5-6c Market Dependence

Market dependence denotes the extent to which a firm's revenues or profits are derived from a particular market.[98] In general, competitors with high market dependence are likely to respond strongly to attacks threatening their market position.[99] Interestingly, the threatened firm in these instances may not always respond quickly, even though an effective response to an attack on the firm's position in a critical market is important.

At an annual compound growth rate of 11 percent, recent predictions are that e-commerce sales will grow more than any other segment of the retail industry through at least 2017. Obviously, this growth rate is attractive to firms of all kinds including, as it turns out, Walmart. Established in 2000 as part of the world's largest firm by sales volume (with revenue of roughly $469 billion in 2012), Walmart.com is the giant retailer's attempt to become extremely successful in the e-commerce space. Today, over 1 million products are available through Walmart.com, with additional ones being regularly added to the site. Of course, competing in e-commerce pits Walmart.com squarely in competition with Amazon.com the largest online store on the planet.[100]

To date, Walmart's e-commerce business is generating roughly $9 billion per year in sales, which is just a bit over 2 percent of the firm's total revenue. Thus, Walmart currently has very little dependence for its success on the e-commerce market. Of course, Walmart is taking actions such as trying to better integrate its physical stores with its technological and logistics skills[101] and "considering a radical plan to have store customers deliver packages to online buyers, a new twist on speedier delivery services that the company hopes will enable it to better compete with Amazon.com, Inc."[102]

In contrast to Walmart, Amazon.com currently derives a strong majority of its sales volume from the e-commerce market, meaning that it has a high degree of market dependence. With $61 billion in revenue in 2012, the firm is substantially smaller than Walmart, although its total e-commerce sales revenue dwarfs that of Walmart.com's $9 billion. Given its dominant market position in e-commerce and in light of its dependence on the e-commerce market, it is virtually guaranteed that Amazon.com will continue responding to Walmart.com's competitive actions and responses.

5-7 Competitive Dynamics

Whereas competitive rivalry concerns the ongoing actions and responses between a firm and its direct competitors for an advantageous market position, *competitive dynamics* concerns the ongoing actions and responses among *all* firms competing within a market for advantageous positions.

To explain competitive dynamics, we explore the effects of varying rates of competitive speed in different markets (called slow-cycle, fast-cycle, and standard-cycle markets) on the behavior (actions and responses) of all competitors within a given market. Competitive behaviors as well as the reasons for taking them are similar within each market type, but differ across types of markets. Thus, competitive dynamics differ in slow-cycle, fast-cycle, and standard-cycle markets.

As noted in Chapter 1, firms want to sustain their competitive advantages for as long as possible, although no advantage is permanently sustainable. However, as we discuss next, the sustainability of the firm's competitive advantages differs by market type. In the main though, the degree of sustainability is affected by how quickly competitors can imitate a rival's competitive advantages and how costly it is to do so.

Slow-cycle markets are markets in which the firm's competitive advantages are shielded from imitation, commonly for long periods of time, and where imitation is costly.

5-7a Slow-Cycle Markets

Slow-cycle markets are markets in which the firm's competitive advantages are shielded from imitation, commonly for long periods of time, and where imitation is costly.[103] Thus, competitive advantages are sustainable over longer periods of time in slow-cycle markets.

Building a unique and proprietary capability produces a competitive advantage and success in a slow-cycle market. This type of advantage is difficult for competitors to understand. As discussed in Chapter 3, a difficult-to-understand and costly-to-imitate capability usually results from unique historical conditions, causal ambiguity, and/or social complexity. Copyrights and patents are examples of these types of capabilities. After a proprietary advantage is developed on the basis of using its capabilities, the competitive actions and responses a firm takes in a slow-cycle market are oriented to protecting, maintaining, and extending that advantage. Major strategic actions in these markets, such as acquisitions, usually carry less risk than in faster-cycle markets.[104]

