The Competitiveness of Markets with Switching Costs

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Source: The RAND Journal of Economics , Spring, 1987, Vol. 18, No. 1 (Spring, 1987), pp. 138-150

Published by: Wiley on behalf of RAND Corporation

This paper has a purpose to study a two-period differentiated-products duopoly in which consumers are partially "locked in" by switching costs that they face in the second period.The researcher developed the model from von Weizsacker's (1984) adding three conditions first, look for a subgame-perfect equilibrium, the less competitiveness and higher profit after the first period, in which firms no need to set the same price every period. Next, extend the model by suppose that new customer will replace after the old one leave the market is fractioned by $v \varepsilon [0,1]$; and then The model has only two interval time. The research also considers in each case to look at more detail in the case of special interest for the first period consisting of 1. Naive consumer expectations 2. Rational consumer expectations, and the second period has 1. Unchanged preferences across periods 2. Dependent preferences across periods and 3. The general case.

After conducting the model the researcher found out that after the initial period the firm always raises the price in the second period so that the firm can enjoy monopoly power by exploiting the advantage from the first-period customer as supplier. Next, there are a few customers who change their taste and are less sensitive to price differences among the firms. Then, the second period market has become less competitive due to switching costs making demand more inelastic. Finally, each firm has the same strategies. If firms gain the lower share in the market, firms will set the price low. Otherwise, set a high price. The key importance is the market share that firm will gain in the initial period. It will show the performance of each firm.

Overall, The switching costs can cause the firm’s profitability to increase or decrease each period. The profit is always higher than the market without switching cost. The more independence preference customers, the more competitiveness.

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