

Exclusivity as (in)efficient insurance

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Abstract

Antitrust authorities often scrutinize long-term exclusivity contracts between an incumbent firm and a buyer out of fear that it will foreclose the market. Parties may defend it on the grounds that (1) The buyer is risk averse and needs to hedge its risk; (2) The financial market is insufficiently liquid to provide insurance; hence, the buyer needs to turn to the incumbent. Extending Aghion and Bolton (1987), we show that although these arguments are seemingly correct, the efficiency defense should not be upheld. Even in the absence of a liquid financial market, the incumbent firm and the buyer can sign a bilateral financial forward contract which hedges the buyer, without foreclosing the market.

Moreover, if exclusivity contracts are allowed, then a liquid financial market will never develop, as the incumbent will use the exclusivity contract to manipulate market outcomes to the detriment of financial investors.