

ESM0268 first mover advantage

Definition

The benefit enjoyed by a firm as the consequence of its early entry into a new market.

Abstract

'First mover advantage' refers to the benefit enjoyed by a firm as the consequence of its early entry into a new market. Although the term suggests that early entry is desirable, the advantages of pioneering a new market are often offset by disadvantages. The question of whether a 'first mover advantage' is likely on balance in any specific context depends on the characteristics of the emerging market and the entering firm.

In a business context, 'first mover advantage' refers to the benefit enjoyed by a firm as the consequence of its early entry into a new market. This benefit pertains to economic profit; however, many studies focus on market share or survival, which are easier to measure. Although the term 'first mover advantage' suggests that early entry is desirable, market pioneering is a high-risk strategy. The advantages of pioneering a new market are often offset by disadvantages. The question of whether on balance a 'first mover advantage' exists in any specific context depends on the characteristics of the emerging market and the entering firm. 'First movers' often prove to be less successful than rivals that enter later, and established firms are frequently advised to track the market's early development and pursue a 'fast follower' strategy. (One commonly cited example of a 'fast follower' is Microsoft.)

The potential existence of first mover advantage raises the broader strategic question of the optimal timing of entry. Strictly speaking, a market has only one 'first mover', but in practice, multiple firms are often identified as 'first movers' or 'pioneers'. Such classification is not unreasonable, given that firms may enter the market more or less simultaneously, and in many cases the exact date of entry is not precisely defined. Firms that enter later in the evolution of the market are characterized as 'followers' and may be further distinguished as 'fast followers', 'late followers', and so on.

Many hundreds of articles have been published on the topic of first mover advantage, often seeking relatively simple prescriptions for managers or conclusive findings for researchers. Given the contingent nature of first mover advantage, broad

generalizations have been elusive. Interpretive summaries of the literature can be found in numerous survey articles, including Golder and Tellis (1993), Kalyanaram, Robinson and Urban (1995), Suarez and Lanzolla (2005) and Vanderwerf and Mahon (1997). The discussion below largely follows Lieberman and Montgomery (1988, 1998).

Problems of definition and sampling have hindered empirical studies of first mover advantage, adding to the lack of consensus in the literature. For example, there is often ambiguity regarding the date of market birth and the appropriate definition of market breadth. Disagreements over these dimensions may lead one observer to classify a given firm as the first mover, whereas another may view that firm either as a follower or as an entrant into a separate or precursor market. A further complication is that multiple categories of new markets can arise within a given product domain; for example, fundamentally new products, new technological 'generations' of existing products, and new geographical markets for products previously introduced elsewhere. Some of these markets emerge as the outcome of radical innovation, whereas others emerge incrementally in a more predictable way. Moreover, sampling biases can lead to the omission of important firms. For example, available data sources (or imperfect human memories) may go back only as far as the initial firm that achieved market success, omitting the true pioneer(s) that failed to survive.

A related issue is 'endogeneity', or interdependence between cause and effect. A pioneering firm may prove successful not because it chose to pursue a 'first mover' strategy, but rather because of underlying skills that enabled the firm to implement that strategy effectively. Indeed, as discussed below, the optimal choice between first mover and follower strategies depends on the resources and capabilities of the firm.

Market characteristics and the sustainability of first mover advantage

Although 'luck' plays an important role in determining whether a first mover strategy will ultimately be successful, an astute entrant must consider characteristics of the market in deciding the optimal timing of entry. A first mover strategy will not be sustainable unless one or more of the following market characteristics is present: (1) appropriable technology, (2) pre-emptible resources, (3) customer

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switching costs, (4) network effects. To be successful, a first mover must exploit these characteristics to defend against competition from follower firms.

Appropriable technology. A market pioneer that develops unique technology must find a way to keep that technology proprietary. Patents are a common mechanism, but their effectiveness varies greatly across industries. Secrecy and aggressive movement down a 'learning curve' are also mechanisms that can allow a firm to maintain technological leadership. Even so, such an advantage is difficult to maintain in industries where technological progress is rapid, as rivals have greater opportunity to leapfrog the pioneer's technology.

Pre-emptible resources. In some markets, superior resources can be acquired pre-emptively by the initial entrant. These include raw material inputs, geographical locations and, potentially, positions in consumers' perceptual space. Although appealing in theory, such resource pre-emption seldom confers a large advantage in practice.

Customer switching costs. The initial entrant in the market may have the ability to develop buyer switching costs or 'lock in'. Once these mechanisms are in place, later entrants must invest greater resources to attract customers away from the pioneer. Many types of switching costs are commonly identified, including initial investments made by the buyer in adapting to the seller's product, product specific learning by the buyer over time, and contractual switching costs intentionally created by the seller.

Network effects. In situations where customers seek a common standard or the ability to interact with other users, the pioneering firm has the first opportunity to develop 'network effects'. Such effects, which are most common in the information technology sector, create a preference among buyers for the standard product that is similar to a switching cost. In addition, network effects may attract valuable alliance partners to the leading firm.

Firm characteristics and the relative benefits of first mover versus follower strategies

Even when features of the market allow a first mover to defend against competition, a follower strategy may be superior for many firms. Followers typically benefit from investments made by early entrants and from the resolution of uncertainty. (Such benefits to

followers are, in effect, 'first mover disadvantages'.) More specifically, early entrants often must invest in buyer education and infrastructure in order to develop the new market. To some extent, followers can 'free ride' on these investments and on the R&D of pioneering firms, which may resolve key uncertainties about the best technological approaches and salient customer needs. In many industries, this resolution occurs through convergence on a 'dominant design' or product format that meets the needs of the majority of customers in a relatively low-cost way. If an astute follower is able to time its entry to coincide with the emergence of the dominant design, it can avoid the costly experimentation and potential mistakes committed by early entrants prior to this stage.

For established firms, such a 'fast follower' strategy is often advocated as being superior to an attempt at first mover (e.g., Markides and Geroski, 2005). Established firms are likely to have complementary assets and skills in marketing, distribution and manufacturing that allow production to be scaled up quickly and efficiently to serve a mass market. Rather than commit these assets early and risk significant loss, it may be optimal for an established firm to track the early evolution of the market and prepare to enter at the start of the rapid growth phase. Moreover, established firms typically lack the skills needed for radical innovation and hence may be relatively ineffective in the early phase of the industry.

Most new companies do not have the resources of established firms, and hence a superior strategy for start-ups may be to attempt entry as a pioneer. If the firm is initially successful and can exploit the market characteristics described above to defend against imitation, the firm may be able to grow rapidly and enjoy a substantial competitive advantage. Alternatively, many early entrants sell out to larger firms that seek market-specific resources needed to support a follower type strategy.

The above generalizations apply most directly to markets for products that are fundamentally new. When markets emerge more incrementally, in the form of new product generations or geographical/international locations, established incumbents are likely to play a greater role in the early phase (Mitchell, 1991).

Summary: contingent nature of first mover advantage

For the reasons indicated above, first mover advantage is contingent on the characteristics of the emerging market as well as the capabilities and resources of the potential entrant. Luck also plays a large role in determining the success of a pioneering firm. Most contemporary research on first mover advantage aims to elaborate the contingencies that link entry order to performance for a given type of firm. Managers are advised to avoid simple prescriptions and carefully evaluate the likely benefits and costs of first mover versus follower strategies in the context of their specific market and firm.

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See also

appropriability regime; competitive advantages; market entry strategies; network effects; preemption - entry timing; switching cost

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Non-Print Items

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market entry
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network effects
pre-emptible resources

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