

Topics

Cesaltina Pacheco Pires and Margarida Catalão-Lopes* Economies of Scope, Entry Deterrence and Welfare

Abstract: This paper develops a model where the incumbent may expand to a related market to signal economies of scope and deter entry in the former market. We show that the incumbent only expands when scope economies are large enough. Thus expansion is a signal of larger economies of scope and, for certain parameter values, leads to entry deterrence. Although our game is two-period, the expansion strategy creates a long-term advantage. We further investigate the implications of prohibiting an entry-deterrent expansion. A major finding is that, in our model, this prohibition always decreases consumer surplus. In terms of global welfare, the impact is ambiguous but negative for many parameter values.

Keywords: economies of scope, signalling, entry deterrence

JEL Classification: L12, L13, L25

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1 Introduction

In this paper we study the entry deterrence when the incumbent benefits from economies of scope if he expands to another product's market. The paper shows that in the presence of economies of scope deterring entry may be welfare improving, since it increases efficiency and generates social surplus in the new market.

Economies of scope are usually related with the existence of inputs that may be shared among two or more production processes. These may be physical inputs, or “intangible” ones, such as, for instance, a given technology, managerial experience or a good sales team. Common examples of industries where economies of scope are relevant include telecommunications (share of inputs