Competitive Strategy

LEARNING OBJECTIVES

Studying this chapter should provide you with the knowledge to:

1. Create a strategic group map and a strategy canvas of a competitive landscape.
2. Analyze a company's competitors to identify the likely ways they will respond to a company's strategic moves using a competitor response profile.
3. Describe the different types of competitive strategies that can be deployed contingent on the environment in which a company operates.
4. Choose or create a competitive strategy suitable to a company's competitive situation.

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Delta Simplifies Its Fares

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In January 2005, facing increasing competition from low-fare carriers, Delta Airlines introduced a new pricing plan called *simplifares* that dramatically cut ticket prices across most of Delta's domestic US routes. Paul Matsen, Delta's chief marketing officer, stated, "We could sit back and wait for low-fare competition to force us to react, but we're going on the offense."[1] The company cut ticket prices by as much as 50 percent and eliminated the Saturday-night stay requirement that had long helped airlines distinguish between leisure travelers and business travelers. Furthermore, it capped the price for a last-minute coach fare at $499 and a first-class fare to anywhere in the country at $599. Although the new pricing scheme would immediately create a drag on revenue, Delta expected that over the long run the pricing move would be good for the airline by helping it take back passenger volume from the low-fare carriers. Business travelers, in particular, had been increasingly moving to low-fare carriers for their travel. In fact, near Cincinnati, where *simplifares* was first piloted, many business travelers preferred to drive to a smaller airport and pay the fares of AirTran or ATA rather than the higher fares of Delta. The new pricing structure was expected to bring these customers back to Delta.

Although Delta hoped for a new source of advantage from this pricing move, Delta's main competitors—the full-fare carriers such as American and United—responded to *simplifares* by immediately matching Delta's prices. Within days, business fares in the top 40 routes flown by major airlines were down by an average of one-third, and American Airlines' fares were down by 44 percent.[2] Perhaps as a way to slow the free fall, Northwest airlines warned the industry that "fare simplifications" would immediately and adversely affect industry revenues, but other airlines ignored the warning.[3]

By July, just six months later, Delta was already making upward price adjustments, citing a spike in the cost of fuel.[4] The company abandoned the $499 cap and raised the ceiling by $100. Again, major carriers immediately followed suit. On the day of the announcement, a spokesman for Continental stated, "All I can tell you is that we did match Delta's fare, and the match was effective today. Whatever Delta did, we did."[5] Meanwhile, the low-fare carriers welcomed the move as evidence that full-fare carriers were burdened with cost structures that were simply too high to match their low ticket prices.

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Despite the effort exerted to implement the new pricing strategy, by 2008, Delta had completely abandoned the *simplifares* initiative. Richard Anderson, Delta's CEO, seemed to suggest that efforts to compete on price with the low-fare carriers had been misguided. Cutting prices for business travelers had disastrous effects on revenue because the expected growth in passenger volume never materialized. This was largely because of competitive price matching. In a clear return to its previous strategy, Mr. Anderson stated, "You really have to have a differential [between business and leisure travel]. We offer different products to different customers based on their attributes. That's better for an international carrier offering . . . different products on the same airplane."[6]

Competition is a reality for business firms. Whether a company faces competitors that are actively striving to erode its market share or potential new entrants to its market, nearly all managers must grapple with how to compete. In some markets, competition is light because firms are highly differentiated or because they face few rivals. In other markets, competition can be very intense. In such markets, and as the opening case demonstrates, a company must acknowledge the reality that competitors are watching and are likely to react to its strategic actions. Had Delta realized how quickly its competitors would respond to its pricing moves, the company might have tried a different strategy to improve its performance against low-fare carriers.

How does a company know which actions to take in the face of competition? And what actions are likely to be the most effective in the differing competitive situations that a firm might face? How will competitors respond to a company's strategic moves? This chapter provides answers to these questions by identifying a set of tools for competitive analysis along with strategies for responding to competitors that are useful under a variety of market circumstances. The overall objective is to help strategists understand how a company can improve its performance in the face of competition.

In order to effectively compete, a company must first *know the competition* and then it must launch strategies to *win against the competition*. The first two sections of the chapter, "Understanding the Competitive Landscape" and "Evaluating the Competition," address knowing the competition. The latter two sections, "Principles of Competitive Strategy" and "Competitive Actions for Different Market Environments," address winning against the competition.

