

Strategic Behavior

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- Firms can make changes in prices, decide on quantities or other use other levers to reduce competition and increase profits. Such behavior is called strategic behavior.
- Firms may engage in
 - non-cooperative strategic behavior, or
 - cooperative strategic behavior

Non-cooperative strategic behavior

The firm may want to prevent competitors's market-entry by various means:

- Predatory pricing
- Limit pricing
- Lowering own costs
- Raising competitors' costs

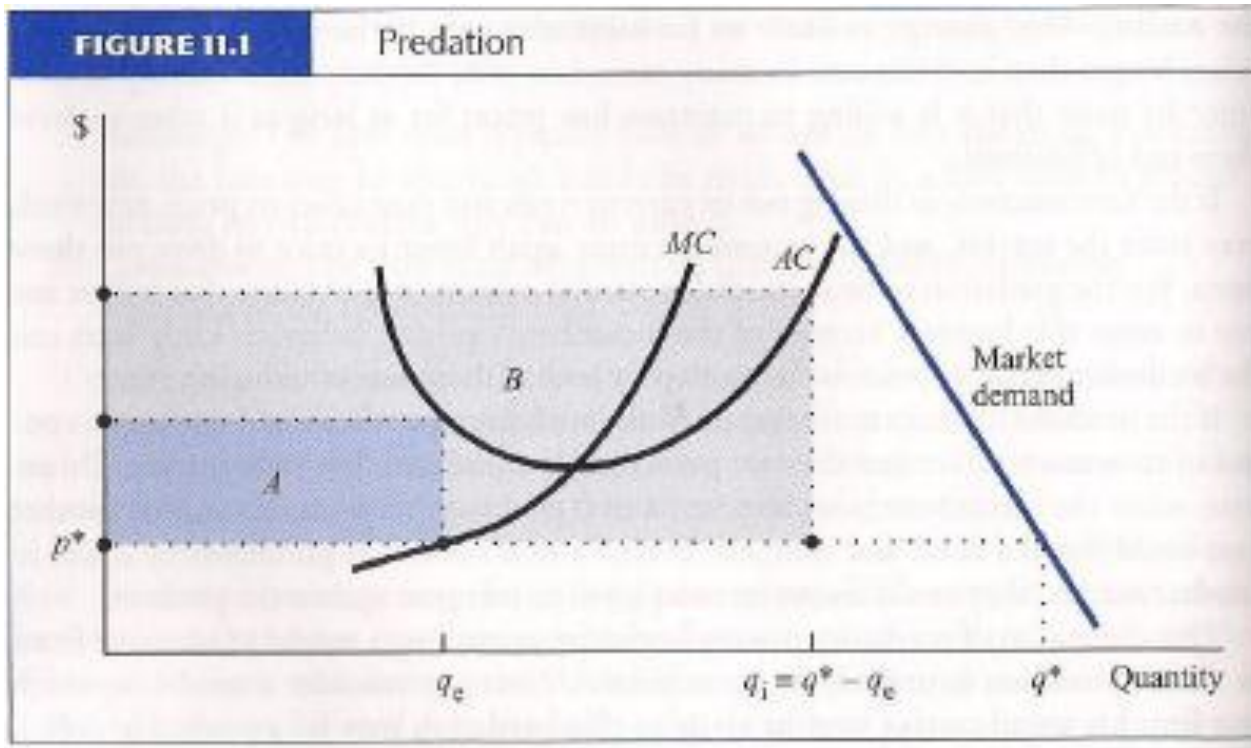
Non-cooperative strategic behavior

Predatory pricing: Lowering prices (below costs) to pressure the competitors.

Predatory pricing will cause the incumbent to suffer losses.

Non-cooperative strategic behavior

Predatory pricing: identical cost structures



Non-cooperative strategic behavior

Predatory pricing: identical cost structures

- it is difficult for the incumbent to succeed when cost structures are similar.

