An ESRC Research Centre
CCP CENTRE FOR COMPETITION POLICY

November 2008

Matching Own Prices, Rivals' Prices, or Both

CCP Policy Briefing

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 is 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

W: www.ccp.uea.ac.uk
T: +44 (0)1603 593715
A: UEA, Norwich, NR4 7TJ

UEA NORWICH

E·S·R·C ECONOMIC & SOCIAL RESEARCH COUNCIL

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

The ESRC Centre for Competition Policy (CCP), at the University of East Anglia, undertakes competition policy research, incorporating economic, legal, management and political science perspectives, that has real-world policy relevance without compromising academic rigour.

FOR MORE INFORMATION

The full working paper (CCP Working Paper 08-26) and more information about CCP and its research is available from our website: www.ccp.uea.ac.uk

ABOUT THE AUTHORS

- **Professor Morten Hviid** is a founding member of CCP and Professor of Competition Law within the Norwich Law School at UEA. He teaches and researches in the areas of competition law, contract law and tort law. His current research focuses on two areas of competition law: cartel and cartel-like behaviour, and private enforcement.
- **Professor Greg Shaffer** teaches in the Simon School of Business at the University of Rochester and in the Department of Economics at UEA. He visits CCP on a regular basis to work with various members shared interests. His research employs game-theory models to examine issues in pricing policies, antitrust and regulation, distribution channels, vertical restraints, principal-agent theory, and oligopoly models of strategic competition.

W: www.ccp.uea.ac.uk
T: +44 (0)1603 593715
A: UEA, Norwich, NR4 7TJ