

# Negotiation with Dominant Supplier: Power Determination, Partnership, and Joint Buying

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## Abstract

A power imbalance between the market-dominant supplier and the buyer occurs because the former has more strength and leverage to persuade the latter to come closer to their bargaining stance. Analyzing the negotiating power impacts the success rate of negotiation. This study argued that a formal analysis to determine the negotiating power of a dominant supplier must be performed before structuring negotiation strategies. This study explores various ways to determine the power of a supplier such as The Herfindahl-Hirschman Index, profit rate, and Lerner Index. The study also discussed managing and improving partnerships with a powerful supplier in planning, investment, and profit-sharing. However, when a relationship with a powerful supplier is unbalanced and against the interests of the buyer firm, a partnership with other buyer firms emerges as the last resort to combat the power of suppliers. We discussed how different the forms of the buyer's cooperation such as joint buying and buyer's cartel can decrease the negotiation power of a dominant supplier.

**Keywords:** *Buyer's cartel, Dominant supplier, Joint buying, Market power, Partnership*

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**Article type:** Research article  
**Keywords:** *Buyer's cartel, Dominant supplier, Joint buying, Market power, Partnership*  
**JEL codes:** G20: General; G29: Other

Received: 15 October 2017    Revised: 30 November 2017    Accepted: 03 December 2017

## Suggested citation:

Vafin, A. (2017) 'Negotiation with Dominant Supplier: Power Determination, Partnership, and Joint Buying', *International Journal of Contemporary Financial Issues*, 2(1), pp. 51–63.

## 1. Introduction

Suppliers have a direct influence on the goods and services of a company. This might include things like labor, promotion, delivery, raw materials, and so forth (Chapman and Carter, 1990). A corporation wishing to acquire assumes the position of the buyer, while the supply assumes the role of the seller. Suppliers' power means the capacity to control pricing, delivery dates, accessibility, and even the reliability of the things they provide (Lacoste and Blois, 2015). Any supplier manipulation has a significant impact on the profitability of a corporation that depends on other businesses to meet operational demands.

When a firm's suppliers have a heavy influence on the value chain, it may have a big impact on how the company treats its own consumers. A corporation may have to accept the supplier's influence via product pricing, product quality, and quantity available, depending on the supplier's choice (Singh and Power, 2009). A company's ability to continue in business may be jeopardized if there is too much disturbance in any of these areas. To avoid being controlled by the whims of a supplier, a firm, sometimes, may need to shut down or relocate to a different sector (Gelderman, Semeijn and De Zoete, 2008) (Kähkönen, 2014) (Meehan and Wright, 2012).

Increased expenses are frequently the first concern that a firm faces when dealing with a strong supplier (Hajmohammad and Vachon, 2016) (DeGraba, 2013). A supplier who realizes they can not be fired may insist on boosting raw material costs too quickly or ahead of agreed-upon deadlines. If the buyer has no option but to pay these rates, the resulting increase in overall production costs must be borne by the firm or passed on to the customer. If the company's profit margin does not enable it to sustain this pressure, market prices will rise. This move may not be well received by the target market, and sales may suffer as a result. Another unfavorable effect might be the loss of clients to a rival product or substitution (Li, Sheng and Liu, 2010). If a supplier refuses or is unable to achieve volume objectives, the firm may be forced to cope with demand that exceeds supply (Tangpong *et al.*, 2015).

There may be instances when the supplier chooses to sacrifice product quality in order to save money. If the quality concerns are severe enough to affect user experience, this will have a direct influence on the company's product line and may have a detrimental impact on the end customer. There may be an upsurge in complaints, refunds, and exchanges, as well as, in the worst-case scenario, a complete switchover to a different product (Kimungu and Maringa, 2010; Hu, Rabinovich and Hou, 2015).

The spectrum of supplier power, like buyer power, varies by industry and through time. A supplier power study, in general, comprises the following sector factors: First, a limited negotiating power when there are numerous suppliers and few purchasers. Many enterprises that rely on one or two suppliers, on the other hand, eventually increase the negotiating strength of those distributors (Tang, 1999). Second, the sales percentage defines how important a company is to the provider. Suppliers will be less eager to discuss conditions if just a small proportion of revenue is involved. At the same time, the customer will be forced to agree because they require this delivery (Choi *et al.*, 2002). As a consequence, the buying power of suppliers increases. Alternative suppliers from whom a corporation may get the needed items are referred to as substitutes. Having a variety of options reduces reliance on a single source, weakening supplier power. However, if a company's alternatives are restricted, its present suppliers may be able to exercise significant negotiation pressure (Terpend, Tyler and Krause, 2008).

