Cannibalism, Switching Costs and the Location Of Service Branches

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Research Questions

- Why consumers don’t move between service branches?
- Why branches of competing firms cluster, while some areas have no service branches?
- Why the number of firms decreases and the number of branches per firm increases?
Basic Model

- Switching costs (SC) apply when customers switch firms.
- Competition along a line between two firms H and I.
- In the first period two branches HA and IB. Branch of firm H(I) located at A(B).
- The customer minimizes total cost composed of price, transfer costs and SC.
First Period/Second Period

- The branches split the market. The customer chooses HA and not IB if:
  \[ P_H + t(x-a) < P_I + t(b-x) \]

- In the second period a branch is added. If the customer changes a firm he pays S.
- If he moves from HA to IC he pays
  \[ P_I + S + t lx - cl \]
The Firm Introduces a branch adjacent to incumbent branches

- The branch can be introduced between the branch and the origin or between two branches.
- The firm does not gain new customers: they only move from one branch to another. In terms of market share no gain, but adds costs.
- It is not profitable to the firm
The Firm Introduces a Branch Adjacent to Incumbent Competing Branches

- The branch can be introduced between the competing branch and the origin or between two competing branches.
- The firm can gain new customers if the prices are relatively low. In terms of market share, it depends on the prices and the location of the branch.
- The firm will benefit from locating the branch adjacent to competitors.
- The firm may gain the whole market.
The Firm Introduces a Branch Between a Competing Branch and Its Own Branch

- The firm can gain new customers if the prices are relatively low. In terms of market share, it depends on the prices and the location of the branch.
- The firm might benefit from locating the branch adjacent to the competitor’s branch.
- The firm may lose some of the market share of its own branch.
Corporate Cannibalism

The process of eating one’s own arm in order to ensure the continued viability and future health of the corporate body and soul

- Shapiro’s Fad Surfer’s Dictionary
Cannibalism among Branches

When a firm introduces a branch between its own branch and the competitor’s, it eats its own arm in order to ensure viability.
Conclusions

- Switching Costs explain the low mobility of customers among firms.
- The reaction of firms: clusters of firms offering substitute services.
- Firms eating each other, while increasing the number of branches
Empirical Evidence

- The change in the number of banks in Israel 1950-1990
- The dispersion of branches in Haifa, Israel, clusters vs. neighborhoods without a branch