Competition Demystified

- ❏ Strategic choices are outward looking and involve two key issues: 1) selecting the arena of competition, the one in which to engage, and 2) the management of external agents.

- ❏ Strategic analysis should begin with two key questions: In the market in which the firm currently competes or plans to enter, do any competitive advantages actually exist? And if they do, what kind of advantages are they?
    a. Barriers to entry is the most important factor: “no other feature of the competitive landscape has as much influence on a company’s success as where it stands in regard to these barriers.”
    b. “The existence of barriers to entry means that incumbent firms are able to do what potential rivals cannot. Being able to do what rivals cannot is the definition of a competitive advantage.”

- ❏ It is important to remember that size and rapid growth of the target markets are liabilities for incumbents, not assets. Big markets will support many competitors, even when there are substantial fixed costs. Markets grow rapidly because they attract many new customers, who are by definition noncaptive. They may provide a base of viable scale for new entrants. The appropriate strategy for both incumbents and entrants is to identify niche markets, understanding that not all niches are equally attractive. An attractive niche must be characterized by customer captivity, small size relative to the level of fixed costs, and the absence of vigilant, dominant competitors. Ideally, it will also be readily extendable at the edges.

- ❏ Competitive advantages are invariably market-specific. They do not travel to meet the aspirations of growth-obsessed CEOs.

- ❏ Competitors with patient capital and an emotional commitment to the business can impair the profitability of efficient competitors for years.

- ❏ Omitting an examination of the competitive environment simply because it cannot be neatly incorporated into a financial model ignores crucial information and impairs the quality of the analysis.

- ❏ Financial analysis employed to support strategic investment decisions “is almost always built around calculations of future cash flows” and “the cash flows themselves are based on estimates of future sales, profit margins, tax rates, capital investment requirements, and the cost of capital. Underlying them are another set of estimates regarding market size and growth rates, attainable market shares, gross margins, overhead expense ratios,” etc, etc, etc, etc… “Many of the variables that inform these metrics will depend on the intensity of future competition. But it is difficult to forecast precisely how competition will affect each variable. Moreover, competitive conditions do not influence these variables independently; the intensity of competition affects many of them simultaneously.”

- ❏ There are only a few types of competitive advantages (demand, supply, and economies of scale) and two straightforward tests (market-share stability and high return on capital) to confirm their existence.