# THINKING STRATEGICALLY

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Quotable Quotes

Game theory:

“the greatest auction in history”

“When government auctioneers need worldly advice, where can they turn? To mathematical economists, of course ... As for the firms that want to get their hands on a sliver of the airwaves, their best bet is to go out first and hire themselves a good game theorist.”
The Economist, July 23, 1994, p.70.

the “most dramatic example of game theory’s new power ... It was a triumph, not only for the FCC and the taxpayers, but also for game theory (and game theorists).”
Fortune, February 6, 1995, p.36.

“Game theory, long an intellectual pastime, came into its own as a business tool.”

“Game theory is hot.”
Game Theory

“Conventional economics takes the structure of markets as fixed. People are thought of as simple stimulus-response machines. Sellers and buyers assume that products and prices are fixed, and they optimize production and consumption accordingly. Conventional economics has its place in describing the operation of established, mature markets, but it doesn’t capture people’s creativity in finding new ways of interacting with one another.

Game theory is a different way of looking at the world. In game theory, nothing is fixed. The economy is dynamic and evolving. The players create new markets and take on multiple roles. They innovate. No one takes products or prices as given. If this sounds like the free-form and rapidly transforming marketplace, that’s why game theory may be the kernel of a new economics for the new economy.”

— Brandenburger & Nalebuff
Foreword to Co-opetition
1. **Strategic Decision Making**

1.1 A Decision

Piemax Inc. bakes and sells sweet (dessert) pies. Its decision:

- price high or low for today’s pies?

Considerations?

- prices of rivals’ pies?
- prices of non-pie substitutes?

One possibility:

simply optimise its pricing policy for some, given its beliefs about rivals’ prices
Think strategically.

Or:

try to predict those prices,

using Piemax’ knowledge of the industry,

in particular: Piemax’ knowledge that its rivals choose their prices on the basis of their own predictions of the market environment, including Piemax’ own prices.
Think strategically.

Or:

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in particular: Piemax’ knowledge that its rivals choose their prices on the basis of their own predictions of the market environment, including Piemax’ own prices.

Game Theory →

Piemax should build a model of the behaviour of each individual competitor,

? look for behaviour → an equilibrium of the model?

Later: what is an equilibrium?

Later: ought Piemax to believe that the market outcome → equilibrium?

Now: what kind of model?
The simplest kind of model.

Simplest:
- all bakers operate for one day only (a so-called one-shot model)
- all firms know the production technology of the others
- study with the tools of:
  - payoff matrix games and
  - Nash equilibrium
The simplest kind of model.

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— all firms know the production technology of the others
— study with the tools of:
  ➢ payoff matrix games and
  ➢ Nash equilibrium

Nash Equilibrium: no player has any incentive to change his or her action, assuming that the other player(s) have chosen their best actions for themselves.

Nash equilibria are self-reinforcing.
Repeated interactions.

If more than one day (a repeated game or interaction):
   — then Piemax’s objectives?
   (more than maximising today’s profits)
   e.g. low price today may
   → customers switch from a rival brand
   → may increase Piemax’ market share in the future
Repeated interactions.

If more than one day (a repeated game or interaction):

— then Piemax’s objectives?

(more than maximising today’s profits)

e.g. low price today may

→ customers switch from a rival brand

→ may increase Piemax’ market share in the future

e.g. baking a large batch of pies may

→ allow learning by doing by the staff

& lower production costs in the future
But there are dangers.

But beware:

its rivals may be influenced by Piemax’s price today
→ low Piemax price, which may
→ a price war.

dynamic games and game trees
→ solution concept of subgame perfection

Subgame Perfect Equilibrium: a Nash equilibrium that does not rely on non-credible threats.
Uncertainty and information.

Uncertainty?

What if Piemax is uncertain of the cost functions or the long-term objectives of its rivals?

— Has Cupcake Pty Ltd just made a breakthrough in large-batch production?

