Journal of Business Models (2022), Vol. 10, No. 1, pp. 11-18

JOURNAL OF BUSINESS MODELS

Incumbent Business Model Innovation Under Misperceived Hypercompetition

Kristian J. Sund[1] and Annesofie Lindskov[2]

Abstract

Hypercompetition theory states that incumbent firms must restructure their organizations, resources, and product portfolios, as competitive advantages cannot be sustained over time. Yet, hypercompetition is rarer than many scholars and practitioners suggest. In this paper, we suggest that if managers misperceive the true state of competition in their industry, they run two potential risks. The first is to underestimate the competitive dynamics and to therefore focus too much on incremental changes to their existing business model. The second is to overestimate the dynamics and to waste resources on unnecessary radical business model innovation. In this chapter we discuss these risks in light of recent research on both hypercompetition and on incumbent business model innovation.

Acknowledgements: We thank journal reviewers for their useful comments. An earlier version was presented at the 2021 Business Model Conference.

Keywords: hypercompetition, sustainable competitive advantage, dynamic competition, technology-intensive sectors, performance

Please cite this paper as: Sund, K. J. and Lindskov, A. (2022), Incumbent Business Model Innovation Under Misperceived Hypercompetition, Vol. 10, No. 1, pp. 11-18

1 Professor of Strategic Management at Roskilde University, sund@ruc.dk
2 Roskilde University & Sino-Danish College, the University of Chinese Academy of Sciences, annesli@ruc.dk

ISSN: 2246-2465
DOI: https://doi.org/10.54337/jbm.v10i1.6825

Introduction

The balancing of incremental and radical business model innovation (BMI) is a critical activity for incumbent firms facing changing environments (Amit & Zott, 2012; Egfjord & Sund, 2020; Khanagha, Volberda, and Oshri, 2014; Sund, Bogers, & Sahramaa, 2021). Radical innovations lead to a discontinuity, while incremental innovations build on the existing (Bucherer, Eisert, & Gassmann, 2012). In stable and less competitive environments, incumbent firms can build sustainable competitive advantages by making incremental improvements around existing capabilities (Jensen & Sund, 2017), or to the orchestration of existing resources (Sund, Barnes, & Mattsson, 2018). In environments characterized by intense competition, this becomes more difficult, and managers may seek to explore more radical forms of BMI in order to escape this competition. One type of environment that makes it difficult to build sustainable advantages is that characterized by hypercompetition. This is an environment that D'Aveni (1994) defines as "*an environment of intense change, in which flexible, aggressive, innovative competitors move into markets easily and rapidly, eroding the advantages of the large and established players*" (D'Aveni, 1994: 6). In hypercompetitive markets, such established players (incumbent firms), can gain only a temporary competitive advantage through incremental changes to their business model. A more radical change made to the business model may instead differentiate the firm from its competitors and create a more sustained competitive advantage. But what if managers misperceive the true nature of the environment?

Under intense competitive conditions, firms succeed or fail based on their ability to reinvent themselves, develop new advantages, undermine the advantages of their competitors, and increase their competitive intensity (i.e. the frequency of competitive actions). Yet managers may misjudge their competitive environment. Managers make decisions on behalf of their organization based on their subjective perceptions of the competitive reality, not on the reality itself. How managers perceive the environment thus guides their business modelling activities, something which has been pointed out in recent literature examining the cognitive aspects of BMI (Sund, Galavan, & Bogers, 2020). What are the implications of misjudging hypercompetition? In this short paper we explore this question.

Hypercompetition and Business Model Innovation

The resource-based view of the firm suggests that the primary goal for managers is to create sustainable competitive advantages that can lead to above-normal returns (Hall, 1993; Oliver, 1997). This can be achieved through barriers to imitation and substitution (Reed & DeFillippi, 1990), by accumulating rare and valuable resources (Barney 1991; Kraaijenbrink, Spender, & Groen, 2010), by building and defending core competences (Prahalad, 1993), or through superior resource orchestration (Sund, Barnes, & Mattsson, 2018). It has long been recognized that the ability to achieve advantage is intimately linked to the state of the competitive environment. Sustainable competitive advantage requires conditions of environmental heterogeneity that are durable, and as Peteraf (1993: 182) writes:

> *"This will be the case only if there are in place ex post limits to competition as well. By this I mean that subsequent to a firm's gaining a superior position and earning rents, there must be forces which limit competition for those rents."*

