




# Market Dynamics and Entry

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## Books on the topic by Geroski:

- (1) P. Geroski (1991): *Market dynamics and Entry* (Cambridge, MA: Blackwell)
  - (2) P. Geroski, R. Gilbert and A. Jacquemin (1990): *Barriers to Entry and Strategic Competition* (New York: Harwood Academic Publishers).
  - (3) P. Geroski (1994): *Market structure, Corporate Performance and Innovative Activity* (Oxford: OUP).
  - (4) P. Geroski (2003): *The Evolution of New Markets* (Oxford: OUP).
  - (5) Numerous academic articles
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## What I plan to do:


- ① I'd like to use the next 19 minutes to build on Paul's work by making 5 points (and raise a few questions for all of us to consider)






## Point #1: The role of new entry


*“Entry is generally conceived of as a force of discipline in markets...[It] is an additional source of supply outside the control of incumbent firms which helps to bring about competitive market outcomes. [Yet] this is a rather static view. Entry can also play a more creative role in markets, serving as a vehicle for the introduction and diffusion of innovations...” (Geroski, 1991, p. 210)*





## Therefore:

- ◎ It's important to appreciate that we could have two types of entry in any market: “*imitative*” or “*innovative*” entry. They are different “beasts”, are triggered by different mechanisms, have different effects and view barriers to entry differently.
  - ◎ Does it make sense to treat them as the same phenomenon?
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## Point #2: Which type of entry is more desirable?


- The evidence is that entry is not a particularly powerful force of discipline in markets.

*\* Excess profits persist far longer than expected and convergence to the competitive equilibrium could take up to 70 years (Mueller, 1986, 1990; Geroski, 1988).*

- On the other hand, innovative entry “...brings more benefits to consumers in the long run than does the market discipline that entry provides in the short and medium run.” (Geroski, 1991, p. 214)
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## Despite this:

- ◎ *“The data suggest that there is almost no doubt that “innovative entry” constitutes little more than a small proportion of total entry attempts...” (Geroski, 1991, p. 230)*
  - ◎ Johnson and Cathcart (1979) found innovative entry to be 12% of total entry. Gould and Keeble (1984) found this to be only 10%. O’Farrell and Crouchley (1984) found it to be 4%. *“...the bottom line, then, seems to be that, at most, 10% of all new firms are innovative entrants...” (Geroski, 1991, p. 230).*
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## Therefore:

- ① Should we be showing some more interest on how to promote not just entry in general but “innovative entry” in particular?
  - ② Do we know what promotes one type of entry over another? What role could public policy play in this? What role should business or economic departments play?
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**Point #3: Looking at imitative entry:**

*Imitative* entry could potentially erode profits in two interrelated ways:


- By increasing total industry supply (and thus driving prices down);
- Through strategy convergence, whereby new entrants imitate the strategies of incumbent firms.

