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Risk and Fairness in Channel Relationships: Evidence of Behavioral Inconsistencies

INTERVIENE

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ABSTRACT

In channel negotiations between suppliers and retailers there is often significant uncertainty that is unevenly distributed between the two firms. While there is ample evidence in the literature that both risk preferences and fairness would matter in such contexts, there is a lack of evidence on how subjects' beliefs and preferences for risk and fairness interact, leaving open the question of how individuals will attempt to fairly compensate risk that they or their channel partner face. To address the question, we model a wholesale pricing decision between a supplier and a retailer who may not be risk neutral and may care for fairness. We then compare the prediction of the theoretical model with data from two incentive-compatible experiments. We find that suppliers squeeze retailers more when retailers face risk, even though (1) suppliers are not more generous when they face risk themselves, and (2) retailers do not accept worse offers under risk. We show that this behavior is incompatible with preferences for risk and/or fairness in which subjects' beliefs about the other players' preferences are consistent with their actual preferences. Using a structural approach, we then estimate the behavioral parameters and find evidence that suppliers underestimate the risk aversion of retailers leading to significant deadweight losses in situations where the retailer (vs. the supplier) carries the risk.