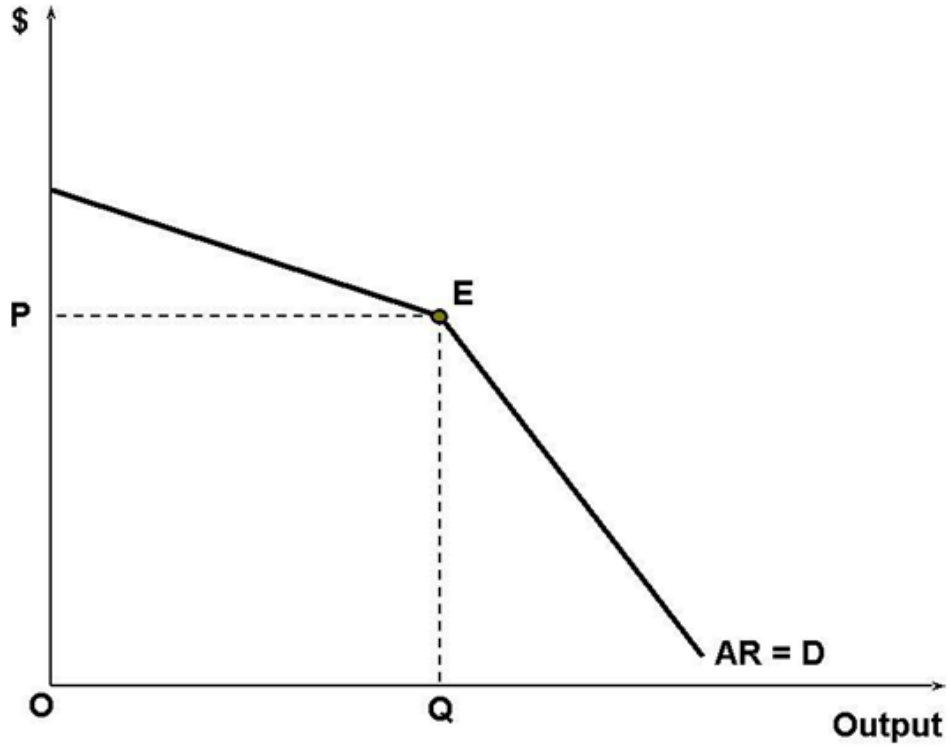
# Competitive Moves

Chapter 5 in Porter's book

# Competitive Moves

- In most industries, a central characteristic of competition is that firms are mutually dependent, i.e., firms feel the effects of each others' moves and are prone to react to them.
- In this situation, which economists call an oligopoly, the outcome of a competitive move by one firm depends at least to some extent on the reactions of its rivals.
- In an oligopoly, the firm faces a dilemma. It can pursue the interests (profitability) of the industry as a whole, and thereby not incite competitive reaction, or it can behave in its own narrow self-interest at the risk of touching off retaliation and escalating industry competition to a battle.
- See the next slide for the theoretical model of this situation.

# Kinked Demand Curve for Oligopolies



# Kinked Demand Curve for Oligopolies (cont'd)

- Above the kink, demand is relatively elastic because all other firms' prices remain unchanged. If one of the firms raises prices and the others do not follow with price increases, the firm that raised prices will find its demand fall.
- Below the kink, demand is relatively inelastic because all other firms will introduce a similar price cut. That is, if one firm cuts prices and the other firms similarly cut prices, demand will increase, but total revenues will fall. (Total revenues are calculated by multiplying Q by P, which is the area of the square shown or of a rectangle which would be formed if prices moved either up or down. The square has a larger area than any of the rectangles, which is why Point E is the place of maximum revenues.)
- Therefore, the best option for the oligopolist is to produce at **point E** which is the equilibrium point and the kink point. This theoretical model was proposed in 1947, but has failed to receive conclusive evidence for support because such price moves usually get restored to Point E so quickly that it is not possible to get data on the effect.

# Competitive Moves (cont'd)
## *The Prisoners' Dilemma*

- This situation is analogous to the Prisoners' Dilemma. One version of it goes as follows.
- Two prisoners sit in jail, each with the choice of squealing on each other or maintaining silence.
  - If neither squeals, both go free.
  - If both squeal, both get hanged.
  - If one talks and the other does not, then the squealer not only gets released but also collects a reward.

