

Strategic Pricing and Competition

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AAI conference
June 2012

Disclaimer

- Contrary to some of the publicity, I am not (now) at the FTC
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When is Pricing “Strategic”?

- Not merely “important” or “high”
 - Business school usage?
- Not simply extraction of firm’s surplus created
 - Not mere price discrimination

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- Affects competition and offers available *from others*
 - Game theory usage?
- Can you do that? How?!

Yes, you can!

- Pricing practices can be “strategic” in collusive or competition-softening ways
- Can also be “strategic” in exclusionary ways—less obvious and more controversial

Strategic Pricing to Soften Competition

- Pricing practices can be “strategic” in collusive or competition-softening ways
 - Clarify your pricing and change the game
 - GE/Westinghouse
- Not just high price educing high price in response

Drip pricing

- Recent BE workshop followed on OFT report
 - Mary Sullivan at FTC; website
- Undisclosed or surprise pricing supplements
 - Shipping and handling
 - Service and spare parts
 - Baggage check, convenience fees, ...
- Akin to aftermarkets
 - But...

Drip pricing as foremarket issue

- Naïve consumers may be fooled but won't they wise up?
- How do consumers wise up?
 - Getting good at predicting p^* from p
 - Recognizing you can't predict
- In the latter case, cross-elasticity may plunge!
 - Obscure pricing as competition-softening practice

Can pricing practices be exclusionary?

- Many are skeptical:
 - If price high, doesn't exclude
 - If price low, no harm
 - Posner (2001)
- “rare exception”: predation
 - Formulated as DF pricing below cost
 - Real point is (low; ...; high) pricing *pattern* that takes more from consumers *but* offers less room to rivals (than...)
 - Edlin and Farrell “Freedom to Trade”

Learning from Exceptions

- Certain kinds of algebraic statements are either *always* true ($x + 1 = 2 - 1 + x$) or *almost never* true ($x = 3$)
- Is something similar here?

Exclusive Dealing as Strategic Pricing

- Simple high pricing might attract entry
- Sometimes high price, with threat to change tactics if customer deals with rival, can exclude rival without lowering price--much
 - Details elided here...

Market-share discounts as exclusion

- Unlike a quantity discount, a market-share discount can tax incremental purchases from rival
 - Potentially sustain high marginal price from dominant firm, without erosion or topping-up
- In circumstances where exclusive dealing would be problematic, this too may be problematic
- Complex topic not 100% understood

Pricing to Compound Customers

- Two-sided markets
 - Many interesting innocent questions
 - Competitive concerns too
- Interchange and payment-system pricing
- Co-pay coupons for drugs

Conclusions

- Drip and other pricing practices can soften competition;
 - Sometimes might even amount to collusion
- Pricing practices can also be exclusionary
 - Predation: (low; ...; high)
 - Exclusive dealing: divide and conquer, threats, etc.
- Don't view all price issues in terms of *levels*