A Primer on Bargaining: How Mergers May Affect Negotiated Prices

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Prices are determined in different ways in different markets. In some markets, a market price is determined by the quantity suppliers choose to supply. In other markets, sellers set prices and buyers choose whether and how much to purchase at those prices. In other markets, buyers organize auctions, sellers offer bids, and prices are determined based on those bids and buyers' purchasing decisions. In still other markets, buyers and sellers negotiate prices through bilateral bargaining.

In this article, we provide a primer on how economists approach bargaining. We describe a basic framework and use the framework to discuss how mergers of suppliers, mergers of buyers, and vertical mergers may affect negotiated prices. We illustrate the practical application of this framework to each type of merger in the context of (1) shoe suppliers and retailers, (2) hospitals and insurance providers, and (3) video content providers and distributors.

Bargaining Framework

The Setting. We consider bargaining between an intermediary and an input supplier. While bargaining may occur between any buyer and seller, prices in business-to-business transactions are often negotiated.

Gains-from-Trade. An intermediary and an input supplier will transact if there are "gains-from-trade." There are gains-from-trade if the "gross benefit" the intermediary gets from purchasing from the supplier is greater than the cost the supplier incurs in selling to the intermediary.[1]

Consider the following hypothetical example of a retailer, Johnnie's, negotiating with a shoe manufacturer, Nike, over the price of a shipment of shoes. We assume Johnnie's has already reached agreements to carry Adidas and New Balance. We also assume Nike has already reached agreements to supply Jerry's and Sportsman's, two competitors of Johnnie's.

If Johnnie's carries Nikes, Johnnie's will make a certain amount of revenue on its sales of Nikes. Alternatively, if Johnnie's does not carry Nikes, the consumers who would have bought Nikes from Johnnie's will buy something else. Some will buy Adidas or New Balance from Johnnie's, while others will buy Nikes from Jerry's or Sportsman's. Johnnie's will earn a certain amount of profit on these additional sales of Adidas and New Balance, while Nike will earn a certain amount of profit on the additional sales to Jerry's and Sportsman's.

Johnnie's gross benefit from carrying Nikes is the difference between the revenue Johnnie's would make on sales of Nikes and the profit Johnnie's would make on these additional sales of

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[1] It is common to make the simplifying assumption that the seller knows the buyer's gross benefit and the buyer knows the seller's cost.

Adidas and New Balance.[2] We assume Johnnie's would earn $10,000 in revenue from the sale of Nikes. We also assume that if Johnnie's does not carry Nikes, Johnnie's would earn $2,000 in additional profit from the sale of Adidas and New Balance. Thus, Johnnie's gross benefit is $8,000 ($10,000 – $2,000). We also assume Nike incurs $3,000 to make the shoes it sells Johnnie's, plus an opportunity cost of $1,000 from the profit Nike would earn on its additional sales to Jerry's and Sportsman's if it does not sell to Johnnie's. Nike's cost is therefore $4,000 ($3,000 + $1,000). Because Johnnie's gross benefit is $8,000 and Nike's cost is $4,000, there are gains-from-trade. Any price for the shipment of shoes between $8,000 and $4,000 will leave Johnnie's and Nike better off relative to not contracting.

Bargaining Solution. The price an intermediary and a supplier negotiate divides the gains-from-trade between them. If the intermediary is a more skilled or effective negotiator, it will be able to negotiate a lower price and capture a larger share of the gains-from-trade. If the supplier is a more skilled or effective negotiator, it will be able to negotiate a higher price and capture a larger share of the gains-from-trade.[3] In our hypothetical example, if Nike is a more skilled negotiator, it will be able to negotiate a price closer to $8,000—the highest price Johnnie's is willing to pay. If Johnnie's is a more skilled negotiator, it will be able to negotiate a price closer to $4,000—the lowest price Nike is willing to accept. If Johnnie's and Nike are equally skilled negotiators, they will divide the gains-from-trade equally and negotiate a price that is equal to $6,000.[4]

The price an intermediary and a supplier negotiate divides the gains-from-trade between them.