Not surprisingly, more recently scholars have pointed out that when competition becomes very intensive, competitive advantages become temporary in nature (see e.g. Dagnino, Picone, & Ferrigno, 2021; Sirmon, Hitt, Arregle, & Campbell, 2010). The concept of hypercompetition emerged in the 1990s to account for the empirical observation that competition actually appeared to have intensified over time, at least in certain industries in the United States (D'Aveni, 1995). Some scholars argue that as the competitive intensity escalates, the competitive environment becomes characterized by disruptions, only rarely punctuated by stable periods (D'Aveni, 1999, 1994; D'Aveni & Dagnino, 2010). Since then, there have been a handful of large-scale empirical studies trying to ascertain whether other industries, including in other parts of the world, are becoming hypercompetitive, as some have suggested (see e.g. Lindskov, 2021; McNamara, Vaaler, & Devers, 2003; Vaaler & McNamara, 2010). The evidence is mixed, suggesting that hypercompetition is not a universal phenomenon, but one that is limited in industry, geographical space, and time (Lindskov, Sund, & Dreyer, 2021).

Scholars argue that when markets become hypercompetitive, the competitive intensity increases and competitive advantages disappear quickly, forcing firms to more rapidly shift resources and product portfolios (see e.g., Andrevski & Ferrier, 2019; D'Aveni, 1994). The dilemma managers face becomes whether to focus on the gradual and incremental refinement of current advantages, or, at the right time, try to more radically change the business model, or even seek a new business model altogether. Essentially the dilemma is of business model exploitation versus business model exploration (Foss & Saebi, 2016; Giesen, Riddleberger, Christner, & Bell, 2010; Jensen & Sund, 2017). In this context, we define the degree of radicality as the extent to which a BMI departs from the existing model (Taran, Boer, & Lindgren, 2015). While the radical BMI has the potential to move the incumbent firm into new markets, thereby escaping the hypercompetition of the existing market, the incremental BMI involves minor extensions or improvements (Bucherer, Eisert, & Gassmann, 2012). Thus, managers need to understand the competitive dynamics within their industry, to be able to understand when and by how much to innovate the business model. If managers misperceive the true state of competition in their industry, they might end up focusing too much on incremental changes, or alternatively waste resources on what may be unnecessary radical changes.

The Risks of Misperception

Managers have been called information workers, who capture information about the environment, interpret this information, and act on it on behalf of their organization, in what is essentially an ongoing organizational sensemaking process (Daft & Weick, 1984; Sund, 2013). Managers within the same organization may capture different information about the environment, which can affect how different departments prioritize innovation (Egfjord & Sund, 2020; Sund, Bogers, & Sahramaa, 2021). There is also plentiful evidence to suggest that humans fall victim to the general problem of knowledge overconfidence (Kahneman, 2011). This problem affects managers in their decision-making (Mezias & Starbuck, 2003; Sund, 2016). Managers are thus known to misperceive the competitive environment and have too much confidence in their own interpretations of that environment. One explanation for this bias has to do with the way we search for information in memory. When faced with a question or problem, managers will tend first to conduct a rapid memory search for a possible solution. Once this has been found, they will seek to confirm their initial judgment, filtering out information that does not fit (Kahneman, 2011). In the context of a collective management team decision, pressures to socially conform may amplify this tendency (McGill, Johnson, & Bantel, 1994). The implication is that managers tend to underestimate the degree of uncertainty surrounding their own perceptions and decisions (Sund, 2016).

In figure 1, we propose a simple matrix with four scenarios of how managers' perceptions of the competitive environment, related to hypercompetition, may affect the balancing of incremental and radical business model innovation (BMI). As a reminder, and for the sake of simplicity, we here define incremental BMI as a change to the business model involving minor extensions or improvements (Bucherer, Eisert, & Gassmann, 2012). We define radical BMI as a change of many components of the business model, or the adoption of an entirely new one, allowing the incumbent to escape the condition of hypercompetition. This is consistent with the approach of numerous scholars, although we recognize that there are many other conceptualizations in literature (for a discussion see e.g., Foss and Saebi, 2016; Taran, Boer, & Lindgren, 2015)).

In the absence of hypercompetition, managers may correctly identify that their market is normally competitive. This is illustrated in quadrant A in Figure 1. In this circumstance, their knowledge of the environment can be considered correctly calibrated (Mezias & Starbuck, 2003), and managers should be in a position to correctly balance incremental and radical forms of BMI. It may in this context be possible to build sustainable competitive advantages, and to engage in incremental exploitative BMI around these to adapt to a slowly evolving market, thereby keeping up advantage. It should be noted that management may still have a desire to diversify their company through radical BMI, but the decision is not predicated on the intensity of competition in the current market environment.

