Entry and Deterrence

Entry Strategy Recap

- High profits incentivize entry (Industry Analysis)
    - So what's stopping firms?
- Strong incentives to deter!
    - Monopolist earns more than two duopolists put together
        - Best the duopolists can do is collude!
    - Monopolist Profit - Duopolist Profit > Duopolist Profit
        - If entry, Monopolist Loss > Entrant Gain
- Week 6 focus: Strategic/endogenous BTEs
    - Reputation
    - Signaling
        - Fighting
        - Excess Capacity (in this note)
    - Product Proliferation (in this note)
        - Cereal characteristics
        - Sleeping patents (check out Rank Xerox!)
        - Airport space (British Airways in London)

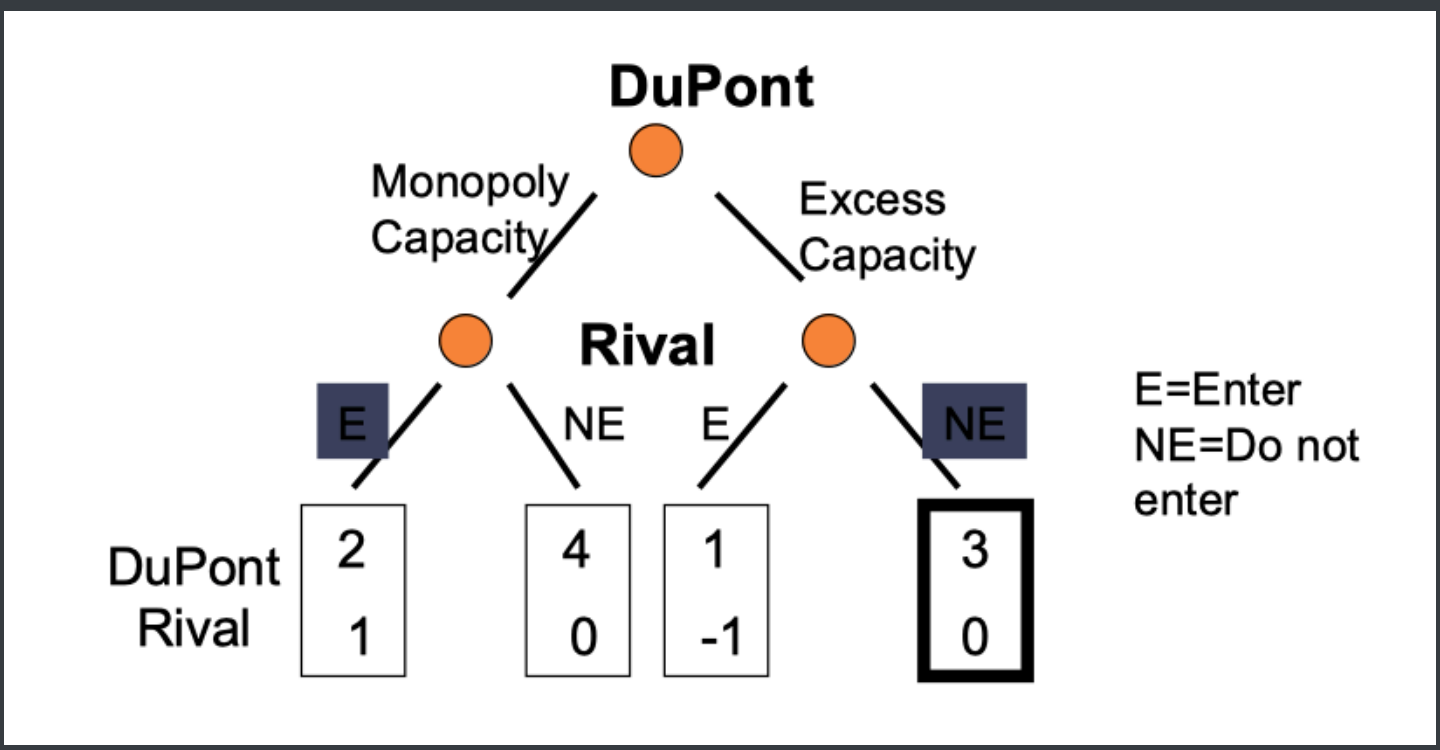
Deterrence Toolbox Addendum

(Not predation!)

