



ECONOMICS TOPIC VIDEOS

Unit 3 Micro – 16 Mark Q







Threat of Competition & Business Behaviour

Hosted by Geoff Riley

16 Mark Unit 3 Data Question

- KAA 8 marks
- Evaluation 8 marks
- 3 KAA points – define, apply, explain (use diagram)
- 3 Evaluation points – apply, explain to support
- Question normally says "assess" – but it will always require you to use evaluation + a suitable analysis diagram
- Some questions will require specific use of game theory as part of the answer

“To what extent does the threat of competition affect a firm’s behaviour. Use an industry of your choice.” (16 marks)

Coca Cola	Britvic	AG Barr	GlaxoSmithKline	Danone	Others
					
Main Brands Coca-Cola, Sprite, Fanta, Lilt, Dr Pepper, Relentless, Monster, Oasis, glaceau vitamin water, 5 Alive, Ocean Spray and Powerade. Coca Cola also owns 60 per cent of Innocent soft drinks	Main Brands Robinsons, J20, Fruit Shoot, Whites, Britvic, Purdey's, Juicy drench, drench, Pennine Spring and Tango	Main Brands IRN-BRU, Tizer, D'N'B, KA, Barr's Originals, Strathmore spring water	Main Brands Lucozade and Ribena <i>Note: April 2013, GSK announced plans to de-merge these two brands from their company</i>	Main Brands Evian, Volvic and Badoit	Main Brands Red Bull Nichols Vimto, Panda, Ben Shaws & Dayla

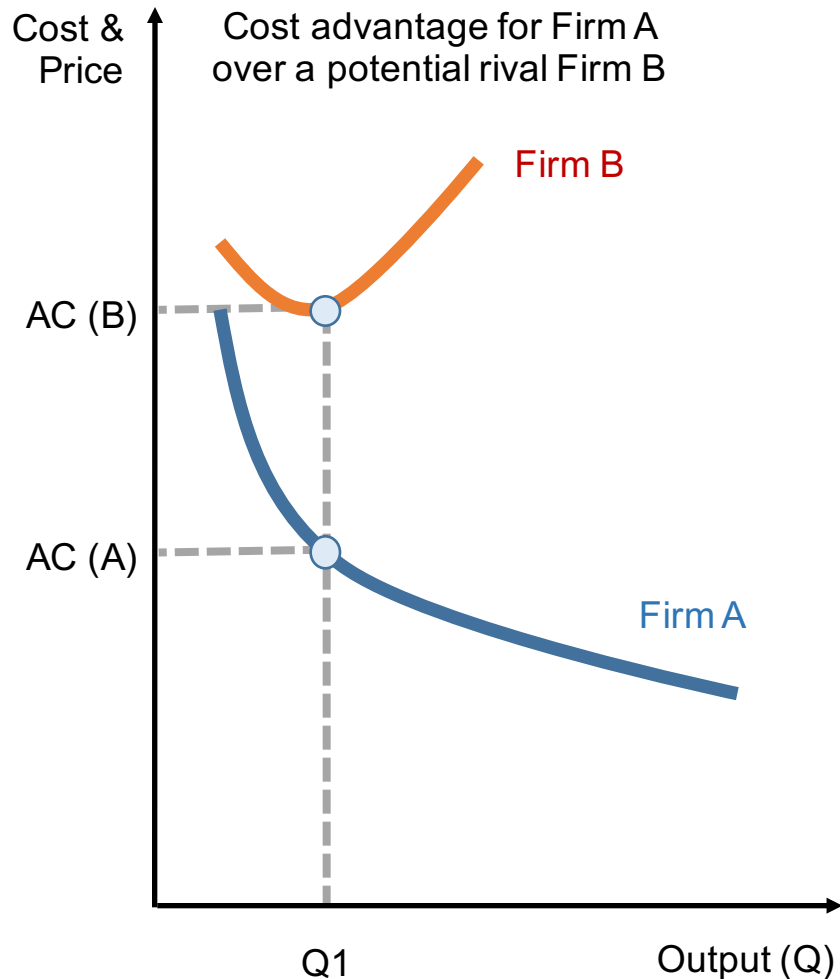
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- “Threat of competition”
 - Associated with **contestable markets**
 - Contestable markets require:
 - A pool of new entrants willing and able to enter the market – e.g. app developers, platform businesses, foreign firms
 - No significant **entry or exit (sunk) costs** – this lowers the commercial risks of market entry
 - Equal access to available industry technologies
 - High rates of “customer churn” (demand switching)
- The **threat** of competition is different from **actual competition**
- Behaviour of firms is shown through pricing, investment, output and marketing, research spending. Oligopoly – interdependent decisions
- Behaviour of firms depends in part on their commercial objectives

