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Re-examination of the Theory of Competition

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In this chapter, an attempt is made (1) to distinguish the relations between price-competition and technology-competition by examining the characteristics of consumer behavior under price-competition and the character of prices as a marketing policy of firms, and (2) to grasp, in a broad sense, the effects of maintaining price-competition, considering at the same time the restraint on product differentiation and mass advertisement (which lead to oligopoly) and the promotion of technological development. Likewise, we seek to understand here in a wide scope the price-competition among retailers—including the essay to free retailers and wholesalers from the control of monopolistic manufacturing firms and to lead them to independence—by analyzing the changes in consumer behavior caused by the introduction of price-competition into the retail market.¹)

The conditions of demand in Japan are now coming into existence which force firms to compete in prices, and it is considered important to re-examine the effects of price-competition in a new light.

1. Relations between price-competition and technological development.

So far, not only the technological development that is promoted in accordance with governmental demand but also the firms’ technological development, promoted independently by themselves on the basis of the demand in civil market—which is discussed below—has often been considered in relation to monopoly¹). In addition, monopolistic firms have been required to afford to invest in development researches and to bear the risks in the investment; also,
effective causes of technological development have been regarded as attributable to monopolistic firms' control over market—in particular, their ability to get rid of price-competition—which makes it possible to obtain, for a long time, surplus-profits by the help of innovational technology\(^2\). It is quite obvious that monopolistic firms alone are not necessarily capable of investing in technological development and of standing the risks, and that any firm that makes certain profits will do; moreover, it cannot readily be declared for sure that effective causes of technological development are due to monopolistic firms' ability to get rid of price-competition.

As the industrial concentration goes on, because of the reinforcement of inter-dependence among firms; price-competition, which is expected to be immediately opposed by rivals, is cut out; and, rather, investment is made centrally in product differentiation and advertisement, so as to develop new & replacement demand and to attract demand to their brands; furthermore, it must be noted that investment in technological development is often restrained too. A highly-concentrated industry is highly matured, generally; in it, unexplored parts in technology are scarce, and technological development is risky as well as expensive, requiring enormous investments. Moreover, technological development, like price-competition, incites demand-flow among manufacturing firms, and by reason of rival firms' competitive technological development—which is comparatively easily done—it necessitates another and higher level of technological development that is more difficult and dangerous. Thus, in a highly-matured & concentrated industry, as price-competition is cut out, at the same time the investment in technological development is checked. The research and development of products of monopolistic firms in a highly-concentrated industry—which are conducted without the interference of price-competition—in most cases simply aim at small and almost meaningless technical changes for product differentiation. "A manufacturing firm that has succeeded in technological development comes to control market by promoting product differentiation and mass advertisement, in
order to maintain surplus-profits from the elimination of price-competition as can clearly be seen in Japan. We are likely to be led to a wrong conclusion, such as: "Monopolistic firms that have established market- & channel control conduct technological innovation, so that they may control wholesalers and retailers in hopes of cutting down the chances of price-competition in distribution processes." However, it must also be noted that market- & channel-control will, rather, come after technological development. It must be kept in mind that, where free competition goes on among firms as to price and technology, concentration has not proceeded so notably; that concentration itself has been promoted by successful firms in technological development through product differentiation, mass advertisement, and consolidation of firms, in order to evade price-competition and the next stage of technological development\(^3\). The general trend is: the group of firms, which have raised the rate of market share, will make concentrated investments in the creation of indiscriminate mass demand, so as to secure a less risky and higher rate of profit; and they reciprocally try to avoid the investment in technological development, as in the case of price-competition—although they can conduct it. As can be seen here, monopolistic firms tend to evade technological development, even if capable of it, because the developmental investment is dangerous and because a new development will become necessary by reason of rival firms' following development in the same line.

In general, technological development is not so much promoted by expected surplus-profits as it is dependent on conditions that compel it—i.e., the competitive pressure which threatens to destroy the firms. At least, technological development proceeds faster in competitive markets than in characteristically monopolistic markets. It is hoped here that such effective causes of technological development will be clarified in relation to price-competition.

It is considered possible to see in the following the outline of the fact that there exists a system where technological development
and price-competition are directly connected to each other and proceed together: in a highly-concentrated monopolistic industry—in which technological development is risky because of few unexplored parts in technology; obvious extension of industry demand cannot be expected; interdependence is visible among a few firms—when price-competition, contrary to manufacturing firms’ intentions, is introduced by discount retailers (for instance), technological innovation advances in parallel. Moreover, the inter-relation system between price-competition and technological progress can be perceived in the fact that, even in a rather highly-concentrated monopolistic industry, in its fields of such products as are easily compared with others so that elimination of price-competition is hard, technological innovations in products proceed together with price-competition.

