

# RESALE PRICE MAINTENANCE AFTER *LEEGIN*: TOPICS AND QUESTIONS FOR RESEARCH

*Prepared Remarks*

## FTC Hearings on Resale Price Maintenance: Empirical Evidence on the Effects of Resale Price Maintenance

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### INTRODUCTION

Interest in empirical research that examines resale price maintenance (RPM) has increased as a result of the Supreme Court's decision in *Leegin Creative Leather Products, Inc. v. PSKS*. The Court's decision requires that going forward vertical price restraints including RPM are to be judged according to the rule of reason. My remarks today identify and organize potential topics and questions of interest for research that may help to inform application of the rule of reason to RPM. These include the nature, frequency and practice of RPM (i.e., *the phenomenon*); the two general schools of thought whose perspectives inform our theoretical understanding of RPM's competitive effects (i.e., *assumptions*); the outcomes and processes of the procompetitive and anticompetitive explanations for RPM (i.e., *theory*); conditions antecedent to RPM's competitive effects (i.e., *antecedents*); the existence and comparative benefits of less restrictive alternatives to RPM (i.e., *alternatives*); special circumstances of interest with

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respect to RPM including Internet retailing and dual distribution (i.e., *special contexts*) and additional topics and questions for research (i.e., *other topics/questions of interest*).

[Prior to beginning I want to acknowledge that extant understanding of many of these topics has benefitted from considerable thought over time and across various literatures and this thinking should serve as the foundation for future research. As well, it is also likely that some topics and questions (regarding RPM) have been addressed through existing empirical research in other domains. This research should also be incorporated going forward. At the same time it is acknowledged that some topics and questions may be more difficult to address than others through new research. Finally, although I do not address the nature of research best suited to address the topics and questions identified, as a general statement, multiple approaches drawing on varying sources of data and applying differing forms of analysis are likely to permit the greatest advancement to our understanding of RPM and its competitive effects. This would include a range of research designs from exploratory to descriptive to causal studies. It would also include both cross-sectional and longitudinal analysis. It would also include case studies and other qualitative techniques, empirical modeling, consumer and manager surveys, and laboratory and field experiments. *The important point is that given any one “way of knowing” has both benefits and limitations we should be open to different approaches when it comes to future research concerning RPM.*]

## **RESALE PRICE MAINTENANCE**

### **“RPM” Practices**

Resale price maintenance (RPM) restricts intrabrand price competition by fixing or restricting (as a maximum or minimum) the price at which a reseller sells a manufacturer’s product. At focus in *Leegin* and today is *minimum* resale price maintenance which restricts or fixes the minimum price at which a reseller sells a manufacturer’s products. As a practice minimum RPM may take many forms. In its classic formulation, RPM involves directly controlling the retail transaction price for the manufacturer’s products. RPM may also be accomplished through so-called Colgate programs where a manufacturer announces its recommended retail prices and stops

dealing with retailers that do not follow its suggestions. However, RPM may also be accomplished indirectly. For example, the transaction price of a product may be controlled indirectly through limiting free goods, occasion gifts, two-for-ones, etc. Prices and intrabrand price competition may also be controlled and restricted through minimum advertising policies (MAP) that target and restrict communications regarding lower than recommended prices. Other approaches include restrictive distribution practices involving price where, for example, a retailer is restricted from reselling its products on the Internet based on an assumption that it will be sold for a lower price if allowed. Other variations are likely employed as well. *For this reason it is important that all of the various practices through which intrabrand price competition is restricted be a part of empirical work that examines RPM.* This is especially important because actions to address one practice may lead to other practices having the same effect but a different form.

