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OPPORTUNITIES FOR NEW COMPETITION

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We see our large manufacturing industries getting bigger and bigger and our economic theory getting weaker and weaker. When a corporation controls more wealth than most countries in the world, it makes us uncomfortable. When some companies are large enough to spend millions of dollars exploring the Alaskan oil fields, while other companies struggle to maintain their business, inequalities, imagined or real, are present, which go against our "common-sense nature."

In 1969, Dr. A. C. Hoffman, V. P., Kraft Foods Company (7) said he has had a lifetime interest in the economics of large scale enterprises. "Almost from the outset, I accepted economic determinism as essentially valid, and accordingly looked upon the rise of big business in American industry with equanimity and approval. It seemed to me that most of what was happening represented the necessary institutional adjustment to the development and best utilization of modern science and technology; and in spite of some occasional excesses and abuses on the part of big business, I believed its growth to be mainly in the public's interests. I still believe this."

"But I must say to you that I have been completely flabbergasted by the recent avalanche of conglomerate mergers. I did not foresee anything like this, and I am more than a little frightened by it. At the present rate at which American industry is being merged and consolidated, we will indeed reach that ultimate stage of monopoly capitalism which Marx predicted - and about one hundred years ahead of schedule!"

The concern about corporate size is not new. It has been with us for centuries and has been developed in monopolistic theory. But one present economic theory of monopoly is not based in the reality of current business trends. At the same time anti-trusters complain about entry barriers, businessmen complain about shortened product life cycles and excessive competition. ^{1/}

Our classic stance in regard to monopoly is that the structure causes output restriction and high prices as the firm acts to maximize profits in

^{1/} See Bain., J. S. (1) or (2, chapter 7) or the complaint of F.T.C. vs Cereal Manufacturers for discussion of entry barriers and Time, May 22, 1972 pp 88-89 for discussion of excessive competition

disregard of consumer wants. The monopolist is able to act that way because competitors cannot enter. On the other hand, where entry is free and easy, price competition emerges. Price competition with atomistic buyers and sellers is considered to be our ideal. It is our model for instruction. We haven't had that ideal 'economic democracy' for the last couple of generations. Yet we see around us daily that people are living better in the presence of large organizations than they lived under an atomistic structure.

Baine (1,2) has developed our theoretical response with his concept of barriers to entry. He maintains that an industry may be concentrated in relation to the number of firms and the percent of the market supplied and still competitive if other firms can easily enter the industry. Conventional price theory suggests that equilibrium prices will be established with a condition of free and easy entry.

It seems, therefore, if a more sensitive concept of entry can be developed, it would help unravel the conflicting appraisals which range from restricted entry to excessive competition. This more sensitive concept of entry may require a higher degree of classification than Bain used. As we look at the food industries, for example, several sub-structures are recognized as having distinct organization and behavior patterns. Features which stimulate entry may be very different from one substructure to another.

The Handy-Padberg model of substructures in the food industries was developed from the data made available by the National Commission on Food Marketing (5). The model is therefore well based in reality. It provides us with a theoretical map of the food industry as it is. One half of their model emphasizes economic efficiency. Physical efficiency of the production of food materials, such as canned or frozen food, is supplied by a large fringe of small and medium size manufacturers. These manufacturers produce to the specifications of large national food distributors. This food distribution core (large food chains) stresses efficiency of warehousing and retailing, with emphasis of retail on price competition. This half of the model offers society an economy alternative.

The other half of their model is composed of large core manufacturers where brands are emphasized. They sell primarily to small and medium-size food retailers who stress merchandizing. This half of the model stresses advertising, promotion, and new product development. It offers society new products.

Bain's conditions of entry fit the fringe manufacturers of the Handy model in the food industry very well. Absolute cost ranges in the area of one to ten million dollars which is available to entrepreneurs. If we place egg producing-packing firms in this fringe category (as suppliers of chain stores) absolute cost is as low as \$500,000. Firms in this category stress the physical efficiency of production. Advertising and promotion costs of less than 2 percent place them in Bain's lowest category for these costs. The individual plants have an economy of scale that is efficient and there is no, or very little, advantage to multi-plant firms.

Bain's model fits the large distributors (the food distribution core) to the extent that they stress physical efficiency and price competition with low advertising and promotion costs. Entry into food retailing is easily attained by small independent stores. 2/

The nature of entry into food retailing and into the fringe of small manufacturers fits comfortably into Bains model. These industries have low barriers to entry, they tend to be price competitive and product differentiation is not important. Although it is not explicitly stated, Bains idea of entry is the emergence of a new firm. It is not the movement of an already established firm into a new industry. It may be useful to make this difference clear -- original entry could refer to the emergence of a new firm while conglomerate entry would refer to the movement of an established firm into the industry under consideration.

If the basis of concern about entry is the extent and effectiveness of competition, the different types of entry may be about equally useful. They both represent the opportunity of economic resources to flow to a pocket of profit. They may be distinguishable in different terms of the nature of opportunity of individuals. Conglomerate entry may make an industry competitive but it represents little freedom of opportunity to individuals.

