacturers hefty slotting fees to put a new product on their store shelves. The size of these fees limits the types of products that come to market: large, well-funded firms with established **brand equity** are the only ones that can afford to pay the big fees and get their products on store shelves. When firms must make a high upfront investment just to get into the game, many get shy about taking on additional risks. As a result, they may restrict funding for development of truly revolutionary offerings, leaving consumers with merely evolutionary products that make it to market.

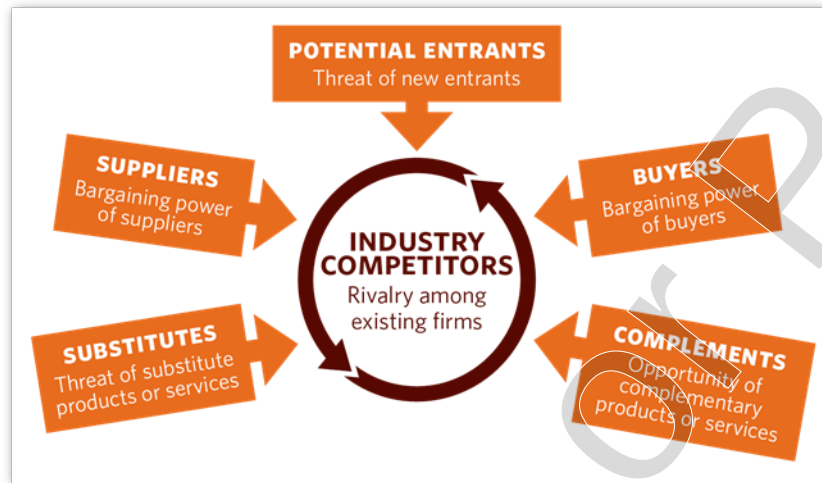
Rules of engagement can also determine which games are most attractive. Some industries are highly regulated, which limits firms' control over how they develop, price, promote, and distribute their products. In the pharmaceutical industry, for example, a rigorous and lengthy product-approval process drives R&D costs up. Patent law protects product innovations only for short periods, which restricts firms' ability to charge premium prices in the long term. And promotion and distribution regulations raise marketing costs.

Marketers can use the PARTS framework to analyze the potential competitive games available in the marketplace and assess their attractiveness. (See Supplemental Reading 3.1 for insights on the structure of different types of games.)

2.3.2 Finding a Profitable Competitive Space

Like games, some industries are more attractive than others. Michael Porter has identified the competitive forces that influence an industry's attractiveness.⁶ His core framework identified five forces, but industry researchers subsequently proposed adding a sixth force (complements).⁷ These six forces, summarized in **Exhibit 6** and in **Video 3**, create the profitability potential for an industry and for the firms competing within it, helping managers to understand the opportunities and pitfalls of a particular competitive space. We will consider each force in turn.

EXHIBIT 6 Forces Governing Competition in an Industry



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VIDEO 3 The Six Forces



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Industry Competitors

Analyzing an industry's competitors can help managers assess the intensity of its competitiveness (low, moderate, or high). Industries characterized by highly intense competition often witness price wars, big spending on advertising and marketing, and frequent new-product introductions—all of which can sap players' profits. By contrast, industries that aren't as intensely competitive can be more profitable for players that venture into them.

Analysis of competitors can also reveal the basis on which firms compete. In some industries, firms compete on price; in others, it's product or service differentiation. To successfully deploy their company's resources and capabilities, managers must understand the basis of competition in that industry. For example, Amazon's operational strength has enabled it to succeed in many industries where efficient operations are essential. Starting in the book-selling business, Amazon then expanded to selling music and movies, household goods, and health and beauty products. In industries where competition is based on a luxury brand image, however, Amazon's operational competencies would be largely useless.

Understanding an industry's competitors can also generate insight into how rivals are configured in the competitive landscape. *Monopolists*, firms that

compete in industries in which they are the only dominant player, usually hold tremendous power over consumers—power that lets them charge high prices and thus capture considerable value from the market. *Oligopolists*, firms in industries where a few strong competitors hold the majority of market share, engage in tacit cooperation that lets them maintain their relatively high profitability, or they launch bitter price contests that drive profits down for each of them. Industries with **perfect competition** have many different competitors, all selling similar goods. These industries are characterized by intense competition, which makes them the least profitable.

Potential Entrants

The entry of new players into an industry raises the intensity of competition, putting profits under pressure.⁸ Thus, industries that have formidable **entry barriers (e.g., high startup costs)**, where the costs of entering the industry are high, and minimal **exit barriers (e.g., write-off and closure costs)**, where the costs of exiting the industry are low, are the most attractive. That's because few firms are drawn into the industry, and companies that are struggling can easily leave rather than try to stay and eke out a profit.

Marketers can use numerous strategies to erect entry barriers that discourage other companies from entering the industry. For instance, they can build brand equity, beef up their marketing communications, and strengthen customer loyalty. Building brand equity takes time and money, resources that newcomers may have in short supply. Industries characterized by large media budgets are often unattractive to startup firms with meager budgets, as they cannot compete in a communications war. Locking customers into long-term contracts can make it hard for new firms to steal those customers, further decreasing the industry's attractiveness. Marketers can also use feint attacks to hold new competitors at bay. For example, a software company may make a *vaporware* announcement (promoting software to the public that may actually never be manufactured or released), or a consumer-goods company may hint at a potential merger or partnership that would make the new entity indomitable.

