Defensive Marketing

How a Strong Incumbent Can Protect Its Position

by John H. Roberts

Facing deregulation, the Australian telephone company Telstra developed a marketing strategy that blunted the attack of a potentially powerful new rival.

MARKETING IS TYPICALLY SEEN as a tool for growth. A company can use it to successfully launch a product, make inroads into a new market, or gain share with existing products in its current market. But for nearly every new product launch, market entrant, or industry upstart grabbing market share, there is an incumbent that must defend its position. If the defender can't hang on to what it has, it loses the foundation on which to build its own growth.

While there has been much research on marketing as an offensive tactic, there has been remarkably little on how strong incumbents can use marketing to preemptively respond to new or anticipated threats, whether they arise because of deregulation, patent expiration, changing technology, or rivals' shifting competitive advantage. And that's a shame, because many of the marketing challenges defenders face have distinct characteristics. For example, an incumbent usually has an installed base of customers, which means the company has detailed information about the customers it wants to keep and how it might keep them. But a new entrant has the advantage of being able to cherry-pick valuable customers, raiding the most fertile segments in the market, while the incumbent has to defend across its entire customer base.

When the Australian telecommunications market was fully deregulated in the late-1990s, state-owned Telstra faced competition for the first time. And its new rival, a joint subsidiary of American company BellSouth and UK company Cable & Wireless, promised to be a formidable contender. Telstra knew it was going to lose significant market share to the newcomer, called Optus; its goal was to both minimize and slow the rate of that loss while retaining its valuable customers.

Telstra adopted a defensive marketing method that allowed it to do just that. Using a model to predict consumers' responses to the rival service (a model that marketing analyst Charles Nelson, marketing professor Pamela Morrison, and I helped develop as consultants to

Telstra), the company was able to select from a variety of strategies that ultimately helped to blunt Optus's attack. Telstra's defense was particularly effective because the company initiated it even before Optus began doing business.

In some cases, the method led Telstra to make sharp changes in strategic direction. The company rethought its pricing strategy, for instance, to counter an Optus strength that the customer response model unexpectedly revealed, helping Telstra to retain several points of market share it otherwise would have lost. The strategies described here, though specific to Telstra's situation, offer lessons for any company facing new and potentially damaging competition.

Deciding What to Fight With

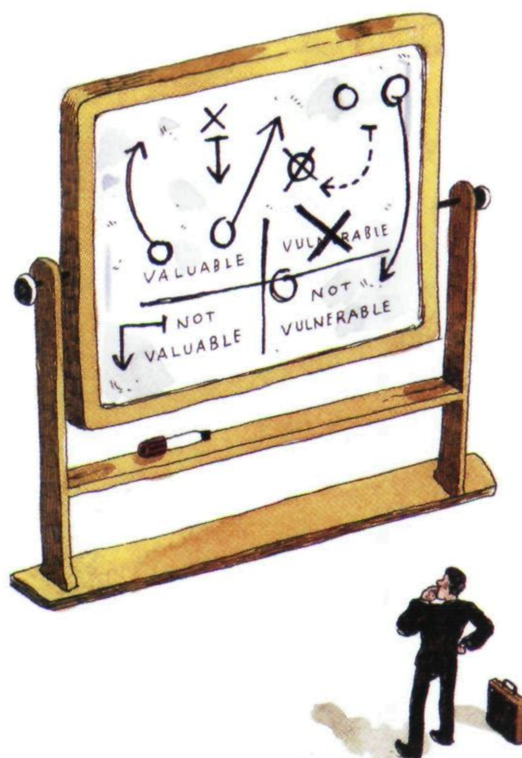
Defensive marketing begins with an assessment of the weapons you have available to protect your market position. These include your brand identity, or how customers perceive you; the mix of products and services supporting that identity, including their pricing; and the

JOHN HENDRIX

means of communicating your identity, such as advertising.

The effectiveness of these weapons will depend on several factors, including your status as an incumbent. For example, you may decide that your brand identity needs to be modified if you are to retain customers or delay their defection. But this may prove difficult: While consumers' perceptions of a new entrant are likely to be malleable, their image of an incumbent is likely to be well formed. The defender may own the perception of "heritage" in the customer's mind – but may also be stuck with that label despite massive advertising outlays aimed at changing it. Meanwhile, a new entrant can relatively quickly and easily adopt an image – say, "breath of fresh air" – from an array of branding alternatives.

In other cases, a weapon such as advertising may be *more* effective in the hands of a defender because of the incumbent's size. For example, if the incumbent has ten times the revenue of the new entrant and each puts the same percentage of revenue into advertising, the defender will be able to outshout the newcomer by an order of magnitude, giving it an obvious advantage – at least when communicating messages that aren't intended to entirely reposition a well-established brand.



