DO NOT COPY

Judo Economics

The early 1990s saw a new wave of start-ups in the U.S. airline business. One entrant, Kiwi International Air Lines, took to the skies in September 1992 with two leased Boeing 727s, flying from Newark to Chicago, Atlanta, and Orlando.[1] Kiwi aimed to attract small-business travelers looking to save money but lacking the flexibility to book in advance. Offering 727s reconfigured for extra legroom, as well as a full meal service, Kiwi claimed that its single-class service was equivalent to business class on most major carriers. Fares were to be pegged to the lowest restricted fares in the market, but offered on an unrestricted basis.

Kiwi had been founded by a group of former Eastern, Pan Am, and Midway Airlines employees who had invested their own money in the venture and planned to work for about half the salaries of their counterparts at the major carriers. As a non-unionized airline, Kiwi also hoped to benefit from more flexible work rules.

Describing his company's strategy, Kiwi CEO Robert Iverson emphasized that he had no intention of challenging the majors: "We designed our system to stay out of the way of the large carriers and make sure they understand we pose no threat. The seats we take away will be insignificant, so our presence in the market will have no measurable impact on their yields."[2] One industry analyst was less optimistic, however: "[T]he markets in which Kiwi will be competing are highly visible ones, and for psychological reasons the last thing the big carriers will want to do is give up even 5% of their share."[3]

Another setting in which entrants have recently sought to capture market share from large established players is the U.S. credit card industry. In the early 1990s, the industry witnessed an onslaught of new players wooing customers with offers of low interest rates and small or nonexistent fees. Some 6,000 firms now offer credit cards in the U.S., including some very

---

[1]See "The Season of Upstart Startups," *Business Week,* August 31, 1992, pp. 68-69.

[2]"Kiwi Takes Special Steps to Survive Among Sharks," *Aviation Week & Space Technology,* October 5, 1992, pp. 44-45.

[3]*Ibid.*

Professor Adam M. Brandenburger prepared this case as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. Assistance from Rena Henderson and Research Assistant Julia Kou is gratefully acknowledged.

Copyright © 1994 by the President and Fellows of Harvard College. To order copies or request permission to reproduce materials, call (800) 545-7685 or write the Harvard Business School Publishing, Boston, MA 02163. No part of this publication may be reproduced, stored in a retrieval system, used in a spreadsheet, or transmitted in any form or by any means—electronic, mechanical, photocopying, recording, or otherwise—without the permission of Harvard Business School.

successful specialist issuers such as MBNA, First USA, and Advanta. These developments have posed a dilemma for the established players in the industry, principally Citicorp and Chase Manhattan:

> They could cut prices to match those of the specialist issuers; Chase reckons that the no-fee, low-rate deals it currently offers to new cardholders are as attractive as anything in the market. Such deals might help banks refresh their established portfolios. But existing customers are increasingly unwilling to go on paying old prices. And lowering prices across the board would have an immediate and dire effect on profits. Credit cards generate predictable and juicy flows of cash, which banks are understandably loth to give up.
>
> That is why their response to date has been more prosaic. They have done little except count their current blessings and hope to slow the erosion of their market share. True, . . . Citicorp has . . . tried to hang on its customers by segmenting them and launching an array of cards designed to appeal to different groups. (*The Economist*, November 20, 1993, p. 88)

This case explores some aspects of the game between a company seeking to enter a market and a company that is an established player in that market.

The Game

In a certain market, there is a single incumbent player with sufficient capacity to serve all potential buyers. There is also a second company which is considering entering the market.

The game unfolds in four stages. In the first stage, the potential entrant must decide whether or not to enter the market. If it enters, it incurs a nominal, irrecoverable entry cost. In stage two, the entrant decides simultaneously on how many buyers to target and on a single price at which to offer its product to the buyers it is targeting. In stage three, the incumbent responds to the entrant's choices by deciding on a single price at which to offer its own product to all buyers. In the fourth and final stage, buyers make their purchase decisions, and each company serves the buyers that decide to purchase from it.

There are 100 potential buyers in the market, each interested in purchasing one unit of product from either the incumbent or the entrant. However, only those buyers targeted by the entrant have the option of purchasing from it. To see how this works, think of the buyers as arrayed in a certain order and labeled as buyer 1, buyer 2, . . . , buyer 100. Suppose, as an example, that the entrant has targeted 10 buyers. Then, buyers 1 through 10 each get to decide whether to purchase from the incumbent or the entrant (or from neither). Buyers 11 through 100 each get to decide whether to purchase from the incumbent (or not at all). This second group of buyers does not have the option of purchasing from the entrant. Likewise, if the entrant has targeted 20 buyers, then buyers 1 through 20 have the option of buying from it; buyers 21 through 100 do not. And similarly, for different choices by the entrant as to how many buyers to target.

References:

"Judo Economics: Capacity Limitation and Coupon Competition," by Judith Gelman and Steven Salop, *Bell Journal of Economics*, 1983, Vol. 14, pp. 315-325.

"Judo and the Art of Entry," Harvard Business School Publishing, 187-165, Rev. February 1991.

DO NOT COPY