Multimarket competition
Theory and evidence

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The multimarket perspective identifies potential entrants as existing firms in related markets. The paper uses this new framework to analyze entry strategies and entry deterrence. Successful entry-permitting and entry-deterring strategies require understanding of the feedbacks from the entry market to the home market and vice versa. The multimarket perspective integrates literature on industrial organization and strategic management.

1. Introduction

Potential entry is a challenge to strategic management (SM) as this topic raises issues such as the identification of potential entrants, the selection of entry markets and the scale of entry. SM theory recognizes the key importance of potential entry [Porter (1980)]. This is an area where industrial organization (IO) has made many useful contributions [Gilbert (1989)]. Yet it can be argued that the mainstream of IO centers on entry by new firms [Kottke (1962, p. 25)]. If, however, potential entrants are existing firms, their home market can be of crucial importance to their entry strategies. A steady flow of literature within IO and SM emphasizes this point. Multimarket competition is a new framework that integrates the isolated pieces of literature. The key feature of multimarket competition is that inside (that is, from within the set of related markets) rivals are able to (relatively quickly) overcome barriers which are unsurmountable to outside (that is, from outside the set of related markets) entrants.

Multimarket competition introduces new elements into strategy choice. This paper illustrates the implications of the new framework of multimarket competition for business strategy by reviewing relevant literature and putting dispersed contributions into a unifying perspective. The framework opens up perspectives which are relevant for decision making by multinational, diversified and/or integrated enterprises. Section 2 introduces multimarket
competition. Section 3 presents empirical evidence. Section 4 deals with entry deterrence and entry strategies. Section 5 summarizes the argument.

2. Multimarket competition

Porter's (1980, p. 4) famous schedule of 'Forces Driving Industry Competition' identifies five sources of (potential) competition. His concept of extended rivalry encompasses rivalry with other incumbent firms ('he'), threats of substitutes, potential entry and bargaining power of suppliers and buyers. Each incumbent firm buys inputs in input markets and sells output in output markets. The firm's suppliers and buyers not only exert bargaining power, but they are also potential entrants ('she') if they integrate forward or backward. Substitutes can be demand substitutes, if a technically different product serves similar needs, or technical substitutes, if an existing supplier can switch production from the substitute to the incumbent firm's product. Thus the forces of potential competition which an incumbent firm is facing, are related to the constellation of markets in which he operates.

The new framework of multimarket competition complements Porter's argument by distinguishing five key features that drive rivalry if firms meet in multiple markets: (1) focus of rivalry; (2) resource economizing entry; (3) multimarket spillovers; (4) one-sided and reciprocal entry; and (5) multimarket collusion. Specific sources of inspiration are the literature on diversification, integration, multiproduct firms, multinational enterprise, interbrand competition, transaction costs and international trade.

(1) Focus of Rivalry. Competition can be associated with three categories of games which are characterized by the focus of rivalry that dominates competition. First, the incumbents against incumbents game is studied in the well-established theories of (im)perfect competition without (free) entry [Shapiro (1989)]: Only internal market conditions determine competition. Actual rivalry drives competition. Second, the entry deterrence literature focuses on the incumbents against entrants game [Gilbert (1989)]: External conditions dominate over internal competition. Potential rivalry rules competition. The entrants against entrants game is explored only sporadically [Nti (1989)]: Multiple potential entrants have to coordinate (implicitly or explicitly) simultaneous entry decisions. Entry rivalry may invalidate the force of potential competition.

(2) Resource Economizing Entry. Inside entrants can economize on resources. An inside entrant can divert resources from home to entry market, which, on the one hand, economizes on entry cost but gives an (opportunity) cost of entry on the other. Economized entry cost follows from using (excess) resources in order to supply an entry market. Entry is associated with either adjustment cost in production, if the entry market good is a technical
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substitute, or transport cost in exporting, if the product is transferred from
the home base to another region or country. Entry is easy if the entry costs
are low [Calem (1988, p. 171)]. If firms have to operate at full capacity in
order to satisfy demand in the home market, entry gives an opportunity cost
in the sense of home market profit foregone by withdrawing capacity from
the home market [Bulow et al. (1985)]. The entry opportunity cost is zero if
excess resources are employed [Cairns and Mahabir (1988)] or if the
resources have a public good character. Intangible assets (such as knowhow,
consumer goodwill and management skills) have this characteristic [Teece
(1980, 1982)].

