To understand how competitors will respond to your next move, evaluate the situation in their terms – *not yours.*
This disconnect arises because the only rigorous framework for explaining rivals’ behavior—game theory—often becomes unmanageable in the real world. For a start, most game theory models presume that all players use the basic principles of game theory—an assumption that is manifestly false. Further, game theory models become unwieldy when a competitor has many options, when the strategist is unsure which metrics his rival will use to evaluate them, or when there are multiple competitors, each of whom might react differently. But when strategists instead use ad hoc predictions or war-gaming exercises, the analysis can become almost entirely arbitrary. The number of qualitative considerations that enter the prediction process—personal biases and hidden agendas, for example—risk rendering the results suspect and make senior management more likely to reject counterintuitive results.

Over the past few years, as we have led McKinsey’s efforts on modeling competitive behavior, we have worked with many companies to predict likely reactions to their strategic moves. Through that work, and through a survey of senior executives we conducted in 2008, we have developed a practical approach to predicting competitive behavior that stays close to the theoretical rigor and accuracy of game theory but is as easy to apply as most of the alternative methods. (See the sidebar “Our Research” for more on the survey we used.) Our approach involves distilling all possible analyses of a rival’s response to a particular strategic move into a sequential consideration of three questions:

■ Will the competitor react at all?
■ What options will the competitor actively consider?
■ Which option will the competitor most likely choose?

Two facts make this simplified process possible. First, if your adversary uses rudimentary analytic techniques—which our survey shows to be the case for most companies—then you can use those techniques to predict his response. Second, most large companies, we found in our research, follow a predictable pattern in determining their reaction to a competitor’s move.

The payoffs from adopting the approach we advocate can be high—particularly compared with the cost of making no predictions at all. We helped the largest player in a transaction-processing industry recognize that a new direction in its strategy would probably provoke a constructive, rather than destructive, response from its biggest rival. The company implemented the strategy, the rival responded as predicted, and the result was a turnaround in the fortunes of the entire industry. We also watched from the sidelines as a telecom company failed to understand its rivals and so paid too much for a new telecom license—a mistake that cost the company $1 billion and contributed to its bankruptcy within a few years.

In this article, we will examine each of the three questions above and reveal many of the norms, biases, and patterns that companies follow in studying their rivals. Please note that the results cited in this article are averages across industries, locations, company sizes, and competitive environments—all of which can affect these tendencies significantly. (In actual client situations, we use tendencies specific to the client’s circumstances.) If you have specific information about how your market segment has behaved or, even better, how an adversary generally makes choices, you should substitute it for our averages.

Will the Competitor React at All?

Even companies that do analyze their competitors usually fail to consider that a rival might choose not to respond to a strategic move. In ignoring that possibility, the strategist lowers his estimate of the expected value of his company’s move: the higher the perceived probability of counteraction by competitors, the lower the expected payoff. And with a lower expected payoff, the company is less likely to take bold action.

Why do otherwise diligent strategists skip this step? First, all managers—including, somewhat ironically, those who don’t bother with competitive analysis at all—are schooled in stories of companies that failed by ignoring their rivals, so they are afraid that in assuming no reaction they will end up being a protagonist in one of those narratives. If they actively predict no reaction, and the competitor does respond, they fear that they will look even worse. To avoid those scenarios, they err on the side of assuming a response. Second, in companies that use war-gaming exercises, individuals must represent the competitor. These people often think they will look smarter and more engaged if they predict a brilliant move or countermove by the competitor than if they simply report to the group, “We’ve thought about it, and we don’t think we should do anything.” Imagine if a day-long war-gaming workshop started off that way. The organizers would probably ignore the initial find-
ing and force the group to continue the move-countermove exercise.

The first step in analyzing competitor reaction, therefore, is to address the likelihood of no reaction. To determine this, you must ask four subquestions. If the answer to any of them is no, the chances of a response are low.

