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Survival of The Fittest: How Competitive Service Overlap and Retail Format Impact Incumbents' Vulnerability to New Entrants

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Abstract

Many retailers invest in ancillary services to provide shoppers with additional reasons to come to their stores. However, it is unclear whether these services insulate incumbents from new entrants. We address this question by examining how the size and uniqueness of an incumbent's service portfolio protects its sales after a new competitor enters. We study uniqueness by introducing the notion of "competitive service overlap" (CSO) that operationalizes service similarity, and show both that retailers are best served by offering many services and that particularly successful retailers have more unique service portfolios. Furthermore, the impact of uniqueness is most prominent when a grocery incumbent faces a discounter entrant (e.g., Kroger facing a Wal-Mart entry).
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Introduction

Over the past decade, retailers have faced mounting pressures from manufacturers in the form of disintermediation, internet commerce, and shoppers who are demanding greater value at lower price points (e.g., Basker 2007; Jia 2008; Neumann 2008). As a result, some retail giants like Great Atlantic & Pacific Tea Company (A&P) have been forced into bankruptcy, while Sears and others struggle to remain relevant (Cavale 2013; Erman and Humer 2010). The challenges faced by these retailers stand in stark contrast to the successes of retailers like Whole Foods and Albertsons, that are not only thriving but growing rapidly (Elejalde-Ruiz 2014; Whole Foods 2014 Annual Report).

Clearly, it has become critically important for retailers to intelligently position themselves to remain competitive in the marketplace. Although retailers can position themselves along various dimensions, many are investing in ancillary services towards this end. Retailers see services as an efficient and cost effective way to achieve differentiation and boost sales. The hope is that offering ancillary services will allow retailers to achieve substantive differentiation, increase the value of their offerings, motivate shoppers to patronize them over competitors, and minimize the probability that their patrons will switch to new entrants. With this in mind, Target is bringing Starbucks coffee shops to more of its stores and Giant Eagle introduced table-service restaurants to its Market District stores (Giant Eagle 2015; Target 2012 Annual Report). In fact, the *Wall Street Journal* (Haddon 2016) recently reported that grocers are adding a variety of new services to compete against discounters and online rivals, including yoga studios, wine bars, spas, and putting greens.

Despite this push towards services, it is unclear if they actually provide retailers with competitive lift and insulate incumbents from new entrants. We address this issue by examining how the size and uniqueness of incumbent retailers' service portfolios impact their sales in the face of new competitors. Service similarity varies such that a new entrant's service offering may exactly match that of the incumbent or may not

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overlap with it at all. We capture the extent of overlap between incumbents and new entrants by introducing the construct of "competitive service overlap" (CSO).

Through a field-based quasi-experiment, we show that incumbents with many services better withstand new competitive threats than those with few services. However, beyond simply having a lot of services, our results indicate that it is important for retail incumbents to offer unique services, because doing so can further inoculate them from new entrants. We also show that service overlap impacts competitors differently. For instance, unique services are particularly important for grocery incumbents competing against new discounters, but are far less important when the new entrant is a grocery store.

We organize the remainder of the paper as follows. We begin by reviewing the relevant literature and then explicate the basis of our CSO construct. Following this, we introduce our model and discuss our methodology and data. We then present our results, after which we close with a discussion of the theoretical and managerial implications of our findings. Overall, our research contributes toward explaining how services create value in a competitive context, painting a more comprehensive picture of retail competition, and providing retailers with more precise direction as they deploy resources and develop programs.

Drivers of Retail Performance

Product assortment, quality of offerings, atmosphere, pricing structure, location, and friendliness of salespeople have been shown to be important determinants of store choice (e.g., Hoch et al. 1995; Pan and Zinkhan 2006; Reinartz and Kumar 1999). Although shopper and competitive factors account for 67% of the variation in consumer price elasticity, their importance largely disappears when market factors are also considered (e.g., Hoch et al. 1995; Reinartz and Kumar 1999). In line with this, Reinartz and Kumar (1999) conclude that location is the most important determinant of retail success, noting that "...even if a store has superior characteristics in terms of scrambled offerings, assortment, and service, these aspects cannot make up for locational disadvantages" (p. 20). Comparatively, Pan and Zinkhan's (2006) meta-analysis suggests that shoppers' store choice is primarily determined by a store's assortment of products.

While retailers can take various steps to increase the attractiveness of their stores and encourage shopper patronage, they must do so without sacrificing efficiency. Arnold, Oum, and Tigert (1983) examine returns relative to competitors and find that location, low pricing, assortment, shopper service initiatives, cleanliness, and shopping environment can be used to achieve competitive advantage. Of these factors, however, only superior location and low pricing can be leveraged to achieve long-term advantage.

Other research has examined how best to respond to new Walmart store entries and has found that differentiation is superior to emulation (Ailawadi et al. 2010; Basker and Noel 2009; Gielens et al. 2008). For example, Ailawadi et al. (2010) report that retailers can minimize Walmart's impact by increasing prices, shrinking assortments, increasing stock of top-tier and private label brands, increasing the breadth and depth of their promotional campaigns, and adopting other activities to leverage niche populations. Gielens et al. (2008) reach a similar conclusion in finding that incumbents are best served by minimizing assortment, market, and positional overlap with Walmart. They suggest that incumbents should emphasize Hi-Lo pricing and focus on niches that Walmart ignores to minimize direct comparability. Gielens et al. (2008) also note that incumbents with experience competing against Walmart are less vulnerable than those with less experience.

Within the last decade, researchers have begun to examine the role played by services in encouraging superior retail positions. These findings suggest that service-based differentiation can lead to superior performance and becomes increasingly important as competition intensifies (e.g., Arnold et al. 2009; Ramani and Kumar 2008; Seiders et al. 2005). In addition, Arnold et al. (2009) report that when sold together, products and services provide shoppers with solutions rather than quick fixes, and such "solution selling" is necessary to achieve competitive differentiation in markets with intense rivalry.

In sum, prior research identifies services that retailers can leverage to improve their retail positions and stresses the importance of emphasizing unique services when facing new Walmart stores. We extend this literature by explaining how the uniqueness and size of retail incumbents' service portfolios impact their ability to compete against both Wal-Mart stores and new grocery entrants. In addition, we conduct an effect size analysis to determine whether the impact of services is stable or varying across different incumbent-entrant format pairs.

Competitive Service Overlap

Overlaps with new competitors in terms of market, assortment, and position have been shown to increase an incumbent's vulnerability (e.g., Ailawadi et al. 2010; Gielens et al. 2008). Chen and Miller (1994) and Chen (1996) argue that incumbents that overlap extensively with new entrants are more directly threatened by the new entrant's arrival than those that exhibit low overlap. In contrast, first-mover theory suggests that first movers gain advantage by creating or acquiring scarce resources before rivals. According to this theory, the first successful entrant to a market establishes a loyal shopper base that is largely unwilling to switch to new competitors because of the opportunity costs of doing so (Carpenter and Nakamoto 1998; Lieberman and Montgomery 1998; Makadok 2001). However, first-mover advantages diminish when the new entrant provides a unique and valuable service offering (Shankar, Carpenter, and Krishnamurthi 1998). In this case, the new entrant captures a share of the incumbent's shoppers whose demands are not adequately met, and switching from incumbents can ensue at a high rate. This implies that incumbents benefit from sharing services with new entrants.

As this discussion indicates, there is a disagreement among researchers as to the impact of similarities between competitors on incumbent performance. Competition theory suggests that overlap favors new entrants and uniformly heightens the likelihood that shoppers will switch to new entrants, whereas the first-mover literature argues that incumbents can capitalize

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