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Competitive Churning: Still a Viable Strategy?

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I. Introduction

In her book, *Business in East Asia* (2001), Sonia El Kahal described competitive churning as involving the quick imitations of a new product by competitors adding new features, the pioneering firm then responds by upgrading the first entry, and competitors renewing the attacks. This process can continue ad infinitum, only shifting direction when a revolutionary innovation is introduced. Although the phrase competitive churning may be relatively new to our vernacular, the basic concept has been around for some time. The Industrial Revolution, as an example, thrust a significant amount of change on the world and was the catalyst for launching the modern society. The difference between the past and now is the speed in which change is introduced and the corresponding adaptation to change.

Over the past couple of decades, Japanese (and later Korean) companies have refined the art of competitive churning, and by doing so have enhanced their company's international competitiveness. However, since the fall of 2008, the global economy has slowed down considerably, bringing significant changes in consumer behavior. In the United States, for example, consumers have moved from the reckless pursuit of the 'latest gadget' to significantly more measured purchases based on needs. Therefore, it is reasonable to ask if competitive churning is still a viable strategy.

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II. Competitive Churning

Competitive churning is most visible in the high-tech industry, where technological advances constantly evolve. One example is the smart phone market. Apple's iPhone, which itself is continuously going through a process of churning, was a competitive response to the Blackberry. But even before the iPhone's release in 2007, LG had already released a button-less interface handset co-branded with Italian Prada (Questex Media Group, Inc., 2007). Currently, there are a handful of iPhone imitations across the globe. CECT (a Chinese company) is presently working on its P168 model which will be marketed in Europe; it features a dual sim tray, an innovation not found on the iPhone (Sze, 2006-2009). Another Chinese company, Meizu, recently revealed the Meizu M8 (Meizu Co., Ltd, 2009). Its biggest advantage being that it has no need for an AT&T contract. There are many other iPhone "killers", the most recent being an HTC LeoSpotted which has a bigger display and a better camera than the iPhone (iPhone Killer, 2007-2009) and Motorola's Droid which is nearly as thin as the iPhone, but with a bigger screen and a slide-out keyboard (Hansel, 2009). In short, companies keep upping the ante by bringing products on the market with features not found in the original iPhone: GPS, higher data rate, vibration feedback, texting aids, video recording, HD video, or a higher resolution camera.

But competitive churning can also be seen in more mundane markets. To gain, or even to maintain market share, consumer products companies regularly improve their product offerings by adding features that further appeal to consumers. For example, Kimberly-Clark Corporation and Procter & Gamble have waged a battle for market share by introducing diapers with enhanced features. As a result, both companies have extensive diaper product lines that include; newborn diapers that accommodate the umbilical cord, diapers for active babies, leak proof diapers, overnight diapers and diapers containing a strip that indicates when a diaper is ready to be changed (Byron, 2009). In 2008, Procter and Gamble's "Pampers brand introduced Swaddlers Sensitive, a hypoallergenic diaper that lets air reach the baby's skin and includes a "wetness indicator" strip to show when a diaper needs changing" (Byron, 2009). In April of 2009, Kimberly-Clark Corporation responded by introducing the Huggies brand "Pure & Natural, a new line of premium diapers that contain aloe, vitamin E and organic cotton" (Byron, 2009).

III. Competitive Churning in Japan

In her book, Sonia El Kahal claims that the vast majority of Japanese companies use competitive churning as a primary strategy. However, most of her evidence is indirect and does not distinguish whether the strategy was planned or emergent (Mintzberg, 1978).

Recently, the author of this paper surveyed 55 medium- and large-sized manufacturers in Japan. Industries represented included: consumer products, electronics, computers, cell phones and gaming. Twenty-seven companies (49%) stated that they have used competitive churning as a primary strategy before the fall of 2008, while 14 companies (25%) said that they had not used such a strategy before the fall of 2008. It should be noted that 8 firms (15%) did not wish to discuss their strategy and 6 firms (11%) simply did not answer my request for participation. These results indicate that competitive churning was widely used as a primary strategy by Japanese companies prior to the fall of 2008, but the practice may not have been as prolific as Kahal described in her book.

