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Competing in times of evolution and revolution

An essay on long-term firm survival

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Abstract

Purpose – Ideas from microeconomics, market-positioning theory and resource-based theory have been brought together to develop a framework for discussing firm competitiveness and survival.

Design/methodology/approach – Propositions about the nature of scale economies, time, resource imitability and customer-perceived benefits are used to provide a basis for the analysis of firms and their markets. The structures of markets and the impact of innovation and environment on these structures are discussed.

Findings – A number of hypotheses are advanced. When movements in consumer perceptions and technology are slow and predictable, leading firms may have developed enough resource capital to remain dominant. When they are not, opportunities for market leadership changes occur.

Research limitations/implications – A conclusion is that strategic management should involve the study of firms in the context of their market situation. Market-based case studies should seek to understand how markets evolve over time by tracking changes in key variables.

Practical implications – The paper outlines factors that firms' managers need to take into account in order to evaluate their relationships with their competitors. How these relationships impact on industry structure and the long-term equilibrium that would result if these relationships remain unchanged is discussed.

Originality/value – A contribution to thinking about research and practical strategic management longitudinally is proposed. The approach emphasises the importance of relationships between firms and the factors that may dynamically change those relationships.

Keywords Competitive advantage, Companies, Strategic management, Market position

Paper type Conceptual paper

Introduction

Over the last 25 years students of strategic management have debated the relative merits of two major explanations for competitive advantage, marketing positioning (generic strategy) (Porter, 1980, 1985) and resource-based ideas (Barney, 1991; Peteraf, 1993). From both these perspectives competitive advantage and superior performance are linked. Either competitive advantage is the result of market position or it can be better explained by differences in firms' resource endowments). (In this paper a firm's resources are broadly defined as the assets, knowledge and skills to which it has access.) Powell (2001) has criticised strategy research in which competitive advantage is measured and explained by superior performance. This tautology has been discussed in the strategy literature (Porter, 1991; Priem and Butler, 2001a, b). Above average performance is itself an elusive variable, above average compared to what and on what indicator? In some

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growing markets where profits for the major competitors are negative above average performance when measured by profitability indicators could be negative but there can still be managerial and investor confidence that a firm has both a potential to be profitable and have a long-term existence. In this paper I propose that firms be assessed not just with respect to current performance but respect to their long-term survival. This requires that the manager, consultant and researcher take a longitudinal view to firm positioning. As a part of this I emphasise that classifying markets with respect to their similarity/differences to theoretical markets is a useful component of strategic analysis. Markets can be seen as operating either at an equilibrium number of competitors or moving towards one. The long-term equilibrium number of firms and the time for that equilibrium to be achieved is a function of the economies of scale in the market and the rate at which resources are transferred between firms.

If a firm has an inimitable resource that allows it an advantage in product value it will gain market share from its competitors. If it can sustain that advantage over all production volumes it will eventually become a monopoly. A viable firm is one that can expect to exist, every thing else being equal, at a long-run equilibrium point. However, in real environments equilibrium positions can change and, to remain or to become long-term viable, firms must change as the factors that change the equilibrium point change. If a market can be defined with reference to its approximation to a theoretical market, a firm's management can then use this approximation to evaluate options that exploit imperfections between its market and an ideal type and to carry out actions that improve its competitive position, which is related to its projected existence at equilibrium, in its favour. If a market's equilibrium point is changing so quickly that predictions are impossible then the market can be defined as chaotic.

The discussion of performance and competitive advantage is replaced with the discussion of the manifestations of resource imitability: product features and costs and the manifestations of market position: perceived customer benefits and price. This then avoids debates on the tautological relationship between competitive advantage and superior performance. However, the measurement of variables remains problematic.

The remaining parts of the paper are structured as follows:

- defining variables that characterise a theoretical market;
- external environments and market structures;
- firm-based factors and the structure of markets; and
- strategic management in different circumstances.

