RPM: Theories of harm

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Introduction

- **Focus: specific theories of harm**

  - Strategic motives: cf. Greg Shaffer's contibution

  - 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

- **Jullien-Rey (*Rand Journal of Economics*, 38(4):983-1001, 2007)**

  - 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*, …)
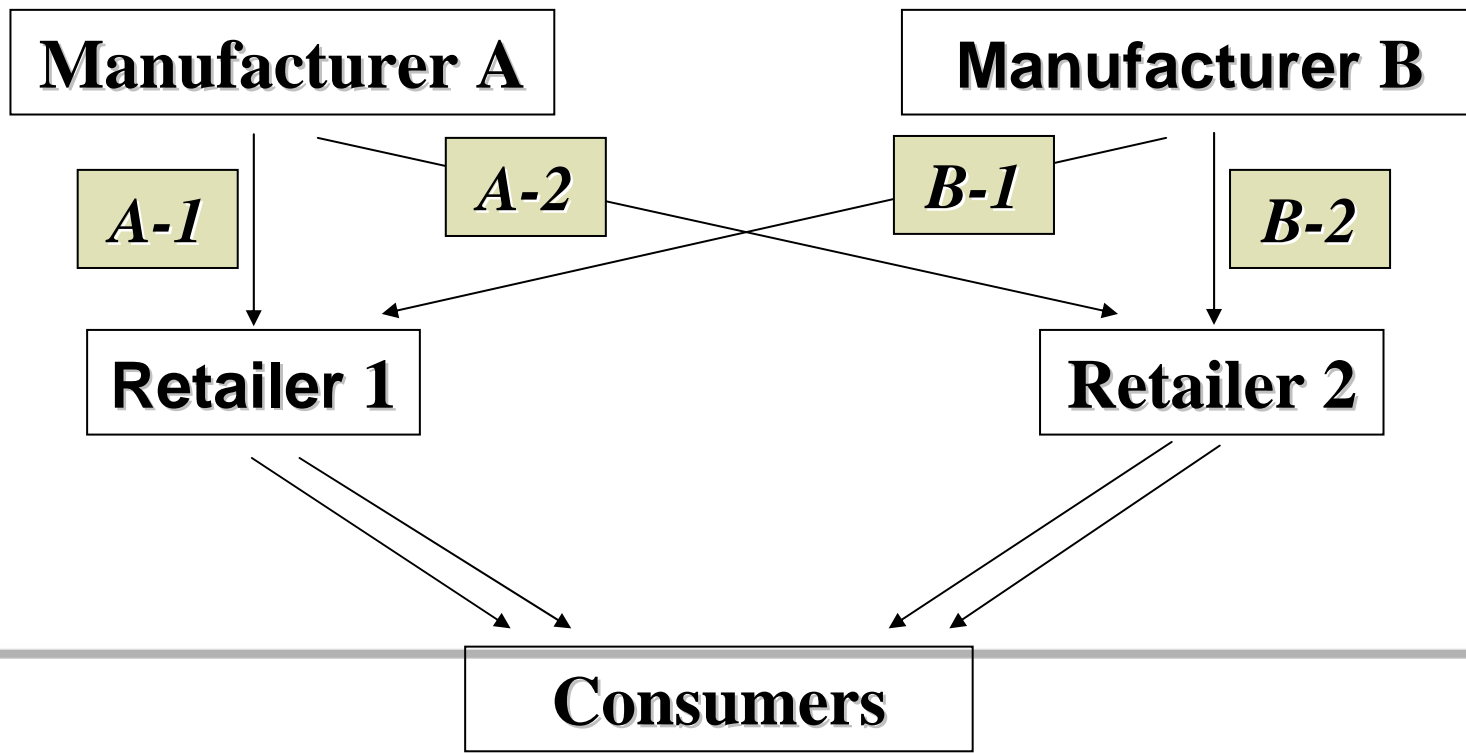
Interlocking relationships

- **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**

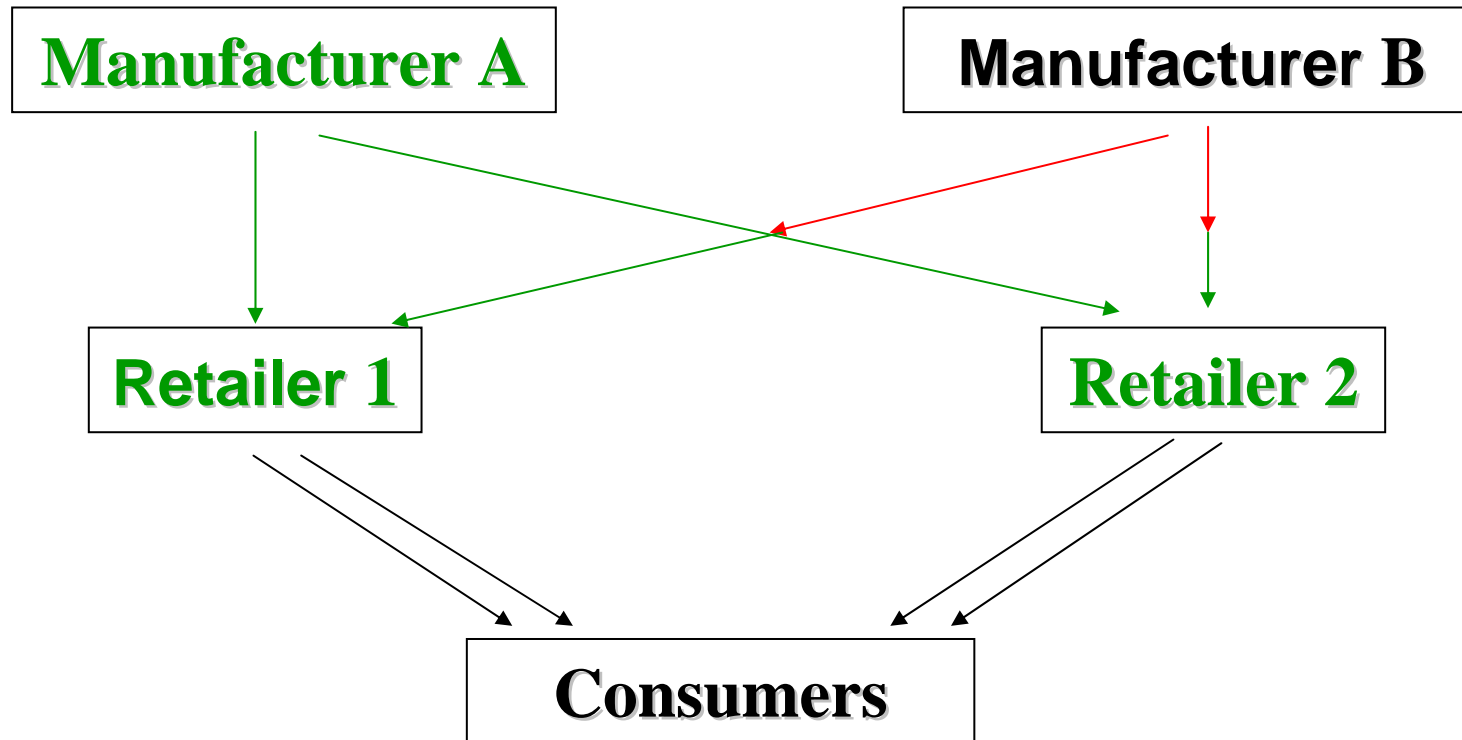 $\rightarrow$ retail prices are (somewhat) competitive ($p^c < p^M$)

- **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

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