The negotiated price also will tend to be higher if the intermediary's gross benefit from purchasing from the supplier is larger. This may be the case if the intermediary charges a high price to its own customers. The intermediary's gross benefit will also be larger if it is more dependent on the supplier—e.g., if the intermediary does not have a good alternative to the supplier and so would earn very little profit if it does not purchase from it.[5]

Returning to our hypothetical example, suppose Johnnie's can earn revenue of $12,000 rather than $10,000 on sales of Nikes. Johnnie's gross benefit would now be $10,000 ($12,000 – $2,000) rather than $8,000 ($10,000 – $2,000). If Johnnie's and Nike divide the gains-from-trade equally, the negotiated price will now be $7,000 rather than $6,000.[6] Increasing Johnnie's gross benefit by $2,000 increases the negotiated price by $1,000 if Johnnie's and Nike divide the gains-from-trade equally. Alternatively, suppose again that Johnnie's can earn revenue of $10,000 on sales of Nikes, but can only earn an additional profit of $1,000 rather than $2,000 on sales of Adidas and New Balance if it does not carry Nikes. Johnnie's gross benefit from carrying Nikes would be $9,000 ($10,000 – $1,000) rather than $8,000 ($10,000 – $2,000). If Johnnie's and Nike divide the gains-from-trade equally, the negotiated price will now be $6,500 rather than $6,000.[7]

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2 We can think of the profit Johnnie's would make on these additional sales of Adidas and New Balance as an opportunity cost that Johnnie's incurs by carrying Nikes.

3 In the standard bargaining framework, the relative bargaining ability of the buyer and seller is modeled as an index that ranges from 0 to 1. When the buyer has a lot of bargaining ability relative to the seller, the value will be closer to 1. When the buyer has little bargaining ability relative to the seller, the value will be closer to 0. While a negotiation may unfold in any number of ways, the outcome of the negotiation process is that some portion of the gains-from-trade accrues to the buyer, while the remaining portion accrues to the supplier. If the buyer and seller are equally good negotiators, they will split the gains-from-trade in half.

4 If the price is $6,000, Johnnie's net benefit is $2,000 ($8,000 – $6,000) and Nike's economic profit is $2,000 ($6,000 – $4,000).

5 The intermediary's gross benefit will be lower if the intermediary is not dependent on a supplier—e.g., if the intermediary has a good alternative to the supplier and so could do well if it does not reach an agreement with the supplier.

6 If the price is $7,000, Johnnie's net benefit is $3,000 ($10,000 – $7,000) and Nike's economic profit is $3,000 ($7,000 – $4,000).

7 If the price is $6,500, Johnnie's net benefit is $2,500 ($9,000 – $6,500) and Nike's economic profit is $2,500 ($6,500 – $4,000).

The negotiated price also will tend to be higher if the supplier's cost of selling to the intermediary is higher. This may be the case if the supplier's incremental cost and/or opportunity cost is higher. The supplier's opportunity cost may be higher if the supplier is less dependent on an intermediary—e.g., if the supplier has a good alternative to the intermediary and so could do well if it does not sell to it.[8] For example, if Nike incurs an opportunity cost of $2,000 rather than $1,000 by selling to Johnnie's because more consumers would buy Nikes from Jerry's or Sportsman's if Nike does not sell to Johnnie's, then Nike's cost will be $5,000 ($3,000 + $2,000) rather than $4,000 ($3,000 + $1,000). If Johnnie's gross benefit from carrying Nikes is $8,000 and Nike's cost is $5,000, the negotiated price will be $6,500 rather than $6,000.[9] Increasing Nike's cost by $1,000 increases the negotiated price by $500 if Johnnie's and Nike divide the gains-from-trade equally.

A merger of suppliers may affect a negotiated price by changing the bargaining stakes. . . . These changes in bargaining stakes may enable the merged supplier to negotiate a higher price with the intermediary.