Defining variables and conditions that characterise a theoretical market

For the sake of simplicity in the first instance I define a market in which only one segment and one product exists and customer wants are homogenous (not heterogeneous). I also make assumptions about this market:

- The market remains constant in size unless specific actions or events cause instant step changes in its size. It does not grow and develop slowly. This allows a discussion of market share changes under constant market size.
- Buyers have equal power.
- Buyers' wants are identical.
- All changes are imitative, adaptive and incremental..

One other variable determines the nature of the industry's structure. The ratio of scale economies relative to the size of the industry (range from low, near 0, to greater than 1); this defines whether this market is:

- perfectly competitive;
- an oligopoly; or
- a monopoly.

We can discuss how real markets differ from these theoretical markets. Consider how a profit maximising firm operating in a perfectly competitive environment can try to change the nature of the market (move it from being perfectly competitive) and improve its competitive position with respect to its competitors. It can try to make the product in a different way from its competitors so that its production costs are lowered. It can exploit this in two ways offering customers more at the same price or offering customers the current benefits package at a lower price. If everything that the ambitious firm does is rapidly imitated by other firms, there will be a period of evolution as competitors develop more and more efficient methods of production. However, since all these changes are imitable and every advance made by one supplier will be imitated by all others, no long-term advantage will accrue and all gains will be passed to customers (Porter, 1996). The nature of the industry will not alter unless the nature of the relative scale economies changes. In this latter situation each identical output firm would realise this and amalgamation and moves to monopoly or oligopoly would occur. Barney (1991) made this point when he observed that homogeneous resources would lead to all firms implementing the same strategies, and that without differentiation there cannot be competitive advantage.

However, in a situation when imitability transfer is not rapid as it is in our ideal economic model case and the innovation allows for initial lower costs combined with scale economies the innovator of the particular resource or skill could elect to try to achieve market share by lowering price. Then by the time competitors have been able to acquire the resources required the originator has had an opportunity to gain an advantage through the development of economies of scale, which must be relatively large compared to the whole market turnover. A first mover advantage is achieved. The first mover firm has now changed the market structure and has been able to guarantee its survival at the equilibrium position of that structure. In this situation the perfectly or monopolistically competitive market will move to oligopoly or monopoly, as laggard firms are unable to achieve economies quickly enough and cease to exist. Similarly, oligopolies may move to monopolies. The reverse is also conceivable new entrants may, through the use of different technology, break a monopoly and destroy oligopolies. These ideas lead to the following propositions:

P1a. If imitable technology provides a way of increasing or decreasing relative scale economies in a market there will be a decrease or increase in the long-term equilibrium number of firms in that market, i.e. the market will concentrate or fragment.

P1b. If a firm develops a temporarily exclusive technology that reduces product cost and has the potential to lower costs further through scale economies, it will be in a position to achieve market domination if it can maintain inimitability for sufficient time for these economies to be achieved. (Whilst the technological advantage may be temporary, the economies of scale may act as a more permanent barrier to entry.)

P1c. If a firm is able to sustain the supply of greater customer-perceived value to all the market's customers and at a price that allows it be the only company in the market whose price is greater than cost, then there will be a move to monopoly.

P1d. If a small number of firms are able to sustain the supply of greater customer-perceived value to all the market's customers and at a price that allows them to be the only companies in the market whose price is greater than cost, then there will be move to oligopoly.

Note: customer-perceived value is difficult to measure but is understood as a function of customer-perceived benefits in relation to price.

Changes in organisation environments can also change the structure of markets. Important factors are the changes in customer perceptions of the product, technological innovation and the nature of government legislation. If changes in the organisation's environment change the size of the market the equilibrium state of the market can be redefined. If changes in consumer tastes and expectation change markets can change in size and in some conditions cease to exist. These issues are further discussed below.

I define changes that can impact on the nature of the long-term structure of the market, equilibrium number of firms, as revolutionary and changes that do not as evolutionary. Thus if the long-term equilibrium number of firms moves from very many (approximate perfect competition) to few (approximate oligopoly), or oligopoly to monopoly or perfect competition etc. then a revolution has occurred.