Non-cooperative strategic behavior

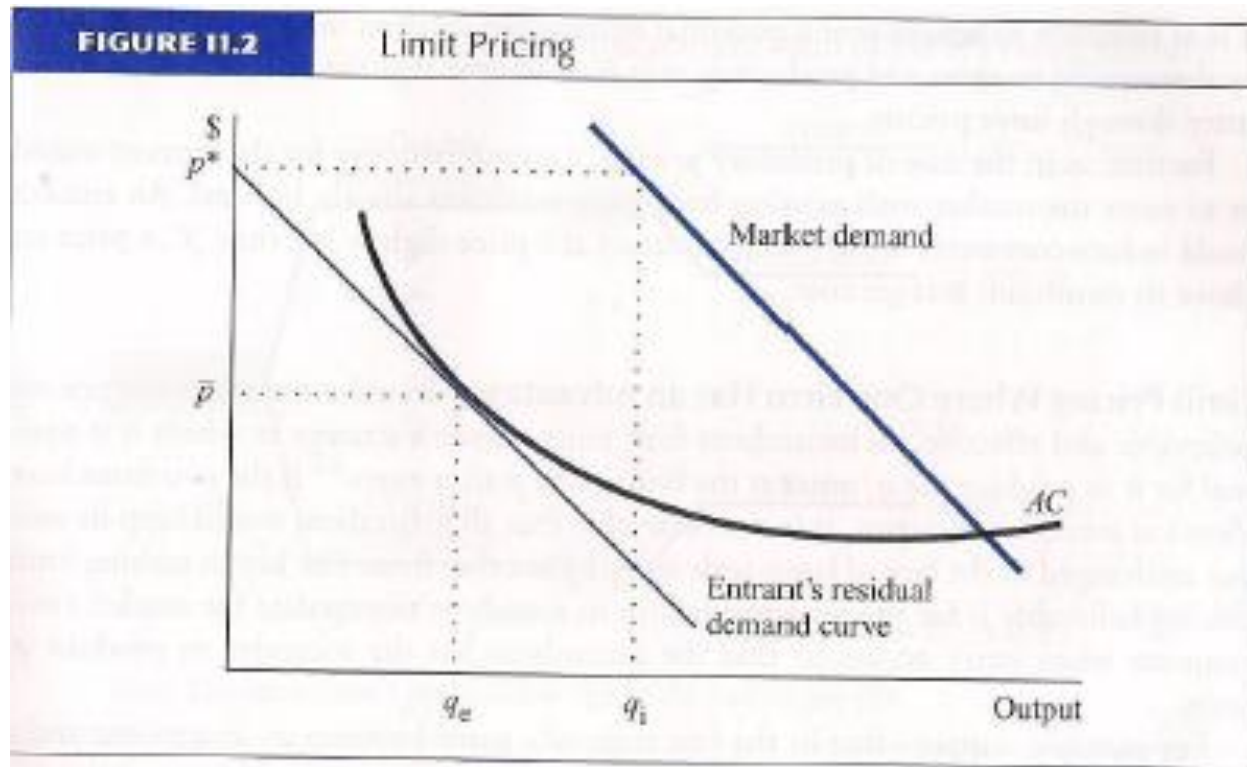
Predatory pricing: differing cost structures

If the incumbent has a cost advantage, that may help it succeed.

Moreover- if the incumbent can credibly convince the competitor that it has lower costs, predatory pricing may be successful- the entrant may believe that the incumbent has lower costs even if it does not.