Substitutes

When substitutes for a firm's offerings exist, consumers can easily shift to them. To retain customers, companies may lower prices or step up their marketing spending to create a perception of differentiation. Both moves drive down profitability. The worst type of industry to compete in is one in which there are perfect substitutes for a product or service.

Firms confronted with many substitutes need to differentiate their offerings to command a price that will deliver a profit. If they don't differentiate, customers will buy from the company that has the lowest price, making it impossible for other businesses to compete profitably. Patents and trademarks can help firms differentiate their products from substitutes and protect them from copycat imitations. A strong brand with established equity with consumers can also help transform a **commodity product or service** into a differentiated offering.

Buyers

The amount of power that buyers have in an industry also determines profitability. Buyers can be the end users of a product or service, such as the consumer who uses a manufacturing company's laundry detergent. Or they can be other middleman companies, such as retailers or distributors that bring the product or service to the end user.

Price-sensitive buyers who have substitutes available to them and who can easily switch offerings have power over the companies that make those products and services. Buyers also gain power when they organize themselves into collective buying units or when they share products' pricing information among themselves. What's more, they can accumulate power if they possess the capabilities to produce or obtain a product or service themselves rather than having to buy it from a company. Firms selling to powerful buyers have relatively little flexibility over their pricing and often give more value to their customers by lowering their prices in an effort to keep them satisfied. They must deliver what their buyers want—or risk losing them.

Conversely, buyers who are highly loyal to a brand, who have such strong preferences that nothing can substitute for the product or service they want, or who are locked into a purchasing contract, have relatively little power over the companies from which they're buying. Therefore, smart marketers use the tools in their arsenal to deepen consumers' loyalty to their brand, to increase customer "stickiness" through long-term contracts, or to make customers so dependent on a product that switching would be difficult or costly for them.

Suppliers

The amount of power that suppliers have in an industry also determines its profitability. A company's suppliers include enterprises that sell the raw materials needed to manufacture its products or the processes needed to deliver its services. Suppliers also include the employees who make a company's products or deliver its services.

Suppliers that sell materials or offer processes that have no substitutes, or that can make the product or deliver the service themselves and sell it directly to consumers, gain power over their customer companies. Suppliers also gain power when the cost of switching suppliers is high; for instance, when a product would need to be significantly redesigned to accommodate a change in its raw materials. In such cases, the customer firm is stuck working with its suppliers.

Suppliers can gain further power through *ingredient branding*, branding an ingredient or component sold by a supplier and used in a product or service. For example, many computer manufacturers use ingredient branding to inform consumers that their computer contains an Intel processor. Once customers associate a product with a particular ingredient brand, the company may feel compelled to keep using the branded ingredient in its offering. As a result, it becomes dependent on the supplier of that ingredient.

Powerful suppliers can raise their prices or limit the supply of materials or processes needed to build the customer company's product or deliver its service. Firms with powerful suppliers thus have less room to negotiate prices and other terms.

Complements

Many offerings can be bundled with other products or services (*complements*) to deliver greater value to customers. The consideration of complements as a sixth force was added to the model by industry researchers in the 1990s. These bundles, made up of complementary offerings from various firms, can help each company involved attract and serve more customers or sell more of their own products. Imagine how much less peanut butter would be sold without jelly, or how many fewer hotel rooms would be sold in Orlando, Florida, without direct flights from major cities. A web of complementary products well marketed by others can enhance sales for any one of the companies contributing a part of the bundle and thus boost that firm's profitability.

Industry Analysis

A thorough analysis of the six forces can help managers understand the constraints of the current game being played in their industry and craft strategies for changing that game to make it more attractive. For example, if many substitutes for a product exist, a firm can differentiate its offering to enhance its appeal to consumers to a degree that they view it as nonsubstitutable. If suppliers become too powerful, companies can vertically integrate—producing the raw materials they need in-house and developing their own branded ingredients.

In industries where customers have few marketplace options and are locked into buying from a company, managers at that company can raise prices to capture more value from each sale. If competitors are weak, manufacturers can lock retailers into exclusive deals to block rivals from gaining access to this distribution channel. If **network effects** (demand economies of scale) prevail in the industry, as they do in the video gaming industry, managers can lock in complementors, such as game designers, through noncompete clauses in contracts. Habituating consumers to a product is also a good idea. When an offering has become part of a daily routine, such as stopping at Starbucks on the way to the office, customers find it difficult to switch, which deepens their loyalty.

For more information about industry analysis, see *Core Reading: Industry Analysis* (HBP No. 8101).

2.3.3 Finding a New Game

If the way an existing industry is structured leaves little or no room for profitable strategic maneuvering, managers may decide to find a new game. W. Chan Kim and Renee Mauborgne studied more than 100 years' worth of strategic moves made by firms in competition. They found that trying to outperform the competition in an existing market often ends in futility. The researchers term this type of game a **red ocean**, because competitors bloody the "water" as they battle to win a greater share of existing demand. In red oceans, demand is stagnant, and the only way to win is to savage the competition—a scenario that no one really wants.

For this reason, Kim and Mauborgne recommend looking for so-called **blue oceans**, new market spaces where competition does not yet exist. These uncontested market spaces offer ample opportunities for companies to create demand through tactics such as attracting new customer segments, expanding the boundaries of an existing industry through revolutionary products or services, reinventing solutions to unsolved problems, or uncovering needs that consumers themselves didn't know they had. Blue oceans hold a greater promise of profitable growth because market demand is expanding and competitors are often slow to dip their toes in. See the sidebar "Nintendo Discovers a Blue Ocean" for an example.