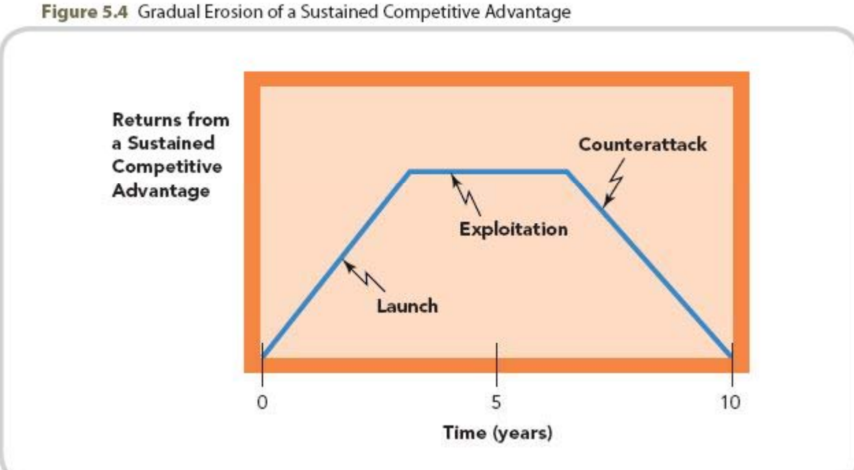
Walt Disney Co. continues to extend its proprietary characters, such as Mickey Mouse, Minnie Mouse, and Goofy. These characters have a unique historical development as a result of Walt and Roy Disney's creativity and vision for entertaining people. Products based on the characters seen in Disney's animated films are sold through Disney's theme park shops as well as freestanding retail outlets called Disney Stores. Because copyrights shield it, the proprietary nature of Disney's advantage in terms of animated character trademarks protects the firm from imitation by competitors.

Consistent with another attribute of competition in a slow-cycle market, Disney protects its exclusive rights to its characters and their use. As with all firms competing in slow-cycle markets, Disney's competitive actions (such as building theme parks in France, Japan, and China) and responses (such as lawsuits to protect its right to fully control use of its animated characters) maintain and extend its proprietary competitive advantage while protecting it.

Patent laws and regulatory requirements such as those in the United States requiring FDA (Food and Drug Administration) approval to launch new products shield pharmaceutical companies' positions. Competitors in this market try to extend patents on their drugs to maintain advantageous positions that patents provide. However, after a patent expires, the firm is no longer shielded from competition, allowing generic imitations and usually leading to a loss of sales and profits. This was the case for Pfizer when Lipitor (which is the best-selling drug in history) went off patent in the fall of 2011. The firm's profits declined 19 percent in the first quarter after that event. The loss of patents is an industry-level concern too, as suggested by the fact that roughly $38.5 billion in sales revenue was lost in 2012 as a result of drugs going off patent.[105]

The competitive dynamics generated by firms competing in slow-cycle markets are shown in Figure 5.4. In slow-cycle markets, firms launch a product (e.g., a new drug) that

Figure 5.4 Gradual Erosion of a Sustained Competitive Advantage



Source: Adapted from I. C. MacMillan, 1988, Controlling competitive dynamics by taking strategic initiative, *Academy of Management Executive*, II(2): 111–118.

has been developed through a proprietary advantage (e.g., R&D) and then exploit it for as long as possible while the product is shielded from competition. Eventually, competitors respond to the action with a counterattack. In markets for drugs, this counterattack commonly occurs as patents expire or are broken through legal means, creating the need for another product launch by the firm seeking a protected market position.

5-7b Fast-Cycle Markets

Fast-cycle markets are markets in which the firm's capabilities that contribute to competitive advantages aren't shielded from imitation and where imitation is often rapid and inexpensive.[106] Thus, competitive advantages aren't sustainable in fast-cycle markets. Firms competing in fast-cycle markets recognize the importance of speed; these companies appreciate that "time is as precious a business resource as money or head count—and that the costs of hesitation and delay are just as steep as going over budget or missing a financial forecast."[107] Such high-velocity environments place considerable pressures on top managers to quickly make strategic decisions that are also effective. The often substantial competition and technology-based strategic focus make the strategic decision complex, increasing the need for a comprehensive approach integrated with decision speed, two often-conflicting characteristics of the strategic decision process.[108]

Reverse engineering and the rate of technology diffusion facilitate the rapid imitation that takes place in fast-cycle markets. A competitor uses reverse engineering to quickly gain the knowledge required to imitate or improve the firm's products. Technology is diffused rapidly in fast-cycle markets, making it available to competitors in a short period. The technology often used by fast-cycle competitors isn't proprietary, nor is it protected by patents as is the technology used by firms competing in slow-cycle markets. For example, only a few hundred parts, which are readily available on the open market, are required to build a PC. Patents protect only a few of these parts, such as microprocessor chips. Interestingly, research also demonstrates that showing what an incumbent firm knows and its research capability can be a deterrent to other firms to enter a market, even a fast-cycle market.[109]

