Strategy 101

- **Value pie**
  - Value of industry = buyers’ values minus total costs
  - Firm’s value = value of industry \times 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