

Analyzing the Competition

LESSON 16



Main Idea

In this unit we will focus on competition. We will learn about how to determine who the competition is, competitive analysis, and how competition affects a business. We will then cover information dealing with direct competition, indirect competition, and competition based on location and pricing. We will review how to develop a competitive strategy and, lastly, we will review some mathematics associated with competition.

After completing this lesson you will be able to:

- Determine who the competition is and how they are affecting your business
- Give example of the two types of competition
- Explain the advantages and disadvantages of competitors sharing the same trade area
- Describe the impact competition has on pricing
- Explain factors that can contribute to a store gaining a competitive advantage
- Calculate market share
- Evaluate the competition

Key Terms

- Competition
- Trade Area
- Direct Competition
- Indirect Competition
- Market Share
- Price
- Price Competition
- Pricing to Meet the Competition
- Non-price Competition
- Competitive Advantage

Who is the Competition?

It is important for retailers to know who their competition is and to understand as much as possible about that competition. We have already learned that the competition is a business that sells the same or comparable merchandise within a given trade area. Trade area describes the geographic neighborhood of a business, which provides most of its customers. The Internet should be considered when analyzing trade area. An online search for businesses selling the same or similar items will reveal many competitors that must be considered. Remember that the Internet has become an important part of the marketplace.

You can identify the competition by driving around a trade area, looking through the phone book, and searching online. Whatever method or combination of methods you use, it is important to identify all the competition.

Direct and Indirect Competition

Competition can be divided into two groups: direct competition and indirect competition. Direct competition is a business that offers the same products as another and so competes for the same customers. An example is a store that sells jeans and shirts located one mile from another store that sells jeans and shirts. Indirect competition is a business that offers products that are not the same, but that are similar enough to satisfy the same customer need. For instance, a barbeque restaurant might compete indirectly with a pizza restaurant. Barbeque and pizza are different types of food, but both satisfy the same customer need of hunger.

Analyzing Strengths and Weaknesses

To understand the competition retailers begin by analyzing the strengths and weaknesses of each competitor. A visit to competitors can be helpful for identifying their products, their pricing, the appearance of their store, and any other areas you wish to compare. Make a checklist and notes about each of the areas of comparison and honestly assess how each area compares to your store. A competitor might offer extensive product selection. That is a strength. The same competitor's customer service might be mediocre. That is a weakness. Continue through your checklist for each of your business's competitors. Answer this question—what do they do better than you? Once your analysis is complete, you will have a good idea of the strengths and weaknesses of your competition compared to those of your business.

How Competition Affects Your Business

We have mentioned in earlier units that competition is good for business. Customers enjoy comparison shopping; therefore, competition can help attract additional customers. Competition also helps keep retailers sharp and forces them to continually strive for improvement. Retailers use the measure of market share to tell how well their business is doing compared with the competition. Market share is the percentage that a store has of the total sales in its trade area. The higher the percentage of market share a business has, the better it is doing in relation to the competition. A small or declining percentage of market share indicates that there is a problem that needs to be addressed.

Competition and Location

We briefly discussed competition as a factor to consider when selecting a store location. We also stated earlier in this unit that competition can be beneficial to a business. Before selecting a store location, retailers must assess both the direct and the indirect competition in the trade area. Start with learning who the competition is and exactly where they are located. Your proximity to your competitors will have an effect on your business. Too little competition makes it more difficult to attract customers, especially those who want to comparison shop. Too much competition in a trade area makes it difficult for the existing customer base to keep all the stores in business. This can be especially true for a new store locating among more established ones.

Pricing and the Competition

Competition is a consideration when a retailer considers the pricing of merchandise. Price is the amount of money a business charges for items it offers for sale. Price competition happens when multiple stores carry the exact same product at different prices. Price competition is based on the idea that all other factors being equal, customers will buy an item where the price is lowest. In many cases, competing retailers price like merchandise at the same price points. Customers going from store to competing store will see the same items priced at the same prices. This is called pricing to meet the competition.

Sometimes a retailer will price an item below the price being charged by competitors for the same item. The usual reason for doing this is to increase sales of this item or to attract new or additional customers to the store.

Pricing like merchandise above the prices charged by competitors is another option for retailers. For this pricing strategy to be successful, customers must sense an added value from purchasing the item at that store. Convenience is a typical reason why customers might consider purchasing higher priced like merchandise.

Some retailers decide to compete on factors other than the price of the merchandise they sell, such as the quality of merchandise, the size of the merchandise selection, customer service, or other special services valued by customers. This type of competition is called non-price competition. For instance, a customer might be willing to pay more for a washing machine if he or she knows that the store they are buying from offers fast and reliable repair service. Retailers should always be sensitive to laws protecting customers relative to pricing, as discussed in the Pricing unit.

Competitive Advantage

Competitive advantage is the term used to express the advantage that a business can offer over a competitor's business. It is a factor that causes customers to choose to buy at one store over another. Competitive advantage can be based on one factor or on multiple factors. Outstanding customer service, merchandise selection, or any number of other factors can all contribute to a competitive advantage. This advantage must be something that customers perceive as a value that they cannot get elsewhere.

Developing a Competitive Strategy

Most retailers develop a strategy or plan to help their businesses remain relevant in their trade area. The first step is to get to know the competition. The competitive analysis that is part of a business plan is helpful for learning about the competition and about each competitor's activities. A proper competitive strategy includes the frequent updating of information about the competition. New competitors change the business landscape. Changes in the way an established competitor does business can also have significant consequences for a retailer. It is very important to keep informed about the competition.