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An assessment of the strengths and weaknesses of your arsenal will help you choose from four types of defensive marketing strategies. A customer defects when the benefits of staying with an incumbent are outweighed by those of switching to a new entrant. And that doesn't necessarily happen right away; an incumbent may be able to delay a customer's switch. Consequently, to hold on to customers, the incumbent can try to increase its perceived advantages in their eyes (a *positive strategy*). In the case of customers who will ultimately switch, the incumbent can try to at least slow the rate of their departure (an *inertial strategy*). Similarly, the incumbent can try to reduce its perceived drawbacks relative to the new rival, again either to retain customers (a *parity strategy*) or to decelerate the loss of them (a *retarding strategy*). With the first two types of strategies, you establish and communicate your points of superiority relative to the new entrant; with the second two, you establish and communicate strategic points of comparability with your rival. (See the exhibit "Choosing the Right Defensive Strategy.")

Telstra identified its areas of superiority and weakness relative to Optus by conducting an economic analysis of the competitive landscape and by using the model for predicting customer responses to both companies' moves. Take the issue of pricing. Telstra had originally planned to meet an anticipated Optus pricing challenge head-on, relying on its greater financial resources to weather a price war. But an economic analysis suggested that pricing was in fact likely to be a source of weakness for Telstra because it had a cost disadvantage. While government regulations stipulated that Telstra charge Optus only the marginal cost of providing capacity to the newcomer on the Telstra network, the incumbent had to bear the entire fixed costs of maintaining the network. Despite Telstra's deep financial resources, a price war clearly wouldn't be a good way to retain customers.

If Telstra had gone ahead and decided, despite its cost disadvantage, to compete with Optus on price, the strategy would have been doubly flawed, as the customer response model revealed. The model allows an incumbent to accurately gauge consumer reactions to both its and the new entrant's market-

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ing actions – and thereby focus its efforts on areas that will be most effective in minimizing the level and rate of market share loss to the new entrant. (For a detailed description of the model, go to www.agsm.edu.au/cam-defence.)

In the area of pricing, the model revealed that Telstra's customers, although likely to respond favorably to Optus's low prices, didn't view lower Telstra prices as a strong incentive to stay with the company – possibly because a Telstra price decrease would only raise questions in consumers' minds about why the company hadn't dropped its prices before it had competition.

Realizing its dual weaknesses in this area – hindered from offering better pricing because of its higher cost structure and now realizing that its customers wouldn't value its price cuts as much as Optus's – Telstra adopted a parity strategy in which it created strategically chosen, but quite limited, points of price superiority over Optus. That is, while Optus on average offered lower prices, Telstra's prices were lower on some routes and at certain times of day. This meant that the lower-priced carrier for a given customer depended on that individual's specific calling patterns – a muddied situation in which consumers were less likely to take the big step of switching phone companies on the basis of price.

The success of Telstra's pricing strategy, supported by aggressive advertising, was evident in survey results – when asked whether Telstra or Optus offered cheaper service, many people said they didn't know or "it depends" – and in an assessment by the Australian Consumers' Association, publisher of *Choice* magazine, which declined to recommend either Telstra or Optus as the outright cheapest provider.

Another area of weakness that Telstra needed to counter, this one with a retarding strategy, concerned what might be called the "punishment factor." The model suggested that people would switch more quickly to Optus if they were angry with Telstra and wanted to "teach Telstra a lesson." Telstra moved swiftly to assuage these people with a television advertising campaign that implicitly acknowledged the company's service shortcomings but emphasized its vow to improve. The anthemic jingle proclaimed, "Good, better, best. We will never rest. Until our good is better. And our better best." In mounting this campaign, Telstra leveraged the incumbent's typical advantage of advertising clout: Six months after Optus entered the market, Telstra still had a market share 12 times that of its rival and could afford a major advertising effort.

But this retarding strategy wouldn't have worked if Telstra hadn't backed up its message with improved service. The customer response model indicated that nearly 60% of customers thought that "most people had a major service problem with Telstra." (Interestingly, only 19% reported having experienced a problem themselves – an indication that Telstra, while disappointing a significant number of customers, was actually doing a better job of providing service than it was in communicating its record to customers.) Consequently, Telstra launched a high-profile effort to upgrade and publicize its service efforts – particularly in the area of billing, a hot spot for criticism – as a way to improve customers' experiences and perceptions.

Telstra considered and rejected one inertial strategy. The customer data suggested that consumers' perceptions of reliability were an important driver in the rate of share loss: "Using Optus might be risky" was one of the strongest factors in people's decisions about whether to switch quickly to the new provider. Telstra wondered if it could leverage this risk aversion, as well as its long-established reputation for dependability, to slow customers' defections to Optus. But the market research also showed that customers felt they could easily switch back to Telstra if Optus did not live up to its promise, so Telstra decided not to make any marketing moves based on customers' differing perceptions of reliability.

