

*Stylized Scenario: Strategic Behaviour Among Manufacturers*

It has been argued that some vertical restraints are used by manufacturers to restrict upstream competition.

● *Entry Deterrence:*

One of the better known arguments is that *exclusivity contracts* (such as exclusive dealing, long-term contracts with retailers) form a barrier to entry. Such contracts force new manufacturers to set up their own distribution networks (which is costly, whether or not the new distributors can quickly offset their disadvantages in terms of goodwill and experience). Thus, new manufacturers are less inclined to enter.

(1) The incumbents possess first-mover advantages. Consider a single incumbent facing a single potential entrant in which a dealer must have some units of two intermediate goods to sell the final product.

- If the incumbent ties the sales of the two goods, then the potential entrant will be forced to enter both markets.

If there are substantial fixed costs of entering the two markets simultaneously, then the risk involved in entry is increased. Or, is it decreased?

- Bork argued that the need to raise capital for entry into two markets simultaneously would not make entry more difficult since the potential reward from entry would be commensurately increased.<sup>25</sup>
- Williamson countered that, when the profitability of entry depends upon specialized knowledge or skills that are not readily observable, a potential entrant's lack of experience in a given market may increase the firm's cost of raising capital. The threat of entry would thus be reduced if, in order to come into the target market, the entrant also had to come into a market with which it was unfamiliar.<sup>26</sup>

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<sup>25</sup> R.H. Bork, "Vertical Integration and the Sherman Act: The Legal History of an Economic Misconception", *University of Chicago Law Review*, (22) 1954: 157-201.

<sup>26</sup> Oliver E. Williamson, "Assessing Vertical Market Restrictions: Antitrust Ramifications of the Transactions Cost Approach", *University of Pennsylvania Law Review*, (127) 1979: 953-93.