Competitor analysis and accounting

(Relevant to Paper II -- PBE Management Accounting and Finance)

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Every day we see competition in products and services in a modern business society. Competitor analysis and accounting is a central issue in strategic management accounting. These techniques help companies analyze and master the competitive situation. Competitor analysis and accounting is also called competitor-focused accounting or accounting for the competition.

Key benefits of competitor analysis and accounting

Competitor analysis and accounting is regarded as a central element in business planning and control. There are four key benefits of competitor analysis and accounting:

1. **Industry benchmarking.** Companies compare themselves with similar companies in the same industry to identify their strengths and weaknesses. For example, Bank of East Asia sets Hang Seng Bank as its benchmark for comparison, as both are local banks in Hong Kong.
2. **Learning from competitors.** Companies study their similar market experiments to those which they are planning. For example, mobile phone service companies compare plans of other mobile companies when planning a new promotion of phone services.
3. **Positioning.** Companies try to identify their competitors' strengths when choosing competition methods, either by cutting the product price to exercise cost leadership or by launching a new product or service to achieve product specialization.
4. **Identifying opportunities and threats.** Competitor analysis and accounting links with the traditional strengths, weaknesses, opportunities and threats (SWOT) analysis for handling both business opportunities and threats.

Some query why competitor analysis is critical for identifying opportunities and threats. To answer this, think about what questions an organization should ask to identify these. In fact, competitor analysis helps decision makers understand who the competitors are and what the market structure is. It allows management to identify its competitors' making and selling strategies. By understanding who the competitors are and how they operate, managers can remove the issue of other companies making moves that are detrimental to their companies' health. Managers can also learn from their competitors.

Competitor analysis helps answer the following questions:

Who are the main competitors?

What are the company's objectives?
What are its strengths and weaknesses?
How well is it doing?
Can the company predict competitors' future moves?

Five basic steps help answer these questions:

1. Determine the customers and services of the company.
2. Identify current and potential competitors.
3. Gather basic information on each competitor.
4. Conduct in-depth research on each competitor.
5. Conduct a comparative analysis of competitors.

Product price and quality are the concerns in competition. The company should conduct competitor accounting alongside its competitor analysis to assess competitors' relative quality and price. The major concerns are:

- Compare the position of the business with that of its competitors with regard to quality and price.
- If the industry is mature, the basis of competition is frequently based on selling prices, as the product has become a well-understood commodity.
- Identify the key success factor to achieve a comparative cost advantage.

It is helpful for a company to conduct best-practice benchmarking, comparing its performance against that of the best competitor in the industry. This helps to increase company productivity growth. Subsequently, the company can break through to a higher standard of performance.

Value-chain analysis is also helpful. It helps a company understand where and how it adds value. It helps the company determine its own sources of competitive advantage, and it can then dissect strategically relevant activities so as to understand the sources of competitive advantage through cost leadership or product specialization.

Companies practicing competitor analysis and accounting should also carry out competitive position monitoring. Through this they analyze competitor positions within the industry by assessing and monitoring trends in competitor sales. In addition, companies should conduct industry profitability analysis. This provides them with a gauge for the nature and intensity of competition.

<u>Five key forces affecting industry competition</u>

Companies should consider the five key forces that affect industry competition.

1. **Entry barriers.** How many companies are there in the same industry? How easy is it for a new company to enter the industry? Is there legislation which would permit entry of a new company? Is there sufficient demand for a new entrant? For instance, 7-11 and Circle K dominate the convenience shop industry in Hong Kong. They provide a 24-hour convenience-goods retail service, and make it difficult for others to enter the industry. Round-the-clock

retailing is essential to the competitive ability of these two convenience shop chains.

2. **Competitive rivalry.** How many competitors are there in the industry? How intense is competition in the industry? In Hong Kong, for example, there are three major supermarkets: PARKnSHOP, Wellcome and China Resource Vanguard. There are also some other higher or lower classes supermarkets of smaller size. However, if PARKnSHOP uses competitor analysis and accounting, it will only compare itself with Wellcome or China Resource Vanguard, and not the various smaller supermarkets, since these do not impose a direct threat on its operations.