Nintendo Discovers a Blue Ocean

After years of fighting head-to-head with its rivals Sega, Sony, and Microsoft for a share in the red-ocean market of video game home consoles and handheld systems, Nintendo moved to a blue-ocean strategy by launching its Wii video game console.

For years the four companies had bombarded the gaming market with a steady stream of new products offering increasingly advanced graphics and playing features aimed at winning the business of hard-core gamers and locking up the best game designers to develop software compatible with their systems.

As the gaming market matured and as gamers demanded more sophisticated, challenging, and technology-rich games, video games became too complicated for large swaths of consumers. Moreover, companies were finding it increasingly difficult to develop innovations for this market. Technological advances were becoming increasingly expensive, which drove console costs up.

Recognizing these developments, Nintendo identified a blue ocean and launched its Wii gaming console to serve a previously ignored market. Its technology was advanced in some ways—featuring handheld, motion-sensing controllers that let Nintendo transfer players' body movements to the screen and that made the game more interactive, social, and fun. But in other ways the Wii was simpler than the prevailing consoles of the day, featuring stripped-down graphics and lower processing speeds. The Wii also sold at a lower price because Nintendo used energy-saving chips and a standard optical disk player to keep costs down.

Nintendo initially targeted nongamers with the Wii. Indeed, 70% of the company's \$40 million launch advertising budget targeted older consumers and less experienced gamers. Ads featured parents and grandparents playing with their children and shattered the stereotype of a gamer.

Nintendo's blue-ocean strategy proved profitable. During its 2007 launch in the United States, Nintendo sold more Wii units than Microsoft's Xbox and Sony's PlayStation products combined. By the end of 2014, more than 100 million Wii consoles had been sold around the world.

Managers who are constantly scanning the environment for emerging developments or significant swings in technologies, tastes, fashions, or trends—and who are nimble and adaptive enough to capitalize on them—have an advantage. W. Brian Arthur studies the technology sector and has found that

staying on top of a rapidly changing landscape is critical. “Above all,” Arthur writes, “the rewards go to the players who are first to make sense of the new games looming out of the technological fog, to see their shape, to cognize them. Bill Gates is not so much a wizard of technology as a wizard of precognition, of discerning the shape of the next game. . . . Success goes to those who have the vision to foresee, to imagine, what shapes these next games will take.”⁹

2.3.4 Changing the Game

Playing in a no-win industry is uncomfortable at best and unprofitable at worst. Companies that want to compete in such an industry must alter the game to enable moves that will help them win. To change the game, a company can change the players who occupy the arena, the benefits and costs of playing, the rules of engagement, the tactics they use, or the game’s scope—or any combination of these PARTS. **Exhibit 7** and the sidebar “Changing the Ancient Game of Winemaking” show some examples.

EXHIBIT 7 Examples of Companies That Changed the Game

Which PARTS Changed	How It Changed
Players	UberX challenged taxi services when it hired everyday drivers and empowered them to use their own cars to transport passengers around the city.
Added values	Using other breweries’ excess capacity to brew its beer, Sam Adams catapulted over entry barriers in the beer industry and reduced its fixed costs, becoming more nimble and profitable.
Rules of engagement	Airbnb, the online service that connects property owners with people who want to rent their property, does not charge renters until 24 hours after their stay begins. This deters owners from misrepresenting their properties.
Tactics	Google built its brand almost entirely without advertising, eliminating a major cost and changing the way the game could be played.
Scope	Nintendo’s Wii expanded the scope of the video game market by generating demand among nongamers through fitness applications.

Changing the Ancient Game of Winemaking

The wine industry had long been dominated by so-called Old World producers from France, Italy, and Spain. New World competitors from Australia, the United States, and Chile challenged Old World producers' market leadership. Rather than taking on entrenched competitors on the existing battlefield, where the incumbents held all the advantages, the newcomers altered the value proposition and the marketing mix (product, price, promotion, and place strategies) they used to sell their wine, in order to make the wine game more favorable to them.¹⁰

The new companies recognized that ancient traditions, restrictive industry regulations, and national and international laws bound Old World producers to a particular business model that also created daunting entry barriers. These customs and regulations dictated almost every aspect of winemaking, including harvesting, production, marketing, and quality control. Producers were locked into inflexible distribution channel agreements with multiple partners that extracted a portion of the value along the way and left little for the winemaker.

To avoid going head-to-head with Old World opponents, New World wine companies deployed a five-pronged strategy. First, they pursued a different target market: unpretentious people who liked beer and spirits and who had felt intimidated by the wine industry's mystique. The companies sought to make brands that such consumers would see as fun, not stuffy or snooty.

Second, the new companies experimented with new grape-growing and winemaking technologies that enabled them to produce larger quantities at lower costs, with less variability in the final product. They built huge vineyards to boost their grape-growing capacity so they could readily adapt their product lines when consumers' tastes changed.

Third, they differentiated themselves with innovative "wine-in-a-box" packaging, which gave consumers a convenient way to transport and store wine. Screw-off caps replaced corks, which lowered costs further and eliminated wine spoilage.

Fourth, the New World firms controlled the entire distribution chain, from grape growing to product placement in retail chains. This control increased their bargaining power with retailers, reduced distribution costs, and ensured quality. The cost savings allowed them to price their wines lower, achieving price points equivalent to the price of a six-pack of beer.

Fifth, they built strong brands for their products. The small size of the Old World vineyards put constraints on their marketing budgets, so building a global brand was beyond their reach. New World brands leveraged their size advantage to invest heavily in strengthening their brands. By 2007 New World wine producers claimed as many as 14 of the world's top 20 wine brands.