IV. Perceived Benefits of Competitive Churning

In the course of my survey, companies were asked to select benefits that come from following competitive churning as a primary strategy. In general, 54% of respondents agreed that competitive churning benefits both consumers and manufacturers and as such should be fostered by organizations and encouraged by other stakeholders, such as governments and employees. More specific benefits, and the percent of companies that agreed, are as follows.(1)

(1) Total adds up to more than 100% as companies could select more than one benefit.

73%	Consumers have more options
59%	Products become more competitively priced
44%	Forces a company to be innovative
24%	Manufacturers can charge a premium price for their products
17%	Allows more companies to compete in the marketplace

It is interesting to note that more companies agreed on the benefits to consumers: *Consumers have more options and Products become more competitively priced;* then agreed on benefits to manufacturers: *Forces a company to be innovative and Manufacturers can charge a premium price for their products*. These results could represent the general attention paid to consumers by many Japanese companies. It could also reflect Japanese managers' reluctance to acknowledge that certain actions could benefit them more than consumers. It is also noteworthy that the most agreed upon benefit was the perception that competitive churning gives consumers more options. Anecdotal evidence supports their perceptions. Many industry observers argue that churning in the cell phone industry forces companies to expand their product lists, at least in part because churning allows cell phone manufacturers to invest more time and money on localizing and customizing phones than in manufacturing the hardware (O'Reilly, 2006).

Finally, it is also interesting to note that significantly more managers agree that using competitive churning as a primary strategy leads to more competitive pricing rather than premium pricing. This would fit with arguments made by proponents of competitive churning that suggest that competitive churning forces companies to focus on speed to market and manufacturing efficiencies. Finally, while many companies agreed that competitive churning benefits consumers through more competitive pricing; many companies mentioned that sometimes those same forces are a threat to individual companies and the industry as a whole.

V. Concerns About Churning

Our survey next asked companies whether they will continue to actively pursue competitive churning as a primary strategy in today's economic climate. Not surprising that among the companies that said that they had not used such a strategy before the fall of 2008, 12 (86%) had no plans to use it in the future. The other two firms had not yet made a decision. Among those companies that admitted that they had used competitive churning as a primary strategy before the fall of 2008, four (15%) said they will no longer practice competitive churning, while another 7 (26%) stated that they are reconsidering their strategy. Therefore, there would appear to be at least some questions about using churning as a primary strategy in today's economic climate.

Among their concerns, respondents noted that new products can often become obsolete quickly, resulting in companies spending significant amount of money on product improvements that result in little or no profits. In addition, a number of companies agreed that churning can inhibit the innovation of new products. When competitive churning is present in an industry, products become very similar from company to company, market share is tugged back and forth between competitors and the market becomes a one-dimensional game of price. Kim and Mauborgne (2005) compared this situation to a spot in the ocean filled with competing sharks. The result of the churning is the "…accelerated commoditization of products..." (p. 8) which leads to brutal, bloody price wars turning the ocean red. Once this occurs it often results in "a precipitous decline in industry profits" (Rao, et al. 2000). The only winner in a price war is the consumer, and even the consumer only wins for a short while.

VI. A counter to First Mover Advantage

In certain markets, competitive churning can be an effective weapon to eliminate or reduce first-mover advantages. It is argued that competitors who enter the market second and even third have more funds to invest into marketing and advertising as well as improving the already existing product, giving them the advantage that the first entrant once had.

Many late-entrants claim that they have little in the way of initial R&D costs. The majority of such costs involve the reverse-engineering process. While several months or years may be spent by a first-mover to develop a new product for the market, late-entrants can spend considerably less time to get their product to the market. Less time spent means less money invested as the product is prepared for the market. This savings can be passed along to the consumer; therefore the late-entrant can have an immediate cost advantage. The late-entrant can also attempt to compete on differentiation. Initial products of the first-mover may have certain features that consumers do not like. The late-entrant can then capitalize on this fact and produce a product that is more suitable to the customer.

