Screening Contracts As A Barrier To Entry

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A seller contracts with a downstream buyer under the threat of upstream entry. The buyer has private information on his downward sloping demand and on the efficiency gains of entry. Strategic and screening concerns interact in the design of nonlinear contracts.

We provide a rationale for the use of rebates, discounts and minimal purchase requirements under various contracting scenarios.

With market-share contracts, the incumbent designs nonlinear tariffs that depend on whether the buyer also purchases from the entrant or not.

Screening distortions are mitigated and the incumbent's marginal prices come closer to but remain above marginal cost when entry occurs.

Entry is inefficient, reduced to decrease the buyer's information rent, but it remains positively correlated with consumption.

When restricted to offer a single nonlinear tariff whether the buyer also purchases from the entrant or not, the incumbent face a conflict between preventing entry which is now costly and screening. Entry is no longer positively correlated with consumption and marginal prices may be lower than marginal cost. The optimal contract shares key features of an all-unit discount tariff.