Bidding Markets

Paul Klemperer

Edgeworth Professor of Economics,
University of Oxford

Member, UK Competition Commission

paul.klemperer@economics.ox.ac.uk

Bidding Markets

Common submission to a Competition Authority:

Because X is a bidding market …

‘market power is impossible’ — *consultants’ fallacy*

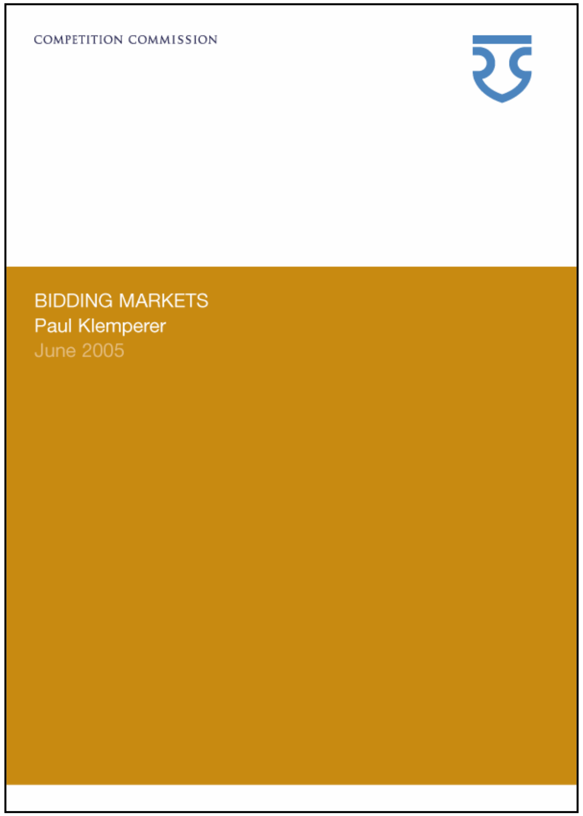
anyway

‘market power is not bad’ — *academics’ fallacy*

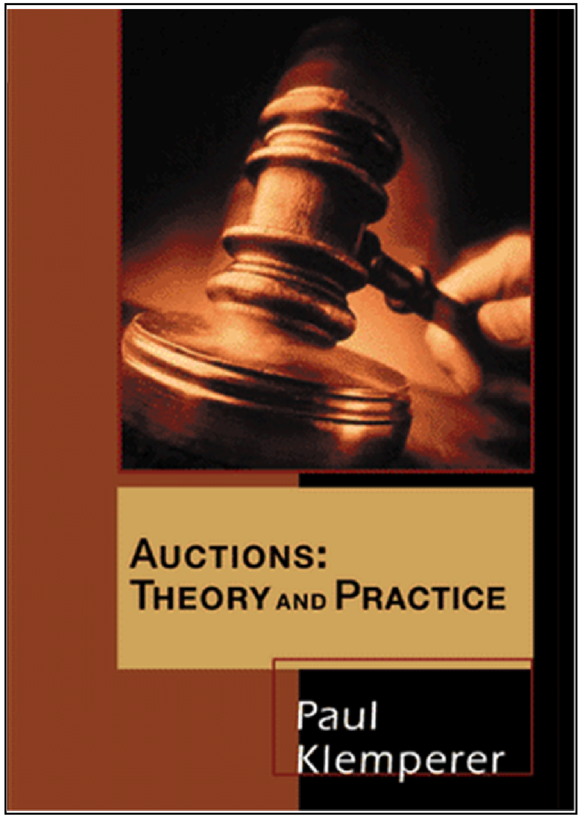
anyway

‘even when market power is bad, regulatory intervention is unnecessary’ — *regulators’ fallacy*

For other issues and more information see:



and



What is a Bidding Market?

"*the [European] Commission described a true bidding market as one where*

'tenders take place infrequently,

while the
value of each individual contract is usually very significant.

Contracts are typically awarded to a single successful bidder (so-called "winner-takes-all" principle).' "

– *Patterson and Shapiro (2001)*

Contracts are typically awarded to a single successful bidder (so-called "winner-takes-all" principle)

Winner takes all

value of each individual contract is usually very significant

Lumpy competition

"Do-or-die"
"Bet your company"

tenders take place infrequently

Every contest begins afresh

"in a pure bidding market…every tender is a new contest to be won solely on the merits of the bid"

"because...is a bidding market there are no switching costs"

What is a Bidding Market?

