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Exclusive contracts with complementary inputs☆

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ABSTRACT

This study constructs a model of anticompetitive exclusive contracts in the presence of complementary inputs. A downstream firm transforms multiple complementary inputs into final products. When complementary input suppliers have market power, upstream competition within a given input market benefits not only the downstream firm, but also the

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complementary input suppliers, by raising complementary input prices. Thus, the downstream firm is unable to earn higher profits, even when socially efficient entry is allowed. Hence, the inefficient incumbent supplier can deter socially efficient entry by using exclusive contracts, even in the absence of scale economies, downstream competition, and relationship-specific investment.

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1. Introduction

In vertical supply chain relationships, firms often engage in contracts including vertical restraints, such as exclusive contracts, loyalty rebates, slotting fees, resale price maintenance, quantity fixing, and tie-ins.[1] Among vertical restraints, exclusive contracts have long been controversial.[2] Once signed, exclusive contracts deter efficient entrants; thus, they may appear to be anticompetitive. However, scholars from the Chicago School oppose this view. Based on analytic models, they argue that rational economic agents do not sign contracts to deter more efficient entrants (Posner, 1976; Bork, 1978).[3] In rebuttals of this argument, following Aghion and Bolton (1987), several researchers present market environments in which anticompetitive exclusive dealing occurs (e.g., Rasmusen et al., 1991; Segal and Whinston, 2000a; Simpson and Wickelgren, 2007; Abito and Wright, 2008).

The present study considers complementary inputs, and provides an economic environment within which anticompetitive exclusive dealing occurs. In a real-world business situation, final-good producers often transform multiple inputs into final products. More importantly, there exist complementary input suppliers with market power. In the Intel antitrust case, for example, Microsoft is a supplier with strong market power.[4] Moreover, in the antitrust case of Ticketmaster, popular artists, who provide complementary inputs for ticketing services, can have strong bargaining power over concert venues that sign exclusive contracts with Ticketmaster.[5] Therefore, when analyzing anticompetitive exclusive dealing in real-world situations, the interaction between complementary input suppliers cannot be neglected.

[1] The pioneering work of Rey and Tirole (1986) comprehensively considers these topics. More recently, Asker and Bar-Isaac (2014) use a repeated game to consider the matter. Excellent surveys of vertical restraints are provided by Rey and Tirole (2007) and Rey and Vergé (2008).

[2] Setting exclusive territories is a typical example of exclusive-dealing agreements. For instance, see Mathewson and Winter (1984), Rey and Stiglitz (1995), and Matsumura (2003).

[3] For analyses of the impact of this argument on antitrust policies, see Motta (2004) and Whinston (2006).

[4] Intel was accused of awarding rebates and various other payments to major original equipment manufacturers (e.g., Dell and HP). In a single quarter in 2007, conditional rebates and payments from Intel amounted to 76% of Dell's operating profit (Gans, 2013). See also Japan Fair Trade Commission (2005), and the European Commission (2009).

[5] See Finkelstein and Lagan (1995) for a discussion of the Ticketmaster case.

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