Cost Coordination

Joe Harrington

Abstract :
When firms engage in price discrimination under competition, they can face a trade-off when choosing to collude. In order to maintain price discrimination, upper-level executives may have to involve those lower-level employees with the demand information needed to tailor prices to markets and customers. However, that comes with an enhanced risk of the cartel's discovery. Alternatively, those executives could centralize pricing authority and coordinate on a more uniform price but that means foregoing some of the profits from price discrimination. Here we put forth a third option which is for upper-level executives to coordinate on inflating the cost used in pricing by lower-level employees. Coordinating cost reports is shown to be more profitable than coordinating prices when market heterogeneity is sufficiently great or firms' products are sufficiently differentiated. Recent cartel episodes in which executives coordinated list prices or surcharges are explained to have some of the crucial features of this collusive scheme.