(3) Multimarket Spillovers. Inside firms can exploit multimarket spillovers—or industry drivers [for example, Yip (1989)]. Multimarket spillovers are
defined as externalities between two or more markets: That is, the payoffs in
market A have an impact on the payoffs in market B and vice versa. Bulow
et al. (1985) distinguish supply from demand spillovers. The former include
joint (dis)economies of scale or scope. Operating in two or more markets has
an impact on the cost of production and selling. Vertical integration
(dis)advantages are a third example [Brunner (1961)]. Multimarket demand
spillovers cover goodwill in the home market which carries over to the entry
market [Margolis (1989)]. The strategy of firms in market A influences the
scale of demand in market B (and vice versa). Caves (1982) summarizes
spillovers in the context of multinational enterprise, whereas Teece (1982)
lists multimarket externalities which diversified firms can exploit. A key
argument in this literature is that (excess) fungible but intangible assets can
be exploited by multimarket operation. The key point is that positive
(negative) multimarket spillovers, as opposed to economized entry cost,
increase (decrease) the overall profit of the entrant beyond (below) the entry
profit per se [Porter (1980, p. 349)].

(4) One-Sided and Reciprocal Entry. Calem (1988) explicitly offers two
economic rationales for one-sided entry. First, the incumbent firm's entry
cost is sufficiently large to trigger his decision to refrain from entering the
potential entrant's market [Calem (1988, p. 175)]. Second, legal or regulatory
barriers exist which prevent incumbent firms from being potential entrant
into the rival's market [Calem (1988, p. 182)]. However, one-sided entry is
far from the only plausible case [Venables (1990)]. Inside firms can exert a
summarizes the strategic implications by arguing that 'multiple markets
provide a way in which one firm can reward another for not attacking it, or
conversely, provide a way of disciplining a renegade.' Three examples
illustrate reciprocal entry (threats). First, incumbent firms in the entry market
may decide to retaliate in the entrant's home market [Calem (1988)]. This
strategy of counter-attack is a parry to the potential entrant's entry attack
which anticipate the potential rivals’ entry move: Counter-competition entails actions (for example, entry into the potential entrants’ home market) that force the potential entrant to tie resources to her home market. Third, hostage or foothold strategies can be employed so as to keep potential entrants in check [Caves (1982)]. A foothold in the potential entrants’ home market signals the ability to immediately respond to the potential entrants’ entry strategy by retaliation in her home market [Karnani and Wernerfelt (1985)].

(5) **Multimarket Collusion.** Multimarket contact among inside firms facilitates multimarket collusion [Bernheim and Whinston (1990)]. The outcome of multimarket competition (after, for example, a series of entry and reciprocal entry moves) may well be a reduction in competition [Caves (1982)]. Edwards (1955) proposed the hypothesis that firms meeting in several markets recognize their interdependence and therefore may decide to tune down competition. Companies with multimarket encounters are inclined to facilitate collusion [Feinberg (1985)], since the payoff of the cooperative outcome exceeds the competitive profit [Kantarelis and Veendorp (1988)]. This phenomenon is also recognized in the literature on international trade [Jacquemin (1989)]. For example, reciprocal dumping is the worst of both worlds (or, to be precise, four worlds in a Prisoners’ Dilemma): If both parties agree upon refraining from dumping, joint profit is maximized [Pinto (1986)].

### 3. Current evidence

The framework identifies five forces of multimarket competition. The key point is that the entry threat from related (and thus existing) firms differs qualitatively from new firm entry. Empirical evidence supports this view. Existing firms tend to enter at a much larger scale than new firms [Hause and Du Rietz (1984, p. 746)] and to encroach on the market share of the leading incumbent firms [Berry (1974–5, p. 202)]. Existing firms in related markets seem to have a higher speed of entry than unrelated firms with few related skills and assets [Lambkin (1988, p. 131)]. Moreover, existing (diversifying) firm entry does not seem to be responsive to barriers to entry, while the opposite holds for new (or small) firm entry [Gorecki (1975, p. 144)].

The argument underlying these findings is that a successful entry strategy may build upon the entrant’s home market. If positive spillovers exist between related markets, an efficiency motive makes firms enter all of these markets. If they do so, they tend to develop high multimarket contact. Scott (1982) presents a test of the hypothesis that multimarket contact is too high to be random. His sample contains 437 of the 1000 largest U.S. manufacturers in 1974. He concludes that multimarket contact far exceeds the level that would occur by chance. This indicates the relevance of multimarket
spillovers (or multimarket economies, in his words) to firm’s decision making. By way of illustration current evidence on entry and collusion in a set of related markets is collected below. Three topics pass under review: (1) one-sided entry; (2) reciprocal entry; and (3) multimarket collusion.

