"Cartel Formation through Strategic Information Leakage in a Distribution Channel"

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From

TAU

יום שני, 21 באוקטובר 2013, בשעה 14:00
סמינריון 011, בניין איריסון-לאודר, קמפוס המרכז הבינתחומי, רחוב כנפי נשרים, הרצליה

Abstract

This paper studies the ability of competing retailers to form a cartel by sharing information with their mutual manufacturer. In a market characterized by demand uncertainty, colluding retailers desire to share information about the potential market demand in order to coordinate on the optimal collusive retail price. However, since direct information-sharing between competing firms is considered to be a possible signal for collusion, according to the antitrust laws, the retailers search for a mechanism to exchange information in a manner that would not raise the suspicions of the antitrust authorities. This paper examines such a mechanism: each retailer shares his private information with the mutual manufacturer and uses the wholesale price to infer the market condition and coordinate on the cartel price. Although a cartel at the retail level limits the manufacturer's sold quantity, under certain conditions, the manufacturer is better accepting the retailers’ private information, thereby facilitating the cartel formation. Moreover, a situation in which the retailers cannot collude by sharing information horizontally and they collude by sharing information with the manufacturer can result in a lower consumer surplus.