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“Vertical Market Power” in a Systemic Concept of Market Power

abstract

Highlights of Baum J., 2004: Vertical Market Power - The relevance of up-stream and down-stream concentration to the performance of industries with special regard to Austrian data:

In the core of (former) standard industrial economics there are concepts of determining the performance of industries (empirically defined by some proxies for profit rates) by market power. The market power is measured usually by an index of (horizontal) concentration of the industry. In an general framework this would be only one story and there are some critical points on this procedure - but it is a relevant story.
So it does make sense to generalize these “classical” market structure – performances analyses. Here ***a systemic concept of market power*** *is developed: not only an index of horizontal concentration of the industry is controlling for the performance but also the concentration in up-stream and down-stream industries and also the performance in these industries. So the horizontal concentration is only one element of market power relations of industries.*
In the traditional theoretical-empirical literature – rarely – we find elements of vertical market power – referred to as “buyer power”, “buyer/seller/supplier concentration”, and “vertical organization”. Combining such elements a scheme for systemic market power including vertical market power was developed classifying horizontal concentration as an important special case of concentration. Additionally there were introduced indicators for the relevance of input and output industries (proxies for possibilities of substitution) and trade variables (export an import.

This concept was used for the econometric analysis of industry performance using Austrian cross industry data. Evidence was found for a negative impact of vertical market power (up-stream and down-stream concentration) on industry performance. These results have still more weight, as available data originate from years of upswing when (vertical) market power tends to be less effective due to a more dynamic demand.
Stylized facts of the (performance) indicators show an atypical situation for 1976 : Without consideration of calculatory “employer’s salary” the price-cost-margins of the higher ranked firms within industries in this year were generally less than those of smaller firms. After 1976 this pattern reversed: coherently the

gaps of the price-cost-margins of the four largest firms clearly increased in relation to the rest of the industry between 1976 –1983 – 1988.

Often negative and varying signs of horizontal concentration vanished when vertical market power was included, and when the industry profits were corrected by the calculatory "employer's salary", which has to be calculated especially for small firms: A positive effect of horizontal concentration on performance can mostly be observed when the indicators for vertical market power are used also as explanatory variables and when the industry profits are corrected by calculatory "employer's salary"

*Full text online in German:
http://www.purkersdorf-online.at/lib/arbeiten/dissertation-oekonomie.doc