Late-entrants also face decreased marketing/research expenses. Initial costs, such as the advertising expenditures, needed to make consumers aware of the new innovations can be staggering. This cost is usually absorbed by the first-mover. The risk of the unknown is considerably reduced for the late-entrant, as these companies already know that there is demand for the product. Therefore, late-entrants have the advantage of consumers knowing and understanding the basic features of the product. Advertising dollars can then be spent making consumers aware of additional appealing features of the late-entrant such as capacity or cost. In addition, late entrants can introduce new product features without cannibalizing prior investments and do not need to dedicate resources to maintain and service older product lines. Finally, the incumbent firm tends to be at a disadvantage because it is difficult to predict the necessary production capacity and marketing capabilities needed to expand in the new market (Suarez & Lanzolla, 2005).

As Andy Grove, former Intel's chairman put it: "Innovations with the power to transform entire industries are the Holy Grail of business strategy. Unfortunately, the innovators don't always survive" (Grove, 2003). Napster is a good example of a company developing an innovative business model. Unfortunately it failed to integrate it with legal issues and its market share was taken away by other peer-to-peer (P2P) networks. As such, Napster was liquidated in 2002. Another example can be found in the portable computer market. The Osborne was released in 1981 (Computer History Museum, 2006). A series of other portable computers soon followed with advanced features and larger screens and by 1983 Osborne filed for bankruptcy (Osborne, 2009). Osborne was not able to respond as quickly as other companies, who had added more advanced features.

As Kahal (2001) mentions, a sustained proliferation of new products is the only way to sustain a first-mover advantage (p. 222). In other words, the first-mover must continuously introduce new products in order to maintain any advantage that they generate. However, this process can only be repeated so many times before a first-mover is no longer able to afford their strategy as a pioneer. The initial costs of R&D, development, marketing and production will eventually be too great to bear against a limited timeframe to reap any profits from a higher margin product. Once the late-entrants have reverse-engineered the product, prices and margins will decrease. Once this happens, the first-mover will find it increasingly difficult to generate margins large enough to alleviate the severe upfront costs. The first-mover may see a much smaller overall profit, or even a loss, as the industry moves further along in the product lifecycle.

For example, in the mobile phone industry, Nokia is the worldwide leader in terms of market share, though other manufacturers have been closing the gap and new entrants, like Apple iPhones, have added to the highly competitive marketplace. Interestingly, just because a company possesses a fair sized market share it doesn't always equate into profits. In 2008, upstart Apple made 20% of the industry profits with minimal market share while Motorola and Sony Ericsson, with more experience and much larger market shares, essentially made no money during the same period.(2)

In sum, the high probability of losing the first mover advantage can lead companies to hesitate to release or invest in unproven technologies. Therefore,

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(2) Retrieved on November 5, 2009 from everythingiCafe, http://www.everythingicafe.com/blog/apple-ringing-up-profits/2009/07/20/

industries where many late-entrants practice competitive churning as a primary strategy may experience significantly fewer major innovations over time.

Churn seems to be most suited in markets and products where the technological development is rapid and the growth of the market, through quick consumer acceptance, is just as rapid. Yet, Suarez and Lanzolla (2005) cite Netscape, the web browser and the company by the same name, as an example of a company whose resources were outmatched by latter entrants in a very rapidly evolving environment.

