**Patent Licensing, Entry and the Incentive to Innovate. (Chang Zhao and Yair Tauman)**

**Abstract:**

We analyze the economic impact of process innovations where the innovator auctions off licenses to both potential entrants and incumbent firms.

It is shown that opening the market to entrant licensees, the incentive to innovate is maximized in a monopoly market as was envisioned by Schumpeter (1942).

This is in contrast to previous literature on licensing of process innovations where entry is excluded.

There the incentive to innovate is maximized in oligopoly market if licenses are sold by auction (Sen and Tauman (2007)) or in competitive market if licenses are sold by royalty (Arrow (1962)).

The post-innovation market structure, the diffusion of the innovation and the social welfare are analyzed and compared with the case where entry is excluded.