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“The Effect of Link Costs on the Formation and Outcome of Buyer-Seller Networks”

Abstract

In many settings potential partners must form a link to engage in an exchange. We examine experimentally how bilateral link costs affect the formation of links between a single seller and two potential buyers as well as the ensuing bargaining process. Standard theory predicts that link costs lead to less competitive networks, but that link costs do not affect the bargaining outcomes conditional on the network. We find support for the first but not the second prediction. Conditional on the type of the network, link costs have a significant impact on bargaining outcomes. In particular, link costs induce the seller to ask a lower price in case she faces one buyer but not in case she faces two buyers. These results cannot be explained by inequality aversion, equity theory, or loss aversion. Hence our study falsifies the assumption that bargaining is independent of costs incurred earlier.