A TACIT THOUGHT

WEEKLY INSIGHTS AND VIEWS

TACIT INVESTMENT MANAGEMENT

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Everyone is familiar with the concept of monopoly but a word which is increasingly common in the financial press but is less well known is the related idea of monopsony.

Monopoly is loosely defined as the "exclusive possession or control of a service or good." Monopsony is defined as a "market situation where there is a large dominant buyer." In other words, both situations grant economic power to the principal agent; in the first case to raise prices but in the second case to lower prices.

Think of a situation where there are many sellers of a good or service but there is only one buyer. That buyer has the power to make the competing sellers bid against each other to arrive at the lowest price to secure the only available business.

In the UK, for a time, the major supermarkets came close to that kind of market power. Essentially, they had sufficient buying power in the different regions of the UK to set prices. It is well known that producer margins collapsed.

Thinking more globally, the major US networks like Amazon have pricing power sufficient to compete other retailers out of the market. The high street is littered with failed retailers. Why is this important? Surely the cheapest price is always good for consumers?

This is where rational micro-economic behaviour conflicts with equally rational macro-economics because to a broad approximation every consumer is also a producer somewhere in the economic value chain.

In essence, for any two economic agents; the spending of the first equates to the income of the second. Relentless price erosion; an exclusive focus on cost-cutting, in the end, reduces total incomes.

This is one reason why there is a backlash against globalisation. The market power of the key global networks is such that their scale can drive down prices but their volumes allow them to function on very much smaller margins than their smaller, say, retail competitors. Prices down; volumes and profits up to the monopsonist; total incomes down in the economy as a whole.

As we noted last week, you can see this in the UK where incomes have simply followed prices down.

We know from the financial crisis and particularly from the Eurozone crisis that financial imbalances are deeply destructive but very quietly, there is a growing imbalance in the distribution of market and pricing power between producers, intermediate buyers and consumers.

Knowingly or not that is the conflict that is being played out in legislatures around the world. For investors it divides the corporate world into winners and losers!

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