Backwards Integration and Strategic Delegation

by

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Research question

Research question: ***can passive partial backwards integration be anti-competitive?***

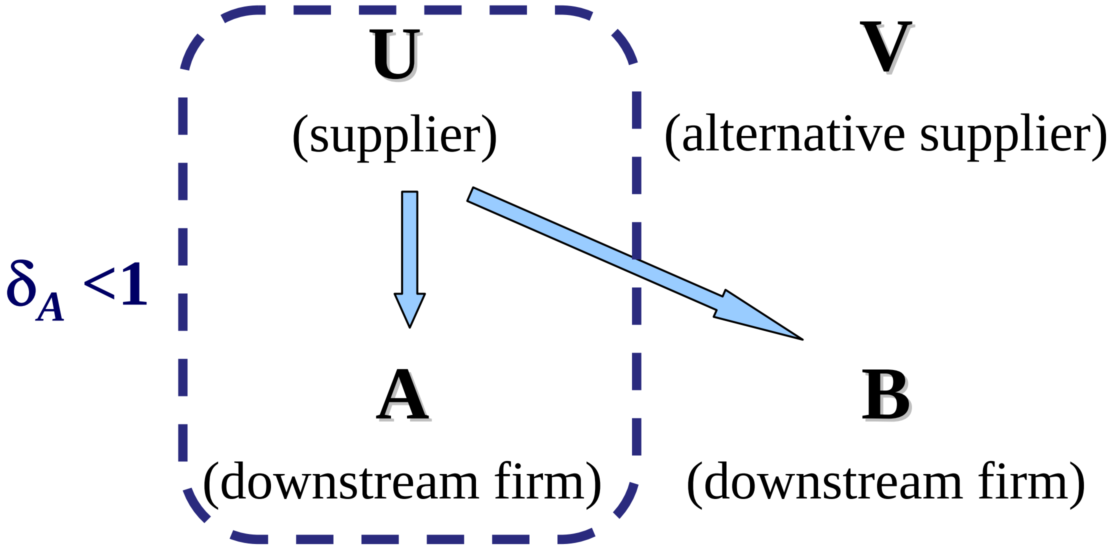
Partial: less than 100% ownership

Passive:

- Upstream supplier cannot (direct) control the downstream prices
- Downstream firm cannot (directly) control the wholesale prices

Short answer: under some conditions, yes! Because it is passive

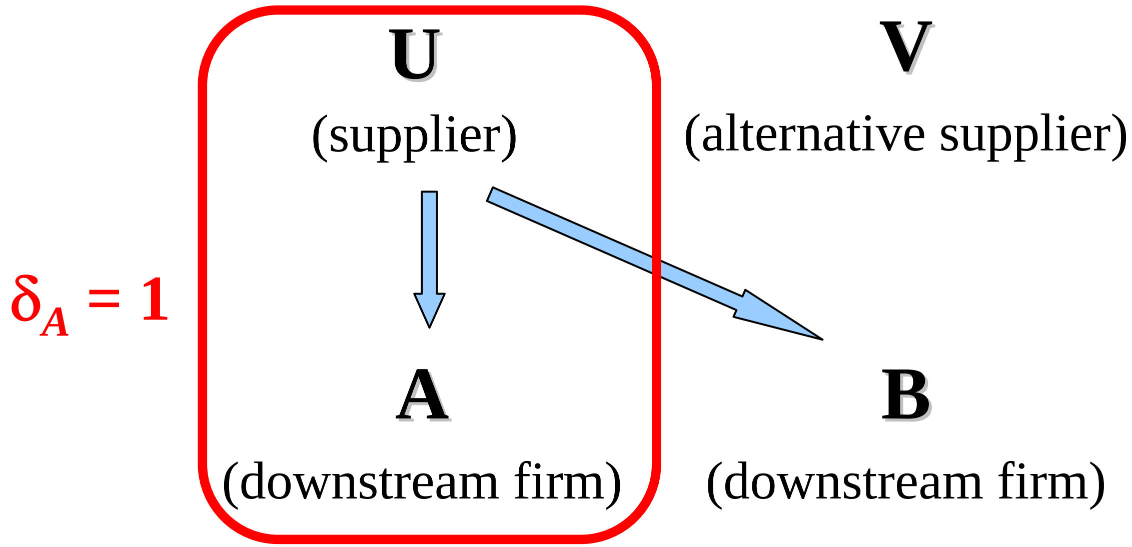
Passive partial integration



Partial passive integration:

