

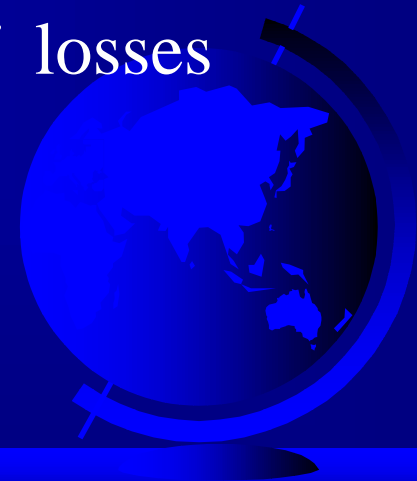


Predatory Pricing

By Kevin Hinde

Predatory Pricing

- ❖ Firms who have market power in more than one market may set prices below cost in one period in order to drive out rivals and restrict entry. Having done so, it once again raises price.
- ❖ Predation will be considered a strategy if the present value of profits earned after rivals have exited is greater than the present value of losses from predation.



Legal Rules for dealing with Predation

❖ The following broad judgements, taken from EC Court decisions

❖ $P < AVC$

Predation can be assumed

❖ $AVC < P < ATC$

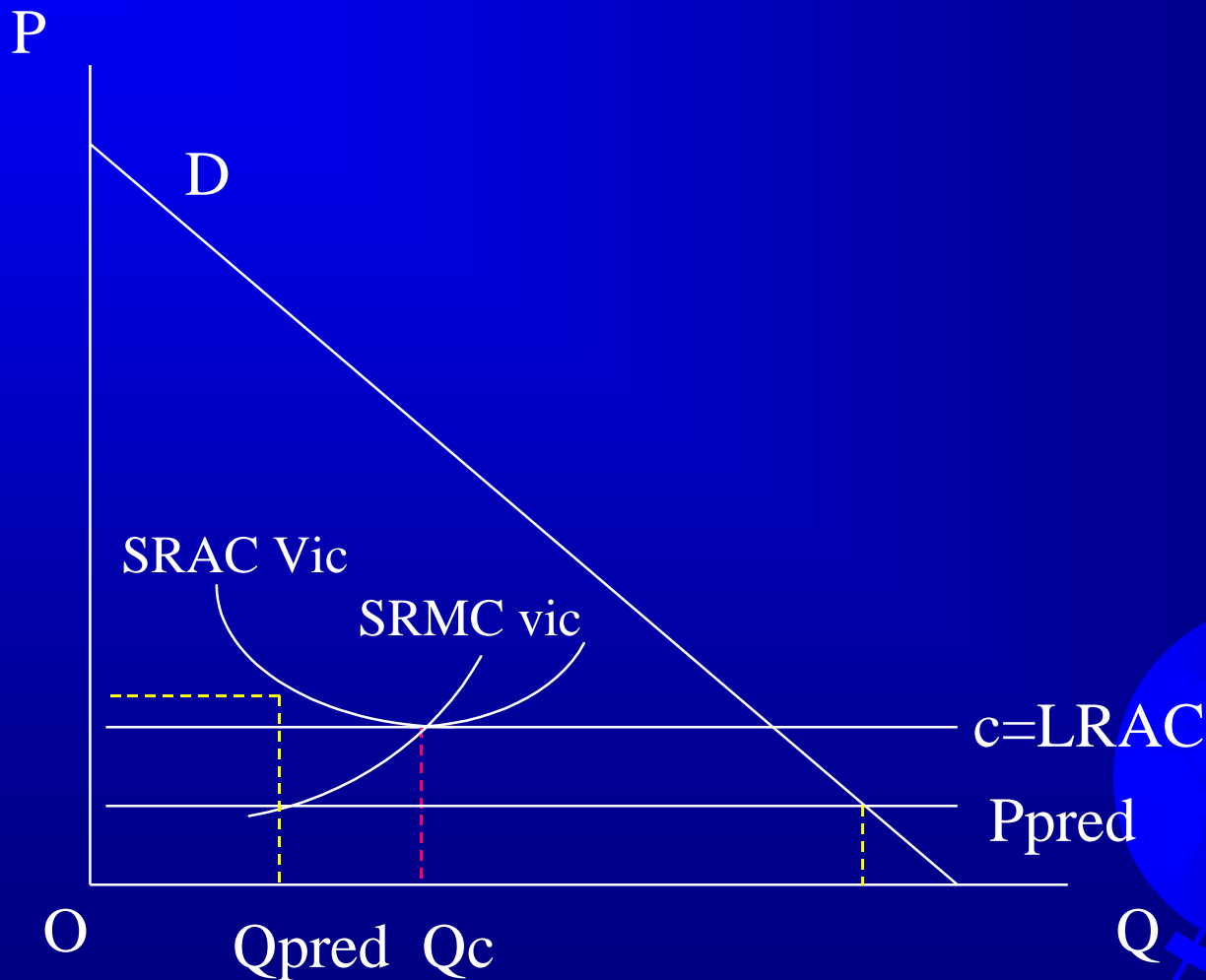
Evidence on costs may indicate predation but authorities need evidence that a dominant undertaking was looking to eliminate a competitor

