

# **Defending the Beachhead: Telstra vs Optus**

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For every new entrant, and every innovation by an existing competitor, there is at least one incumbent seeking to defend its market share and profit. Yet market defence has attracted much less attention than market attack. This is a serious weakness in strategy and marketing. Defence against competitive attack poses an important problem and the issues facing the defender are different to those facing the attacker. While some guidance comes from Hauser and Shugan (1983) in advising directional defensive moves with respect to price and advertising and a survey of industry practice is provided by Gatignon, Robertson and Fein (1997), nowhere can we see how to calibrate specifically how a defendant should respond over time.

In this article, we focus on one aspect of defensive strategy, defending against a new market entrant. Much of the thinking would be equally applicable in the context of defending against other competitive assaults such as a major new product launch or an aggressive move into a new distribution channel.

We specifically focus on, in marketing warfare terms, "defending the beachhead": short-term strategy to (a) minimise the competitor's market share gain during the first few months after launch, while (b) enabling the incumbent to avoid expending more resources or sacrificing more profit (eg through price-cutting) than necessary. A successful defence of the beachhead will provide the platform for a longer-term strategy to keep the new entrant bottled up, regain the lost market share, or even force the new entrant to withdraw from the market.

The defender has four generic strategic options (Figure 1) Firstly, it must decide whether to emphasize its own strong points or to counterattack at the entrant's weak spots. Secondly, it must determine whether to try to reduce the final amount of territory (market share) that the new entrant gains or to focus on slowing the rate at which that territory is won.

**Figure 1: The Defender's Strategic Options**

	<b>Harness Own Strengths</b>	<b>Expose Entrant's Weaknesses</b>
<b>Ultimate New Product Appeal</b>	<b>Positive Strategies</b>	<b>Negative Strategies</b>

**Rate at which New Product gains Share**

<b>Inertial Strategies</b>	<b>Retarding Strategies</b>

How should it decide which combination of these strategies to adopt? The usual answer is to use judgement, perhaps supported by some customer research and analysis of the incumbent's and new entrant's relative strengths and weaknesses.

We argue that a more formal approach which explicitly models the key issue – customer behaviour – will generally outperform this judgemental method. If the new entrant can be regarded as the enemy then the consumer's mind is the battleground. We illustrate our approach with a particular case, Telstra versus Optus.

Optus, a joint venture between Bell South and Cable & Wireless, was launching into the Australian telecommunications market. The incumbent (our client) was Telstra, the state-owned telecommunications monopoly. The particular battleground was the valuable heavy calling segment of the residential long distance market.

As always in marketing warfare, the quality of strategy depends on understanding how the terrain differentially favours the relative strengths of the combatants. Our approach was therefore based on a formal model of consumer adoption and on qualitative and quantitative market research and modelling. The aim was to give Telstra two things: a forecast of Optus's market share gains over the first six months, and diagnostic information about the likely impact of alternative defensive strategies by Telstra.