### **RPM Arrangements**

In formal terms, resale price maintenance is further defined as an *agreement* between participants at different levels of a distribution structure to establish the resale price of products or services. Proof of a vertical agreement has been a requirement under the law as it has developed up to *Leegin* and it is unclear whether this has changed. But it is well-known that a manufacturer may gain the cooperation of a reseller in many ways that fall short of an explicit agreement. They may also employ novel ways in which to maintain this cooperation through monitoring and enforcement of an arrangement. *Colgate* policies represent an attempt to deal with this situation in the context of RPM.<sup>2</sup> *It is important that empirical work going forward err on the side of inclusiveness. Research should identify and capture (1) the various ways through which the cooperation of a reseller to restrict intrabrand price competition may be accomplished, (2) the mechanisms employed to monitor these arrangements, and (3) how they are enforced over time.*

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<sup>2</sup> Such policies are said to result in de facto RPM where retailers follow the recommended prices because they fear they will be terminated if they do not.

## Frequency of RPM

Although whether RPM would increase post-*Leegin* no longer appears to be as much a question as it once was, *documenting any changes in the use of RPM since Leegin should be a further important part of future empirical work.* Following modern trends in application of the rule of reason commentators predicted that RPM would increase post-*Leegin* and anecdotal reports since the decision appear to bear out that the practice has increased. A content analysis conducted recently by my colleagues and I of published opinions offered by legal and industry commentators and appearing in the popular and trade press found that over 95% of the 42 published articles contained opinions that RPM was likely to increase post-*Leegin*. Half of these articles contained opinions referencing 14 different industries suggesting that any increase in RPM post-*Leegin* would not be narrow in scope. Diverse industries are identified in this list including: automotive products, baby products, bicycles, consumer electronics, furniture, health and beauty aids, imaging and pictures, kitchen and bath, personal computers, wireless communications and women's wear. The list also includes luxury and premium brands of products in general, and franchising and Internet retailers as distinct models of retailing. Anecdotal reports continue to add to this evidence. *Continued and systematic examination of the depth and breadth of RPM's use since Leegin should continue to be an important area for research.*

## SCHOOLS OF THOUGHT

An important basis for understanding the competitive implications of RPM is the underlying assumptions adopted (either explicitly or implicitly) by the two perspectives or *schools of thought* toward RPM. Each differs with respect to how the complexity of competition found downstream of manufacturers within a distribution system should be treated.<sup>3</sup> This results in very different conclusions as to: (1) a manufacturer's interests

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<sup>3</sup> As widely characterized and applied in the economic literature concerning RPM, one school of thought holds that the retail market and retailing may be best understood through economic theory which conceives of it as inert and perfectly competitive, unless they are cartelized or monopolized. Alternately, the other school of thought holds that the retail market and retailing may be best understood, in addition, through the added guidance of economic theories of imperfect competition. See especially Robert L. Steiner, *Does Advertising Lower Consumer Prices?* 37 J.MKTNG, 19 (1973); *Basic Relationships in Consumer Goods*

in adopting RPM, (2) the likelihood of circumstances leading to its abuse, and (3) the relevance of differing forms of competition for safeguarding against this abuse. *Thus, an important starting point for understanding RPM and the empirical relevance of competitive explanations of its effects is the extent to which the marketplace subscribes to the features and processes of each school of thought.*

### **Manufacturer Interests in Adopting RPM**

Although both schools of thought agree that manufacturers and consumers benefit from intrabrand competition that keeps the cost of distribution and retail prices low, given their differing perspectives they diverge as to the extent to which these interests maintain their alignment in the real-world. One school sees that unless a market is cartelized or monopolized, the interests of manufacturers and consumers are generally aligned when it comes to the use of RPM. This leads to the conclusion that RPM is more often adopted by a manufacturer for the procompetitive purpose of increasing its sales because it otherwise would make little sense -- RPM would just result in excess profits to retailers and higher prices to consumers. The other school sees the interests of manufacturers and consumers diverging at times and in significant ways. This leads to the conclusion that a manufacturer may adopt RPM voluntarily for anticompetitive purposes as well as involuntarily leading to anticompetitive effects. *Understanding the extent to which manufacturers and consumers interests in adopting RPM may diverge and in what ways is therefore an important area for specific research.*

