The Use of Exclusive Contracts to Deter Entry

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Abstract: This paper shows that an upstream monopolist that sells to competing downstream firms can profitably use exclusive contracts to deter entry even where scale economies are absent. The incumbent monopolist can often place each downstream firm in a prisoner’s dilemma by offering downstream firms a discount if they sign an exclusive contract covering later periods. Because a downstream firm that refuses to sign the exclusive contract loses profit in the initial period to downstream firms that sign the exclusive contract, downstream firms will sign exclusive contracts even when, over the longer-term, they would obtain the upstream good at a lower price if they all refused to sign.

* This article reflects the opinion of the authors and is not intended to represent the position of the Federal Trade Commission or the views of any individual Commissioner. Ezra Friedman, Ian Gale, David Reiffen, Louis Silvia, and John Yun provided helpful comments.