COMPETITIVE INTELLIGENCE FOR PORTFOLIO COMPANIES

Over the past couple of months, Acclaro has fielded several inquiries from private equity groups curious about what can be learned about competitors' operations. The following white paper breaks down a competitor by functional area of the business and describes the questions Acclaro would address in a competitive intelligence assignment.

Competing in niche industries with few or no public companies as proxies and limited published market data, portfolio companies must operate somewhat blindly in their industry segments. However, some private equity groups have encouraged their portfolio companies to utilize competitve intelligence practitioners. They do so to augment their internal understanding of the competitive landscape, competitor capabilities, and most importantly, competitor intentions.

Corporate Strategies

Since strategies and tactics originate from a corporate goal or objective, it is important to understand that core goal as a starting point. Does the competitor want to focus on growth or profitability? Is it concerned about quality or service or price leadership?

Once we understand the core goal, we can identify the strategies in place to attain this goal. If the goal is to become the easiest organization to work with in the industry, what are the steps a competitor will take at a corporate level to ensure this happens?

We would also probe into the core competencies, unique selling points, and value propositions of the organization. What does it believe it is uniquely good at compared to the competition that is critical to its business model? In addition to understanding this core capability, we would assess its impact. What benefits or difference does this capability make that exceed the benefits of working with other providers of the product or service?

Competitive Strategies

The ultimate purpose of competitive strategy is to get inside the heads of competitors, anticipate their moves, and take the initiative to thwart the effectiveness of their plans.

Most middle market companies are frequently small and serve often obscure markets. Their competitive strategies are typically pedestrian. However, the competitors of a portfolio company have a sense of each competitor's strengths and weaknesses. And they have a plan to defeat each of their competitors they see when bidding against them. This is what we strive to determine. What are the presumed opportunities they see to gain share from specific competitors (including our portfolio company)?

More generally, we can ask the competitor to describe market opportunities and threats.

We can also ask the competitor to tell us about their unique positioning in this market.

Financials

While it is not possible (or legal) to probe into the competitor's books, it is not unusual for a contact to respond to a question by stating "let me look it up." Using the context of a market study, it is entirely within reason to ask a contact how their gross margins have been lately, what their growth rate is, or even how inventory turns are trending. Of course, these questions are difficult. There must be some rapport with the competitor on a slightly different subject first. The questions need a context – they cannot just come out of left field. And there may need to be some horse-trading (sharing of market knowledge).

Financial strategies and intentions related to balance sheet decisions can be uncovered, as well. These discoveries are helpful in developing an assessment of the owner's commitment to the business over the long-term. Where is the owner investing? How much is the owner willing to risk today in order to generate future cash flows?

Products and Services

Since product strategy is all about differentiation, we seek input on just that – how the competitor perceives its products or services to distinguish themselves in the marketplace. Not just existing products; new ones, too.

How important is innovation to this competitor? What new products or innovations is the competitor working on? We would also inquire about where the competitor focuses on new product development. In other words, what is most important: time to market, low product cost, low development cost, product performance, quality and reliability, service responsiveness and flexibility, etc.?

While we know generally about the kinds of products and services the competitor offers, we have no real sense of how these different product or service categories relate. What percentage of sales does each product area represent?

Products are, of course, driven by customer demand. What specific customer need or demand are the company's products (or specific product) striving to address? Understanding this general issue requires comprehending a more specific one – what is the target market for these products?

Brand and Promotions

The target market is an important starting point in figuring out their brand and promotions strategies. Brand strategy is like a three legged stool. One leg involves understanding the target customer and, more importantly, its needs. The second leg involves differentiating its ability to meet customer needs from the competitors. The third leg involves communicating this competence or ability to meet customer needs.

There are four main promotional tools available to any company: advertising, personal selling, sales promotions, and publicity. Which one does the competitor focus upon? What is the core theme, main idea, or message that permeates customer communication efforts of the organization?

This leads us to the brand, brand promise, and brand strategy. Every brand strives to have a clear voice, identity, or personality. Most brands, however, are not very clear in that regard. We help clients understand the rationale behind brand decisions and get to their intentions. "We are trying to make the brand friendlier and attractive for women – that is our primary objective with the brand right now." If that is the case, how does that brand intent tie into product and marketing decisions?

Brands make promises. Good brands make these promises crystal clear. Great brands choose promises that meet customer needs, and still differentiate them from competitors' promises. And they deliver on the results. One role that we perform is to determine what the intended promise is at the competitor organization.

Distribution

Distribution strategies involve planning how to pass the product from organization to organization, entity to entity, until it reaches the final destination, the end-customer. We can diagram what percentage of sales goes through each channel of distribution (e.g., distributors, wholesalers, dealers, manufacturer's reps, direct sales force). Even starting at the point of sale, one can determine how the customer interface works, how orders are placed, and how orders are fulfilled. When we study distribution, we look for the current state of reality in how products are distributed, and we look for the intended future state, as well.

A strong distribution function in any company will have a pre-determined distribution objective or goal: to be premium positioned, to be everywhere, to be quick, to control the flow of product closely, etc. We can determine the competitor's distribution strategy.

Sales

The sales strategy reveals the core sales steps being taken to achieve the corporate goal. If the goal is to become the easiest player to do business with, what are the steps the sales organization is taking to make that goal happen? Who are major accounts, and how does the competitor select key customers?

