Market Competition and the Crucible of Pain and Pressure: Some Preliminary Thoughts

By

Bruce W. Marion

wp 106

*University of Wisconsin-Madison, Department of Agricultural Economics.

Market Competition and the Crucible of Pain and Pressure:
Some Preliminary Thoughts*

Bruce W. Marion

As the years pass, I find myself drawn to defining the common themes of life's experiences. This is true of my interest in understanding markets. In 30+ years as a professional economist, I've seen enough poor research and aberrations to view individual studies and case examples with a degree of distrust. And--the level of my distrust is inversely related to the extent to which a study or case example is consistent with the vast majority of the literature. In this paper, I want to comment on some of the common themes I perceive from both the academic literature and from market and industry examples.

Economists and policymakers with interests in the performance of markets have often thought there are trade-offs in different aspects of performance as one moves from an atomistic market of small firms to a concentrated market of large firms. Let me note just a couple of examples:

1) Schumpeter saw some degree of market power as facilitating firm innovations. His "creative destruction"--the process of dynamic competition--was a major trade-off or counterbalance to the market power that allowed some degree of monopoly rents.

2) Lester Thurow, Malcolm Baldridge and others have argued that

---

*Comments at AAEA session, "Consumer Gain or Loss from Non-price Competition in Food Processing," August 8, 1994.

international competitiveness could be enhanced by relaxing our antitrust laws and encouraging industry consolidations. I.e.--in their view, giant firms and concentrated industries might have market power in the U.S., but would also be more effective in global competition.

The point I want to make today is that we should have learned a good bit over the last 20 years about the way markets work--if we were paying attention. I believe the evidence points more in the direction of a lack of competition negatively affecting most dimensions of performance, not helping one and hurting another. And--to me, this is a pretty fundamental issue.

Time doesn't allow me to expand on each of these--but just think of some of the market experiments we've witnessed in the last 20-25 years.

1) Seen the consequences of state run industries being converted to private companies in market economies like the UK and Mexico.

2) Seen the conversion of centralized economies in E. Europe to market economies and the privatization of firms and resources. And we've learned something about what the enterprises in these countries have had to do in order to compete with companies from western economies.

3) Seen the consequences of deregulating several U.S. industries such as telephone, airlines, trucking.

4) We've observed the impact of imports on U.S. industries such as autos and steel.

5) We've learned more about the consequences when cartels break down.

6) Seen some evidence of the consequences of exclusive geographic territories in concentrated industries; what happens when intrabrand competition is eliminated?

7) Learned more about what industries are successful in global competition and which aren't.

8) Have had a host of empirical research on market competition.

State run firms, regulated public utilities, cartels, firms with exclusive geographic territories, and tight oligopolies or dominant firm industries all have one thing in common--a lack of tough competition. And--there are some similarities in the performance of these markets and firms. They tend to be characterized by:

- Poor technical efficiency
- Bloated costs
- High prices
- Slowness in adopting new technology & developing new products. I.e., not progressive
- Poor responsiveness to customer desires
- Firms and managers that are bureaucratic, unimaginative and risk averse

The central theme I see coming out of this potpourri of market experiments is that a lack of tough competition has broad impacts on firm and market performance. I see no redeeming virtues--no trade-offs--that are often expected from the quiet life.

In a sense, what we're observing, I believe, is the way human beings respond to an environment of pressure v. an environment of the quiet life.

--In athletic training--they say "no pain, no gain."

--In athletics--we improve the most when we play against tough competitors.

--In universities, the most productive period of our career is often prior to tenure.

--There may be a good bit of truth in the old adage, "Necessity is the mother of invention."

--Research shows that people age more slowly if they are intellectually challenged.

--As individuals--we often grow the most during periods of great pain and suffering. Some of our most profound writings have come out of prisons. Many of the folks I know who have gone through divorce or lost a child have grown greatly as individuals.

--This week I read about one scientist who claims that people who have happy childhoods are never driven to achieve their potential.

Are people in their role as businessmen any different? Is the crucible of pain and pressure important there also for good performance on both price and non-price dimensions?

John Sutton in his book Sunk Costs and Market Structure used the term "toughness of competition" to refer to the functional relationship between concentration and prices/or margins in homogeneous goods industries. An industry with "tough competition" is more akin to a Bertrand oligopoly versus a Cournot oligopoly.

Sutton is particularly referring to industries that are protected by government price supports and import quotas and that are more likely to experience soft rather than tough competition. I prefer to use the term "tough competition" more broadly as the opposite of soft or protected competition.

Michael Porter, in his book The Competitive Advantage of Nations strikes a somewhat similar theme. Industries that experience "tough competition" because of demanding customers and intense competitive rivalry in their home markets are more likely to be efficient, at the cutting edge in their products, and therefore to be able to compete well in global markets.

Perhaps we need to supplement our existing theories of competition with a theory of pain and pressure as the requisites for "tough competition." The market environment clearly influences the degree of "pain and pressure." So also can such things as leveraged buyouts and cost-cutting measures. In the long run, however, the discipline of the market environment may be the most important determinant of tough v. soft competition. The degree of industry concentration and leading firm dominance, the level of entry barriers, the degree of product differentiation, and international trade policies largely determine whether firms and managers are exposed to the crucible of "pain and pressure."