In the situation illustrated in quadrant B in Figure 1, managers (mis)perceive their market environment to be more dynamic than it is. Managers believe the environment to be hypercompetitive, which may lead them furthermore to assume that it would be impossible to maintain a sustainable competitive advantage. The perceived solution could investments in radical BMI, aimed less at the further exploitation of existing advantages, but more at seeking new advantages, through excessive product or market development, or even unrelated diversification. As the market is in fact not hypercompetitive, environmental munificence and company resource slack may enable such exploration. This could include making strategic unrelated acquisitions. The problem of unprofitable diversification is described in literature (see e.g. Markides, 1995), and we thus propose that one explanation for such investments could be misperceptions of hypercompetition.

In the situation illustrated in quadrant C in Figure 1, managers again misperceive their market environment, but this time underestimating the true nature of competitive dynamics. This situation is evidenced in the numerous empirical studies uncovering problems of myopia (Levinthal & March, 1993), core rigidities (Hacklin, Inganas, Marxt, & Pluss, 2009; Leonard-Barton, 1992), and managing strategic change (Johnson, 1992). Managers believe the environment to be relatively stable, leading them to keep focussing on incremental business model adaptation around what they perceive to be strong unique resources and core competences. Meanwhile, the environment is changing rapidly, performance suffers, and by the time management recognizes that their competitive advantages are eroded, it may even be too late to successfully shift the focus towards more radical BMI. In particular, diminishing environmental munificence and a lack of slack resources may limit the options for investments if these are postponed for too long.

Finally, in the situation illustrated in quadrant D in Figure 1, managers correctly perceive their market to be hypercompetitive. Bogner and Barr (2000) argue that in hypercompetitive environments, characterised by extreme uncertainty, conventional

	Market perceived to be normally competitive	**Market perceived to be hypercompetitive**
Normally competitive market	A: Managers correctly balance the need for exploitation and exploration, and may seek advantages through incremental BMI	B: Managers may waste resources looking for a new basis for competition through radical BMI, when they could exploit more their existing advantages with incremental BMI
Hypercompetitive market	C: Managers underestimate the competitive dynamics and focus too much on incremental BMI at the expense of radical BMI	D: Managers correctly identify and act on the need to invest in radical BMI in addition to incremental BMI

Figure 1: Perceptions of hypercompetition and business model innovation

sensemaking frameworks do not work. Instead, managers in such environments must rely on a higher diversity of information and access to real-time information. Managers also need a faster decision-making process, and have to focus on business model experimentation as part of their sensemaking (Egfjord & Sund, 2020; Sund, Bogers, & Sahramaa, 2021). There is mounting evidence that for incumbent firms, radical BMI is challenging, as is managing multiple business models under one organization (Snihur and Tarzijan, 2018; Sund, Bogers, Villarroel, and Foss, 2016). Correctly identifying the true nature of competition in the environment may provide the firm with a better chance of correctly balancing incremental and radical BMI.

Concluding Remarks

In hypercompetitive environments, firms do not necessarily need to have a revolutionary product or service to gain a competitive advantage, but a unique business model can shield the firm from competition. While firms can gain and sustain competitive advantages through BMI, the balance of incremental and radical BMI depends on correctly perceiving the competitive conditions. If managers misperceive the intensity of the competitive environment, they may waste resources on exploring new opportunities, fail to conduct such exploration, or fail to exploit existing advantages. This insight, coupled with evidence that hypercompetition may not be common (Lindskov, Sund, & Dreyer, 2021), has important implications.

Firstly, it serves as a warning to scholars against using managers as informants on the true state of the industry environment. This warning has been discussed numerous times in literature in general (Kumar, Stern, & Anderson, 1993; Mezias, & Starbuck, 2003; Sund, 2016; Sutcliffe, 1994), but we extend this warning to perceptions of hypercompetition. The fact that a manager believes the industry environment to be hypercompetitive, or that a firm appears to invest heavily in incremental or radical BMI, is not an indication of hypercompetition in itself.

Secondly, empirically documented issues of organizational myopia (Levinthal & March, 1993), core rigidities (Hacklin, Inganas, Marxt, & Pluss, 2009; Leonard-Barton, 1992), and strategic drift (Johnson, 1992), could at least in part be explained by misperceptions of the degree of competition in the environment, and a subsequent mis-balancing of business model exploration and exploitation. The implication of misperception is that managers may be over- or underestimating the industry conditions in which they compete, affecting their investments. The issue of knowledge overconfidence thus serves as a warning to analyze carefully the true state of the environment before making investments (Markides, 1995). Verifying our four proposed scenarios empirically could be done in a number of ways. Qualitative case study work could seek to verify the existence of misperceptions and associated misbalancing of BMI. Quantitative work could seek to verify the extent to which such misperceptions actually take place, and perhaps quantify the implications in terms of firm performance and returns to investors, an area that does not appear to have received much attention in the business model literature so far (Cuc, 2019; Wirtz, Göttel, & Daiser, 2016).

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