### **Market Circumstances for the Abuse of RPM**

The two schools of thought also possess different views concerning the likelihood that circumstances required for the abuse of RPM will be found in practice. Both acknowledge the prospect that RPM may facilitate a manufacturer cartel or be abused by a powerful manufacturer. However, because they draw different conclusions concerning the degree to which manufacturers' and consumers' interests tend toward alignment in practice they differ as to the potential for the abuse of RPM by retailers through retail collusion and the exercise of retail market power. *Therefore, understanding the extent to which circumstances conducive to the accumulation and exercise of retail market power*

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Industries, 7 RESEARCH IN MKTNG, 165 (1984); *The Inverse Association Between the Margins of Manufacturers and Retailers*, 8 REV.INDUS. ORG. 717 (1993); *Vertical Competition, Horizontal Competition and Market Power*, 53 ANTIRUST BUL. No.2, 252 (2008)

*via RPM and for the use of RPM to facilitate retail collusion are present is also an area for specific research.*

### **Competition for Safeguarding Against Abuse of RPM**

The two schools of thought also differ as to the importance of differing forms of competition for safeguarding against competitive abuses of RPM. One school emphasizes *interbrand* competition, assigning less importance and effect to *intra*brand competition. Subscribing to the logic that “when interbrand competition exists... it provides a significant check on the exploitation of intra-brand market power because of the ability of consumers to substitute a different brand of the same product”<sup>4</sup> competition between brands is thought to sufficiently safeguard against abuses of RPM. Sacrificing competition among retailers to invigorate competition between brands is therefore considered a welfare enhancing tradeoff. The other school emphasizes the importance of both inter and intra-brand competition (as well as “vertical competition” between channel participants). Viewing consumers’ substitution processes to be subject to market imperfections, each is considered to play an important safeguarding role. Citing evidence that it is competition among retailers that primarily disciplines retail margins, intra-brand competition is viewed as critically important for safeguarding against abuses of RPM. Sacrificing competition among retailers to invigorate interbrand competition is therefore not seen to be automatically a welfare enhancing tradeoff. *Therefore the extent to which interbrand and intra-brand competition (as well as vertical competition) safeguard against the abuse of RPM is an important area for more specific research.*

## **THEORIES OF COMPETITIVE EFFECTS**

The differing perspectives of the two schools of thought translate directly into explanations for the competitive effects of RPM. *As a general matter, research is needed that investigates the empirical relevance of these explanations. This research should include examination of both the aggregate market outcomes found to occur and the more specific managerial and consumer processes leading to these outcomes.*

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<sup>4</sup> *GTE Sylvania*, 433 U.S. 52, n. 19 (1976).

## **Procompetitive Explanations for RPM**

Procompetitive explanations describe how manufacturers voluntarily adopt RPM to increase sales through encouraging and securing promotional services otherwise jeopardized by various principal-agent problems (i.e., motivating a party to act on their behalf). RPM thereby stimulates interbrand competition by restricting intrabrand price competition. Welfare is enhanced because despite the restriction of intrabrand price competition, demand increases given consumers value the added promotional services. *Research is needed to better understand the nature and authenticity of these problems, the frequency and impact of their occurrence, and the effectiveness of RPM in solving these problems. This research should also include investigation of any theoretical challenges to the procompetitive explanations.*

**Special services with free riding.** The primary procompetitive explanation for RPM is that it helps manufacturers to gain the patronage of retailers to provide special point-of-sale promotional services that otherwise would be jeopardized as a result of free riding by competing retailers. Free riding occurs when consumers go to retailers who provide the services, but subsequently purchase from a retailer that does not. RPM's higher and uniform prices can encourage retailer investments in these services. At the same time, RPM can safeguard these investments against free riding by retailers who offer the product at a lower price but without the services. *Key questions for research include: How do manufacturers obtain the patronage of retailers to invest in special point-of-sale promotional services? Is the provision of these services significantly jeopardized by free riding? Does RPM solve manufacturers' problems in obtaining the patronage of their retailers with respect to special point of sale promotional services? Does RPM safeguards these services from free riding? What issues challenge RPM's effectiveness in solving these problems?*

