Entry Deterring Effects of Contractual Relations in the Dairy Processing Sector

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Entry deterring effects of contractual relations in the dairy processing sector

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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

Model set-up
**Assumptions**
- Marginal costs: MC Rival < MC Incumbent
- Risk averse producer
- Fixed retail price

**Scenarios**
1. Basic monopsony situation
2. Rival’s market entry situation

**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**
  - Risk aversion
  - Entry probability of rival
- **Effects on market actors**
  - Incumbent dairy: higher profit in monopsony situation
  - Producer: higher profit in entry situation

Objective
- Stylized problem statement

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Timing</th>
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<tbody>
<tr>
<td>1. Basic monopsony situation</td>
<td>Incumbent dairy offers exclusive contract to producer, producer decides whether to accept</td>
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<tr>
<td>2. Rival’s market entry situation</td>
<td>Rival decides upon entry, price competition</td>
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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