Lecture Note I-10
Information Policy

- Competition policy
- Government's role

Public policy

- "Cooperate centric view" v. "policy centric view"
  - profitability v. net social benefits
- Adam Smith: competitive pressures between producers will often induce them to make choice that maximize the general welfare
- Jim Barksdale (CEO of Netscape) : "…working with the government is far more productive than trying to ignore it."

Themes of Information Policy

- Differentiation of products and prices
  - High first-copy costs of information and information technology
  - Problem: charge different users different prices for essentially the same product
- Lock-in
  - Information products works together in systems, switching any single product can be very costly to users
  - Problem: Aftermarket monopolist
- Positive feedback
  - Network externality is ubiquitous in the information industry
  - Problem: Standard (Cartels and Collusion)

Competition Policy

- Principles of Competition Policy
  - Ensure a fair fight, not to punish winners or protect losers
- Sherman Act (1890)
  - Monopoly isn't illegal, but attempt to monopolize is
- Clayton Act (1914)
  - Protects competition as a process

Price Differentiation

- Price and product differentiation
  - Mass customization, differential pricing, personalized content, versioning
- Robinson-Patman Act (1936)
  - Price discrimination is illegal if it "effectively lessens competition"
- Legal arguments that work
  - Can set lower prices resulting from lower costs
  - Set differential prices to meet competition
  - Pricing only questionable if it "lessens competition"

Example 1: Differential Pricing Can Hurt Consumers

- 100 people wtp \$20, 1000 people wtp \$6 (No delay)
- Optimal flat price = \$6
  - Revenue=\$6600 (6X(100+1000))
- 100 people wtp \$20 for early edition, \$5 for later, 1000 people wtp \$5 for later
- Versioning: Optimal to sell at (early, \$20) and (later, \$5)
  - Revenue=\$7000 (20X100+5X1000)
- Consumers now are worse off
  - Inefficient: social loss \$1*1000 (due to delay)

Example 2 : Differential Pricing Can Benefit Consumers

- 1000 consumers wtp $20, 100 people wtp $6 for early, $5 for later
- Optimal flat price = $20
  - Revenue=$20000 (20x1000)
- Versioning: sell for (early, $20) and (later, $5)
  - Revenue=$20500 (20x1000+5x100)
- Key: will versioning increase size of market? social gain $5*100 (due to new customers)

Government Choices

- Do nothing
- Act on basis that monopoly was illegally obtained
  - Break up
  - Prohibit suspect practices
- Regulate the monopolist
  - Control genuine monopoly power where it exists

Implications for Strategy

- Monopoly may be inhibited from using strategies that are legal for other firms
  - Even small firms may be accused of antitrust violations
    - E.g. Iomega Zip drive (product design, distribution, IP enforcement)
- Mergers and acquisitions, cooperation with rivals to set standards, and market dominance can antitrust scrutiny
- Cooperative standard setting can be investigated if there are pricing, collusion, cartels

Cooperative Standards Setting

- Cooperation or collusion ?
- Standards setting or cartel?
- Watch out for prices and terms agreements
- Performance standards as barrier to entry
- Patent cross licenses
- Interconnection agreements

Single Firm Conduct

- Exclusive dealing provision
  - Insists its customers not deal with its competitors
- Tying (bundling)
  - Insists its customers take another product if they want the monopolized item
  - Internet Explorer is separate product or merely part of an integrated operating system ?

Government Role’s in Achieving Critical Mass

- Private sector can be creative about network externalities
- Important basic technology needs to be proven or demonstrated
  - E.g. Internet
  - The government can provide critical mass to ignite positive feedback, but it should be cautious about picking winner

Summary

- Don't expect government's role to diminish
- Every company needs to know the rules
- You can usually use differential pricing
- Policy should ensure fair fight, not punish winners or protect losers
- Mergers are subject to review by Justice Department and Federal Trade Commission
- Cooperate to set standards and develop new technologies, so long as efforts benefit consumers
- If you gain a leading share of market, conduct audit of your practices
- Don't expect government regulation of telecom to diminish any time soon