***Do we know the relative strength of the two effects?***

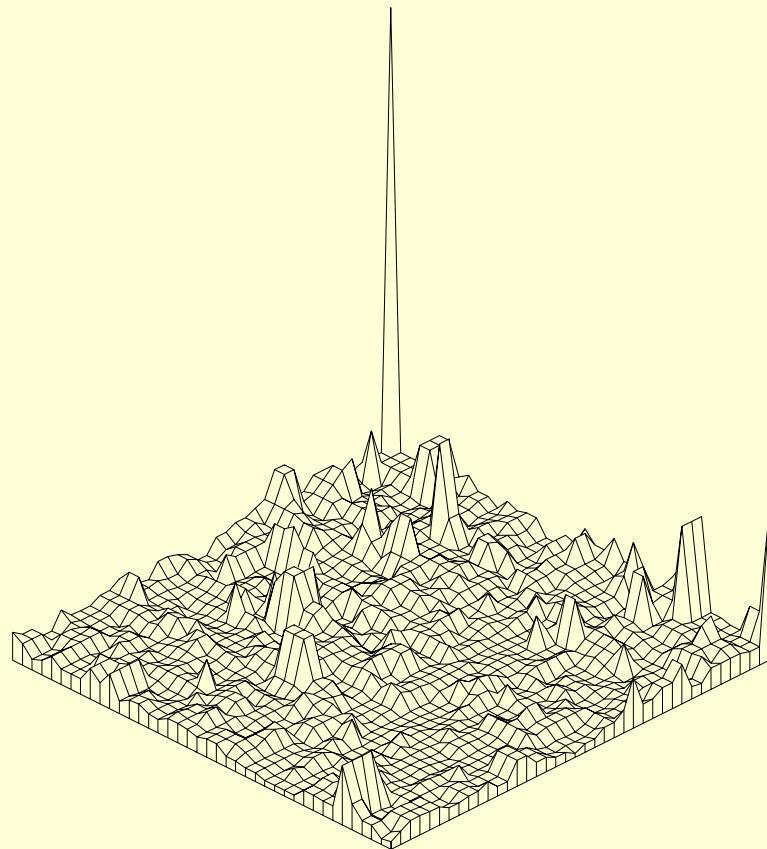
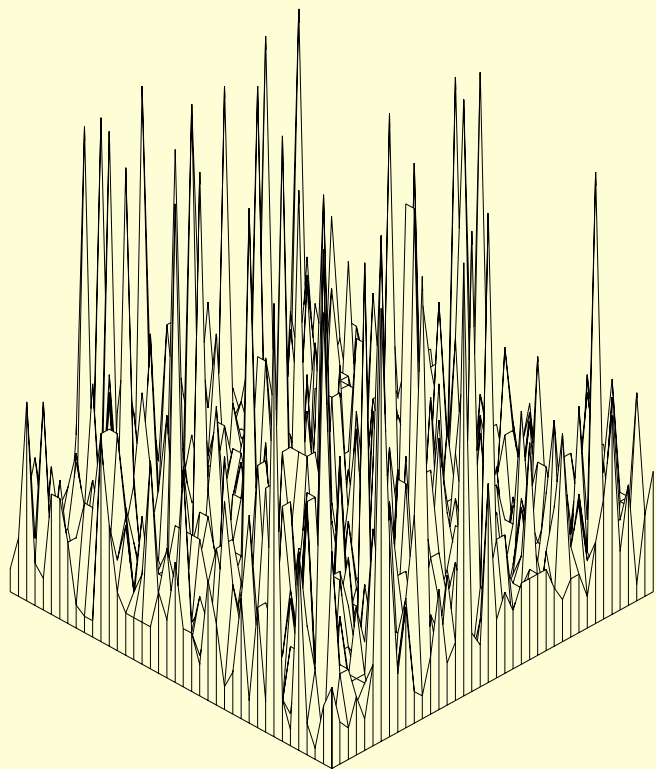




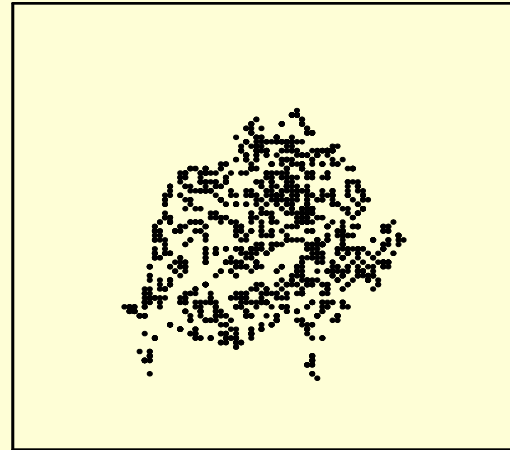
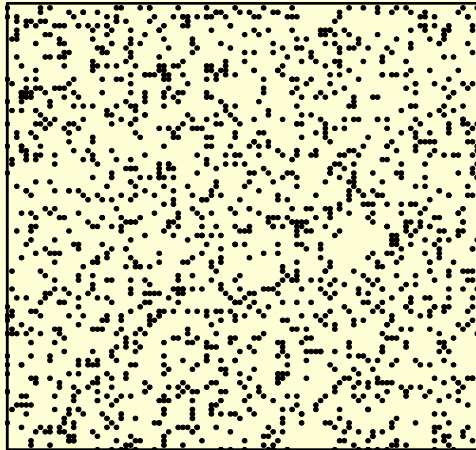
## Why is this important?

