Informing Markets vs. Regulators

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Abstract

Both the market and the regulator have incomplete information regarding products' characteristics, but non-governmental organizations and activists often have expertise or motivation to investigate and acquire new information. Negative signals about a product's environmental externalities, for example, may either persuade a regulator to regulate the industry, or buyers to switch to better products. This paper investigates when activists prefer informative lobbying (i.e., informing regulators) rather than boycotts (i.e., informing buyers). We show that the latter strategy, referred to as (informational) boycotts, is preferred and chosen when the industry in question is very competitive, while informational lobbying is preferred when most products are expected to be quite harmful, on average. The workhorse model is simple and can be used to endogenize both the firms' types (i.e., the expected harm) and the market structure. Firms' incentives to self-regulate are stronger when they risk boycotts (rather than lobbying) if and only if the market is very competitive. To motivate self-regulation, the regulator may therefore want to commit to an "open-door policy" to facilitate informational lobbying in less-competitive environments, but to commit to a "closed-door policy" in more competitive environments. When the market structure is endogenous, a "closed-door policy" is more likely to be beneficial because firms are more willing to enter when they risk boycotts than when they risk lobbying, we show. The theory is consistent with several differences in activism behavior and open-door policies between Europe and the US.

Key words: Private politics, activism, boycotts, self-regulation, informational lobbying, cheap talk, hard vs. soft information, information acquisition, market entry, US vs. Europe.