To Response or Not To Response:
Competitors' Response to Leading Firm's Strategic Action-Considering Customer Benefit

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Abstract

This study intends to analyze how a firm's action which might shrink customer benefit has an impact on competitors' subsequent reactions. Our study has its own distinctiveness that we have considered customers who actually have influences on competition dynamics.

Unlike previous researches on strategic action and reaction, our study has attempted to approach from customer benefit perspective that has not been considered in micro rivalry area. Based on previous researches on micro rivalry, institutional theory, red queen effect, customer benefit, we have drawn three interesting competing hypotheses.

Key words: micro rivalry, strategic action, customer benefit

Introduction

"Outback Steakhouse – Offered 10% discounts and anniversary coupons from the day of membership card issued. However, its policy has been changed so now customers can only use their membership cards after they have their membership cards registered online from august 2009", "TGIF – Stop serving free breads, and removed free soup and drink from lunch set menu", "Bennigan's – Altering free chicken salad to one glass of wine for membership customers", "KFC – Excluded salad from smart-choice menu", "Pizzahut – No coupon issued for Fresh-delight pizza, no discount benefit is offered"[1]

These are actual cases that some renowned Korean restaurants have removed free services and coupons that they had been served by the year of 2009. Customers would be perplexed when they realized their regular restaurants have restricted free services. Ultimately, this restriction would have impact on future customer choice. Moreover, not only to customer choice, it is apparent that one firm's action would affect competitors' reaction.

Stimulated from above cases, we would like to analyze how a firm's action which might shrink customer benefit has an impact on competitors' subsequent reactions.

Though firms are not restricted by regulation, they voluntarily show some actions that might shrink customer benefit. Especially, customer benefit shrink action is frequently taken by market leading firms.

This leads us to wonder how other firms react to the actions of leading firm. Do they imitate the action of leading firm? Or, do they attempt to de-thrown the leader by offering benefits

[1] Newsis, 2009-02-04. "Higher dining expense for coming Valentine' day".

that the leader has eliminated? Or is it also possible that followers take wait-and-see strategy rather than show instant reaction.

From above standpoint, this study has laid its focus on firms' strategic actions and responses. For this research, we have set up research hypotheses how top firm's strategic actions which might shrink customer benefit impact competitors' reactions.

Having distinctive research perspective from previous researches on strategic actions and reactions(Smith et al., 1991; Miller and Chen, 1994, 1996; Ferrier et al., 1999; Chen and Miller, 1994, 1995; Chen et al., 1992; Chen, 1996; Derfus et al., 2008), this study attempts to conceptualize firms' strategic actions from new point of view. Specifically, this study approaches strategic action with the angle of customer benefit. Literatures on micro rivalry have dichotomously categorized the entity of action as 'focal firm' and its 'rivalry'. However, this study has its own distinctiveness that we have considered customers who actually have influences on competition dynamics. This customer benefit oriented perspective has reflected on categorizations of firms' competitive action. Therefore, this study would be a pioneer research categorizing types of actions focusing customer benefit.

Also, this study puts equivalent emphasis on top market share firm as the entity of strategic action. Previous researches have been criticized for executing empirical researches without clarifications of strategic action entity(Smith et al., 1991; Miller and Chen, 1994; Ferrier et al., 1999; Chen and Miller, 1994, 1995; Chen et al., 1992; Chen, 1996). Ultimately, this limitation has led that these researches is lack of clear understanding on actions of top performer and reactions of rival competitors. There would be substantial difference between firms reaction scale to the action of top performer and that of second-tier performers. It can be predicted rival firms would detect and react most sensitively toward strategic actions of leading firms which have great impact on entire market. It has been verified that market position actually has significant influence on reactions of rival firms(Derfus et al,. 2008). From this logic, this study focuses on the strategic actions of number one firm in market and specifies the entity of strategic action as firm with the largest market share.

In this research, we would like to propose new perspective on strategic actions along with the prediction whether there would be difference between reactions toward customer benefit-reducing strategic actions and customer benefit-increasing strategic actions. In assessing this prediction, we have proposed competing hypotheses with various theories from institution theory, resource-based theory, as well as red-queen effect theory. Research hypotheses on propensity to imitation, likeliness of response, average response lag have been presented.

From following chapter, previous research streams of micro rivalry would be presented. On the top of literature review, competing hypotheses on main issue and their logical background are suggested. Conclusion and directions for future research will be presented later on.

