

Abstract

Entry barriers in the retail sector are a frequent policy regulation in some countries. We evaluate the price effects of the entry of LIDL, a German hard discount supermarket chain, in the Gran Canaria (Canary Islands, Spain) in 2010 and only after winning a long legal battle. We first make a theoretical analysis of how an incumbent reacts when entry by a new operator is announced but does not know the level of quality the entrant will offer. We also analyze the incumbent's pricing strategy after entry has materialized and uncertainty disappears. Secondly, we use a database obtained from a special survey for a representative sample of supermarkets in Gran Canaria to estimate how incumbents reacted to entry in the products sold and not sold by LIDL. We show that there is some evidence that prices for all goods prior to entry were initially lower in supermarkets close to the future entrant compared to supermarkets further away. However, after entry incumbents' prices for products not sold by the entrant actually rose near the entrant's new stores, compared to a suitable control group of supermarkets farther away.

Keywords: Entry, Quality uncertainty, Prices, Retailing

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Policy Implications

From a wider public policy point of view our paper provides further evidence that entry does affect prices of products sold by supermarkets. Therefore, entry regulations in the retail sector such as those currently applied in Spain most probably harm consumers by restricting competition and raising prices. Furthermore, competition in this industry is localized in the sense that supermarkets compete intensely only with stores that are near-by (less than 1.5 kilometers according to our results). Thus, planning regulations that limit the number of stores or store floor area that can be built in certain zones (according to population or some other parameter) are particularly questionable from an economic point of view.