

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