In markets that are characterized by rapid pace of technological progress and slow demand (such as we have experienced after fall of 2008), competitive churning inhibits international competitiveness. This is partly because the fast pace of technological change brings new competitors who think that they can increase their market share by improving earlier versions of the product and adding new features. A company that competes in this market can become too reactive to what its competitors are doing. In fact, it is possible that these companies can become so pre-occupied with its competitors' moves that they can fail to formulate and execute a consistent long-term customer-oriented strategy. It is argued that that is exactly what happened at Motorola; it missed a "shift in consumer preferences from phones intended primarily for talking to those that did nearly everything a computer could do. (Hansell, pg. 15)"

In addition, slow consumer demand makes churning strategies counter-productive. Since the market is slow to accept new product versions, a company is spinning its wheels in vain in trying to come up with newer and better versions than its competitors. Most products fail to generate significant consumer interest. Therefore, any competitive advantage a company may gain by introducing new products is short-lived. Digital cameras, for example, did not begin to grow until nearly a decade after Sony introduced the first digital camera, the Mavica, in 1981. Yet technological improvements of digital cameras such as the digital image density continued to grow extremely fast. New product versions were obsolete within a year without sufficient sales to recoup costs (Suarez & Lanzolla, 2005).

VII. Challenges

The results of the survey indicate that companies can either proliferate or flounder under competitive churning environments. So what factors are needed to ensure that companies that elect to utilize competitive churning as a primary strategy are successful? To answer that question, the final section of our survey asked companies: Given today's climate what are the challenges facing companies that wish to pursue competitive churning?

Some mangers stated that businesses need to draw and keep customers with something more than just their manufactured product because similar products are available from other companies, such as great customer service, product availability or a comprehensive warranty. Others mentioned that the key to success will be hiring practices that get the best and brightest individuals who can effectively make decisions that help their company adapt to changing conditions.

More specific challenges, and the percent of companies that agreed, are as follows.[3]

87%	Having adequate knowledge of consumer preferences
83%	Understanding the competitive landscape
78%	Having the appropriate technological know-how
64%	Recruiting/promoting appropriate staff
52%	Promoting Churning
35%	Ability of reverse-engineer
22%	Being flexible
17%	Willingness to cannibalize their own existing products

VIII. Promoting Churning

Churning gives each company a greater incentive to offer targeted

(3) Total adds up to more than 100% as companies could select more than one benefit

promotions and work on a strategy to try to increase their market share. One method to gain market share is to develop an offensive promotion, which is one that is given to consumers who prefer the rival's product. An example of offensive promoting may involve a company who offers incentives to join their subscription or service, such as an internet provider or telephone service. Offensive promotion can also involve marketing which compares one's own product to that of another company in order to increase interest and comparatively increase market share by offering a better product. Another method to gain market share is called defensive promotion, which involves consumers who prefer one's own product. For example, to maintain the company's product share, it may offer special coupons or offers to those who already have the product or service. Defensive promotion may also involve improving the product incrementally over the competition to keep the current customer base satisfied with the product, thus reducing churning due to the ability to keep up with the competition in technology or quality. Since competitive churning is so prevalent, it is clear that most companies focus on offensive promotion because using this method results in greater success in taking market share from competitors (Shaffer & Zhang, 2002).

IX. Conclusion

It would appear that competitive churning has different effects on different companies and its viability is viewed differently by different companies. It was suggested that competitive churning improves international competitiveness in markets characterized by rapid technological innovation and high consumer acceptance. But it is not clear if those same benefits can be gained in markets characterized by weak demand. This study has discovered that there are some concerns among market participants that using competitive churning as a primary strategy may inhibit international competitiveness in the current economic environment. But at least one question remains, for companies that wish to move away from competitive churning, what are their alternative strategies.

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<Summary>

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In this paper, the author examines whether Competitive Churning is still a viable strategy given apparent changes in consumer behavior after the financial markets crashed in late 2008. In a survey of 55 Japanese manufacturers, the author found that the practice of Competitive Churning may not have been as widespread as earlier researchers had reported. In addition, a notable number of firms in Japan who had been practicing Competitive Churning prior to 2008 replied that they would no longer practice Competitive Churning or that they are considering stopping the practice. Concerns about the practice of Competitive Churning and the challenges facing companies who engage in Competitive Churning are also discussed.