**Quality certification.** An extension of the special services explanation involves the reputation of high-quality prestige retailers rather than point-of-sale promotion. Because of their reputation, prestige retailers are said to "certify" (i.e., signal) to consumers the value of the products they carry. Retailers who have not made similar investments and free ride on these signals may jeopardize the incentive for prestige retailers to provide this certification. RPM solves this problem through insuring prestige

retailers a sufficient margin to invest in their reputation and safeguarding against free riding that can otherwise occur. *Key questions for research include: How do manufacturers communicate the value of the products they sell? Do they rely on prestige retailers to certify or signal to consumers the value of their products? Is this certification process significantly jeopardized by free riding? Does RPM solve manufacturers' problems in communicating the value of their products? What issues challenge RPM's effectiveness in solving this problem?*

**Special services without free riding.** RPM has also been said to gain the support of retailers to invest in and provide promotional services that would be otherwise jeopardized not by free riding, but by their tendency to gravitate toward intrabrand price competition. RPM overcomes this problem through limiting retail price competition thereby inducing retailers to compete on promotional services. *Key questions for research include: How do manufacturers obtain the patronage of retailers to invest in and provide promotional services? Is the provision of these services significantly jeopardized by a tendency of retailers to gravitate toward intrabrand price competition? Does RPM solve this problem? What issues challenge RPM's effectiveness in solving this problem?*

**Incomplete contracting.** RPM has been further theorized to be used to solve manufacturer-retailer contracting problems. Where a manufacturer is unable to write a legally enforceable contract for the promotional services it desires its retailers to perform RPM provides the requisite incentives and enforcement mechanisms to obtain these services. *Key questions for research include: Do manufacturers write contracts with retailers for the services they desire their retailers to provide? Do these contracts pose significant enforcement problems for manufacturers? Does RPM solve manufacturer's contracting problems? What issues challenge RPM's effectiveness in solving this problem?*

**Brand image.** RPM has been further said to be used by manufacturers to maintain and build their brand image. RPM insures a retail price commensurate with a manufacturer's desired image that would be tarnished and lead to a decline in demand where retailers sell the product (1) at a lower price, (2) through discounted prices or (3) following a loss leader pricing strategy. *Key questions for research include: How do*

*manufacturers maintain the desired image for their brands? Is this brand image tarnished leading to a decline in demand where retailers sell the product at a lower price? ...or at discounted prices? ...or following a loss leader pricing strategy? Does RPM solve manufacturers' problems in maintaining their desired brand image? What issues challenge RPM's effectiveness in solving these problems?*

**Destructive competition.** RPM has additionally been theorized to help limit “destructive” price competition. RPM insures against retail price competition (e.g., destructive price wars) that results in all retailers not being able to cover their fixed costs thereby endangering a distribution system with consequences for the loss of consumer choice. *Key questions for research include: How do retailers compete against one another on price? Does “destructive” price competition occur? Does this type of competition pose challenges for manufacturer's distribution systems? For consumer choice? Does RPM solve manufacturers' problems with destructive price competition? What issues challenge RPM's effectiveness in solving this problem?*

**Demand uncertainty.** RPM has also been said to help address future uncertainty in demand for a manufacturer's products. RPM reduces uncertainty concerning future retail demand for a new or existing product through guaranteeing retailers that they will make a sufficient profit to (1) recover the costs of any excessive quantities of the product purchased should they overestimate demand and (2) encourage them to purchase large enough quantities should they underestimate demand. *Key questions for research include: How do manufacturers and retailers forecast consumer demand for their products? How frequently do they underestimate demand? ...overestimate demand? Does uncertainty in these estimates reduce retailers' propensity to purchase manufacturers' products? Does RPM solve manufacturers and retailers forecasting problems? What issues challenge RPM's effectiveness in solving these problems?*

**Retailer allocation.** Another explanation for RPM is that it helps retailers insure an appropriate number of retail outlets. Demand for a product is not only a function of price (lower prices result in greater demand) but also the number of retail outlets through which it is sold (more outlets result in greater demand). The use of RPM permits manufacturers to strike the profit maximizing balance between (1) higher retail prices that encourage more retailers to carry their product and (2) lower retail prices that encourage

more demand for their product. *Key questions for research include: How do manufacturers choose the price they wish their product to be sold at retail? Do manufacturers face problems in striking a balance between lower retail prices that encourage more consumer demand and higher prices that encourage more retailers to carry their products? Does RPM solve manufacturers pricing problems? What issues challenge RPM's effectiveness in solving these problems?*