Theoretical Background

Researches on Micro rivalry

Micro rivalry has been defined as firms' competitive moves in a certain market, and their exchange relationships(Porter, 1980). According to some researchers, micro rivalry is shaped when firms exchange competitive actions, and the essence of micro rivalry could be defined as aggressive action and reaction(Chen, 1996; Chen and MacMillan, 1992; Chen et al., 1992). Following the logic of game theory, when a firm takes certain action leaves two available options to competing firms. First option is showing response, and the second option is not(Chen et al., 1992). Therefore, the analysis level of micro rivalry can be simplified into action-reaction dyad(Chen and MacMillan, 1992). This also leads micro rivalry analysis has laid its purpose on analyzing competitive dynamics among firms through the lens of action and reaction scheme.

Micro rivalry research has its origin in critiques on industrial organization perspectives which view industry structure affects actions in that industry, and firm actions also have influence on firm performances. This perspective is called as S-C-P model(Caves, 1984), and assumes that actions and reactions are identical in the same industry without considering firm resources and capabilities. The motives of micro rivalry can be explained by resource-based view that firms' interactions seek to attain scare resources is shown in action-reaction scheme(Clarke-Hill et al., 2003).

Micro rivalry researches have been executed by some noticeable researchers, most of the researches define types of actions and empirically validate reactions. Among them, Smith et al.,(1991) categorized actions and reactions in American domestic airlines industry. They executed empirical study in order to identify various factors which affect reactions to relevant actions. Chen et al.,(1992) also studied characteristics of actions in order to predict reactions through 32 American domestic routes from 1979 to 1986. In the study of Miller and Chen(1994), they have defined competitive inertia in order to explain the motives of strategic actions. Regarding inertia, previous researches viewed inertia as internal concept, while Miller and Chen(1994) has enlarged this concept by considering external environment and competitive relations. Three factors which cause inertia are intensive to act, awareness of action requirements and alternatives, constraints on managerial action. Based on the study of Miller and Chen(1994), Chen(1996) suggested theoretical framework for inter-firm rivalry. In his research, Chen(1996) refined sources of competitive inertia as awareness, motivation, and capability. Preceding variables might affect competitive inertia are market commonality and resource similarity. Those two preceding factors have been studied by Gimeno and Woo(1996) for hyper-competition. Chen and Miller(1994) have suggested 'chain and gate model'. In their research, close rivals competing in similar areas(like strategic groups) have high level of awareness to each other. Therefore, they tend to show high level of reaction to certain action. Those research results can be regarded to support the golden rule in the theory of multimarket competition. It has been empirically proved that rival companies competing in several markets tend refrain from aggressive attacks in adjacent areas.

Miller and Chen(1996)'s research also enlarged the research scope by including diversity of customer demand in industry, industry growth rate as environmental factors for micro rivalry. This study has considered not only the impact of focal firm's strategic actions on rival's reaction, but also attempted to include performance variables. Specifically, this study has investigated economic motives of firm's conformity action and nonconformity action in the perspective of social relationship.

Among recent micro rivalry researches, Derfus et al.,(2008) studied the impact of focal firm's action on the level of rival's strategic reaction, and ultimately the impact on performance. They have also considered moderating variables as industry characteristics(industry concentration and demand characteristics), and market position.

Summarizing micro rivalry literatures, mainstream of the research is defining focal firm's action types, and how actions have certain impact on rival's reaction. It is also noticeable that recent researches additionally consider industry characteristics and internal factors.

Here forth, types of action and triggers by action will be discussed in more detail.

Type of Action

Austrian school has focused on the asymmetry of market. According to Austrian school, market leadership cannot be stable or internal. Therefore, status in a market is constantly influenced by rival firm's competitive move. The notion of action can be interpreted as aggressive moves which contain intention to threat rival. Schumpeter(1982) stated that though

a firm accomplished market leadership by competitive action, it cannot maintain current market status without additional actions. If competitive action is defined as new moves challenging current market status-status quo(Jacobson, 1992), new competitive action is viewed as new and idiosyncratic competitive action(Ferrier and Smith, 1999). For summary, new competitive action can be defined as action with intention to destroy status quo(Kirzner, 1997). This is distinguished point from previous competitive action view.

Some research defined action as specific and observable competitive move that prevent competitive position(Smith et al., 1991).

