The importance of assymetric information in forming customers' buying behavior

Karaoulanis Andreas

andrekaraoul@gmail.com

ABSTRACT

The main goal of this paper is to underline the importance of assymetric information as part of the game theory and to highlight the author's prevalent opinion that the bargaining game on the basis of assymetric information is a dominant tool for companies in every industry. The competitive advantage that companies need to obtain usually, according to the author, passes thru the answer of the fundamental "customer dilemma".

Key words

Assymetric information; game theory; customer dilemma; bargaining.

Academic Discipline and Sub discipline

Business; management; strategy.

Type

Literary analysis

Council for Innovative Research

Peer Review Research Publishing System

International Journal of Advanced Research in Education Technology and Management

Vol.4, No.1

www.cirworld.org, editorijaretm@gmail.com

INTRODUCTION

Information nowadays is very important in helping companies understand their customers' needs and in developing their buying behavior. When buyers and sellers have systematically different information about a product, this "problem" is known as assymetric information (Keat et al., 2014).But why assymetric information can develop or even alter customers' behavior thus decision while buying a product?

MARKETING AND CUSTOMER CORRELATION

According to Dawar (2013), a company is market- oriented if it has mastered the art of listening to customers in order to understand their needs, something which inevitably will lead in developing the right products customers need thus good sales for the company.

Some companies in order to obtain a competitive advantage in their respective markets they try to develop an "intimate" relationship with their customers via the "customers as innovators" approach (Thomke et al., 2002). They try to give to their customers all the tools needed in order to help them design and develop their own products, something which, on the long run, will both benefit them and the companies, as R& D has been long costly and inexact as a process, especially the last years (Thomke, et al., 2002).

This last, "customers as innovators approach", is the one which involves a "true" and sincere "relationship" between companies and customers. A relationship which will be defined by the symmetric information about the product. But what happens if the company will choose to follow the other way around which means assymetric information as we pre- defined it in the introduction part? What if one part of seller- buyer duet tend to be at a systematic informational advantage relative to the other part in this market interaction (Keat, et al., 2014)?

ASSYMETRIC INFORMATION

There are several examples of assymetric information in every business. For example, in the health insurance market, the buyers know more information about their own health than their potential providers (Econport, 2006). This is also the case in so many industries, like the used cars one, where the buyer will buy a used can cheaper than a new one, even if the car is only one day old. This happens because the buyer is wary that something will go wrong with the car, even if the seller try to persuade her for the opposite (Econport, 2006). This phenomenon/ tactic has vast influence in pricing and generally in business as it can affect both sellers' and buyers' decisions and strategies.

As Steve Jobs said during an interview in Business Week in 1997 (Chunka Mui, 2011) "A lot of times, people don't know what they want until you show it to them". This is a very important statement which has its foundations upon the assymetric information we examined before. Companies which need to sell, have two ways to sell which, according to the author's opinion, are the following:

- ✓ Interact with your customers in order to hear their needs and sell in order to fulfil them
- ✓ Sell what you think is best for your customers.

It is the author's prevalent idea that companies need to follow the first approach. An intimate and sincere relationship with customers in order to meet their needs should be the cornerstone upon which the whole company should rest. Creating satisfaction for your customers is a fundamental principle of business, as satisfied customers are usually returning ones, something which on the long run will create a sustainable competitive advantage for the respective company.

But if there must be a sincere relationship between the seller and the buyer, why assymetric information is so common? Is it because companies don't tend to follow this approach or because customers don't want to get involved in such relationship as the only thing they want is to buy a good value for money product, or both or something else? This is a big question which is the authors of the paper intention to be answered in the following chapters.

THE BARGAINING APPROACH

According to Keat et al. (2014), bargaining is negotiating over the terms of an agreement. In terms selling and buying this agreement is the buying of a product. Getting into bargaining is a quite complicated task which involves many parameters. A very important parameter which has vast impact in bargaining is information. Assymetric information has important implications for individual bargaining behavior (Samuelson, 1984). When one of the "players", seller or buyer, involved in such bargaining has much better information than the other (assymetric information), she can attain the advantage needed in order to get the best bargain (Samuelson, 1984). This is a very important factor in terms of bargaining, as it can deliver to both seller and buyer the desired result of this procedure.

