Anticompetitive Loyalty Discounts by a Dominant Producer Threatened by Partial Entry

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Puzzling (but not unusual) Pricing Scheme

- **Customers who buy less than 100 units pay $10 per unit**
- **Customers who buy at least 100 units pay $9 per unit**
- **Why it is puzzling:**
  - Total cost of 99 units is $990
  - Total cost of 100 units is $900
  - Why does the seller charge less for more?

Puzzling, but anticompetitive?

- **If it is anticompetitive, does it fit into some other anticompetitive category?**
  - Predatory pricing?
  - Exclusive dealing?
  - Tying?
- **More generally, if it is anticompetitive, is it exclusionary or collusive?**

Setting

- **Incumbent monopolist**
- **Competition from an entrant that can compete for part but not all its market**
- **Differentiation within the competitive segment**
  - Within the competitive segment, some customers prefer (and are willing to pay a premium for) the entrant's product while others prefer (and are willing to pay a premium for) the incumbent's

Numerical Example for this presentation

- **All customers get a value of $100 from the incumbent's product**
- **Competitive segment is 20% of the market**
- **In the competitive segment, half the customers prefer the entrant's product while half prefer the incumbent's**
  - Maximum premium customers are willing to pay for their preferred brand ranges linearly from $0 to $20

Comparison

- **Simple pricing**
  - Incumbent charges a constant price per unit that is the same in the monopolized and competitive segments
- **Pricing strategies to target price cuts to the competitive segment**
  - Segment pricing (different prices for the monopolized and competitive segments)
  - Discounted marginal prices for purchases above a threshold
- **Loyalty discounts**
  - Discounted average prices conditional on reaching a threshold

Results for Simple Pricing

- **Incumbent charges $100, entrant charges $80**
  - Entrant captures the entire competitive segment
- **Incumbent cedes the competitive sector to the entrant because cutting prices to attract customers in the competitive segment results in too big a profit sacrifice in the monopolized segment**

Results for Segment Pricing

- **Monopolist charges $100 in the monopolized segment and $30 in the competitive segment**
- **Entrant charges $25**
  - Technical aside: the incumbent moves first
- **Price in the monopolized sector is the same as with simple pricing but pricing in the competitive segment is lower**
- **Average price is about $85.40**

Results for Discounted Marginal Price

- **With a threshold of 80%, the monopolist's undiscounted price is $101.25 and its discounted price is $20**
- **Entrant's price is also $20**
- **Average price is $85**

Lesson from Analysis of Segment and Discounted Marginal Prices

- **Consumers benefit from pricing structures in which the incumbent can target its discounts to meet a competitive threat**
  - Discounts on incremental sales above a threshold are pro-competitive (if they are not predatory)
  - In a multi-product setting, discounts off list for incremental purchases above a threshold for total purchases are procompetitive

Result with Loyalty Discount

- **“Discounted” price of $94.72 condition on purchases of at least 90.4% of the market**
- **Entrant charges $95.69**
- **Points to notice**
  - Entrant’s share is approximately efficient (and, with different parameter values can even be above the efficient level)
  - Average price is about $94.80

Why the strategy works

- **All units discounts confront the entrant with the choice of accepting an allocated share at a relatively high price or having to compete *very* aggressively to get any incremental share**
- **Entrant rationally takes the allocated share at the high price**
- **Anticipating this, the incumbent can also charge a high price**

Back to the questions

- **Anticompetitive?** *Yes*
- **What category?**
  - Predatory pricing? *No, price is high, not low*
  - Exclusive dealing? *Not literally, but it is quantity forcing*
  - Tying? *Not inaccurate, but not helpful*
  - More generally, if it is anticompetitive, is it exclusionary or collusive? *More of a facilitating device than exclusionary*

What Sections of What Statutes Does it Violate?

- **In Europe, "Abuse of Dominance" would be a good characterization**
  - The setting in this model presumes a dominant supplier
  - A case that rests on this model should require a showing of dominance
- **In US,**
  - Procrustes might be able to fit this theory into either a Sherman Section 1 or Sherman Section 2 bed
  - Perhaps it fits within a "gap filling" approach to a (slightly) expanded FTC Act Section 5