HOW DO MARKET CONCENTRATION AND MIMETIC BEHAVIOR INFLUENCE STRATEGIC RENEWAL

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ABSTRACT

In the increasingly dynamic and competitive business environment of today, incumbent firms are facing rapid and profound changes in macro social, economic, political and technological conditions. Such a turbulent setting may disrupt the inertia of the incumbent firms, from a wide range of industries, and urge them to make drastic and often irreversible strategic decisions. Such vital strategic decisions include strategic renewal which, as the literature sustains, is a necessary requirement to remain competitive, but difficult to achieve. This paper aims to develop understanding on major areas of strategic renewal from the point of view of some aspects of the institutional environment. Its goal is to establish the relationship between different market conditions and the way companies react in terms of strategic renewal and change. Moreover it statistically investigates the degree to which companies decide to "run" in their own rhythm or just imitate other incumbent companies in the industry.

KEYWORDS: *strategic renewal, mimetic behavior, market concentration, exploitation, exploration*

A brief introduction to the strategic renewal "fairy tale"…

> *"Now! Now!" cried the Queen. "Faster! Faster!" And they went so fast that at last they seemed to skim through the air, hardly touching the ground with their feet till, suddenly, just as Alice was getting quite exhausted, they stopped, and she found herself sitting on the ground, breathless and giddy. The Queen propped her up against a tree, and said kindly. "You may rest a little now." Alice looked round her in great surprise. "Why, I do believe we've been under this tree the whole time! Everything's just as it was!"*
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> *Lewis Carroll; Through the Looking Glass, 1946: 178-179*

In the increasingly dynamic and competitive business environment of today, all too often, corporations may feel themselves in the same position as Alice in Wonderland: they work hard to develop their strategy, only to find out that results are not as desired. With increasing technological, demographic, and business model changes, strategic renewal is high on the managerial agenda.

Incumbent firms are facing rapid and profound changes in macro social, economic, political and technological conditions [11]. Such a turbulent setting may disrupt the strategic passivity of the incumbent firms, from a wide range of industries, and urge them to make drastic and often irreversible strategic decisions. Due to different market specific aspects such as the competition level, entry and exit barriers and market structure, incumbent firms generally need to decide on several important strategic options. One choice is either to institutionalize the strategic behavior that exploits the current strategies of the company, or to adopt an explorative strategy that develops new competencies that have an insight into the future [5]. Another option is represented by the choice of either growing organically through internal strategic renewal or engaging in external strategic renewal actions such as alliances and acquisition. Further more firms may opt for a process related strategic choice, namely, mimetic behavior. This means that, firms adopt similar strategic actions as other organizations that are perceived successful or legitimate in their filed [4].

What this paper aims to research is how companies "run" in different "wonderlands". For example companies may find themselves in institutional "wonderlands" which are sociologically driven or in market "wonderlands" which are economically driven. The thesis investigates how certain market structures in the energy sector from different countries in Western and Northwestern Europe influence the strategic renewal behavior of incumbent companies. Moreover it investigates the degree to which companies decide to "run" in their own rhythm which implies being more market driven and less risk adverse, or just imitate other incumbent companies in the industry which implies being rather competitive driven and risk adverse [7]. As far as we are documented there have been no attempts in the literature so far to explain the relationship between the degree of market concentration and mimetic behavior.

Strategic renewal as exploitation and exploration

According to the work of *Floyd and Lane* [5] strategic renewal is presented as a firm's strategic process of a development path of exploitative and explorative strategic renewal actions to align with or adapt to changing (environmental and institutional) issues. *March* [8] refers to exploitative actions as familiar and incremental changes which build upon existing organizational knowledge and aim at meeting the needs of existing customers, while he refers to exploratory actions as unfamiliar and radical change which require new knowledge and departures from existing competencies. On one hand, exploitation is characterized by improved levels of efficiency, higher productivity, and processes selection and implementation. On the other hand, exploration is defined by higher, riskier and long term investments, experimentation, search and desire to discover and innovate. In general exploration is associated with organic structures, loosely coupled systems, path breaking, improvisation, autonomy and chaos, and emerging markets and technologies. Complementary, exploitation is associated with mechanistic structures, tightly coupled systems, path dependence, routinization control and stable markets and technologies [3].