“To what extent does the threat of competition affect a firm’s behaviour. Use an industry of your choice.” (16 marks)

- Build analysis first by looking at pricing behaviour
- 1. Limit pricing** – pricing below profit max in order to deter the entry of a rival firm
 - May involve pricing close to average cost (normal profit)
 - Sacrificing some short-term profits – may lead to lower share price
 - **Evaluation:** Depends in part on scale of unit cost difference between established and potential rival firms
 - 2. Predatory pricing** – pricing below cost to inflict losses on marginal firms (new entrants)
 - Illegal under UK and EU competition law
 - Rarely happens (satisficing behaviour is more common)

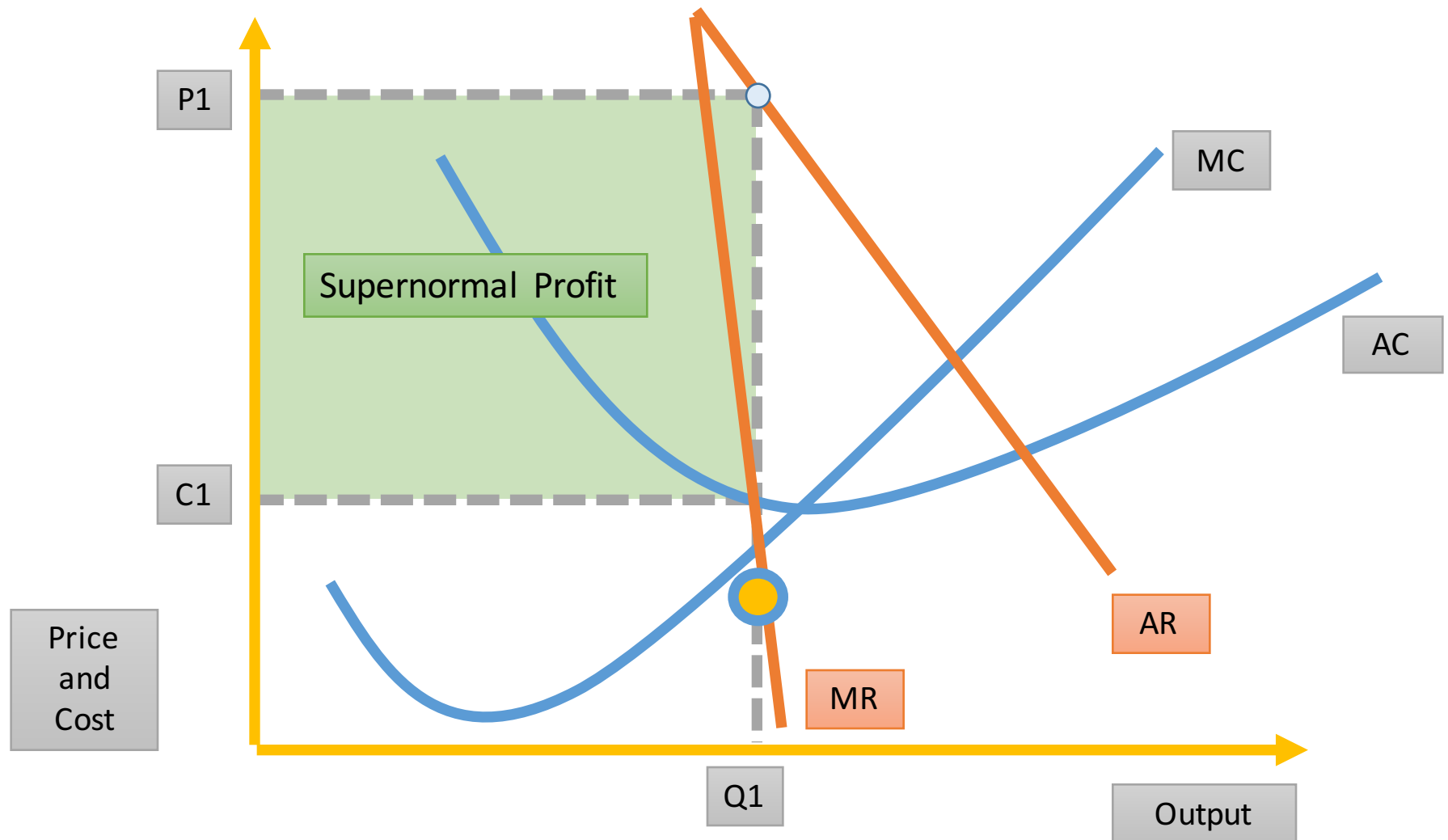
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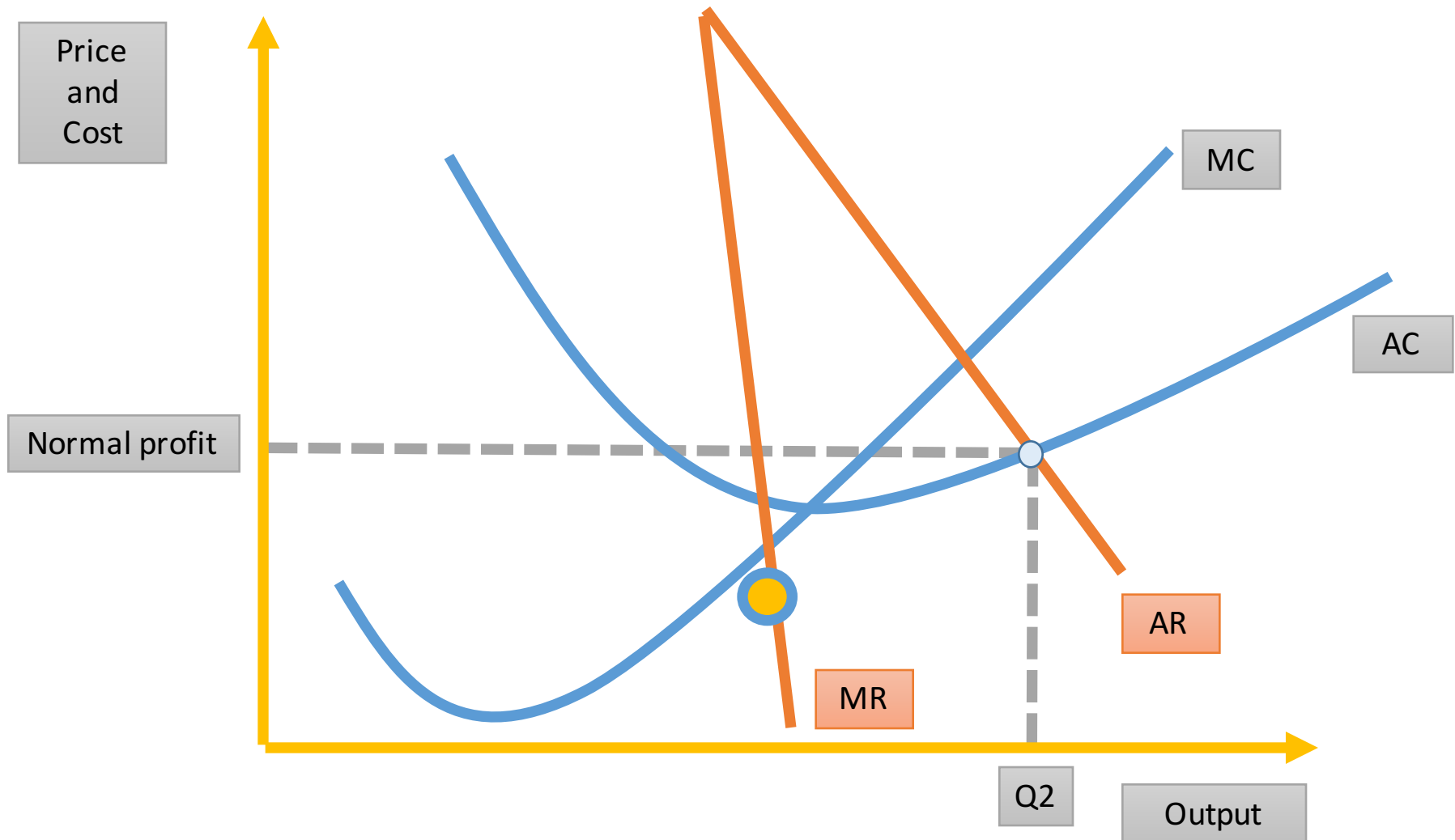
At output Q_1 – firm A has a big **cost advantage** over a potential rival firm B