(1) One-Sided Entry. Kotte (1962, p. 43) observes that ‘food distributors’ entry into the bread industry illustrate the mixed results of “countervailing power”. (...) where food chains have established their own bakeries they may be tempted to go a step further, selling bread below cost and recouping on other merchandise. (...) The typical retailer probably is persuaded that the leaders attract a good deal of extra business in other products. (...) [This] creates an impossible situation for non-integrated bakers’. This is an example of one-sided entry: The chain food store enters the bread market, while non-integrated bakeries do not enter the non-bread food market. Entry deterrence is likely to fail against a combination of positive multimarket spillovers and one-sided entry.

Multinational enterprises (MNEs), for example Japanese firms, often engage in one-sided entry from a protected home market. This endows them with a competitive advantage: ‘In the case where the U.S. market is open and a large foreign market is closed, foreign competitors would be able to achieve more efficient scale via volume in the domestic and overseas sales, while domestic competitors would be squeezed into a portion of the domestic market. (...) Under these economic conditions – large scale learning – access to foreign markets and control over the home market would become a firm’s top priority’ [Yoffie and Milner (1989, p. 113)]. The foreign MNE benefits from a multimarket supply spillover between the entry and her (protected) home market. She recovers fixed costs of R&D and the like in her home market. This asymmetry affects pricing in the entry market as the foreign MNE prices in order to recover marginal production and transportation costs, whereas the domestic producers price in order to recover R&D and all other fixed expenses as well.

Domestic suppliers perceive the MNEs’ pricing policy as dumping. That is, ‘industries in Japan and other PBCs (i.e., Pacific Basin Countries) often enjoy very supportive relationships with their governments. Frequently this includes protection against imports into their domestic markets. This permits the PBCs to subsidize exports to other markets with profits from domestic sales. Zenith complained to the U.S. Trade Commission that in 1976 the least-expensive 19-inch color television set available in Japan was priced at the equivalent of $700, but the same and comparable sets were selling for less than $350 in the United States. Domestic TV set makers could not retaliate by lowering prices, since their entire domestic sales would be affected in a price war. But Pacific Basin competitors could maintain lower prices on the export portion of their sales knowing that their profitable home market was
protected’ [Willard and Savara (1988, p. 70)]. In reported cases, U.S. firms affected seek a strategic trade policy from the U.S. government to enforce reciprocal access to the Japanese market [Yoffie and Milner (1989, pp. 118, 124)].

(2) Reciprocal Entry. Global competition shows many examples of multi-market competition and entry by existing (foreign) firms. For example, an entry motive for U.S. firms in Japan is to tap local resources and skills. Production by the Japanese affiliate is then exported back into the U.S. [Encarnation (1987, pp. 38–39)]. By using Japan as an export platform the U.S. firm exploits a multimarket supply spillover from the Japanese market to her home market. Watson (1982, p. 40) suggests another entry motive. Firms may preempt future entrants by counter-competition. That is, the ‘pursuit of a foreign competitor’s domestic markets can help protect the threatened company’s own home market sales’.

Entry by a multinational enterprise by setting up a local subsidiary can be part of a wider strategy involving competition with another MNE in other markets [Caves (1982, pp. 106–107)]. That is to say, reciprocal entry requires a local subsidiary. Or, a ‘subsidiary on the invader's turf establishes both a means of retaliation and a hostage that can be staked out in any subsequent understanding between the two parents’ [Caves (1982, p. 107)]. Case studies by Karnani and Wernerfelt (1985) show that firms do indeed use a foreign subsidiary for a reciprocal response. Particularly illustrative are the fights between Goodyear and Michelin in the tyre market, Maxwell House and Proctor and Gamble in the roasted coffee industry and BIC and Gillette in the markets for pens and razors.

The general pattern for competition between U.S. and E.C. firms may run in the opposite direction, as Graham (1978) suggests. Graham reports a study of direct investments by U.S. firms in Europe and vice versa. His finding is that an increase in the number of U.S. subsidiaries in Europe is typically followed, after a lag, by an increase of European subsidiaries in the U.S. The lag is four years for industries such as chemicals, refineries and instruments. Graham suggests that this fact represents rivalry: European firms install subsidiaries as a response to previous U.S. moves. So, he suggests that reciprocal entry explains this pattern.

