Exclusive Tie-ups for Handsets in the Wireless Industry

Abstract: We examine when and why a service provider and a handset vendor may have a tie-up for a handset to be exclusive to the service provider. Our findings may help explain three otherwise puzzling market observations: (i) why exclusive tie-ups are more common in the U.S. than in Europe or Asia, (ii) why such tie-ups are more often with smaller vendors like LG or Sagem than with industry majors such as Nokia, and (iii) why industry experts hold U.S. service providers responsible for handsets in the U.S. being less advanced than those in Europe or Asia.

While an exclusive tie-up is generally regarded as a means for the service provider to differentiate itself through handsets, we find that it serves an additional strategic purpose: it raises a rival service provider's handset costs by reducing the competition faced by a rival handset vendor. We find that this strategic effect may in fact be the source of competitive advantage gained through the tie-up. This suggests that, for instance, in evaluating whether AT&T paid too high a price for the iPhone, one must also consider how this deal affects Verizon's costs of procuring a competing phone. Interestingly, we find that an exclusive tie-up may benefit the rival handset vendor.

Our model yields two testable predictions: (i) the total price for service and handset will be higher in markets with exclusive tie-ups, and (ii) the service provider subsidy on an exclusive handset will be lower than on a non-exclusive one.