Merger of Suppliers

Theory. A merger of suppliers may affect a negotiated price by changing the bargaining stakes. Prior to a merger, if the intermediary and one of the merging suppliers do not reach a supply agreement, the intermediary can purchase from the other merging supplier. After the merger, the intermediary may lose this backup option, because the merged suppliers can negotiate jointly after their merger. Depending on the extent to which the intermediary considers the merging suppliers to be substitutes for each other, the loss of this backup option may increase the importance to the intermediary of reaching an agreement with the merged supplier and may decrease the importance to the merged supplier of reaching an agreement with the intermediary.[10] These changes in bargaining stakes may enable the merged supplier to negotiate a higher price with the intermediary.[11]

Returning to our hypothetical example, consider a merger of Nike and Adidas. Prior to the merger, if Johnnie's does not reach an agreement with Nike, some consumers who would have purchased Nikes from Johnnie's will instead purchase Adidas or New Balance from Johnnie's, while other consumers will purchase Nikes from Jerry's or Sportsman's. The more consumers who would purchase Adidas or New Balance from Johnnie's, the stronger Johnnie's bargaining position vis-à-vis Nike and the weaker Nike's bargaining position vis-à-vis Johnnie's. The more consumers who would purchase Nikes from Jerry's or Sportsman's, the weaker Johnnie's bargaining position and the stronger Nike's bargaining position.

[8] The supplier's opportunity cost will be lower if the supplier is more dependent on an intermediary—e.g., if the supplier does not have a good alternative to the intermediary and so could earn very little profit if it does not sell to the intermediary.

[9] If the price is $6,500, Johnnie's net benefit is $1,500 ($8,000 – $6,500) and Nike's economic profit is $1,500 ($6,500 – $5,000).

[10] If one of the merging suppliers does not reach an agreement with an intermediary prior to the merger, many consumers may continue to purchase from the intermediary if the intermediary's product is just as good or almost as good when the intermediary purchases from the other merging supplier. This means that the intermediary may not lose many sales and the merging supplier may lose a lot of sales if the two parties do not reach a supply agreement. But if the intermediary's product is much worse when it does not purchase from either merging supplier, many consumers may switch to other intermediaries who have agreements with the merged supplier. This means that the intermediary may lose many sales and the merged supplier may lose fewer sales if the intermediary and merged supplier do not reach an agreement.

[11] The magnitude of any such price increase will depend on the extent to which the intermediary considers the merging suppliers to be substitutes for each other. If the intermediary does not consider them to be close substitutes, the merger may have little or no impact on the bargaining stakes. An intermediary may not consider merging suppliers to be close substitutes in markets in which there are multiple suppliers that are not highly differentiated.

Now consider what happens if Nike and Adidas merge and negotiate jointly with Johnnie's. If Johnnie's does not reach an agreement with Nike/Adidas post-merger, consumers who, prior to the merger, would have purchased Adidas instead of Nikes from Johnnie's if Johnnie's had not reached an agreement with Nike, no longer have the option to purchase Adidas because if Johnnie's does not reach an agreement with Nike then it also does not reach an agreement with Adidas. Now these consumers will either purchase New Balance from Johnnie's or purchase Nikes from Jerry's or Sportsman's. This latter group of consumers that purchases Nikes from Jerry's or Sportsman's represents sales Nike would have lost to Adidas prior to the merger, but now makes through Jerry's or Sportsman's after the merger. This group also represents sales Johnnie's would have made prior to the merger, but now loses to Jerry's or Sportsman's after the merger. These diverted sales change the bargaining stakes—they decrease the importance to Nike of reaching an agreement with Johnnie's and increase the importance to Johnnie's of reaching an agreement with Nike. These changes in bargaining stakes may enable Nike/Adidas to negotiate a higher price with Johnnie's.

A merger of suppliers also may generate efficiencies that reduce the merged supplier's incremental costs. Given lower costs, the merged supplier may be willing to accept a lower price. As in posted price markets, at least some of any merger-specific reductions in incremental costs—efficiencies—may be passed through by the merged supplier to its customers. For example, if the merger of Nike and Adidas reduces Nike/Adidas' cost of supplying shoes, the additional sales Nike/Adidas makes through Johnnie's become more valuable to Nike/Adidas. This changes the bargaining stakes by increasing the importance to Nike/Adidas of reaching an agreement with Johnnie's, and this may enable Johnnie's to negotiate a lower price with Nike/Adidas.

Hospital Merger. Hospitals negotiate reimbursement rates with commercial health insurers. These reimbursement rates depend on the extent to which the hospital and insurer each benefit from the hospital participating in the insurer's provider network. The hospital may benefit because participation in the insurer's provider network may increase its patient volume. The insurer may benefit because the hospital's participation in its provider network may increase the attractiveness of its provider network to purchasers of commercial health insurance—employers and individuals.