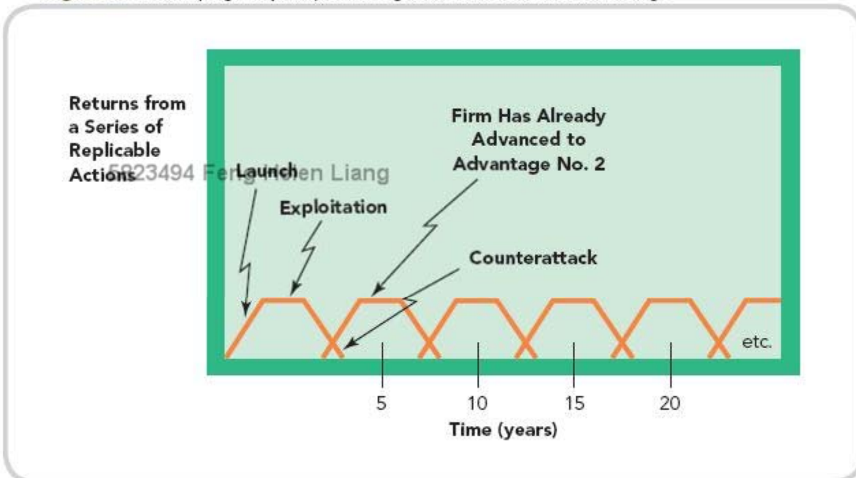
Fast-cycle markets are more volatile than slow-cycle and standard-cycle markets. Indeed, the pace of competition in fast-cycle markets is almost frenzied, as companies rely on innovations as the engines of their growth. Because prices often decline quickly in these markets, companies need to profit rapidly from their product innovations.

Recognizing this reality, firms avoid "loyalty" to any of their products, preferring to cannibalize their own before competitors learn how to do so through successful imitation. This emphasis creates competitive dynamics that differ substantially from those found in slow-cycle markets. Instead of concentrating on protecting, maintaining, and extending competitive advantages, as in slow-cycle markets, companies competing in fast-cycle markets focus on learning how to rapidly and continuously develop new competitive advantages that are superior to those they replace. They commonly search for fast and effective means of developing new products. For example, it is common in some industries with fast-cycle markets for firms to use strategic alliances to gain access to new technologies and thereby develop and introduce more new products into the market.[110] In recent years, many of these alliances have been offshore (with partners in foreign countries) in order to access appropriate skills while maintaining lower costs. However, finding the balance between sharing knowledge and skills with a foreign partner and preventing that partner from appropriating value from the focal firm's contributions to the alliance is challenging.[111]

Fast-cycle markets are markets in which the firm's capabilities that contribute to competitive advantages aren't shielded from imitation and where imitation is often rapid and inexpensive.

The competitive behavior of firms competing in fast-cycle markets is shown in Figure 5.5. Competitive dynamics in this market type entail actions and responses that are oriented to rapid and continuous product introductions and the development of a stream of ever-changing competitive advantages. The firm launches a product to achieve a competitive advantage and then exploits the advantage for as long as possible. However, the firm also

Figure 5.5 Developing Temporary Advantages to Create Sustained Advantage



Source: Adapted from I. C. MacMillan, 1988, Controlling competitive dynamics by taking strategic initiative, *Academy of Management Executive*, II(2): 111–118.

tries to develop another temporary competitive advantage before competitors can respond to the first one. Thus, competitive dynamics in fast-cycle markets often result in rapid product upgrades as well as quick product innovations.[112]

As our discussion suggests, innovation plays a critical role in the competitive dynamics in fast-cycle markets. For individual firms then, innovation is a key source of competitive advantage. Through innovation, the firm can cannibalize its own products before competitors successfully imitate them and still maintain an advantage through next-generation products.

5-7c Standard-Cycle Markets

Standard-cycle markets are markets in which the firm's competitive advantages are partially shielded from imitation and imitation is moderately costly. Competitive advantages are partially sustainable in standard-cycle markets, but only when the firm is able to continuously upgrade the quality of its capabilities as a foundation for being able to stay ahead of competitors. The competitive actions and responses in standard-cycle markets are designed to seek large market shares, to gain customer loyalty through brand names, and to carefully control a firm's operations in order to consistently provide the same positive experience for customers.[113]

Companies competing in standard-cycle markets tend to serve many customers in what are typically highly competitive markets. Because the capabilities and core competencies on which their competitive advantages are based are less specialized, imitation is faster and less costly for standard-cycle firms than for those competing in slow-cycle markets. However, imitation is slower and more expensive in these markets than in fast-cycle markets. Thus, competitive dynamics in standard-cycle markets rest midway between the characteristics of dynamics in slow-cycle and fast-cycle markets. Imitation comes less quickly and is more expensive for standard-cycle competitors when a firm is able to develop economies of scale by combining coordinated and integrated design and manufacturing processes with a large sales volume for its products.

