

Situational Early Warning

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Most early warning systems have a fundamental weakness—they are sometimes too strategic and provide little guidance regarding tactical problems, which can have a significant impact on the organization's performance. Indeed, most early warning systems do an excellent job preventing events that take some time to unfold, such as the following:

- The entrance of a competitor
- The acceptance of a technology
- The enactment of a new law

But they are not as good when it comes to the following tactical problems:

- The emergence of a price war
- The introduction of a promotion
- The launch of a new competing product

These tactical problems are generally overlooked by scenario analysis (as it is usually conducted in strategic early warning), although some of the above mentioned strategic issues might also be missed, if not specifically addressed in the scenario. Therefore, conventional early warning systems do a great job of warning us of paradigm-breaking situations but a not-so-good job when it comes to incremental change. A company would need to address both scenarios as it faces challenges connected with both types of environmental changes.

SIGNALING TACTICAL PROBLEMS

We propose a new methodology to allow organizations to better acquire early signals on these tactical problems and to complement their strategic early warning systems. We named this methodology “situational early warning,” because these issues represent actual situations that can happen to any organization and should be prevented to the extent possible.

The situations that can affect the company's performance may take place among players at all levels of the competitive environment. For example, suppliers might forward integrate, customers might backward integrate, or potential entrants could emerge as current competitors.

We do not believe that this situational approach would be particularly successful at predicting the issues among other competitive factors, such as those covered by the STEEP analysis (sociological, technological, economic, environmental, and political trends). The main reason for not recommending situational early warning in the STEEP type of analysis is that these factors typically take a relatively long time to unfold and would be better monitored through conventional early warning processes and scenario development.

The key steps contained in the situational early warning methodology are as follows:

1. Identify players
2. Set and prioritize the situations to monitor
3. Define leading indicators

4. Monitor situations
5. Analyze the indicators
6. Determine and implement action
7. Learn from experience

1. IDENTIFY PLAYERS

The first activity in this process is identifying the players that we wish to monitor. The list has to be as extensive as possible, because the purpose of early warning is to avoid any and all surprises (Gilad, 2004). Later on in the process, we will prioritize the importance of these players and automate the information gathering as much as possible to reach a compromise between cost and comprehensiveness.

The methodology used to identify players maps out the competitive arena by marking the players who interact or might interact in the supplier markets (including capital markets) and the demand markets (including potential entrants and substitutes). We say “might interact” because we want to prevent surprises and therefore have to consider not only current but also likely players. (A detailed approach on how to do this can be found in Comai and Tena Millán’s recent book, *Mapping & Anticipating the Competitive Landscape* 2006).

2. SET AND PRIORITIZE THE SITUATIONS TO MONITOR

Once the players have been set, the intelligence gatherers must then set out the situations to monitor. The most typical situations to monitor are the following:

- The launch of a competing product
- An emerging price war
- A competing aggressive promotion
- The introduction and acceptance of a technology
- The entrance of a new competitor

All the situations must be defined for each player, because the purpose is to avoid surprises. After you prioritize these situations by player, many of the situations will not be monitored because they do not pass the cost-benefit test. Both the competitive intelligence department and the intelligence end users prioritize the set of monitored players and situations to better use scarce resources. The CI department prepares a situational assessment of the potential effect of each player and situation on the company’s performance. Based on this first assessment, the intelligence end users decide which situations to monitor. The best way to decide which set of players and situations to monitor is to do an initial rough assessment of each set’s impact on your organization’s performance. The greater the potential impact, the higher the monitoring priority.

SIDEBAR 1: NOT ALL INDICATORS ARE CREATED THE SAME

Indicators have to be tailored to the type of player. And indicators for suppliers are not the same as those for direct competitors. They also need to be tailored by specific competitor, because resources are not evenly distributed among competitors. A monitored indicator is often a resource that the competitor may not have to change or make effective for its strategy.

For example, tracking the entrance of a supplier or a competitor in a particular market might use a completely different set of indicators. In the case of a supplier, it might be useful to track the purchases of machinery, the supplier’s relationships with distributors of final products or the customer itself, the hiring of key personnel or personnel with expertise in the market, technological developments, attendance at trade fairs, and so on.

In the case of a direct competitor, distributors and end customers are a valuable source of indicators. But we may not look for the contact signs that might lead us to infer that the supplier is trying to enter the market. Primary intelligence is needed to understand the underlying cause of this contact, which may detect signs that Competitor X is trying to enter the market—for example, through pilot tests or word of mouth.