If we now relax the condition that the market has to be homogeneous, i.e. customer wants are not identical; we can consider the situation developing from a perfectly competitive single product market. When customers start showing preferences for different product features and their consequent benefits we can define the emergence of multi product markets. Multi-product markets are those markets in which different customer segments buy functionally similar products with different levels of benefits (it is clearly difficult to measure product benefits absolutely but the concept recognises that differentiation is multi-faceted and in many product groups it may be possible by, for example, surveys to order the relative level of consumer-perceived benefits). Multi-product markets can be defined as follows:

- there is a basic product with a minimum level of benefits, each buyer chooses whether s/he wants to pay more for extra benefits above the minimum;
- buyers fall into groups with similar wants;
- buyers will prefer more benefits at a given price; and
- if the prices of all products drop buyers may opt for a higher benefits product or use the money not spent on saving or alternative products.

If a multi product market emerges from a single product market then if the only variable that changes is relative economies of scale, a number of possible outcomes can be postulated depending of the nature of those scale economies.

If economies of scale are different in different segments and there are no cross-segment effects then the nature of the industry structure in each segment will be different and each segment can be regarded as a separate market. If on the other hand there are cross-segment effects on scale economies then again a number of possibilities exist that can be summed up by the following propositions.

P2. A condition for the existence of firms focusing exclusively on a narrow range of products in multi-product markets is that their market positions and resources cannot be imitated by broad-based suppliers harnessing greater cross-product economies of scale.

P3. Firms focussing on narrow range of products in a multi product market will exist if there are diseconomies associated with operating across-segments.

We can now consider the situation where resources are now inimitable and that firms can acquire resources that other firms cannot. If this happens firms can either produce products with benefits that no other firm can match or they can produce products with imitable benefits but at lower costs due to inimitable manufacturing technology. If a firm can produce any product benefits at a lower cost than its competitors over all levels of production it will gain a monopoly position on the market place. This leads to:

P4. If one firm gains an inimitable advantage in the costs/benefits ratio over all production volumes it will move to a monopoly position in the market if it uses this advantage to provide greater customer-perceived value in terms of price for a given set of benefits.

However, as argued above, if imitability only exists for a finite time and different firms can produce either superior products or lower cost products alternately, i.e. no one competitor can sustain non-scale-based superiority for a sustained period, then markets will remain in a dynamic equilibrium. In the short time an extrapolation would suggest a change in competitor numbers but the changing resource balance between competitors can keep long-term equilibriums relatively constant.

The essence of this discussion is that strategic management is grounded in economic theory and it is this theory that can be used to govern research and practice. Thus from the axioms of economics theoretical idealised markets propositions can be developed and used to discus real markets. The propositions are essentially analytical and their usefulness is judged as to the extent to which they can explain phenomena in real markets and guide managerial action in such markets. Strategic management is thus an applied science or technology based on other disciplines including economics and psychology.

External environments and market structures

However, we need to discuss more fully the idea of causality (Porter, 1991; Powell, 2003) and address the question as to potential sources of inimitability. Firms do not act in isolation; they are influenced by forces that change their markets. Markets are influenced by the actions of firms and markets are influenced by events beyond the control of firms which in turn influence the actions of firms. The task of management is to understand the impact of events on their markets, not the nature of the events themselves. We have indicated the motivations of firms' managers to be maximize their own organisation's chances of survival as a driver for change. Thus the task of the manager remains the classical strategic management one of understanding both their internal and external environments (Johnson and Scholes, 2002; Williamson *et al.*, 2004). However, the focus is on understanding the firm as a component of a market that is moving to equilibrium that may itself move before it is achieved. The implications for managers in thinking about long-term survival are that it focuses their attention on the long-term impact of actions and events in specific ways. There are a number of questions that strategic managers working from this perspective face:

- What will be the impact of change to the market size (demand for the product) on my firm and other firms in the industry?
- What actions can change scale economies in the market?
- Will the market become more or less segmented and what changes will drive such events?
- What are the factors that could lead to the development of inimitable resources in this market?
- Where will our firm end up if nothing changes?
- How can we change or maintain equilibrium destiny?