1. Learning economies
2. Vertical integration
3. Lower customer churn
4. Monopsony power

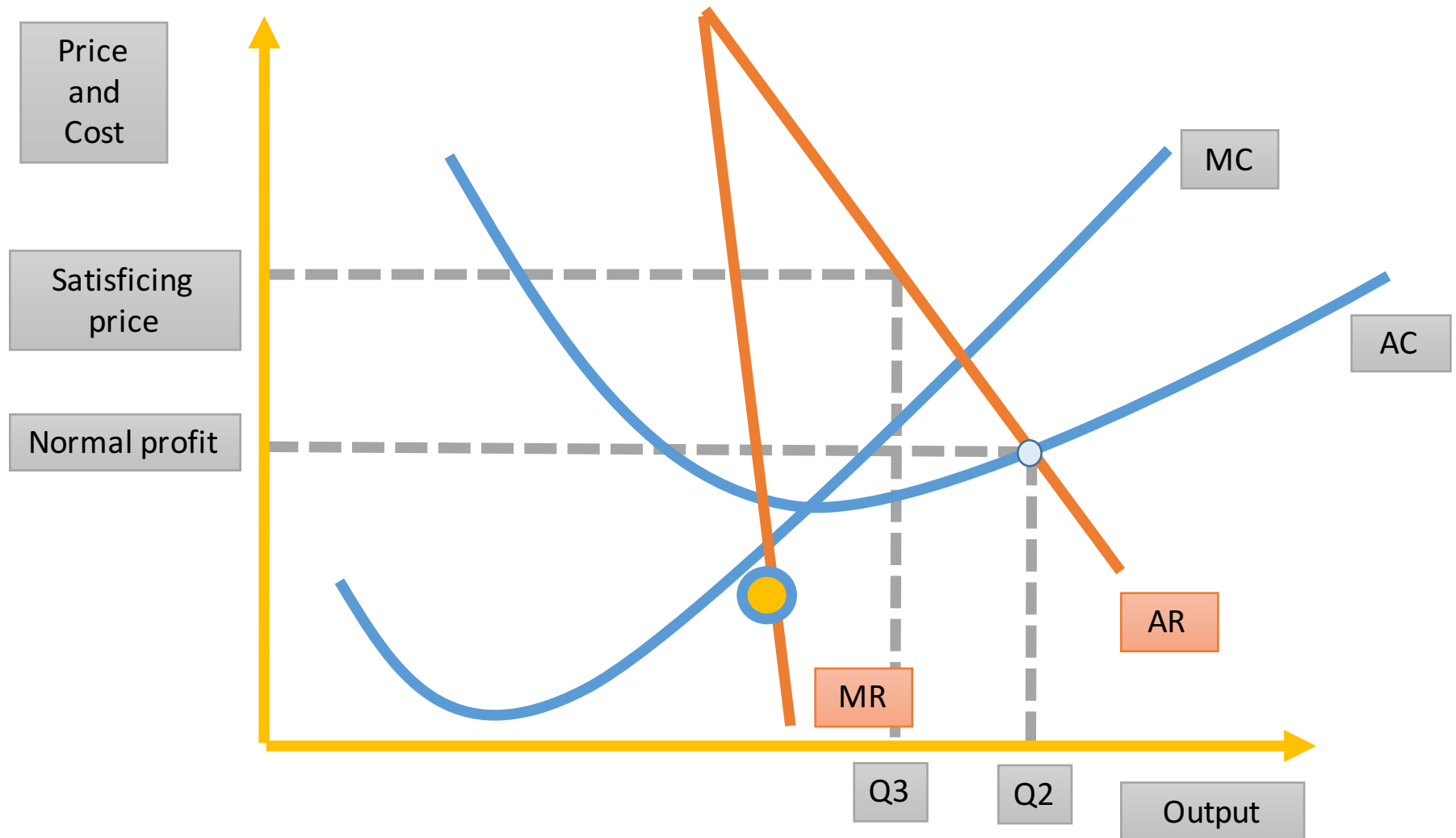
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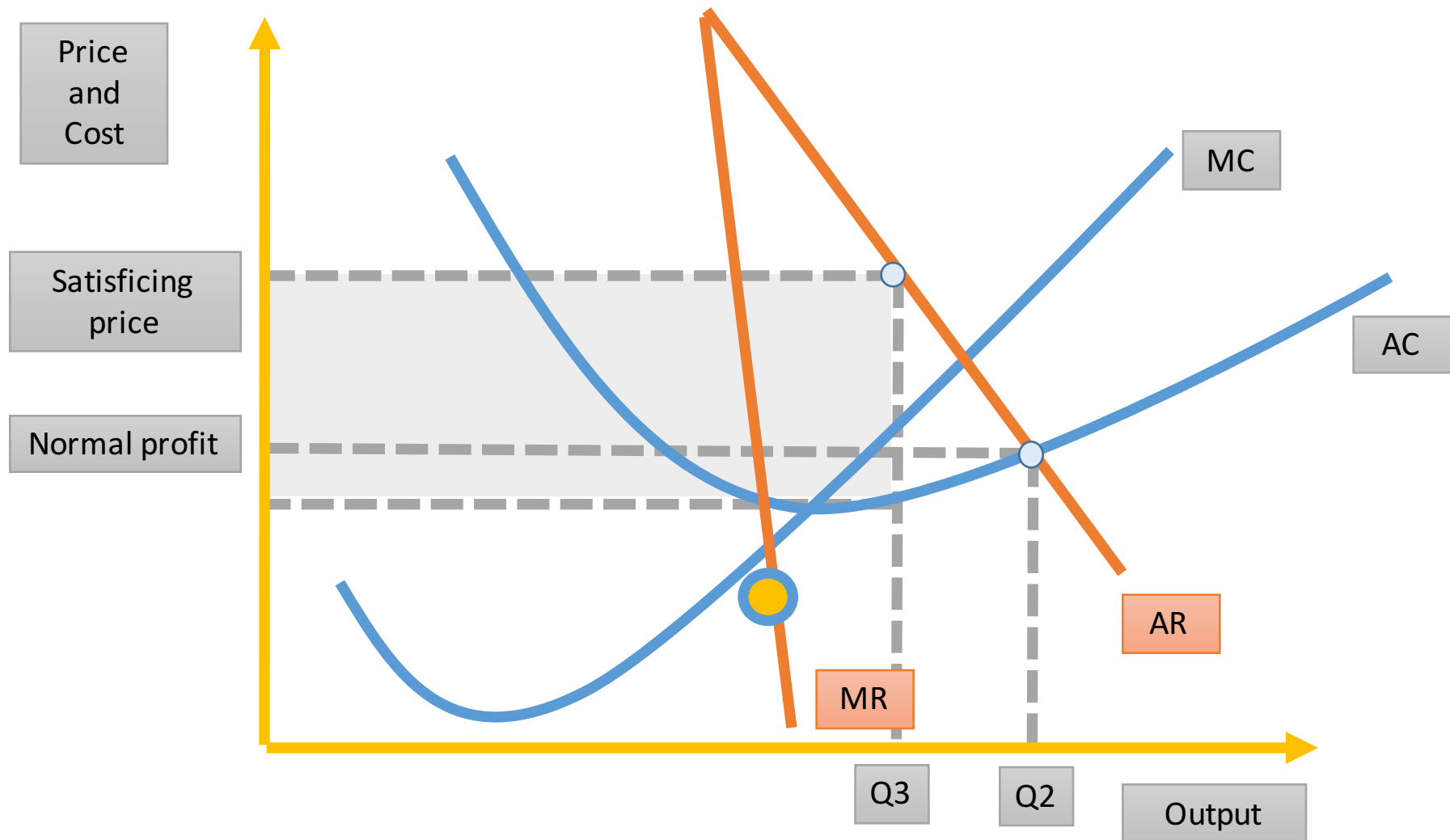
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- Non-price competition

