Direct and Indirect Bargaining Costs and the Scope of the Firm

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We compare the magnitude of bargaining costs within and between firms. The results are derived from a unique dataset comparing internal and external transactions for the same categories of parts at a single high-technology firm. They confirm that *direct* bargaining costs are higher with external suppliers, at least in part because there is more to bargain over. The need to negotiate price and formal contracts typically leads to longer ex ante negotiations and an increased likelihood of ex post renegotiations when circumstances change. We also observed higher *indirect* bargaining costs with external suppliers. The introduction of procurement specialists to external supply relationships disperses information and decision-making more widely across the organization. Moreover, information that may hinder contractual negotiations is often either suppressed or delayed and, because engineers are unable or unwilling to enforce these information restrictions, all communication with external suppliers passes through procurement personnel. The data suggests that these differences greatly hinder coordination and contribute to the determination of which parts are made internally versus externally.