

Evaluating Your Company's Competitive Position

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Today, more and more businesses are forced to operate in global markets characterized by short technology cycles and dynamic cross-border trades of goods and services. In this type of fluid environment, taking stock of the competition on a regular basis is becoming increasingly important. In fact, taking an honest assessment of your competitive environment will give you your best chance to uncover ways to capitalize on previously unseen opportunities or develop defenses to fend off a competitive threat.

Competitive analysis evaluates a company's strategic position and its ability to



compete in its market against its peers. The objective is to assess characteristics of the business, economy and industry as a whole that affect the future of the firm and determine whether or

not its performance will be consistent with past results. In turn, this helps identify the causes behind the results and recognize the factors that underlie the business' strategic advantages and disadvantages. Most importantly, competitive analysis helps you measure and manage the process of value creation by providing you with valuable insights on value drivers (company strengths) and risk drivers (sources of uncertainty).

There are several techniques for identifying a company's competitive advantage such as customer segmentation analysis, competitive business systems analysis and industry structure analysis. The essence of all these techniques is to assess whether the competitive environment in which a company operates is likely to enable it to earn excess profits and how the company is positioned within the industry against its peers.

Perhaps one of the most influential analytical models for assessing the nature of competition in an industry is Michael Porter's Five Forces of Competitive Position model, which he describes in his seminal book *Competitive Strategy* (1980). Porter explains that there are five forces that determine industry attractiveness and long-term industry profitability:

- The threat of entry of new competitors
- The threat of substitutes
- The bargaining power of buyers
- The bargaining power of suppliers
- The degree of rivalry among existing competitors

Threat of New Entrants – New entrants in an industry can raise the level of competition, thereby reducing its attractiveness by creating downward pressure on profitability. What determines the likelihood of entry of new competitors in an industry largely depends on the barriers to entry. Some key barriers to entry include: economies of scale, capital or investment requirements, customer switching costs, absolute cost advantages,

government policy or access to distribution channels.

Threat of Substitutes – The presence of substitute products or services contributes to lower industry profitability by constraining the ability of firms to raise prices. For the most part, the threat of substitutes depends on buyers' willingness to change, the relative price and performance of substitutes and the cost of switching to substitutes.

Suppliers' Leverage – The cost of raw materials, labor and components can have a significant impact on a company's profitability. If suppliers have a high bargaining power over a business, then in theory the company's industry tends to be less attractive due to its potential for lower profits. The bargaining power of suppliers will be high when there are many buyers and few dominant suppliers and/or when the industry is not a key customer group to the supplier.

Buyers' Leverage – Buyers are those who create demand in an industry. The bargaining power of buyers is greater when: there are few dominant buyers and many sellers in the industry; buyers purchase a significant portion of the output; products are standardized; buyers have the ability to buy a producing firm or a rival, and/or the industry is not a key supplying group for buyers.

Intensity of Rivalry – In traditional economic models, competition among rival firms has the potential to drive profits to zero. However, competition is not always perfect and firms are usually skillful at developing competitive advantages that differentiate them from rivals. These competitive advantages may take the form of changing prices, improving differentiation and creating new distribution channels, among others. In general, the intensity of rivalry among competi-

tors in an industry tends to be higher when: competitors are small or equally sized; products cannot be differentiated (commodities); switching costs are low; competitors are pursuing aggressive growth strategies, or when the barriers to exit are high.

The purpose of conducting a competitive analysis is to help you identify and assess how industry factors will affect your business' ability to compete. It will assist you in examining the attractiveness of operating in a given industry and the business' relative position vis-à-vis your competitors in that industry. Based on these insights, you can formulate strategies, first at the industry level and subsequently at the company level, to chart your company's strategic direction.

The objective, of course, is to capitalize on your business' strategic advantages while minimizing or neutralizing the consequences of its disadvantages. But this requires a clear understanding of the overall profitability constraints in the industry in which you operate, the characteristics most likely to change that level of profitability and the strategies and resources required to compete successfully in that environment.

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