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Play the game: in business, your competitor may also be your friend

With the increasing talk of international trade wars, you may start to feel a greater sense of protectionism and competition emerging around the world as the global economy moves away from globalisation and becomes more complex. But is more competition a bad thing? You may not realise it but competitors can be good for your business – and it's all about the economics of strategy and interdependence, in which companies take a Game Theoretic approach to competitive strategy. The well-established Porter's 5 forces offers a useful framework that can help you understand your competitive environment and map your positioning against your competitors. But a Game Theoretic approach gives you a very different perspective. Game Theory dates back to the 1930s and interdependence lies at its heart: it can be defined as 'The study of mathematical models of conflict and cooperation between intelligent rational decision-makers'. There are many different game typologies and dimensions, for example – cooperative/non-cooperative, symmetric/asymmetric, simultaneous/ sequential , but what do these have to do with business? In every natural ecosystem, such as the Savannah grasslands of East Africa where the Lion may be king and top of the food chain, all the 'players' (in this case the animal inhabitants) still have to compete within a series of interdependent relationships. In the realm of geopolitics, during the post WW2 Cold War the 'game' of nuclear proliferation was being played out non-cooperatively between the former USSR and the Unites States, until the game changed and through a process of cooperation in the 1980s, the two super-powers were able to negotiate a reduction of nuclear arms stocks and to reduce further proliferation of nuclear weapons. (This is the quintessential example of what game theorists understand as a 'Prisoners' Dilemma' game where parties recognise the incentives of playing a cooperative game). In a competitive situation, Game Theory can help you understand the environment, understand your interdependence with competitors, and help you make better strategic business decisions. Here's a summary of the logic in a nutshell: a competitor action triggers a reaction in any interdependent setting and the better the competitors know each other, the better they can understand and predict the reaction and behaviour of the others. With Game Theory, we are placing interdependence at the centre of our enquiry and analysis of our business situation, and then trying to understand our competitors better – predicting their patterns of behaviour and so informing our strategy and strategic decision making by applying psychology and the principles of behavioural economics. We see interdependence in business in relationships such as Apple vs. Samsung in the smartphone industry, where Samsung has historically been considered to have the second mover advantage, and can read Apple signals about its new models and pricing strategies, and then respond accordingly. There are many other examples from neighbourhood coffee shops to global pharma and telecommunications companies – even business schools. In fact, most economic activity within global MNCs tends to happen within the context of oligopolies (usually five dominating players or less) where competitive interdependence is key and Game Theoretic thinking is most useful. All the players influence each other through deeply embedded interdependent relationships as they each strive to do what's best for them (or increase their market power, as each seeks an advantage; these are often created through a process of consolidation and even mergers and acquisitions). The idea is that all the players in an interdependent setting should recognise the benefits of playing the game. In the case of interdependent situations where price is the key variable, for example, players will come to understand the benefits of cooperating to command higher prices, although competition law or the inability to enforce potential cooperative agreements may prevent companies from collaborating or cooperating to fix prices to any degree. In a slightly different context, Game Theory also provides some perspective on the need for organisations to coordinate strategies and their incentives to gaining first mover advantages through 'credible commitment'; this may apply, for example, to situations with high R&D investment requirements by pharma companies in niche therapeutic areas or aerospace with space only for a single player. A Porter based approach would pose the question: "what market are we competing in and how can we compete better?" Game Theory asks: "What market should I be in?" Companies recognising their interdependence with competitors can apply Game Theory and are more likely to make better decisions that result in better outcomes. In fact, it is when we operate in a market where we know our competitors best that we are also best placed to predict their likely reaction to our actions, and so we can ultimately adopt the best strategies in the first place. ***Xavier Duran is MBA Director, Alliance Manchester Business School, The University of Manchester***

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