‘COMMENTARAO’ IN “THE TELEGRAPH” OF OCTOBER 14 2015
“PRERDATORY Pricing-Market Warfare and how it is changing” by S L Rao

Information Technology has brought about an insidious competition to established businesses. Bookshops are shutting down. Old-fashioned meter taxis are disappearing. Stores selling white goods are declining. Marriage brokers and marriage advertisements are on the decline. Old-style travel agents are going out of business. The list keeps lengthening. The pace of change in all aspects of our daily lives is accelerating. Is all this change is improving the lives of consumers better, with more convenience, wider choice, better prices and delivery.Is it likely to stay that way or will the consumer be more exploited over time?

The 20th century saw the flowering of marketing management in India. Determining consumer needs, designing products to meet them, providing the convenience and ease of use, using advertising to inform and attract consumers, making goods and services available easily, were all in the bags of tricks of marketing managers. Marketing tries to attract and hold customers to the products and services the company is offering. Any good marketer is trying to create a monopoly for his offering so that he can build further on that consumer base. These techniques found wide use. Thos who used them became well-established as businesses.

Any marketing manager has to estimate the financial requirements and performance of the product. In introducing a new product one has to decide the amounts

that can be used in introducing it in the market. These expenditures would be on advertising and promotion, distribution, merchandising and display, temporary price reductions,and giving samples for consumer trials.

Cost of the product is another factor. At the early stages of introducing a product, the cost is an ambiguous concept. Cost would vary with volume, ingredients, corporate services to it, etc. In determining price for a new offering one has to forecast price and the expected sales and production volumes. Cost for a high volume might be significantly lower than for a large volume. A producer with many other products has to allocate common costs between different products. Should a new product have to bear its share of various corporate overhead expenses from the outset? Or should the new product be given a holiday by the company from bearing these overhead costs till the product has settled in the market?

All this finally reflects itself in the price at which the product/service is offered. One way in which marketers try for early large volume sales is through penetration and predatory pricing. These are discouraged by competition authorities.

Penetration pricing is a pricing strategy where a company sets a low price on a new product in an attempt to fast gain market share, typically with the intention of raising prices in the future. The purpose of penetration pricing is to attract customers with low initial prices. Consequent trial might make them loyal users. Consumers are creatures of habit. They tend to continue to consume the products and brands that they are familiar with, so they may continue to use the new product even if prices increase over time.

The strategy of penetration pricing can raise legal concerns if it interferes with competition. In the United States, antitrust laws exist to prevent anti-competitive business activity. If penetration pricing is pushed too far (in extent and duration), it can become a form of predatory pricing, which is illegal under antitrust laws. Predatory pricing involves setting prices so low that it forces competitors out of a market, allowing the predator in the future to raise prices to a level higher than normal market levels.

Competition between companies tends to be good for consumers. One cannot get away with setting unreasonably high prices. If one company sets prices too high, consumers can purchase goods from a different company. If predatory pricing goes unchecked, it can result in a monopoly where a single company is the only supplier of goods or services. When a single company controls an entire market. Prices are no longer determined by the market and the company can set whatever price it wishes. The U.S. Federal Trade Commission can force monopolistic companies to split apart so as to increase competition.

New entry is difficult and expensive when there is a monopoly to contend with. Competition regulators try to break up monopolies.

A new twist to this is when a company is able to subsidize a product from the profits of its other products. Or, it has such deep pockets that it can take a loss on that product until the competitors have to shut down. ITC's cigarette business is highly profitable. It enabled ITC to invest in consumer products and it to become among the top

companies in consumer products (with Lever, Godrej, etc). Of course the products were high quality and the marketing techniques well thought out. The substantial profits ITC makes from cigarettes must have helped it to invest heavily in these new product markets and achieve high shares quickly. It might be asked whether this is fair competition especially to smaller companies and those that do not have such deep pockets.

Some may view penetration pricing as unethical. In essence, penetration pricing is a sort of bait-and-switch; it baits new customers in with artificially low initial prices and then might increase prices once consumers are comfortable with the company's products. Businesses give free or underpriced samples of products or services to lure new customers.

The case of Ola and Uber cabs is an example where this question is relevant. They use advanced information technology and GPS to locate the customer's location as well as the nearest cab, are able to predict when the taxi sill turn up. They use differential pricing depending on the traffic and time of day. Any surplus price as a result, is entirely to the company's benefit. They also accept an advance deposit from which the fare is deducted, so that there is no handling of cash in using a cab. The interest on the deposit also adds to the profit of the cab company. An estimation of the actual revenues might show that there is a consequent substantial surplus for the cab company. What appears to be penetration pricing is not that. Many times, however, the fares are much lower than the competition. One result has

been the decline of the old-fashioned taxi. Is this pricing unfair? One has to look at total revenues and costs to estimate if prices are below cost. The fact is that consumers like what they get and have switched from competition.

Will Ola or Uber after a few years raise prices after old taxis are eliminated? If they do, will it be possible for new entrants to come in and compete? The answer seems to be that the consumer is presently benefited. The future must be left to unravel and a regulator must contain any consumer exploitation.

E-commerce is another field which is hurting old fashioned bricks and mortar companies. These e-commerce companies invest heavily in warehousing, packing and delivery, as well as sophisticated computer systems. Presumably these costs are amortized over a period of years and not in one year. Their costs might be lower than bricks and mortar competition. Companies like Amazon or Flipkart have enormous and growing market capitalization, almost unlimited funding, make big losses, and deliver products at specially low prices.

Are such companies engaged in predatory pricing which lasts for years, eliminates competition and will then charge higher prices? Funding agencies are happy to invest in them. Consumers are happy to buy from them. Possibly prices may be raised after they are well established. We

must have a regulatory mechanism that watches out for the consumer interest. (1285)