Assymetric information can give to customers the advantage needed in order to help them achieve a better bargain thus buy, so the fact per se of the much better information can be a very strong incentive for both customers and sellers which will inevitably lead them out of what we called several lines above “sincere relationship”. Such relationship will throw away the advantage one could acquire thru assymetric information, so there is no logic in doing so. On the other hand, there is a certain customer category which is called “loyal customers”.

According to the online Cambridge dictionary (n.d.), customer loyalty is “the fact of a customer buying products or services from the same company over a long period of time”. Such a customer behavior requires a sincere relationship between the seller and the buyer. Although such a customer seems very beneficial for the company as she is a returning one, something which means stable and constant profits, there are several companies which do not see it in that way. Many companies focus on other customer categories such as on wandering customers (customers who “they have no specific need or desire in mind when they come into the store. Rather, they want a sense of experience and/or community”), impulse customers (“they do not have buying a particular item at the top of their “To Do” list, but come into the store on a whim. They will purchase what seems good at the time”) or need-based customers (“they have a specific intention to buy a particular type of item”) (Hunter, 2015). Exercising the bargaining game in such customer categories will have as a prerequisite asymmetry in terms of information.

There are several bargaining “games” which are well known in every industry. The most important of them are the following:

- ✓ A *cooperative game*, which is a game “in which the players can negotiate explicit binding contracts over various states of nature” (Keat et al., 2014, p. 465).
- ✓ A *zero sum game*, in which “the sum of payouts is constant” for the players involved (Keat et al., 2014, p.465).
- ✓ A *variable sum game*, in which “the sum of payouts for each set of strategies, varies”. This kind of games also are well known as “non- zero sum games” or “non- constant- sum games” (Keat et al., 2014, p.465).

In all the above mentioned kind of games the most important paragon which is the cornerstone upon which every player (seller or buyer) establishes her strategies in terms of negotiation, is information. This information is always assymetric. The only difference is that assymetric information can be used in different ways in every respective game category, something which will lead to different results.

In conclusion, although is out of the scope of this paper to dig deeper into this matter, assymetric information is a very decisive paragon in bargaining. It is inevitable that this kind of information not only will shape the sellers but also the buyers behavior, as she will react to bargaining according to the information she has in hands while trying to figure out what information the other part of the bargaining game might have. It is important here to underline that sometimes not only real information but also the hypothesis of some kind of information can be positively or negatively influence the result of a bargain.

THE PRISONER’S DILEMMA, MARKETING METRICS AND THE CUSTOMER DILEMMA

This element of the game theory often occurs in oligopolistic markets. It is based upon the dilemma two hypothetical prisoners are facing while they are interrogated separately from their prosecutors. They have the dilemma to confess or not the crime they are supposed they commit together depending on the payoffs their prosecutors use in the whole bargaining process in order to make them confess. If they won’t confess they will both be convicted of possession of stolen goods (Keat et al., 2014). In this occasion, i.e. large companies which illegally try to manipulate prices by following a common pricing policy after they arranged that, the asymmetry in information is inevitably favorable for the one part of the bargaining duet. The seller. But such a behavior, although illegal, is very difficult to be implemented in not oligopolistic[1] markets. It needs only few, thus strong players in the arena in order to implement the “prisoner’s dilemma” approach.

[1] The term oligopoly is derived from two Greek words: ‘oligi’ means few and ‘polein’ means to sell. Oligopoly is a market structure in which there are only a few sellers (but more than two) of the homogeneous or differentiated products. So, oligopoly lies in between monopolistic competition and monopoly. Oligopoly refers to a market situation in which there are a few firms selling homogeneous or differentiated products. Oligopoly is, sometimes, also known as ‘competition among the few’ as there are few sellers in the market and every seller influences and is influenced by the behavior of other firms (Chand, 2015).

Another important paragon which gives great power to one of the players in order to implement the strategic movements that will break the equilibrium in bargaining, is marketing metrics. Marketing metrics can accumulate huge amounts of information for the player (who almost always is the seller/ company). According to Best, 2014) marketing metrics measure marketing performance while marketing analytics are the tools and data used to create marketing metrics. While marketing metrics gauge the company's performance, it is very important to understand that they also measure and write down customers' behavior, which leads to the specific company's performance. This kind of marketing metrics is called "customer metrics" which gauge a business or product in terms of its performance with customers (Best, 2014, p.49). This kind of "research" creates an asymmetry in information, which also deranges the balance between the "negotiators".