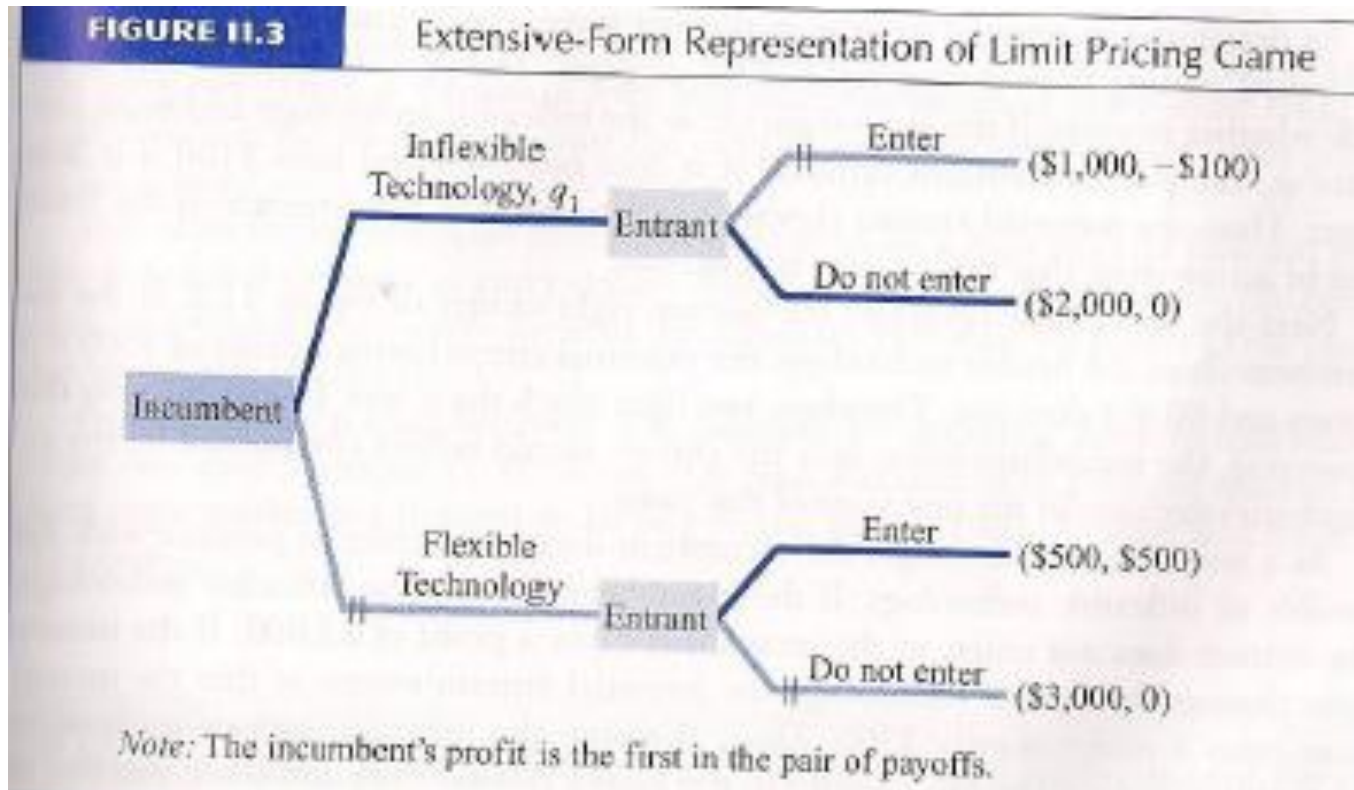
Non-cooperative strategic behavior

Limit pricing: Increasing the output so that residual demand for the competitor diminishes.



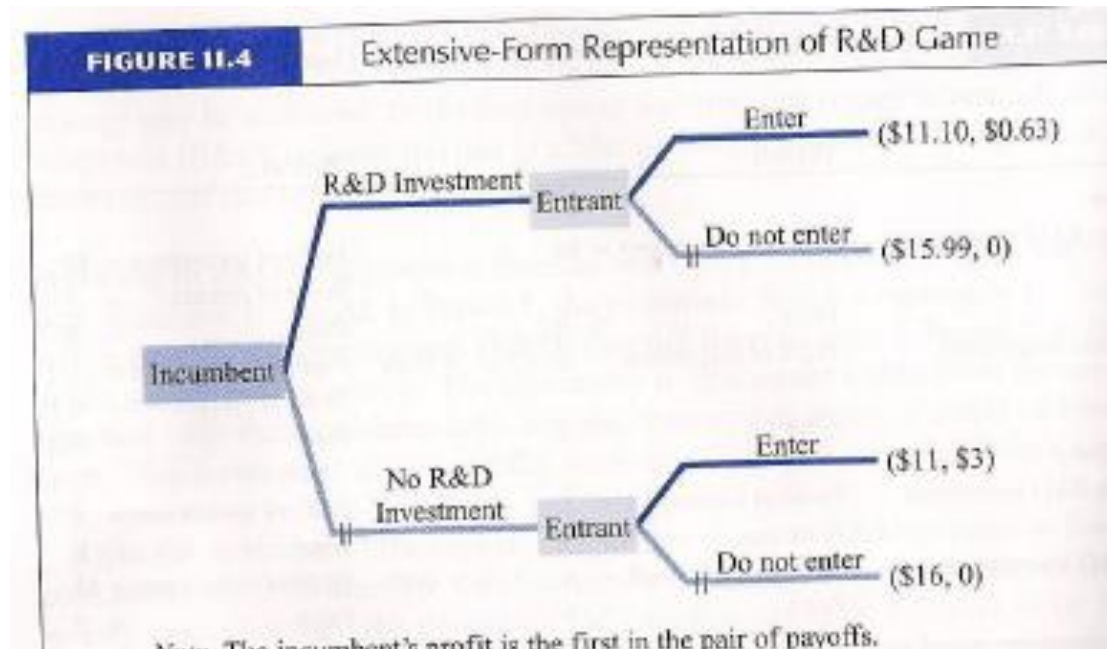
Non-cooperative strategic behavior

Limit pricing with incumbent's cost advantage



Lowering production costs

- The incumbent may invest in R&D in production processes to lower costs in the next round and prevent competitor entry



Raising competitor's costs

- Bundles
- Regulations
- Raising own and competitor costs

Cooperative Behavior

- Similar to cartel / collusion behavior