Non-technical Summary

Project Title:
Vertical Differentiation in the PC Software Market: Should Product Bundling Be Socially Plausible If It Does not Lead to Efficient Market Foreclosure?

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Short Description
The social welfare effect of tying a low-quality to a high-quality complementary product in a vertically differentiated market for systems

Full Description

What are the main market conditions (in terms of market size and qualities) at which tying could be driven by sales-saving rather than predatory incentives? What would be the social welfare effect of tying in such a case?

The present paper steps on the assumption that PC software systems are vertically differentiated to show that in this case the tying behavior of Microsoft during the so-called “browser wars” in the 1990s could have been motivated by own-sales-saving rather than predatory (entry-deterrence) incentives. The main objective of the paper is to measure the welfare effect of product tying in the case when it could be considered as a defensive strategy by the multi-product firm.

The main findings in the chapter are that:
- tying could be motivated by sales-saving incentives given sufficiently narrow market size and exogenously restricted range in which the low-quality good of the multi-product firm could vary.
- tying arrangement maximizes the multi-product firm’s profit but leaves the market non-covered which has a negative partial effect on the social welfare.
- tying has also a potential to improve the social welfare by increasing the average quality offered in the market.
- the non-tying subgame equilibrium is strictly Pareto dominated by the tying outcome.

The main corollary of the paper is that making Microsoft supply a Linux version of its application software emerges as a stronger competition-enhancing policy measure than unbundling.