Because of large volumes, the size of mass markets, and the need to develop scale economies, the competition for market share is intense in standard-cycle markets. This form of competition is readily evident in the battles among consumer foods' producers, such as candy makers and major competitors Hershey Co.; Nestle, SA; Mondelez International, Inc.

Standard-cycle markets are markets in which the firm's competitive advantages are partially shielded from imitation and imitation is moderately costly.

(the new name for the former Kraft Foods Inc.); and Mars. (Of the firms, Hershey is far more dependent on candy sales than are the others.) Taste and the ingredients used to develop it, advertising campaigns, package designs, and availability through additional distribution channels are some of the many dimensions on which these competitors aggressively compete for the purpose of increasing their share of the candy market as broadly defined.[114]

Innovation can also drive competitive actions and responses in standard-cycle markets, especially when rivalry is intense. Some innovations in standard-cycle markets are incremental rather than radical in nature (incremental and radical innovations are discussed in Chapter 13). For example, consumer foods producers are innovating within their lines of healthy products. Today, many firms are relying on innovation as a means of competing in standard-cycle markets and earning above-average returns.

Overall, innovation has a substantial influence on competitive dynamics as it affects the actions and responses of all companies competing within a slow-cycle, fast-cycle, or standard-cycle market. We have emphasized the importance of innovation to the firm's strategic competitiveness in earlier chapters and do so again in Chapter 13. These discussions highlight the importance of innovation for firms regardless of the type of competitive dynamics they encounter while competing.

SUMMARY

- Competitors are firms competing in the same market, offering similar products, and targeting similar customers. Competitive rivalry is the ongoing set of competitive actions and responses occurring between competitors as they compete against each other for an advantageous market position. The outcomes of competitive rivalry influence the firm's ability to sustain its competitive advantages as well as the level (average, below average, or above average) of its financial returns.
- Competitive behavior is the set of competitive actions and responses an individual firm takes while engaged in competitive rivalry. Competitive dynamics is the set of actions and responses taken by all firms that are competitors within a particular market.
- Firms study competitive rivalry in order to predict the competitive actions and responses each of their competitors are likely to take. Competitive actions are either strategic or tactical in nature. The firm takes competitive actions to defend or build its competitive advantages or to improve its market position. Competitive responses are taken to counter the effects of a competitor's competitive action. A strategic action or a strategic response requires a significant commitment of organizational resources, is difficult to successfully implement, and is difficult to reverse. In contrast, a tactical action or a tactical response requires fewer organizational resources and is easier to implement and reverse. For example, for an airline company, entering major new markets is an example of a strategic action or a strategic response; changing its prices in a particular market is an example of a tactical action or a tactical response.
- A competitor analysis is the first step the firm takes to be able to predict its competitors' actions and responses. In Chapter 2, we discussed what firms do to *understand* competitors. This discussion was extended in this chapter to describe what the firm does to *predict* competitors' market-based actions. Thus, understanding precedes prediction. Market commonality (the number of markets with which competitors are jointly involved and their importance to each) and resource similarity (how comparable competitors' resources are in terms of type and amount) are studied to complete a competitor analysis. In general, the greater the market commonality and resource similarity, the more firms acknowledge that they are direct competitors.
- Market commonality and resource similarity shape the firm's awareness (the degree to which it and its competitors understand their mutual interdependence), motivation (the firm's incentive to attack or respond), and ability (the quality of the resources available to the firm to attack and respond). Having knowledge of these characteristics of a competitor increases the quality of the firm's predictions about that competitor's actions and responses.
- In addition to market commonality and resource similarity and awareness, motivation, and ability, three more specific factors affect the likelihood a competitor will take competitive actions. The first of these concerns first-mover benefits. First movers, those taking an initial competitive action, often gain loyal customers and earn above-average returns until competitors can successfully respond to their action. Not all firms can be first movers in that they may lack the awareness, motivation, or ability required to engage in this type of competitive behavior. Moreover, some firms prefer to be a second mover (the firm responding to the first mover's action). One reason for this is that second movers, especially those acting quickly, can successfully compete against the first mover. By evaluating the first mover's product, customers' reactions to it, and the responses of other competitors to the first mover, the second mover may be able to avoid the early entrant's mistakes and