❖ $P > ATC$

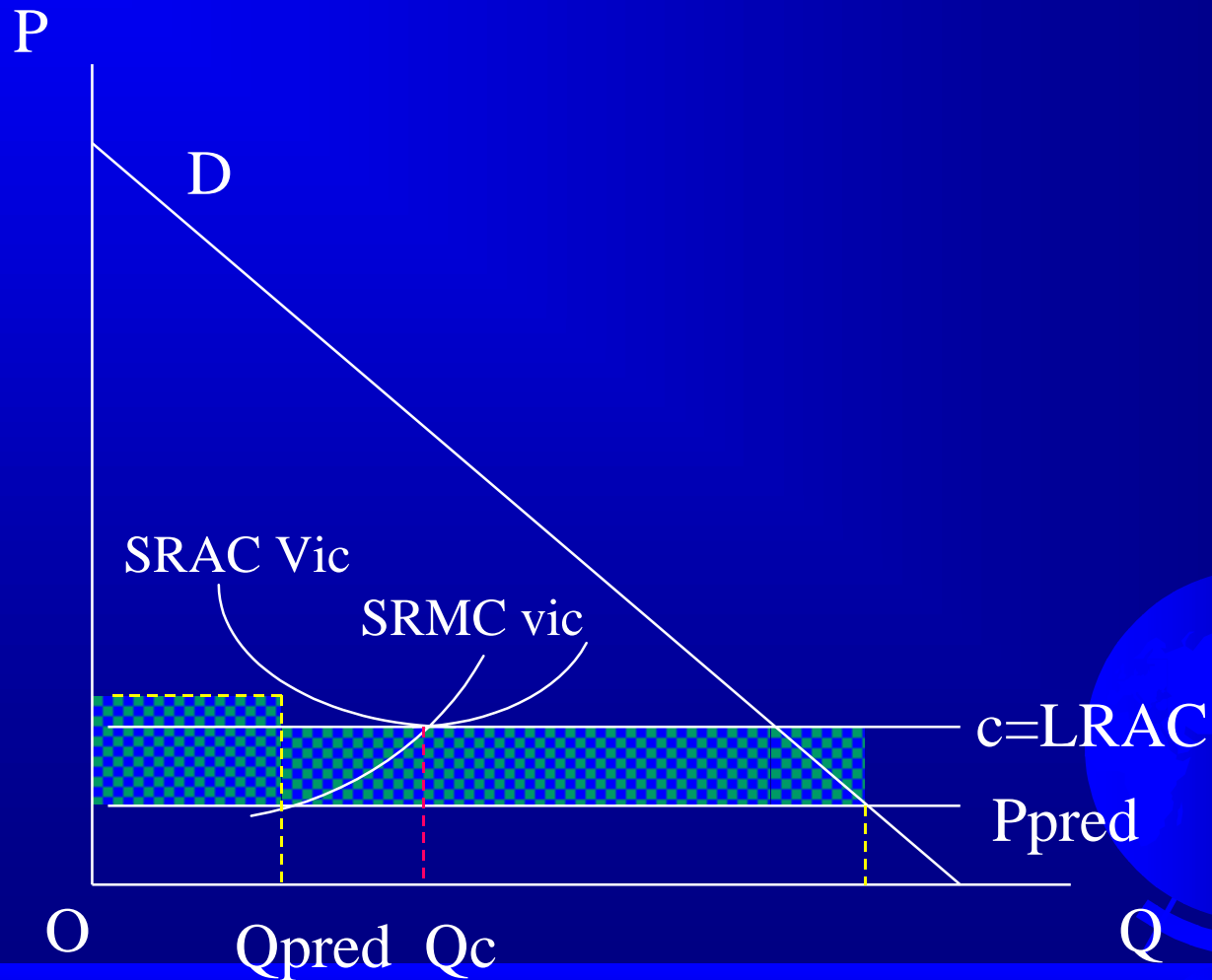
Evidence does not indicate predation



Predatory Pricing: Stage 1

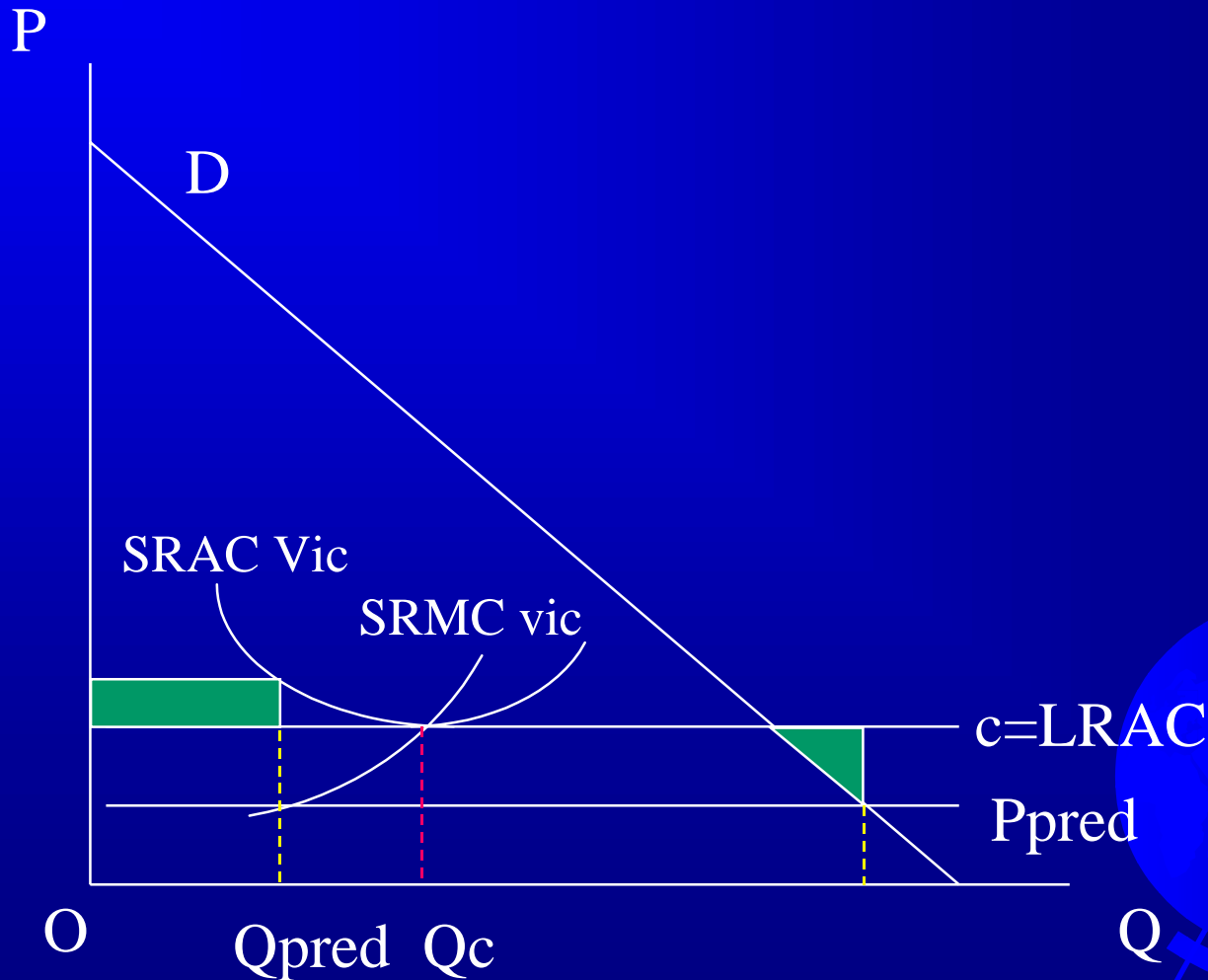


Predatory Pricing: Stage 1 Loss



Predatory Pricing: Stage 1

Net Loss to society



Predatory Pricing

- ❖ In the second stage the predator can embark upon monopoly pricing.
- ❖ Note predation requires
 - capital markets to be imperfect
 - ◆ target firms are unable to lend money to weather the storm
 - consumer coalitions to fail
 - ◆ here the problem is that there are large transaction costs in negotiating contracts.
 - that merger is not a possible alternative (but then again this would may be viewed as anti-competitive)

