ABSTRACT

In the standard one-sided hold-up problem, a party that must bear the full cost of an investment, but shares the investment surplus with other parties, will underinvest relative to the surplus-maximizing investment level. In these models, the level of investment and the profit of the investor increase in the investor’s bargaining power. In our model, a retail firm bargains simultaneously with two suppliers to purchase one product from each of them to resell to consumers. Either the retail firm or the suppliers can make demand-increasing investments in the respective products. We show that when the products compete in the final market, investment in one product allows that product to take market share from the other, which affects the investment decision for the other product. This interaction between the two investment problems leads to counterintuitive results in terms of investment incentives. Depending on the bargaining power of the two suppliers, the retailer generally underinvests in one product, but overinvests in the other. These countervailing incentives can offset each other, which gives the retailer efficient investment incentives for both products, even if he has no bargaining power at all. If only the suppliers invest, then if one supplier doesn’t have full bargaining power vis-à-vis the retailer, it is beneficial for the total supply chain if the other supplier does not have full bargaining power either. Overall, our results show that standard hold-up results do not necessarily hold when multiple bargaining parties are involved.

(Copies of the paper are available in the AOIS Department offices)