3. **Substitute products.** What substitutes pose a threat to the company's profitability? Do other competitors offer a similar or alternative product? In recent years, young people prefer fast food to 'dim sum' food in Chinese restaurants. Chinese restaurants have clearly been replaced by fast food shops in both number and turnover.

4. **Supplier power.** How much bargaining power do suppliers possess? This will be determined by the number of suppliers in the industry, the other companies that they supply products to, and the individual company's relationship with its suppliers.

5. **Customer power.** How much bargaining power do customers possess? Do the customers determine what the business is? For instance, a high-class boutique in Causeway Bay is not very susceptible to the bargaining power of buyers but, on the other hand, an outlet shop in Sham Shui Po, as the profit margin from an outlet shop is lower than that of a high-class boutique.

Problems with competitor analysis

In general, it is difficult to collect information on competitors. Companies are reluctant to share information and to quantify the direct financial benefits of competitor analysis. Companies that undertake competitor analysis will perform better than those which do not. Clearly, though, smaller companies cannot afford to conduct competitor analysis.

Management accountant's role in competitor analysis

Management accountants perform three main roles in competitive analysis:

(a) collecting, analyzing and comparing competitors' relative costs and investments;
(b) assessing the quality of the information; and
(c) predicting the future costs of competitors' products.

Competitor array

One common and useful technique in analyzing the competitive position of companies is constructing a competitor array. The procedures are:

1. Define the industry, especially the scope and nature of the industry.

2. Determine who the competitors are.
3. Determine who the customers are and what benefits they expect.
4. Determine what the key success factors are in the industry.
5. Rank the key success factors by giving each one a weighting (the sum of all the weightings must add up to one).
6. Rate each competitor on each of the key success factors.
7. Multiply each cell in the matrix by the factor weighting.

For example, two competitors are weighted using four key industry success factors: distribution network, customer focus, economies of scale and product innovation.

Competitor array - **two dimensional matrix**

Key industry success factors	Weighting	Competitor 1 rating	Competitor 1 weighted	Competitor 2 rating	Competitor 2 weighted
1 – Distribution network	0.4	6	**2.4**	3	**1.2**
2 - Customer focus	0.3	4	**1.2**	5	**1.5**
3 - Economies of scale	0.2	3	**0.6**	3	**0.6**
4 - Product innovation	0.1	7	**0.7**	4	**0.4**
Totals	1.0	20	**4.9**	15	**3.7**

Competitor rating 1 - 10

We can see that competitor 1 is rated higher than competitor 2 on product innovation ability (7 out of 10, compared to 4 out of 10) and distribution networks (6 out of 10). Yet competitor 2 is rated higher on customer focus (5 out of 10). Overall, competitor 1 is rated slightly higher than competitor 2 (20 out of 40 compared to 15 out of 40). But when the success factors are weighted according to their importance, competitor 1 gets a far better rating (4.9 compared to 3.7).

In other survey findings, four contingent factors (**strategic mission, competitive strategy, company size** and **industry**) have been found to affect relative use and perceived usefulness of each competitor accounting practice. Prospector companies made greater use of and perceived greater usefulness in competitor accounting practices. Companies that build a strategic mission are more likely to use strategic pricing and strategic costing, and to perceive these as being of greater helpfulness. Size is positively associated with greater use of and greater perceived usefulness in competitor accounting practices. Logically, large companies can afford the resources to conduct competitor analysis and accounting, and hence perceive its value for dealing with business competition. Business competition in new service industries, such as the mobile phone business, is supposed to be more severe than that in traditional production industries like furniture manufacture. The market potential and opportunity for new services are huge and dynamic.

<u>Conclusion</u>

Competitor analysis and accounting generates and monitors competitor costs and strategic information. Five key forces (entry barriers, competitive rivalry, substitute products, supplier power and customer power) affect industry competition. An ideal technique to developing specific cost estimates is based on detailed analysis of the market, the competitors' cost structure, products and product costs. As a consequence, management accountants have to cooperate with their marketing and technical colleagues to conduct relevant competitor analysis and accounting.

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