Choosing the Right Defensive Strategy

Defensive marketing strategies can be categorized by their aims – that is, whether a strategy is designed to retain customers or merely to slow the rate of their switching to a new rival. They can also be categorized by the means to achieve those aims – that is, whether a strategy focuses on the incumbent's strengths or on the rival's perceived strengths.

	Leverage your strengths	Mitigate your rival's strengths
Retain customers	**Positive strategies:** Hold on to customers by emphasizing the perceived advantages of your product, service, or company.	**Parity strategies:** Hold on to customers by matching, neutralizing, or blunting the perceived advantages of the new entrant's product, service, or company.
Slow the rate of customer loss	**Inertial strategies:** Acknowledge that some customers will leave despite your strengths, but offer product or service enhancements that will delay their defection. Emphasize that benefits lost in the switch may be major ones.	**Retarding strategies:** Acknowledge that some customers will leave because of the new entrant's perceived advantages, but offer product or service enhancements that will delay their defection. Emphasize that benefits gained in the switch may be only minor ones.

An inertial strategy that the company did use is one available, in some form, to many incumbents. Based on consumers' positive perceptions of Telstra as a homegrown company, the incumbent (in its advertising copy, press releases, and product support) played up its Australian roots – and, by implication, Optus's foreign owners and recent arrival in the Australian market. This, combined with the established relationship consumers had with Telstra, allowed a somewhat nostalgic feeling of "better the devil you know" to influence consumers' judgments.

Deciding Whom to Fight For

After having looked at the marketing strategies you can adopt and the weapons you can wield to defend your share, you need to take a closer look at your customers. Individual consumers will differ both in the likelihood that they'll switch to a rival and in the reasons that would prompt them to do so. Furthermore, there are clearly some customers you'd hate to lose more than others.

Therefore, you need to segment your customers based on two variables: their value to you and their vulnerability to being poached by the new entrant. (See the exhibit "Value and Vulnerability.") You can identify the customers you are at greatest risk of losing, or the *vulnerables,* by using the customer response model. You can identify the customers you would most like to retain, or the *valuables,* by assessing their direct and indirect effect on your profitability. In Telstra's case, this included, for example, the degree to which customers used the network during nonpeak hours, when there was plenty of system capacity. Incumbents have the advantage of knowing which customers they want to keep because of existing data – for Telstra, its current customers' calling patterns. (At the same time, however, Telstra couldn't easily walk away from the mass market. Unlike Optus, it couldn't select only the most profitable customers, the ones it had identified as valuables.)

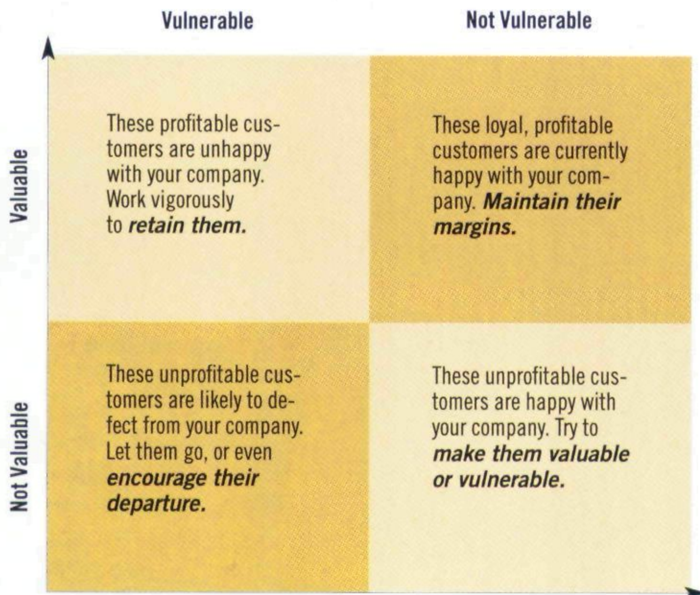
So what challenges do you face with each of these customer segments? In the case of customers who are vulnerable but not valuable, none at all: In fact, you *hope* they switch to the new entrant. For customers who are not vulnerable and not valuable, you try to make them more valuable by reducing the cost of serving them or getting them to increase their purchase of higher-margin products or services. If that isn't successful, you may actually try to increase their vulnerability to the blandishments of your rival by, say, reducing the services you currently offer that are unprofitable for you. For example, deregulation typically permits companies to eliminate such practices as rate averaging, which in effect subsidizes certain customers at the expense of others through discounts and concessions like extended payment plans.

