

The Information Economy

Summary

Strategy 101

- ▶ **Value pie**

- ▶ Value of industry = buyers' values minus total costs
- ▶ Firm's value = value of industry × firm's share of pie

- ▶ **Six forces**

- ▶ Substitutes, rivals, entrants, suppliers, buyers, complements

- ▶ **Market definition**

- ▶ What is relevant for the question you are asking?

- ▶ **Coherent strategies**

- ▶ Choices that complement each other.

Information Goods

- ▶ **What's special about information goods?**
 - ▶ High fixed, low marginal costs.
- ▶ **Market type 1: differentiated goods**
 - ▶ Horizontal differentiation
 - ▶ Vertical differentiation
- ▶ **Market type 2: dominant firm**
 - ▶ First mover advantage
 - ▶ Technological or cost advantage
- ▶ **Other aspects of information goods**
 - ▶ Long tail, customizability, user created content, experimentation and adaptation, market design.

How to Price

- ▶ **Basic rule: Monopoly formula from Econ 101.**
- ▶ **Price discrimination**
 - ▶ Third degree (group pricing)
 - ▶ Second degree (indirect discrimination, versioning)
- ▶ **Bundling**
 - ▶ Reduces dispersion of consumers WTP
- ▶ **Zero prices**
 - ▶ Avoid transactions cost, anonymity, psychology

Switching Costs and Lock-in

- ▶ **Switching costs matter**
 - ▶ Determine firm's profits [valuation principle]
 - ▶ Determine how much it costs to win a customer
- ▶ **Switching costs come from**
 - ▶ Investments in complementary assets (training, durable goods)
 - ▶ Contracts, loyalty programs, transactions costs.
- ▶ **Seller's strategy**
 - ▶ Invest in base – penetration pricing, influential customers.
 - ▶ Encourage entrenchment – loyalty programs, staggered sales
 - ▶ Leverage base – prices, complementary products
- ▶ **Buyer's strategy**
 - ▶ Introductory discount, dual sourcing, information, bonds

Networks

- ▶ **Network externality**
 - ▶ Agents' values depend on the number (and identity) of users.
- ▶ **Equilibrium**
 - ▶ Fulfilled expectations demand is hump shaped.
 - ▶ Given a price, there are multiple equilibria.
 - ▶ Monopoly pricing – network effect boosts marginal revenue.
- ▶ **Overcoming inertia**
 - ▶ Mobilization - introductory discounts, focused networks
 - ▶ Collective switching costs – coordinate switching
- ▶ **Open (fight within market) vs. closed (fight for market)**
 - ▶ Closed – penetration pricing, develop complements
 - ▶ Open – sell enhancements, sell complements
- ▶ **Compatibility choice (backwards, forwards, neither)**

Platforms

- ▶ **Platform brings together groups of users**
 - ▶ Same-side and cross-side network effects
- ▶ **Pricing**
 - ▶ Subsidize those who create value for others
 - ▶ Flexibility in details of fee structure
- ▶ **Competitive strategy**
 - ▶ Competing in winner take all market, avoiding envelopment
- ▶ **Mobilization**
 - ▶ Subsidizing one side
 - ▶ Start as vendor or merchant and transition