A merger of hospitals may increase the reimbursement rates negotiated with an insurer by changing the bargaining stakes. Prior to the merger, if an insurer and one of the merging hospitals do not reach an agreement, the insurer can still contract with the other merging hospital. After the merger, if an insurer and one of the merged hospitals do not reach an agreement, the insurer may not be able to contract with the other merged hospital. Depending on the extent to which consumers consider the merging hospitals to be substitutes for each other, the prospect of offering a provider network that does not include either merging hospital could be much worse than the prospect of offering a provider network that includes one but not the other merging hospital. This change in the bargaining stakes may enable the merged hospital to negotiate higher reimbursement rates with the insurer.[12]

A merger of hospitals also may generate efficiencies that reduce the merged hospital's costs of providing medical care to an insurer's enrollees. Given lower costs, the merged hospital may be willing to accept lower reimbursement rates.

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[12] The magnitude of any increase in reimbursement rates will depend on the extent to which consumers consider the merging hospitals to be substitutes for each other. If consumers do not consider them to be close substitutes, the merger may have little or no impact on the bargaining stakes. Consumers may not consider hospitals to be close substitutes in markets in which there are multiple hospitals that are not highly differentiated.

Video Content Provider Merger. Video content providers negotiate programming fees with multichannel video programming distributors (MVPDs).[13] These fees depend on the extent to which the video content provider and MVPD each benefit from the video content provider participating in the MVPD's programming network. The video content provider may benefit because participation in the MVPD's network may increase viewership of its programs, and this may help it generate advertising revenue. The MVPD may benefit because the video content provider's participation in its programming network may help the MVPD sell subscriptions.

A merger of video content providers may increase the fees negotiated with an MVPD by changing the bargaining stakes. Prior to the merger, if an MVPD and one of the merging video content providers do not reach an agreement, the MVPD can still contract with the other merging video content provider. After the merger, if an MVPD and one of the merged video content providers do not reach an agreement, the MVPD may not be able to contract with the other merged video content provider. Depending on the extent to which consumers consider the merging video content providers to be substitutes for each other, the prospect of offering a programming network that does not include either merging video content provider could be much worse than the prospect of offering a programming network that includes one but not the other merged video content provider. These changes in bargaining stakes may enable the merged video content provider to negotiate higher fees with the MVPD.[14]

A merger of video content providers also may generate efficiencies that reduce their costs of developing programming. Given lower costs, the merged video content provider may be willing to accept lower fees.

Merger of Intermediaries

Theory. The impact of an intermediary merger on a negotiated input price is a bit more complicated. Given the positioning of intermediaries in the middle of supply chains, the impact of an intermediary merger on the prices the merging intermediaries negotiate with input suppliers may depend on the impact of the merger on the prices the merging intermediaries charge their own customers, and vice versa.

A merger of intermediaries may increase the importance to a supplier of reaching an agreement with the merged intermediary and decrease the importance to the merged intermediary of reaching an agreement with the supplier.[15] These changes in bargaining stakes may create downward pressure on the input price the merging intermediary negotiates with the supplier.

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[13] In using the term MVPD, we take no position on which types of distributors are considered to be MVPDs.

[14] The magnitude of any increase in fees will depend on the extent to which consumers consider the merging video content providers to be substitutes for each other. If consumers do not consider them to be close substitutes, the merger may have little or no impact on the bargaining stakes.

[15] Prior to the merger, if one of the merging intermediaries does not purchase from a particular supplier, some consumers may instead purchase from the other merging intermediary. Post-merger, the merged intermediaries may negotiate with the supplier together. If the merged intermediaries do not purchase from the supplier, some of the consumers who would have substituted between the merging intermediaries may continue to purchase from the merged intermediaries, while other consumers may now substitute to another intermediary. The consumers who continue to purchase from the merged intermediaries represent sales that the merged intermediaries would have lost prior to the merger, but no longer lose after the merger if one of them ceases to purchase from the supplier. These retained sales reduce the merged intermediaries' benefit from purchasing from the supplier, and this reduced benefit enables the merged intermediaries to negotiate a lower price with the supplier. These retained sales also represent sales that the supplier would have recaptured prior to the merger, but would not recapture after the merger. These lost sales decrease the supplier's cost of contracting with the merged intermediaries, which also helps the merged intermediaries to negotiate a lower price with the supplier.

