



## COMPETITOR ANALYSIS: THE DEMAND AND SUPPLY APPROACH

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Around the year 500 BC, the great Chinese military strategies, Sun Tzu, wrote a book on the Art of War'. One of the famous quotations by Sun Tzu is:

'if you are ignorant of both your enemy and yourself, then you are a fall and certain to be defeated in every battle. If you know yourself, but not you enemy, for every battle won, you will suffer a loss. If you know your enemy and yourself, you will win every battle'

Competitor has actually two way approaches in defining the actual meaning of the word. The terms 'market', 'industry' and 'business' have been commonly used and the meaning of these words are generally understood. However, in order to identify 'who are competitors', it is important to understand the 'nature of a market' which may consist of the definitions of demand and supply approach.

### The Supply Approach

Economists have emphasised the market definition in terms of supply when they define an industry as a set of competing firms using similar technologies and/or manufacturing processes. Therefore, 'industry' is a synonym of 'market', according to the supply approach of market definition. At firm level, competitors can be identified using the SIC code and the Strategic Group Analysis (SGA). Day, Weintz and Wensley (1979) however, suggested that although industry type classifications have gained wide acceptance due to their stability and clarity, they are actually of "questionable applicability" because they are derived from the supply-side factors only.

SGA is the most popular and widely used concept in the supply side approach. The term strategic group was first used by Hunt (1972) who analysed profitability in the white goods industry through the concept of strategic groups. Hunt (1972) defined strategic group as "a group of firms within the industry that are highly symmetric with respect to cost structure, the degree of vertical integration, and the degree of product differentiation,

formal organisation, control systems and management rewards/punishments and the personal views and preferences for various possible outcomes". Porter (1985) gave similar definition that is "a group of firms in an industry following the same or a similar strategy along the strategic dimension." Therefore, the firms within the group resemble one another and, therefore, are likely to respond in the same way to disturbances, to recognise their mutual dependence quite closely and to be able to anticipate each other's reactions quite accurately. Furthermore, according to Aaker (1995), a strategic group is a group of firms that; (a) over time pursues similar competitive strategies, (b) has similar characteristics; and (c) has similar assets and competencies.

Based on these definitions, the differences in firms' strategies for competing in an industry can be identified (Czepiel, 1992). The strategic group concept has attracted a growing body of literature to determine the relationship between industry and competition. Porter (1979) utilises the concept of strategic group to understand the industry structure and hypothesise that the industry is comprised of leaders and followers. His findings are consistent with the theory of strategic groups that important differences exists in the structural feature that explain profit levels for different companies within the strategic groups. The strategic groups approach assumes that the strategic diversity of an industry can be simplified by classifying the firms into different competitive groups. For example, Cool and Derick (1993) who analysed the United States pharmaceutical industry, found that a decline in the industry profit level was linked to increasing rivalry in the environment and not by a change in the size distribution of firms. Although strategic group analysis is more valuable as a descriptive rather than a predictive tool, it provides a useful mean in gaining a broad picture of the types of firms within the industry, the kind of strategies that proved viable and the differences in firms that are positioned in relation to one another (Grant, 1991). This view is supported by Reger and Huff (1993) who mentioned that managers within an industry have consistent perceptions of groupings of similar firms. This is not surprising as the thinking processes of managers in identifying competitors have some similar paths with mental categorisation, as explained later.

On the other hand, Mathur and Kenyon (1997) argued that the concept of industry is flawed and does not represent the reality, because the starting point for businesses such as in banking and finance is customer choice and their unit of choice is the single offering and not the product or a company (Mathur and Kenyon, 1997). Therefore, the demand approach in defining a market is analysed in the following section.

