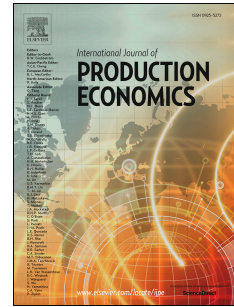


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Ambiguity Aversion in Buyer-Seller Relationships: A Contingent-Claims and Social Network Explanation

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Abstract

Negotiations between buyers and sellers (or suppliers) of goods and services have become increasingly important due to the growing trend towards international purchasing, outsourcing and global supply networks together with the high uncertainty associated with them. This paper examines the effect of ambiguity aversion on price negotiations using multiple-priors-based real options with non-extreme outcomes. We study price negotiation between a buyer and seller in a dual contingent-claims setting (call option holding buyer vs. put option holding seller) to derive optimal agreement conditions under ambiguity with and without social network effects. We find that while higher ambiguity aversion raises the threshold for commitment for the seller, it has equivocal effects on the buyer's negotiation prospects in the absence of network control. Conversely when network position and relative bargaining power are accounted for, we find the buyer's implicit price (or negotiation threshold) decreases (or increases) unequivocally with increasing aversion to ambiguity. Extending extant real options research on price negotiation to the case of ambiguity, this set of results provides new insights into the role of ambiguity aversion and network structures in buyer-seller relationships, including how they influence the range of negotiation agreement between buyers and sellers. The results also help assist managers in formulating robust buying/selling strategies for bargaining under uncertainty. By knowing their network positions and gathering background information or inferring the other party's ambiguity tolerance beforehand, buyers and sellers can anticipate where the negotiation is heading in terms of price negotiation range and mutual agreement possibilities.

Keywords: buyer-seller relationships; real options; supply networks; social networks; multiple-priors; ambiguity

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