Vertical Mergers, Foreclosure and Raising Rivals' Costs -- Experimental Evidence

Abstract: The hypothesis that vertically integrated firms have an incentive to foreclose the input market because foreclosure raises its downstream rivals' costs is the subject of much controversy in the theoretical industrial organization literature. A powerful argument against this hypothesis is that such foreclosure cannot occur in Nash equilibrium. The laboratory data reported in this paper provide experimental evidence in favor of the hypothesis. Markets with a vertically integrated firm are significantly less competitive than those where firms are separated. While the results violate the standard equilibrium notion, they are consistent with the quantal-response generalization of Nash equilibrium.

Prof. Dr. Hans-Theo Normann
Goethe-University Frankfurt