Bargaining, Bonding, and Partial Ownership

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This paper provides a theory of interfirm partial ownership. We consider a setting in which an upstream firm can make two alternative types of investment: either specific investment that only a particular downstream firm can use, or general investment that any downstream firm is capable of using. When the benefits from specific and general investment are both stochastic, equity participation by the downstream firm in the upstream firm can lead to more efficient outcomes than take-or-pay contracts. The optimal ownership stake of the downstream firm is less than 50% under a natural assumption about relative bargaining power.

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