Competitive Customization

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We study a duopoly competition where customers have different preferences and one or both firms can offer customized products geared to those preferences. Firms differ in their production costs and customization capabilities. We analyze the effects of these differences and characterize the firms’ strategic process choices. We find that the value of customization to a firm critically depends on both its own production cost and on its competitor’s capabilities. In particular, customization can be profitable only if it builds on the foundation of an efficient production process. Even costless flexibility improvements can hurt a firm due to its competitor’s response. Overall, we find that efficiency is driven by competition whereas flexibility is driven by the desire to extract surplus. In particular, firms with larger market shares make larger investments in customization.

*joint work with Prof. Haim Mendelson