Lecture Note I-6
Managing Lock-In

- Buyers' strategies to avoid lock-in
- Sellers' strategies to exploit lock-in

Basic Strategy for Buyers

- Bargain for compensation at beginning
  - Convey the impression that your benefits from switching are small and costs large
  - Express your ability to influence other purchasers
- Limit your vulnerability
  - Dual sourcing (partial switching)
  - Demand compensation for each step
- Watch out for creeping lock-in
  - Insist having the rights to relationship information with the seller
  - E.g. doctor switching

Buyers : Watch Out For

- Vague commitments
- Revealing too much about vulnerabilities
- Entrenchment phase strategy
  - May want to switch in part, just to gain leverage

Basic Strategy for Sellers

- Invest
  - Employ tactics to build your installed base at least possible cost
  - Figure different valuable customers and tailor your offering to match
- Entrench
  - Design products and promotions so that customers continue to invest in your product or systems
  - Lengthen and strengthen cycle
- Leverage
  - Maximize the value of installed base
  - Sell complementary products to these consumers

Basic Tensions (sellers vs buyers)

- For sellers: claim openness, but don't deliver
  - Example: simple open interface (RTF), powerful closed interface (DOC)
- For buyers: say you have large switching costs to get large compensation
  - But want to minimize lock-in as much as possible

Investing in an Installed Base

- Looking ahead at the whole look-in cycle
  - Recognize lock-in customers are valuable assets
- Fighting for new customers
  - Revenue from lock-in customers is the return on the investment
- Structure the life-cycle deal
  - Be explicit about commitments to openness you make to attract customers
- High market shares don't imply high switching costs
  - Rival often design their products to minimize switching cost (Netscape Navigator v MS Explorer)
- Attracting buyers with high switching costs
  - Offer discounts to influential buyers
- Multiplayer strategies
  - Look for opportunities to exploit divergent interests
  - Selling to influence buyers and the others will follow

Encouraging Customer Entrenchment

- Entrenchment by design
  - Offer value-added information services to deepen your relationship with your customer
- Loyalty program and cumulative discount
  - The reward to past loyalty must be available only to customers who remain loyal

Leveraging Your Installed Base

- Selling complementary products
- Selling access to your installed base
- Setting differential prices to achieve lock-in
  - Prices aimed at locked-in customers may not appeal to new buyers. Differential pricing is the solution
- Attempts to raise search costs
  - Make yourself easy to find and your rivals hard to find
- Exploiting first-mover advantage
  - Staggers termination dates on different customer contracts to keep rivals from achieving scale economies
- Controlling cycle length
  - Get your customers to extend their contracts before those contracts expire

Summary

- Buyers
  - Bargain hard
  - Use second-sourcing and open systems
  - Improve bargaining position at choice stage
- Sellers
  - Invest in your installed base
  - Cultivate influential buyers
  - Design product and pricing to get customers to invest in your technology
  - Sell your customers complementary products
  - Sell access to your installed base