### **Anticompetitive Explanations of RPM**

Anticompetitive explanations of RPM explain how in the absence of evidence that RPM promotes interbrand competition through encouraging and securing promotional services RPM restricts intrabrand price competition and results in higher retail prices. They also explain how RPM may be adopted voluntarily and involuntarily against the interests of consumer to limit interbrand competition through facilitating collusion and the exercise of market power among and by manufacturers and retailers. The anticompetitive explanations further describe how RPM can lead to reduced efficiency and innovation in retailing and other anticompetitive effects independent of the original purpose for its adoption. *As with the procompetitive explanations, research is needed to better understand each explanation including how RPM is adopted, compelled or otherwise results in the suppression of competition in the ways described, how often this occurs, and how detrimental the results are for consumer welfare. This research should also include investigation of any theoretical challenges to the anticompetitive explanations.*

**Higher retail prices.** An important anticompetitive explanation of RPM is that absent evidence it promotes interbrand competition, RPM suppresses intrabrand competition and results in higher retail prices. With few exceptions, both the procompetitive and anticompetitive explanations for RPM include higher prices in their descriptions of its competitive effects. Prior empirical research provides evidence that RPM has resulted in higher prices. An exception is that RPM may not result in higher prices where a manufacturer implements it through *reducing* its wholesale prices rather than by raising its retail prices.<sup>5</sup> *Key questions for research include: Does RPM*

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<sup>5</sup> Another potential is the prospect that prices may be lower under RPM where a manufacturer adopts costlier alternatives to control resale prices.

*systematically result in higher prices as past evidence and theory suggests? How often is RPM implemented through a reduction in wholesale prices rather than an increase in retail prices thereby providing an exception to the general case that RPM raises prices? In the absence of evidence that RPM promotes interbrand competition, how detrimental are the effects for consumer welfare? What issues challenge the use of RPM in this way?*

**Facilitating collusion.** One of the primary anticompetitive explanations for RPM is that it is used to facilitate anticompetitive collusion among manufacturers or retailers to restrict intrabrand price competition and raise prices and/or to more particularly forestall or exclude more efficient competition. In a retail cartel, the higher uniform prices of RPM aid members in organizing and stabilizing the cartel. Cartel members collude to set prices and then compel a common manufacturer to adopt RPM to help organize their price fixing. RPM also facilitates enforcement of the cartel by thwarting incentives by retailers to defect and offer lower prices to consumers. In a manufacturer cartel, the higher uniform price of RPM removes the incentive to offer its retailers lower wholesale prices which would thereby facilitate cheating on the cartel. Because retail prices are more easily monitored than wholesale prices RPM further facilitates a manufacturer cartel through assisting with its enforcement by making it easier to identify cheating manufacturers. *Key questions for research include: How often do retailer and manufacturer cartels occur? How often do manufacturers adopt RPM to aid in the organization of a manufacturer cartel? Enforcement of a manufacturer cartel? How often do retailers compel the use of RPM to aid in the organization of a retailer cartel? Enforcement of a retail cartel? How is the organization and enforcement of such cartels accomplished? What evidence of this cartel organization and enforcement is available? How detrimental are the effects of RPM facilitated cartels for consumer welfare? What issues challenge the use of RPM in this way?*

**Exercise of market power:** Another primary anticompetitive explanation for RPM is that rather than members of a cartel, a single powerful manufacturer or retailer can impose RPM or constrict its use to generally restrict intrabrand price competition and raise prices and/or to more particularly forestall or exclude more efficient competition. A powerful retailer may constrict a manufacturer to adopt RPM within its distribution system to suppress competition. A powerful manufacturer may also adopt