Distinguishing between original and conglomerate entry also has another implication. Original entry is clearly a "small"business concept. It reaches to business activity related primarily to physical functions -- manufacture, storage, merchandising, etc. The research and development and advertising sequence of larger manufacturers require the Galbraithian technostructure and scale economics which just completely preclude original entrants.3/ On the other hand, conglomerate entry is feasible and very frequent. 4/

Entry Into Large Manufacturer Sector

When attention is directed to entry conditions in the large manufacturer sector of the food industry, Bain's ideas about original entry are of little use. A careful look at the functions performed and the competitive focus of these firms illustrates this point.

The large manufacturer shows a qualitative performance through product differentiation by responding to consumer wants rather than by monopolistically restricting output. Padberg (9) points out the explosive change in consumer disposable income shows a steady income in deflated dollars from 1910 to 1935 and an increase of 2.2 times between 1935 and 1965. Data for the period after 1965 indicate that disposable income per person has continued to rise steadily each year despite inflation and tax increases. Disposable income per person for 1970 shows this continuing trend.

2/ See Padberg (10) chapter 7.

3/ See Galbraith (4) chapter 6.

4/ See Handy and Padberg (6)

The consumer is now called 'affluent' for good reason. With income more than doubled the amount of dollars available beyond those necessary for existence has more than doubled. The percent of families in the population with \$10,000 or more total money income, has increased steadily from 13.2 percent in 1950 to 49.1 percent in 1970. The increase in income has had a tremendous effect on the life style of the population. People are interested in new things and buy them in abundance. The business community and specifically the large core manufacturers are trying to discover the new wants of people and are trying to supply those wants.

This process requires market research to debrief the constantly changing consumer, R&D to relate one technological capability to changing wants and advertising to direct the passive, busy consumer to the new offerings in the market. This sequence is the engine of progress. It is through this sequence that a better life emerges. We don't want to spend our doubled income for twice as much of the staples of subsistence we bought a generation ago. We want different (better) things.

Rather than restricting output the large core manufacturers tend to increase total supplies to consumers by developing new products. The cereal industry provides an example. Regular cereal sales (corn flakes, rice crispies, wheat flakes, etc.) were practically stable over the entire period (3, p. 150 and 8). Pre-sweetened cereals and nutritional-health type cereals (Total, Special K) added to the total sales for cereal. Conversely, more total consumer purchases were made when innovative products were made available because more demands were being satisfied. Consumers purchased 25.3 percent more cereal (866 million pounds) in 1964 than in 1954 (691 million pounds). The increase was due to the innovative products. Newly discovered wants had been supplied by qualitative performance of the core manufacturers.

The qualitative competition is no place for the original entrant. The process of change is very expensive and risky as illustrated by the high failure rate of new products. 5/ Its returns are also short lived because (particularly in the food industry) private label alternatives at cheaper prices soon follow successful new products.

The conglomerate structure has several advantages in the "progress sequence." 6/ First, they can enter. 7/ Second, they have many overheads such as research facilities and expertise, accepted brand names, and distribution systems. Third, their conglomerate structure is a hedge against the risk of any particular industry. For these reasons, it shouldn't be too surprising to learn that entry into the large manufacturer sector is usually effected by conglomerate merger. This becomes the vehicle by which

5/ See discussion of new products in Padberg (11) chapter 5.

6/ Progress is defined as the process of making many qualitative changes available for consumer choice. Consumer choice defines what is better-- for example, the Mustang is better than the Edsal. The process which made both choices available is called progress.

7/ See Handy and Padberg (6).

economic resources flow into economic activities where the progress sequence is important.

Does Conglomerate Entry Work?

There is no quarrel with Bain and his entry concept when it relates to quantitative performance by "small business." He points out accurately that institutional features of whatever kind which restrict the capability for new firms to emerge as competitors tends to cause restrictive behavior and higher prices. The problem with his concept is that it does not understand or accommodate the "progress sequence." According to the standards of Bain's concept, large manufacturer sectors of the economy have high entry barriers. This is true because, for whatever reason (absolute cost disadvantage, product differentiation or scale economies), original entrants are essentially precluded. Does that mean that the flow of economic resources to new opportunities is impeded?

In most cases (particularly in the food industries) it does not. While new firms cannot enter, there are many established ones with overheads and staffs ready and able to enter. This is illustrated in a Time explanation of why General Foods has its share of competitive troubles.

"one of General Foods problems is that new products no longer stay unique for very long. Just about any new drink, breakfast food or pudding is almost immediately surrounded by a horde of imitations." 8/

This characterization suggests abundance of entry capability. It comes from other conglomerates. It comes much quicker than it could possibly come from original entry.

Conclusions and Implications

Living in an affluent society, we must some day learn something about the economics of affluence. One of the most complex and difficult aspects of this challenge is to understand progress. Among perhaps many things, this will require expanding our concept of entry and entry barriers. The traditional concept of entry which has a test of whether an original competitor can enter is inadequate. Conglomerate entry is superior to original entry in "big business" sectors.

Galbraith pointed out that various resources provided the limits of economic activity at different points in history. 9/ First land then capital occupied the center of the stage. More recently, he argues, due to the extensive capability of the economy to generate capital and the increasing complexity of scientific applications, the extent and quality of trained people have become the limiting factor. If we look around

8/ Time, May 22, 1972. pp 88-89.

9/ See Galbraith (4) chapter 5.

us at the abundance of college graduates (at whatever level, B.S., M.S., Ph.D.) this limitation cannot be severe. It is unlikely that any institutional barriers will effectively isolate markets from this reservoir of economic resources. The evidence is that resources move about with surprising fluidity.

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