

Reply to Referee Report 1

I thank the anonymous referee for his comments. I turn now to the specific points.

Main Comments

“Entry Commitment. The entrant commits to enter the market without knowing the incumbent’s price. It is surprising that the entrant commits to enter at time 0 and later it leaves the market if it obtains non-positive profits.”

The model is constructed in such a way that the entrant decides to enter if it anticipates that its profits will be positive, otherwise it stays out, which seems to me a realistic assumption. Moreover:

- this structure is the same as in Armstrong and Vickers (1993).
- in equilibrium the entrant firm either enters or stays out (see my Result 1, p.7). It never occurs that the entrant firm first enters and then leaves the market.
- assuming positive entrance costs F does not alter qualitatively the results. In this case the entrant firm decides to enter if it anticipates that its profits will be larger than F (instead of 0, as in the paper). Clearly, the higher is F the more restricted is the parameter space under which the entrant firm decides to enter in equilibrium, either setting the profit maximizing price or adopting the “fight-to-survive” strategy.

“The author assumes that the entrant sets price before the incumbent and says that it is according to the traditional price discrimination literature. However, he does not quote papers that make this assumption.”

Maybe the referee has not read footnote 5, where I explicitly say: “See, among the others, Thisse and Vives (1988), De Fraja and Norman (1993) and Tabuchi (1999). As Tabuchi (1999) argues: “such a leader-follower relationship may be justified by the flexibility of the price schedule used by the discriminatory pricing firm since it could easily cut the price at each location in secret if it were profitable” (p. 619).”

Not only I quoted papers that makes my assumption (other papers which I have not quoted are for example Eber, 1997, Liu and Serfes, 2004, Liu and Serfes, 2007), but Tabuchi (1999) paper also provides the intuition for the assumption.

“In Liu and Serfes (2005), firms simultaneously set prices”

I think that the referee’s comment is not entirely appropriate. In Liu and Serfes (2005) firms simultaneously set prices only when they are symmetric in pricing policies. If firms are asymmetric in pricing policies (as in my model) the authors assume like me that the uniform pricing firm sets the price before the price discriminating firm. In fact, “firm L will set, in stage 3, its uniform price to maximize its profits [...]. Firm H , given firm L ’ uniform price, sets in stage 4 its discriminatory prices” (Liu and Serfes, 2005, p.348). See also Liu and Serfes, 2005, p.349.

Other Comment

• *In Introduction, the author quotes the paper Bolton et al., 2000. However, this paper does not appear on references*

The paper appears on references. I’ve simply written “Brodley, J., Bolton, P. and M. Riordan (2000)”, instead of “Bolton, P., Brodley, J. and M. Riordan (2000)”. I’ll correct this typo.

References (not appearing in the text)

- Armstrong, M. and J. Vickers (1993), "Price Discrimination, Competition and Regulation", *The Journal of Industrial Economics*, 41, 335-359.
- Eber, N. (1997), "A Note on the Strategic Choice of Spatial Price Discrimination", *Economics Letters*, 55, 419-423.
- Liu, Q. and K. Serfes (2005), "Imperfect Price Discrimination in a Vertical Differentiation Model", *International Journal of Industrial Organization*, 23, 341-354
- Liu, Q. and K. Serfes (2007), "Market Segmentation and Collusive Behaviour", *International Journal of Industrial Organization*, 25, 353-378