Sometimes the best game changers end up helping not only themselves but also their competitors. Such companies use **co-opetition**, cooperation and collaboration between competing businesses, with reciprocal benefits in mind. For example, US insurance companies banded together to lobby state and federal governments for pro-industry insurance regulation changes. And facing public outcry about their efforts to market soda to children, PepsiCo and the Coca-Cola Company teamed up to voluntarily pull their soda products out of American elementary schools, changing the landscape of soda marketing but saving their image with the public.

When competitive forces are too strong, eroding opportunities to capture value from marketplace transactions, the smartest move may be deciding not to compete. As Brandenburg and Nalebuff once pointed out, “Sometimes it’s smart to change who is playing the game. That includes yourself.”¹¹

2.4 Playing the Game Right

Once managers have analyzed the games and their players and selected the right game to play, they must strategize about how to play that game right. The right moves to make depend on a host of conditions—including whether a company is an incumbent or a challenger, is an underdog or a top dog, is operating from a position of strength or weakness, and has more to gain or to lose. See the sidebar “Lipitor Enters Late but Topples Market Leaders” for an example.

Lipitor Enters Late but Topples Market Leaders

In 1997 Warner-Lambert launched a cholesterol-lowering statin drug, Lipitor. It was the fifth pharmaceutical brand to enter the crowded and fast-growing product offering. Three of the existing brands were blockbusters, scoring more than \$1 billion per year in sales. Doctors—important gatekeepers in the decision-making process for prescription drugs—were satisfied with existing options and didn’t see a need for another statin. But Warner-Lambert plunged ahead, confident that its product was superior. To take on its powerful competitors, it teamed up with Pfizer, a marketing and sales powerhouse known for its successful stewardship of Zoloft and Viagra.

Seeing doctors as a significant barrier, the team mobilized direct-to-consumer advertising, spending millions to urge patients to check their cholesterol levels in a bid to drive demand for statin drugs and to encourage people to ask their doctors for Lipitor. Spending \$1 billion on 400 clinical tests with 80,000 patients, the companies also set out to convince doctors that Lipitor was a better drug. They priced Lipitor 10% below the market leader, Zocor, and blanketed doctors’ offices with free samples,

reaching 90,000 physicians (60% of the key decision makers) before the product's launch.¹²

Within three years, Lipitor became the top-selling statin. In its first 15 years, the product achieved over \$125 billion in sales, becoming the world's best-selling drug. Using a mix of offense and defense throughout Lipitor's product life cycle, managers maneuvered the drug's ascension from market challenger to market leader.

But by 2012, Lipitor faced a new competitive threat. Lower-priced, generic versions of the drug were entering the market. Within weeks, Lipitor's sales dropped 50%. It was time for Warner-Lambert to reevaluate its competitive strategy.

2.4.1 Offensive Strategies

To go on the offensive, managers can target market leaders that have grown too big and that have lost touch with their customers. They can also take on market challengers that lack the resources to topple the market leader but whose technologies or strategies are worthy of imitation. Finally, they can target market nichers that have staked a claim in a valuable market segment that they're too small to defend. Marketers can use a number of different offensive strategies to make these moves, several of which we will discuss.

Comparative Advertising

Smaller companies can sometimes benefit by using comparative advertising to launch a direct frontal attack on the market leader. The blind taste or use test is a case in point. In 1975, for example, Pepsi's brand team found a compelling way to differentiate its product when blind taste tests showed that people preferred the taste of Pepsi to that of its archrival, Coca-Cola. The team took the Pepsi Challenge taste test on a national tour, setting up booths in supermarkets and on street corners, inviting customers to taste for themselves. The effort energized Pepsi sales, catapulting the brand into the number one slot for the best-selling soft drink in American supermarkets.

More recently, the pizza giant Domino's used a similar strategy to combat rival Subway by demonstrating that people prefer Domino's oven-baked sandwiches. Subway tried to stop Domino's from running the campaign, sending a cease-and-desist letter. Domino's retaliated with an ad in which the company's president, David Brandon, reinforced his product's positioning by cooking the letter in a pizza oven and quipping, "I was going to burn the letter, but everything is better when it's oven-baked."

Other brands use comparative advertising to point out deficiencies in rivals' offerings or to highlight their own advantages. **Exhibit 8** shows an example from

the automotive industry, in which BMW responds to Audi's superiority claim with one of its own, placing a larger billboard next to BMW's smaller one and headlining it "Checkmate." Still other examples are Progresso's and Campbell's fight over which soup brand uses more monosodium glutamate (MSG) and Verizon's and Comcast's argument over which company provides better coverage and faster download speeds.

EXHIBIT 8 The Comparative Ad War Between Audi and BMW



Source: Azadeh Ensha, "Audi and BMW Engage in Billboard Battle," New York Times, April 23, 2009, <http://wheels.blogs.nytimes.com/2009/04/23/audi-and-bmw-engage-in-billboard-battle/>.

First-Mover Advantage

Many firms hurry to be the first to market with an innovation, believing they can gain a **first-mover advantage**. Being the pioneer can sometimes give a company time to establish brand clout and build customer loyalty. Gillette, for example, tries hard to be the first razor a young man uses when he starts shaving. Gillette sends a birthday greeting and a free razor to men across America on their eighteenth birthday, in an effort to establish loyalty so strong that competing brands can't break it.

Touting their founding positions can give first movers additional competitive power. Take Levi's, which advertises itself as the original jeans company.