1. **Will your rival see your actions?**

Even if an action appears obvious to you, your competitor may not recognize it, for at least two reasons. First, most companies rely on incomplete data to assess changes in the marketplace. For example, most large consumer goods companies in China gather data on competitor volumes in only 30 large cities, which account for about half of the market. As a result, they simply do not detect new products targeting smaller cities. In the United States, a major consumer products company recently missed significant inroads by a competitor because the market-tracking service it (and most similar companies) used did not survey dollar stores, which accounted for 20% of the market for this type of good. Second, if your new product will affect several of your competitor’s business units, it may not register as significant to any one unit and so may be overlooked. On average, only 23% of the participants in our survey learned about a competitor’s innovation early enough to respond before it hit the market (although we asked respondents broadly about product or service innovations, we will use the term “new product” to describe these particular responses). When it came to competitors’ pricing moves, only 12% of the respondents learned about a price change in time to prepare a preemptive response. (In our research, we asked one group about responses to an innovation and another group about responses to pricing moves.)

Remember also that you can improve your odds of escaping detection even more by exploiting your competitors’ blind spots, some of which will become obvious as you consider the next three subquestions.

2. **Will the competitor feel threatened?**

Even if your competitor sees your actions, he may not feel threatened — and, accordingly, will not think that mounting a response is worth the expense and distraction. Most companies assess performance strictly against their annual budgets. If the financial goals in the budget can still be met despite your planned ones: matching a price change or introducing a me-too product. For guidance, some examine what their business unit did the last time or what has happened elsewhere in their company. It’s very likely that your rivals will also seek advice from board members and external advisers.

**Which option will your competitor choose?**

Look at this question through a competitor’s lens, not your own. Most companies use simple, short-term measures. Only about 15% track NPV. Seventeen percent use short-term market share, while another 17% use short-term earnings. Twenty percent look at long-term market share, and 21% look at long-term earnings. Do not take the phrase “long-term” too literally: Only 15% look more than four years ahead, and the time horizon varies across industries and locations.

**IDEA IN PRACTICE**

Only 23% of the executives we surveyed learned about a competitor’s new offering early enough to respond before it hit the market.
Predicting Your Competitor’s Reaction

action, management will see the company as “on plan” and will feel safe. So, understanding whether your adversary will stay on track despite your action is central to determining whether he will respond and is often easier to figure out than you might expect. Some companies announce their goals by product line. Many companies release earnings targets. For public companies that don’t formally release their targets, the earnings estimates of securities analysts—which many companies take as their targets—can substitute. If no such information is available, simply measure the previous year’s growth rate in volume and assume the company will want to achieve a similar rate in the current year. After determining your competitor’s likely goals, you can examine industry sales data to determine whether the company is on track. Add in the probable effects of your action, and you can make an initial prediction about whether the company will stay on track.

3. Will mounting a response be a priority? Your adversary already has a full agenda before you make a move. On it are product launches, marketing campaigns, reorganizations, major acquisitions, plant openings, and cost reduction efforts—some or all of which must be curtailed in order to react to your move. Therefore, to the degree that your adversary has already committed to plans that will fully occupy his attention, he will be reluctant to shift priorities. By understanding the perceived “cost” to your competitor of forgoing his planned initiatives, you can sense whether he may choose to ignore you. Further, remember that some priorities of the business unit you are threatening will probably have been established by its corporate parent. For example, suppose a unit’s parent faces earnings pressure from Wall Street. If the unit’s orders are to generate current earnings, its management might not react (or might choose an inadequate response) despite feeling quite threatened—if a strong reaction would be even more expensive in the short-term than ignoring your action.

4. Can your rival overcome organizational inertia? Even if top management wants to react, the organization as a whole may resist. Several factors can contribute to this impediment. First, if reacting requires the company to make major organizational changes, it is very unlikely to do so unless the threat is immediate and deadly. We once worked with a telecom client that would face competition from new entrants within three years. To prepare, the client needed a new planning process, which would take the full three years to develop and implement. Because the threat did not affect current performance—even though managers acknowledged it—the company could not muster the will to do more than make small changes. As a result, it eventually lost more than 30% of its market share.

Second, managers are generally reluctant to abandon their success formula, and if they decide to go ahead and make a change, they are very poor at doing so. Employees follow thousands of procedures that were established to reinforce the formula. These die hard.

Third, companies have great difficulty mounting a response that requires the cooperation of third parties, which may not share their sense of urgency. In the late 1980s, a small U.S. pizza delivery chain called Papa John’s noticed a change in consumers’ perception of the quality of Pizza Hut and Domino’s (the top two chains) and used the opportunity to create a differentiated value proposition captured in the slogan, “Better ingredients. Better pizza.” Papa John’s expanded rapidly throughout the 1990s and became the third largest pizza chain in the country, while the two bigger rivals stagnated. Unable to mobilize their franchises around quality until the threat became undeniable, the big chains did not respond with better pizzas of their own until 2000.

