Matching own Prices, Rivals’ Prices, or Both

BACKGROUND

• Many retailers promise that they will not be undersold by rivals (price-matching guarantees) and extend their promise to include their own future prices if they should decrease (most-favoured-customer clauses).
• The literature has shown that each promise independently has the potential to facilitate monopoly pricing, and so one might think that the two promises are substitutes.

METHODOLOGY

• The authors consider whether there may be competition-related motives for combining price-matching guarantees and most-favoured-customer clauses. At issue is whether the two practices adopted by a single firm jointly lead to higher prices than either one could have facilitated by itself.
• The analysis draws on a simple two-period, two-firm setting. The decision whether or not to adopt a practice is made at the beginning of each period and is assumed to be common knowledge.

KEY FINDINGS

• In equilibrium, one firm will unilaterally adopt both a price-matching guarantee and a most-favoured-customer clause. This will lead to higher prices than either practice could have facilitated by itself.
• A firm that adopts a price-matching guarantee with most-favoured-customer protection clearly signals to its rival that it is about to raise its price. Thus, the adoption is an invitation to the other firm to follow it in raising prices.
• Price-matching guarantees and most-favoured-customer clauses complement each other, each covering for the other’s weaknesses: the firm’s price-matching guarantees reduce the rival’s incentive to cut prices in each period, whereas the firm’s first-period most-favoured-customer clause reduces its own incentive to cut prices.
• A firm’s most-favoured-customer clause essentially provides a substitute for rivals’ price-matching guarantees. With this in mind, it is clear that the main results carry over to more than two firms.
• The results are robust when costs are incurred from consumers requesting that prices be matched (‘hassle’ costs). Moreover, as the number of
periods increases, equilibrium prices may become close to monopoly prices.

POLICY ISSUES

• The results present a worry from a competition policy perspective: since the high prices that are facilitated result from unilateral adoption of a guarantee to consumers, and the practice is not necessarily carried out by a dominant firm, no conventional competition law can reach it.

• The results add weight to the argument that to get a clearer assessment of the anti-competitive effects of the various forms of price promises, data on sectoral patterns of adoption combined with the precise details of the promises themselves are needed.

• The precise details of the guarantees, including any restrictions imposed on them, together with information on patterns of adoption would, even in the absence of information about prices or the incidence of activation by customers, enable some discrimination between competing theories.

THE CCP

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