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# Incumbent's price response to new entry: The case of Japanese supermarkets

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### ARTICLE INFO

#### Article history:

Received 1 December 2008

Revised 20 August 2009

Available online 22 December 2009

#### JEL Classification:

D4

D43

L1

L11

L5

L52

L8

L81

#### Keywords:

Competition

Market structure

Zoning regulation

Pricing

Retail industry

Japan

### ABSTRACT

**Abe, Naohito, and Kawaguchi, Daiji**—Incumbent's price response to new entry: The case of Japanese supermarkets

Large-scale supermarkets have rapidly expanded in Japan over the past two decades, partly because of zoning deregulations for large-scale merchants. This study examines the effect of supermarket openings on the price of national-brand products sold at local incumbents, using scanner price data with a panel structure. Detailed geographic information on store location enables us to define treatment and control groups to control for unobserved heterogeneity and temporary demand shock. The analysis reveals that stores in the treatment group lowered their prices of curry paste, bottled tea, instant noodles, and toothpaste by 0.4–3.1% more than stores in a control group in response to a large-scale supermarket opening. *J. Japanese Int. Economies* 24 (2) (2010) 196–212. Institute of Economic Research, Hitotsubashi University, 2-1 aka, Kunitachi, Tokyo 186-8603, Japan; Graduate School of Economics, Hitotsubashi University, 2-1 Naka, Kunitachi, Tokyo 186-8601, Japan.

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## 1. Introduction

The retail sector has been regarded as one of Japan's least productive industries. In 2000, the McKinsey Global Institute issued a very influential report, which found Japan's overall retail productivity is half of the US's; in particular, the productivity of small-scale retail stores is only 19% of that in

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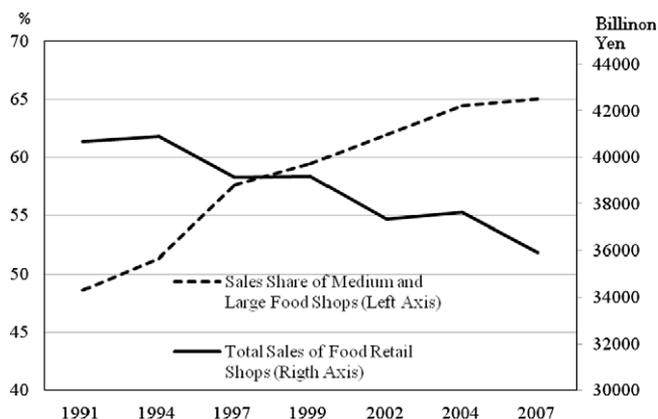


Fig. 1. Annual sales of retail food shops.

the US. The report points out that the large share of unproductive small retail shops was the main cause of overall low productivity. The report claims that this lower productivity hurt Japanese consumers through high prices.

Since the report's issuance in 2000, the structure of Japanese retail industries has changed dramatically. Fig. 1 displays the recent changes of the share by medium- and large-scale food stores, as well as total sales in Japan.<sup>1</sup> The figure clearly shows that medium- to large-scale food stores increased their presence in Japan. The numbers of large food stores and mom-and-pop shops are reported in Fig. 2, which indicates that since 1991, the number of small food stores has decreased by about 50%, while medium-large stores have increased by about 20%.

Although there are various reasons for the changes, one of the most influential causes was the deregulation of store locations at the national level. Small retail shops in Japan had been protected from competition with large retail shops by governmental regulation. Under the Large-Scale Retail Store Law (*Daikibo Kouri Tenpo Ho*), which was enacted in 1974, potential supermarket entrants with a floor area of 500 or more square meters had to obtain permission from local incumbent merchants, as well as confirmation from local authorities. That is, the entry of large retail shops that would compete with local stores was heavily regulated. In 2000, the Large-Scale Retail Store Location Law (*Daikibo Kouri Tenpo Ricchi Ho*) replaced the Large-Scale Retail Store Law. This new law dropped the requirement for the local merchant union's agreement for approval, and local authorities almost automatically approved new stores if the applications could prove that the new stores would not harm the local community's environment, for example, by causing excessive noise or traffic jams, through an environmental assessment report. In response to this deregulation, openings of new large retail stores increased dramatically. Whether this rapid expansion of large retail shops benefited consumers through lower prices remains an empirical question.

Studies on the effect of large supermarket entry on local pricing are rapidly emerging. Basker (2005) examines the effect of Wal-Mart openings on the pricing of local incumbents, using a city-level, quarterly panel price survey from the US. She selected 10 national brand items and found that Wal-Mart openings reduced the city's average price of several products by 1.5–3%. A follow-up study by Basker and Noel (2009), based on panel data, again reports a price reduction effect of 1–2%. Hausman and Leibtag (2009a,b) report that Wal-Mart sells identical food items 15–25% lower than traditional supermarkets. Lira et al. (2007) examine the effect of opening new supermarkets on the local price index of 15 food-related items and find that local prices are reduced by 7–11%, based on Chilean data. Manuszak and Moul (2008) examine the case of office supply stores in the US and report that a higher

<sup>1</sup> In Fig. 1, medium-large food shops include food stores that are larger than 250 square meters. In the total sales (solid line), we did not include sales by large department stores because we could not separate sales of foods from sales of other items. The data come from the Current Survey of Commerce, The Ministry of Economy, Trade and Industry.

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