Usually, when price-competition is introduced, consumer behavior becomes well-organized or self-reliant. Consumers tend to change their ways of brand choices, reacting to prices; to extend their range of selection of brands, with experience and knowledge; and to stop insisting on particular brands. A point to be noted here is that consumers not only respond to prices more intensely than before, but also (1) become acute to goods’ substantial or technological differences—e.g., differences in specific details of products—and (2) at the same time come to respond less to product differentiation—to meaningless and psychological differentiation—and mass-advertisement or so-called “services” to promote sales. Another fact that relates price-competition and technological development is that, in cases where the price-elasticity in demand is prominent; where favorable conditions exist for lowering prices because of the economy of scale in production; where, accordingly, prices cut despite the strong interdependence among firms—in such cases technological development becomes necessary in order to establish products’ substantial differences for minimizing the effects of rival firms’ counterblows in competitive price-cutting. In other words, for the sake of cutting prices, products’ substantial differences should be made complete as a safe means of preventing or minimizing the effects
of rival firms' following price-cutting. In general, in cases where enough substantial product differences cannot be obtained to prevent competitive counterblows as to lowering prices, or where it cannot be expected that still newer products' substantial differences might successively be obtained against powerful rival firms' adaptation, or where they want to evade the efforts to develop other & next differences of products—in such cases as above, the substantial differences of products, which have been created through the pressure of price-competition, come to be used as the pressure for raising prices instead. The rise in prices which comes along with technological innovation in products is not so much annoyed—in relation to competition among firms—as the lowering of prices is; and it does not necessitate so much rapid adaptation of rival firms. In a highly-concentrated monopolistic industry, it is quite probable that the price-raising policy is adopted, together with technological innovation in products, in order to avoid commotion in connection with competition among firms; as has been mentioned before, in a highly-concentrated monopolistic industry, it is often seen that price-competition is eliminated to enlarge common profits and that technological development itself becomes sluggish, and competition among manufacturers comes to concentrate on additional functions and simple product differentiation, which are not essential in actual use, and on advertisements concerning suchlike.

The technological development that has been discussed so far is in relation to specific details of products, i.e., technical structures and functions of products; also, there is the technological development concerning manufacturing processes. As for process-innovation, the risk is not too great in its introduction, and it is supposed to be promoted by such motives as foreseen expenditure-reduction or productivity-improvement—namely, acquisition of surplus profits; in fact, monopolistic firms are often willing to promote investment in process-innovation. However, an important point is that the introduction of such process-innovation is possibly conducted faster if the market is competitive than if it is monopolistic. It is
very clear that price-competition, with threats of destruction, forces manufacturing firms to process-innovation; on the other hand, the expectation of secure profits, from the downward shift of cost function through process-innovation, must be greater in a competitive market than in a monopolistic market, and it can be said that effective causes of process-innovation are more powerful in a competitive market rather than in a monopoly-inclined market\(^4\).

When we say that price-competition promotes technological development, we must remember that this "price-competition" does not mean such a severe competition as to compress manufacturers' profits for a long time and to drastically reduce their capacity of investing in research-development and of bearing risks in the investment. Moreover, although price-competition still remains—even under the inflation and excess-demand—as a competition concerning the extent and timing of price-raising, under the progressing inflation, technology-introduction requiring new investment is restrained, for it is accompanied with a rise in prices of production factors, and a long term investment in research-development is most likely limited. It is rather that, here, through the price-raising by agreement among manufacturers and price-leadership, price-control is more forcibly conducted and steady relations among firms are sought after—even in industries of comparatively low concentration rate, not to mention highly-concentrated monopolistic industries. Under the inflation growing worse, technological development becomes sluggish; add to this, real income goes down—and consumers start to realize it more intensely, so that product differentiation and advertisement become less effective—and then special efforts come to be made to control prices among manufacturing firms.

