ENTRY AND EXIT 2

Context and concepts

- Context: You’re the incumbent in an industry facing potential new entrants. How can you deter them?
- Concepts: entry deterrence, preemption, predation, judo economics.

Preemption with capacity

Example: Dupont in the titanium dioxide industry in the 1970s

- Normal capacity
- Excess capacity

Idea: Leave no room for new entrants in “product space”

Example: Ready-to-eat breakfast cereals

Product proliferation

- Idea: Leave no room for new entrants in “product space”
- Example: Ready-to-eat breakfast cereals

- Analysis: Linear characteristics model with one dimension (sweetness)

Monopoly vs preemption strategy

\[ x = \text{maximum "distance" that consumers are willing to travel} \]
\[ y = \text{minimum market share necessary to recover entry cost} \]

**Monopoly strategy:**
- minimum number of stores that covers market.

**Preemption strategy:**
- minimum number of stores such that no entry is profitable.
Product proliferation

- Conclusion: product proliferation may deter entry.
- Spatial example: Staples

Staples was trying to build a critical mass of stores in the Northeast to shut out competitors ... By building these networks [of stores] in the big markets like New York and Boston, we have kept competitors out for a very, very long period.

--- Thomas Stemberg

Other preemption strategies

- Xerox plain-paper copiers: sleeping patents.
- Airport landing slots: Compass II (Australia).
- Long-term contracts.
  - Nutrasweet
  - RTP
  - Gas Natural, SA

Predatory pricing

Price low to induce rival’s exit.

Paradox: it is difficult to commit to a future price; how can below-cost pricing induce exit?

The Chicago School argument: predatory pricing doesn’t work for the predator.

Why predation might work

- Asymmetric information about cost
  - American Tobacco
  - France Telecom
- Reputation for aggression
  - DeBeers
  - Murdoch
- Learning curves and network effects
  - Boeing in 1970s
- Capital markets: “deep pockets” can be important
  - American Airlines v Northwest
  - UK supermarket chains and grocery stores

Judo economics

JuDo = the soft way.
A less aggressive strategy may be optimal in that it avoids retaliation by rival firm.

Judo economics...

- San Miguel: small capacity
- Southwest, Ryanair: unusual routes, secondary airports
Incumbent firms have a variety of ways to discourage entry: long-term contracts, aggressive pricing, excess capacity, product proliferation, reputation for aggressive response.

Entrants can moderate the aggressive response of an incumbent by entering on a small scale or in secondary markets (Judo).