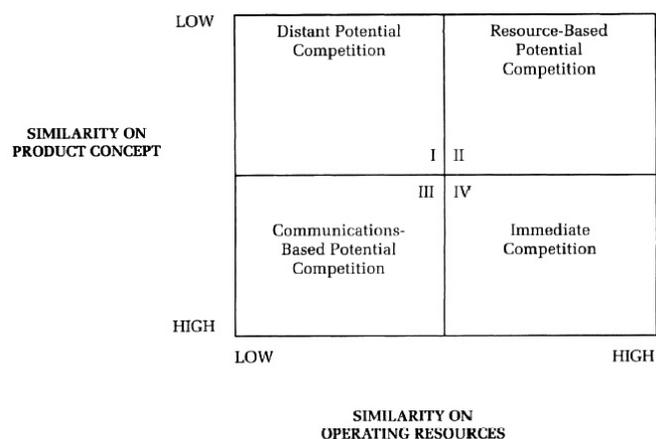
## The Demand Approach

The demand side approach by marketers, defines a market as 'a group of potential customers with similar needs and sellers offering the goods and services to satisfy those needs' (McCarthy and Perreault, 1984). As stated by Kotler, a market 'consists of all the potential customers sharing a particular need or want who might be willing and able to engage in exchange to satisfy that need or want'. The concept of a Single Competitive Market (SCM) introduced by Mathur (1988, 1992) is based on the notion that competition takes place between companies' offerings and not the companies themselves. Findings by Devlin (1996) showed that managers, who are involved in the marketing of a large number of service offerings that customers may perceive to be complex, are more likely to employ the notion of the SCM when mapping their competitive environment. In essence, the concept of SCM is similar to the idea of a strategic product market previously introduced by Day, Shocker and Srivastava (1979). The product-market is defined as 'the set of products judged to be substitutes within those usage situations in which similar patterns of benefits and the customers for who such uses are relevant are sought.' Using the same product market definition, Srivastava, Alpert and Schocker (1984) developed and tested a market analysis framework based on customer perception of substitutability-in-use. In this study, the upscale customers were asked to judge the appropriateness of twenty-four different financial services across each of twelve different usage situations. The findings showed that when product preferences were dependent on the use/consumption context, situational variables helped to make prediction on the products (financial services) on demand. However, the finding revealed that product preference based on a hierarchical cluster that requires exclusive group membership can be misleading.

Therefore, the demand approach proponents argued that the offerings, therefore, are in direct competition with one another (e.g Mathur 1988, Czepiel, 1992; O'Shaughnessy, 1995). The indirect competitors as explained by Czepiel (1992) are those who serve related customer groups but do not offer identical products. For instance, Coke and Pepsi are in direct competition as both use similar product and marketing technologies to satisfy almost identical customer needs (Weitz, 1985). The indirect competitors for Coke or Pepsi are other types of soft drinks or other types of drinks. In addition, the potential competitors are those that may represent a threat to the firm in the future, depending on the attractiveness of the firm's market and entry barriers (Day 1977).

Having explained the definitions of direct and indirect competitors, Park and Smith (1990) proposed that potential competitors can become actual competitors when the consumer perceives a high level of substitutability in terms of product abilities to offer

functional needs and when the competing firms use similar operating resources to bring about exchange. Based on consumer perspectives, Park and Smith (1990) offered an approach to competitive analysis that focuses on inter-industry learning. In this conceptual study, firms are classified along a continuum of potential to actual competitors (Figure 1) with firms in Cell 1 having the least similarity in product concept and operating resources, thus resembling distant competitor. On the other hand, firms in Cell IV are direct competitors as these firms offer the closest product concept through the same strength of company resources. The potential competitors in Cell II, although offering least similarity in product concept, can grow to compete head to head as both sides have common strengths in company resources. Thus, potential competitors can become actual competitors when the consumer perceives a high level of substitutability in terms of product abilities to fulfil function needs and when the competing firms use similar operating resources to bring about exchange (Park and Smith, 1990). Cell III firms offer similar product concept to referent firms, thus can be regarded as potential competitors, although possessing different levels of resources. This study suggested a three-step approach to monitoring competitors in order to gain insights for innovative marketing strategies to: (1) identify the product class alternatives that consumers view as similar to the referent product or which use similar operating resources to facilitate exchange (2) identify firms that offer such products (3) input data for mapping in diagram.



**Figure 1: A Framework for diagnosing a competitive environment**

Source: Park and Smith (1990).

Market definition based on the customer needs has an advantage as it views competition as a matter of degree, rather than a yes or no proposition (Weitz, 1985). Offerings also are much more narrowly defined than products as each offering has its own unique market. For instance, according to Mathur and Kenyon, (1997), London's Dorchester Hotel comprises a number of separate offerings; luxury hotel accommodation, restaurant services, cocktail bar drinks and various personal services and retail products. Thus, the hotel customers may be much the same, but each offering will have separate set of competitors. Therefore, as market definitions based on demand are broad in concept that embrace many aspects, this implies that manager should have a broad approach in identifying competitors.

## Benefits of Knowing Your Competitors

Henderson (1983) stated that “the success of any marketing strategy depends on the strengths of the competitor analysis on which it is based”. An understanding of competitive behaviour including firms’ moves and counter moves is fundamental to strategic management (Chen, 1996; Porter 1980; Smith, Grimm & Gannon, 1992;). Chen *et al.* (1992) for instance found evidence that the stronger an action attack on key markets of competitors, the greater the number of counteractions by the competitors. Haywood (1986) highlighted 6 main benefits of conducting competitor analysis. These are:

- (a) enlarges a company understanding of the multiple choices that customers have;
- (b) source of new ideas and confirmation of an operators’ own idea;
- (c) facilitates better predictions about the future
- (d) enforce an operator to evaluate any prospective course of action in the light of possible responses by competitors;
- (e) focuses a specific company’s product/services that need to be emphasised; and
- (f) helps point up competitors’ weaknesses.

Despite the assertions and research in competitive rivalry and the importance of understanding competitors, there has been not much research in competitor analysis that provide evidence on how much benefit does a firm receives by conducting competitor analysis. Thus the benefits of competitor analysis should also be studied along with other mentioned consequences such as financial benefits of competitor analysis.

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**Note:** Complete references can be obtained from the author.