

Non-Technical Summary

Essential facilities provide the incumbent firm with an advantage in the provision of associated downstream facilities. For example, there may be costs that are common between the downstream and essential facilities such that provision of the downstream facility by the provider of the essential facility is cheaper than having competitive provision. However, competitors may be more innovatory and this may reduce the cost of provision of the overall product even though there are more firms than are strictly necessary. The competing firms need access to the essential facility and in our framework the price of access to the essential facility and the price of the final product provided by the incumbent are regulated. The paper addresses the issue of how regulators can use access pricing to promote entry by innovatory firms in the presence of essential facilities. The entrants have lower costs that spillover to firms in the market but the regulator is not able to distinguish which entrants have low costs and which do not.

Where entrants are of differing quality technology spillovers have two effects. One is positive in that the incumbent can copy the cheaper technology of the entrant. This reduces cost in the industry and offsets the fixed entry cost associated with entry. The other is a negative effect in that the ability to use access pricing to deter entry of bad quality entrants is reduced. That is, it is protected from the consequences of its high costs and poor technology, if a good firm has already entered or may be about to enter, since it can copy the cheaper technology. The higher cost entrant is bad for efficiency since it causes additional fixed costs to be incurred and brings no benefit but the spillovers prevent it from being 'hurt' by its own relative inefficiency. The greater the spillover the greater the desire to attract good entrants but also the harder it is to penalise poor quality entrants.

This paper considers this dilemma and the consequences for public policy. The question we address is whether the lack of full information encourages the regulator to sustain entry enhancing policies for longer or whether the regulator makes entry harder. Generally, we show that the incentives are for the regulator to limit entry enhancement in the face of incomplete information rather than be more open in the face of the inability to determine the good firms from the bad ones. We also show that for certain configurations the good firm has an incentive to raise its costs, i.e., become a less good competitor.