Reputation in Marketing Channels: Repeated-Transactions Bargaining with Two-Sided Uncertainty

Darryl T. Banks • J. Wesley Hutchinson • Robert J. Meyer
The Fuqua School of Business, Duke University, Durham, North Carolina 27708
The Wharton School, University of Pennsylvania, 1400 Steinberg Hall-Dietrich Hall, Philadelphia, Pennsylvania 19104
dbanks@mail.duke.edu • wes@mktgmail.upenn.edu • meyers@mkt@gmail.upenn.edu

Marketing channel interactions typically feature three characteristics that have not been incorporated together in an analytic study: (1) the parties can do business repeatedly over time, often under different terms of trade (e.g., prices may vary), (2) the terms that the seller offers one buyer may be different from those she offers another, giving each interaction the flavor of bilateral monopoly bargaining, and (3) the buyer and seller come to the interaction uncertain about the valuations each holds for the good, but they do know each other’s reputation for valuation. The seller might, for example, come to the bargaining table aware that the buyer has a strong reputation for being willing to pay only low prices, and the buyer might come aware that the seller is strongly reputed for high cost and is, therefore, willing to offer only high prices.

The latter characteristic raises an interesting question: When engaged in a marketing channel interaction, what type of reputation is best for a buyer or seller to take to the bargaining table? In this paper, we answer that question by incorporating each of the characteristics that typify channel interactions in a formal game-theoretic bargaining model. We determine how the reputations that buyers and sellers bring to the bargaining table affect their equilibrium strategies and payoffs.

Our analysis shows that, in general, the best reputation for the seller to take to the bargaining table is one that makes the buyer nearly certain in his belief that the seller’s cost is high, a result that matches intuition. The best reputation for the buyer, however, is counterintuitive. We show that an increase in the buyer’s reputed willingness to pay can actually cause the seller to offer a lower price. The best reputation for the buyer to take to the bargaining table is, therefore, one that makes the seller believe that there is a significant chance that he is willing to pay a high price. This result is new to the literature and brings with it immediate managerial implications that we discuss. Our analysis also shows that modeling the buyer as a forward-looking strategic player yields different results than does following the normal convention of modeling the buyer as a nonstrategic price-taker. We discuss why future research on channels and on reference-dependent utility theory should consider these differences.

1. Introduction
Suppose that software giant, Microsoft, has an innovative new product, the marginal cost of which is high. They decide that the best channel for selling the product to customers is through retailing giant Wal-Mart, and Wal-Mart highly values the product. As is typical of marketing channel interactions, Wal-Mart does not know what Microsoft’s cost is, and Microsoft is likewise uncertain about Wal-Mart’s valuation. In other words, there is ”two-sided uncer-