Getting into your **competitor's head**

To anticipate the moves of your rivals, you must understand how their strategists and decision makers think.

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The global financial crisis that erupted in 2008 shows, with painful clarity, that we live in an interdependent business world. In bleak times and fair, the success of a company's strategy often depends greatly on the strategies of its competitors. In periods of financial turmoil, for instance, the prospects—and even survival—of a bank often depend on the near-term M&A of its rivals. Similarly, the ultimate success of Boeing's new commercial jet, the 787 Dreamliner, will depend on the way Airbus positions, markets, and sells its new and competing A380 and A350. Pfizer's ability to sustain market share and profitability in the market for cholesterol-lowering treatments will depend on the moves of the company's branded and generic pharmaceutical competitors, to say nothing of biotech and medical-product companies developing alternative treatments.

This strategic interdependence implies that the ability to anticipate your competitors' strategies is essential. Yet a recent survey of business executives found that the actions and reactions of potential rivals almost never play a role in, for example, decisions to introduce and price new products.[1] An important reason for this neglect, we believe, is that strategic-planning tools, such as game theory and scenario planning, are of limited use unless a company can correctly define the key elements of the strategic game,

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[1] David Montgomery, Marian Chapman Moore, and Joel Urbany, "Reasoning about competitive reactions: Evidence from executives," *Marketing Science*, 2005, Volume 24, Number 1, pp. 138–49.

especially the strategic options and objectives of competitors. This is no easy task. Rare is the company that truly understands what its competitors and their decision makers care about most, how they perceive their assets and capabilities, and what all this means for their strategies. A company with such insights could reverse-engineer the moves of competitors and predict what they were likely to do. In a credit crunch, for instance, such a company would be well positioned to buy financial and nonfinancial assets at attractive prices if it knew that poorly capitalized competitors would avoid new risk and therefore not bid for these assets.

Getting inside your competitor's head is difficult because companies (and their decision makers) usually are not alike. At any time, a company has assets, resources, market positions, and capabilities it must protect, leverage, and build upon. Different endowments imply different strategies even in the same general market environment. What's more, even a competitor with similar endowments may pursue different strategies if its owners, stakeholders, and decision makers have a different objective.

So if you want to anticipate rather than react to strategic moves, you must analyze a competitor at two levels: organizational and individual. At the organizational level, you have to think like a strategist of your competitor by searching for the perfect strategic fit between its endowments and its changing market environment. At the individual level, you have to think like the decision makers of the competitor, identifying who among them makes which decisions and the influences and incentives guiding their choices. This approach moves you beyond the data-gathering efforts of most competitive-intelligence functions, toward a thought process that helps turn competitive intelligence into competitive insights. While our approach won't eliminate surprises, it will help you better understand your competitors and their likely moves and eliminate some of the guesswork that undermines the development of strategies in an increasingly interdependent business world.

Think like your competitor's strategist

When your competitor resembles you, chances are it will pursue similar strategies—what we call symmetric competition. When companies have different assets, resources, capabilities, and market positions, they will probably react to the same market opportunities and threats in different ways—what we call asymmetric competition. One of the keys to predicting a competitor's future strategies is to understand how much or little it resembles your company.

In the fast-food industry, for example, two leading players, McDonald's and Burger King, face the same market trends but have responded in markedly different ways to the obesity backlash. McDonald's has rolled out a variety of foods it promotes as healthy. Burger King has introduced high-fat, high-calorie sandwiches supported by in-your-face, politically incorrect ads. As the dominant player, McDonald's is the lightning rod for the consumer and government backlash on obesity. It can't afford to thumb its nose at these concerns. Smaller players like Burger King, realizing this, see an opportunity to cherry-pick share in the less health-conscious fast-food segment. Burger King competes asymmetrically.

Companies can determine whether they face symmetric or asymmetric competition by using the resource-based view of strategy: the idea that they should protect, leverage, extend, build, or acquire resources and capabilities that are valuable, rare, and inimitable and that can be successfully exploited. Resources come in three categories: tangible assets (for example, physical, technological, financial, and human resources), intangible assets (brands, reputation, and knowledge), and current market positions (access to customers, economies of scale and scope, and experience). Capabilities come in two categories: the ability both to identify and to exploit opportunities better than others do.