2. Effects of the introduction of price competition by innovational retailers.

In the case of Japan, the effects, if small, must be valued to
a certain degree of the fact that innovatory retailers (large-scale discount retailers such as supermarkets) have introduced price-competition into the distribution process, where manufacturing firms' control had been under reinforcement. John K. Galbraith took up, as a subject, the countervailing power of large-scale retailers, but the countervailing power itself merely brings about a situation of pseudo-monopoly on both sides, and the consequences brought by large-scale retailers into competition processes cannot be fully valued if discussed in the phase of the counterforce alone. The influences of large-scale discount retailers must be considered in a wide scope, as a factor which, besides destroying a part of monopolistic manufacturing firms' channel control—through the counterforce—introduced price-competition into distribution processes, promoted the independence of retailers in general, and, furthermore, caused price- & technology-competition among manufacturers. Even in a highly-concentrated monopolistic industry, if discount retailers have successfully come into the distribution processes there, price-competition comes to proceed—as well as among retailers—among monopolistic manufacturers, contradicting their intentions. Motivated by such an introduction of price-competition by discount retailers, the means of control of manufacturing firms over the ultimate demand tend to become powerless; retailers, on the contrary, partly with the help of penetration into retailers of innovational ways of sales, come to offer consumers their own independent chances of selection—by the correction of customary retail prices in general and by a variety of stocks of many brands—and come to exercise their singular customer-attracting force on consumers who have, influenced by prices, begun free brand-choice. Manufacturing firms come to depend more upon retailers as to customer-attracting power for sales, and it gets hard for them to control retailers of their own will. Moreover, the range of free selection of stores for consumers is enlarged by the diversification of retail-systems—caused by the interference of innovatory retailers—and by the extension of geographical mobility of consumers; this fact must oblige manufacturers to
supply the market through various processes, must make restrictive-process policy unfavorable, and the control of manufacturing firms over retailers even more difficult.

In general, when manufacturers aim at a wide-scale penetration into market, they cannot but depend upon discount retailers and, in part, obey their interferences; particularly in cases where the brand has already been accepted in market so that manufacturing firms' special efforts to create demand are not necessary, or where the competition among brands is severe—there, large-scale retailers' interfering force is usually great to manufacturers.

Furthermore, the large-scale retailer comes to integrate the manufacturing process and to establish the "private brand"; but it should be taken account of that there is a limit to the use of this private brand, and thus to its role in the introduction of competition. Private brands, in general, are accepted by consumers—at lower prices than those of manufacturing firms' "national brands"—only when such national brands have been introduced into market and have secured their places there. Moreover, as the means of promotion of private brands are chiefly their prices, products are usually those alone in which technological differences and product differentiation are not extensive, and products whose demand freely flows among brands. The essential qualities of private-brand products are not necessarily inferior to those of national brands; however, because retailers cannot keep up, on a grand scale, a demand-creation system for their brands, their brands can be received simply on the basis of price-comparison with national brands which have already attained security in market. In addition, the above takes place but on a local scale, and their positions in market are mostly low. Especially in Japan the private-brand status is often low in comparison with that of the national brand. From now onward, the private-brand status in market will tend to rise higher, for reasons that the private brand will be evaluated anew as consumers come to judge products better than before; that consumers will be able to bear more risks with the increasing income; or that,
conversely, they will start—on account of the aggravating inflation—to react to prices more alertly. In Japan, nevertheless, as has been mentioned above the private-brand status is usually low and the range of product-development is narrow for retailers; thus it follows that a manufacturing-process integration on a huge scale is regarded as nearly impossible. Also, it cannot be denied that large-scale retailers, whose merit consists fundamentally in the variety in their stocks, are basically suited to ask for concession as free judges for the rich supply-source rather than for the manufacturing-process integration. Therefore, the effects may not be expected too much of the competition-introduction by retailers who have achieved the manufacturing-process integration; only, with respect to ensuring a stable supply-source for retailers, such an integration may be supposed to grow valuable in future. Still, however, retailers need to cut down their production-investment to the lowest limit possible, and to maintain the free choice (for customers) of supply-sources at the highest level. Yet, such private brands as are ordered to product specifications alone can choose where to place the orders on the ground of the prices in competition with manufacturing firms’ national brands; thus it might be that they are free from the rigidity as in the case of the manufacturing-process integration, and that they can maintain the promotion chiefly with appeals in prices. It is also possible that some reduced prices are allowed, when they have been first supplied from manufacturers under the name of the private brands. In all events, however, the introduction of price-competition among manufacturers is—in consideration of the private-brand status in market—inevitably less effective than the direct discount of manufacturers’ brands.

At any rate, as to private brands, it is only that some useful role can be expected of them in pressing upon the manufacturers’ market and in somewhat checking its monopolistic behavior in pricing; and they cannot, though expected of some, go so far as to organize a new channel that is capable of resisting the channel controlled by manufacturers. Especially in fields of industry where many of the
evils of manufacturing firms' monopolistic behavior have become visible and where it is most necessary to introduce competition, the establishment itself of private brands cannot be realized. It should be noted further that what motivates the introduction of private brands is often the desire to obtain a high profit rate and a steady custom. The revolutionary point of discount retailers lies in correcting manufacturing firms' demand-fastening policy and monopolistic behavior in pricing; but such private brands as have been introduced motivated thus are apt to become a medium through which retailers—who have accomplished their own market status in virtue of the revolutionary character of such brands—start to compress this very character, and become inclined to monopolistic behavior. This must be understood if one considered the fact that the general trend is that private brands adopt the low-price policy against national brands simply because their status is still low; that they, if possible, want to intensify product differentiation, to advertise on a nation-wide scale, and to fortify their competitive standing, so as to set up conditions under which monopolistic behavior in pricing is viable.

