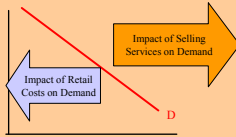


## Issues in Special Selling



## The Consumer's Choice

- When both types of dealers are in operation, smart consumers will
  - Go to the high price, high service, dealer for product information,
  - Go to the low price, low service dealer, for purchase.
- They will get a free ride.

## The Retailer's Choice

		Retailer 2	
		Service-Lean	Service-Rich
Retailer 1	Service-Lean	$\pi_2 = \$0$	$\pi_2 = -\$50$
	Service-Rich	$\pi_1 = \$0$	$\pi_1 = \$100$
		$\pi_2 = \$100$	$\pi_2 = \$0$
		$\pi_1 = -\$50$	$\pi_1 = \$0$

## The Conclusion

- Service Rich Retailers get driven out.

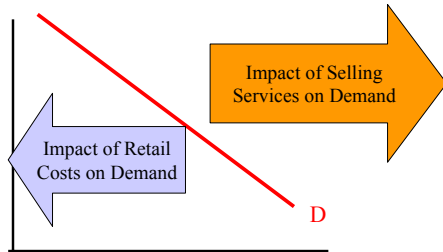
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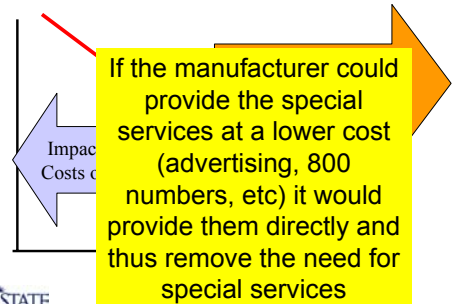
## The Conclusion

- Service Rich Retailers get driven out.
- Not so when the manufacturer sets a minimum retail price.
  - Consumers choose between a high price, high service dealer and a high price, low service dealer.
  - The low service dealer must change his ways to survive.
  - In short, the manufacturer can maintain his strategy of requiring high services if he sets a minimum price.

## Which Makes Sense



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## An Example

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- \$10 per unit spend on special selling adds 10% to demand.
- Alternatively, \$10 per unit spend on advertising, 800 numbers, etc., adds 15% to demand.
- The manufacturer should mount the ad campaign and not do special services.

## When does special selling pay?

- Personal Computers
  - Dell
  - Clancy-Paul

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- If the information is not brand specific, the manufacturer cannot enforce special services. Customers would just go to another dealer selling a comparable unbranded product
- If transaction costs are small, the retailer can charge for special services, and thus the free rider problem disappears, as does the need to require special services.

## When do Free Riders Arise?

- **Free rider problems are more severe for new products than for established products.**
- Free rider problems are more severe for complex or technical goods.
- Free rider problems are more severe when a consumer's time is low relative to the cost of a product.

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## Alternatives to RPM

- **Provide information at company-owned demonstration stores that do not sell products.**
- Limit the number of dealers and implicitly grant each dealer an exclusive territory.
- Design products with unique features that make it more costly for other manufacturers to clone.
- Prescreen retailers and use only those with a reputation of providing a service rich environment.

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## Quality Certification

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- These are high service, high cost retailers. The fact that they carry the product conveys information.

## Saks or Wal-Mart?

- The free rider problem arises if the good is also available at Wal-Mart
  - High quality retailers are reluctant to carry a good unless they get assurances that only better stores will carry it.

## Saks or Wal-Mart?

- The free rider problem arises if the good is also available at Wal-Mart
- The manufacturer will be reluctant to allow Wal-Mart to carry it.
  - It will lose the advantage from being carried by the high quality stores.

## McDonalds and Free Riders

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We talk later about how McDonald's deals with this problem

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- But if RPM is in effect, cutting my price to \$17 simply means that the retailer gets an extra \$1.

End

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