In the video-game-console business, the strategies of Microsoft and Sony, which are attempting to dominate next-generation systems, are largely predictable—based on each company's tangible and intangible assets and current market position. Although the core businesses of the two competitors will be affected by video game consoles differently, both sides see them as potential digital hubs replacing some current stand-alone consumer electronic devices, such as DVD players, and interconnecting with high-definition televisions, personal computers, MP3 players, digital cameras, and so forth.

For Sony, which has valuable businesses in consumer electronics and in audio and video content, it is important to establish the PlayStation as the living-room hub, so that any cannibalization of the company's consumer electronics businesses comes from within. After the recent victory of Sony's Blu-ray standard over Toshiba's HD-DVD, Sony stands to realize a huge payoff in future licensing revenues. The PlayStation, which plays only Blu-ray disks, is thus one of the company's most important vehicles in driving demand for Blu-ray gaming, video, and audio content.

Microsoft has limited hardware and content businesses but dominates personal computers and network software. Establishing the Xbox as the living-room hub would therefore help to protect and extend its software businesses. For Microsoft, it is crucial that the "digital living room" of the future should run on Microsoft software. If an Apple product became the hub of future "iHome" living rooms, Microsoft's software business might suffer.

Sony and Microsoft therefore have different motives for fighting this console battle. Yet the current market positions (existing businesses and economies of scope), tangible assets (patents, cash), and intangible assets (knowledge, brands) of both companies suggest that they will compete aggressively to win. It was predictable that they would produce consoles which, so far, have been far superior technologically to previous systems and interconnect seamlessly with the Internet, computers, and a wide variety of consumer electronics devices. It was also predictable that both companies would price their consoles below cost to establish an installed base in the world's living rooms quickly. The competition to win exclusive access to the best third-party developers' games, as well as consumer mindshare, will also probably continue to be waged more aggressively than it was in previous console generations. For Microsoft and Sony, the resource-based view of strategy helps us to understand that this battle is about far more than dominance in the video game industry and thus to identify the aggressive strategies both are likely to follow.

Nintendo, in contrast, is largely a pure-play video game company and thus an asymmetric competitor to Microsoft and Sony. The resource-based view of strategy explains why Nintendo's latest console, the Wii, focuses primarily on the game-playing experience and isn't positioned as a digital hub for living rooms. The Wii's most innovative feature is therefore a new, easy-to-use controller appealing to new and hardcore gamers alike. The Wii has few of the expensive digital-hub features built into the rival consoles and thus made its debut with a lower retail price.

Applying the resource-based view of strategy to competitors in a rigorous, systematic, and fact-based way can help you identify the options they will probably consider for any strategic issue. But if you want to gain better insight into which of those options your competitors are likeliest to choose, you have to move beyond a general analysis of their communications, behavior, assets, and capabilities and also think about the personal perceptions and incentives of their decision makers.

Think like your competitor's decision makers

Since the objectives of corporate decision makers rarely align completely with corporate objectives, companies often act in ways that seem inconsistent with their stated strategic intentions or with the unbiased assessments of outsiders about the best paths for them to follow. So if you want to predict the next moves of a competitor, you must often consider the preferences and incentives of its decision makers.

The key to getting inside the head of a competitor making any decision is first identifying who is most likely to make it and then figuring out how the objectives and incentives of that person or group may influence the competitor's actions. In most companies, owners and top managers make divestment decisions, for example. Strategic pricing and service decisions are often made, within broad corporate guidelines, by frontline sales personnel and managers.

Owners and other important stakeholders

The objectives of the person or group with a controlling interest in your competitor probably have a major influence on its strategy. Sometimes, personal preferences are particularly relevant: it's likely that Virgin's pioneering foray into the commercial space travel industry partially reflects the adventurous tastes of its charismatic founder, Sir Richard Branson. For family-owned or -controlled businesses—public or private—family values, history, and relationships may drive strategy. A competitor owned by a private-equity firm is likely to focus on near-term performance improvements to generate cash and make the company more attractive to buyers. While every private-equity firm is different, you can often forecast the tactics any given one will take by studying its history, since many such firms often repeat their successful strategies.