The kind and quality of items supplied are affected by the material shortage. If a company's manufacturing line relies on just one supplier for the correct quality of input, any shortfalls or timetables will have a substantial influence on the final product (Leitzel, 1994). As a result, supplier power increases. Any demand for short-term things strengthens supplier power since corporations can not keep large amounts of such items in their warehouses in case of supply interruptions. Moreover, the expense of switching providers is represented by switching costs. High switching prices force most businesses to continue with their present suppliers, whereas the low cost of change allows them to be more flexible (Murugkar, Ramaswami and Shelar, 2007).

Suppliers may have additional influence as a result of the following factors (Park, 1967; Sherman, 1989; Haan, 1998; Sheng, Zhao and Yang, 2015; Browning and Zupan, 2020):

If there are a lot of them in comparison to purchasers.

If moving to a different provider comes with hefty switching costs.

If they can integrate forward or start manufacturing the product on their own.

If they have the necessary skills or technology to produce things.

If their product has a lot of unique features.

If there are a lot of purchasers but none of them account for a major amount of sales.

If no other options are available.

If there are powerful end-users who can influence the organization in a supplier's favor (This can be the case in labor situations).

Suppliers have strong negotiating power in all of these circumstances, allowing them to demand premium pricing and establish their own timetables.

Similarly, suppliers' negotiating power is limited when:

There are a small number of customers and a large number of providers.

Buyers are not reliant on providers to deliver products and services.

The goods on sale are not unique.

The expenses of switching providers are modest.

There are substitutes available.

In terms of income, suppliers are reliant on the size of a customer.

## 2. Quantifying the dominance of dominant supplier

One of the basic and popular methods is the concentration ratio. A concentration ratio is a ratio of a company's market shares to the total market size in economics (Krivka, 2016). This ratio also compares the size of a corporation or organization to the size of the market as a whole. The Herfindahl-Hirschman

Index is the most often used method for calculating market concentration (HHI). This index is computed by multiplying the square root of each firm's percentage market share in the industry (Weinstock, 1984). If the market had a monopoly, the index may soar to 100 points. However, when the index falls, the market becomes more competitive. For the ideal competition, the indication may reach zero.

The Herfindahl-Herschman Index (HHI) is also used to calculate the size of a company by squaring the percentage share of each company in the industry and adding the results (Naldi and Flamini, 2014). The HHI is sometimes seen as a more accurate predictor of market concentration. The concentration ratio is a key indicator of whether a market or sector is monopolistic, oligopolistic, or has good competition between competitors. It refers to how tightly a few giant corporations dominate a market or sector. For example, if a business's concentration ratio is almost 100 percent, it shows that it is the only visible company and runs a monopoly. On the other side, if all businesses have a low concentration ratio, the market is competitive (Hall and Tideman, 1967). The market share of the four biggest businesses is compared to the total market or industry when a four-firm concentration ratio is utilized. If the five-firm concentration ratio increases from 40% to 60%, it indicates a reduction in competitive pressures (Geithman, Marvel and Weiss, 1981); (George, 1975). It may result in increased consumer pricing. A monopoly is defined as a company having a market share of more than 25% (Baskin, 1987). Any company that crosses this line has a significant market position.

There is more possibility for collaboration and abuse of monopolistic power if the three-firm concentration ratio is larger than 80% (Hogan and Jeter, 1999); (Durnev and Kim, 2005). In some sectors, the government may need to enlist the help of a regulator to ensure that monopolistic power isn't exploited. For example, if the market is controlled by a few small enterprises, the government has a regulator for railroads, electricity, and gas (Pittman, 1976). Varied sectors have different levels of company concentration. It might be due to the product's nature, its restricted availability, or the fact that a certain nation or country owns the bulk of the natural resources necessary for the product. The concentration ratio aids in comprehending the industry's nature. The industry may be controlled by a few companies, or there may be a lot of rivalries.