Developing a competitive advantage will not only build customer loyalty, but it will help the business stand out and will make it unique.

Summary

This unit has provided information about competition. We have learned about direct and indirect competition and how to determine who the competition is. We looked at analyzing the competition's strengths and weaknesses and how competition can affect a business. Next, we reviewed the effects of location and pricing on competition. We looked at the importance of competitive advantage and a competitive strategy, and we discussed mathematics associated with competition.

Key Math Concepts

COMPUTE MARKET SHARE

Market share is an important measure of how a business is doing against its competition.

Market Share Percentage = Sales of a Specific Business ÷ Total Sales in Trade Area

Key Terms

Competition

A business that sells the same or comparable merchandise within a given trade area.

Trade Area

The geographic neighborhood of a business, which provides most of its customers.

Direct Competition

A business that offers the same products as another and so competes for the same customers.

Indirect Competition

A business that offers products that are not the same, but that are similar enough to satisfy the same customer need.

Market Share

The percentage that a store has of the total sales in its trade area.

Price

The amount of money a business charges for items it offers for sale.

Price Competition

A result of multiple stores carrying the exact same product at different prices.

Pricing to Meet the Competition

A term that describes the practice of competing retailers pricing like merchandise at the same price points.

Non-price Competition

Competition based on factors other than the price of the merchandise sold.

Competitive Advantage

The term used to express the advantage that a business can offer over a competitor's business.

Analyzing the Competition

1. You are the owner of a bookstore in a strip mall located one mile from a regional shopping mall. The mall has a branch of a national chain of bookstores. You have followed the policy of pricing bestsellers to meet the competition. The very popular author of several blockbuster bestsellers has just released a new book, and you have learned that the mall bookstore is going to run a promotion for two weeks that will give buyers an extra 10% off the already discounted cover price. The mall bookstore and your store both give a 20% discount on bestsellers, and the cover price of the new book is \$26.95. The cost of the book to your store is \$13.00. You plan to meet the competitor's promotional price. What is your margin per book at the 20% discount price? At the 30% discount price? If you sell 175 copies over the two-week period, what impact will this pricing have on your margin during the 30% off promotion?

2. Your sales for last month were \$140,000. Total sales among all competitors in your trade area were \$588,000. What was your market share percentage for last month?

3. There are four stores selling CDs in a trade area. CD sales for last month for each store are as follows:

Store A \$12,640 Store B \$23,540 Store C \$18,725 Store D \$21,435

What percentage of the CD market share did each store have last month?

4. Your store is selling a nationally advertised coffee pot at the manufacturer's suggested retail price of \$39.95. Your trade area is very price conscious. You have just learned that your closest competitor has lowered the price of this coffee pot to \$34.95. You have determined to lower your price to 5% below that of the competitor. What will be your new selling price? What is the total amount of the markdown?

Analyzing the Competition

1. Select a store in your local trade area. Identify the store and describe the merchandise it carries. Then identify the stores within a five-mile radius that are direct competitors and identify stores within the same area that are indirect competitors. Provide your rationale for each selection.

2. Describe the merchandise offerings of two pairs of stores in your area. One store pairing engages in price competition. The other store pairing engages in non-price competition. Explain the reasons for your selections.

3. Explain some ways in which a retailer can gain a competitive advantage and why this is important.

4. What is market share and why is it important?

Analyzing the Competition

GOAL: Your goal is to analyze your competition and then devise a strategy to increase your market share.

YOUR SITUATION: In this lesson you control Pricing, Promotion, and Market Research.

1. Run the **Competitive Prices, Market Research, Financials, Market Share, Pricing, Promotion, Direct Mail, Billboards, Radio Advertising, and Storefront Ads** sections of the Tutorial.
2. Open the Analyzing the Competition lesson.
3. Your store is named Yours. Observe your competitors and fill in **Worksheet 1**.
 - a. For the Price column, use **Reports->Competitive Prices**.
 - b. For Primary Customer Segment Served, use a **Survey** and the **Segment** option.
 - c. For Promotional Strategy, use **Reports->Financials** and click the **More Detail** button. To see competitor financial statements use the **View** menu to switch between stores.
 - d. For Current Market Share, use **Reports->Market Share**.

QUESTION 1: What is your current market share? Which stores do you think represent your most direct competition?

QUESTION 2: Write down a strategy to use pricing and promotional changes to increase your market share. Your goal is a 10% point increase in market share.

4. Implement your strategy and run the simulation forward 3 weeks.

QUESTION 3: What was your gain in market share? Which competitors lost share and by how much?

5. If you did not increase your share by 10%, revise your strategy and run the simulation forward 3 weeks. Repeat this process until you have achieved a 10% increase in market share.

QUESTION 4: What was the pricing and promotional strategy you used that increased your share by 10%?

WORKSHEET 1

Store	Price <i>(higher, lower, same)</i>	Proximity <i>(closest, next closest, furthest)</i>	Primary Customer Segment <i>(students, office pros., retirees)</i>	Promotional Strategy <i>(radio, direct mail, billboards)</i>	Served Current Market Share <i>(% of revenue)</i>
Kathy's					
Malcolm's					
Kenneth's					
Yours					