(3) Multimarket Collusion. The outcome of a sequence of entry and reciprocal entry moves may well be a reduction in competition. Caves illustrates this by the example that ‘at the extreme, markets can wind up less competitive after the peace treaty is signed than they were before the initial aggressive move. An example of this adverse development was the British tobacco market after the entry of American Tobacco in 1901. Induced by the British tariff structure, American purchased a leading British producer. That event caused 13 dismayed British rivals to merge into Imperial Tobacco.
After a year of duopolistic rivalry, a peace treaty gave Imperial a monopoly of the British and Irish markets, and American got a guarantee that Imperial would not sell in the United States or its dependencies. British–American Tobacco was organized as a joint venture to handle business in the rest of the world [Caves (1982, pp. 104–105)].

Market sharing agreements, such as by American and Imperial Tobacco, are an example of multimarket collusion. Edwards (1955) proposed the hypothesis that 'when sellers meet in several markets, their recognition of the interdependence of their operations may blunt the vigor of their competition with each other' [Scott (1982, p. 369)]. Feinberg (1985) specifies Edwards' hypothesis by arguing that 'companies meeting rivals in more than one market will be able to facilitate collusion in one or all of those markets' [Feinberg (1985, p. 238)].

Multimarket contact research seeks to verify this hypothesis [Heggestad and Rhoades (1978) and Feinberg (1985)]. As one consequence of multimarket contact, firms (in the case below Japanese semiconductor suppliers) may develop a follow-the-leader strategy: 'Japanese companies, unlike most of their American counterparts, competed in other consumer and industrial product areas as well as in semiconductors. Such diversification heightened pressures for imitative behavior at home and abroad. Sequential foreign investment was one response' [Encarnation (1987, p. 32)].

4. Entry strategies and entry deterrence

Key strategies concern entry deterrence and actual entry. The first strategy is associated with signaling unprofitable entry opportunities, whereas the second policy goes hand in hand with the selection of entry markets. The five features of multimarket competition indicate factors that can facilitate both strategies. The imperatives are summarized in table 1.

Future research can be directed at identifying the ways by which firms may recognize and implement these strategies. By way of illustration two issues which are related to multimarket strategies are discussed briefly: (1) protect the home market at least during the entry process; and (2) select an entry market.

(1) Home Market Protection. If a firm enters a second market, she may reduce her barriers to exit from the first. This is a strategic weakness, as Eaton and Lipsey (1980, p. 728) have shown. Entry into another market may involve partial exit, i.e., a reallocation of resources away from the home towards the entry market. Thus entry goes along with a reduction of exit barriers. This may invite entry into her own home market for two reasons. First, partial exit reduces the size of her commitment to the home market and raises expected entry profits in her home market. Second, it raises the expectation that she will react upon entry by accommodation. Since entry
reduces home market profits, she may shift even more resources into her entry market, which implies that she accommodates entry by (partial) exit [Calem (1988, p. 172)]. This scenario can be avoided by selecting an entry market, if available, which increases the exit barrier from her home market. If an entry market induces significant positive spillovers to the home market, entry can raise the commitment to the home market.

(2) Entry Market Selection. With multiple entry markets two criteria can be indicated which can guide selection of a specific market. First, the potential entrant should take into account that her entry changes the incumbent firm’s opportunity cost of entry. Reciprocal entry may occur. The incumbent firm’s response is most favorable if he faces an entry barrier to the potential entrant’s home market, yet low exit barriers to other markets. Second, entry barriers and multimarket spillovers are critical. Barriers to entry can lose significance for potential entrants who are incumbent elsewhere. Economies of scale, for instance, are not a barrier if potential entrants have already realized their economies in a home market [Brunner (1961) and Yip (1982)]. Economies of scale or scope even invite entry if potential entrants exceed in size or scope the incumbent firms in a market. Similar arguments hold for other barriers: Product differentiation and absolute cost advantages. Thus multimarket spillovers can help to overcome entry barriers. Moreover, they increase the profitability of entry without undermining the commitment to the home market.

5. Appraisal

Multimarket modeling offers a framework for analyzing entry strategies
and what Yip (1982) calls 'gateways to entry': Opportunities for potential entry. It also explores the strategic implications of transferring the battleground from the incumbent firm's home market to the potential entrant's home market. So, the multimarket framework identifies entry deterrence instruments which incumbent firms can use if they face a threat of existing firm entry. These insights gain relevance in the context of increasing global competition.

References