Returning to our hypothetical example, we now consider a merger of Johnnie's and Jerry's. Prior to the merger, if Nike does not reach an agreement with Johnnie's, some consumers will purchase Nikes from Jerry's or Sportsman's. The ability to make sales through Jerry's and Sportsman's gives Nike a stronger bargaining position when negotiating with Johnnie's, which enables Nike to negotiate a higher price with Johnnie's.

Now suppose Johnnie's and Jerry's merge and negotiate with Nike jointly. If Nike does not reach an agreement with Johnnie's/Jerry's, consumers who would have purchased Nikes from Jerry's if Johnnie's does not carry Nikes now will either purchase Nikes from Sportsman's or purchase Adidas or New Balance from Johnnie's/Jerry's. This latter group of consumers that purchases Adidas or New Balance from Johnnie's/Jerry's represents sales that Nike would have made prior to the merger, but now loses after the merger. This group also represents sales that Johnnie's would have lost prior to the merger, but now retains after the merger. These sales change the bargaining stakes—they increase the importance to Nike of reaching an agreement with Johnnie's/Jerry's and decrease the importance to Johnnie's/Jerry's of reaching an agreement with Nike. These changes in bargaining stakes will enable Johnnie's/Jerry's to negotiate a lower price from Nike.

The merger of intermediaries may also generate efficiencies that reduce the merging intermediary's incremental costs of selling its products.

The merger of intermediaries may also increase the merging intermediary's market power in the downstream market in which it is a seller, and this may create upward pressure on the price the merging intermediary charges in the downstream market. For example, prior to the merger, Jerry's constrains Johnnie's prices and vice versa. If Johnnie's and Jerry's merge, they no longer constrain each other's prices and this will tend to create upward pressure on their prices.

These direct effects may subsequently have countervailing effects. The direct downward pressure on the negotiated input price may create downward pressure on the price the merging intermediary charges in the downstream market, while the direct upward pressure on the price the merging intermediary charges in the downstream market may create upward pressure on the negotiated input price. For example, direct downward pressure on the price Johnnie's/Jerry's negotiates with Nike may create downward pressure on the price Johnnie's/Jerry's charges consumers, while the direct upward pressure on the price Johnnie's/Jerry's charges consumers may create upward pressure on the price Johnnie's/Jerry's negotiates with Nike.

The merger of intermediaries may also generate efficiencies that reduce the merging intermediary's incremental costs of selling its products. Any such efficiencies can create additional downward pressure on the price the merging intermediary charges in the downstream market and upward pressure on the input price the merging intermediary negotiates with the supplier. For example, if the merger of Johnnie's and Jerry's reduces its cost of selling shoes, the additional sales Johnnie's/Jerry's makes by carrying Nike are more valuable to it. This may change the bargaining stakes by increasing the importance to Johnnie's/Jerry's of reaching an agreement with Nike and this may enable Nike to negotiate a higher price with Johnnie's/Jerry's.

Thus, a merger of intermediaries may create downward or upward pressure on negotiated input prices and on the prices the merging intermediaries charge. How these countervailing effects balance out will depend on the situation.[16]

Health Insurer Mergers. Given the positioning of health insurers in the middle of supply chains, the impact of a merger of insurers on the reimbursement rates they negotiate with health

[16] We take no position as to whether decreases in negotiated input prices should be considered cognizable efficiencies when evaluating the impact of a merger of intermediaries on competition in the downstream market.

care providers may depend on the impact of the merger on the premiums they charge their own customers, and vice versa.

A merger of insurers may create downward pressure on the reimbursement rates the merging insurers negotiate with health care providers, and upward pressure on the premiums the merging insurers charge their own customers. The downward pressure on the negotiated reimbursement rates may subsequently create countervailing downward pressure on premiums, while the upward pressure on premiums may subsequently create countervailing upward pressure on negotiated reimbursement rates. A merger of health insurers may also generate efficiencies that reduce the merging insurer's incremental costs of selling its insurance products. Any such efficiencies can create additional downward pressure on premiums and upward pressure on negotiated reimbursement rates.

MVPD Merger. Like commercial health insurers, MVPDs are positioned in the middle of the supply chain, and so the impact of a merger of MVPDs on the programming fees they negotiate with content providers may depend on the impact of the merger on the prices they charge their own subscribers, and vice versa.