As the environments of firms change the sizes of their markets can change. Changes in the size of demand do not change absolute scale economies but can change relative scale economies. So a reduction in market size can change the long-term equilibrium point. Thus firms with an eye on survival should be considering the impact of factors that change market size and relative scale economies.

For instance the attack on the World Trade Center reduced the number of US citizens travelling on airlines, the occurrence of foot and mouth in the UK in 2002 reduced the number of tourists travelling to that country. Whilst incidents like these are predictable as possible options in scenario building, making provisions for low probability events may be difficult to justify. Firms cannot accommodate every specific possibility, but it is suggested that they consider events generically thus addressing chance not specifically but generally.

Consumers buy from the array of products that they perceive as available to them. Thus particular wants are met by particular products at different times. Some products exist now that have not always existed and some products have become obsolete, thus either consumer wants are changing in some fundamental way or the nature of wants is changing. Thus the role of the firm trying to anticipate changing wants is to understand those changes that affect the way markets grow and change both incrementally and stepwise. Over time consumers develop wants and if the market is alert and responsive to those wants then products evolve. If there is equality between firms they develop equally. If, however, some firms or one firm is more responsive to the impact of these changes on customers' perceptions of their product they will, given the resources, be more able to offer customers prices and product features that are more attractive than their competitors. Thus changing customer perceptions offer opportunities for product development, firms who can exploit these changing perceptions may be able to change the long-term market equilibrium point. This resource imitability can be associated with market position as well as with product and processes (Srivastava *et al.*, 2001).

In those cases where incumbents have developed advantages based on relationships concerned with outside regulation of their market and then events have developed beliefs amongst legislators that such relationships are no longer consistent with meeting the needs of consumers. In these situations legislation can change and the relationships between firms and the long-term equilibrium point of the market can change as new entrants with new resources and ideas enter the market place.

So further questions are raised about market size and customer wants and the impact of these changes on the nature of the market and how any one firm can optimise its position:

- What will happen to the long-term structure of the market if the demand for the product changes?
- What is the impact of changing customer wants?
- How will the present products evolve as modified products replace older ones?
- Will the market split into segments?
- Will segments converge and the number of products segments decrease?
- Does a firm with an expertise (a resource) in environmental scanning have a potential to survive where others do not? What aspects of the environment should the firm focus on?
- Is it possible to reduce scenario planning by focusing key questions about the consequences of predictable but seemingly improbable acts taken as unique events, but less unlikely if taken as one of many potential causes of a particular effect (Quinn, 1978)?

Firm-based factors and the structure of markets

Suppose we start with the (absurd) assumption that at one point all firms are equal in perfectly competitive environments. Clearly in perfectly competitive markets it is by definition impossible for a firm to make sustained above average profits. Therefore, rational managers of ambitious firms will try to take advantage of conditions that make markets different from perfectly competitive markets.

If customer perceptions of product benefits are unchanging and homogeneous then the only way that one firm can gain an advantage is to reduce the cost of producing features that customers perceive as valuable. If, however, customers' perceptions of product benefits are either homogeneous but unbounded or heterogeneous then there are other routes to advantage. These have been discussed above.

In all cases for a firm to achieve an advantage compared to a firm operating in a perfectly or monopolistically competitive market it must achieve economies of scale (a special case of an inimitable resource) or some other inimitable resource that reduce the features/cost ratio of the product so that customers can be offered a product that is perceived to have superior value (the consumer's judgement of the ratio of price to perceived benefits) to competitive products.

In real situations the long-term imitability, and hence value, of resources is never certain so managers have to undertake activities that attempt to maximise their chances of survival in conditions of incomplete knowledge. Bognor *et al.* (1999) have discussed the nature and sources of resource imitability. A firm can obtain resources and develop resources by:

- the purchase of assets;
- the purchase of human skill;
- using the human skill to manufacture/develop tangible and intangible assets;
- using human skill to develop expertise in particular activities;
- learning and improving skill in activities through repeated performance;
- observing and copying the activities of other firms; and
- absorbing information from their environment.