— Does Sweetstuff plc care more about market share than about current profits?

— And how much do these rivals know about Piemax?

Incomplete information games.
Learning.

Learning:

➢ if the industry continues for several periods, then Piemax ought to learn about Cupcake’s and Sweetstuff’s private information from their current pricing behaviour and use this information to improve its future strategy.

➢ In anticipation, Cupcake and Sweetstuff may be loath to let their prices reveal information that enhances Piemax’s competitive position:

➢ they may attempt to manipulate Piemax’s information.
1.2 Strategic Interaction

Game theory → a game plan, a specification of actions covering all possible eventualities

Strategic situations: influence, to outguess, or to adapt to the decisions or lines of behaviour that others have just adopted or are expected to adopt — Schelling.

Look forward and reason backwards.
In others’ shoes.

Game theory is the study of rational behaviour in situations involving interdependence.

➢ May involve common interests: coordination
➢ May involve competing interests: rivalry
➢ Rational behaviour: players do the best they can, in their eyes;
➢ Because of the players’ interdependence, a rational decision in a game must be based on a prediction of others’ responses.

By putting yourself in the other’s shoes and predicting what action the other person will choose, you can decide your own best action.
Similarities.

Many diverse situations have the same essential structure:

— a procurement manager trying to induce a subcontractor to search for cost-reducing innovations
— an entrepreneur negotiating a royalty arrangement with a manufacturing firm to license the use of a new technology
— a sales manager devising a commission–payments scheme to motivate salespeople
— a production manager deciding between piece-rate and wage payments to workers
— designing a managerial incentive system
— how low to bid for a government contract
— how high to bid in an auction
— a takeover raider’s decision on what price to offer for a firm
— a negotiation between a corporation and a foreign government over the setting up of a manufacturing plant
— the haggling between a buyer and seller of a used car
— collective bargaining between a trade union/employees and an employer
1.3 Some Interactions

1.3.1 Auctioning a Five-Dollar Note

Rules:

➤ First bid: 20¢
➤ Lowest step in bidding: 20¢
➤ Auction lasts until the clock starts ringing.
➤ Highest bidder pays bid and gets $5 in return.
➤ Second-highest bidder also pays, but gets nothing.
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Write down the situation as seen by

1. the high bidder, and
2. the second highest bidder.

What happened?

Escalation and entrapment

Examples?
1.3.2 Schelling’s Game

Rules:

➢ Single play, $4 to play
➢ Vote “C” (Coöperate) or “D” (Defect).
➢ Sign your ballot. (and commit to pay the entry fee.)
➢ If x\% vote “C” and (100 – x)\% vote “D”:
   • then “C”’s’ payoff = \((\frac{x}{100} \times $6) – $4
   • then “D”’s’ payoff = “C” payoff + $2
➢ Or: You needn’t play at all.
Schelling’s Game

Note: the game costs $4 to join.
Schelling’s Game

WHAT HAPPENED?

➢ numbers & payoffs.
➢ previous years?

Dilemma: \[ \begin{cases} \text{coöperate for the common good or} \\ \text{defect for oneself} \end{cases} \]

Public/private information

Examples?
1.3.3 The Ice-Cream Sellers

(See Marks in the Folder)

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<th>C</th>
<th>R</th>
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</tbody>
</table>

➢ Demonstration
➢ Payoff matrix
➢ Incentives for movement?
➢ Examples?
Modelling the ice-cream sellers.

We can model this interaction with a simplification: each firm can either:

➢ move to the centre of the beach (M), or
➢ not move (stay put) (NM).

The share of ice-creams each sells (to the total population of 80 sunbathers) depends on its move and that of its rival.

Since each has two choices for its location, there are $2 \times 2 = 4$ possibilities.

We use arrows and a payoff matrix\(^1\), which clearly outlines the possible actions of each and the resulting outcomes.

---

1. See the **Glossary** in the Folder for new meanings.
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We use arrows and a **payoff matrix**, which clearly outlines the possible actions of each and the resulting outcomes.