Even with direct competitors, the indicators might be different. For example, Competitor X might have machinery for producing product A, but not have access to a distribution channel. Competitor Y might have the access to the channel, but lack the machinery. Therefore, in the case of Competitor X, sought-after indicators would be signs of contact with the distribution channel, such as meetings with key distributors. In the case of Competitor Y, the indicators will be contacts with machinery suppliers or the purchase of machinery.

We do not believe that competitive intelligence departments should compute a specific expected value—the impact multiplied by the likelihood, for example. Gilad states that when there are many events and players, it is difficult to establish a reliable statistical number (Gilad 2004). In addition, the value of such a number would be quite subjective and exposed to error. The relative numbers are not important; their relative rankings are.

SIDEBAR 2: ANTICIPATING WHEN A PRICE WAR WILL UNFOLD

As part of its early warning system, a leading consumer goods company in a Latin American country monitored the strategies that a select number of leading global competitors employed in different countries. Based on its experience, the company knew that these countries were countries where changes in strategy took effect well before they were applied in the country where it operated. Specifically, the competitors usually began to implement new strategies in one Latin American country one year before they applied the strategies to the company's country of interest.

The company first detected a change of competitor strategy in a well-developed country. The competitor began a price war, converting a mainstream brand into an economy brand. The competitor gained significant share by driving small competitors out of business. The company took note and increased its efforts to monitor competitor activity in an indicator country, which was always the first one to implement new strategies in Latin America. They also prepared for a price war. Six months later, a price war broke out in the monitored country. The competitor again wanted to drive out small competitors operating in the economy segment of the market, but its action also affected mainstream brands

and competitors. The company's brand was positioned as mainstream in that market.

The company understood that, in time, the competitor would take the same action in the company's home country. The company accelerated its efforts to benchmark its operations against this global competitor to reduce the cost gap. Even though the company could not compete on scale, it introduced some changes in packaging and manufacturing. Low salaries protected the company somewhat, but import duties also played in the local company's favor, significantly diminishing the price gap, which almost vanished. Furthermore, the company closed some long-term contracts in the hotel, restaurant, and catering channels to secure much of its own sales.

In the end, the company was affected by the price war, but to a much lesser extent than any other competitor in the industry, including the competitor that began the price war. The company had an enviable cost position and some long-term contracts that protected it, and it was able to profit from additional demand as some smaller companies went out of the market.

3. DEFINE LEADING INDICATORS

To set up the situational monitoring, competitive intelligence practitioners must define leading indicators for each type of player. The monitoring criteria for a supplier are not the same as the ones for a direct competitor, and the impact of a monitored situation is different for different players. (For details on this, please see Sidebar 1: "Not all indicators are created the same.") For example, the impact of an emerging price war would not be have the same level of importance in the case of a supplier; it could be viewed as an opportunity instead of a threat. If the emerging price war was initiated by a competitor, it must be thoroughly monitored and analyzed.

Note that individual information sources have different ranks and applications according to their ability to predict events and trends. For example, advertisements are an excellent way to detect new products or the entrance of a new competitor, but these apply only when the product or competitor is already in the market and therefore do not work for an early warning system.

One of the most important subtleties of emerging markets is that the monitoring of player strategies used in

other countries, especially more developed ones, can serve as a reliable basis of what strategies might be implemented later in emerging countries. (For an example, see Sidebar 2: "Anticipating when a price war will unfold.") Even though we do not have current experience working in the U.S., we believe that to some extent this technique could be successfully used there too.

4. MONITOR SITUATIONS

Once the indicators are set, monitor these situations by setting up a scanning system for indicators or signals from players.

Most likely, the competitive intelligence department will not be able to monitor the whole set of indicators by itself and probably will have to delegate some of the information gathering to other parts of the organization. Contracting with an outside company for this monitoring is attractive in terms of efficiency. Outside monitoring companies can reach economies of scale and expertise because their experience with this type of work can span several industries. But we believe that this activity is better done "in house," because

consultants would require significant expertise in the industry (and especially with the company, its competitors, its suppliers, and related others) to know clearly what each of the signs and indicators mean for each player.

We recommend that the competitive intelligence department should delegate part of the information gathering to the persons closest to the indicator who have the expertise to understand the nuances of the indicator's information. These people need incentives to come back to the competitive intelligence department with the information.

The tasking requirements for the indicators have to be specific. For example, "tell us if Competitor X is hiring new employees." Requirements such as "tell us anything you hear on our competitors" are too general and would receive only a lukewarm response, if any at all.

