Abstract

Vertical Integration as Strategic Behavior in a Spatial Setting:

Reducing Rivals Revenues

This paper provides a formal treatment of how vertical integration may deter entry "by reducing rivals' revenues". We examine a spatial market with the locations of firms fixed due to location-specific (sunk cost) investments at both the upstream and downstream level. We show that vertical integration restricts the potential entrant from selling to its most desirable customers, and thereby enables the upstream firm to expand its market and increase profits without attracting entry. Further, we show that integration is particularly beneficial in a growing and uncertain market, where the ability to integrate enables a firm to wait until future events unfold before any action is taken to deter entry.

firms as the market expands. A final consideration in a more general framework is that vertical integration may produce net benefits in terms of cost reduction (reduced bargaining problems, sharing of information, etc.) and avoidance of successive monopoly distortion. Consequently, it is not clear that vertical integration should be discouraged by antitrust authorities, even if it can be determined that "foreclosure" was the primary motivating strategy.