Being pioneers can also help firms establish technical standards for an industry. To illustrate, when high-definition televisions flooded the market and delivered a higher-quality viewing experience, they created an opportunity for new products designed to store and play large digital and audio files. A technological-format war erupted. Two viable competitors emerged: Blu-ray, led by Sony and Pioneer, versus high-definition DVD, led by Toshiba and NEC.

Content producers, such as movie studios and video game developers, aligned with one side or the other. Between 2006 and 2008, the two formats battled in the marketplace, as each consortium's disk player vied to capture consumers' heads and hearts. But consumers hesitated to commit to a high-priced device that might become obsolete if the other format emerged as the victor. The industry thus grew slowly. Following the hard-fought battle, Blu-ray emerged victorious after garnering majority support from content producers and distribution channels.

First movers may also gain an opportunity to lock in customers, distribution channels, or complementors (providers of compatible goods or services). In product categories with large **switching costs**, being first can enable a company to capture customers and keep them, owing to the "stickiness" of the ensuing relationship. In industries where distribution channels are limited or where retailers or other partners carry only one brand, getting in early can block other competitors from entering. Locking up complementors, as Apple did in the early days of smartphone applications (apps), provides a natural advantage over the competition. Developing an app is a time-consuming and costly endeavor, and the different standards required by Apple versus Google's requirements for its Android network forced app developers to choose which rival they wanted to work with first. Apple's earlier entry into the app marketplace gave it a significant head start.

Imitation

Companies can gain much by copying another business's innovation if it's not legally protected. Fast following is often the strategy of choice in industries where first-mover advantages are illusory. Today's startup economy is rife with **fast followers**, who imitate entrepreneurs' innovations and use their scale or professional marketing organizations to bring imitation products to market more effectively. Even big companies knock each other off. Burger King, for instance, launched a copycat version of McDonald's Egg McMuffin and poked fun at itself by running an ad that showed the King, Burger King's mascot, breaking into McDonald's headquarters to steal the recipe. The tagline for the ad? "It's not that original but it's super affordable."¹³

Price

Offering a comparable product at a lower price is a quick way to steal customers from a rival, particularly in industries characterized by elastic demand and highly price-sensitive customers. Nescafé took on Starbucks's Via instant coffee with an aggressive outdoor billboard campaign proclaiming, "Starbucks makes great instant. We make great instant. So why does theirs cost 400% more?"¹⁴

But to use price as an offensive weapon, a company must be the low-cost provider in the industry. Walmart's operational efficiencies enable it to price goods lower than its competitors every day. The company highlights this competitive advantage in price-comparison ads in which consumers are presented with receipts for the same basket of goods purchased at Walmart and at one of its competitors. To see how a price war played out in the telecommunications industry, see the sidebar "Everyone Loses in a Price War."

Everyone Loses in a Price War

Price wars often devolve into lose-lose situations. The US telecommunications industry offers a sobering example. Following deregulation of the US long-distance telecommunications market in the 1980s, a newly emerged rival, MCI, tried to chip away at former monopolist AT&T's market share by offering consumers lower-priced long-distance calling. When consumers resisted moving away from AT&T because of the hassles involved in switching carriers, MCI began offering switching bonuses. Soon, long-distance customers were bombarded with \$100 checks from both companies, inviting them to switch from one carrier to the other. Savvy consumers switched from AT&T to MCI, cashed the check from MCI, and then waited for an incentive from AT&T to switch back. Before long, both companies' profits began to suffer.

MCI finally wised up to the folly of this approach and launched its "Friends and Family Plan," offering residential customers discounts when they called other people on the MCI network. This plan turned MCI's customers into its sales force, encouraging them to recruit people they knew to switch to MCI. Given that most customers remained with AT&T, MCI had to offer its discounted rates for only a small percentage of calls placed. Thus, it could reap greater profits from calls outside the network. MCI's stroke of genius came from its realization that AT&T would have trouble matching this program. With its dominant market share, offering discounts for calls within AT&T's network would have carried a much larger price tag for the telecom giant. Thanks to its smaller size, MCI could change tactics far more nimbly than AT&T could.

As we've noted, price wars often lead to debilitating profitability losses for the combatants. Once a downward price spiral begins, it's hard for a firm to stop lowering its prices in lockstep with its rivals. Failing to do so usually results in a loss of volume, as customers switch to the cheapest offering. Ending a price war once it has begun takes courage and a strong stomach to weather these short-term volume losses. Holding ground on price or even raising prices slightly sends an important signal to rivals that the firm isn't willing to fight on price any

longer. This can be enough to stop competitors from lowering their prices and lead to an uneasy détente.

Offering Differentiation

Many companies use product and service differentiation to gain advantage in the marketplace and to stop price wars. Giving consumers more reasons to choose an offering, not just its pricing versus the competition's, reduces the price sensitivity of consumers. Undifferentiated products and services become commodities, and consumers rely on price differences to choose from among them, usually opting for the least expensive choice. When a company deploys marketing strategies that convince customers its offering is unique and better than its rivals', it doesn't have to get pulled into a price war that another company starts.

In more mature, stable industries, competing firms invest heavily in research and development to differentiate their offerings. But this approach can catalyze a features arms race, in which contestants produce differentiation merely for its own sake versus adding features that deliver real benefits that customers value. Youngme Moon terms this "heterogeneous homogeneity," where all products are different in the category, but their differences are indiscernible to most consumers. A glance at the toothpaste aisle in most supermarkets brings this phenomenon to life. An endless struggle to differentiate products in highly competitive categories has led to augmented products that add costs but fail to generate new value.¹⁵

2.4.2 Defensive Strategies

Incumbents across industries often find themselves struggling to defend their market positions as new entrants infiltrate the arena. Companies playing defense strive to retain existing customers and, if that fails, to slow the defection rate.