The influence of market structure on strategic renewal actions

The concept of market structure, as well as that of strategic decision making, is central topic to both economics and marketing. In the decision-making process, market structure has an important role through its impact on the decision-making environment [10]. Markets are classified in strong relation to the structure of the industry associated with the market. Industry structure is categorized based on a number of market structure variables which are assumed to determine the extent and characteristics of competition [10]. Market structure has a high importance because it influences market outcomes through its impact on the motivations, opportunities and decisions of economic actors participating in the market.

In his seminal contribution, *Schumpeter (1942)* claimed that accepting the principles of the imperfectly competitive markets is vital in order to achieve rapid technical progress. He argued that for a large incumbent firm to operate in imperfectly competitive markets, represents the most conducive condition for technical progress. To the extent that the more concentrated the market in which large firms operate the more closely approximates an imperfectly competitive market in which firms possess market power, led to the long-standing and much debated hypothesis that more concentrated markets are more conducive for innovation. Exploratory strategic renewal usually requires a significant level of slack that only large firms with high market power tend to have. However, these large firms are most likely to be located in highly concentrated industries, while less concentrated industries tend to have many small firms, which do not have a significant level of slack to produce major innovations but can still produce minor innovations in the form of exploitative actions of strategic renewal. In addition to this, in high velocity markets where concentration is usually low, firms often engage in product differentiation strategies, which most of the time is represented by minor innovation, namely exploitative actions. Based on this argumentation we propose our first hypothesis

Hypothesis 1: The higher the market concentration of a national industry more explorative strategic renewal behavior of incumbent firms

The influence of mimetic pressures on Strategic Renewal Actions

Imitation is a common form of behavior that arises in a variety of business domains. Firms imitate each other in the introduction of new products and processes, in the adoption of managerial methods and organizational forms, and in market entry and the timing of investment. Despite its frequent occurrence, imitation can have radically different causes and implications. Firms may imitate to avoid falling behind their rivals, or because they believe that others' actions convey information. The matching of rivals' actions can intensify competition, or have the opposite effects by promoting collusion [7].

Institutional theory suggests that institutionalization is a social process by which structures, policies, and programs acquire "taken for granted" status [10]. According to *Dimagio and Powell* [4] firms in their institutional environments experience three types of institutional forces (pressure), namely: coercive pressure, normative pressure and mimetic pressure. Mimetic pressures suggest that firms may imitate the strategic moves of other organizations that are perceived to be successful or legitimate. *Dimagio and Powell* [4] conclude that mimetic behavior is resulting from standard responses to environmental uncertainty.

Abrahamson and Rosenkopf [1] suggest that firms which do not adopt a certain strategic action that has already been adopted by other large firms, risk to lose stakeholders' support, particularly that of shareholders, which may lead them to adopt the innovation after all. Moreover strategic renewal actions are usually highly observable and have a great market signaling capacity [9]. Taking into account these effects of a firm's strategic renewal action over the market, it is very likely that firms will not allow themselves the risk of not mimicking the strategic renewal actions of their rivals.

Hypothesis 2: Incumbent firms in a national industry will engage in imitation which will result in similar strategic renewal behavior.