In the study of competitive inertia, Miller and Chen(1994) categorized actions into strategic and tactical actions. According to this study, tactical actions might include price changes, advertising campaigns, and incremental product or service adjustments. Strategic actions might include major facilities expansions, M&A, strategic alliances, and important new products or services. Therefore, it can be said that strategic actions might include lager expenditure of resources, longer time horizon, and a greater departure from the status quo than that of tactical actions(Galbraith and Kazanjian, 1996; Dutton and Duncan, 1987).

This study has attempted to define actions of leading firms as “direct and observable moves with the intention of fortifying competitive status” (Smith et al., 1991) based on Austrian perspective. From similar logic, reactions of rival firms can be defined as “specific and observable reactions to competitive status protection moves of leading firms” (Smith et al., 1991).

As discussed earlier in the introduction, this study seeks to investigate strategic action focusing its impact on customer benefit. Customer benefit researches have been heavily studied in Marketing area. Chandon, Wansink, and Laurent(2000) classified customer benefit into hedonic customer benefit and utilitarian customer benefit. First, utilitarian benefit is consisted of saving benefit, quality benefit, and convenience benefit. Saving benefit let customer perceive monetary savings like lowering unit prices or free promotion. The level of price deduction and the difference from reference price makes customer perceive monetary savings and promote willingness to pay. Convenience benefit reduces exploration cost which leads to increase shopping efficiency. Convenience benefit reminds products to customers and helps them to find products they would like to purchase. However, hedonic benefit has been classified value expression benefit, information benefit, and entertainment benefit. Customers with value expression perceive self image and extended desire for personal value(Schindle, 1992). Information benefit satisfies customers needs for exploration, diversity, and information(Baumgartner and Sttenkamp 1996; Kahn and Louie 1990). Entertainment benefit provides customer promotions, contests, and give-away products.

However, customer benefit classification is limited to firms’ actions might increase customer benefit. There haven’t been ample researches from the perspective of customer benefit increase or decrease. Therefore, this research has laid it fundamental objective as classification firms action that might increase or decrease customer hedonic or utilitarian benefit.

Triggers by Action

Smith et al,.(1991) predicted that certain action in a market triggers response, and they empirically tested with action and response data from American domestic airlines industry. Response refers certain reactions toward other firm’s attempt to maintain or increase its market status(Porter, 1980). Smith et al,.(1991) identified four attributes of competitive response-response likelihood, response imitation, response lag, and response order. Response likelihood is the degree of reaction toward rival’s action, response imitation is degree to

which a response mimics an action. Response lag refers time until response, and response order means response order in certain market.

Chen, Smith, and Grimm(1992) emphasized that response is predictable based on the characteristics of action. In 1991, Chen only considered attributes of response. However, in his later research(Chen et al., 1992) they analyzed action and response equivalently. In their research, Chen et al.,(1992) identified attributes of response as number of rival firms, and response lag. The competitive advantage of initiating firm tends to shrink as response increases, which leads to lose its monopolistic advantage(Mansfield, 1968; Nelson and Winter, 1982). When a firm introduces new technology or moves to new market, it has been proved that the longer response lag, firm shows lower performance, quick response facilitates higher performance. In this study, attributes of response are response lag and the number of response firm.

Chen(1996) presented new perspective that market is formed by interactions of actions and responses. He considered characteristics of both market and firm capabilities to identify preceding conditions of actions and responses, and performance variables initiated by those preceding variables. Competitors have been categorized by market similarity and resource similarity. Those similarities are preceding variables to predict action perception, motive, and ability. Chen(1996) has discovered circular structure since performance variables affect market share, and market share also has an impact on market and resource similarity.

On the other hand, Ferrier, Smith and Grimm(1999) have attempted to connect the consequences of action to market performance. They concluded that firm's total competitive action, action timing, action repertoire simplicity, and leader-challenger action dissimilarity have substantial impact on market share and market leader status.

Since our study could be recognized as the first research to classify action type based on customer benefit, the main concern is figuring out how action types influence rival's response from customer benefit lens. Explanatory variables are as follow: propensity to imitation, likelihood of response, and response lag.