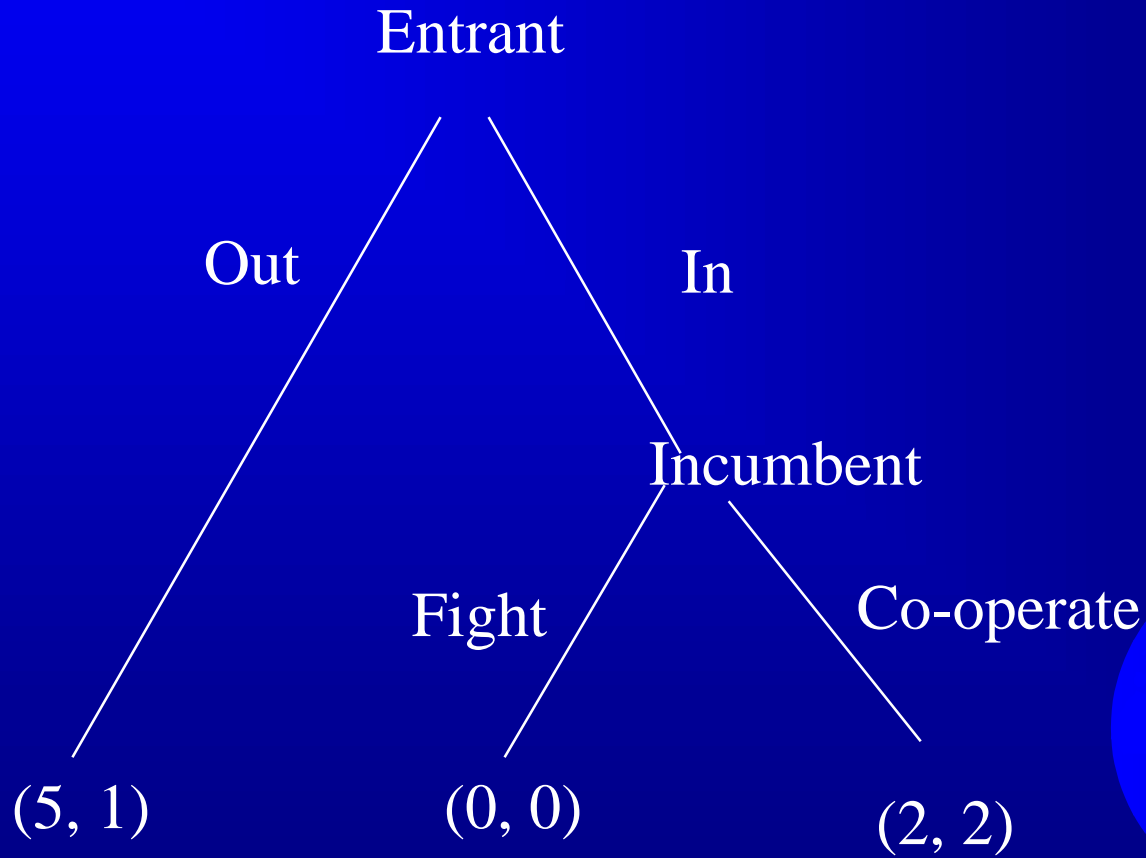


The Chain Store Paradox

- ❖ An incumbent 'Chain Store' faces 20 entrants in 20 towns.
- ❖ Each entrant must decide whether or not to enter.
- ❖ The incumbent must decide whether to fight or share the market.
- ❖ What will happen?
- ❖ The answer depends on how we encompass information.