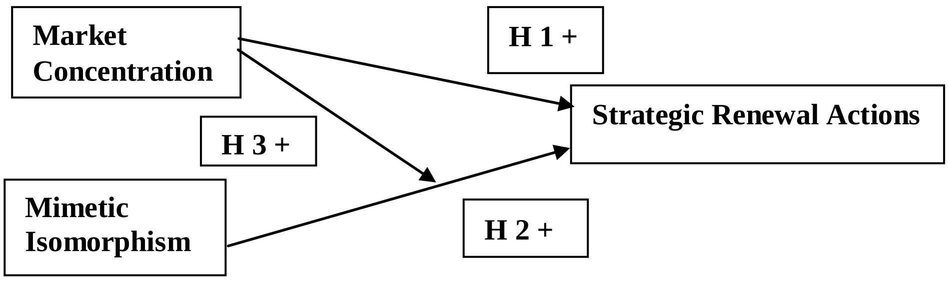
The joint impact of market structure and mimetic behavior on strategic renewal

The lower the market concentration the lower the relative market share of the incumbent firms, so the incumbent firms will fight for market share and will engage in a relatively high number of company unique strategic actions in order to over perform their rivals and acquire more market share. Companies seek to differentiate in order to impress their customers and most of them develop new and unique products and services and try to impose on the market. Thus the lower the market concentration, the higher the market dynamism and the uniqueness of strategic actions is. Put it differently, if the market concentration is relatively low, incumbent firms will develop their own strategic actions rather than engaging in trait based mimetic behavior. Moreover when market concentration is low it might even be difficult to precisely identify a large and successful enough company which to copy.

On the other hand if the market concentration is high it means that the market is rather mature, with the incumbent firm having a solid market position with a relatively high level of market share. There are few large firms which already have a large enough client base and a very strong stakeholder group on which they depend. Although the competition may still be as intense as in low concentrated markets, the number of rivals for an incumbent firm is drastically reduced. Focusing on fewer but stronger rivals develops stronger interdependencies between the incumbent firms which will monitor each other much more carefully.

In highly concentrated markets, incumbent firms do not usually have the luxury of following their own strategic path without altering it with by imitating the strategic actions of other large firms because this will be too risky for their long term survival [6]. Hence it is expected that in highly concentrated markets incumbent firms are more inclined to adopt strategic renewal actions of other incumbents in order not to risk to lose market share and stakeholder support.

Hypothesis 3: ***The degree of market concentration moderates the likelihood that incumbent firms engage in mimetic behavior such that firms are more likely to mimic competitors under conditions of high market concentration than under conditions of low market concentration.***



Methodology of the research and statistical analysis of the hypotheses

In order to statistically analyze our hypotheses we have chosen a **sample population** of 13 firms from which we extracted strategic renewal actions. The sample population was based on three criteria. First, the firm should belong to the first four largest companies in their countries in terms of turnover. Second, the firm should be involved in generation, sale and trade of energy in order to be able to conduct an unbiased comparison as possible. Third the firm should have annual reports in English during the entire time span of the research (1999-2006). Based on the aforementioned criteria the researched population includes a number of 13 incumbent companies from Belgium (Electrabel and Distrigas) France (GDF and EDF), Germany (E.ON, RWE, EnBW), The Netherlands (Nuon, Essent, Eneco) UK (Centrica, SSE) and Sweden (Vattenfall).

The **extraction of data** was realized by a pair of researchers who conducted a document analysis to identify of the strategic renewal actions undertaken by the analyzed firms. The data was selected from secondary sources, namely the English version of the annual reports between 1999 and 2006 of the sample firms. Following previous research [11], each identified strategic renewal action was coded either as exploitation or as exploration. **Coding** every action as either exploration or exploitation should be a reliable coding procedure from the point of view of consistency and reproducibility [11]. Moreover, we consider concerns regarding reproducibility as being fairly low since every extract from the annual reports are of an explicit nature.

We used **4 important metrics**, namely one dependent variable and three independent variables**.** Our dependent variable was analyzed at firm year level and is strongly related to strategic renewal. More precisely, it is represented by the ratio of the total number of explorative strategic renewal actions undertaken by a certain firm in a certain year over the total number of strategic renewal actions undertaken by that firm in that particular year. Of the total of 1,390 strategic renewal actions extracted, 567 (42%) were coded as explorative actions, while the rest of 823 (58%) were represented by exploitative actions.