What are the sales if neither moves (or both NM)? Each sells to half the beach.

What are the sales if **You** move to the centre (M) and your rival stays put at the three-quarter point?

What if you both move?

Given the analysis, what should you do?
The Ice-Cream Sellers

The other seller

<table>
<thead>
<tr>
<th></th>
<th>M</th>
<th>NM</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>M</strong></td>
<td>40, 40</td>
<td>50, 30</td>
</tr>
<tr>
<td><strong>NM</strong></td>
<td>30, 50</td>
<td>40, 40</td>
</tr>
</tbody>
</table>

**TABLE 1.** The payoff matrix (You, Other)

A non-cooperative, zero-sum game, with a **dominant strategy**, or dominant move.
1.3.4 The Prisoner's Dilemma
(See Marks in the Folder)

The Payoff Matrix:
➢ The Cheater’s Reward = 5
➢ The Sucker’s Payoff = 0
➢ Mutual defection = 2
➢ Mutual cooperation = 4

These are chosen so that: 5 + 0 < 4 + 4
so that C,C is efficient in a repeated game.
The Prisoner’s Dilemma

A need for:

✸ communication
✸ coördination
✸ trust
✸ or?

Efficient Outcome: there is no other combination of actions or strategies that would make at least one player better off without making any other player worse off.
The Prisoner’s Dilemma

A non-cooperative, positive-sum game, with a dominant strategy.

TABLE 2. The payoff matrix (You, Other)

<table>
<thead>
<tr>
<th></th>
<th>C</th>
<th>D</th>
</tr>
</thead>
<tbody>
<tr>
<td>You C</td>
<td>4, 4</td>
<td>0, 5</td>
</tr>
<tr>
<td>You D</td>
<td>5, 0</td>
<td>2, 2</td>
</tr>
</tbody>
</table>

Efficient at _____

Nash Equilibrium at _____
1.3.5 The Capacity Game

Two firms each produce identical products and each must decide whether to Expand (E) its capacity in the next year or not (DNE).

A larger capacity will increase its share of the market, but at a lower price.

The simultaneous capacity game between Alpha and Beta can be written as a payoff matrix.
The Capacity Game

Beta

<table>
<thead>
<tr>
<th></th>
<th>DNE</th>
<th>Expand</th>
</tr>
</thead>
<tbody>
<tr>
<td>DNE</td>
<td>$18, $18</td>
<td>$15, $20</td>
</tr>
<tr>
<td>Expand</td>
<td>$20, $15</td>
<td>$16, $16</td>
</tr>
</tbody>
</table>

**TABLE 3.** The payoff matrix (Alpha, Beta)

A non-cooperative, positive-sum game, with a dominant strategy.

Efficient at _____

Nash Equilibrium at _____
**Equilibrium.**

At a **Nash equilibrium**, each player is doing the best it can, given the strategies of the other players.

We can use arrows in the payoff matrix to see what each player should do, given the other player’s action.

The Nash equilibrium is a self-reinforcing focal point, and expectations of the other’s behaviour are fulfilled.

The Nash equilibrium is not necessarily efficient.

The game above is an example of the Prisoner’s Dilemma: in its one-shot version there is a conflict between collective interest and self-interest.
An example: Advertising.

Given the social costs associated with litigation, why is it increasing? David Ogilvy has said, “Half the money spent on advertising is wasted; the problem is identifying which half.” Is the explanation for the amount of advertising a Prisoner’s Dilemma?
1.4 Modelling Players’ Preferences

Without uncertainty or any dice-rolling, we need only rank the four combinations:

- best, good, bad, worst:

→ payoffs of 4, 3, 2, and 1, respectively, in a $2 \times 2$ interaction.
1.5 More Interactions

1.5.1 Battle of the Bismark Sea

It’s 1943: Actors:

➢ Admiral Imamura: ordered to transport Japanese troops across the Bismark Sea to New Guinea, and

➢ Admiral Kenney: wishes to bomb Imamura’s troop transports.
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Decisions/Actions:

➢ Imamura:
  — a shorter Northern route or
  — a longer Southern route

➢ Kenney: where to send his planes to look for Imamura’s ships; he can recall his planes if the first decision was wrong, but then the number of days of bombing is reduced.
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Some ships are bombed in all four combinations. Kenney and Imamura each have the same action set — \{North, South\} — but their payoffs are never the same. Imamura’s losses are Kenney’s gains: a zero-sum game.
Market analogue?

Two companies, K and I, trying to maximise their shares of a market of constant size by choosing between two product designs N and S.

K has a marketing advantage, and would like to compete head-to-head, while I would rather carve out its own niche.
### The Battle of the Bismark Sea

**TABLE 4.** The payoff matrix (Kenney, Imamura)

A non-cooperative, zero-sum game, with an iterated dominant strategy equilibrium.

<table>
<thead>
<tr>
<th></th>
<th>North</th>
<th>South</th>
</tr>
</thead>
<tbody>
<tr>
<td>North</td>
<td>2, -2</td>
<td>2, -2</td>
</tr>
<tr>
<td>South</td>
<td>1, -1</td>
<td>3, -3</td>
</tr>
</tbody>
</table>
The Battle of the Bismark Sea

<table>
<thead>
<tr>
<th></th>
<th>Imamura</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>North</td>
<td></td>
<td>South</td>
</tr>
<tr>
<td>North</td>
<td>2, -2</td>
<td>2, -2</td>
</tr>
<tr>
<td>South</td>
<td>1, -1</td>
<td>3, -3</td>
</tr>
</tbody>
</table>

**TABLE 5.** The payoff matrix (Kenney, Imamura)

A non-cooperative, zero-sum game, with an iterated dominant strategy equilibrium.

There is no other equilibrium combination: with all other combinations, at least one of the players stands to gain by changing his action, given the other’s action.

For Imamura, going N weakly dominates going S.

Neither player has a dominant strategy.
Players’ choices.

Neither player has a **dominant strategy**:

➢ Kenney would choose
  
  — North if he thought Imamura would choose North, but
  
  — South if he thought Imamura would choose South.
  
  — So Kenney’s best response is a function of what Imamura does.

➢ Imamura would choose
  
  — North if he thought Kenney would choose South, but
  
  — either if he thought Kenney would choose North.
  
  — For Imamura, North is **weakly dominant**.

And Kenney knows it and chooses North too.
Equilibrium.

The strategy combination (North, North) is an iterated dominant strategy equilibrium. (It was the outcome in 1943.)

(North, North) is a (Nash) equilibrium, because:

➢ Kenney has no incentive to alter his action from North to South so long as Imamura chooses North, and

➢ Imamura gains nothing by changing his action from North to South so long as Kenney chooses North.
1.5.2 The Battle of the Sexes

The Players & Actions:

➢ a man (Hal) who wants to go to the Theatre and
➢ a woman (Shirl) who wants to go to a Concert.

While selfish, they are deeply in love, and would, if necessary, sacrifice their preferences to be with each other.

No iterated dominant strategy equilibrium.
Two Nash equilibria:

➢ (Theatre, Theatre): given that Hal chooses Theatre, so does Shirl.
➢ (Concert, Concert), by the same reasoning.

How do the players know which to choose?

(A coordination game.)
Players' choices.

If they do not talk beforehand, Hal might go to the Concert and Shirl to the Theatre, each mistaken about the other’s beliefs.

Focal points?

Repetition?

Each of the Nash equilibria is collectively rational (efficient): no other strategy combination increases the payoff of one player without reducing that of the other.

