Effects of Predatory Pricing on Competition

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Predatory Pricing

Price is said to be predatory
only when,

- Predator is in a dominant position in the market
- Sets the price below cost

which is used as a mean of monopolizing a market

The Predator sets its price so low for a sufficient period of time to drive out the competitors from the market and thus he makes the market more vulnerable to monopoly and then they rage up the price to have huge sum of profit. To understand Predatory pricing you should know what is competitive pricing

Competitive Pricing

- ✓ This is the process of selecting strategic price points to best take advantage of a product or service based market relative to competition.
- ✓ This pricing method is used more often by businesses selling similar products, since services can vary from business to business, while the attributes of a product remain similar

<u>Practical Implementation:</u>

This type of pricing strategy is generally used once a price for a product or service has reached a level of equilibrium, which occurs when a product has been on the market for a long time and there are many substitutes for the product.

Competitive Pricing vs Price Matching

- Competitive Pricing and Price matching concept go hand-in-hand.

For Example:

In November 2014, Amazon projected price changes to approximately 80 million items in preparation for the holiday season. Other retailers, including Walmart and Best Buy, announced a price-matching program. This allowed customers of Walmart or Best Buy to receive a product at the lower price without risking customers taking their business to Amazon solely for pricing reasons

Competitive Pricing vs Predatory Pricing

- ✓ There is only a thin line of difference between competitive pricing and predatory pricing when a government interferes in a situation where the pricing is done for a competitive purpose and it is wrongly understood as predatory pricing then market regulators will not be available any more and the situation will become more worse and vice versa.

- ✓ How did the concept of predatory pricing evolved ?

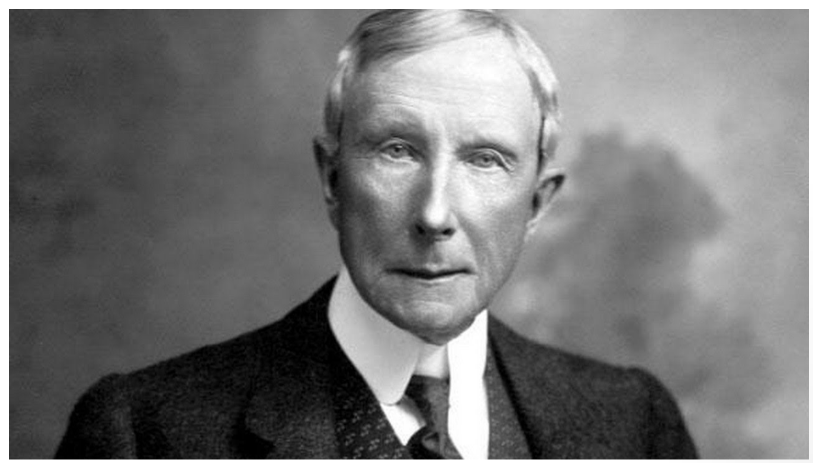
  Let us understand how did the concept of predatory pricing evolve with the help of Case Law

Case Law – John D Rockefeller

- In 1870, Rockefeller and his associates incorporated the Standard Oil Company, which immediately prospered. With success came acquisitions, as Standard began buying out its competitors.
- Standard's footprint got bigger as well, and it bought up competitors in other regions, soon pursuing ambitions of being an industry player both coast-to-coast in the U.S. and abroad. **In just over a decade since Standard Oil was incorporated, it had a near monopoly of the oil business in the U.S.** and consolidated each division under one giant corporate umbrella, with Rockefeller overseeing all of it.

- With such an aggressive push into the industry, the public and the U.S. Congress took notice of Standard and its seemingly unstoppable march.
- U.S. Congress jumped into the fray with both feet with the Sherman Antitrust Act, and two years later the Ohio Supreme Court deemed Standard Oil a monopoly that stood in violation of Ohio law.

- Always eager to be a step ahead, Rockefeller dissolved the corporation and allowed each property under the Standard banner to be run by others which was over all controlled by Rockfeller.
- Just nine years after the company broke itself into pieces in the face of antitrust legislation, those pieces were again reassembled in a holding company. In 1911, however, the U.S. Supreme Court declared the new entity in violation of the Sherman Antitrust Act and illegal, and it was again forced to dissolve.



Predatory Pricing - Rational

Modern Economist around the
world doesn't accept the concept of predatory pricing and they come up with a new set of theory.

