Loss Leading as an Exploitative Practice*

Zhijun Chen† Patrick Rey‡

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Abstract

Loss Leading pricing is often referred to as an advertising strategy which allows retailers to attract consumers by subsidizing some products and make profits from other items; in this way, below-cost pricing may improve consumer welfare by compensating consumers for their lack of information. This paper shows that large retailers can instead use loss leading as an exploitative device at the detriment of smaller retailers, without any efficiency justification in terms of distribution cost or advertising. We show further that banning below-cost pricing can unambiguously increase consumer surplus and social welfare as well as smaller retailers' profit.

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†The ESRC Centre for Competition Policy, University of East Anglia, and College of Economics, Zhejiang University; Email: z.chen@uea.ac.uk.

‡Toulouse School of Economics (IDEI, GREMAQ and IUF); Email: prey@cict.fr