Research Hypotheses

Action Type and propensity to imitation

Since a firm shows its reaction after analyzing other firm's action as opportunities and threats, not every firm would show identical reactions to certain action(Chen, 1996). If a firm takes an action that might negatively affect customer benefit, its products and services would not be chosen by customers, and risk itself to lower market share. Therefore, taking an imitation which might cause negative effect on customer benefit will be perceived as threat a reacting firm. Rather than simply imitating, a firm would conceive the same action of a leader as opportunity to higher market share. This is because simple imitation only strengthens the competition intensity, and lowers market share(Smith et al., 1991). From this logic, we can predict that certain action which negatively impact customer benefit will show lower propensity to imitation.

On the contrary, if a firm takes a strategic action that increases customer benefit, customers would show high sensitivity to that strategic action. Then market demand will arise, initiating new customers' influx. This can be interpreted that customers show tendency of herd action act and think similar to others(Robert, 1995). Other things being equal, if a firm takes action offers higher customer benefit would earn higher market share. For this reason, competing firms would consider inability to imitate customer benefit increasing strategy as a possible threat to them. If firms provide products and services with higher customer benefit, customers may possess higher satisfaction level. This tendency leads products and services which can guarantee higher level of customer benefit are only survived in markets. Therefore, we are

also able to find snowball effect tendencies that if a few rival firms initiate actions might boost customer benefit, other firms also imitate their actions in order to satisfy customer expectations(Farrell et al., 1985). Therefore, an action that might decrease customer benefit would show higher propensity to imitation.

From above discussion, we have drawn the first research hypothesis as follow.

H_1 : Leading firms' type of action categorized by customer benefit will be related to rival firm's propensity to imitation.

[Specifically, an action that decreases customer benefit would lower the propensity to imitation of competing firms, while an action that increases customer benefit would higher the propensity to imitation of competing firms.]

Chen et al.,(1992) have specified that reactions would be differ by rival firms' reputation. This is because firms have tendencies to put reference points on actions of higher market status firms. Following the logic of institutional theory, individual firm converges itself to other firms' strategies in attempt to overcome cognitive limitations. This mimetic isomorphism secures legitimacy of strategy, and ultimately resources from suppliers as well as customers(DiMaggio and Powell, 1983). Because mimicking others who already have achieved legitimacy from market would positively impact on firm performance. Leader has earned legitimacy form market, so that leading firm also has secured legitimacy for its strategic actions. The legitimacy makes followers who possess lower market share follow the leader(Haveman, 1993). Also, leaders' actions are highly visible compare to followers, which makes them well inspected and stand out(Burns and Whole, 1993). From this logic, we may predict that following firms attempt to imitate leading firms actions regardless of customer benefit enhancement. Therefore, the propensity of leading firms' action is not influenced by actions categorized by customer benefit. So we have drawn the hypothesis as follow.

[Alternative Hypothesis]

H_1' :Leading firms' type of action categorized by customer benefit will not be related to rival firm's propensity to imitation.

[Specifically, Propensity to imitation will not show significant difference between customer benefit –increasing action and decreasing action.]

Type of action and the likelihood of response

As we have discussed earlier, this study attempts to cover general issues on market leading firm's action, and predict how the rest following firms would response. We can assume that the likelihood of response toward leading firm's predictable action would be higher that of non-leading firms. Regarding customer benefit increasing actions, other things being equal, it is also can be predicted that customer would show higher preference. However, customer benefit decreasing action is hard to predict how competing firms and customers would response. This is because embedded information in this action is not familiar with rival firms, at the same time, this information is conceived as higher uncertainty, the likelihood of response would be low(Smith et al., 1991). Based on above discussion, following hypothesis is suggested.

H_2 : Leading firms' type of action categorized by customer benefit is related to rival's likelihood of response.

[Specifically, an action that decreases customer benefit would lower the likelihood of response, while an action that increases customer benefit would higher the likelihood of response.]

As we have discussed in the theoretical background section, ‘chain and gate model’ which has been theorized by Chen and Miller(1994) predicted close rival firms would show high level of awareness toward each other, and response sensitively since they possess similar responsiveness and damage level. This can be translated close rivals basically assume that competitors take actions with clear intensions. Therefore, regardless of rival’s action type, close rivals may show similar level of responsiveness. The concept of generational technology change(Lawless and Anderson, 1996) might add logical validity to the type of action would not have significant impact on the likelihood of response. Regards generational technology change, this concept represents obvious technological development within technological regime. However, succeeding technology does not completely substitute existing technology, and the value of existing technology is still remained. Adding this concept to our chain of logic, we may assume that showing any type of response preserves current market share despite the fact rival’s strategy is not same as ours. Therefore, rival firms would response when leading firm takes certain action regardless of customer benefit.