The sales breakdown by market served helps shed light on the Company's priorities and successes. We can also determine the breakdown between domestic and foreign sales. It can also be helpful to simply ask salespeople, who are often highly opinionated, and where the company's priorities lie.

The organization of the sales force can be revealing, too, in understanding the company's priorities. In addition to determining the make-up of the sales organization (i.e., number of salespeople, territory breakdown, reporting structure), it is important to reveal the customer penetration strategy being utilized most aggressively (online, mail, call-center, etc.).

Pricing

When a competitor prices its products or services, it may have one of a number of possible goals in mind: profit maximization, revenue maximization, quantity maximization, price leadership, etc. Depending on the goal in mind, it may select from a range of possible pricing strategies: competition-based, cost plus, creaming/ skimming, loss leader, market oriented, penetration, dynamic, target, etc. We are able to determine which goal and which strategy a competitor has selected.

The competitor will choose a pricing strategy based, in part, on its understanding of customer drivers:

- to what extent is the chosen segment of customers price-sensitive?
- is mass appeal for the product coming soon?
- are there clear quality differences between its products and other's?

Other issues that can be studied involve trends in pricing across the market, the impact or onset of rebates, even target price ranges for a new product.

Operations

Operations tie directly into the corporate goal, of course. For example, if the goal is to be known as the low-cost and low-price producer, what specific actions are happening in operations to drive costs down? What are the operations strategies to achieve the corporate goal?

An interesting place to dig deeper is the value chain. What value-added steps occur where, before reaching the customer (e.g., degree of manufacturing integration, utilization of unique materials, utilization of unique or proprietary processes, etc.)?

Sourcing is another important aspect of operations. Researchers can determine purchase quantities of various materials, and even identify suppliers for various raw materials. They can determine the type of contracts in place (e.g., yearly contractual vs. spot buys).

In the manufacturing environment, there are a number of specific, tangible facts that can be learned about a competitor's operations. A qualified research-based consulting firm can determine the line speed rates and yields of equipment. It can assess product rework and reject rates, and understand the higher level quality control practices and mantras.

Facilities and Labor

While facilities and labor do not tie directly into intent (corporate goals and strategies), the make-up of the facilities and labor force can reveal capabilities. For example, learning about the age, condition, and equipment utilized in a manufacturing plant can help assess production capacity.

Learning about the employees can also reveal much about the capabilities of the organization. For example, how many employees are there? Is the plant union or non-union, and what are the representative salary and wage levels? What are the metrics used to calculate employee productivity? What is the benchmark of typical productivity? These are just a few examples of the kinds of questions that can be posed to competitors about their facilities and labor.

R&D and Innovation

The innovation or R&D strategy reveals the steps that the R&D department is taking to ensure it carries out the goal of the corporation. What is the area of focus or emphasis for R&D (true innovation and novel concepts, updating of existing products, value-added features and benefits for existing products). The origin of the competitor's R&D focus and activities may be internally driven programs, customer/market demands and unmet needs, competitors' activities, etc. Our role is to determine not only what the source of the R&D focus is, but what the emphasis and strategies truly are.

Other ways to assess the importance of R&D to the organization are to determine the R&D budget, the number of R&D employees, the educational levels of these employees, and the reporting structure of R&D in the organization. Finally, it can be helpful to learn about any cross-functional relationships that R&D has with other departments in the company. In addition to manufacturing and engineering, does R&D have direct working relationships with marketing, sales, strategic planning, or corporate development?

Ownership, Management, Culture, and Organizational Structure

While an organization's ownership and organizational structure, management team, and corporate culture have little to do with the goals and strategies of the organization, they can be revealing nevertheless. If the company is owned by one individual, often the direction of the company is far more staid, predictable, and determined by past events than if it is controlled by a group of investors.

Similarly, if the management team is a group of highly educated MBAs with significant experience in a diverse range of industries, they will make decisions differently than a group of individuals who grew up in the industry at hand.

Corporate culture can be defined as the psychology, attitudes, experiences, beliefs and values (personal and cultural values) of an organization. Understanding a culture can be helpful in predicting actions, and responses, in the marketplace.

The organizational structure can reveal who controls the power, and which departments wield the most influence. Organizational structures of various competitors often reflect the areas of focus of those organizations.

M&A Interest

When an organization is owned by a parent company, holding company, or private equity group, much can be learned by inquiring about the divestiture intentions and interests of those higher level organizations. Similarly, asking the owner-operators about their interest in selling their businesses can reveal their level of commitment to the business.

Conclusion

Most private equity portfolio companies have a narrow and shallow understanding of their competitors. The portfolio company does not have clarity on many of the functional areas we have covered here, and their knowledge base is thin. Those subject areas they do understand (e.g., revenue, product line, and core strengths and weaknesses) do not extend deeply into a range of finance, product or corporate strategy issues.

Every project is unique. While this white paper presents a possible laundry list of issues which can and should be studied in each major functional area, it is a generic list. Competitive intelligence projects are custom-tailored to the unique needs and interests of the portfolio company.

Also, a one-time review of the competitive landscape is not enough. The functional understanding described in this white paper can certainly not be achieved in one study. The portfolio company needs to build up a baseline understanding, with help from a third-party consulting firm with expertise in competitive intelligence. This baseline understanding should be updated annually, probing both more deeply into known areas, and broadly into areas that are not yet understood. Over time, a portfolio company will be able to anticipate competitor's moves and make bold decisions understanding in advance how the competitors will or will not respond.

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