

# Competition is **good** for start-ups

>> Conventional wisdom suggests that avoiding competitive pressure is the job of every good manager. But could being exposed to increased competition in the early stages of a firm's life actually be good for its long-term survival prospects?

**O**ur research on the survival rates of UK firms, which is based on data comprising nearly two million business start-ups, indicates that some competition is actually good for business survival. Firms that start-up in a crowded market space (referred to as 'red oceans' in Kim and Mauborgne's book, *Blue Ocean Strategy*) have a higher three-year survival rate than those born in less competitive markets. The findings indicate that the early life experience of being born into a tough market environment appears to have an immunisation effect. By exposing

these start-ups to some of the harsh elements of competition in their early life, it helps them to develop a business culture equivalent to an 'antibody for competition'.

A metaphor is useful to help understand these results. In the medical profession the pioneers of vaccination faced a degree of resistance to their approach for preventing illness. It appeared counter-intuitive to expose a person to an illness in order to protect them from it. Whether encountering an illness through vaccination or real-life

exposure, a positive outcome hinges on the benefits of stimulating an immune response over the negative consequences of an inflammatory reaction. Notably, this trade-off is often more favorable for younger people. For example, it is much less painful and dangerous to catch chicken pox as a child than as an adult. It seems that some of these lessons apply to management where competition is one of the main causes of businesses failing. Exposing a business to a non-fatal dose of competition can become an effective immunisation against the threat of competition in the future.

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Of course, our research still supports the importance of strategies aimed at creating a competitive advantage or finding a new market space, but it does indicate that some exposure to the harsh realities of a competitive environment is good for the long term health of a business. So what are the lessons for those who want to immunise their business against the negative effects of competition?

**Born to run**

A highly competitive start-up environment can create a culture of efficiency in a firm. This helps immunise the business against the threat of competition in the future. The world's largest low-cost carrier, Southwest Airlines, launched in a very crowded airline industry. Early competition forced it to create an efficiency-based, low-cost culture. They turned this no-frills approach into a successful marketing strategy to survive the immediate competitive response from dominant airlines.

**Feel the pain**

The financial crisis caused a decline in customers for the US car industry, leading to an overcrowded and highly competitive market. Whether the US government's rescue finance for the car industry was justified or not, it allowed a breathing space for car manufacturers to respond to the highly competitive market environment.

The 'do or die' nature of the competition faced by Chrysler caused it to restructure into a more efficient organisation and innovate across its product line. In fact, it prompted Chrysler to undergo change that would have been unlikely in the absence of this level of competitive pressure. Chrysler is now in a far more healthy position to survive future competition in the car industry. As far as the managerial objective of immunising an established business against the force of competition, it illustrates that a crisis can bring opportunity.

**Born-again competitors**

Copying the financial pressure associated with a highly competitive environment promotes an efficient organisation. In the 1980s one of the arguments of those championing UK privatisation was that government funding of state-owned businesses allows them to detach from the competitive pressures of the market. Quite simply, loss making state owned businesses knew they could turn to the Government for funding and be insulated from competitive pressure.

The Sealed Air Corporation in the US is a good example of a company who adopted a risky strategy to push internal financial pressures to the other extreme in order to resemble a highly competitive market. They were initially in the luxurious position of having

low levels of debt equivalent to just 9% of the firm's market capitalisation. The company had a sustainable competitive position in the market and this resulted in staff complacency. The management sanctioned a nine fold increase in debt and then used \$21m of cash reserves to pay out a special dividend of \$330m equivalent to 87% of the firm's market value. The resulting financial pressure was akin to a cashflow conscious firm in a highly competitive market. It caused both cultural and organisational change that led to cost-cutting measures, increased productivity and overall improved performance. While there is clearly risk in creating internal financial pressure, this trades off with the reward from having a more internally efficient organisation.

**Create your own pressure**

Replicating a competitive environment within an organisation can create an efficient culture and immunise against competition. The Virgin Group use a strategy to replicate the pressure of a competitive environment by structuring many of its businesses into a series of small business units or teams who benchmark their performance against one another. So although not in competition for customers these teams compete to outperform the performance of their internal rivals by trying to be more innovative and cost-effective.

**Don't splash the cash**

Never overfund a new venture. An overfunded business allows it to detach from the reality of the market. Boo.com illustrates this point. The business was overfunded and enabled the founders to take enormous and unnecessary risks, embarking on lavish strategies that lacked foundation and support in the market place. When the money ran out the business failed while the online clothing market, which Boo.com sought to exploit, actually witnessed a growth of successful lesser resourced new ventures.

A challenging environment causes young companies to focus on satisfying customer needs. At the core of all these lessons is the idea that exposing a business to either 'safe' levels of real competition or mimicking the effects of a competitive environment within the organisation, can have long lasting positive effects on the efficiency and survival of the organisation. **MF**

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