Signaling: Excess Capacity

- Adding capacity can deter entry
- Allows incumbent to expand output quickly/cheaply
- Credible signal of a price war response to entry
- ... but isn't optimal without deterrence effect!
- An Antitrust Example: *United States v Alcoa*
  - Aluminum monopolist through 1940
  - Built 'too many' plants and signed big exclusive contracts with input producers
  - Both forms of excess capacity commitments to deter entry

Game Theory Example

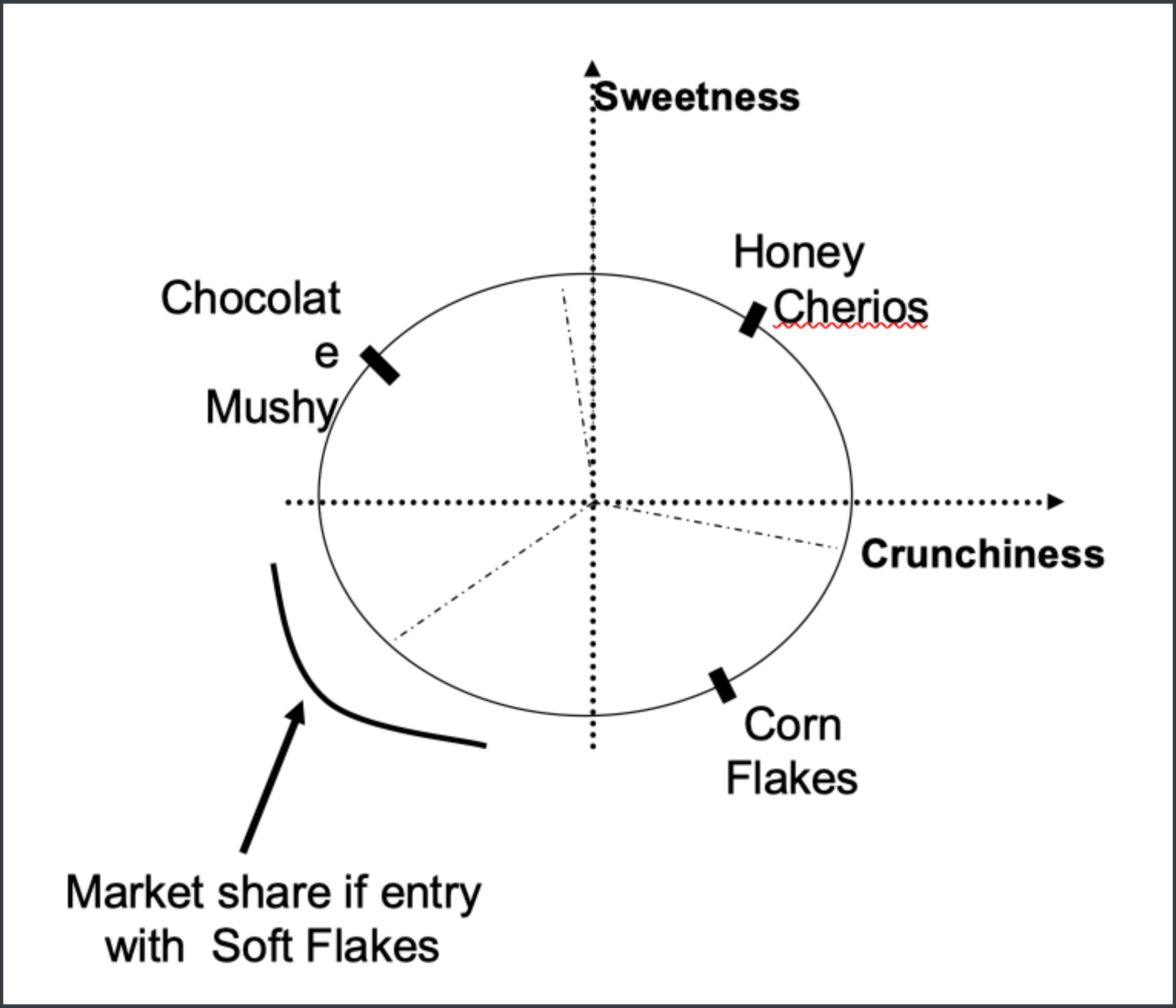


Proliferation: Connection to Product Differentiation

- Entry deterrence by making 'too many' products
  - Leave no room for entrant's product
- Using product differentiation for evil?

    - Dense product space means entrants can't differentiate themselves
    - Only option is (unprofitable) tough price competition
- Examples
    - Airlines (departure times)
    - Big Pharma
    - Ready-To-Eat breakfast cereals

Game Theory Example



Judo Economics

- Enter small!
  - Incumbent does not have incentive to lower price to compete
  - Gains back some customers, but loses revenue per customer (see below)
- Need to communicate credibly
  - Example: Build small plant

Ryanair Takeaways

- Costs and competition
  - Ryanair's competitive advantage is on the cost side
  - Low marginal costs means price wars especially bad!
- Targeted responses
  - Less costly response since incumbent doesn't lose as much revenue per customer (see above)
  - Complex airline pricing gives a lot of flexibility to target
- Judo Economics?
  - Ryanair's initial entry ignored these principles!
    - Went after Air Lingus's most profitable route
    - Clear intention to expand further
  - ... and the Ryan brothers paid the price!

Next Part of the Course

1. What makes some firms more efficient, anyway?
2. How much should you do 'in-house'?
3. Anything special about 'tech'?

> Life is never stagnation.