"Summary of articles by Robert H. Frank and Philip J. Cook: How Winner-Take-All Markets Arise *and* The Growth of Winner-Take-All Markets" in Frontier Issues in Economic Thought, Volume 5: The Political Economy of Inequality. Island Press: Washington DC, 2001.

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A recent commercial, referring to the Olympics, said, "You don't win the silver medal, you lose the gold." There are increasing numbers of competitions – and not only in athletics – in which winning first place is all that matters to the participants. These chapters, from a well-known book on the subject, analyze the sources of winner-take-all markets, and the factors that promote their growth.

Winner-Take-All Markets Defined

Winners in many arenas, including athletic competitions, elections, competitive bidding, and the pursuit of top positions in many institutions, have several characteristics in common. One is that each has prevailed in a contest whose payoffs depend on relative rather than absolute performance. The winner of an athletic or electoral race must come in ahead of everyone else running at the same time, but need not meet any absolute standards of accomplishment. Production workers, in contrast, are often paid for the amount they produce, i.e. they are rewarded for their absolute, not relative, performance.

Another common characteristic of winner-take-all competitions is that the rewards are concentrated in the hands of one or a few top performers, with small differences in talent or effort giving rise to potentially enormous differences in results. Only hundredths of a second separate first and second place winners in many Olympic events; only minor differences in musical quality, undetectable to many listeners, separate the most famous and successful classical musicians from the virtually unknown second tier of performers.

These characteristics alone do not give rise to inequalities of income; in unglamorous sports such as handball or horseshoes, even the champions need to have day jobs in remunerative occupations. However, when the prizes in a competition are large, winner-take-all markets can produce immense incomes for the lucky few. Large prizes can arise in mass markets with millions of buyers or viewers, or in "deep-pocket" markets where a few buyers are intensely interested in the winner's performance.

Winner-take-all competition can arise among rival technologies, fashions, political entities, or even universities competing for scarce research funds and famous researchers. The winners can be determined by lottery, auction, majority vote, or coercion. For our purposes, though, the most important are competitions among individuals and firms in the marketplace.

Sources of Winner-Take-All Markets

Several factors, affecting both supply and demand, allow the emergence of winner-take-all markets. On the supply side, economies of scale in production and distribution create a tendency for one product or supplier to dominate the market. The costs (aside from paying the performers) are no greater to record the performances of the very best actors and musicians rather than those who are less famous, or to broadcast tennis matches between the world's top players rather than those of lower rank.

On the demand side, network economies make a product more valuable when more consumers use it. Telephones, fax machines, and DOS/Windows-based computers are all valuable to individuals in large part because so many other people already use them. Choosing a common make of car because it is easy to get it repaired, or reading a best-selling book because it is easy to find people to discuss it with, are also examples of the importance of network economies.
A similar phenomenon on the demand side has been described as "lock-in" to a leading technology. If the rate at which a technology improves and its costs decline is related to its prevalence in use, then the first technology to be adopted gains a head start in cost reduction that becomes larger over time. Eventually it may become impossible for alternate technologies to compete because they must start from so far behind.

Other self-reinforcing processes lead to the formation of prestige and reputation; these also involve positive-feedback effects, in which success breeds success. There are natural limits to the number of names, products, and activities that people can remember and pay attention to – the "mental shelf space" problem – implying that there is a big payoff to becoming famous enough to be on the shelf. The importance of habit formation, and the slow development of acquired tastes in most areas of consumption, lead to brand loyalty and the persistence of reputations. Similar factors in business create a preference for selecting the most established vendors or hiring the best-known consultants; your boss is less likely to question your judgment if you make the safe, familiar choice.

Positional concerns, such as conspicuous consumption intended to display one's superior wealth and prestige, leads to demand for expensive, high-status goods and services. This is particularly important since wealth and income are already quite unequally distributed; those at the top have substantial resources to spend on public displays of prestige.

The Growth of Winner-Take-All Markets

Winner-take-all markets are hardly new, but they are becoming more important. Several factors have promoted their growth in recent years. The long-term tendency toward falling transportation and tariff costs allows the dominant suppliers to reach ever-larger markets. The rise of telecommunications and electronic computing have created global information flows and encouraged the emergence of global markets, reinforcing the decline in transportation costs. Advances in communication technology also intensify the mental-shelf-space constraints, as the number of sellers competing for our attention has grown, but our capacity for attention has not.

Thus a smaller percentage of sellers can hope to win the competition, intensifying the winner-take-all nature of many markets.

Network economies have become of growing importance in the era of electronic communications; English has acquired a de facto status as the language of global communication in business, science, and even entertainment. The growing size of the world market allows an expanded division of labor and more specialized production processes, increasing the power of those producers who understand and can manipulate the new information flows. All these trends promote the expansion and intensification of winner-take-all markets.

In many markets, a variety of formal and informal rules traditionally prevented winner-take-all competition; these rules have been eroded in recent years. The defeat of the reserve clause in baseball was followed by similar changes in other major league sports, providing players with the benefits of free agency and allowing owners to bid for each other's best players. Businesses, in the past, had informal norms that encouraged promotion of executives from within and discouraged competitive recruitment from outside, a system that produced top salaries that were modest by today's standards. As recently as 1984, it was widely viewed as surprising when Apple hired a soft-drink marketing executive to run a computer company. Today, of course, top executives enjoy free agency, and the opportunity to change teams frequently, much like professional athletes.

Other competitive pressures that have led to increased bidding for top executives include deregulation of many industries and the threat of outside takeovers financed by junk bonds and other new sources of funds. Within large companies, the shift away from traditional employment contracts toward the use of independent contractors has increased performance-based competition, and driven up the salaries of the best performers.

Changes in the social context also promote positional, or status-oriented, competition. Since the affluence of the richest Americans has grown far faster than average incomes, there have been increases in both the acceptability of public displays of wealth, and the share of all consumer spending devoted to elite, positional consumption. Indeed, as winner-take-all markets have become more common, there is a growing tendency for top performers in many fields to compare themselves to other well-known and well-paid individuals, rather than to their own co-workers. Thus winner-take-all markets become a self-reinforcing process, amplifying their effects on society through the process of social comparisons.

Of course, not every trend points in the same direction. New technologies have allowed niche marketing and boutique-style enterprises to flourish in some areas. Microbreweries and specialized cable channels are two well-known cases. The Internet allows extremely narrowly defined groups – dentists interested in scuba diving, for example – to stay in contact with each other. Such trends have potentially contradictory implications. A continuing movement toward boutique retailing might fragment the huge winner-take-all markets and thereby reduce star performers' salaries. On the other hand, the same process also raises the number of competing sellers, which might worsen the mental-shelf-space problem and increase the rewards for being on top. The net effect on the distribution of economic rewards is uncertain, and may vary from one industry to another.