There is a **first-mover advantage** in this sequential-move game.
The Battle of the Sexes

<table>
<thead>
<tr>
<th></th>
<th>Theatre</th>
<th>Concert</th>
</tr>
</thead>
<tbody>
<tr>
<td>Theatre</td>
<td>2, 1</td>
<td>-1, -1</td>
</tr>
<tr>
<td>Hal</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Concert</td>
<td>-1, -1</td>
<td>1, 2</td>
</tr>
</tbody>
</table>

**TABLE 6.** The payoff matrix (Hal, Shirl)
A non-cooperative, positive-sum game, with two Nash equilibria.
Market analogue?

- An industry-wide standard when two dominant firms have different preferences but both want a common standard.
- The choice of language used in a contract when two firms want to formalise a sales agreement but prefer different terms.
1.5.3 The Ultimatum Game

➢ Your daughter, Maggie, asks for your sage advice.
➢ She has agreed to participate in a lab experiment.
➢ The experiment is two-player bargaining, with Maggie as Player 1.
➢ She is to be given $10, and will be asked to divide it between herself and Player 2, whose identity is unknown to her.
➢ Maggie must make Player 2 an offer,
➢ Then Player 2 can either:
   — accept the offer, in which case he will receive whatever Maggie offered him, or
   — he can reject, in which case neither player receives anything.
➢ How much should Maggie offer?
Maggie's choices.

➢ Distinguish:
   ① the rationalist’s answer from
   ② the likely agreement in practice from
   ③ the just agreement.

The rationalist:

➢ Player 1 should offer Player 2 5¢ (the smallest coin).
➢ Player 2 will accept, since 5¢ is better than nothing.
➢ But offering only 5¢ seems risky, since, if Player 2 is insulted, it would cost him only 5¢ to reject it.
➢ Maybe Maggie should offer more. But how much more?
An Example:

➢ At a local motel in a small town, a few times a year (graduations, local festivals etc.) there is enormous demand for rooms.

➢ (On graduation weekends, for instance, some parents stay in hotels as much as 80 km away.)

➢ The usual price for a room in his motel is $95 a night. Normal practice in town is to retain the usual rates, but insist on a three-night minimum stay.

➢ The motel owner estimates he could easily fill the motel for graduation weekends at a rate of $280 a night, while retaining the three-night minimum stay.

➢ But there is a risk of being labelled a “gouger”, which could damage regular business.

➢ What should he do?
1.5.4 The Inheritance Game

The players:
➢ Elizabeth, an aged mother, wishes to give an heirloom to one of
➢ her several daughters.

The game:
➢ E. wants to benefit the daughter who values it most.
➢ But the daughters may be dishonest: each has an incentive to exaggerate
   its worth to her.
A second-price auction.

so E. devises the following scheme:

— asks the daughters to tell her confidentially (i.e. a sealed bid) their values, and
— promises to give it to the one who reports the highest value
— the highest bidder gets the heirloom, but only pays the second-highest reported valuation.

Will Elizabeth’s scheme (a Vickrey\(^2\) auction, or second-price auction) make honesty the best policy?

\[2. \text{ The late Bill Vickrey shared the Nobel prize in economics in 1996.}\]
A second-price auction.

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Will Elizabeth’s scheme (a Vickrey auction, or second-price auction) make honesty the best policy?

Yes.
Why? Thinking through the options.

Consider your reasoning as one of the daughters:

➢ three options: truthfulness, exaggeration, or understatement.
➢ The amount you pay is independent of what you say it’s worth,
➢ so the only effect of your report is to determine whether or not you win the heirloom, and hence what you must pay.
Why? Thinking through the options.

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➢ Exaggeration: the possibility that you make the highest report when you would not otherwise have, had you been honest.

  i.e., that the second-highest report, the one you now exceed, is higher than your true valuation.

But → that what you must pay (the second-highest report) is more than what you think the heirloom is worth.

Exaggeration not in your interest.
Why? Thinking through the options.

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   But → that what you must pay (the second-highest report) is more than what you think the heirloom is worth.

Exaggeration not in your interest.

