COMPETITIVE ANALYSIS

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Everybody is constantly being bombarded with comments on the extensive changes the next millennium is going to bring to all of us - that is, the survivors of the pending ominous New Year's Eve; however, as our calendars are based on a man-made accounting for time, the chances are not so bad. One could philosophise that in this aspect, Schiller was wrong: "there is no such thing as chance; and what to us seems merest accident springs from the deepest source of destiny".

We don't think that is the case, unless it is destiny that, nowadays, competition not only comes from the next town or state, but from all around the globe, thanks to improved technology, including the Internet. This is simply something all of us must learn to deal with, as mankind has had to absorb so many disconcerting innovations over the last centuries.

Previously, we have commented on the impact the Internet is starting to have on virtually every business, bringing more rapid changes than ever before. These are going to accelerate in the next millennium; yet most valuation texts, even the most respected, spend little time discussing how to obtain information about the competitive environment in which a business operates.

Today, that is of greater importance than ever, as the size and character of the market served has become one of the principal determinants of the value of a business. By the way, as Internet companies are valued on a totally different basis from their physical counterparts in the same market, it is advisable for your clients to set up their Internet operations as independent entities; this should be done not only to maximize values, but, so that, in case things don't go so well, the new kid can't drag your old love down with it - or the other way 'round.

Looking at competitors, many managers seem to remember and rely on the childhood tale about the ostrich sticking its head in the sand to avoid seeing approaching danger, sort of "What you don't know can't hurt you". The exact opposite is true for success.

Imagine a firm spending many months and many shekels on introducing a new product. Just before they are ready to shrink-wrap it and battle Wal-Mart for shelf space, they espy an announcement in the trade press that a competitor a few thousand miles away has just come out with something similar. What do you think that's going to do to profits, and hence, the value of the company?

Unless you are among the Fortune 1000, or perhaps a government agency, it is impractical to engage in industrial espionage, but, as Yogi Berra once said, "you can observe a lot by watching". Watching and listening are activities in which not too many people engage; that includes otherwise well-informed managers, who often have very little notion of what their competitors are actually doing. In that case, the Valuator may be forced to become a corporate "Detective Colombo". This is tricky, time-consuming effort that sometimes resembles Sisyphus' labor, but the alternative could be an erroneous conclusion. At worst, you might be hauled up before a professional organization or regulatory authority, and have to answer questions about inadequate due diligence.

The raw materials for this process are usually easily accessible: TRADE PUBLICATIONS and daily newspapers. Whether the field is new to you - such as software - or if you have done numerous similar valuations - as for instance restaurants, manufacturers, retailers - try to understand the dynamics of the market by reading every relevant publication.

As we mentioned in previous columns, our firm concentrates on technology, and to keep up with events in the software industry alone, we look at about 30 different titles a month. If you are a specialist, subscriptions are a nice luxury, although most of the periodicals are available at local libraries, or from management. Also, need I say it, there's also an enormous amount of information on the Web, which can supply promising leads.

After skimming the industry news, go shopping. FIND OUT WHO ARE THE BEST SELLERS. If it is a consumer item, approach retailers and talk to their sales people about which comparable products sell and what stays on the shelf. If the item is bought by businesses, talk to customers to discover how your client's products stack up against the alternatives. With the right approach, you'd be surprised how much a proud-of-his-company's-product executive will tell you, or what you can deduce from what he does not tell you.

In the past, products did not change very rapidly. Aspirin was modified once shortly after Bayer introduced its best seller a hundred years ago, when the firm removed a much touted ingredient, but Mr. Kellogg's stuff is still going strong, we all like the same Heinz ketchup as our great-grand parents, and ivory soap continues to float in our bathtubs.

Not so much with the new stuff. Merchandise introduced just half a decade ago has been quickly superseded by other items, better, newer, whiter, healthier, more modern, more useful, suited to today's lifestyle - whatever. If your client rests on his laurels, his competitors will soon hit the market and his profits with one of those "new, improved" products.

For that reason, it is essential to understand where his current offerings stand in their life cycle. Are they mature, no longer glamorous, like a restaurant that's hot till the guy down the street opens up something different? Will the new goodies be out of the lab and ready for sale before the present items have worn out their welcome? It is better for your client to cannibalize his own creations than have a competitor do it.

As part of SLEUTHING THE COMPETITION the Valuator should talk to the client's sales people; usually, they know more than they think they know, and often more than the boss about the market. Sometimes managers regard their firm's competitors with haughty disdain, even contempt; this may lead to blind spots. Sit down with the executive in charge of selling each product line and ask him and his staff about their rivals; cover not only the products but also the strengths, weaknesses and market shares in particular geographical areas or industry segments.

Also, find out what your client's managers know about the competition's distributors and other delivery channels, as well as their manufacturing methods. A good game to play is to get an executive to take the role of a potential customer trying to solve a problem, and to consider from that point of view what is really important about both your client's products and those of his competitors. Try to compare them and the related services feature-for-feature.