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Understanding the Competitive Landscape

In order to compete effectively, a firm must understand the structure of the competitive environment in which it operates. Most industries contain groups of companies that compete directly against each other but only indirectly against companies in other groups. This situation arises because of differences in customer needs and preferences, which give rise to various customer segments. As companies pursue these segments, they develop business models that are well-suited to serving one segment but not so well-suited to serving other segments in the market. Firms with similar business models cluster together by pursuing the same segments of customers.

Strategic Groups and Mobility Barriers

An analysis that breaks down the structure of a market or industry into these constituent groups is called a **strategic group** analysis. Visualizing this group structure is an important component of competitive analysis because it identifies the major arenas of competition and who competes directly with whom.

strategic group A set of companies that compete in similar ways with similar business models pursuing similar sets of customers.

In the United States, Delta, United, and American Airlines compete in the full-fare segment of the industry (See Animated Executive Summary, "Competitor Interaction"). Delta encounters American or United on many of its routes between pairs of cities because these companies compete in Delta's primary customer segment—business travelers. Among the companies in this group, airlines compete head-to-head and watch the moves of their competitors closely. They respond to one another's competitive moves almost immediately in order to maintain

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a valuable competitive position. Other airlines, such as Southwest, JetBlue, Frontier, or Spirit compete in the discounted or low-fare segment of the industry. They offer few frills, less popular airports, or no reserved seating. These companies compete head-to-head with each other more than they compete with the full-fare carriers.

Even though companies within groups compete head-to-head, and companies in other groups are less of a threat, rivals in other groups cannot be completely ignored. Rivals could begin targeting customer segments with new offerings or more favorable value propositions and eventually steal customers. This is exactly what happened in the case at the opening of the chapter. Low-fare carriers were gaining ground in the business traveler segment of the market when Delta launched its effort to compete on price with these carriers.

Strategic group maps are constructed by identifying the main differences in the ways in which firms in an industry compete to deliver value. These differences typically relate to value chain activities such as relative price, geographic placement, product line breadth, extent of vertical integration, niche or full-service offerings, and so forth. The factors that are relevant vary based on the industry in question. In the airline industry, for example, clues about the most important differences in how firms compete can be found in the opening case description. Two of the important factors mentioned are price and whether airlines are flying to primarily large or small airports (recall that Delta was losing business travelers to smaller airports near Cincinnati). Therefore, to draw a strategic group map of the airline industry, you would place these two factors on the horizontal and vertical axes of a simple two-dimensional chart and plot the companies relative to these axes as outlined in Figure 11.1. If you observe clustering of companies, you have identified strategic groups within the industry, at least along the dimensions chosen. The rule is to choose factors that are the most relevant in describing the differences in how companies compete for customers. In other words, choose the dimensions that create the most distinctive clusters.

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Companies find that switching strategic groups is difficult once they have built a history in one. The reason is that companies in specific strategic groups choose particular ways to configure their activities and these activity systems do not change quickly or easily. This creates a **barrier to mobility** between groups. After a firm is in a particular group, it is not mobile and can't simply leap to a different group.[7] For Delta to effectively compete with low-fare carriers, the company would have to acquire many of the business characteristics of the low-fare carriers. For example, the company would have to change its cost structure, airline fleet, routing, and airport locations, effectively abandoning much of its existing customer base. In the opening case, Delta attempted to compete head-to-head with the low-fare carriers by changing only its price. But the company would have had to change many more of its characteristics in order to be successful.

barrier to mobility Any factor that limits the ability of a company to move between strategic groups.

