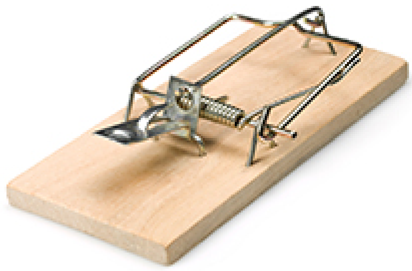
TOMORROW'S CHALLENGES

AVOIDING THE TRAPS OF COMPETITIVE IRRATIONALITY



AVOIDING THE TRAPS OF COMPETITIVE IRRATIONALITY

HOW HURTING YOUR COMPETITOR MIGHT NOT HELP YOU

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In a competitive environment, managers regularly forfeit absolute profit in exchange for favorable standing. With strategic advancement in mind, they aim for position rather than profit and frequently neglect the financial interests of their companies. Known as competitive irrationality, it is a trap easily fallen into, but just as easily avoided when better understood.

The phenomenon of competitive irrationality is well known and has been extensively documented. To paraphrase a popular idiom, it is a situation in which managers saw off the branch on which their company is sitting in order to prevent competitors from climbing the tree. Individuals engage in often risky behavior when they deprive themselves of something just to prevent others from gaining it as well. So far, social psychologists and behavioral economists have stopped short of investigating countermeasures to a conduct that is frequently destructive.

In our study “Debiasing competitive irrationality: How managers can be prevented from trading off absolute for relative profit” we have identified and tested specific potential remedies for competitive irrationality.

Relative happiness

The inherent tendency of people to evaluate themselves in comparison to others creates the “positional concerns” that are found throughout human relationships. According to evolutionary psychology, it is a way to ensure access to scarce resources and mating partners. After all, it is not important to be as strong or smart as humanly possible – it is sufficient to be stronger or smarter than the immediate competitor in order to appease one's hunger or to be successful in a mating contest. From a social psychology perspective, engaging in comparisons has been identified as an efficient tool for self-enhancement and self-improvement: downward comparisons can boost self-esteem; upward comparisons can help develop new capabilities or procure advancement.

This explains why there are limits to the traditional wisdom and common belief that happiness or success are directly linked to positional advancement. The “Easterlin paradox,” whereby making everyone better off does not make everyone happier, reintroduces the notion that subjective well-being remains intrinsically linked to relative position: if others become wealthy, they take away from the happiness that one can derive from being wealthy; relative income, and not purely absolute income, determines one's sense of well-being.

Managers tend to behave likewise. Despite explicit instructions to maximize profit, they frequently make competitively irrational decisions that sacrifice absolute profit for relative position vis-à-vis competitors. They instigate unjustified price wars, overbid during acquisitions processes or refrain from profitable cooperation with competitors. The consequences are rarely positive.

For instance, when the major record companies in Germany decided in the late nineties to protect themselves against illegal file-sharing over the Internet that the MP3 file format had made possible, residual rivalries between the companies slowed down the establishment of an alternative platform named PhonoLine. iTunes came in and took the market by storm, rendering their efforts obsolete. All incumbents lost out on a tremendous business opportunity because everyone was primarily concerned about their relative positions.

Countering competitive irrationality – three simple measures

The underlying psychological processes and mechanisms that contribute to competitive irrationality have been abundantly reviewed, as have the consequences. Surprisingly, almost no attention has been devoted to possible countermeasures, which was the reason for engaging our study. Through our research, we identified three measures that significantly reduce competitive irrationality. The apparent simplicity of these measures should not detract from their importance, since for competitive irrationality, as is the case for many kinds of irrational behavior, realization is the beginning of the remedy.

1. Be aware of interfering biases:
Simply being aware of competitive irrationality can reduce its hold on decision-makers. Positional concerns are no longer a question of survival, as they were when resources were scarce, so managers need to step back and resist their natural compulsion to beat the competitor just for the sake of it. In most industries, there is room for a number of competitors.

2. Reduce time pressure:
Our research revealed that time pressure actually amplifies the importance of relative standing, but since decisions that are made at time's gun point are rarely appropriate, such haste makes waste. Remembering that pressure can amplify positional concerns to the detriment of the financial health of a company, several measures can be considered to combat their negative influence: moving deadlines, re-prioritizing tasks or simply temporarily removing the decision-maker from an over-stimulating environment.

3. Expand reference groups:
Finally, it is also essential to reconsider who it is we are comparing ourselves to. Typically, companies have a clearly defined set of competitors that they have been competing with for a long time and, in many cases, the strategic focus revolves around "beating competitors X, Y, and Z" at any cost. As we pointed out above, this competitively irrational behavior in itself is already problematic. However, in addition this irrational focus on trying to beat a specific set of competitors also often prevents us to look beyond our traditional industry boundaries. As real competition is increasingly starting to take place outside the boundaries of our established reference groups, an overly strong focus is likely to be a recipe for failure. Expanding the reference group can help prevent blind spots, as well as favor or accelerate innovation.

Pyrrhus may have won the battle of Asculum, but the victory came at a devastating cost to the winner. Likewise, attempting to contain a competitor might not be to a company's benefit. Managers must be alerted to the potentially harmful effects of such strategies. Our research suggests that simply being aware of the limitations of positional concerns goes a long way to avoiding the traps of competitive irrationality.

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