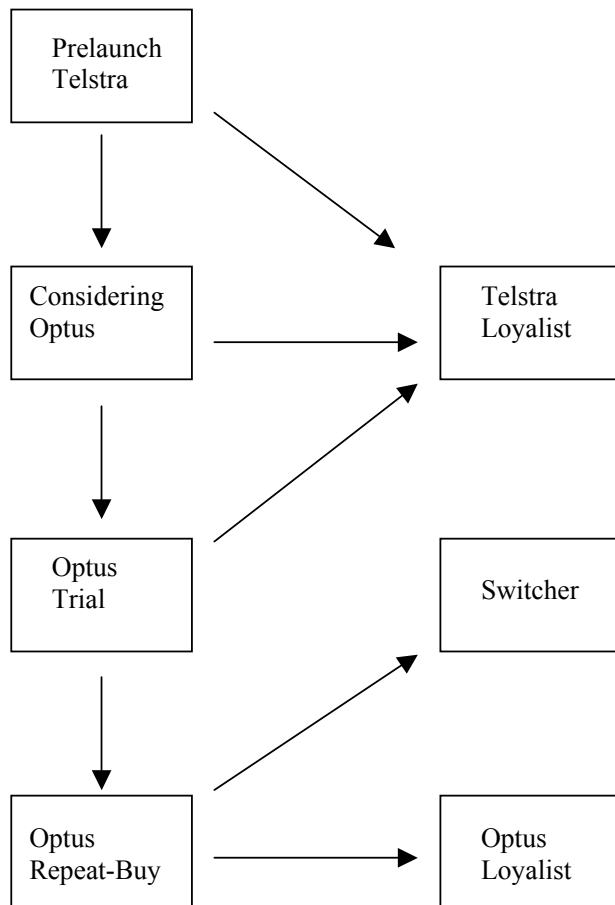
### **Model of Consumer Adoption**

In strategy modelling, an important issue is how much to simplify. We recommend a middle-range model which includes the main possible stages and routes of consumer adoption, but in simplified form. In marketing this is called a "macro flow" model (Urban and Hauser 1993, Chapter 17).

Based on focus groups, we developed the macro flow model in Figure 2. In this model, all consumers start as Prelaunch Telstra users before the Optus launch and end up in one of three states: still a Telstra loyalist, an Optus loyalist, or a nonloyal switcher between the two

companies. To reach these states, consumers may flow through three behavioural states labelled Considering Optus, Optus Trial, and Optus Repeat-Buy. For simplicity, the model allows only two possible flows out of each of these states. The model aims to estimate how many people will flow along each arrow and the rate at which they will do so.

**Figure 2: Consumer Adoption Model**



**Applying the Model**

Using market research, respondents were taken through a learning process where they were first told about the new entrant and then gradually given more information about it using simulated advertisements and other material. This enabled us to estimate consumer beliefs

about Optus at the different stages of knowledge that would occur as the market evolved (see Technical Appendix for details).

Given the status quo in terms of existing consumer perceptions and a reasonably good expectation of what Optus would charge, the model gave forecasts of the rate at which it would gain market share. These proved remarkably accurate (Table 1):

**Table 1: Forecast Accuracy**

Time After Launch	Optus Market share	
	Forecast	Actual
3 Months	4.8%	4.0%
6 Months	8.8%	8.8%

Extrapolating, we estimated that Optus would eventually gain a 20% market share given Optus’ predicted market entry strategy and the best defence that the model was able to suggest to Telstra to overcome it. After five years (when the government totally deregulated the market) Optus’ market share was with five points of this. [PADDY I am in the process of getting an exact number.]

**Marketing Diagnosis**

At least as important as these forecasts was the diagnostic information provided by the model to help Telstra plan its defensive strategy.

The primary drivers of choice of the new entrant were attitudes towards Telstra as a company and beliefs about what the Optus offering would be like. That is, the first lesson we learned in the market research, and one that all defenders must understand, was that the criteria that are used to judge the new entrant will be different to those used to judge the incumbent.

Thus, focus groups indicated fourteen attributes which were important in judging Telstra. These were reduced to three underlying dimensions using principal components factor analysis: “How strong is my relationship with Telstra?”, “What do I believe of its service delivery?” and “Do I see it as big and impersonal?”. In contrast, attitudes to Optus and the

idea of competition were measured on nine separate attributes. These were distilled down to “*Is there a downside?*”, “*Am I restless with my existing supplier?*”, “*Do I have a high level of inertia to change?*”, and “*Do I care about competition?*”.

The first three factors provide the means by which the incumbent can adopt positive actions in the strategy matrix in Figure 1 to improve its long term equilibrium appeal. The second four factors enable it to understand how it can use negative strategies to exploit and expose the entrant’s weaknesses. These negative strategies are not without some risk, however. With the advent of MCI and Sprint into the US telecommunications market, AT&T tried negative advertising suggesting that new entrants would not be able to match its technological sophistication. These campaigns backfired badly.

Having understood the criteria that consumers would use to judge the incumbent and the new entrant, we then looked at the determinants of how people would flow through the decision process in Figure 2, based on the two adversaries’ positions on these criteria. The determinants of each stage of the process are outlined in Figure 3.

