

### Information Rules:

A Strategic Guide to the Network Economy

## Managing Lock-In

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## Basic Strategy for Buyers

- Bargain for compensation at beginning
- Limit your vulnerability
  - Dual sourcing
  - Demand compensation for each step
- Watch out for partial contracts
  - Temptation to cut quality

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## Basic Strategy for Sellers

- Design products and promotions to attract customers
- Lengthen and strengthen cycle
- Sell complementary products to these consumers
- Tension: claim openness, but don't deliver
  - Example: simple open interface (RTF), powerful closed interface (DOC)

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## Basic Tension in Buyer's Strategy

- Say you have large switching costs to get large compensation
- But want to minimize lock-in as much as possible

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## Watch Out For

- Vague commitments
- Revealing too much about vulnerabilities
- Entrenchment phase strategy
  - May want to switch, in part just to gain leverage
- Avoid creeping lock-in
- Keep info on usage to yourself

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## Value of Installed Base

- High market shares don't imply high switching costs
  - Lotus
  - Navigator
  - Cisco
- Low market share can still mean large lock-in
  - Computer Associates

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## Look Ahead in Lock-In Cycle

- Calculate present value over whole cycle
- Look at type of customer
- Special case: Perfect Competition
  - Similar products, many competitors
  - Competition forces you to invest in discounts to get consumers locked in
  - Just earn normal rate of return on those investments; quasiprofits

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## Extra-normal Returns?

- Different product
- Lower cost
- Examples:
  - First-mover advantage (unique product)
  - Information advantage

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## Which Buyers are Valuable?

- Think of future revenue streams
- More streams are better
- Influential buyers
  - Additional cash generated by sale to particular consumer
  - BBS operators

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## Influential Buyers, cont'd.

- Buyers with high switch costs
- Buyer side: convince the seller you are influential
  - May already be locked in
  - Buyer has incentive to exaggerate
- Watch out for churn (phone calls, ISPs)
- Buyers with growing needs are very attractive

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## Strategic Variables in Lock-in Cycle

- Magnitude of switch costs
- Loyalty programs
- Cumulative volume discounts
- Rely on infotech
  - Loyalty programs will become more widespread
  - Convert conventional markets to lock-in markets

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## Loyalty Programs

- Requirements contracts
- Frequent buyer program
- Tension with promotions -- offer better deal to non-customers
- Burden of locked-in customers: offer too high a price to attract new customers
  - Price discrimination, stripped down product
- Consumer switch costs
  - Will go down due to Internet

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## Multiplayer strategies

- Decision maker and payer
  - Frequent flyer miles
  - Infant formulas at hospitals
  - Automobile tires
- Buyers of complements
  - Different customers buy razors and blades
  - Subsidize the far-sighted group, tax the short-sighted group
    - BBS operators
    - Netscape suite

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## Lock-in and Complementary Products

- Visa and Amex: Visa gave away payment services to capture interest charges
- Operating system and applications
- Extra profits on complements makes primary market more competitive
- Differential prices
- BargainFinder, MusicMaker
  - Unique
  - Cycle length

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## Contractual Commitments

- Lifetime of durable equipment
- Complementary assets with different lifetimes
- Buyer side: try to synchronize
- Seller side: try pre-emptive renewal

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## Structuring Deal

- Be sensitive to budgets
- Open systems, copyright protection
- Multi-year contracts with large customers
- Makes it hard to get scale to compete

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## New Versions and Upgrades

- Don't want to leave opportunities open
- Pre-announcements, vaporware
- Avoid charges of predation

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## Lessons

- Buyers
  - Bargain hard
  - Use second-sourcing and open systems
  - Improve bargaining position at choice stage
- Sellers
  - Invest in your installed base
  - Cultivate influential buyers

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## Lessons, continued

- Sellers
  - Design product and pricing to get customers to invest in your technology
  - Sell your customers complementary products
  - Sell access to your installed base