It also inherits assets through the nature and location of its founders (Porter, 1990).

Strategic management under different circumstances

Firm behaviour in a market where products are identical or similar and there are many competitors (approximating to a perfectly or monopolistically competitive environment).

In this situation firms may seek to pursue economies of scale if they are available. This would suggest that firm amalgamation would take place until these economies are realised. If they are no economies of scale an ambitious firm could try to find such economies but in order to succeed would have to implement them before others. Inimitability would be required. The firm seeking such advantages is trying to change the equilibrium number of firms in the market. It is trying to precipitate a revolution in market structure.. Another approach would be to try to exploit/develop heterogeneous customer perceptions of different benefits from the standard product. This could lead to product differentiation, increased benefits products, or low cost lower than average benefits products (Porter, 1980). This would require inimitability at least in the short term for some firms while more permanent long-term advantages were developed. For example early mover advantages that could accrue are economies of scale and brand reputation. In this situation one can envisage moves to oligopoly as more successful firms gain market share.

Firm behaviour in oligopolies where products have some degree of similarity, economies of scale exist similar and there are few competitors

In situations like this a number of potential market structures exist:

- All products are similar and competitors have comparable resource endowments and comparable market share. There are an equilibrium number of competitors and they are equally matched. This is characterised as competition in times of evolution. In this situation they can compete head on and reduce the industry profits or they can collude. If they compete head on and each tries to improve production efficiency and the products' perceived value they make economic profits and pass on all efficiency gains to their customers. However, in this situation they are unlikely to attract new entrants into their industry. Imitative strategies in this situation are not likely to achieve above average profitability, so for any firm with ambitions to make above average profits as the dominant player they need to develop strategies that are likely to diminish the number of equilibrium players in the market. The firm gains an advantage that allows it to offer a higher value product than its competitors. If this advantage is sustained it will become the dominant firm. The alternative strategy is collusion whilst maintaining entry barriers so that new entrants are not attracted in by attractive profits. In a collusive environment all companies will make more profit than would be the case in a competitive environment and average profits will be high. However, in this kind of market one might expect not to find consistent performance (Powell, 2003).

- All products are dissimilar enough for one competitor to have a larger market share than other competitors. The leading firm will have a dominant position. Each firm in this situation will have different strategic objectives. If the leading firm is more cost efficient because of its size it will wish to maintain its increase in market share and reinvest its profits into maintaining its advantages. Runner up firms may also recognise that if the status quo remains they will continue to lose market share. In this revolutionary situation there will be efforts to match the offerings of the dominant firm. Industry realignment may take place as the dominant firm takes over weaker firms or stronger runner up firms take over the weaker firms in order to match the dominant firm. If collusion takes place in these kinds of environments it is likely that the key negotiator will be the dominant firm.
- The market is served by competitors offering a range of products with some suppliers having shares in different segments. The market is a multi product market. In multi-product markets, firms can either offer a range of products or specialise in specific segments. Again the profitability of firms depends on the balance of power between rivals. Decisions about competition or collusion will have to be made on the same basis as discussed above. However, a major dilemma for firms is whether they can survive as broad-based suppliers or focused suppliers. The equilibrium point for these kinds of markets could be monopoly in some segments and oligopoly in others. The automotive market is a useful case to discuss these ideas.

Managing environmental threats and opportunities

The above discussion explains how difference in resource endowments impact on firm survival. Firm s that can provide the best value products most profitably will survive. However firms must be continually aware how customer perceptions and exogenous technical advances can affect the way that customer value develops and is delivered. A key resource for successful firms is a competence in environmental scanning. Paradoxically firms need to be prepared for sudden environmental changes that can suddenly impact on demand for their product but do not have to predict the precise nature of such events. However, firms do have to be aware of the content of changes in consumer perceptions and the content of technical changes.