As well as management, enlist colleagues, associates, even other clients in the quest for information. Get your son to tell you if in his circle the yo-yo has indeed made the strong come-back we read about, and ask your niece to help you test the software you are valuing. Using the Internet and other sources mentioned above, look for news about competitors; examine publicity and advertising material, especially employment notices: Help Wanted Ads and announcements of new employees often reveal information about upcoming projects.

A standard requirement of due diligence concerning investment is to telephone competitors, customers, and suppliers. With the no-border situation offered by the Internet, don't just stick to your own bailiwick; try to get enough information to size up the situation thousands of miles away. Embassies, consulates, or trade commissions are usually eager to provide assistance. This approach is equally important in a valuation engagement.

When talking to competitors, request catalogues, samples, brochures and reference customers; if possible, get reactions to your client's products. When asked, tell them who you are, if not, don't. A good lead-in is to say that you are conducting an industry study.

Important information from customers includes the answers to questions such as:

- By what means did you decide on the product and how long did it take you to find it?
- What suppliers did you consider and eventually use for this category?
- Step by step, how did you arrive at that decision?
- What were the most important factors?
- Who has the best sales force?

The objective is to get a clear understanding of what each participant offers and what they tell their customers. Nearly every firm will send you what you ask for, especially if you suggest that some client might be interested in their products in the future. This material and the customers' responses to the questions, even if they seem irrelevant, may lead to important conclusions concerning the future of your client's business.

Don't overlook the private lives of the competitor's main protagonists - nor your client's; one partner in a business ran off with the other partner's wife; at a critical moment neither could be found for a week, which had a substantial impact on the company's value.

The publicly traded comparables should include identified competitors, even if they are very much larger. Annual reports and SEC Filings are available on the Internet; an "interested" call to a stockbroker should provide investment research studies on the industry, as may the competitors' Websites and standard online sources, such as Dow Jones, Reuters, Lexus-Nexus and DiaLog. Check for "newsgroups" that your client's customers are likely to frequent and pose questions about the competitors' products as well as your clients; the responses are often poignant and informative.

A useful source for Financial Statements of privately owned companies is Dunn & Bradstreet - for a price. If the budget allows, we sometimes call, even visit, the CEO of the publicly owned competition to discuss their strategy and investment outlook.

Trade shows can be a major source of competitive information. Booths are often staffed by people who know what is actually happening, but who often don't realize what topics are safe and which are out of bounds. They may want to ingratiate themselves to a possible customer, or, being slightly insecure, feel that "inside information" will command respect. Sometimes it only takes a little prodding to get them started. Industry gossip has it that entire marketing plans have unwittingly been revealed at trade shows.

Collecting data about competitors is only half the job; it then has to be turned into information and analyzed. We organize the material in a matrix similar to the one set out below; the categories should be adjusted to suit the situation, but the seven major items are all necessary. Even if some squares remain empty, the process of filling in the form helps you to realize what you know and what you still have to dig for.

In following matrix ranking provides +5 (most favourable) to -5 (least favourable) against a benchmark. For example, under Profitability and financing, the RMA figures would be the basis.

Competitive Analysis

Competitive Analysis Matrix

Function	Client	A Co	B Inc	C	D LLP
		Comparables			
Profitability	+1	+2	+2	-1	-2
Financing	-1	-1	1	0	0
Product/Range					
· current	3	1	-1	1	1
· pipeline (R&D)	-1	2	-1	2	0
Markets					
· geographical	-1	-2	-1	2	3
· functional	3	1	2	4	-1
· share	2	1	3	4	-1
· growth	4	1	-1	2	1
R&D (Processes)					
Delivery Mechanisms					
· advertising	-1	-2	-3	2	1
· promotions	2	5	2	1	4
· distribution	n/a	1	n/a	2	-1
· dealers	n/a	3	n/a	5	-2
· sales force	3	n/a	-1	n/a	n/a
Strategy					
· strengths	3	1	4	3	1
· weaknesses	-2	-2	-1	-2	-3
· opportunities	4	2	1	3	5
· threats	-1	-2	-3	-2	-1
Organization/Personnel	-1	1	2	1	-1

In the mid 1990s our firm was engaged to value a product developed at a cost of $8 million by a publicly traded multi-million dollar company. With considerable pride, we were informed that no competitive products were available. That turned out to be true as far as Canada was concerned, but diligent research located 43 similar items in various countries around the world - and that was before the Internet was generally available. As a result, there was no chance to make sales beyond the comparatively small local market, and months of research, laborious crafting and worst, all that money, brass, lolly, boodle, smackers, had gone down the drain. We valued the product at only a few hundred thousand dollars, leading to its abandonment and the shutting down of the whole related group headed by a soon-departed vice-president.