Consideration of the new entrant could be reduced if Telstra improved service delivery and developed a closer relationship with its customers. Consideration could also be contained if it was able to communicate that there was indeed a downside to switching carrier (particularly since Optus was not going to provide a full service offering) or if it could reduce the level of restlessness of consumers.

The most interesting point about pricing, which was significant in both the trial and repeat models, was that the price sensitivity for the incumbent was lower than the price sensitivity for the new entrant. Given that competition was likely to lead to lower prices, this was bad news for Telstra. A price decrease by Optus would be more valued than a price decrease by Telstra. If Telstra got into a price war it would be hit by a double whammy: first, its margins would be eroded and, second, even if it was able to maintain price parity or a similar price differential relative to the new entrant, it would gain a lower share as price decreased. (Of course, it does not follow that it is in the interests of the new entrant to start a price war since its margins would also be eroded).

Note that trial, given that the consumer will consider the new entrant, is primarily driven by relative price (and also restlessness with the incumbent). It is interesting to observe that inertia which serves to slow repeat and thus acts in favour of the incumbent becomes a

liability once repeat has occurred since a consumer with high inertia can now no longer be bothered to keep on continuing to use the existing carrier.

Originally Telstra thought that the best place to erect inertial strategies was to try to persuade the consumer that there was no need to try the new entrant. These data show that in fact inertia may well be most effectively employed after trial has occurred. This came as a surprise to management. The best line of defence in fact was not at consideration but after having let the consumer try the product to just let it fade out of his or her mind. Finally, the conversion model to stop the consumers who repeat with the new entrant from staying with it totally, could potentially be influenced by decreasing the consumer perception that Telstra was arrogant and insensitive.

**Figure 3: Prelaunch Calibration of Flow Models**

**Consideration Model: "I would consider the new entrant"**

<i>Determinants</i>	<i>Effect</i>
Restless with Telstra	0.84
No downside to change	0.53
High inertia	-0.29
Good relationship with Telstra	-0.14
Telstra's service delivery good	-0.11

**Trial Model: "I would try the new entrant"**

<i>Determinants</i>	<i>Effect</i>
Telstra's relative price	-0.77
Restless with Telstra	0.27
Relative price squared	0.26
Optus price plan	0.17
Telstra price plan	-0.16

**Repeat Model: "Given satisfactory trial, I would repeat"**

<i>Determinants</i>	<i>Effect</i>
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Telstra's relative price	-0.50
Optus price plan	0.25
High inertia	-0.23
No downside to change	0.16
Telstra "big and impersonal"	0.16
Relative price squared	0.13
Telstra price plan	-0.12

**Conversion Model: "I would still use the incumbent"**

<i>Determinants</i>	<i>Effect</i>
Telstra's relative price	0.63
Telstra "big and impersonal"	-0.32
High inertia	-0.32
Optus price plan	-0.27
No downside to change	-0.25
Competition is irrelevant	0.17
Telstra price plan	0.13
Relative price squared	-0.10

These strategies all provided good ammunition to contain the market share that Optus would gain. A further requirement was to understand the rate at which it would gain that share. We addressed that problem in two ways. First, new entrants had invaded other telecommunications markets and so we were able to fit a diffusion model to see their historical diffusion rates in foreign markets and by analogy to estimate likely progress in this market. Second, we asked respondents how long they thought it would take them to make a decision about the new entrant. Remarkably, the migration rates from these very different methods proved to be almost identical (see Mahajan, Muller and Bass 1990 for a review of calibrating such diffusion models). Because we had self-stated migration rates, we could see the different consumer characteristics that fast and slow migration rates were associated with. By looking at the determinants that would lead to consumers changing quickly to the new entrant we were able to see how that could possibly be slowed. The determinants of the rate of conversion (as opposed to the degree) are included in Figure 4.