Another aspect of monitoring situations that must be settled is the time frame for updating the indicators. Most secondary sources can be updated on a daily basis, while primary information will most probably follow a weekly, monthly, or quarterly update.

Data entry into the system must take into account the person who monitors the indicator. From our experience in Latin America, asking a salesman to do a report is a daunting task—they do not like to write, but would be glad to talk. Other people, such as accountants, would prefer to write a report with all possible details. Of course these are stereotypes, but they emphasize the fact that the system has to adapt to the gatherers' preferred styles. The competitive intelligence department then has to make this information accessible in the way preferred by the intelligence user, which again will vary by individual.

5. ANALYZE THE INDICATORS

A key step in situational early warning is analyzing the indicators to determine which situation is most likely to occur. The analysis phase is particularly important because available indicators will clearly indicate a situation only in a very few cases. They often can satisfy several hypotheses at the same time, especially because causes and effects are not always clear from the outside, at least at the beginning. We recommend using the analytical technique outlined by Heuer, the "analysis of competing hypothesis," as a means of identifying the most likely hypothesis and outcome (Heuer, 1999).

In some situations, leading indicators may trigger the need for a war-gaming exercise—if, for example, you need to determine how to respond to a price war or the entry of a new competitor. Other situations might require scenario analysis or an additional competitive intelligence project to gathering additional information to determine the exact nature of the signal.

SIDEBAR 3: SOMETIMES DOING NOTHING IS THE BEST OPTION

A leading consumer goods company learned through a casual chat with a TV channel representative that a competitor would soon introduce an advertising and promotional campaign with huge prizes for consumers. The competitor planned the promotional campaign for all its current products. The company only competed with one product for which the competitor was not particularly strong, and the company led with a huge market share of more than 80%. Yet because every market-share percentage point was worth several million dollars (U.S.), the company was heavily concerned about the promotion.

In spite of their concerns, the company decided to wait and see before responding to the competitor's action, because it did not know the effect the promotion would have on market share. If it had a minimal effect, the company would not have to respond. The company decided on this approach because a response was potentially too costly. While in the "wait and see" mode, the company developed its own targeted promotion to win the promotion war, if needed.

The company assembled all information in a war room, where AC Nielsen information was gathered on a daily basis. Different individuals held daily talks with supermarket chains and distributors to assess whether a response was needed. The company reviewed the results of the competitor's promotion every day to gauge its level of success and the appropriate response.

As time went by, the decision not to respond emerged as the best one, as the competitor's promotion was not successful enough in the market where both manufacturers competed to trigger a response. This saved the company the cost of a large promotion.

6. DETERMINING AND IMPLEMENT ACTION

Based on the intelligence provided by the early warning system, management should make a decision based on the CI department's recommendations. These recommendations must be developed once sufficient signs or indicators predict that a situation will occur. This is a relatively tricky process. Management has to be involved in defining the indicators to follow. For example, if Competitor X purchases Y machinery, an alarm must sound.

The recommendations should include a do-nothing alternative (management usually loves that one) and that one might be, in some cases, the best option. (For a case study, see Sidebar 3: “Sometimes doing nothing is the best option.”) No more than three or four alternatives need to be presented to management, although the competitive intelligence department must cover any alternatives that management might ask about.

Ideally, the deliverable on which management bases their decision should include the following:

- A description of the possible situation and other possibilities based on other hypotheses
- The likely impact that the situation would have on the company’s performance
- A set of courses of action chosen by the competitive intelligence department, outlining the pros and cons of every alternative as well as the expected response from competitors (in some cases, the actions can include the need for further investigation)

7. LEARN FROM EXPERIENCE

Learning from your experiences in applying a situational early warning process is particularly useful when it did not detect a situation, or when the action taken was not appropriate. The goal of any early warning process not only must be to avoid surprises, but also to take effective decisions and actions afterward.

Learning from a successful situation is particularly difficult because, with success, the participants want to pat themselves on the back for having done a great job. For each successful situation, however, you should have a debriefing with the CI department and the persons who were in charge of the tracking the indicators to determine what was done right, what went wrong (yes, even if you succeeded, you may have done something wrong), and what can be improved. Successful situational early warning cases can also serve as

victorious war stories to improve the resources devoted to the early warning system and to the intelligence department as a whole.

Even though we focused mostly on threats, we agree with Gilad and Hedin that a working early warning system requires a focus on both threats and opportunities, since both are different faces of the same coin (Gilad, 2004; Hedin, 2006). We hope that we have added some new knowledge and ideas for your early warning system, and will be glad to receive feedback on the article.

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