[Alternative Hypothesis]
H_2’: Leading firms’ type of action categorized by customer benefit will not be related to rival’s likelihood of response.
[Specifically, likeliness of response will not show significant difference between customer benefit increasing action and decreasing action.]

Action type and response lag

Valuable, rare, inimitable, and hard to substitutable resource provides sustainable competitive advantage to firms, and secures market position(Barney, 1991). Resource is clearly the source of sustainable competitive advantage. Regards this perspective, Barney(1986) has held his theory that every factor can be traded in factor markets. However, Dierickx and Cool(1989) separated asset into stock and flow. Unlike flow asset, stock asset takes time to accumulate within firm and bended with corporate culture or organizational structure. Because of market imperfection, not every factor can be traded in market. This ultimately leads us realize that not every firm identically can possess valuable resources. Maintaining the latter perspective, we would like specify average response lag concept. Most customer benefit increasing action requires additional resources like facility, professional staff, or management effort. Therefore, decision should be made regarding resource reallocation and reconfiguration. Compare to customer benefit decreasing actions, customer benefit increasing strategic actions tend to have complicated decision making process as well as resource acquisition cost is accompanied. For these reasons, when a leading firm takes customer benefit increasing action, rivals need substantial amount of time to prepare necessary resource, leads to low level of imitation(Smith et al., 1991). Consequently, this will increase average response time lag of rival firms.

H_3 : Customer benefit increasing type of action will have positive impact on rival firm’s average response lag.

On the contrary, type of action will have negative impact on rival firm’s average response lag can be explained by red queen effect.

Regards environment and individual firm relation, traditional researches insist environment unilaterally controls firms, interactions between environment and firms have not been seriously considered.

Red queen effect is typically used term in ecology, Derfus et al., (2008) have attempted to apply this concept to corporate market environment. Red queen effect shares similar context with co-evolution concept, which means continuous interactions and evolutions are involved. In the world of co-evolution, a firm interacts with market through constant evolutions and builds short-term balance in that market. Derfus et al.,(2008) have defined active interactions between firms and market as their basic premise. This minimizes time gap of firm interactions, requires rapid response toward rival firm's strategic action. As long as its slack resources and firm resources are allowed, average response lag will be shortened. Specially, firms tend to show sensitive responses toward customer benefit increasing strategy since it accompanies fast reactions from customers(Derfus et al., 2008). Since rival firms and surrounding environment are constantly evolving, a firm would response swiftly at least not to fall behind. Consequently, we can predict that customer benefit increasing action type will show negative impact on average response lag of rival firms.

[Alternative Hypothesis]
H_3' : Customer benefit increasing type of action will have negative impact on rival firm's average response lag.

Conclusion and Directions for Future Research

Unlike previous researches on strategic action and reaction(Smith et al., 1991; Miller and Chen, 1994, 1996; Ferrier et al., 1999; Chen and Miller, 1994, 1995; Chen et al., 1992; Chen, 1996; Derfus et al., 2008), our study has attempted to approach from customer benefit perspective that has not been considered in micro rivalry area. Having been noticed that there are plenty cases of customer benefit decreasing activities, this can be interpreted as an attempt to overcome limitation of strategic approach that only concerns customer benefit increasing actions like price cutting or free services. This may raise a critical issue on micro rivalry in strategic dynamics domain that they haven't fully considered characteristics and types of strategic actions. Moreover, our study may contribute bridging micro rivalry and customer benefit research that provide wider and fresh perspective. Along with theoretical contribution above, we also expect that this study also provide valuable implications for practitioners. First, we have attempted to predict directions of strategic actions as well as logics to infer rival's responses. Second, this study has attempted to make practitioners understood the mechanism of customer benefit increasing or decreasing actions and responses. Also, this study might help decision makers to plan regarding this issue, make them predict rival's responses for future reference.

Though we may receive some credits for those theoretical and empirical contributions as the first study to categorize strategic action type, we have to admit that there are some limitations like other studies of initial stage.

For this reason, we need to further specify how those strategic actions might impact focal firm's performance. From similar standpoint, munificence logical ground for dynamics of action-response-re-attack chain is highly required.

If we can overcome those limitations mentioned above, this study might take one further step toward theory that provides substantial implications. We also expect bridging this research to diverse strategic dynamic domain like multi-market contact(MMC), strategic group.

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