

# Inefficient Buyer Mergers To Obtain Size Discounts

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## Abstract

This paper analyzes the welfare implications of buyer mergers when one monopoly manufacturer sells its product to many separate and locally competitive retail markets. Assuming diseconomies of scale upstream, we show that a larger retailer gets size discounts from the supplier, i.e., it has a higher buyer power than smaller retailers. Different from the conventional argument that more buyer power reduces retail prices, we show that a larger retailer does not pass on size discounts to consumer prices when firms bargain over non-linear supply contracts. Moreover, size discounts for the larger buyer do not lead to higher tariffs for smaller buyers, i.e., there is no waterbed effect, when supply contracts are non-linear. We next illustrate that size discounts might result in inefficient buyer mergers increasing consumer prices. This is found to be the case when independent stores want to merge to improve their bargaining power vis-à-vis the supplier, and thus get size discounts, even if the merger deteriorates their downstream efficiency. For policy concerns, we show that inefficient mergers are more likely to occur when downstream competition is weaker, for instance, due to strict commercial zoning rules.

**Keywords** Buyer mergers, non-linear supply contracts, size discounts, waterbed effects, commercial zoning laws.

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