Another approach to identifying the power of suppliers is the rate of profits. J.S. Bain utilized profit rate as a monopolistic power indicator (Bain, 1941, 1951). Economists define high profits as returns that are sufficiently greater than all opportunity costs that prospective new entrants want in order to join the sector. The amount of super-normal earnings a company can make is a measure of its monopolistic power. A business generates only normal profits under ideal competition. New entrants will not generally compete away monopoly earnings in a monopoly. However, there will be a certain level of profit at which new enterprises will consider it worthwhile to take the risk of breaking the monopoly. The bigger the monopolist's position, the more profits he can make without recruiting new competitors. In summary, neither the concentration ratio nor the profit rate is perfect indicators of monopolistic power, yet both have some utility and are extensively employed.

A.P. Lerner proposed the Lerner Index (Lerner, 1934), a monopolistic power metric, that has received a lot of traction and is often mentioned in the literature. Lerner uses perfect competition as a starting point for calculating monopolistic power. Pure or perfect competition, he believes, is the condition of social optimum or maximum welfare, and any divergence from it indicates the existence of monopolistic power, which leads to resource misallocation or a state that is less than ideal.

In perfect competition, the price is equal to the marginal cost of the item in the equilibrium position. And it is under perfect competition that price equality with marginal cost promotes maximum welfare spending or optimal resource allocation. When competition isn't ideal or pure, a firm's demand curve will slant downward, and the marginal revenue curve will be below it. As a result, in a seller's equilibrium position, when competition is less than perfect (perfect), that is, when it is imperfect, marginal cost will equal marginal revenue, but the price will be greater than marginal cost or marginal revenue. According to Professor Lerner, this difference between pricing and marginal cost is evidence of monopolistic power. The bigger the price-to-marginal-cost gap, the stronger the seller's monopolistic power.

$P - MC/P =$  monopoly power degree (Elzinga and Mills, 2011)

Where P stands for price and MC stands for marginal cost at the equilibrium production level.

When competition is complete or pure, price (P) equals marginal cost, and Lerner's index of monopoly power equals zero, showing no monopoly power at all, since when price equals marginal cost,  $P - MC$  equals zero, and the preceding calculation yields a value of zero. Lerner's monopolistic power index =  $(P - MC/P) = 0/P = 0$  under perfect competition (Hindriks and Myles, 2013). The marginal cost will be equivalent to 0 and Lerner's index of monopolistic power  $(P-MC/P)$  will be equal to one or unity when the monopolized product has no production costs, that is when the commodity is a free commodity whose supply is dominated by one individual.  $P - MC/P = P - 0/P = P/P = 1$  when MC is equal to zero (Pepall, Richards and Norman, 2014) (Karier, 2016).

### **3. Improving/managing relationship with suppliers//partnership with supplier**

Companies understand that concentrating just on the price of the items and services they acquire will restrict the value they can produce. These businesses recognize that when sellers and buyers are ready and able to work together, they can frequently uncover large new sources of revenue that benefit both parties. For example, buyers and suppliers might collaborate to produce inventive new items, increasing revenue and profits for both sides. They may take a holistic approach to supply-chain efficiency, revamping their operations together to eliminate waste and duplication of effort, or procuring raw materials collectively (Srinivasan, Mukherjee and Gaur, 2011). Alternatively, they may work together to improve service levels, mitigate risks, and strengthen the integrated supply chain by collaborating on predicting, budgeting, and capacity management (Agus and Hassan, 2008).

Buyers can be involved in a partnership with the powerful supplier in Investments. There are funds available to bring innovative items or skills to market. The success of the project will be determined by the proper allocation of resources and investment by all parties involved. This does not always imply that the investment quantities are identical. It is also possible that the financial benefit gained by both firms in this collaboration is not equal (Gallear, Ghobadian and He, 2015). Regardless, all parties must commit to the vision, strategies, and goals by investing the necessary financial and human resources and being committed to the mission (Lettice, Wyatt and Evans, 2010).

Partnership with a powerful supplier in planning and management systems can also bring benefits to the buyer firm. Both organizations must approach their combined efforts with a vision and strategy that are harmonized, and the specific plans must be harmonized as well. Plans define the resources involved, the important activity milestones, and the roles and obligations of both parties (Mirani, Moore and Weber,

2001). Both parties, in this situation, are fully committed and interested in the whole strategy for it to be successful (Ounnar, Pujo and Mekaouche, 2007). A management system should include regular company evaluations. To achieve alignment at all levels of the organization, include them in the relationship strategy.

