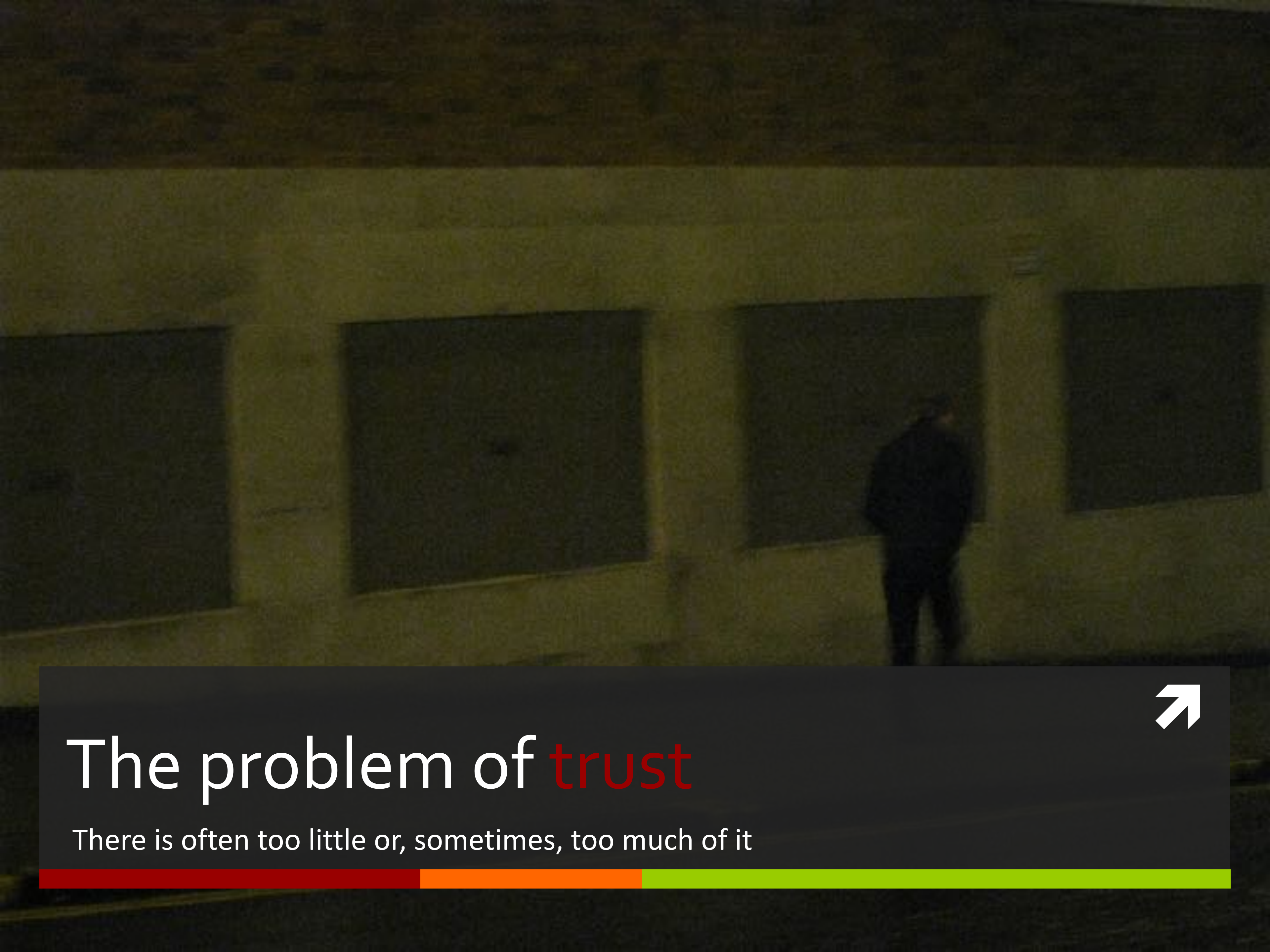
Week 10: Tactics

Dr Christopher Pokarier | EB202 Introduction to Business

Challenges for businesses

- Getting customers to commit
- Avoiding hold-up (by staff, suppliers etc)
- Avoiding lock-in (& inflicting it upon customers & staff!)
- Discouraging competition (legally)
- Getting a fair deal in business partnerships
- Basic problems of credible commitments & credible threats