Whereas all competitors will notice a large move, our experience suggests that companies overestimate by 20% to 30% the likelihood that a medium to small action will be noticed. In addition, 17% of our survey respondents reported making no response even if they did notice. This is remarkable, because respondents were describing only situations they recalled most vividly, in which their company noticed a threat and classified the action as a “major” move with “the potential to significantly affect your view of your competitive position in your market segment.” Thus, the likelihood of no response in the average real-world situation could be much higher. Considering all these factors, it is reasonable to assume that companies do not respond to their rivals’ moves at least one-third of the time—certainly enough to justify an explicit effort on your part to determine whether your rival will. What’s more, simply asking yourself whether a competitor will respond streamlines the entire task. If you predict the company won’t respond, you can skip the remaining steps.
What Options Will the Competitor Actively Consider?

According to classical game theory, your next step would be to develop the full list of options your competitor could consider, on the assumption that it would study all of them before selecting one. This very assumption, however, lowers companies’ confidence in their ability to predict and hence leads them to forgo analysis. In contrast, our experience with clients and the results of the survey indicate that although competitors may discuss many response options, they seriously investigate only a small number. The day-to-day responsibilities that prevent some competitors from responding at all can also prevent them from allocating time to analyzing all options.

When we looked at the number of options examined by companies searching for responses to a rival’s new-product launch or price change, we found that the overwhelming majority consider fewer than four. The median number of options actively considered was almost exactly between two and three. The distribution was also tight: Almost 75% of the respondents looked at two or three; 10% or less looked at five or more. Because you can’t know which options a rival will consider, you must analyze more than he does. That said, the number can be contained, because you can predict which options he will analyze. For both the innovation and pricing groups in our survey, the most common option competitors analyzed was “the single most obvious counteraction” (in these situations, that would be introducing a me-too product or matching a price change). In both cases, about 55% of the participants indicated that they considered this most obvious option, and over one in three of those who examined only one option selected that response. So, there’s a good chance that a rival is seriously considering the most obvious response.

There were some differences, however, in the other options considered in a new-product context and those considered in a pricing context. Forty-three percent of pricing managers looked at what their business unit did the last time it faced a similar situation, whereas only 26% in the innovation group did so. Twenty-five percent of the innovation managers reported that they were likely to look at recent actions by other business units in the company, whereas 16% of pricing managers would take this approach. About 30% of managers in both groups sought advice from board members and external advisers. The second-least likely option (20% for both groups) was looking at the experiences of the business unit the time before last, and the least likely option (19% for both groups) was considering the prior experience of the executive in charge. The bottom line is that you don’t need to look too far back to figure out which options your rivals will analyze.

Which Option Will the Competitor Most Likely Choose?

From the previous step, you will have developed a short list of options your adversary is likely to consider. Now your task is to home in on the one he will choose. For many strategists, this prediction causes the most anxiety. It does not need to. Remember that the only alternative to making this prediction – avoiding predictions – is much worse, so you do not have to be accurate 100% of the time for the effort to be valuable.

Classical game theory (the kind most strategists know) takes a complex route to that prediction: It says that a competitor will choose the option that maximizes his net present value after taking into account all sequential moves and counter-moves by all competitors (each of whom typically has perfect knowledge of the others’ motives, economics, and options) until a new equilibrium is reached. Unfortunately, no part of that prescription generally holds in the real world.

If strategists combine the spirit of game theory with the actual behavior of companies, prediction can be both simplified and improved. Our experience has taught us to begin with this
Predicting Your Competitor’s Reaction

**OUR RESEARCH** The findings presented in this article combine our experiences helping clients make competitive predictions over the past 15 years with the results of a survey we conducted in 2008 at McKinsey & Company, in which senior executives reported on their responses to competitors’ initiatives. The survey was intended to test the validity of the framework we have developed over the past few years and to quantify the underlying behavioral tendencies we have observed. Certain parts of the framework—such as estimating the likelihood of a company’s failure to notice an adversary’s move—could not be tested in such a survey and so are reported here on the basis of our experiences alone.