Both the buyer firm and the dominant supplier can partner in risk management (Lam, 2003; Hopkin, 2013). Every business effort involves some level of risk. When two businesses join together to conduct business, they take on additional and shared risks (Salazar, 2017b, 2017a). Some of these characteristics are exclusive to their industry or market, while others are common by the fact that they are working together to achieve success. It is vital that both partners recognize these dangers and communicate openly with one another. An open and straightforward relationship will provide both parties the insight they have to deal with dangers as they arise without damaging the connection.

Additionally, the buyer firm can engage in partnership with a powerful supplier firm in profit. Winners produce more winners. In the long run, market success must be shared throughout the whole value chain. The most successful supply chains will have tight, vested, and mutually beneficial connections at the top levels of the provider hierarchy (Ojala and Hallikas, 2006; Thomas and Fugate, 2011). A more mutual benefit will be generated by successful partnerships than by less-successful collaborations. When everything is constructed correctly, there is less risk of subsequent disagreements about who received what and who didn't. Growth in market share, access to technology, increased profitability, and other benefits are instances of what each side might gain.

The accurate value of partnership with a powerful supplier may be difficult to evaluate, particularly when organizations are also pursuing more traditional procurement and supply-chain optimization techniques with the same vendors, or when they are upgrading product designs and manufacturing processes at the same time. Even when firms have the desire to seek larger levels of supplier cooperation, executives often state that they lack the necessary skills, lack the frameworks to develop outstanding supplier-collaboration programs, and lack the personnel to manage them. Essentially, excellent supplier cooperation needs much more than just following a procedure or structure; it necessitates the long-term commitment of leadership and decision-makers.

#### **4. Buyer's cooperation to combat dominant supplier**

The bargaining position of a purchaser with relation to its supplier(s) of products or services is referred to as buyer power. The buyer, acting alone or in concert with other buyers, may lower the purchase price of its input below the supplier's regular selling price, up or down a competitive level, using purchasing techniques. There are two sorts of buyer power: monopsony influence, which indicates a withholding effect and is inefficient, and is named the opposite of monopoly power; and negotiating (or countering) power, in which strategies other than withholding may be employed to the buyer's advantage to decrease the input's price. If there is competition in the retailing industry, supra-competitive profits held by the supplier are passed on to the buyer and finally to the end consumers, boosting welfare.

Monopsony power depicts a scenario in which a single buyer exists and the supply side of a market is completely competitive (Mühlemann, Ryan and Wolter, 2011). The buyer will use its market power to reduce the price levels it spends for a good/service below the amount that would exist in a competitive market by suspending purchases (i.e., buying less) (Blair and Harrison, 1992). By refusing to negotiate on price, the buyer sets a purchase price it is prepared to pay for the input. The monopsonist buyer emerges

as a price-maker in this situation. The flipside or mirror image of monopoly power is this method to buyer (monopsony) power. Monopsony is only conceivable when the buyer is confronted with an upward-sloping supply curve, meaning that the marginal unit gets costlier as more are purchased (Ashenfelter and Farber, 2010). Monopsony power also means that suppliers sell under their marginal costs; if this is the scenario, suppliers will be forced out of the market. Monopsony is an uncommon occurrence. Buyers often strive to exercise their buying power not by reducing purchases but by securing better terms.

The bargaining power of buyer firms refers to a buyer's strength in bilateral talks with its supplier (s). By threatening to purchase products from a different party or just having the upper hand in the discussion, the buyer might extract a concession (be it in the shape of price and/or non-price conditions) from the supplier (Bachmann, Demir and Frings, 2021). Bargaining power, unlike monopsony power, does not include withholding demand or obtaining items at a lower price than the market price. Instead, it boosts commerce and balances out seller market power by shifting supra-competitive gains from suppliers to sellers, which may then be passed on to end-users. This is because buyers can only utilize negotiating power if the price is higher than the supplier's marginal cost. As a result, bargaining power tends to improve welfare, which is why there are rarely anticompetitive instances involving this kind of purchase. Bargaining power, on the other hand, may pose anticompetitive issues, which are often tied to exclusionary consequences.