History suggests that firms who wish to anticipate or even precipitate sudden changes in the structure of a market can do this by:

- recognising hitherto unrecognised market opportunities by understanding consumer perceptions of value, e.g. the development of low cost airlines in the UK and Ireland; and
- exploiting new technologies before others, the rise of Amazon books.

The resource advantage is understood but imitating it becomes difficult. Dominant firms can strengthen their position by behaving like monopolists building entry barriers. This can be scale economies or brand reputation, for example Coca-Cola. Dominant firms are likely to have no motive to change a market equilibrium structure that gives them the potential for long-term domination. Runner up firms can try to ape their resource advantage by operating within a similar recipe but from a weaker position but the chances of reversing the long-term trend would appear to be unlikely.

However, if there is a significant change in technology or consumer perceptions there are opportunities for underdog or new entrant firms to change equilibrium market structures because in the new situation there is an opportunity to develop a resource that no other firm has. In this way a revolution can occur and long-run market structure equilibrium and can put the innovator in a dominant position. This becomes more likely if other firms have become complacent and believe that actions that achieved success in the past can still achieve such success in changed times (Miller, 1992)

The following hypotheses come out of this discussion:

H1. The faster the change in technology and/or consumer perceptions the greater is the risk or opportunity for firms in the industry.

H2. The faster the change in technology and/or consumer perceptions the greater is the opportunity for new entrants.

H3. When consumer perceptions and technology are changing slowly and predictably, the dominant firm may have developed enough resource capital so that the basis of its domination is understood but remains elusive to its competitors.

If markets are hypercompetitive the concept of the dominant firm then becomes a tenuous one and the idea of a long-term equilibrium market structure is difficult. The value of resources as assets and competences dedicated to production and marketing become only transiently valuable because they are candidates for obsolescence. McNamara *et al.* (2003) have investigated these ideas, they concluded that markets have not become significantly more changeable in the last twenty years. They concluded that the management of resources in the context of changing environment remains important to explanations of firm performance.

Implications for research

A conclusion from the discussion is that strategic management should involve the study of firms in the context of their market situation. This would suggest that rather than conduct cross-sectional studies of organisation performance at particular teams, market-based case studies should seek to understand how markets evolve with time. This will involve interviews with managers as well as the study of company reports and documentation. Thus historical studies would seem appropriate using company reports, newspaper reports and seeking oral descriptions by managers. This methodology will have problems including those of:

- *Managerial perceptions.* Research with managers on their perceptions of their environment has indicated that managers have different perceptions of problems depending on whether they are viewed retrospectively or contemporaneously. Thus multi sources of data will be required.
- *Variable definition.* A number of writers have commented on the difficulty in defining the variables that define competitive advantage. The concept of

differentiation is particularly troublesome because it is possible to differentiate in a number of different ways (Mintzberg, 1988; Campbell-Hunt, 2000). For this reason it is suggested that firm performance is more usefully thought of as depending on both resource and market positions. When product features (giving benefits) and costs are a consequence of a firm's resource endowments predicating market positions that are a consequence of price and benefits (The related concept of perceived value also needs further consideration). Clearly this does not solve definitional problems but at least highlights them.

Implications for managers

In this paper we outline the factors that firms need to take into account in order to evaluate their position in relation to their competitors and the kind of industry structure that these relationships imply and the long-term equilibrium that would result if these relationships remain unchanged. (Whether this kind of task is possible is another issue.)

In order to do this an algorithm is defined:

- First define your industry with reference to ideal type industries equally matched oligopoly, oligopoly with one dominant player, multi-product market segment, etc.
- Define the extent to which the industry differs/resembles from a theoretical one and the consequences that this has on the long-term equilibrium point of the industry.
- Define those factors, if any, outside the firm that are changing the way that the industry is changing (changing the long-run equilibrium point).
- Define those factors inside the firm or other firms (competitor intelligence), if any, that could change the way that the industry is changing (changing the long-run equilibrium point).
- In the light of this analysis determine whether any particular firm can influence long-run equilibrium conditions.

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