

The Economics of Buyer Power

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Structure of this Short Talk

1. Preliminary Remarks
→ Definitions, restrictions, sources of BP
2. Consequences of BP: Theories of harm
3. Implications for the Metrics of BP
4. Countervailing BP (“Defence”)
5. Concluding Remarks

Preliminary Remarks

- Two key paradigms: How is BP exercised?
 - Through withholding demand (“Monopsony”)
 - Through negotiating individual discounts (“Bargaining”)
- The Bargaining Framework: The Basics
 - Distribution of “net surplus”: “Gross surplus” minus the value of their “outside options”
 - “Outside options”
 - E.g., for the supplier to sell more to other retailers
 - E.g., for the retailer to stock different product.
 - Key levers of bargaining power: Value of outside options

Sources of BP

- Relevance of buyer's size ?
 - Absolute size should typically enhance buyer's outside option
 - May decrease value of the supplier's outside option
- Other sources of BP may not be related to size
E.g., “gatekeeping”, “sophistication”, scope to substitute
- Note: Generally, “total inflicted loss” should matter
→ Large multi-product retailer is not necessarily “stronger”
- Caveat: Restriction to “outside options” ignores other BP channels

Consequences of BP / Potential Harm

- Powerful buyers as “consumer champions” ?
→ Depends on pass-through? (Competition, contracts, etc.)
- Effect on competing buyers?
 - Exit / “Spiral”?
 - “Waterbed effect”?
 - Or “Me too” effect?
- Incentives to invest and innovate?
 - Upstream: “Hold-up” vs. “Keeping on Toes”
 - Downstream: “Double-dividend” of becoming larger/stronger

Consequences of BP (cont.)

- Alternative theories of harm:
 - “Raising rivals’ costs” (strategic overbuying)
 - Collusion: Breaking or facilitating?
 - Vertical restraints:

Metrics of BP: Some Thoughts

- Recall: Various theories of BP
 - Sometimes, not always linked to measures of size
- “Thresholds”: Two conflicting views
 1. No presumption of clear link between BP and harm
 - High threshold (“costly type-I errors”)
 2. In bilateral relationship, already low fraction of supplier’s business sufficient for substantial BP?
 - Low threshold

Standard?

- BP forces rethinking of applied standard
 - Only welfare of final consumers?
→ Ignores upstream inefficiencies
 - Only welfare of “next downstream level”?
→ Justification?

BP as Defence

- Efficiency defence
- Countervailing Power: But
 - How “broad” is the shield of BP?
 - Is BP really a substitute for upstream competition?
E.g. Incentives to invest and innovate?

Concluding Remarks

- BP and supplier dependency: “Direct intervention”?
 - E.g., “code of conduct”
 - But: Intervention must change relationship “structurally”!
 - Key caveat: Is contractual practice efficiency enhancing?

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