A merger of MVPDs may create downward pressure on the programming fees negotiated with video content providers and upward pressure on the prices charged to subscribers. The downward pressure on the negotiated programming fees may subsequently create countervailing downward pressure on subscriber prices, while the upward pressure on subscriber prices may subsequently create countervailing upward pressure on negotiated programming fees. A merger of MVPDs may also generate efficiencies that reduce the merging MVPD's incremental costs. Any such efficiencies may create additional downward pressure on subscriber prices and upward pressure on programming fees.

Merger of an Input Supplier and an Intermediary

Theory. The merger of an input supplier and an intermediary—a vertical merger—also introduces additional considerations, but the same bargaining framework can be used to understand how the integration may affect the input prices the integrated supplier negotiates with now rival intermediaries and the input prices the integrated intermediary negotiates with now rival suppliers.

The integration of a supplier and an intermediary may create upward pressure on the prices the integrated supplier negotiates with rival intermediaries. By selling its input to a rival intermediary, the integrated supplier makes the rival intermediary more competitive, which may decrease the profits of the integrated intermediary. Prior to the integration, the integrated supplier does not consider this effect when negotiating with the rival intermediary. After the integration, the integrated supplier may internalize the effect. This reduces the integrated supplier's gross benefit from contracting with the rival intermediary, creating upward pressure on the price the integrated supplier negotiates with the rival intermediary.[17] For example, suppose Nike purchases Johnnie's. By selling shoes to Jerry's and Sportsman's, Nike makes Jerry's and Sportsman's more attractive to consumers who want to buy Nikes. This decreases Johnny's profits. Prior to purchasing Johnnie's, Nike does not consider this effect when negotiating prices with Jerry's and Sportsman's. After purchasing Johnnie's, Nike may internalize the effect, which reduces Nike's gross benefit from con-

[17] If the reduction in the integrated supplier's gross benefit is large enough, the gains-from-trade could disappear, in which case the integrated supplier might not be willing to contract with the rival intermediary.

tracting with Jerry's and Sportsman's and creates upward pressure on the price Nike negotiates with Jerry's and Sportsman's.

The integration of a supplier and an intermediary may also create downward pressure on the prices the integrated intermediary negotiates with rival suppliers. By contracting with a rival supplier, the integrated intermediary reduces the sales of the integrated supplier, which decreases the integrated supplier's profits. Prior to the integration, the integrated intermediary does not take this effect into account when negotiating with the rival supplier. After the integration, the integrated intermediary may internalize the effect. This reduces the integrated intermediary's gross benefit from contracting with the rival supplier, creating downward pressure on the price the integrated intermediary negotiates with the rival supplier.[18] For example, by carrying Adidas and New Balance, Johnnie's sells fewer Nikes, which decreases Nike's profits. Johnnie's takes this effect into account when negotiating with Adidas and New Balance after its merger with Nike. This effect reduces Johnnie's gross benefit from carrying Adidas and New Balance and creates downward pressure on the price Johnnie's negotiates with Adidas and New Balance.

The merger of a supplier and an intermediary may also affect competition among intermediaries. Post-integration, the integrated supplier may no longer "charge" the integrated intermediary a mark-up. This could improve the integrated intermediary's cost position and enable the integrated intermediary to reduce the price it charges its customers. At the same time, the integrated intermediary may now take into account the effect of lowering its price on the profits the integrated supplier earns selling to rival intermediaries, and this may reduce the integrated intermediary's incentive to reduce its price. For example, Nike may no longer charge Johnnie's a mark-up on Nikes and this could enable Johnnie's to reduce the prices it charges for Nikes. But if Johnnie's reduces the prices it charges for Nikes and therefore sells more Nikes, Nike may make fewer sales to Jerry's and Sportsman's, and this may reduce Johnnie's incentive to reduce the prices it charges for Nikes.

Thus, a merger of a supplier and an intermediary may create upward pressure on the prices the integrated supplier negotiates with rival intermediaries, and downward pressure on the prices the integrated intermediary negotiates with rival suppliers, and could result in intermediaries charging their customers higher or lower prices.