➢ Understating changes the outcome only when you would have won with an honest report;
   but now you report a value lower than that of one of your sisters, so you do not win the heirloom.

Not in your interest either.
It works.

So the mother’s scheme works, and the truth is obtained—but at a price, to Elizabeth, the Mum.

E. receives a payment less than the successful daughter’s valuation, so this daughter earns a profit:

= her valuation – the 2nd-highest valuation.

= the premium the mother forgoes to induce honesty
Market Analogue?

Think: how can the neighbours who propose building a park overcome each household’s temptation to free-ride on the others’ efforts by claiming not to care about the park, when contributions should reflect the household’s valuation of the park?

How can the users of a satellite be induced to reveal their profits so that the operating cost of the satellite can be divided according to the profit each user earns?
1.6 Concepts Used:

**Best response** means the player’s best action when faced with a particular action of his or her rival

**Nash equilibrium** is the outcome that results when all players are simultaneously using their best responses to the others’ actions; thus at an equilibrium all players are doing the best they can, given the others’ decisions; that is, all are playing their best responses.

If, conversely, the game is not at an equilibrium, then at least one of the players could have done better by acting differently.

∴ A Nash equilibrium is self-reinforcing: given that the others don’t deviate, no player has any incentive to change his or her strategy.

An **efficient** outcome is an outcome when there exists no other outcome that all players prefer

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3. John Nash received the Nobel prize in Economics in 1994 for his work done in the early ’50s.
1.7 What Have We Learnt?

**Rule 1:** Look ahead and reason back.

**Rule 2:** If you have a dominant strategy, then use it.

**Rule 3:** Eliminate any dominated strategies from consideration, and go on doing so successively.

**Rule 4:** Look for an equilibrium, a pair of strategies in which each player’s action is the best response to the other’s.
1.8 Several Simple Interactions

(from Dixit & Nalebuff — see Further Reading)

1.8.1 Basketball (or tennis?) and weak hands
— Does the “hot hand” exist?
— What if Larry was known to have a “hot hand”?
— Then other side’s behaviour?
— But Larry’s teammates?
— so that Larry’s hot hand leads to better team performance, although his own performance falls.
— Which of Larry’s hands do the other side focus on?
— So Larry’s hot hand may warm up his other
— Paradoxically, a better left-handed shot may result in a more effective right-handed shot.
— Moreover, you might focus too much on your opponents’ weaknesses and not enough on your own strengths.
1.8.2 To lead or not to lead

Sailing:

— a reversal of “follow the leader”: instead, follow the follower, even if it is clearly pursuing a poor strategy.

— Or play monkey see, monkey do.

— Keynes’ comments on the stock market as a “beauty contest”: the winner is not whoever chooses the most beautiful contestant, but whoever chooses the contestant chosen by most analysts.

Leading stock-market analysts and economic forecasters have a similar incentive to follow the pack, lest they lose their reputations.

— Newcomers may follow riskier strategies, and occasionally are proven correct.

Consider computers: most innovations have come from small, start-up companies. Also true with stainless-steel razor blades (Wilkinson Sword), and disposable nappies.

How to imitate? Immediately (as in sailing) or later to see how successful the approach is (as in computers)? In business the game is not zero-sum (winner take all) and so the wait is more worthwhile.
1.8.3 Here I stand: I can do no other

— To be known to obstinate or intransigent can be powerful: Martin Luther against the Catholic Church, Charles de Gaulle during the War and after, in influencing the evolution of the EEC.

— One player taking a truly irrevocable position leaves the other parties with just two options: take it or leave it.

— Others denied the opportunity to come back with a counteroffer acceptable.

— But usually the possibility of future negotiations — today’s intransigence may be repaid in kind.

— Or others may walk away from the past intransigent.

— A compromise in the short term may prove a better strategy in the long run.

— To achieve the necessary degree of intransigence may be costly: an inflexible personality cannot be turned on and off at will.