RPM together with exclusive distribution to suppress competition. *Key questions for research include: How often are powerful retailers and manufacturers present in a market? How often does a powerful manufacturer adopt RPM to suppress competition? How often does a powerful retailer compel the adoption of RPM by a manufacturer to suppress competition? How is the exercise of such market power accomplished? What evidence of this exercise of market power is available? How detrimental are the effects of RPM related exercises of market power for consumer welfare? What issues challenge the use of RPM in this way?*

**Other anticompetitive explanations.** In addition to these primary anticompetitive explanations for RPM, additional theories of how RPM may lead to anticompetitive outcomes have been advanced. *These are especially interesting and deserving of research because they describe anticompetitive results that are at times “independent” of the rationale advanced for the use of RPM to begin with.*

**Dampened interbrand competition.** RPM has been theorized to dampen interbrand competition at the retail level. Competitors view the creation and use of RPM by manufacturers and their retailers as a “commitment” to higher prices. Where this commitment is present, other manufacturers in turn raise their own prices. *Key questions for research include: How do manufacturers view the use of RPM by other manufacturers? Do they see it as a commitment by the manufacturer and its retailers to a certain price that they will not deviate from? What is the nature and extent of this commitment? How do manufacturers react to the commitment of other manufacturers to RPM? Do they raise their prices as a result of the manufacturer’s commitment? How often does this result? How detrimental is it to consumer welfare? What issues challenge the use of RPM in this way?*

**Emulation by competitors.** The protected margins of one manufacturer’s RPM have also been said to result in the use of RPM by other manufacturers. Other manufacturers can adopt RPM in order to defend or militate against the incentives of a retailer to favor a competing manufacturer’s products protected by RPM. Where this occurs it can result in a misallocation of resources in a given market. *Key questions for research include: What factors contribute to a manufacturer adopting RPM? Do manufacturers adopt RPM to defend or militate against its use by other manufacturers?*

*To what extent does this occur? How detrimental is it to consumer welfare? What issues challenge the use of RPM in this way?*

**Protecting wholesale prices.** RPM has also been said to protect a manufacturer's wholesale price margin. Intrabrand price competition puts pressure on this margin. The use of RPM can relieve this pressure thereby keeping the manufacturers wholesale margins higher than they might otherwise be. *Key questions for research include: What factors put pressure on manufacturers' wholesale margins? Do factors downstream of a manufacturer put pressure on manufacturers' wholesale margins? Does intrabrand price competition that results in lower retail prices put pressure on the wholesale margins of upstream manufacturer's? Do manufacturers adopt practices to relieve this pressure? Do these practices include RPM? How often does this occur? How detrimental is it to consumer welfare? What issues challenge the use of RPM in this way?*

**Unwarranted promotion.** RPM has been further theorized to raise the prospect of unwarranted product promotion on products to which it applies. Retailers can adopt practices that "push" customers to unwittingly purchase products whose margins are protected by RPM even though other products may better fit their needs. *Key questions for research include: What factors contribute to a retailers' promotion of a manufacturers products? Do retailers "push" products covered by RPM? Do consumers in turn unwittingly purchase "pushed" products? To what extent does this occur? How detrimental is it to consumer welfare? What issues challenge the use of RPM in this way?*

**Competitive inertia.** Another anticompetitive explanation is that manufacturers can continue to use RPM beyond any legitimate explanation for its original use because of a belief that if stopped it will result in negative consequences for their relations with retailers and in turn their ability to compete. *Key questions for research include: What factors contribute to the continued use of RPM overtime? What factors contribute to a manufacturer ceasing to use RPM that it has previously adopted? What implications result from a manufacturer ending its use of RPM? ...for retailers? ...and for the manufacturers competitive position vis-à-vis its retailers? Do manufacturers continue to use RPM based upon a belief that it will be harmful to their relationships with retailers?*

*To what extent does this occur? How detrimental is it to consumer welfare? What issues challenge the use of RPM in this way?*

## **ANTECEDENT CIRCUMSTANCES**

To fully understand RPM it is imperative that antecedent circumstances leading to its use be understood. *A logical starting point for identifying these circumstances is the explanations offered to explain RPM's competitive effects.* These explanations identify circumstances that motivate and enable its use. *Each therefore provides guidance as to the antecedent circumstances for RPM and is an area for future research.*

