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Entry Detering Effects of Contractual Relations in the Dairy Processing Sector

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Gesellschaft für Wirtschafts- und Sozialwissenschaften des Landbaues e.V.

**„Wie viel Markt und wie viel Regulierung
braucht eine nachhaltige Agrarentwicklung?“**

Berlin, 25.-27. September 2013

Background & Objective

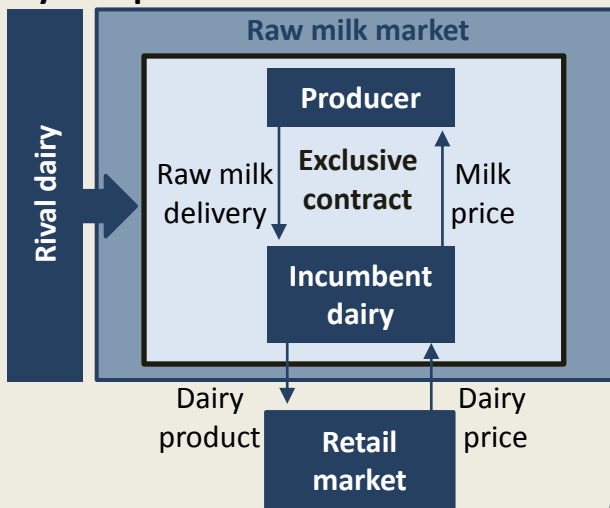
- Milk package: Compulsory contracts with exact specification
- Sector inquiry: Contracts may have anticompetitive effects
- Empirical studies: Farmers prefer
 - Short cancellation periods
 - Possibility to change processors

Objective

Effects of **exclusive contracts** on

- Competition in terms of prices and profits
- Entry of competing processors

Stylized problem statement



Model set-up

Game theoretic model

Assumptions

- Marginal costs: $MC \text{ Rival} < MC \text{ Incumbent}$
- Risk averse producer
- Fixed retail price

Scenarios

1. Basic monopsony situation
2. Rival's market entry situation

Timing

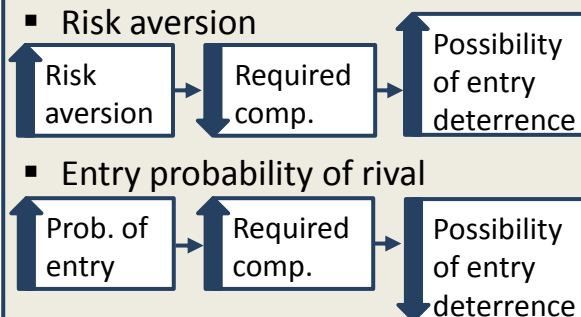
1. Incumbent dairy offers exclusive contract to producer, producer decides whether to accept
2. Rival decides upon entry, price competition

Exclusive contract

- Delivery obligation
- **Producer compensation** for signing, depending on
 - Risk aversion of producer
 - Entry probability of rival
- Required compensation affects possibility to deter entry

Results & Conclusion

Effects on producer compensation



Effects on market actors

- Incumbent dairy: higher profit in monopsony situation
- Producer: higher profit in entry situation

Conclusion

- Contracts may deter entry to raw milk market when producer is risk averse

Implications for contract design

- Consider entry det. effects
- Consider findings from empirical studies
- Short termination clauses to ensure farmers flexibility and a competitive raw milk market