- ◎ Because the “strategy convergence” process could produce a *socially inefficient* outcome. In their efforts to imitate each other, firms could focus their attention on narrow strategy spaces and neglect other strategy options that could lead them to unexploited pockets of profitability. This leads to under-exploitation of available resources in the industry.
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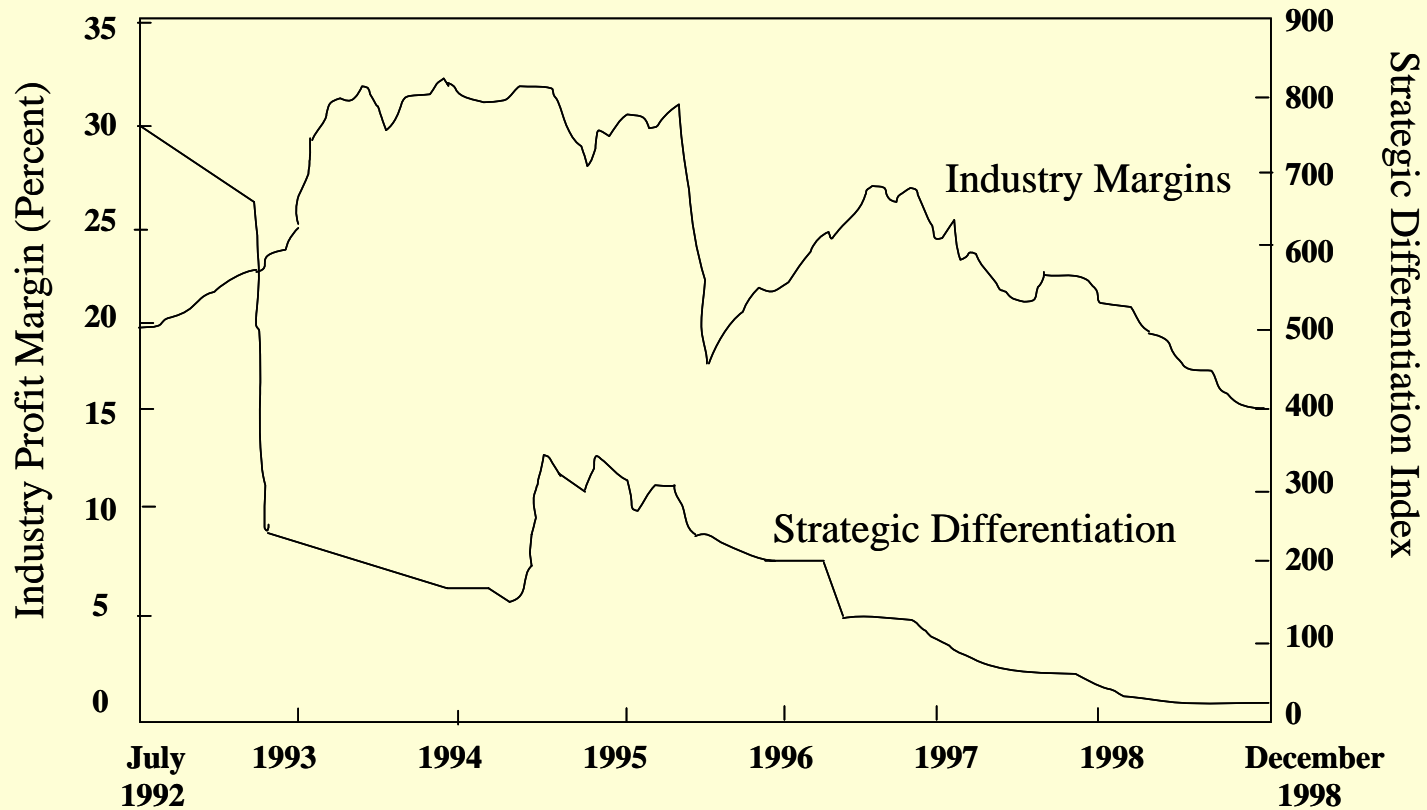
# Profitability of firms in time=1 and t=100