Winner takes all

Lumpy competition

Every contest begins afresh

Easy entry

“because … is a bidding market,
it is easy for non-incumbents to win contracts”

Involves a “bidding process”

Winner takes all

Lumpy competition

Every contest
begins afresh

Easy entry

Bertrand
(price-setting)
competition

2 IDENTICAL FIRMS ENOUGH

Contestable
market

1 FIRM ENOUGH

‘market power is impossible’

“*in bidding markets, historical market share conveys no market power whatsoever*”

“economists define a bidding market as one in which all suppliers have an incentive to bid at competitive levels”

What is a Bidding Market?

Winner takes all

Lumpy competition

Every contest begins afresh

Easy entry

$$\neq$$

Involves a “bidding process”

	'3G' Auction	Consulting Services	National Lottery
Winner takes all	×		
Lumpy competition		×	
Every contest begins afresh			×
Easy entry			×

UK National Lottery

8 bidders for first franchise period

2 bidders for second franchise period
(same winner)

?? bidders for third franchise period

?? dominance of current operator

?? predation

	‘3G’ Auction	Consulting Services	National Lottery	Electricity
Winner takes all	✗	✓	✓	✗
Lumpy competition	✓	✗	✓	✗
Every contest begins afresh	✓	✓?	✗	✗
Easy entry	✓?	✓	✗	✗

Conditions Facilitating Coordination	Electricity
Few firms	✓
High market transparency	✓
Frequent interaction	✓
Predictable demand and costs	✓
No disruptive innovation	✓
Financially unconstrained firms	✓
Firms committed to market	✓
Standardised product	✓
Similar firms	✗?
Buyers can’t easily self-supply	✓
New entry hard	✓

	'3G' Auction	Consulting Services	National Lottery	Electricity
Winner takes all	✗	✓	✓	✗
Lumpy competition	✓	✗	✓	✗
Every contest begins afresh	✓	✓?	✗	✗
Easy entry	✓?	✓	✗	✗

These bidding processes yield predation and dominance, and unilateral and coordinated effects, for usual reasons.

In a bidding market ….‘market power is impossible’

if “bidding market”

≡ *(All of)* **Winner takes all**
Lumpy competition
Every contest begins afresh
Easy entry

≡ *(Only)* **Involves a “bidding process”**

consultants’ fallacy

⟹ term “bidding market” is unhelpful/misleading

⟹ I will now discuss ***bidding processes***

Bidding processes can exacerbate problems:

Lot 283: Marshalltown		Lot 378: Rochester		Lot 452: Waterloo	
McLeod	USWest	McLeod	USWest	McLeod	USWest
56,000				287,000	
		. . .	. . .		
			568,000		
		689,000			
			723,000		
		795,000			
			875,000		313,378
				345,000	
		963,000			
	62,378		1,059,000		
69,000					

auction rules provide language - rich enough
- not too rich

Conditions for Coordinated Effects

(see EC merger guidelines)

firms must be able to:

1. reach common understanding ✓
2. monitor adherence ✓
3. credibly deter deviations ✓
4. prevent non-participants entering ✓

Auctions and Bidding Processes

Common submission to a Competition Authority:

Because X is a market involving a *bidding process*

- ~~‘market power is impossible’~~
- ‘market power is not bad’

academics’ fallacy

- ‘even when market power is bad, regulatory intervention is unnecessary’

Common-values Mergers

Value depends on others' information

winner's curse: "if I won,

others must have disappointing information"

$\Longrightarrow$ bid cautiously

Merged bidders get more information

$\Longrightarrow$ lower winner's curse

$\Longrightarrow$ bid *less* cautiously

$\Longrightarrow$ merger *benefits* bid-taker!! **FALSE**

true that merged bidder bids *less* cautiously,

but compensates for *smaller* winner's curse

Example

Compare $\begin{cases} v_i = t_i & \text{(pure private values)} \\ v_i = \max\limits_j \{t_j\} & \text{(pure common values)} \end{cases}$

In ascending auction,

revenue $=$ highest t_i not owned by winner

$\Rightarrow$ Common values and private values have *same* implications for mergers

$\Rightarrow$ Winners' curses do *not* eliminate competition problems

Common-values and Entry

Furthermore, common values can discourage entry into ascending auctions …

… and so reinforce dominance and support predation

- e.g. some spectrum auctions

- e.g. BSkyB/Manchester United

(“toehold effect”: merged entity would be advantaged in auction for Premiership TV rights, hence perhaps dominate pay-TV market)

Auctions and Bidding Processes

Common submission to a Competition Authority:

Because X is a market involving a *bidding process*

- ~~'market power is impossible'~~

- ~~'market power is not bad'~~

- 'even when market power is bad, regulatory intervention is unnecessary'

(de)regulators' fallacy

“Buyer Power”

Bid-taker can choose auction form:

clever mechanisms,
reserve prices,
bidding credits,
bundling,
etc.

in theory

Bid-taker Power *in practice*

- Are bid-takers constrained?