— How to achieve selective flexibility? or how to achieve and sustain commitment?
1.8.4 Belling the cat — Who will risk his life to bell the cat?

Whistleblowing:
— How do relatively small armies of occupying powers or tyrants control very large populations for long periods?
— Why is a planeload of people powerless before a single hijacker with a gun?
— Apart from problems of communication and coordination, who will act first? (Khrushchev in 1956)
— The hostages’ dilemma?
— The frequent superiority of punishment over reward. (The taxi dispatcher. The eviction of tenants. The sequential bargaining of Japanese electricity companies with Australian coal mines.) The “accordion” effect.
1.8.5 Thin end of the wedge

How is it that gains to the few always seem to get priority over much larger aggregate losses to the many?

— in use of tariffs, quotas, and other protective measures, which raise prices and reduce exports.

— Answer: one case at a time. Myopic decision-makers fail to look ahead and see the whole picture.

— How to develop a system for better long-range strategic vision?
1.8.6 Look before you leap

Many situations are expensive to get out of: a job in a distant city, a computer and its operating system, switching from your frequent-flier airline to another, a marriage.

Once you make a commitment, your bargaining power is weakened.

Strategists who foresee this will use their bargaining power while it exists, before they get into the commitment, typically to gain an up-front payment.

Indeed, such foresight may prevent some people becoming addicted: to heroin, to gambling, to tobacco.
1.8.7 Never give a sucker an even bet

Other people’s actions tell us something about what they know, and we should use such information to guide our own action. Of course, if they realised that, they might try to mislead us. (Rothschild.)
1.8.8 Is game theory a danger?

Rationality on the part of the other player may be dominated by pride and irrationality.

Rationality doesn’t require:

➢ our preferences are the same
➢ our information is the same
➢ our perceptions are the same
1.8.9 Another Simple Simultaneous Game:

The notorious game of Chicken!, as played by young men in fast cars. Here “Bomber” and “Alien” are matched.

**Chicken!**

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<table>
<thead>
<tr>
<th></th>
<th>Veer</th>
<th>Straight</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alien</td>
<td>Blah, Blah</td>
<td>Chicken!, Winner</td>
</tr>
<tr>
<td></td>
<td>Winner, Chicken!</td>
<td>Death? Death?</td>
</tr>
</tbody>
</table>
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**TABLE 7.** The payoff matrix (Alien, Bomber)
1.9 Summary of Strategic Decision Making

The following concepts & tools are introduced:

The Ice-Cream Sellers:
- payoff matrix
- incentives to change — use arrows!
- dominant strategy

The Prisoner’s Dilemma:
- possibility of repetition
- efficient outcome
- non-zero-sum game
- inefficient equilibria

The Battle of the Bismark Sea:
- zero-sum game
- iterated dominant strategy
- Nash equilibrium

The Battle of the Sexes:
- coordination, not rivalry
- first-mover advantage
- focal points
1.10 Ten Lessons.

1. If you have a dominant strategy and no opportunity to agree on another course of action with your opponent, then play that strategy.

2. If you don’t have a dominant strategy but your opponent does, and there is no opportunity to agree on another course of action with your opponent, then expect her to play her dominant strategy and do the best you can in the circumstances.

3. If neither you nor your opponent has a dominant strategy, and there is no opportunity to agree on another course of action, then select, and signal your commitment to, a clear strategy to encourage your opponent to behave in a way you’d prefer.

4. The only credible threat is the one which would be in your interest to carry out, if necessary.

5. Commitment to make a threat credible can pay dividends in the long run.
6. An investment can be profit-increasing if it discourages entry, but costly if your potential competitors are lower-cost than you are.

7. Always take your opponent’s threat seriously if implementation is his dominant strategy.

8. A credible threat is not always a deterrent.

9. A threat which lacks credibility in the short run may be credible in the long run.

10. A firm which appears to be tying its own hands may actually be tying those of its opponent as well.
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