RPM: Theories of harm

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Introduction

**Focus: specific theories of harm**

- Strategic motives: cf. Greg Shaffer’s contribution

- Here
  - RPM as a facilitating practice
  - RPM and interlocking relationships
RPM as a facilitating practice

- **Downstream cartel**
  - Sham vertical agreements
  - Relevance
    - Few cases
    - ... but RPM was per se illegal (and is still a hard-core restriction in the EU)
    - Little incentives to “denounce” such an agreement

- **Upstream collusion**
  
  US Supreme Court (GTE Sylvania (1977), Business Electronics (1988))

  “vertical price arguments might assist horizontal price fixing at the manufactured level (by reducing the manufacturer's incentive to cheat on a cartel, since its retailers could not pass on lower price to consumers.”

  → can RPM facilitate collusion among manufacturers?
RPM and upstream collusion


  - Retailers have better information on local conditions on costs and demand

  - Retail price variability
    - good for profits (makes better use of retailers’ information)
    - bad for collusion (harder to detect deviations)

  - RPM: price imposed by manufacturer, does not react to retailers’ information
    - lower profit (does not use retailers' information)
    - collusion?
      - easier detection of deviation
      - higher incentive to deviate
RPM and upstream collusion

**Insights**

- RPM can indeed help manufacturers to collude higher profits for “intermediate” values of the discount factor
- Welfare impact
  - local shocks on retail costs: prices are higher, do not adjust to costs
  - local shocks on demand: higher prices, but no countercyclical role
  - … but RPM likely to harm welfare when it increases collusive profits
- RPM more effective than other vertical restraints in enhancing the detection of deviations
RPM and upstream collusion

**Applicability**

- Upstream collusion should be a concern
  - Limited number of players
  - Symmetry
  - Stable (demand trend and fluctuations, role of innovation)
  - ...

- Market transparency should be an issue
  - Not likely to be transparent w/o RPM
  - Local variations, other ways to achieve transparency
  - RPM should be used to maintain uniform prices
Interlocking relationships

● Rey-Vergé (2008)
  ● Upstream: differentiated manufacturers (A and B, say)
  ● Downstream: differentiated) retailers (1 and 2, say)
  ● demand pattern for each “channel” (A-1, A-2, B-1, B-2, …)
Interlocking relationships

- **Competition**
  - Upstream: two-part tariffs, with or without RPM
  - Downstream: retail price competition

Note: Dobson and Waterson (2007) on linear tariffs

- **Two possible case wrt retail market power**
  - No retail bottleneck
    - Potential competition at each retail location: selection process (BW 1985)
    - Bypass: manufacturers set-up own their own outlets or sell directly
  - Retail bottlenecks: a single retailer at each retail location (confer rents)
No retail bottleneck (and no RPM)

- Interbrand competition, then intrabrand competition
  → retail prices are (somewhat) competitive ($p_c < p^M$)

- Intuition
  - Manufacturers recover retail margins through fixed fees
  - Internalize impact of (retail) prices on
    - the *entire* margin on sales of own brand
    - the *retail* margin on sales of rival brand
No retail bottleneck

[Diagram showing a supply chain with two manufacturers (Manufacturer A and Manufacturer B) connected to two retailers (Retailer 1 and Retailer 2) which are connected to Consumers.]
No retail bottleneck

**Intuition (cont’d)**

- Retail prices are driven by wholesale (marginal) prices

- Maintaining high retail prices requires high wholesale prices
  - Positive upstream margins
  - Free-riding on rival manufacturer’s upstream margin
Resale Price Maintenance

- **Retail prices are directly set by manufacturers**
  - Internalize as before the impact of (retail) prices on
    - the *entire* margin on sales of own brand
    - the *retail* margin on sales of rival brand
  - No need anymore to use wholesale prices to maintain retail prices
    - squeezing upstream margins yields monopoly outcome
      - each manufacturer becomes the residual claimant on all margins
      - set retail prices at the monopoly level
  - RPM thus eliminates interbrand as well as intrabrand competition
    - RPM eliminates rivalry among “common agents”
    - Other equilibria, but only this one is robust to (even small) retail effort
Retail bottlenecks

- **Retailers earn positive rents**

- **No RPM**
  - “Double agency” may no longer be an equilibrium
  - This happens for “low degrees” of substitutability

- **RPM**
  - There can still exist an equilibrium with monopoly prices
  - Other equilibria
    - manufacturers prefer lowest retail prices
    - retailers prefer highest retail prices
Applicability

- **Interlocking relationships**
  - Does not apply to franchise networks for example
  - Indeed, when manufacturers compete through different (exclusive) retail networks, RPM may result in more intense, head-to-head competition (cf. “competition dampening” literature)

- **Contrast**
  - Limited use by a new entrant vs pervasive use in the market
  - Price floors versus price caps
  - Market-wide versus bilateral terms
Illustration: France

**Current debate**

- 1996 Laws (Galland, Raffarin)

- Merger wave (5 large retailers)
  - Carrefour, Auchan, Casino; Leclerc, Intermarché

- Undesired price evolution

- Reform: Dutreil and Chatel Acts
Illustration: France

Empirical evidence

- France – Germany: branded products in supermarkets
- Biscourp, Boutin and Vergé: market concentration and prices
- Bonnet-Dubois-Simioni 2004
  - French market for bottled water
  - Structural econometric model
    - Berry-Levinson-Pakes *Eca* 1995
    - Berto Villas-Boas 2004
  - Linear prices / two-part tariffs / RPM
  → best fit: two-part tariff + RPM, monopoly prices