In the new era of globalization when someone tries to eliminate competitors from the market and monopolizing the market becomes very difficult for them.

I'll tell you why?

- For a firm to drive its rivals out of business by charging "**excessively**" low prices, it must not only cut its prices but also expand its sales.

↑ **Sales** = ↑ **Loss**

- The objective is to **take so many sales away from rival firms** that they all go bankrupt. But when a firm **increases its sales** at below-cost prices, that firm necessarily **incurs huge losses**. The predator's rivals, while they might all be obliged to also sell at prices below cost, have an advantage that the predator doesn't: they can reduce their sales during the price war in order to keep their losses to a minimum.

- Against these large and certain costs are future profits which must be discounted in two ways,
  - ✓ once to reduce them to present value terms
  - ✓ and then again to reflect the uncertainty that they will arise.

Reason for uncertainty:

1. The prey might enter into long-term contracts with customers (who would not want to see a competing supplier disappear),
2. Even if the victim does go out of business, new entry is possible in the post-predation period (the existence of the victim demonstrates that entry is possible.

Most important, however, is McGee's point that the threat of predation is not credible because it would not pay to carry it out; the dominant firm would lose more by predating than by coexisting with a rival.

- McGee further argues that better monopolising strategies exist. He finds that **mergers to monopoly**, would make more sense to the dominant firm, as mergers would **avoid the large losses** to the dominant firm of a predatory campaign.
- Nevertheless, many people, including antitrust authorities and trade officials, continue to treat predatory pricing as a plausible means of monopolizing markets.
- Ironically, this refusal to dismiss predatory pricing as an utterly unrealistic means of securing monopoly power has a strong likelihood of itself creating monopoly power.

Dow Chemical Company

Herbert Henry Dow, a Canadian by birth, was a remarkable man. A chemist and an entrepreneur, Dow was one of the first people to realize that brine, an abundant mixture of chemicals that often hampers oil drilling, could be broken down into more useful components. Of these, bromine - an essential ingredient for most medicines as well as a vital element to photography - was the most marketable.

Unfortunately for Dow, the world supply of bromine was controlled by Bromkonvention, a German cartel backed by the German government. This powerful monopoly sold bromine at a fixed price of 49 cents per pound, but it would implement a predatory pricing strategy quickly, if challenged

Dow Chemical, established in 1896, began to edge its way into the bromine monopoly. The increased efficiency and cheaper costs allowed Dow to sell his bromine in the U.S. for about 10 cents less per pound.

- When the profits rolled in, Dow expanded into world markets – Especially in Europe
- The Germans responded by flooding the American market with artificially cheap bromine: 15 cents per pound to Dow's 36 cents.
- But, Bromkonvention kept the world price of bromine fixed because many of the producers in the cartel simply would cease production if they were losing money.
- Dow was brilliant entrepreneur and he came up from the situation just like that.

- Quietly, Dow purchased large amounts of the cheap German bromine, repackaged it, and sold it back to the Germans as an export for 27 cents - 22 cents cheaper than the domestic bromine from the same company.
- The large purchases in the U.S. encouraged the Germans to think they were winning. Unbeknownst to them, the cheap bromine from Dow that flooded the German market was, in fact, their own.
- Thus, Dow's product had not been marketed for a loss. Instead, Dow made profits from his export and solidified his company's position in world markets.
- Finally, Bromkonvention was forced to admit defeat and raise its prices back to previous levels. As a result, its worldwide market share inevitably decreased in the face of Dow's superior extraction process.

Conclusion

- For predatory pricing there are stringent provision available in the legal framework against predators, due to which new concept of non-pricing predation comes into effect.
- The rules' against predatory pricing and dumping are natural weapons for the non-price predator, through which they try to raise the rivals cost and drive them out.
- It is important that these rules be no broader than necessary; rules which are overbroad or imprecise invite their abuse for anticompetitive purposes.
- An important point in this argument is that because predation is unlikely to be successful, it is self-deterring and therefore government intervention is unneeded. Self-deterrence arises because if a firm (foolishly) attempts to predate, it inflicts losses on itself but ultimately gains no market power.

"Some people regard private enterprise as a predatory tiger to be shot. Others look on it as a cow they can milk. Not enough people see it as a healthy horse, pulling a sturdy wagon"


THANK YOU