An examination must be made of the characteristics of discount retailers' excessive low-price policy and of their influences upon near-by retailers. In considering their influences on near-by retailers, it must be pointed out first that such a policy is different from the invasive price-policy of manufacturers in an industry where the entry-cost is great. Consumers, when purchasing goods, think very much also of other factors than prices—e.g., convenience; so that, even if an extreme low-price policy is exercised, competitors may not thoroughly be put out of the way, and there still will remain a lot of competitive fringes. Moreover, entry into the retail trade is basically easy, and, even though main competitors have been eliminated, monopolistic behavior in pricing is strictly set limits to; and thus monopoly of the retail trade through extremely low prices is not attractive. It then naturally follows that excessive low prices could hardly be used by retailers to drive competitors away or to achieve monopoly. The extreme low-price policy, in fact, is
only employed for a very short time as regards some species of products, in order merely to attract some temporary customer—not in order to get rid of the rivalry.

Allowing that the extreme low-price policy is not employed directly to eliminate rivals, it yet remains to be examined whether or not it may cause too much price-competition among retailers. Comparatively large-scale retailers who employ such an extreme low-price policy are furnished with a wide variety of stocks, characteristic in their own respective ways, and therefore, in general, a direct competitive interdependency does not visibly exist among them. For this reason, products sold at excessive low prices vary from retailer to retailer, and resistant price-cutting seldom takes place. In other words, it is almost unthinkable that retailers, motivated by one retailer’s extremely low prices, should enter into severe competition. Furthermore, most products sold at excessively low prices are famous brands; in such a case, the manufacturing firms, through wholesalers or directly, control and influence retailers, and they can restrain, from behind retailers’ backs, too radical a plan of price-reduction of theirs, so that a direct price-competition may not be set going among retailers. Here, there is no chance for such a plan to develop into a particularly excessive competition.

Next comes the question as to the effects of retailers’ extreme low-price policy upon manufacturing firms; i. e., does it destroy the firms’ distribution system, or arouse among them such a severe price-competition as to oblige them to lower their standards in reliability, durability and specific details of products? “Special-offer” products are usually famous brands that have already been fully accepted by consumers; middlemen in general hardly ever refuse to deal with such brands, merely because of particular retailers’ extreme low prices adopted only briefly—or even if, on account of these low prices, they must cut down, somewhat, their profits. There is the problem whether or not the excessive low-price policy may induce, among manufacturers, a competition so acute that it brings about a decline in reliability, durability and specific details
of products. Retailers, however, are quite likely to set limits to price-competition with respect to special discounts, and—as has been mentioned above—the manufacturers of famous brands which are sold at "special-discount" prices control and influence middlemen and thus are in a position where they can restrain, to some extent, the price-competition among retailers; therefore it can be assumed that there is hardly any foundation of an excessive competition born among manufacturers. It is possible, rather, to expect that extreme low prices, sensationally adopted, may extinguish such an association in consumers as between prices—or stores—and substantial qualities of products, and may effectively urge manufacturers to try to develop products, technically, and to introduce new technology.

Another problem is that of large-scale discount retailers' monopolistic behavior. It is a fact that such concentration, as can be seen in large cities, of the retail market on a few big retailers might be dangerous as a possible basis of such retailers' monopolistic behavior. That is to say, big retailers adopt the low-price policy and innovatory sales system for the sole purpose of forcing their way in market; once they have reached a satisfactory position in market, they become price-leaders to proximal retailers, come to reduce the discount rate, to create a special demand, and start to increase their investment in store-differentiation in order to make high prices seemingly acceptable. In Japan, especially, consumers' buying activities center on and around large cities, which naturally causes discount retailers to be located likewise; and such locations were liable to lead to high entry-costs, soon reducing the discount rate, and their monopolistic behavior became conspicuous. However, the range of the classes of consumers sensitive to discount prices is now widening; therefore, although in Japan such an opportunity is quite limited, retailers having already achieved a potent status in market may be in danger, if they cut down the discount rate, of inducing the entry of new retailers at a still higher rate of discount, and thus it is a fact that their monopolistic behavior is considerably restrained.
Furthermore, the aggravation of inflation is effective in making consumers perceive more clearly than before that their substantial real income is being reduced; in urging them to watch prices in earnest; and, as well, in getting them to plan their buying activities methodically. It must also be observed that, as consumers' response to prices grows in intensity, in accordance with the aggravating inflation, large-scale discount retailers—who have been in friendly unison with near-by retailers—come to recover their former innovatory character. In an industry in oligopoly, even during the proceedings of the aggravating inflation, a conformity among firms in pricing behavior may be observed as to price-raising, by means of illegal agreements or price-leadership; but among retailers, usually such a conformity cannot be seen. As a result, peripheral retailers are inclined to raise prices more than big retailers do; consumers—who are becoming more reactive to prices—are attracted to big retailers in consequence.

