



Thriving in a Sea of Competition

Coping with the Highly Competitive Environment of a Fragmented Industry

By Jean Van Rensselar

Industries are considered fragmented when there is no clear leader – no one dominant company with the power to influence the industry. If you're in a fragmented industry, this is good news in one regard – smaller companies don't have to worry about being crushed by large competitors. The downside is that, without a smart strategy, opportunities for growth are extremely limited.

Fragmented industries are easy to spot, in addition to having no obvious leader, the industry is rife with small to medium-sized privately held (often family owned) companies.

A fragmented industry is also characterized by one or more of the following:

1. It's new – firms don't yet have the skills or resources to dominate
2. There are usually low entry barriers – it's easy and inexpensive for many people to start a business in the industry (especially true for services).
3. Deep experience isn't necessary for success (think distributors)
4. There is no size advantage in dealing with buyers or suppliers
5. Personal service is important
6. It requires close local control

Fragmented industries are common in the following broad business categories:

- Services
- Retail
- Distribution
- Creative

What Keeps Industries Fragmented?

There are a few things, such as:

- **Lack of Money:** Companies just don't have the funds it takes to make the major changes that overcoming fragmentation requires.
- **Lack of Skills:** Lack of strategic skills and/or information, prevents organizations from growing – they just don't know which changes to make and how to go about making those changes.
- **Lack of Attention from Owners:** They are so busy with day-to-day operations that they don't have the time and mental energy to plan major changes.
- **Lack of Attention from the Outside:** Because there's not a lot of glamour or prestige in your industry, it flies under the radar of outsiders capable of making transformational acquisitions. History shows that outside investors who *do* recognize the opportunity stand to make enormous profits.
- **Complacency:** Owners are happy with the status quo.

Strategic Traps

Competitive strategies that work in some industries, don't work in fragmented industries – mostly because of the intensely competitive nature of fragmentation. Strategic miscues especially relevant to fragmented industries include:

- **Seeking Dominance:** Unless the fundamental structure of the industry changes---making it no longer fragmented---trying to become dominant without making the major acquisitions that most companies are not prepared to make is a losing proposition.
- **Lack of Strategic Discipline:** Strategic discipline – especially in the form of specialization or truly meaningful differentiation---is required for effective competition in all types of industries – but especially in fragmented industries where competition among similar companies can be intense.
- **Assuming that Competitors have the Same Overhead and Objectives:** Given that most firms in a fragmented industry are paying about the same for supplies and services, operational overhead and the tolerance for profitability can vary enormously between competitors.
- **Overreacting to New Products:** In fragmented industries, where there is so little margin for competitive error and so much danger of being left behind, newly introduced products are often embraced irrationally before anyone has had the opportunity to assess the true value. This has the potential to raise costs and overhead and create a competitive *disadvantage*.

Strategies for Overcoming Fragmentation

Organizations that are able to overcome fragmentation stand to reap big benefits for many reasons, not the least of which is that there is almost no threat of being dominated by a competitor. Following are a few proven approaches to capitalizing on a fragmented industry.

- **Create Economies of Scale:** Keep an eye out for new technology that will allow you to duplicate operations across multiple locations and reduce per location costs. Explore opportunities for price leverage with suppliers and service providers before you open new locations. A classic example is advertising.

- Specialize: Specialize in a product or service type (ready to assemble furniture), a product or service segment (high-end furniture), a customer demographic (young marrieds), and/or a type of order (complete bedrooms packages).
- Create an Experience Advantage: Develop, quantify, and market value added experience that industry customers want. This is similar to specializing, but on a large scale where the organization pursues a very large segment with a unique need that is currently not being addressed in the industry.
- Standardize Diverse Market Needs: This is the opposite of customization. Contrary to common wisdom, most buyers in your industry may not want a choice of products and services---they would rather have one all-inclusive, reliable solution that is a good value. This is especially true if differentiators among competitors are fairly meaningless to consumers. There's a saying that the more solutions there are to a problem, the less likely it is that any one of them is a good solution. Create a good solution.
- Identify and Split off Aspects Most Responsible for Fragmentation. Identify the aspects of your industry that are preventing consolidation. Then isolate and neutralize those aspects. For example, if distribution requirements are keeping you small and local, consider contracting with an independent distributor.

6 Steps for Creating a Strategy

1. Determine the structure of your industry and the positions of competitors.
2. Pinpoint the reasons that your industry is fragmented.
3. Determine if the fragmentation can be overcome and, if so, how.
4. Determine if overcoming fragmentation is worth the effort (will it be profitable).
5. Determine how your organization needs to position itself in order to overcome fragmentation.
6. If fragmentation is permanent and unavoidable, determine the best alternative(s) for operating within those bounds.

A note of caution: Those who buy franchises are buying into fragmentation. The nature of franchises---especially centralized control---means that, when it comes to overcoming fragmentation, their hands are effectively tied

Portions of this article are based on Michael Porter's excellent classic, *Competitive Strategy: Techniques for Analyzing Industries and Competitors*. Like all of Porter's books, it's a treasure of practical theory and concrete advice on smart, sustainable competitive strategy.

About the Author

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