The big challenge comes with your valuable customers, whether they're vulnerable or not. The goal is to give the valuable-vulnerables a reason to stay without offering the valuable–not vulnerables a benefit that isn't needed to ensure their loyalty. Telstra had to figure out how to price its services in a way that would defend the valuable-vulnerables against efforts by Optus to lure them away without cutting the rates of the valuable–not vulnerables, customers perfectly happy with the current services at the current prices. It is unethical, and sometimes illegal, to offer different deals to different customers, unless the pricing discrepancy is based on the different costs of serving them. But what if Telstra could get the two groups to self-select the desired pricing plan?

To do this, Telstra analyzed the traits of the two segments. One important finding: The valuable-vulnerables were particularly knowledgeable about the services they were paying for, and they were more likely than the valuable–not vulnerables to research alternatives in order to get a good deal. With this in mind, Telstra launched Flexiplans, add-on services costing between $2 and $10 per month, which allowed customers to, say, extend the hours in which they could make calls at the low weekend rate. The packages targeted particular Optus price plans, as well as times of the

Value and Vulnerability

Classifying your customers based on their value to you and their vulnerability to being poached by a new rival helps determine who is worth keeping and how you should go about doing so.



day and days of the week that were desired calling times for consumers and times of spare capacity for Telstra. This way, Telstra would always have some routes and times of day in which its services were cheaper than Optus's.

The typical reaction of the inquisitive valuable-vulnerables was to do the math and say, "Yes, I'll be a lot better off even after paying the additional monthly charge." The reaction of the valuable–not vulnerables was to say, "I'm paying enough already, and I don't need any extra services"–even if they would have saved money overall with one of the plans. The extra charge didn't generate much additional revenue for Telstra. What it did do was get only those keen on saving money to apply for the Flexiplan packages – and thereby give them a reason to stick with Telstra.

The Spoils of War

Telstra's defensive analyses and strategies helped the company better prepare for Optus's assault by providing accurate estimates of Telstra's potential market share loss. The customer response model indicated that, even given Telstra's use of several defensive strategies, share loss after six months would be more than twice what Telstra's management had originally planned for–nearly 9% rather than the anticipated 4%. The forecast helped the company better allocate its human and capital resources. For example, Telstra reduced its engineering expenditures so they were in line with the lower physical plant requirements resulting from the reduced market share.

More important, the defensive strategies Telstra employed prevented the share loss from being even worse and helped the company contain any losses to strategic areas it had deemed less important. The company's analysis found that the Flexiplan pricing strategy helped Telstra hold on to roughly 4% of the market – representing $28 million in annual revenue – that the company otherwise would have lost. Telstra's "Good, better, best" advertising campaign, designed to prevent the rapid flight of customers angry with the company's past performance, helped it hold on, at least initially, to an additional 3.5% of the market. Changes in the way the company managed its large corporate accounts, the cell phone market, and its international calling services also produced significant savings.

Viewing marketing through a defensive lens helped turn what might have been a rout by Optus into a closely fought battle that left Telstra with some losses but the lion's share of the market. Telstra was ready to fight another day. Its preemptive strategy, implemented prior to Optus's launch, had blunted Optus's initial momentum. And once that happened, it was a lot easier for Telstra to defend its customer base in the long, slow trench warfare that followed.

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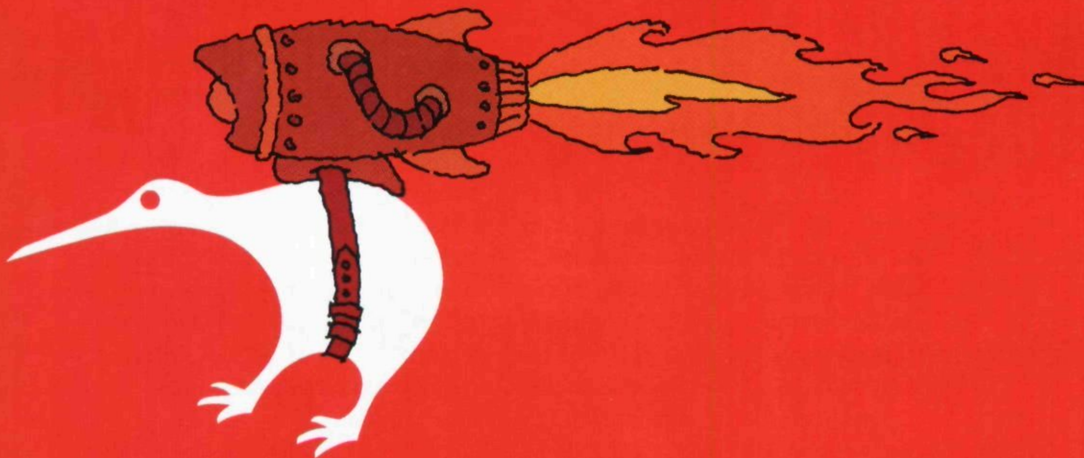

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