Other stakeholders may also profoundly influence a company's strategy, so it often pays to get inside their heads as well. You can't evaluate any large strategic moves GM or Ford might make without considering the interests of the United Auto Workers and how those interests might check or facilitate such moves. The importance of nonowner stakeholders in driving a company's strategy varies by country of origin too. If you compete with a Chinese company, the Chinese government is often a critical stakeholder. In Europe, environmental organizations and other nongovernmental stakeholders exert more power over corporate decision making than they do in the United States.

Top-level management

Since the owners of companies hire top-level management to pursue the owners' strategic objectives, a Martian might think that management's decisions reflect those interests. Earthlings know that this may or may not be true. That's why you must study your competitor's top team.

First, that analysis provides another source of insight into the objectives of the company's owners. When James McNerney arrived at 3M in 2001, for instance, he brought along his belief in GE's "operating system," a centralized change-management methodology that inspired GE's successful approach to Six Sigma, globalization, and e-Business. If you were a 3M competitor, McNerney's history suggested that he would try to turn 3M, which had traditionally favored a fairly loose style of experimentation, into a more operationally accountable company. His hiring signaled the 3M board's intention to focus more aggressively than before on costs and quality. It surely came as no surprise to 3M's board or to the company's competitors that one of McNerney's first strategic moves was to launch a corporate Six Sigma program.

And of course, senior executives aren't always perfect "agents" for a company's owners, whose personal interests and incentives may differ from theirs. Such agency problems quite commonly bedevil even companies with the best governance practices, so it often pays to focus on the objectives of senior leaders as well.

Recommended reading

The works below help readers learn more about the ideas and procedures discussed in this article.

The objectives of organizations

Jay Barney, "Firm resources and sustained competitive advantage," *Journal of Management*, 1991, Volume 17, Number 1, pp. 99–120.

David J. Collis and Cynthia A. Montgomery, "Competing on resources: Strategy in the 1990s," *Harvard Business Review*, July 1995, Volume 73, Number 4, pp. 119–28.

Kevin P. Coyne, Stephen J. D. Hall, and Patricia Gorman Clifford, "Is your core competence a mirage?" mckinseyquarterly.com, February 1997.

James G. March, "Exploration and exploitation in organizational learning," *Organization Science*, 1991, Volume 2, Number 1, pp. 71–87.

The objectives of decision makers

Michael Jensen and Kevin J. Murphy, "CEO incentives: It's not how much you pay, but how," *Harvard Business Review*, May 1990, Volume 68, Number 3, pp. 138–53.

Paul Milgrom and John Roberts, *Economics, Organization & Management*, Englewood Cliffs, NJ: Prentice Hall, 1992.

Game theory, scenario planning, and simulations

Hugh G. Courtney, "Games managers should play," mckinseyquarterly.com, June 2000.

Hugh Courtney, *20/20 Foresight: Crafting Strategy in an Uncertain World*, Boston, MA: Harvard Business School Press, 2001.

Anticipating business surprises

Kenneth G. McGee, *Heads Up: How to Anticipate Business Surprises and Seize Opportunities First*, Boston, MA: Harvard Business School Press, 2004.

General managers and frontline employees

Competitors of a decentralized company must focus not only on the objectives of its owner and corporate leaders but also on those of business unit leaders, middle management, and even frontline staff. Until recently, for example, Ford was decentralized, with each geographic region run almost independently. Automotive competitors that wished to predict Ford's behavior would have needed to focus on the statements and actions of each regional and brand manager, because the company's objectives could vary from location to location and across divisions. But since Alan Mullaly took over as CEO in 2006, he has moved to coordinate some decisions and platforms across divisions and regions. Competitors must now understand what is still decided by regional managers and what by Detroit.

For certain decisions, frontline employees and managers are also important, especially if they make pricing, marketing, service, and operational decisions that significantly influence a company's competitive advantage. Even if decision making is more centralized, the incentives of frontline employees may be misaligned with the objectives of a company's owners or senior leaders. Agency problems may inspire the front line to undercut these objectives.

Suppose, for example, that the head of a division at one of your competitors wants its commissioned sales force to promote a new product. If the sales force is enjoying strong sales from established products, reps may hesitate to risk their compensation to promote the new one. A knowledge of such agency problems—which can often be detected through the chatter between your frontline sales force and the customers you share with competitors—can have great strategic importance for your company. In this case, agency problems will probably delay the point when the new product wins significant sales. You could exploit that time lag to fortify your own presence in the market and possibly to preempt the competitor's new offering.

