Business Horizons (2015) 58, 441—447

Available online at www.sciencedirect.com

ScienceDirect

KELLEY SCHOOL OF BUSINESS
INDIANA UNIVERSITY

www.elsevier.com/locate/bushor

How to avoid regulatory antitrust scrutiny: The behavioral defense

Arpita Agnihotri

IBS, Hyderabad, Andhra Pradesh, 180015, India

KEYWORDS
Competitive dynamics;
Anticompetitive behavior;
Cartel formation;
Regulation;
Duopolies;
Signaling

Abstract Firms, especially those with high profit margins, are often scrutinized by regulatory authorities that suspect them of anticompetitive practices such as cartel formation. In this article I introduce a behavioral approach of competing that suggests firms with even the highest of margins are actually competing aggressively against each other, rather than colluding as the regulatory authorities might suggest. Firms using the behavioral approach can signal to antitrust authorities that their intent is not to restrain competition. Four mechanisms show this competitive orientation: (1) competitive intensity, (2) competitive complexity, (3) attack imitation, and (4) competitive action speed.
© 2015 Kelley School of Business, Indiana University. Published by Elsevier Inc. All rights reserved.

1. Competitive and suspected anticompetitive behavior of firms

Firms with high profit margins often come under the scrutiny of regulatory authorities (Cahan, 1992) because antitrust authorities postulate that high accounting returns are indicative of the monopolistic power of a firm. However, monopolistic power does not always lead to antitrust penalties. For example, Microsoft was charged with having monopoly power in the computing market (Wilcox, 1999) but was not burdened with any kind of antitrust penalties because its aggressive behavior of 55 competitive moves—five times more than its nearest competitors (Grimm, Lee, & Smith, 2005)—left no reason for antitrust authorities to suspect it of exercising its monopolistic power. Microsoft's recent declining focus on the computing business, however, has resulted in less aggressive competitive behavior. Consequently, the European antitrust commission has charged it with alleged anticompetitive practices (Hartung, 2014). Similarly, two auction houses in the United States, Christie's and Sotheby's, competed strongly against each other in the early 1990s. They cut commission rates drastically to be paid by sellers, and sometimes even made donations to sellers' favorite charities and extended financial guarantees to them. Many such competitive moves were common until 1995, when the auction houses abruptly announced they were going to charge fixed prices from sellers and no other extension services were going to be offered. Regulatory authorities later discovered

E-mail address: arpitaagnihotri@yahoo.com

0007-6813/$ — see front matter © 2015 Kelley School of Business, Indiana University. Published by Elsevier Inc. All rights reserved.
http://dx.doi.org/10.1016/j.bushor.2015.04.002

this happened as a result of Christie's and Sotheby's colluding amongst themselves (Ashenfelter & Graddy, 2005).

Competitive authorities opine that firms with significant market powers are likelier to behave less competitively; for example, by forming cartels. This implies that firms with the highest market share in an industry are more likely to collude and control the market (Levenstein & Suslow, 2006). Even the duration of a cartel can increase with an increase in market power of the firm. Hence, well-performing firms in the industry are often investigated by regulatory authorities for anticompetitive practices for which they are sometimes guilty and sometimes not.

How can firms with good strategic intent avoid unnecessary scrutiny by regulatory authorities? When allegations of anticompetitive practices are hurled at them, how can these firms prove themselves innocent? In this study I have tried to answer these questions by introducing the theory and practice of behavioral dynamics of competition (D'Aveni, 1994; Ferrier, Smith, & Grimm, 1999). The study of competitive dynamics reflects how focal firms' competitive actions influence competitors' responses and vice versa. This legal approach focuses on competitive moves taken by firms in a given time period. Broadly, more competitive moves reflect high competitive aggressiveness of firms. Companies that are competitively aggressive are less likely to form cartels, and even if they attract antitrust attention, it is easier for them to prove themselves legitimate and within legal boundaries. Thus, I suggest that firms' competitive behavior is a strong indication of their competitive intent and signals regulatory authorities on the competitive intent of the firm. Hence, firms should make numerous competitive moves and countermoves, not only to raise value for investors and customers but also to justify their fair competitive behavior to various regulatory authorities.

2. Traditional measures of competition

Antitrust authorities generally rely on a few traditional measures of competition to assess the market power of firms and the likelihood of anticompetitive practices: the four firm concentration ratio (CR), the Herfindahl index (HF), and the price-cost margin (Bishop & Walker, 2002). As regards the CR and the HF, the higher these values, the lower the competition in the industry. But in duopoly markets (where firms have high market power), firms like Boeing and Airbus, Nike and Adidas, or Coke and Pepsi have hardly depicted anticompetitive behavior compared to firms in oligopolistic markets. For example, in 2008, Unilever, Procter & Gamble, Colgate, Cussons, and Woolworths colluded to fix prices of detergents in the Australian market. Similarly, in Germany, Mars, Hershey, Nestlé, Kraft Foods, and Cadbury were alleged to have participated in antitrust activities in 2010 (Lorin, 2008). In France, players like Unilever, Colgate-Palmolive, Henkel, and Procter & Gamble were found to be guilty of cartel formation by the European Union (Colchester & Passariello, 2011). Furthermore, in emerging markets like India, oligopolistic players such as those in the milk and cement industries have been accused of anticompetitive behavior via cartel formation (Edwin, 2012). Thus, despite having high market power and the ability to manipulate markets, firms in duopolistic markets have successfully kept regulatory authorities at bay while those in oligopolistic markets like Cadbury or Unilever—supposedly to be more competitive—have caught the attention of regulatory authorities. How was this possible? Duopoly firms, despite having high market power, always signal aggressive competitive behavior to regulatory authorities, unlike the oligopolistic firms mentioned above.

When considering the parameters of CR or HF, policy makers now realize limitations. For example, high market power does not imply anticompetitive behavior, as explained above. Regulators now focus on the price-cost margin approach, which relies on profit margin and profitability differences of firms in the industry, to predict likelihood of cartel formation (Boone, 2004): the greater the profit margin, the lesser the competition. For example, De Beers, which enjoyed a premium profit margin in the diamond industry—as it controlled the majority of the diamond supply—was consequently charged with cartel formation by U.S. Government authorities. But at the same time, in the computing industry, firms such as Apple—whose profit margin was around 20%—behaved far more competitively compared to firms in the lighting industry, like Philips. Philips had a profit margin of 4.5% and yet was found to indulge in anticompetitive practices of cartel formation (Meller, 2009). According to the profit-margin approach, when competitive intensity in the industry increases, efficient firms perform much better, causing profits to shift from less efficient to more efficient firms. Consequently, the profitability gap between firms increases. But firms' efficient operation depends largely on their competitive strategies. Hence, as they operate on economies of scale, low-cost players will be more efficient compared to firms pursuing a differentiation strategy. But this does not imply that differentiated players are less competitive; it means they are simply less efficient

Download English Version:

https://daneshyari.com/en/article/1013969

Download Persian Version:

https://daneshyari.com/article/1013969

Daneshyari.com