The problem of trust

There is often too little or, sometimes, too much of it


APPLE SHOP

Getting customers to commit

- Customers fear being ripped off
- Hence hesitancy to commit prior to checking market conditions (often the first store visited misses out on the sale, despite being competitive on price & quality)
- Customers wary of ‘one shot’ iterations (unlike ‘repeat games’) where the vendor has an incentive to cheat
- Savvy customers should be alert to lock-in by suppliers (and may seek to escape it at the ‘minimum lock-in point’ – eg. as specialized equipment is aging and needs replacing)

Circumstances create distrust

Your good character will be doubted: but try to manage perceptions & signal trustworthiness

Lock-in

Examples:

- Printers & cartridges, Sony & their ‘Memory Sticks’
- Specialist infrastructure & software (requiring technical support, upgrades)
- E-mail address tied to ISP; phone number tied to network provider

Pricing implications: when lock-in is strong, sell the initial product cheaply to get customer commitment and then ‘bleed them dry’

Switching costs

- Total switching costs are those borne by the customer to switch supplier plus the new provider's cost of taking on the new customer (the latter is usually modest)
- Customer's switching costs include search costs (for new supplier), adjustment costs (psychological, learning costs – new systems etc), exit costs (eg. from an existing contract), opportunity costs re engaging in the switch (eg. time thinking about it!)
- Many services firms also benefit from customers' switching costs (eg. banks, health clubs, universities!)
- The value of an existing customer base is a function of total switching costs + the firm's competitive advantage

Avoiding lock-in

- Avoid becoming dependent on ‘proprietary’ systems or standards (that is, owned by one provider
- Look for inter-operability, or presence of ‘independent service organizations’ (ISOs)
- If feasible, engage in dual sourcing or multi-sourcing (some firms & defense departments effectively overpay to keep specialist suppliers in business in order to avoid over-dependence on limited suppliers)
- Be wary of ‘one stop shops’, ‘total solutions providers’, ‘ requirements controls’ that compel exclusive use of one supplier, loyalty programs
- Think beyond contract period: a long product life may still lock you in

Dilemmas

- While the lock-in risk is often evident, significant efficiencies can often be gained from using one supplier alone
- Eg. fleet efficiencies: common aircraft reduce servicing & maintenance costs, make training and staff rotation easier etc
- The risk of hold-up in the aviation business reduced by the intense competition between Airbus Industrie & Boeing & its openness
- Regulators (eg. anti-trust, fair trade or competition commissioners etc) may help sometimes when you are being ruthlessly locked-in.
- Businesses should anticipate that clients will fear lock-in..

Credible commitment + threat

Game theory and psychology provide deep insights into tactical interactions

Credible threats?

- Understand when another party that is making a threat is unlikely to carry it because it is not in their interests to do so.
- Eg. blackmail cases, deadlines or threats that the other party doesn't want to enforce
- Being unforgiving can be costly: cancelling an order because the supplier is late leaves the customer without the needed product
- Short-term forgiveness therefore leads to long-term declines in performance & higher costs (but allows selfish people to get away with a lot of irresponsible behaviour)

Game theory: being credible

- Eliminate options for backing down ('burn your boats, bridges') or backing out of a deal (eg. bond-posting)
- Lock yourself in to give credibility (eg. public announcements)
- Hand over control to others (sometimes a means of 'binding yourself' – such as a 'trip wire' where 3rd party approval is needed; or a means to claim a lack of freedom to make concessions)
- Sequenced threats (frighten many with one threat): better than random threats
- Looking a bit insane can enhance the credibility of your threat! (gangsters)

Discouraging new competitors

- Aggressive discounting in advance of the entry of a new rival into your market often does not work
- Price is too easily changed to be a credible threat
- Aggressive investment in new productive capacity (which may also reduce marginal cost through scale economies) is more credible.
- Pre-emptive locking-in of key clients with long contracts at discount prices just might work (but clients will be wary & regulators often a problem)

Signaling mutual commitment

What else explains the matching orange shirts? (they aren’t Dutch football supporters)