

Rivalry

Let's now talk about rivalry. Rivalry can manifest in multiple ways. The most destructive form of rivalry is a price war among the industry players. In fact, competition on dimensions other than prices such as features, brand, advertising, etc., can increase willingness to pay and, therefore, may be good for the industry.

When does industry competition intensify? That is, rivalry increase. This can happen due to a number of factors. One maybe industry concentration. Concentration measures the number and size distribution of market players. The most common measure is a four firm concentration ratio, which is calculated by summing up the market shares of the top four firms in the industry.

There are other measures too, such as the Herfindahl ratio. In an industry dominated by a single player, for example, Microsoft in operating systems, firms have a greater freedom to set prices. Even in other cases where concentration is high, such as coke and Pepsi in soft drinks price, competition is likely to be muted and will instead be based on advertising, new product development, etc.

As an industry fragments, rivalry will increase significantly. If the industry is slow-growing, incumbent players are more likely to grab market share from each other to support their own growth objectives. This is particularly true in mature or declining industries. Rivalry can also be influenced by the homogeneity of competitors and the diversity of their approaches to competing.

Diversity, here, refers to the similarity in origins, objectives, cause & strategies of key industry players. Higher the diversity, higher the price competition.

Consider Apple, Samsung, Amazon. While Apple and Samsung seek to extract higher hardware margins, Amazon priced its Kindle low in the hope of selling more content. In contrast, Apple sold songs at less than a dollar while the iPod was priced very high.

Consider Coke and Pepsi, a good example of homogeneity. Higher the homogeneity as in the case of Coca-Cola and Pepsi in the soft drink industry, lesser the chances of a dog fight as competitors are evenly balanced, can read each other's signals, and replicate each other's actions.

Cost conditions also influence rivalry, high fixed cost when combined with low marginal cost. Good examples are airlines can feed rivalry. As we saw earlier, in such cases, firms may attempt to achieve scale economies by cutting prices to increase market shares.

Further, if companies offer products or services that are perishable or have high storage costs as in the case of airlines and hotel rooms, the intensity of rivalry increases further.

The next factor, influencing rivalry is product differentiation. When competing products offered are similar or the brands are weak, there is likely to be more competition based on prices. Examples of these are commodity industries, airline industry, petrol stations and so on.

If the switching costs between rivals products are also low as in the case of petrol stations or airline seats, rivalry, again, increases. Excess capacity, even intermittent excess capacity due to cyclical chunky additions to capacity, can intensify rivalry. In many process industries, capacity is added in chunks. On the other hand, the fashion industry is cyclical and that causes a supply-demand mismatch at regular intervals. Under both these conditions, rivalry may be intensified.

If the exit from an industry is difficult, incumbent firms are forced to stay on and fight even when they're incurring losses. Exit may be difficult because of a number of factors including the presence of highly specialized assets, regulatory constraints, strategic interrelationships between different businesses that the firm may own, or even emotional barriers to exiting an industry a problem that entrepreneurs, in particular, may face.