### **Procompetitive Applications of RPM**

Procompetitive explanations describe how RPM is used to encourage and secure retail promotion of a manufacturer's products otherwise jeopardized by principal-agent problems. *Thus, understanding more particularly the basis of these principal-agent problems and the factors that impact a manufacturer's approach to solving them is an area for more specific research.* Principal-agent problems have been studied at length in economics, political science and in the business literatures while factors affecting a manufacturer's approach (including price related strategies) to gaining the patronage of retailers to promote its products have been studied extensively under the label of trade promotion. *Existing research on the topics of principal-agency and trade promotion together with future research involving RPM should prove helpful to understanding the antecedent circumstances for procompetitive applications of RPM.*

### **Anticompetitive Applications of RPM**

Anticompetitive explanations describe how RPM may be adopted or compelled to facilitate collusion and the exercise of market power as well as how RPM may lead to anticompetitive effects independent of its original purpose. *Thus, understanding more particularly the circumstances that lead to collusion and the exercise of market power via RPM is an area for more specific research.* *Circumstances giving rise to anticompetitive effects explained to be independent of the original purpose for RPM is also an area for more specific research.* Collusion and market power are of course a central focus of antitrust economics and each has been studied at length. The three factors identified by

the Supreme Court in *Leegin* as relevant to understanding the economic dangers of RPM reflect application of this knowledge. *Existing research on these topics together with future research involving RPM should prove helpful to understanding the antecedent circumstances for anticompetitive applications of RPM.*

## **LESS RESTRICTIVE ALTERNATIVES**

A manufacturer's objectives to encourage and secure promotional services otherwise jeopardized by principal-agent problems identified by the procompetitive explanations for RPM can be achieved in a variety of ways. Some alternatives may be less restrictive of competition than RPM and therefore bear upon the assessment of RPM's welfare consequences. *Consequently an important area for research is to better understand how manufacturers encourage and secure the retail promotional services they desire. This research should include identification of these alternatives, examination of their comparative restriction of competition, their effectiveness in solving the particular principal-agent problem to which they apply and their costs of implementation and management relative to RPM.*

### **“Classic” Alternatives to RPM**

A number of “classic” alternatives to RPM and its various forms (e.g., MAP, Colgate policies) are advanced in the literature. These include: contractual service agreements where a manufacturer specifies and pays for the promotional services it desires; promotional allowances where a manufacturer reimburse its retailers for their performance of qualifying services; consumer advertising where a manufacturer promotes the product directly to consumers or otherwise provides the promotional services themselves; exclusive and selective distribution where a manufacturer requires qualifying retailers to provide the promotional services and then refuses to continue supplying those that do not or otherwise restrains distribution in an effort to encourage and secure promotion of its products that it desires; and vertical integration where a manufacturer itself engages in retailing thereby assuring the promotional services it desires are provided. *Each alternative provides a fertile area for continuing research. Key research questions include: How often manufacturers select these various*

*alternatives? Their comparative restriction of competition? Their effectiveness in encouraging and securing desired promotional services? Their cost in implementing and managing over time?*

### **Trade Promotion**

Trade promotion describes how manufacturers gain the patronage of their downstream channel members including retailers and for the purpose of encouraging promotion of a manufacturer's products. Given a similar description for RPM under the procompetitive explanations for its use, a potential starting point for understanding alternatives to RPM is to examine the nature, antecedent conditions and effects of trade promotion. *Academic literatures in economics and marketing report studies of trade promotion. Annual surveys of trade promotion and its various practices are conducted by market research firms. Thus, existing research addressing trade promotion should be especially helpful for future research on RPM and its alternatives.*

**Promotional allowances.** Promotional allowances, a form of trade promotion often identified in specific terms as an alternative to RPM actually defines a class of allowances that involve a number of different variations depending on the objectives and how it is employed. *Thus, research focusing on promotional allowances and more particularly the myriad different forms of promotional allowances should also be helpful for future research on RPM and its alternatives.*