- legally	*e.g.* Dutch DCS-1800 auction
- politically	*e.g.* Falck-Wackenhut (prisons)
- organisationally	*e.g.* NAPP (NHS)

- Can bid-takers commit?

- lobbying	*e.g.* Hong Kong 3G auction
- "time consistency"	*e.g.* RJR-Nabisco sale
	BSkyB/Manchester United

Auctions and Bidding Processes

Common submission to a Competition Authority:

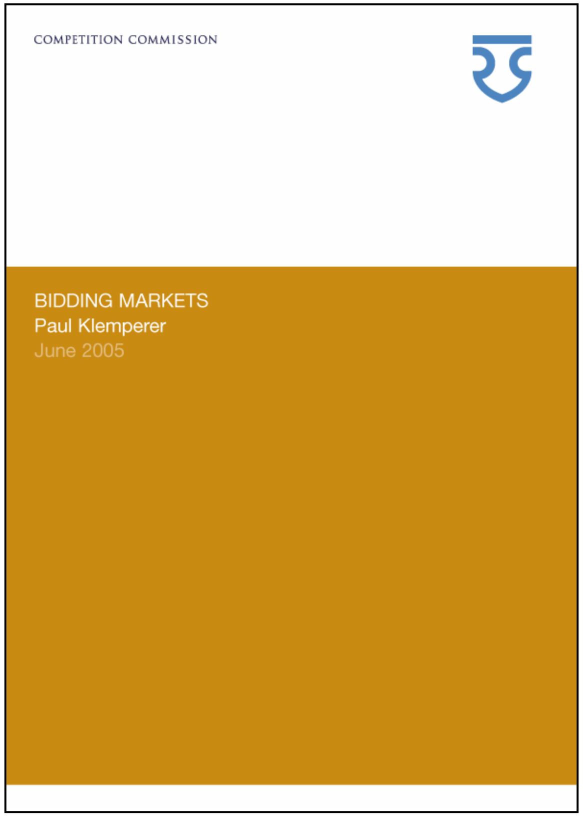
Because X is a market involving a *bidding process*

- ~~‘market power is impossible’~~

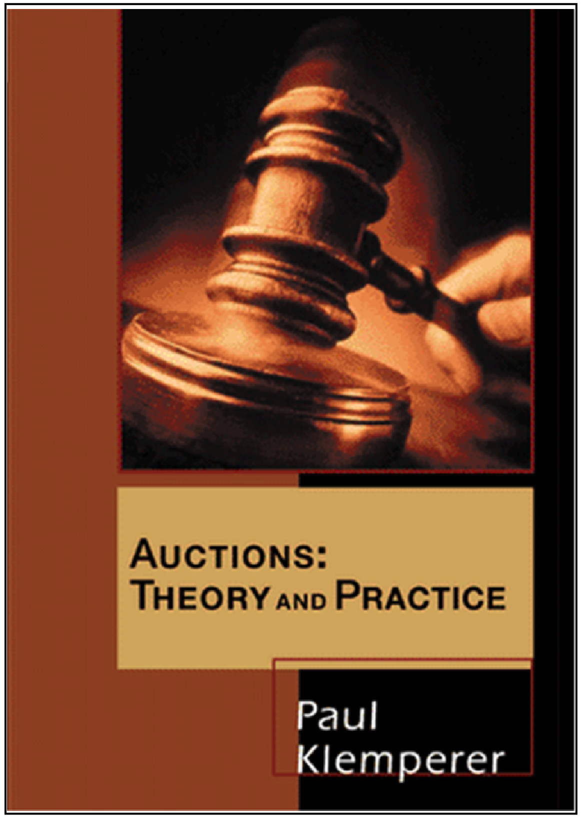
- ~~‘market power is not bad’~~

- ~~‘even when market power is bad, regulatory intervention is unnecessary’~~

For other issues and more information see:



and



Conclusions

- Term “bidding market” is unhelpful and misleading
- 3 common fallacies about markets characterised by auctions and bidding processes:

Consultants’ fallacy

‘market power is impossible’

Academics’ fallacy

‘market power is not bad’

Regulators’ fallacy

‘even when market power is bad, regulatory intervention is unnecessary’