Port Econ J (2003) 2: 1–21

Portuguese Economic Journal
© Springer-Verlag 2003

Predation and reputation acquisition in debt markets*

Cesaltina Pacheco Pires

Departamento de Gestão de Empresas, Universidade de Évora, Largo dos Colegiais, n°2, 7000-803 Évora, Portugal (e-mail: cpires@uevora.pt)

Received: June 2002 / Accepted: December 2002

Abstract. This paper presents a model of predation based on reputational differences between the entrant and an incumbent. While the incumbent has an established reputation in the debt market, the entrants's quality is not yet known in the debt market. We show that the incumbent may have incentives to prey in order to interfere with the "reputation acquisition" of the entrant.

Keywords: Asymmetric information – Financing costs – Predation – Reputation

JEL Classification: C72, D82, G3, L1

1 Introduction

The literature on industrial organization contains a host of arguments on the practice of predation. The most common models are either based on asymmetric or/and incomplete information in the product market (signalling and reputation models) or based on some sort of capital market imperfection.

A common feature of the models based on capital market imperfections is that they stress some difference in the "financial vulnerability" of the incumbent and the entrant.

A first subset of these models simply assumes that the entrant is financially constrained while the incumbent is not. This idea was first proposed by Telser (1966), who argues that predation would not be observed as a consequence of existing financial constraints. The point is that if the entrant is financially constrained and the incumbent knows it, it will pay for the incumbent to prey till the entrant

* I am grateful to one anonymous referee for very valuable comments. In addition, for helpful comments on previous versions of this paper, I thank Drew Fudenberg, Jean Tirole, António Pires, Soumodip Sarkar, and seminar participants at M.I.T., Boston University and Western Ontario University.