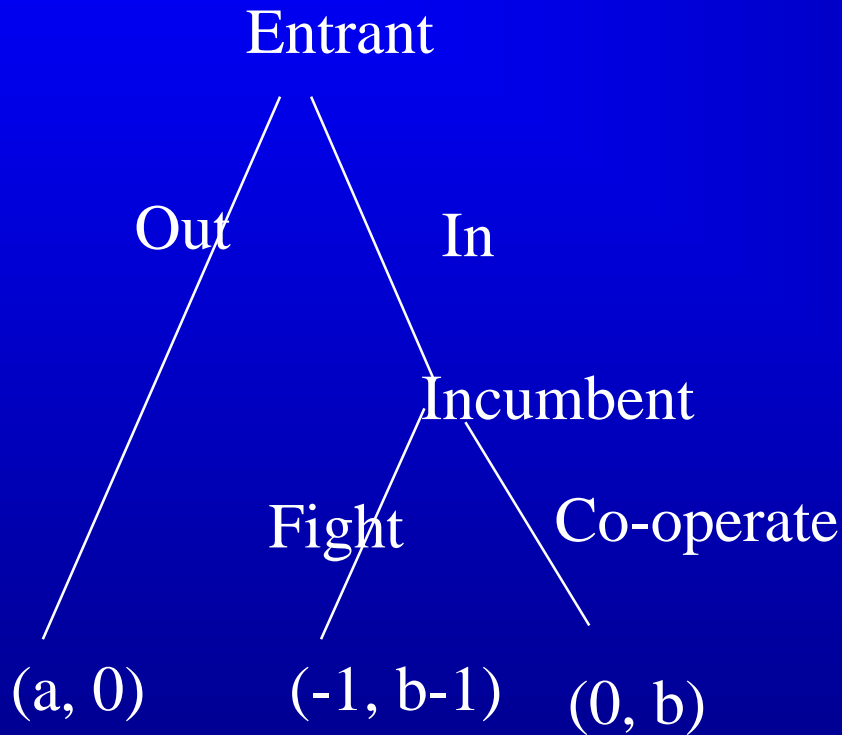


The Chain Store Paradox



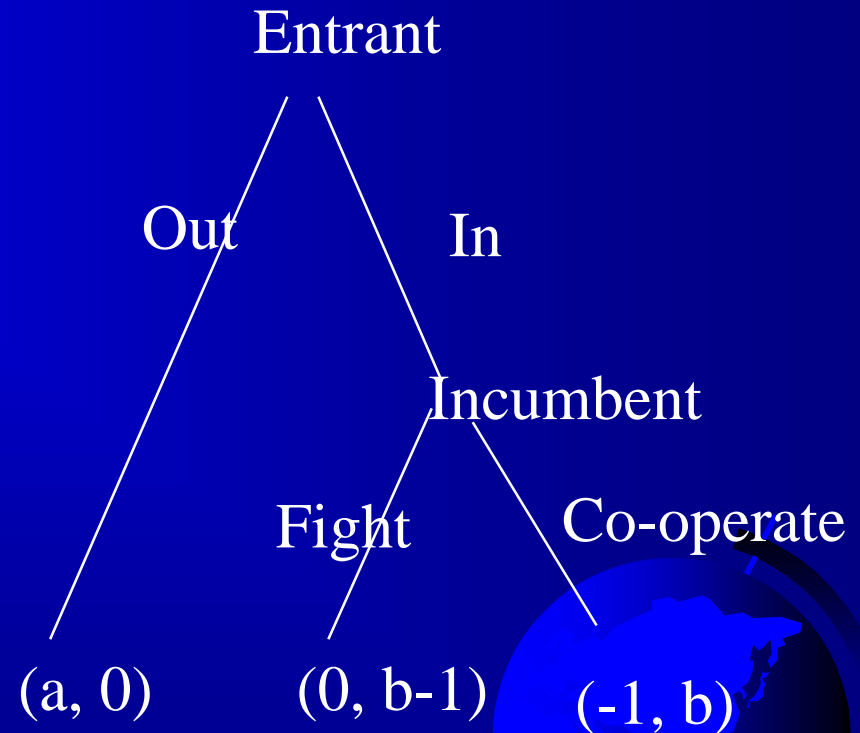
The Chain Store Paradox

Weak Incumbent



Incumbent: $a > 1$

Strong Incumbent



Entrant: $0 < b > 1$

The Chain Store Paradox

- ❖ Note that the incumbent is weak in that they earn more from co-operating than fighting ($0 > -1$)
- ❖ If the incumbent is weak, and the entrant knows this, then the backward induction argument applies and co-operation develops.
- ❖ Hence the incentive to gain a reputation even if the incumbent are weak.
- ❖ The overall profitability of predation does not depend on its profitability in a single period.
- ❖ Note that predation emerges as an equilibrium strategy because information is imperfect.



Examples

❖ UK

- Stagecoach and Darlington Traction Company 1995
- News International

❖ EC

- AKZO



Any Questions?