Steadfast Marketing Support

Many market-leading incumbents become complacent, particularly when their products reach the maturity phase of their life cycle and sales growth slows or even sputters. Managers often milk mature brands for profits, treating them as cash cows and reducing marketing support for these offerings. This leaves the mature brands vulnerable to competitive attack. To sustain their brand equity and loyalty and protect them from competitive attack, companies should maintain marketing support for such brands.

Strong Customer Relationships

An incumbent's installed base of customers is a tremendous asset. Actively managing and nurturing customer relationships, even long-standing ones, constitutes smart defense. Creating incentives for customers to lock into longer-term contracts, offering complementary products and services, and connecting customers to each other to create network effects are all moves that increase switching costs.

Many car companies, for instance, have learned that online brand communities and car clubs build relationships among people who have bought their vehicles. These consumer-to-consumer (C2C) relationships provide valuable social benefits and make it harder for drivers to switch brands when the time comes to replace their cars.

Market Coverage

Incumbents can also leverage their scope and size by covering the market with a broad line of offerings that address major market segments' needs. Covering the market closes off opportunities for market nichers by eliminating gaps—unmet needs—that they would otherwise strive to fill. For instance, consumer-goods manufacturers use line extensions to add new flavors, sizes, product delivery methods, or colors to their product line and lock up incremental shelf space in distribution outlets.

Launching **fighter brands**, lower-priced brands designed to combat, and ideally eliminate, low-priced competitors while protecting the company's premium brands, is another market-coverage strategy. The consumer-goods giant Procter & Gamble deployed this strategy in the diapers category to protect its premium Pampers brand, and Anheuser-Busch used it in the beer category to protect its Budweiser brand. These companies' fighter brands—Luvs and Busch, respectively—serve as deterrents against disruptive competitors introducing less expensive offerings.

Legal Protection

Any first-mover advantages a company gains can swiftly erode if competitors copy the firm's innovation. To guard against this, firms should use legal protections such as patents and trademarks—and enforce them swiftly if another company violates them.

The luxury shoe manufacturer Christian Louboutin did this when it took its competitor to court to defend its *trade dress*, nonfunctional characteristics associated with a product's appearance or feel. All Louboutin shoes feature a

signature red lacquered sole that is visible as the wearer walks. This eye-catching chromatic device signals the brand to onlookers even at a distance. When Yves Saint Laurent began featuring red soles on its designer shoes, Louboutin filed a trademark-infringement claim. The court ruled that the Louboutin red sole generated important brand meanings and granted the company the exclusive right to use the color on the soles of its shoes.

Retaliation

Incumbents can retaliate against aggressive competitors seeking to horn in on their business. Retaliation can be measured to avoid inciting competitors' ire and triggering further aggression. Or it can be no-holds-barred, aimed at devastating or even annihilating a competitor. Retaliation not only punishes an aggressor but also sends a warning to other competitors. Such strategies can take numerous forms, including an unremitting price war, a well-played sales promotion that blocks a competitor's new product launch, trade promotions offering discounts to retail partners during a competitor's key selling season, an aggressive social media or advertising campaign, and a head-to-head new product launch.

But big companies should use caution in retaliating against smaller competitors. Research shows that consumers dislike large companies that compete aggressively.¹⁶ When big brands compete hard against small brands, they risk being perceived as bullies, which incites consumers to give their support to the smaller contenders. To avoid turning consumers off, big brands should be wary of tactics such as moving in across the street from a small, independent competitor, or using heavy-handed price promotions to undercut small rivals' prices.

Winning without a Fight

The best defensive strategies are those that help companies win without having to fight at all. Examples include price-match guarantees (which diminish the incentive for competitors to lower their prices to steal customers), signals warning rivals of a firm's intentions (such as preannouncing a product launch), and public commitments to future courses of action (such as intentions to invest in new manufacturing facilities). These and other strategies can discourage competitors from making aggressive moves.

Framing the Game

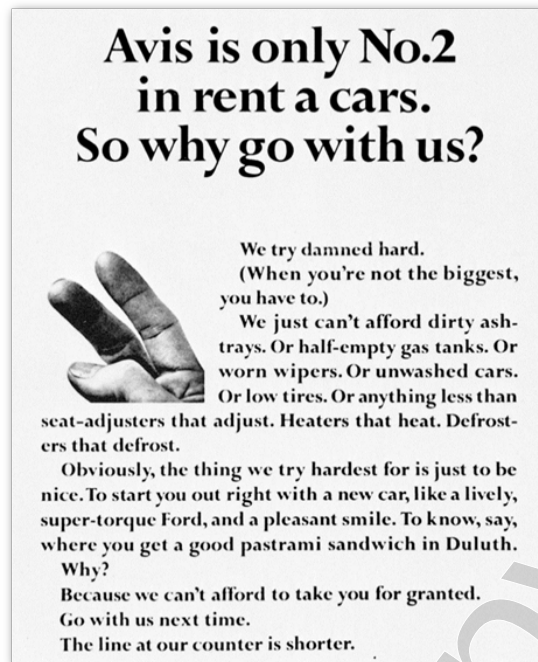
Framing the game, positioning brands in competition with one another in consumers' minds, can help small brands and hurt their larger competitors.¹⁷

This defensive approach is all about appealing to consumer sentiment. For instance, in today's marketplace, the desire to support small local businesses has arisen as a powerful clarion call from many consumers who have concerns about globalization, the closing of independent "mom-and-pop" stores, unfair or unethical business practices, and the power of dominant category killer brands such as Home Depot, Amazon, Starbucks, and Walmart.

