First-Mover Advantage for Internet Startups: Myth or Reality?

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- *Over a span of just four years, 200 online companies selling cosmetics were founded in the United States, yet the large established old economy companies like Estee Lauder and L'Oreal continued to dominate the market.*
- *Business Week estimated that there were between 800 – 1400 business-to-business (B2B) Internet marketplaces in the U.S. in the fall of 2000. Consortium exchanges developed by large incumbents existed in virtually every industry.*

What happened to first mover advantage? Touted by everyone from venture capitalists to journalists to entrepreneurs, the notion of being first to market was taken as sacrosanct in the Internet economy. Yet, if there is one thing that has become apparent in the short history of the online economy, it is that the holy grail of first mover advantage is as elusive as it is exaggerated.

First mover advantage is nothing more than a competitive advantage that accrues to companies by virtue of their being the first entrant to a market. It arises from three primary sources. In industries with steep learning curves, being first to market might confer an advantage by providing a "head start". This is exactly the point a senior manager at the now defunct eToys made when he said about Toysrus.com, "We've been doing it longer – it takes a long time to get this business right. They can't catch us". While bold, such sentiments also seem to miss the point that established companies have been working on their own learning curves related to customers, capabilities, competitive advantage, and consistency for years, and that the challenge of matching such strategic know-how may actually be more difficult than developing the capabilities demanded by the online marketplace.

Consider how easy it is for new entrants to create their own website. IWon.com, an Internet portal that pays people to use it, hired Sapient to built their website and relies on partners for content and features. This practice of outsourcing key elements of online businesses is not unique to IWon.com, and raises a basic question: Where is the first mover advantage? If Tom can build an online portal so easily, so can Mary, and Dick and Harry too. With barriers to entry so low, Internet first movers

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seem unlikely to generate much of a "head start".

Second, in some industries the key resources are scarce; players who move first capture those assets. For example, the best locations in malls or high streets are by definition scarce, and can only go to first movers. While many resources may be valuable to online startups, attention has focused on brand name development as a potential barrier to entry. Autobytel.com, the first mover in the online auto sales sector, has spent more than its total revenue on marketing in an attempt to develop brand recognition. That such expenditures have been much the same as its competitors – with little impact on market share – does not provide a strong endorsement to their supposed first mover advantage.

What's more, the notion that first mover advantage accrues to Internet startups requires a rather narrow definition of what a "market" really is. After all, online entrants were not really the first movers for most sectors; rather, there are old economy companies entrenched at many of the crossroads of the new economy. And while these companies may have been slower to the Internet, it is often inaccurate to characterize them as "late movers"; in fact, it is the established companies with established market positions that were the true first movers in many industries. To understand this insight is to acknowledge that being first to the Internet does not create an advantage for the vast majority of online companies because these companies face competition from traditional competitors in traditional channels. For example, as soon as the big aerospace companies announced creation of their own B2B marketplace, the "first mover advantage" that AviationX had been touting from its inception effectively evaporated. Hence, the old argument that online companies need to be first to establish their brand name with customers seems to require a belief that the new economy is not only different from the old economy, but that it is in an entirely different universe as well.

Finally, a first mover has the opportunity to draw customers into their world, creating "switching costs" that increase brand loyalty. This is the purpose of frequent buying programs by airlines, for example. However, just as there has been little to stop almost all airlines from creating their own frequent flyer program, most online startups have been unable to keep new entrants from imitating their own customer programs. Switching costs are so low, in fact, that many customers rely on comparison-shopping websites to seek out the lowest prices on the Internet. The irony, then, is that even when scale is important, as it often is for online companies, being first does not automatically provide an advantage. With few barriers to entry, most online startups have insufficient time to establish strong market positions, and often resort to quick-fix solutions that further dilute profit objectives.

In addition to the inherent *lack* of first mover advantage in most Internet sectors, the structure of the market has made it even more difficult to protect competitive position. There is huge uncertainty surrounding the Internet, and the strategies that will win. As a result, there is a natural incentive for both entrepreneurs and venture capitalists to enter the arena. Think about how Hollywood and the television industry operate, for example. It is extremely difficult to know in advance which movies or shows will be hits; even the addition of big name stars does not guarantee revenues or ratings. So, as soon as one idea looks promising, everyone rushes to pile on. This is as true for Westerns and soap operas in the 1950s as it is for "Who Wants to Be a Millionaire?" and the various "Survivor-type" TV shows of the turn of the century. The number of online companies selling pet products, or clothes, or CDs, or books, or what have you, all suggests a bandwagon effect. In much the same way, in a highly uncertain emerging field like the Internet, the entry of a company to a particular sector is a positive signal on the potential of that sector. As a result, investors have been more willing to support a startup that entered a market already populated with competitors. In a similar vein, the opportunity for a huge payoff has driven both entrepreneurs and venture capitalists to the Internet. While this pressure has eased from the go-go years of the late 1990s, there is still an incentive to enter the market in case you win the lottery – being acquired or going public.

With these impediments to erecting entry barriers, most first movers among online startups would be unlikely to garner much of an advantage. And of course this is what has happened. For example, many of the first B2C startups began selling in near-commodity categories. Why? Because commodities do not have barriers to entry, and so what made it easy for early movers to enter also made it easy for late movers to enter. Whatever good things might come from being first, they almost always must be followed by effective strategy and development of subsequent competitive advantages. Execution becomes much more important than simply being first. The ease of entry pushes margins down, putting a premium on such things as efficient operations, logistics, managing supply chains, and ability to execute strategy. That it is the old economy late market entrants that have such capabilities is not incidental to the failure rate of many dot-coms. To gain the advantage, first movers must capitalize on the opportunities that come with being a pioneer while at the same time manage the threats that arise. The bottom line: Being first in a market is only an advantage when you do something with it.