3. Characteristics of retail-competition.

It is naturally easy for firms to enter into the retail trade, and it is more so notably in the case where manufacturing firms create the ultimate demand; why, then, does concentration proceed in the retail market? As barriers to entering into the retail trade, capital, conditions of location, covering range of stocks, method of sales, etc. may be enumerated, but none of these seems too great. Yet concentration advances in the retail market; the reason is that, although all the retailers that have grown big have been in possession of such innovational sales methods as the introduction of price-competition, and diversity in inventory of many brands including competitive brands, competitors' adaptation to these methods is slow—or, as in many cases, a totally contrary adaptation, even, may be executed.

Thus, retailers that have grown big by the help of sales methods, backed up with their customer-attracting power, come to
resist manufacturers' control over them, and a tendency toward changes has become perceptible in the distribution-channel system. The appearance of innovational retail stores has made consumers go in the direction of free store-selection; but not only that: as the innovational sales methods have gradually, if slowly, spread among many retailers, they have induced price-competition, which competition has in turn motivated consumers' inclination for free selection of brands. Consumer behavior in purchasing goods has become well planned; and in accordance it has become more difficult for manufacturers to control consumers by the help of product differentiation and advertisement. Manufacturers are now coming to be compelled to go in the direction of relying more upon retailers' consumer-attracting capacity in the final-market sales, of again evaluating the role of retailers, and of admitting their free creative behavior.

The chief basis on which concentration in the retail trade is accelerated is (1) the adoption of innovatory sales- & management-methods—including the low-price policy—and (2) the fact that other retailers do not quickly adapt themselves to this adoption; but it often happens that other and ordinary retailers, once the central market is invaded, can easily introduce similar innovational methods, and that the aggravation of concentration is interrupted at a considerably low level when other revolutionary retailers have entered. Also, a retailer that has reached a governing market-controlling rate is, perhaps for the existence of many competitive proximal retailers or for the competitive pressure of other innovatory retailers, checked in the monopolistic marketing behavior.

It is a fact, nevertheless, that in a market concentrated to some extent a few large-scale retailers were seen to act in an oligopolistic way. For instance, as the concentration progresses, they become more acutely nervous about price-competition, and become inclined to act in market as if they were monopolistic firms, stressing competition in other fields than pricing, and cutting down the discount rate.
In the case of manufacturers, competition in technological development is introduced with the stimulation of prices and technological innovation—which effectually reduces product costs—is promoted in parallel; accordingly the industry often achieves a dynamic advancement. Where competition is carried on, among successful firms in technological innovation, on the ground of technically new products and at a lower level of prices. However, in the distributive trade, accomplishments cannot be successive in the innovation in sales- & management- methods, which innovation offers new chances for price-competition; therefore, it becomes necessary, at a comparatively early stage, to recover competition in “services” and to set limits to price-competition, so as to avoid the passage to destructive competition. For example, the efforts of supermarkets to minimize the possible chances of direct price-competition among themselves can be suspected in the following facts: price-cutting as counterattacks are not frequently seen among themselves; the same products are hardly ever advertised as “special offers” by plural supermarkets at a time; a direct correlation is not always existent between the price-levels of advertised goods and those of goods not advertised. In fact, though, monopolistic retailers stock goods on a large scale and in different constitutions, and interdependence among stores is complicated, making it hard for them to react to one another in rivalry—and such conditions have, supported by the policy of raising and lowering prices often, produced opportunities for price-competition among large-scale retailers, or between a large-scale retailer and other retailers nearby. Thus it is not that they have taken solely to the monopolistic evasion of price-competition. This fact must be admitted; but it must also be remembered that, in the case where the rate of concentration was high, such conditions as mentioned above were the ground—just as they were—of monopolistic behavior as well.
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