# Competitive Moves (cont'd)

- The first question for the firm in considering offensive or defensive moves is the general degree of *instability* in the industry or industry-wide conditions that may mean a move will touch off widespread warfare.
- The underlying *structure* of an industry determines the intensity of competitive rivalry and the ease or difficulty that cooperative or warfare-avoiding outcomes can be found.
- Competitive moves can be either offensive moves to improve position or defensive moves to deter competitors.

# Competitive Moves (cont'd)
## *Types of Offensive and Defensive Moves*

- **Cooperative or Nonthreatening Moves**
  - Moves that improve the firm's position and *improve* competitors' positions even if they do not match the move.
    - For example, advertising that raising primary demand.
  - Moves that improve the firm's position and *improve* competitors' positions *only if* a significant number match the move.
    - For example, changing warranty from two years to one.
  - Moves that will improve the firm's position because competitors *will not* match them.
    - For example, entering a new foreign market that is not of interest to competitors.

# Competitive Moves (cont'd)
## *Types of Offensive and Defense Moves*

- **Threatening Moves**
  - Many moves that would significantly improve a firm's position do threaten competitors, since this is the essence of an oligopoly.
  - Thus a key to success is predicting and influencing retaliation.
    - If retaliation is rapid and effective, then such a move may leave the mover no better off or even worse off.
    - If retaliation is very bitter, the initiator can actually come out a lot worse off then it started.
    - Or, in some cases, the move might provoke no retaliation, in which case the initiator comes out ahead.

# Competitive Moves (cont'd)
## *Lags in Retaliation*

- Lags in retaliation stem from four basic sources:
  - Perceptual lags
  - Lags in mounting a retaliatory campaign
  - Inability to pinpoint retaliation
  - Lags cause by conflicting goals or mixed motives
- Each is covered on the next several slides.

# Competitive Moves (cont'd)

## *Lags in Retaliation*

- **Perceptual lags** involves delays in competitors noticing the significance of the strategy move.
- For example, in the early 1950s Timex entered the watch industry with a very low-priced watch.
  - At the time, the Swiss dominated the world watch industry with high-quality, high-priced watches.
- Timex sold its watches in drugstores and other nonconventional watch outlets.
  - Swiss watches were sold in jewelry stores.
- The Swiss did not react because they perceived Timex's watches to be quite inferior and therefore not competing with the Swiss watches.

# Competitive Moves (cont'd)
## *Lags in Retaliation*

- **Lags in mounting a retaliatory campaign** vary with the type of initial move.
  - Retaliations to a price cut can be immediate
  - But it may take years to match a product or technology change
    - For example, a new automobile requires about three years from planning to introduction.

# Competitive Moves (cont'd)

## *Lags in Retaliation*

- **Inability to pinpoint retaliation** is analogous to having to disrupt a whole system to react to one small change.
  - For example, while there are a few large competitors, there may be some small competitors as well.
  - A price cut by a small competitor may be too costly to draw a retaliation, because the large competitor would have to give the cut to all of its customers and thereby lose revenues.
  - So the price cut by the small competitor may be ignored by the large competitors.

# Competitive Moves (cont'd)

## *Lags in Retaliation*

- **Lags in retaliation caused by conflicting goals or mixed motives** is a situation that has wide applicability in the study of competition.
- This is a situation in which the retaliation would hurt the competitors' business.
  - For example, going back to the Timex case, because the Swiss sold their watches through high-priced stores, it would hurt its distribution network if it followed Timex by putting its watches in drugstores.
  - The Swiss realized the strategic threat only after Timex's sales grew substantially, but even then they were limited in how they could respond.

# Competitive Moves (cont'd)
## *Defensive Moves*

- The problem of defense is, of course, the opposite of the problem of offense.
- Good defense is creating a situation in which competitors, after doing their analysis, will conclude that their offensive move is unwise.
  - The most effective defense is to prevent the battle altogether.
- However, if a competitor does make an offensive move, immediate and strong retaliation would discipline that competitor and tend to prevent it from trying such a move in the future.
  - The loss of profits during the retaliation period may be worthwhile if future conflicts can be avoided as a result.