Negotiating power is often utilized as a pro-competitive argument to defend behavior and make it compliant with competition laws (Gomes-Casseres, 1996). Buying alliances that pool buyer power, resulting in lower input prices and higher output, are prime examples of this situation (Kettl, 2011). Countervailing buyer power is the capacity to adequately neutralize opposite market power based on the buyer's negotiating strength in a commercial partnership. Despite the fact that it is often used, reality demonstrates that achieving the sufficient prerequisites for countervailing buyer power to successfully prohibit seller market power exertion is unusual.

### Buyer's Cartel

A cartel is a group of nearly identical individual companies that, rather than trying to compete with other companies in the industry, enter into collusive contracts to engage in operations such as price-fixing, trying to fix the manufacturing or supply of specific products, or dividing market share or clients between/among themselves (Marshall and Marx, 2014; Harrington and Jr., 2017). Such individuals are referred to be cartel members since they rely on one another and work on previously agreed-upon terms and conditions.

The deployment of cartel power varies based on the members' aims and interests, but also, and significantly, on the structure of the supply side. If supply is substantially price-inelastic, conspiring purchasers have a strong incentive to push down the price as it will not considerably restrict input supply. In other circumstances, supply may be more price elastic, and lowering prices would result in insufficient supply; nevertheless, buyers can still utilize their collective bargaining power to persuade their suppliers to differentiate in price or reject to engage with new competitors or marginal customers (Blair and Daniel Sokol, 2015; Telser, 2017). Therefore, supply elasticity will impact a cartel's operations but may not change its aims.

Buyers' groups are people that pool their purchasing power to get a competitive advantage in the market (Alger, 1999). These organizations, like buyers' cartels, work in concert, but the goal of a buyers' group is to reap the benefits of a joint venture, such as lower transaction costs, per unit expenses, protection against defective items, and so on (Wu and Chiu, 2016). Buyer cartels, on the other hand, solely coordinate their purchases to dominate sellers, limiting competition. Demarcating the two is sometimes a difficult undertaking, demanding a case-by-case approach.

A buyer's joint efforts can create a bilateral monopoly in the market and can decrease the power of a powerful supplier (Blair and Harrison, 1991). A bilateral monopoly is a market system in which there is only one supply and one customer (Howe, 1982). In a market, a bilateral monopoly is a result of combining a monopoly (a single supplier) with a monopsony (a single buyer). When there is market confinement, that is, when there are a restricted number of market players or when the expense of exploring alternative providers is more than the cost of remaining with one. Both the buyer and the seller selling in a bilateral market to maximize earnings. While the seller is more likely to inflate product prices since he is the sole supplier, the buyer will likewise haggle for the lowest price because the seller has no alternative customer. In a market, a bilateral monopoly/oligopoly occurs when there is only one (or a few) buyer(s) and the seller(s) of a specific commodity. The degree of concentration in the product sale or purchase results in mutual interdependence between the seller(s) and the buyer (s).

## 5. Conclusion

Raw materials are required by all industries as inputs to their processes. For some, this comprises labor, while for others, it includes parts and components. This is an important role that requires good connections between buyers and sellers. If there are few suppliers, or if they have certain capabilities and expertise, they may be able to exert substantial influence over the sector. The percentage of total market sales dominated by the biggest group of sellers is referred to as the concentration ratio. The inclusion of numerous businesses' market shares in the concentration ratio is based on the probability that big firms may adopt a common price-output strategy that isn't all that different from what they would adopt if they were all managed by the same person. However, there is a risk that they will not be able to do so. As a result, although a high concentration ratio may be required for monopolistic power to be exercised, it is not sufficient. This research asserted that before developing negotiation tactics, a formal examination of a dominating supplier's bargaining strength should be conducted. This study explores numerous methods for determining a supplier's power, such as the Herfindahl-Hirschman Index, profit rate, and Lerner Index. The research also explored how to manage and improve relationships with a large supplier in terms of planning, investment, and profit-sharing. However, when a relationship with a dominant supplier becomes imbalanced and works against the purchasing firm's interests, a partnership with other buyer businesses arises as the final choice to challenge supplier influence. We examined how various kinds of buyer collaboration, such as joint purchasing and buyer cartels, might reduce a dominant supplier's negotiating position.

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