Regarding hypothesis 1, market concentration, the independent variable is computed as the sum of the combined market share of the first *3* largest firms in a national industry. As far as hypothesis 2 is concerned, mimetic behavior, the independent variable was investigated by relating a firm's exploration orientation to the average exploration orientation of the largest firm's national competitors [11]. Last but not least the joint effect of market concentration and mimetic isomorphism on strategic renewal will be analyzed by developing a third independent variable. This variable was computed as a moderating variable by mean centering the first two independent variables and then multiplying the new mean centered variables [11].

Discussion of the results of the multiple regression model

As anticipated, our first predictor variable namely **market concentration** is positively related to explorative strategic renewal behavior ($B = 0.171$; $p = 0.01$), which supports Hypothesis 1. Although the coefficient of determination R square has an apparently small value of 0.1 we believe that this value is satisfactory since strategic renewal could be affected by an extremely large number of both economical and social factors. We analyzed the case when an industry changes its market concentration with 10% from one year to the other. In this case, the probability of a strategic renewal action to be of exploratory nature increases by 0.05. This means that the chances of a strategic renewal action to be exploration instead of exploitation increases by 5% at every 10% change in market concentration.

The second predictor variable namely **mimetic behavior** is indeed positively related to explorative strategic behavior with a B of 0.155. In the bivariate correlation mimetic behavior is strongly correlated with exploratory behavior having Pearson correlation of 0.567 and a p value of 0.01. However in the multiple regression model the significance level has a very high value of 0.45, thus our second hypothesis does not hold. However, we still believe that the argumentation behind the hypothesis stands true and we suggest for future research that another coding protocol should be adopted. We propose that when mimetic behavior is analyzed, strategic renewal actions should not to be modeled only dichotomously as either exploration or exploitation but also in a more complex way. For example future researchers could classify each action as mergers or acquisitions actions, new market entry actions, product or service innovation oriented actions and capacity expansion actions. By having more than 2 possible outcomes for the strategic renewal actions the chances of high multi colinearity between variables will considerably decrease and a significance level of less than 0.05 could de attained.

The third predictor variable, namely the **joint effect of mimetic behavior and market concentration** is positively related to explorative strategic renewal behavior with a B of 0.175 and a significance value of 0.001.The coefficient of determination, R square, is rather small (0.85), but the same logic as in the case of market concentration applies here as well. Thus according to our third hypothesis which is fully supported, firms will be more inclined towards mimicking the reference firms in conditions of high market concentration.

Some final thoughts on strategic renewal…

Alice's adventure continues as follows…

"Of course it is!" said the Queen. "What would you have it?" "Well, in our country," said Alice, still panting a little, "you'd generally get to somewhere else - if you ran very fast for a long time, as we've been doing." "A slow sort of country!" said the Queen. "Now, here, you see, it takes all the running you can do to keep in the same place. If you want to get somewhere else, you must run at least twice as fast as that!"

Lewis Carroll; Through the Looking Glass, 1946: 178-179

The above applies to firms as well. Exactly as in Alice's case but only organization wise, exploitative renewal actions which are familiar to organizations and consist of incremental changes and build upon existing organizational knowledge [2] may not be enough to boost performance or even to for the organization to survive. Also, similar to Alice's story, companies after a lot of effort and investments they might find themselves in the same performance status or even worse. Sometimes, in order to avoid the frustrations Alice developed when confronted with the Red Queen effect, companies have to "run faster" than they are usually used to. This means that they have to engage in exploratory actions which are unfamiliar and represent radical change which requires new knowledge and departure from existing competencies [2]. Moreover, in order to "get to somewhere else" organizations sometimes may need to depart from the "safety belts" of institutionalism.

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