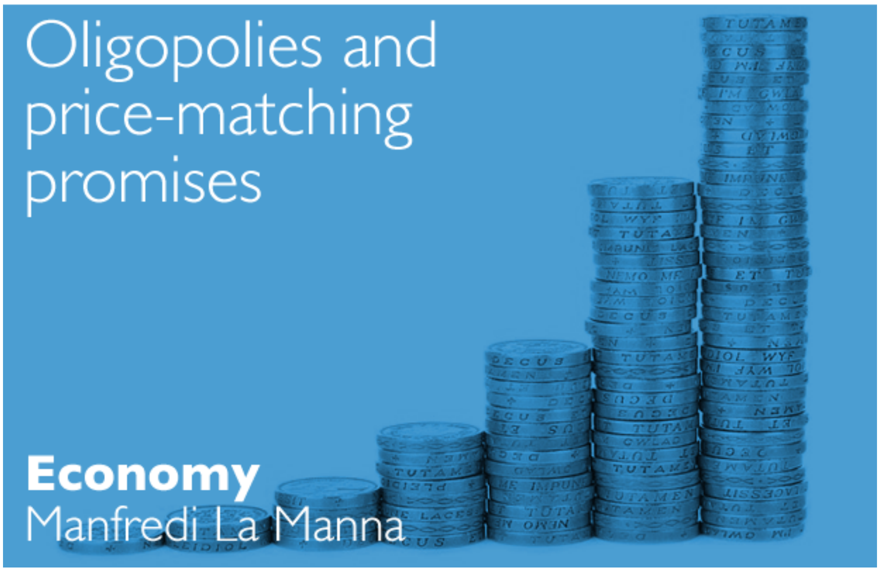
# ScottishReview

Search the SR website:

Search

*19 October 2022*

HOME (HTTPS://WWW.SCOTTISHREVIEW.NET) BECOME A FRIEND (FRIENDSOFSRFORMNEW.HT




Recent visitors to the new premises of John Lewis in the St James Quarter in Edinburgh or in Buchanan Galleries in Glasgow would have noticed a discreet little reminder stating:

*We've now retired our never knowingly undersold policy. As of 23 August 2022, we no longer accept price match claims with our competitors.*

The withdrawal of a 95-year-old policy has not passed unnoticed in the media, which seemed to be more interested in the replacement slogan (*The Guardian* reporting that the banal 'John Lewis: Life is beautiful' catchphrase has been registered with the Intellectual Property Office) than with the competitive implications.

If a large chain of department stores is no longer committed to price matching its competitors, surely customers are going to be worse off, right?
The answer to this apparently trivial question is far from simple and requires some serious unpacking. Who are John Lewis' 'competitors'? The small print reveals that the price-matching promise was limited to national chains with physical premises (not Amazon, then). This restriction clearly defines the relevant competitive market: the small number of department stores with a nationwide presence − an oligopoly.

Price-matching promises are not a British phenomenon, but a universal scheme used by most oligopolies selling similar products, for example, electrical/electronic goods (as many US and Australian readers can confirm).

Oligopolies are market structures that are much misunderstood by the general public and by the media for two good reasons. Depending on how the market is organised, oligopoly members can behave either as fiercely ultra-



**UPFRONT (AnthonySeaton633a.htm**
**Anthony Seaton**
Join the anti-growth brigade!

**COMMENTARY (GerryHassan633a.ht**
**Gerry Hassan**
What will come after Liz Truss?

**PHILOSOPHY (RobinDownie633a.htı**
**Robin Downie**
Living in our nanny state

**ECONOMY (ManfredilaManna633a.ht**
**Manfredi La Manna**
Oligopolies and price-matching promis

**CARTOONS (BobSmith633a.html)**
**Bob Smith**
Kwasi Kwits Kwickly...

**NOTEBOOK (MaryBrown633a.html**
**Dr Mary Brown**
Creators behaving badly

**MEDIA (HamishMackay633a.html)**
**Hamish Mackay**
Digital success at DC Thomson, Garry Sc
new deputy editor of *The Herald*, and m

**TECHNOLOGY (BillMagee633a.htm**
**(Cafe597A.html)Bill Magee**
Staying ahead of the pack

**TRAVEL (CharlieEllis633a.html)**
**(Cafe597A.html)Charlie Ellis**
Palin's eternal flame

**CAFE 1 (Cafe633A.html)**
**(Cafe597A.html)SR Forum**
MSEs have altered the way we live

**CAFE 2 (Cafe633B.html)**
**(Cafe597A.html)SR Forum**
What details are out there already?

competitive firms or as zero-competition monopolies (and anything in between these extremes). Additionally, oligopolies are very difficult to analyse because of the role played by competitive expectations.