Small brands can use these sentiments to their advantage. Merely telling consumers that it's competing against a big brand can help a small brand win support from consumers in a fight against the large brand. In a field experiment at an independent bookstore, consumers purchased more items when they were told that the store was being menaced by a large corporation than when they were told it was competing against other small, independent bookstores. Peet's coffee shops located near a Starbucks are rated more positively by consumers on Yelp than those not facing such direct competition from the larger rival.

Why do consumers like to protect small, local brands from competitors? There are several possible explanations. Research has shown that consumers tend to identify with underdog brands, those that demonstrate passion and determination in the face of external disadvantage.¹⁸ But being small may not be enough to gain consumer support; the presence of a larger competitor is what makes consumers perceive the smaller brand as an underdog. Powerade sports drinks, Sam Adams beer, and Avis rental cars all play up their underdog status in advertising campaigns. **Exhibit 9** shows an example.

EXHIBIT 9 Underdog Advertising Appeals: Avis



Source: <http://www.mga-ideas.com/news/wp-content/uploads/2013/09/240311-bill-bernbach-avis.png>.

2.5 Conclusion

Marketing is a dynamic and therefore complex competitive game: Players make strategic choices and observe and react in real time to one another's moves. All contestants are playing to win, and the rules keep changing. Companies that manage to muscle into a market and achieve a dominant position may find themselves fending off encroachment from others sooner than they expected, and from rivals they never anticipated.

To sweeten the odds of succeeding—and remaining successful—marketers need a deep understanding of their own company's position and that of their rivals, and the analytical skills to map the competitive landscape—including its rules, boundaries, constraints, and areas of opportunity. They must then strategically navigate that landscape, marshaling resources, overcoming challenges, dodging attacks, launching their own offensives—all while adapting to relentless change in the environment. They must sense the market, challenge the status quo, and find their way into win-win situations and out of no-win situations. To do all this, they have to envision the possible games that could be played in the marketplace and identify the most profitable ones. The best marketers know how to shape their competitive strategies to accommodate the

defining characteristics of the marketplace's existing games as well as create new games. In the end, playing the right game and playing the game right can spell the difference between spectacular and enduring market success and abject failure.

3 SUPPLEMENTAL READINGS

Game theorists have identified several different types of games that exist in marketplace competition.

Many managers perceive marketplace competition as a *zero-sum game*, in which one player's gain is the other's loss. In zero-sum games, players fight to win a bigger "slice" of a "pie" that doesn't change size. Rivalries are fierce, and each player strives aggressively to beat the other. The firm with the greatest resources and capabilities generally emerges as the winner.

Yet most marketplace competitions are *non-zero-sum games*, in which players have some complementary interests, as well as some that are in conflict. In non-zero-sum games, one player's gain or loss does not necessarily result in a corresponding loss or gain for another. These types of games require a mix of competitive and cooperative moves to enable the players to reach a *Nash equilibrium* (developed in the 1950s by American mathematician John Nash):¹⁹ a joint solution in which all players cannot do any better by changing their strategies, given the likely response of their competitors. What is the key to competing in non-zero-sum games? Managers must uncover the complementary interests that exist between their companies and their competitors. Then if possible, they should work with the other companies to maximize these interests. At the same time, they need to minimize profitability losses by avoiding direct conflict on noncomplementary interests.

One common non-zero-sum-game is the **prisoner's dilemma**, a paradoxical situation in which, if two individuals or firms act in their own best interest, they both achieve worse outcomes. Industries with two dominant competitors often find themselves locked in a prisoner's dilemma. See the sidebar "Pepsi and Coke: The Prisoner's Dilemma" for an example.

Pepsi and Coke: The Prisoner's Dilemma

Imagine that PepsiCo and the Coca-Cola Company are deciding how to price their cola products. Here are the PARTS in this game:

Players. PepsiCo (Pepsi), the Coca-Cola Company (Coke), and their customers.

Added values. If one company prices its product low while the other prices its product high, the lower-priced brand will reap the lion's share of the units sold, generating \$12 million in profits, while the higher-priced company will make \$7 million in profits. If both competitors price their products high, the companies will split the market and each will receive \$10 million in profits. If both competitors price their products low, the companies will split the market, but profits will erode: each will receive \$9 million in profits. **Exhibit 10** shows a graphical representation of the payoffs.

Rules. Legal statutes prohibit the two competitors from communicating with each other and colluding on prices. Thus, each must choose its price in isolation. They know, however, that the amount of soda each will sell depends on how its price compares to the other's.

Tactics. Each competitor will act with self-interest, trying to maximize its profits.

Scope. Scope includes the period of time that the pricing choices stay in effect, the product SKUs that carry the new price, and the distribution channels that sell the products at the new price.

EXHIBIT 10 Pepsi and Coke in a Prisoner's Dilemma Game

		Coca-Cola	
		HIGH PRICE	LOW PRICE
Pepsi	HIGH PRICE	\$10m \$10m	\$7m \$12m
	LOW PRICE	\$12m \$7m	\$9m \$9m

Play out Pepsi's and Coke's strategies with **Interactive Illustration 1**.

