Dominant firms and entry barriers: an input approach

In recent years there has been renewed interest in, and concern about, firms’ use of vertical control as a way to exert market power. Such behavior could be used to gain a competitive advantage over rivals in input and/or output markets.

In the following paper, the main purpose is to analyse how incumbent firms’ behavior at input markets may create substantial barriers to potential entry. The importance of studying input markets arises in the context of possible entry deterrence strategies, because actions at input markets might be the only credible way to affect negatively to the potential entrants costs. This conversely, affects substantially to the entrants’ expected post-entry profits, which in turn, is the key element while entrants are making their entry decisions.

Based on a vast literature review, I present the common entry barriers in the homogeneous goods industries and analyse the basic conditions for credible entry deterrence. It is also shown how strategic behavior in input markets can be used to deter possible entry, and how vertical relations affect to entry barriers.

Chapter two covers the literature concerning entry, and barriers to entry. Based on an article by Polasky and Bin (2001) a more thorough examination of entry deterrence in a non-renewable resources model is covered. Chapter three analyzes the potential effects of entry deterring strategies by focusing on the issues concerning vertical relations. Mainly based on articles by Salop and Scheffman (1987) and Aghion and Bolton (1987) two central issues are analyzed: (i) how vertical integration might be used to raise rivals’ costs, and (ii) how contracts can create entry barriers. It is shown that vertical integration and contracts may act as possible entry deterring tools for the incumbent firms.

Keywords
- entry barriers
- inputs
- vertical integration
- contracts

Additional information