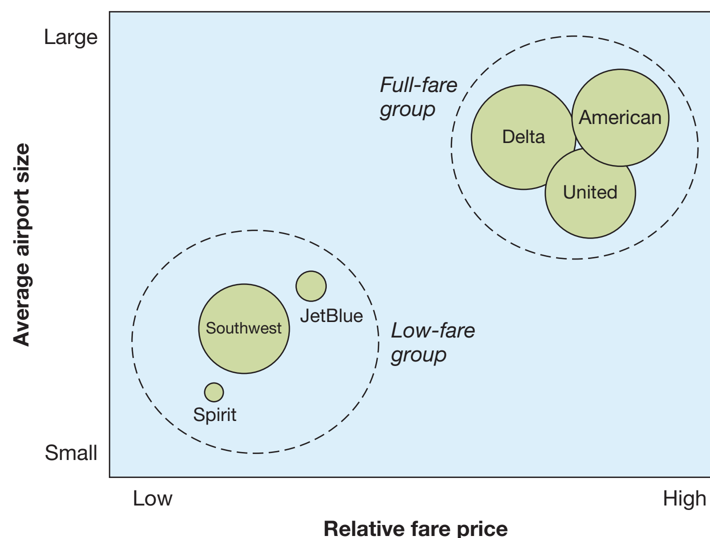

FIGURE 11.1 **Strategic Group Map**

Note: Company circle size relative to revenue

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A strategic group map provides a basis for making competitive assessments not only because it defines who a company's competitors are but also because it can help to analyze potential changes in the landscape. For example, it can indicate whether companies in one group are beginning to appeal to the primary markets of another group. Such was the case when low-fare carriers near Cincinnati began to steal business customers from Delta.

Are firms in any group attempting to change the value they offer and the basis of competition? Is this leading to any changes in the boundaries of groups? Delta attempted to alter group boundaries when it launched a low-fare pricing strategy. Are new firms entering the industry with fundamentally different business models? Southwest certainly did when it first entered the Texas market in Dallas. Are there "empty spaces" on the strategic group map that may invite successful entry? In Figure 11.1, no firms currently operate with high fares at small airports, or with low fares at large airports. If this is the case, does this fact suggest possible alternative competitive approaches to the market? These types of questions can be asked and addressed effectively in the context of the strategic group map (See Strategy in Practice: A Real World Strategic Group Map).

Strategy Canvas

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Another way to evaluate differences among competitors is to employ a strategy canvas. This idea was first introduced by W. Chan Kim and Renée Mauborgne as a way to assess relative competitive strengths and weaknesses against specific purchase criteria.[8] By rating firms on various criteria that customers use to make purchase decisions, the analyst is able to quickly grasp similarities and differences in how companies attempt to offer unique value to customers relative to competitors.

For example, consider a strategy canvas analysis of Southwest Airlines and its unique value proposition relative to full-fare airlines and automobile travel (see Figure 11.2). Various features that customers care about when selecting among travel options are identified and placed on the horizontal axis. These features include price, meals, lounges, seating choices, hub connectivity, and so forth. Next, company performance is evaluated against these criteria and scored on the vertical axis. This scoring is typically based on rigorous quantitative scales, such as those obtained from surveys or other market research. The completed strategy canvas provides insight into how competitive offerings are differentiated.

In Figure 11.2, Southwest's scores more closely resemble automobile travel than they do the scores for other full-service airlines. This analysis uncovers a key point about Southwest's approach to the market. When Herb Kelleher founded the airline in 1971 at Love Field in Dallas to fly passengers to Houston and San Antonio, he set out not to compete with airlines but, rather, with automobile travel.

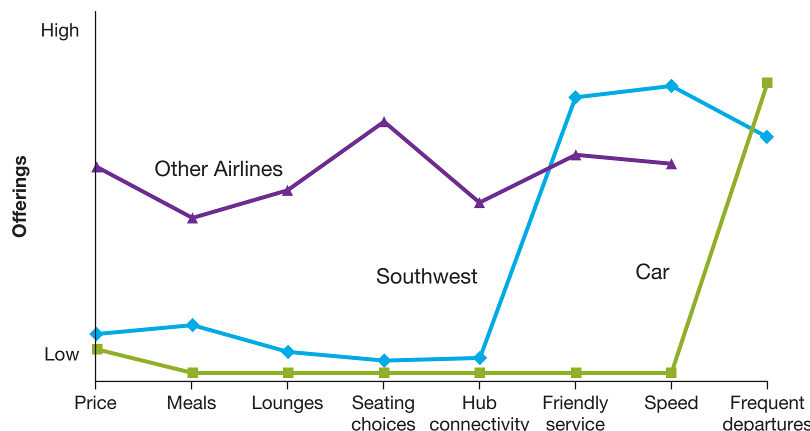

FIGURE 11.2 **Strategy Canvas of the Short-Haul Airline Industry**

Source: Adapted from C. Kim and R. Mauborgne. "Charting Your Company's Future," *Harvard Business Review* (2002).

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