1. Marketing and advertising

- Increased spending to build customer loyalty

2. Product proliferation

- Saturate the market with slightly differentiated products

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- Non-price competition

- 1. Marketing and advertising**

- Increased spending to build customer loyalty

- 2. Product proliferation**

- Saturate the market with slightly differentiated products

- 3. Capital investment and increased research**

- Create spare capacity that to be used if new firms enter
- Bring forward research spending / raise R&D to win patent races and create legal barriers to entry

- 4. Anti-competitive behaviour**

- E.g. “Pay to delay” behaviour by GSK in the drugs market
- Collusion with existing firms to protect their market

“To what extent does the threat of competition affect a firm’s behaviour. Use an industry of your choice.” (16 marks)

- **Key evaluation points:**
- Threat of entry depends on scale of **sunk costs** – **high exit costs make a market less contestable**
- Threat of commercially successful entry is most likely from scaled / diversified and profitable businesses – often TNCs
- Behaviour depends on the ability / willingness of a business to draw on profits / sustain SR losses
- Firm may use takeovers to remove a competitive threat
- Is the threat of entry at a specific point of the supply chain? Or is it more general?
- **Vertical integration** - a tactic to control supply-chain
- Game theory can be used – **e.g. credible threats** deter entry from new firms, if successful – higher profits



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