1. **Relaxes downstream competition:** *A* partially internalizes *U*'s profit from selling to $B \Rightarrow A$ increases its downstream price
2. **Relaxes upstream competition:** A partially internalizes *U's* profit from selling to $A \Rightarrow A$ is willing to pay a higher wholesale price

Active vertical integration



Active vertical integration:

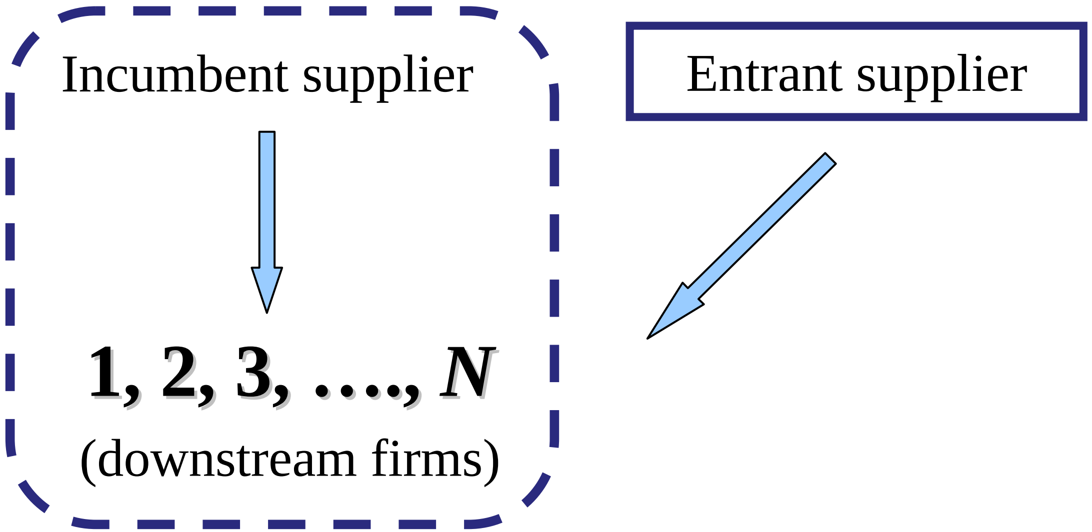
1. **Relaxes downstream competition:** A **fully** internalizes U's profit from selling to $B \Rightarrow A$ increases its downstream price
2. **No double marginalization:** reduces A's costs $\Rightarrow U$-A becomes more aggressive towards B

Main results:

- Passive partial integration may increase joint *U*-*A*’ profit, and prices compared with:
    1. No integration
    2. Active and full vertical integration

- Interesting subject
- Counterintuitive results
- Convincing model:
    - Arbitrary demand functions (satisfying standard assumptions)
    - Two-part tariffs/ price discrimination/uniform price
    - Timing

Passive partial integration as an entry barrier



- *N* downstream firms are partially integrated with the incumbent
- Entrant attempts to enter (can be more efficient than the incumbent)
- Each downstream firm may prefer to stay with the incumbent, given that all others are still integrated with the incumbent

The effect of vertical restraints on competition

- Vertical restraints are suspected of being anti-competitive
- Suppliers sometime impose vertical restraints as a tool for controlling downstream firms
- *U* may have an incentive to impose RPM for eliminating double marginalization
- Passive and partial integration as an incentive for exclusive dealing