Hospital-Insurer Merger. The merger of a hospital and an insurer may affect the bargaining between the integrated hospital and what are now rival insurers—the merger may decrease the integrated hospital's gross benefit from contracting with rival insurers, and this can create upward pressure on the reimbursement rates the integrated hospital negotiates with rival insurers.[19]

The merger of a hospital and an insurer may also affect the bargaining between the integrated insurer and what are now rival hospitals—the merger may decrease the integrated insurer's gross benefit from contracting with rival hospitals, and this decreased gross benefit can create

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18 If the reduction in the integrated intermediary's gross benefit is large enough, the gains-from-trade could disappear, in which case the integrated intermediary might not be willing to contract with the rival supplier.

19 By participating in a rival insurer's network, the integrated hospital may make the rival insurer a stronger competitor, and this may decrease the integrated insurer's profits. Prior to the integration, the integrating hospital ignores this effect when negotiating with a rival insurer. After the integration, the integrated hospital may internalize the effect. This internalization would reduce the extent to which the integrated hospital benefits from contracting with the rival insurer, which would put upward pressure on the reimbursement rates it negotiates with the rival insurer. If the reduction in the integrated hospital's benefit is large enough, the gains-from-trade could be eliminated, in which case the integrated hospital might not be willing to contract with the rival insurer.

downward pressure on the reimbursement rates the integrated insurer negotiates with the rival hospitals.[20]

The merger of a hospital and an insurer may also affect competition among insurers. Post-integration, the integrated hospital may no longer "charge" the integrated insurer a mark-up. The removal of such a mark-up could improve the integrated insurer's cost position and enable it to reduce the premiums it charges its customers. At the same time, the integrated insurer may now take into account the effect of lowering its premiums on the profits the integrated hospital earns treating enrollees of rival insurers, and this may reduce the integrated insurer's incentive to reduce its premiums.[21]

MVPD-Video Content Provider Merger. The merger of a video content provider and an MVPD may result in the same types of effects as a merger of a hospital and an insurer. The merger may decrease the integrated video content provider's gross benefit from contracting with what are now rival MVPDs, and this can create upward pressure on the programming fees the integrated video content provider negotiates with rival MVPDs. The merger may also decrease the integrated MVPD's gross benefit from contracting with what are now rival video content providers, and this decreased benefit can create downward pressure on the programming fees the integrated MVPD negotiates with rival video content providers. By lowering the integrated MVPD's costs and raising the rival MVPDs' costs, the merger may also affect competition among MVPDs.

Wrap Up

A buyer and supplier should transact when there are gains-from-trade. There are gains-from-trade when the buyer's gross benefit from purchasing from the supplier is larger than the supplier's cost of selling to the buyer. When there are gains-from-trade between a buyer and supplier, a negotiated price will serve to divide the gains-from-trade. A negotiated price will tend to be higher when the buyer's gross benefit is larger, when the supplier's cost is higher, and/or when the supplier is a better negotiator than the buyer.

A merger of suppliers may affect a negotiated price by changing the bargaining stakes—increasing the importance to a buyer of purchasing from a supplier and decreasing the importance to the supplier of selling to the buyer. The impact of a merger of intermediaries on the prices negotiated with input suppliers may depend on the impact of the merger on the prices the intermediary charges its own customers, and vice versa. An intermediary merger therefore may result in either a decrease or an increase in the prices negotiated with input suppliers. Finally, a vertical merger may enable the integrated supplier to negotiate higher prices with rival intermediaries, enable the integrated intermediary to negotiate lower prices with rival suppliers, reduce the prices the integrated supplier "charges" the integrated intermediary, and could result in intermediaries charging their customers higher or lower prices. ●

[20] By contracting with a rival hospital, the integrated insurer may reduce the volume of patients who seek care at the integrated hospital, and this may reduce the integrated hospital's profits. Prior to the integration, the integrating insurer ignores this effect when negotiating with the rival hospital. After the integration, the integrated insurer may internalize the effect. This internalization would reduce the extent to which the integrated insurer benefits from contracting with the rival hospital, which would put downward pressure on the reimbursement rates it negotiates with the rival hospital. If the reduction in the integrated insurer's benefit is large enough, the gains-from-trade could be eliminated, in which case the integrated insurer might not be willing to contract with the rival hospital.

[21] If the integrated insurer reduces its premiums, it may win enrollees away from rival insurers, which means that the integrated hospital may treat fewer enrollees of rival insurers.