# Distribution of Firms in the Strategy Space




# Strategy Convergence and profitability in the German Mobile Phone Market, 1992-98






## Empirical results:

- ① Strategic differentiation in the industry declined by 83% in the period 1992-98. This reduced industry profitability by 50%.
  - ② By contrast, the addition of new capacity by new entry caused a 19% decline in industry profitability.
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## Therefore:


- ① Imitative entry might not be as “beneficial” as we assume?
  - ① How can we discourage entry that leads to “strategy convergence”?.
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**Point #4: Looking at innovative entry:**


*“The effects of entry on innovation vary over the product life cycle in various systematic ways...” (Geroski, 1991, p. 214)*

*“Entry often plays a major role early in in the life of most products...in early stages, outsiders are the source of most innovations and use these as a vehicle of entry...[As the market evolves], there is a shift from product towards process innovation...” (Geroski, 1991, p. 239)*





## But how about “business model” innovations?

- ① New entrants can often enter a mature industry through business model innovations. This can enlarge the market by offering a new value proposition that attracts “non-consumers” into the market (e.g. easyJet).
  - ② The new value proposition can also enlarge the existing market by encouraging existing consumers to consume more (e.g. Amazon).
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# Innovations in the Business Model?

Ford (model T)

Dell

Sony (walkman)

IBM (personal computers)

Southwest

University of Phoenix

Nestle (Nespresso)

IKEA

McDonalds

Swatch

Sephora

Komatsu

Starbucks

CNN

USA Today

Canon (copiers)

Kresge (K-Mart)

Wal-Mart

Charles Schwab

easyJet

Texas Instruments (calculators)

Amazon

Enterprise

Home Depot

Body Shop

Ebay

Kodak (in the 1880s)

P&G (disposable diapers)

Nucor

Travelocity

Honda (70cc motorcycles)

Bloomberg

Edward Jones





## Established Companies or New Entrants?

~~Ford (Model T)~~

~~Dell~~

~~Sony (Walkman)~~

~~IBM (personal computers)~~

~~Southwest~~

~~University of Phoenix~~

~~Nestle (Nespresso)~~

~~IKEA~~

~~McDonalds~~

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~~Bloomberg~~

~~Edward Jones~~



## Therefore:

- ⦿ We need to re-think what we mean by “innovation”. It’s not just new products or new technologies. It could be new business models.
  - ⦿ Business model innovations increase consumer welfare. How could public policy encourage this type of innovation?.
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## Point #5: The role of small Vs Big firms:

*“It appears to be the case that large firms often produce rather minor innovations, relying heavily on small firms for basic ideas...”*


**(Geroski, 1991, p. 222)**

*“Entry and outsider firms are almost certainly likely to play a major role in the diffusion of new innovations...”* **(Geroski, 1991, p. 229)**





**It depends on what we mean by  
“innovation”**

- Small firms and new entrants are good at “creation”
  - Large firms (established incumbents) are good at “scaling up” new, radical products.
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## Innovation is two things:

**Creating a new market, that if successful, grows to become a niche.**

**Scaling up this niche into a big mass market**

### **Examples**

**Apple vs Palm**


**Osborne vs IBM**

**? vs Ford**





## Scaling up a market

- **Build the product economically and sell at mass-market price (it doesn't have to be technologically the best!)**
  - **Build consumer confidence in the product (Brands!)**
  - Build the distribution for the mass market
  - Help grow complementary products
- 




## Horses for courses

Small, start-up firms are good at creation

Big established companies are good at scaling up




Each should focus on what  
they are good at!





## Therefore:

- ① Should we be encouraging the organisational model that already exists in “creative” industries (Caves, 2002)?
  - ② Should we be re-evaluating the role of “big” firms in innovation?
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# Get to Work

Any given market only evolves once and explaining why it follows the route that it does requires the skills and methods of a historian as much as it does those of an experimental physicist.

**(Geroski, 1991)**