Consider a textbook monopoly, say, a pharmaceutical company with a new drug and no close substitutes. In setting the price of the drug, no consideration will be given to competitors, for the simple fact that there aren't any. At the other extreme, in a perfectly competitive market, say, broadband providers in Kyiv (where over 1,000 firms compete for urban customers), charging the lowest possible price is a necessary condition for survival – no need to worry about your competitors' actions. Not so in an oligopoly.

Let's strip down the issue to its barest essentials: a small group of firms have to decide individually whether to charge either low prices or high prices. The surprising solution is that, after having considered the effects of their pricing strategy, each firm will have to come to the conclusion that it should charge low prices. It is easy to see why: suppose your competitors went for high prices. By opting for low prices, you can steal away at least some of their customers and hence make more profits. Conversely, if your competitors charge low prices, you would be unwise to go for high prices, as your customers would desert you. In either case, low prices is the optimal strategy.

What has this got to do with 'never knowingly undersold'? I can hear some of the more impatient readers ask. Here is where things get interesting, even perverse. We can reasonably expect highly paid CEOs not to be satisfied with a low-price low-profit equilibrium and oligopolies are replete with practices aimed precisely at escaping the low-profit valley and reaching the summit of high profits, 'never knowingly undersold' being a prime example.

The mistake made by the unsuspecting public, the media, and, alas, by some anti-trust agencies is to view the 'never knowingly undersold' as a message aimed at potential customers. 'Look – the helpful message says – we have nothing to gain from charging high prices: buy from us as you have nothing to lose.' Seen in this light, the withdrawal of such a benign policy would appear to be definitely a bad deal for consumers.

There is, however, an alternative perspective: what if the 'never knowingly undersold' message, far from be aimed at potential customers, was directed at John Lewis' close competitors? What if the true meaning of the message was a tacit and indirect suggestion for each oligopolist to behave anti-competitively and opt for the high-prices strategy? Read in this vein, the message says: 'if you, dear competitor, go for low prices and I for high prices, you would gain nothing, whereas if you, too, go for high prices, we all gain'. The result is that prices for similar goods sold in department stores are remarkably uniform and – who would have guessed? – all on the high side.

There are many other similar practices, *prima facie* pro-consumer, but in fact anti-competitive, that enable oligopolies to sustain high prices, and most of them are not scrutinised properly by anti-trust regulators.

One feature of tacit oligopoly agreements aimed at reducing the incentive to lower prices is that they are inherently unstable: small changes in the economic environment make the implicit agreements lose their impact. The so-called 'cost-of-living' crisis is a massive change, more than likely to have a disruptive effect.

'What is the evidence for this?' I hear some of the more sceptical readers say.


To access previous editions of SR, click on the links below

**11 OCTOBER 2022 (index111022.htm**

**5 OCTOBER 2022 (index051022.htm**

**28 SEPTEMBER 2022 (index280922.h**

**21 SEPTEMBER 2022 (index210922.h**

**13 SEPTEMBER 2022 (index130922.h**

**7 SEPTEMBER 2022 (index070922.ht**

John Lewis is reported to have set aside £500m this year to invest in lowering prices, to offer customers 'everyday quality and value', not to counteract the expected price cuts from its competitors. Pretty compelling evidence.

What I have offered here is an explanation and a prediction of oligopolistic behaviour based on the kind of 'mathematical modelling' that attracts much (misplaced) criticism to economists. But 'mathematical modelling' is not a vanity option 'to feel scientific', but an inevitable necessity: faced with the complexity of oligopolistic expectations, one must abstract away all non-essential features of economic behaviour and try to predict it by means of the simplest construct.

Max Planck (he of quantum theory) found economics 'too complex', preferring theoretical physics instead. 'At least, atoms have no expectations,' he is reported to have exclaimed (perhaps apocryphally).

Let me conclude with a 'mathematical model' (in graphic form) that many readers will have a direct experience of that illustrates rather aptly the value of models. The model in question is totally unrealistic. It does not simplify reality, it distorts it completely. If taken as an approximate description of the phenomenon it is supposed to depict, it would lead to catastrophically wrong conclusions. And yet, for the last 96 years, it has served its purpose in the most efficient way imaginable, helping hundreds of millions of users to achieve their objective.

I refer, of course, to the London Tube map.

*Dr Manfredi La Manna is a Reader in Economics at the University of St Andrews*

**Return to homepage (index.html)**