Richard Meade Toulouse School of Economics

> IDEI/TSE Energy Conference TIGER Forum, Toulouse

> > 6 June 2014

- Question what are the implications of vertical or horizontal mergers involving vertically integrated firms that make retail supply commitments ahead of wholesale trade?
- Marriage of three literatures:
  - Allaz and Vila (1993) forward trading commits firms to be tougher competitors in subsequent trade
  - Salinger (1988) vertical mergers resolve double marginalisation, but might still increase downstream prices (not even allowing for raising rivals' costs – as in Gaudet and van Long (1996))
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- With symmetric firms, linear demand and constant marginal costs, vertical integration (relative to separation) yields:
  - Lower retail prices
  - Higher wholesale quantities (thus lower wholesale price)
- Full vertical separation is not an equilibrium:
  - One firm increases its profits by integrating
- Horizontal mergers:
  - Can result in lower wholesale price when all firms are integrated
  - If they cause prices to rise, they do so more when all firms are

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- Analyses prices, quantities and profits under vertical integration and vertical separation — in an imperfectly competitive vertical industry:
  - Wholesale/upstream trades homogeneous input produced at
  - Retail/downstream transforms that input 1-1, at zero cost,
  - Consumer i makes discrete choice of retailer i:

$$u_{ij} = \alpha \left( \delta_j - p_i^r \right) + \varepsilon_{ij} \longrightarrow q_i^r = S_j(p^r) N$$

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- Timing and competition:
  - Firms compete differentiated Bertrand in retail market
  - Given resulting retail supply commitments, then compete Cournot in wholesale market
- Timing departure is key:
  - Producer commitment comes from sticky retailing ...

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- Why do we have a wholesale market in this setup?
- How do we motivate sticky retailing in a world of price-comparison and customer-switching websites?
  - e.g. www.energyhelpline.com in the UK helps customers to find cheapest supplier, and to switch "in minutes"
- And what about the impact of real-time pricing? Is there really retail commitment?
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- Also, what about general incentives to integrate? e.g. as in Gaudet and van Long (1996)
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- Answers in Meade (2012) with  $n_u$  upstream and  $n_d$ 
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- Integration with  $n_{\mu} \simeq$  separation with  $n_{\mu} + 1$  (and is
- Separated retailers strategically forward overbuy (SFO):
  - Commits both integrated and separated upstream firms ...

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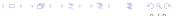
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