Pricing the Right to Renege in Search Markets: Evidence from Trucking

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Abstract

In many search markets, advance contracts allow one party to renege by paying a price in the form of a penalty. This right grants its holder the option to keep searching for alternatives, while the counterparty forfeits its option value. This paper examines the efficiency of the equilibrium price of reneging in the trucking industry, leveraging novel data from an online freight auction platform with a non-pecuniary, relational penalty. I document widespread reneging on the platform and develop a theoretical model of the carrier search process with stochastic offers from outside the platform. The analysis highlights the importance of considering both the direct impact of the penalty on reneging behavior and the equilibrium pass-through of lost welfare to the final transaction price, which influences the alignment of carrier and platform incentives. Using structural estimates of a dynamic model allowing for time-varying penalties, I simulate counterfactual cancellation schedules with both increasing and uniform penalties. The findings suggest that the current near-zero penalties are nearly optimal for social welfare. Additionally, I explore a switch to pecuniary penalties. The socially optimal pecuniary penalty increases overall welfare by 1.6%, primarily driven by an 8.4% rise in platform profits. However, the profit-maximizing penalty increases platform profits by 61.4% but reduces overall welfare by 5.4%, indicating that while pecuniary penalties can create trade gains, they also enable the platform to extract more rents from carriers, reducing overall efficiency.

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