But how customer/ marketing metrics can disturb such equilibrium and create a misbalance which leads to the above mentioned assymetry during the bargain and gives to the seller the competitive advantage needed? It is quite simple and obvious. Companies learn their customers by reading their consumerist behavior. By understanding their customers via the demographics and reach to a conclusion about their consumerist behavior they have the information needed in order to be on the top of the game and guide their customers to their strategic path. This is a victorious approach which is the result of the above mentioned assymetric information. While companies know so much about their customers, customers know so little about the companies from which they buy their goods.

While a strong customer focus and an ongoing commitment to understanding customers' needs and the problems they encounter are the cornerstones of any market- based strategy (Best, 2014, p.149), many companies while they try to focus on their customers, they forget that their main goal is to reach their needs and unfortunately they cross the line. They try to use their information in order to manipulate customers' behavior. This is very tempting as they face the following dilemma: To try to understand their customers' needs and to focus in fulfilling them, or to create to their customers the needs they want in order to guide them to where they want? This kind of dilemma is very dominant in every market, especially in oligopolies where companies tend to be very strong. This "customer dilemma" is one of the major questions companies need to answer while they are planning their market strategic movements.

CONCLUSIONS

Information nowadays is a dominant part of business in any industry. Bargaining is a perpetual game which takes place in all markets in all industries and information is a very decisive paragon which can create a competitive advantage for anyone of the parts of that game. Game theory supports the fact that information is vital while assymetric information is something which can be and is used as a weapon in the hands of the two parts which are in the middle of this bargain game. Assymetric information can be manipulated from both parts. The main conclusion of this paper is that companies nowadays have created a competitive advantage in this perpetual bargaining game between them and their customers as they use several means in order to implement their strategies such as demographics and marketing or customer metrics. The "customer dilemma" which the author of the paper coined as an expression means that companies need to answer the fundamental question which is if they are going to be customer focused in their strategic movements by fulfilling their customers' needs or they are going to drive their customers in the direction they wanted which of course is aligned to their strategic plans. The role of assymetric information in bargaining and the importance of the way companies use it is very important in specific markets such as oligopolies.

REFERENCES

[1] Best R., 2014. Market- Based management. 6th edition. Pearson Education Limited. England.

[2] Cambridge dictionary, n.d. Available at: http://dictionary.cambridge.org/dictionary/english/customer-loyalty. [Accessed 06 January 2016].

[3] Chand S., 2015. The oligopoly market. Example, types and features. Micro economics. Yourarticlelibrary.com [online]. Available at: http://www.yourarticlelibrary.com/oligopoly-market/the-oligopoly-market-example-types-and-features-micro-economics/9140/. [Accessed 07 January 2016].

[4] Chunka Mui, 2011. Five dangerous lessons to learn from Steven Jobs. Forbes [online]. Available at: http://www.forbes.com/sites/chunkamui/2011/10/17/five-dangerous-lessons-to-learn-from-steve-jobs/ [Accessed 06 January 2016].

[5] Dawar N., 2013. When marketing is strategy. Harvard Business Review, Vol.91 (12), pp. 100-108.

[6] Econport, 2006. Assymetric Information. [Online]. Available at: < http://www.econport.org/content/handbook/Imperfect-Information/asymmetric.html> [Accessed 06 January 2016].

[7] Hunter M., 2015. The 5 types of customers. About money [online]. Available at: < http://sbinfocanada.about.com/od/customerservice/a/customertypesmh.htm> [Accessed 06 January 2016].

[8] Keat P.; Young P.; Erfle S., 2014. Managerial Economics. 7th ed. Pearson. UK.

[9] Samuelson W., 1984. Bargaining under assymetric information. Econometrica. Volume 52 (4), pp. 995-1006.

[10] Thomke S.; Von Hippel E., 2002. Customers as innovators: a new way to create value. Harvard Business Review, Volume 80 (4), pp. 74-81.

Andreas Karaoulanis, MBA, MsEng is currently working in the banking sector in Greece. He has an MBA degree in Industrial Management and Economics form Blekinge Institute of Technology in Sweden and a MSc in Engineering from Aristotle University of Thessaloniki. He is very experienced after 25 years of working in several industries like engineering, banking, retail and consulting. He is a Linked In blogger with many managerial posts.