**Figure 4: Determinants of High Rates of Flow Through the Decision Process**

<i>Determinant</i>	<i>Effect</i>
Saving money is the only reason to use Optus	-0.97
Using Optus might be risky	-0.20
Telstra is not responsive to my needs	0.12
I'd use Optus to teach Telstra a lesson	0.08

Speeding up the conversion rate are consumers' perceptions that the incumbent is not responsive to their needs and a resentment of it. Slowing the migration rate down is a perception that there is no real reason to change to the new entrant (except perhaps to save money) and also that maybe it would not be as good. These strategies, the third and fourth boxes of the strategic challenge matrix in Figure 1, are potentially very effective in slowing down the rate at which Optus gains share. For example in the U.S. market, while AT&T was not very successful at reducing the equilibrium appeal of new entrants, one area where it did have an effective campaign was with its inertial strategies. One of AT&T's advertising campaigns had copy along the lines of "When our competitors call you up and offer you substantial savings on your telephone bill, don't believe them. Get it in writing". The beauty of this strategy was it made the whole conversion process just that much more difficult. It was intuitive to customers in that it made sense to get the promise of savings in writing, but it also made the whole process a substantial hassle. Many consumers deferred doing anything about it. The drivers of inertial strategies proved to be an extremely useful way to buoy up the incumbent's share, at least in the short term.

**Conclusion**

The forecasts, which came out of this prelaunch model, came to within 1% of the actual market share for the first six months of the new entrant's operation. They were also extremely diagnostic. By tackling the problem of dynamic defence against a new entrant, we

were able to pick up the different criteria that consumers use to evaluate both the incumbent and the new entrant. That way Telstra could compete on grounds that favoured it.

We were able to identify the real danger of a price war because of the extra margin loss, larger base to which that loss would be applied, and bigger response effect. We found out the sustainability of a defence strategy post-trial, based on the very high expectations of a new entrant. Finally, we discovered that Telstra's service level had a dual role. First, we found that perceived service levels affected how Telstra was perceived as a company. Second, and less obviously, we found that perceptions of Optus could be changed dramatically by changing perceptions of Telstra. Any improvements in service perceptions carried with them this double bonus.

Large, strong and mature organizations spend a lot of time thinking about their growth strategies. In doing so, many of them get blindsided by assuming they will hang on to what they have. Similarly, academics and consultants have spent much time understanding new products and market expansion. They have spent little time considering how to combat them.

There are strong and viable ways in which a company can defend its existing turf. It must understand the advantages it enjoys against the new entrant as well as the disadvantages. It must move the battle to ground where it can exploit those advantages. For example, if an incumbent with a market share of 90% devotes 1% of its revenue to advertising against a new entrant with a 10% share which is also devoting 1% of its revenue to advertising, then the incumbent can gain a share of voice nine times that of the new entrant. Obviously, the incumbent must have something worthwhile to say, but advertising represents an area where its size works for it. Conversely, pricing represents an area where its size works against it.

By understanding the battleground, that is, the consumer, the incumbent can embark upon successful marketing warfare against any attacking force. Without such an understanding it is impossible for the incumbent to focus its defensive forces to areas where they will be most effective. As the Telstra versus Optus case illustrates, formally modelling the consumer adoption process can yield unexpected insights and enable management to develop a more measured and precise defensive strategy.

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## **Technical Appendix**

Discrete choice models are a common technique used to calibrate the flows in models such as the one in Figure 2 (Roberts and Lilien 1993). The relative flows from prelaunch to

consider/not consider, from consider to trial/nontrial, from trial to repeat/rejection, and from repeat to switcher/innovation loyalist can be modelled in terms of consumers' relative utilities for the service provided by the incumbent and the new entrant. Roberts, Nelson and Morrison (1995) provide the mathematical model that underpins this estimation. These utilities may be explained in terms of the consumer's perceptions of different features of the two services (e.g., reliability, line quality, etc.)

The flow rates can be modelled using geometric decay functions and their associated negative exponential distributions. In simple terms, that means that a fixed proportion of consumers in each state will flow out of it every period. This formulation is proposed by Hauser and Wisniewski (1982) although more complex models can be used. For example, Roberts, Nelson and Morrison (1995) also fit a logistic model of which the negative exponential is a subset (Bass 1969).

Combining the relative directions of flow with the rate at which they occur gives the expected proportion of the population that has flowed to any state at a given point in time. Roberts, Nelson and Morrison (1995) solve this seven state, eight flow model so that the numbers in each state can be seen and explained as a function of the managerial variables which influence that state.