Reach a point of view

What happens once you have a better sense of the options your competitors may consider and the way they may evaluate those options?

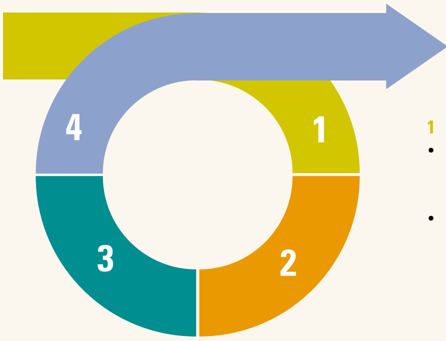
Let's say that your company's market environment is relatively stable and that you have much useful information about your main competitors and their decision makers. You can then apply game theory to determine, with considerable confidence, the strategies your competitors will probably follow to maximize their objectives, as well as the way your own choices may influence those strategies. Suppose, however, that even your best efforts don't give you a clear picture of the resources of your competitors or their decision makers' objectives. Then it is often best to avoid trying to predict the competition's exact behavior and instead to use scenario planning to test your company's strategic possibilities.

In a financial crisis, for example, even the best competitive-intelligence efforts may provide incomplete, excessively complex, or inconsistent information on the competition's strategies and thus fail to support game theory or scenario planning. We have found that one way of generating a point of view in such situations is to conduct "war games." In these exercises, each team, representing a specific competitor, receives a fact pack about that company and its decision makers. The teams then make key strategic decisions for the companies they represent. Through several rounds of competition, every team can act on its own strategies and react to the moves of other teams. The war game forces the players to combine incomplete, and perhaps inconsistent, information on competitors to develop a point of view about which moves make the most and least sense for them and are therefore the most and least likely moves for them to make.

No matter how thorough and insightful your analysis may be, two things are almost sure to happen: your competitor will make some moves you considered unlikely, and some of your data will quickly become obsolete. When a competitor acts in unexpected ways, your company has a crucial learning opportunity. Why were you wrong? Did you, say, miss an important agency problem that undermined the execution of the strategy you thought the competitor would follow? Did the market environment change, creating new threats and opportunities for the competitor? Did

EXHIBIT

The competitor-insight loop



4 Synthesize, learn, and repeat
- Synthesize information to a point of view about which moves make the most and least sense for your competitor
- Learn from ongoing indicators and monitoring
- Repeat

1 Listen to your competitor
- Gather basic competitive intelligence—what are your competitors saying?
- Use pattern recognition—do recent moves and counter-moves reveal strategy?

3 Think like the decision makers for your competitor
- Who is the likely decision maker?
- Are the decision makers' interests aligned with those of the company's owners?

2 Think like a strategist for your competitor
- What are its assets, capabilities, market positions?
- How might it protect, extend, and leverage them?

it bring in a new chairman or CEO? You must diagnose your mistakes, learn from them, and ensure that you use the latest data to develop your point of view.

Learning from your mistakes means managing these competitive-insight activities as an ongoing process for real-time strategic planning and decision making, not as an annual or biannual event in a bureaucratic planning process. Particularly in dynamic markets, where companies have to make decisions constantly, information about competitors must be updated as soon as possible (exhibit).

One key to making this ongoing process more insightful is tapping into the latest competitive intelligence dispersed throughout the frontline workforce. An e-mail address, a blog, or a shared database could let sales reps report on the latest pricing, promotion, negotiation, and sales tactics that competitors use with key customers or customer segments. Engineers might use such facilities to report the latest product pipeline rumors from professional conferences. When possible, companies should also establish appropriate information-sharing arrangements with key partners; suppliers, for example, may provide the latest intelligence on future input prices. As Ken McGee argues in *Heads Up*, most of the information needed for sound business strategy decisions is already available. You just have to create a process to capture and synthesize it meaningfully.

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Strategy's strategist: An interview with Richard Rumelt

Particularly today, no company is an island. Those that most accurately perceive the competitive landscape as it is and is likely to be in the future have a distinct competitive advantage. Our process—focusing on changes in the resources, decision-making structures, and compensation systems of competitors—moves beyond the usual updates on key market trends and uncertainties. Its rewards are huge: fewer surprises from competitors and more opportunities to shape markets to your own advantage. Q

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