(continued)

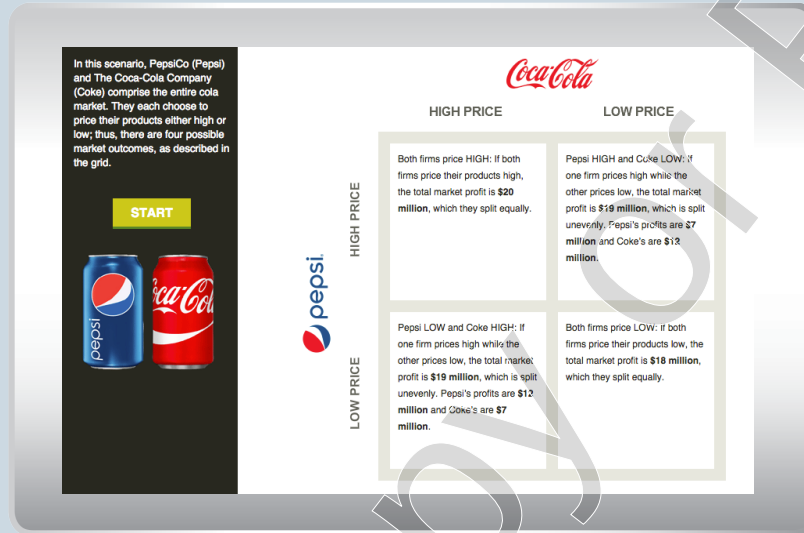
(continued)



INTERACTIVE ILLUSTRATION 1 Prisoner's Dilemma in Pricing



Scan this QR code, click the image, or use this link to access the interactive illustration:
bit.ly/hbsp2pHeicm



The result? If both competitors act in their own self-interest and play their dominant strategy, they both end up in a worse position. Pepsi sees that it always does better if it prices low, regardless of what Coke does. (For instance, if Coke prices low, \$9 million is better than \$7 million, and if Coke prices high, \$12 million is better than \$10 million.) Coke looks at its options and sees that it always does better if it prices low, regardless of what Pepsi does. Thus, both companies price low, leaving both with lower profits. This solution is inferior to the solution in which both price high and capture \$10 million.

Only when Pepsi and Coke cooperate do both achieve a superior solution. While legal provisions proscribe Pepsi and Coke from colluding on price, an understanding of their joint game can help managers understand the best possible moves.

Other types of non-zero-sum games include *positive-sum games*, where win-win solutions—ones in which both competitors benefit—are possible. Win-win strategies face less competitive resistance and often create virtuous cycles of profitable decision making among the players. Competitors that band together to build *primary demand*—demand for a product or service category—as opposed to using marketing dollars to build *secondary demand*—demand for a particular brand within a product category—often see their profits grow as their product or service category expands. We can envision this as getting a bigger slice of an expanding pie.

The most detrimental game is the *negative-sum game*, in which lose-lose solutions are likely to occur. Industries that degenerate into negative-sum games often begin as zero-sum games. The loser in a zero-sum game may make bad decisions to break the structure of the game to gain an advantage, such as starting a price war that hurts all competitors. This behavior triggers a vicious cycle of unprofitable decision making among the players. As profitability suffers, players begin dropping out of the game. Power consolidates with the competitor most able to hold out for the long run—leaving customers with few choices and thus eroding competitiveness in the industry.

4 KEY TERMS

blue-ocean strategy In a blue-ocean strategy, companies seek new opportunities in untapped industries and face no competition. Market boundaries and competitive rules are not yet defined in a blue ocean.

brand equity The value premium or liability that a company realizes from a product with a recognizable name as compared to its generic equivalent.

commodity product or service

A product or service for which perfect substitutes exist in the marketplace.

complementor A firm, brand, or product that adds value to another firm, brand, or product when used in conjunction with it.

co-opetition Cooperation and collaboration between competing businesses with reciprocal benefits in mind.

disruptive innovation Initially, low-end, inferior products or services brought to the market by new competitors that target a new set of customers previously unserved by mainstream product offerings. They are eventually improved and then compete in the existing market segments.

fast follower A company that competes by imitating the innovation of other market competitors and bringing a product or service to market quickly, saving research and development costs and capitalizing on the innovation of others.

first-mover advantage Any of a number of competitive advantages a firm earns by entering a market first.

incumbent Any company that has a significant market share position or that has power in an industry.

market challenger A firm that does not lead the market but wants to and exerts enough influence to gain more market share.

market follower A firm that does not seek to lead the marketplace or challenge the market leader, but instead allows stronger companies to remain at the forefront, preferring instead to imitate their products and services, often at a lower cost.

market leader The company, brand, or product with the largest market share.

market nicher A firm that carves out a small part of the market to address specific consumer needs or wants ignored by competitors.

network effects Phenomena whereby goods or services become more valuable when more people use them.

perfect competition A theoretical market framework in which all companies sell the same product and have the ability to enter and exit the market freely. No firm controls the market price of its product and each business possesses just a small market share. Consumers are completely informed regarding the products and their prices and freely switch their demand to the lowest-price offering.

prisoner's dilemma A paradoxical situation in which two individuals or firms act self-servingly, leading them both to worse outcomes. Despite logically trying to protect themselves, both are left worse off than if they had attempted to cooperate.

red-ocean strategy In a red ocean, market boundaries and competitive rules are already established. Companies compete within the existing framework to gain a greater market share.

share of voice A metric that measures a particular company's level of media spending as a proportion of the total media spend in the category.

switching costs Any negative repercussions that consumers would experience should they switch brands or products, whether monetary, psychological, social, or convenience-based.

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