Of the approximately 4,700 individuals who received the survey, 1,825—almost 40%—responded. Participants were preselected to answer either a set of questions dealing with responses to a product or service innovation or questions about responses to a price change. The total pool was split evenly between the two sets of questions, and the surveys we received mimicked this ratio (914 from innovation and 911 from pricing).

In both sets of questions, we asked participants to describe in detail (based on our framework) the decision-making processes they had followed to formulate a response to a recent “major” move by a competitor. We defined a major move as one with “the potential to significantly affect” the participant’s view of her company’s competitive position. While it’s possible that a major move to one respondent was more or less severe to another, we chose this language to increase the comparability across respondents. Further, we asked them to supply quantitative and qualitative descriptions of the actual moves in order to allow even more precise comparisons.

In addition to asking about the steps taken to respond to the competitive change (the pricing group was asked to consider not only price decreases but also increases, so the moves weren’t necessarily all “threats”), we obtained information on the respondent’s location, industry, basic industry structure, relative size, competitive intelligence gathered, the basic type of innovation (modification or new, existing competitor or new entrant), size of the initial mover, when the company learned about the move, who was in charge of responding, the expected impact, the actual impact, whether the response tried to hurt the initial mover, and the exhaustiveness of the effort.

rule: Of the options your adversary seriously considers, he will choose the one that is most effective (according to his analytic technique) within the constraints of his trade-off between short-term and long-term pain. The rule makes sense, and it has proven accurate in our client work. To apply it, strategists need to examine the following two subquestions:

1. **How many moves ahead does your competitor look?** In chess, we are told that the best players look ahead five or more moves—a process that (intuitively) involves sorting through hundreds of thousands of “if he chooses x, I will choose y, and then he will choose z” scenarios. Thinking ahead in business is a similar process. We have constructed realistic experiments in which the optimal decision changes depending on whether one uses an even or odd number of rounds. Further complicating matters, your adversary’s best response could differ depending on whether he considers only your reaction or those of other competitors as well.

   Fortunately, although there are many ways to analyze a situation, the large majority of companies want to avoid complexity as much as you do, so they restrict themselves to simple, easily replicable analyses. When asked the number of moves and countermoves they analyzed, about 25% of our respondents said that they modeled no interactions beyond their own response. In certain instances (for example, financial services responses to pricing moves), this figure was as high as 45%. The next two most-common answers were assuming a single round of counter-reaction either by the initial mover (the company making the innovation or price change to which the competitor is responding) or by multiple competitors. That is, about 35% worked with a one-stage reaction model. (Again, in certain industries, the percentage was much higher.) Fewer than 10% of the managers we surveyed looked at more than one round of response by more than one competitor.

2. **What metrics does the competitor use?** Companies often mistakenly assume that everyone measures success in the same way. This explains why many of our clients claim that their competitors are “irrational.” But would your most important competitor, who by definition has made a succession of smart decisions (otherwise he would not be your most important competitor), choose this moment to take leave of his senses? Or is he simply pursuing a strategy that looks poor according to your preferred measures but looks very clever according to his? To discover your competitor’s metrics, simply ask yourself, “What measure would have led my competitor to his recent decisions?” You will not have to search far for the answer. Most companies use simple, short-term measures. In our survey, only about 15% of respondents used NPV to evaluate their options. Seventeen percent used short-term market share, while another 17% used short-term earnings. Twenty percent looked at “long-term” market share, while another 21% looked at “long-term” earnings. Do not take our respondents’ use of the phrase “long-term” too literally, though. When asked
Only 25% of our survey participants considered more than two or three options for responding to a rival’s move.

A rigorous analysis of competitors’ behavior doesn’t have to involve a lot of math and talk of Nash equilibria. The key is to focus on understanding how a competitor actually behaves rather than on the theory of how everyone should behave. By studying your competitor’s past behavior and preferences, you can estimate the likelihood of his responding at all, identify the responses he is likely to consider, and evaluate which will have the biggest payoff according to his criteria. This information can give you an accurate idea of what your competitor is likely to do. And the competitor you can predict is the one you can learn to outsmart. Isn’t that what strategy is all about?

Kevin P. Coyne (kevin@thecoynepartnership.com) is a senior teaching professor at Emory University’s Goizueta Business School in Atlanta, a partner with the strategy consulting firm The Coyne Partnership, and a former senior partner at McKinsey & Company. John Horn (john_horn@mckinsey.com) is a consultant at McKinsey in Washington, DC.