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Trading partner choice and bargaining culture in negotiations☆

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ABSTRACT

In negotiated transactions the act of choosing trading partners and "who chooses" creates a bargaining culture that influences trading behavior. Results are presented from experimental markets in which paired buyers and sellers negotiate the repeated sale of units. Relative to a market environment in which traders are randomly matched, choosing a trading partner increases the number of units exchanged and lowers negotiated prices. Collective seller earnings suffer. Who does the choosing, that is, whether buyers select sellers or sellers select buyers, further impacts prices and therefore relative earnings. Those choosing tend to be disadvantaged.

1. Introduction

In many negotiated transactions, there is the practice of buyers announcing that they seek potential sellers. This puts sellers in the position of choosing buyers. Likewise, in some markets there is the practice of sellers announcing they are available to buyers for negotiated sales; in this setting buyers choose sellers. In labor negotiations, for example, it is a matter of practice for employers to choose with whom to bargain, but in some markets employees announce their availability and choose potential employers. In the sale of housing it is usually the seller who seeks a buyer, and the buyer decides with

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whom to commence negotiations. In agricultural land rental markets those seeking to lease land often choose the lessor of the land. In the sale of commodities, we observe consistent practices in some markets of buyers approaching, or choosing, the sellers of grains (malt barley, for example); and in other markets, sellers approach or choose buyers (as in the sale of cattle). We view auto dealers as sellers ready to negotiate with buyers, and buyers choose whom to approach. We believe most negotiated transactions are initiated by either a buyer seeking and choosing a willing seller or a seller seeking and choosing a willing buyer.[1]

When same or similar items are traded over a period of time, traders acquire information about the bargaining style of counterparts. Reputations and expectations are formed, and based on bargaining style, sellers may prefer certain buyers, and buyers may prefer certain sellers. When compared to random matching of agents, choosing with whom to bargain has a potential to impact bargaining outcomes because agents are purposefully brought together. In a laboratory market setting this paper investigates how choosing a bargaining partner affects prices, quantities traded, relative earnings, and total earnings. While random matching tends to move traders toward the predicted equilibrium price in the market, we find that choosing a bargaining partner creates equilibriums with relatively lower prices and larger quantities sold.

Paired traders, privately negotiating a transaction, lack information regarding the experiences of other traders in the market discovering price. Pairs receive restricted signals from their respective trading partners such as initial bids or offers, counteroffers, and the time it takes to reach agreement. Observation of such signals impacts expectations and responses. In this paper a “bargaining style” is characterized through greedy (generous) initial offers/bids and patience (impatience) exhibited in making counteroffers. Together, these two traits decide initial bids and offers, speed of trades, and the eventual price negotiated for each trade. Our contention is that partner choice facilitates the creation and evolution of individual bargaining styles that form a bargaining culture.

We posit that a bargaining culture is bounded by the rules of the trading institution, and once trading rules are in place, a bargaining culture further defines the norms of accepted behavior. Different cultures may (and do) develop within trading institutions, but we argue that a negotiation trading institution coupled with partner choice creates a unique bargaining culture. In laboratory bargaining experiments we find that the act of choosing a partner as well as “who chooses” creates a bargaining culture that is different than when traders are randomly matched. Randomly matched traders tend to make opening bids and offers that bracket the predicted equilibrium price (80 tokens in our experimental design) as the midpoint, and negotiated prices tend to go to this midpoint.

When there is choice of trading partners, the average opening bid from buyers and the average opening offer from sellers shifts downward, which leads to lower negotiated prices overall; and even though all opening bids posted by buyers decline, they are relatively higher when buyers choose sellers and relatively lower when sellers choose buyers. Also, while the act of choosing a trading partner lowers all opening offers, sellers do not seem otherwise affected by whether sellers or buyers choose. Thus choosing affects initial bids and offers of buyers and sellers differently.

Trading pairs also trade more quickly and more units are traded when one partner chooses the other. Impatience to complete the transaction and move on to the next trade is consistent with more generous initial bids and offers. Impatience is reflected in the way traders make counteroffers after their initial openings. An impatient trader will counter more frequently and give up more with each counter. Generosity and impatience move a market toward lower trade prices and more units traded; collective buyer earnings are augmented. In contrast, sellers do much better in a randomly matched bargaining environment.

We believe when agents can choose with whom they bargain, a culture emerges in which they seek counterparts with a desirable bargaining style – these are people who will make generous initial bids or offers and move relatively quickly (impatience) on reaching agreement. Desirable trading partners are willing to give up surplus on a single transaction in order to negotiate on more units overall. However, relatively greedy and slow traders can capture more surplus on a single unit. Because of these opposing incentives buyers and sellers experience a natural tension over the pace of trading. A person who trades slowly forfeits potential surplus on future trades in a repeated setting within a defined trading window. When haggling over the price of an item a trader must evaluate the opportunity cost of foregoing future transactions, but for any discount factor traders seek a match with someone who puts a greater value on future transactions (Muthoo, 1999, Chapter 10).

Below we give more attention to the choosing paradigm in order to explain what is important to traders when they select counterparts with alternative bargaining styles. Four simple styles are suggested, through traders being generous versus greedy and impatient versus patient. From these traits an agent can create and communicate a bargaining style. It is suggested that choice of a trading partner facilitates bargaining styles and overall bargaining culture such that bargaining outcomes are different in a choose environment than in an environment in which traders are randomly matched.

[1] No example will perfectly match our laboratory design of a buyer choosing or seller choosing. In practice we recognize that the act of choosing (or matching) may be clouded by how the pool of buyers and sellers is created. In labor markets, for example, a pool of sellers may choose a buyer, from which the buyer then chooses with whom to negotiate. In this case there are multiple levels of choosing.