

The role of decision rights in incomplete contracts: lessons from automobile franchising

Discussion by Freddy Huet

A summary of the paper

- In automobile franchising:
 - Formal decision rights are sometimes granted to manufacturers (50% of the contracts) and sometimes to dealers (50% of the contracts)
 - But in every case, manufacturers dictate *ex post* their own standards to dealers

⇒ Why assigning formal decision rights to dealers if these rights are used by manufacturers *ex post* ?

A summary of the paper

- The answer: formal decision rights as « last resort mechanisms »:
 - included into contracts to minimize the parties incentives to undertake inefficient and unverifiable actions and to deviate from their relational contract
 - *Example: underinvestment of the dealer in the acquisition of knowledge of local customers, underinvestment of the manufacturer in the brand development*

I. About the role of decision rights in the surplus extracted during the renegotiations

- In incomplete contract models:
 - the one who gets the decision rights gets more negotiation power...
 - ...and then can extract a greater part of the surplus during renegotiations

⇒ You say that this view seems inconsistent with the data in the automobile industry in Italy.

I. About the role of decision rights in the surplus extracted during the renegotiations

- I have the feeling that the data does not show this explicitly:
 - The data show that manufacturers take unilateral decisions...
 - ...that dealers accept these decisions...
 - ...and you seem to infer that the repartition of the surplus is « fair » because dealers accept the manufacturer's decisions

II. About the mechanisms used by the manufacturers to induce dealers to accept unilateral decisions

- Two systems used:
 - Sometimes reward mechanisms (in the form of discounts on price cars)
 - Sometimes sanction mechanisms (in the form of non renewal threats)

⇒ I did not understand why these two types of mechanisms are used (why not using only sanction mechanisms or only reward mechanisms ?)

III. About the concentration of decision rights in the hands of the manufacturer

- Manufacturers *“are better informed on the long-term benefits of different standards and therefore are in a position to serve as specialized decision-makers for the network as a whole”*
- But in this case manufacturers may manipulate the standards to get some informational rents and obtain a greater part of the surplus

III. About the concentration of decision rights in the hands of the manufacturer

- The repartition of the surplus in this sector may then depend:
 - On the repartition of formal decision rights between partners
 - On relational contracting considerations
 - On agency problems

IV. About the nature of decision rights

- I found the nature of these decision rights ambiguous in the article:
 - Last resort mechanisms to incite parties to undertake unverifiable investments ?
 - Last resort mechanisms against opportunistic behaviours and inefficient decisions ?
- These clauses seem simply play the role of hostages whose goal is to constrain opportunistic behaviours of the manufacturers and dealers