### **Other Alternatives**

**Branded variants.** New and different alternatives to accomplish the procompetitive promotional objectives identified for RPM have also emerged over time. For example, branded variants or a branded item which is not directly comparable to other items with the same brand have been suggested to address free riding. *Research into branded variants and their use as an alternative to RPM is an area for further research.* Although originally conceived to address heterogeneous consumer tastes, at least one study has suggested their utility for addressing problems otherwise addressed through RPM. *The identification and study of other new and different alternatives employed in practice is also an area for further research.*

## SPECIAL CIRCUMSTANCES OF INTEREST

### **Internet retailing**

The use of RPM in conjunction with the Internet and Internet retailing provides a special circumstance of interest for future research. Internet retailing involves an innovative platform for communicating and selling to end-users that has grown in importance and sophistication overtime. Projections suggest continued growth for this retail format. The Internet and Internet retailing pose competitive implications for incumbent forms of retailing and specific explanations for RPM as well as the nature of intra and interbrand competition more generally. *For these reasons it is critical that research going forward better understand the nature of Internet and Internet retailing and its interplay with RPM.*

At a general level, emphasis should be given to understanding the Internet's implications for interbrand and intrabrand competition. Use of the Internet enhances competition by effectively "widening" and "deepening" the market for goods and services. Because of the Internet, businesses and consumers are no longer bound by geography and may sell and trade with one another through local, national and global markets; effectively widening the breadth of the market. As well, businesses are able to offer, and consumers are able to compare more products and brands; effectively increasing the depth of the market. *Therefore, research addressing the competitive implications of the Internet's widening and deepening of markets for goods and services for interbrand and intrabrand competition is an important area for research.*

At a more specific level, an area deserving of emphasis involves RPM and existing understanding of Internet retailing relative to prior established models of retailing sometimes referred to as "brick and mortar" retailers. Internet retailers are often juxtaposed against these established models of retailing as a separate and distinct form of retailing. The use of RPM is then justified based upon the assumption that Internet retailers are free riders that are able to offer lower prices not because of their effectiveness and efficiency in serving customers but because they free ride on the

promotional investments of their traditional counterparts.<sup>6</sup> *But in empirical terms do these distinctions continue to apply in the world of 21<sup>st</sup> century retailing? Further, can it also be said with any confidence that Internet retailers are free riders? Indeed, can it be stated with any degree of confidence who is free riding on whom, given the novel ways in which consumers are using the Internet -- often consulting it prior to visiting a brick and mortar retailer? It is for these reasons that special emphasis should be given to understanding Internet retailing relative to established models of retailing and associated justifications for the use of RPM dependent on Internet retailers as free riders.*

### **Dual Distribution**

The use of RPM in conjunction with dual distribution is also a special circumstance of interest. Dual distribution involves a manufacturer selling through more than one channel of distribution to reach the same end-users. One approach involves the use of independent retailers together with manufacturer-owned retail stores. By its nature dual distribution includes both vertical distribution and horizontal competition elements. When employed with RPM, these hybrid arrangements have generated controversy as to their competitive effects. This disagreement emanates, in part, from differences in the two schools of thought toward RPM.

One school holds that dual distribution involving RPM should be treated as a horizontal restraint based upon the fact that the manufacturer who sells directly through its own retailers competes with the independent retailers it also sells to. Under such circumstances, RPM may be adopted to suppress competition that would otherwise occur between the two distribution systems. The other school holds that that dual distribution involving RPM should be treated as a vertical restraint based upon the reasoning that the manufacturer's role as a retailer does not alter its incentives with respect to RPM.<sup>7</sup> Dual

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<sup>6</sup> Extension of the traditional "free-rider" argument to Internet retailers describes how rather than providing consumers with pre-sale information through, for example product demonstrations and other methods, small and mid-size Internet retailers depend on competing brick-and-mortar retailers to do so. They then divert "educated" consumers away through offering them lower prices obtained through their cost savings. Traditional retailers threaten that unless protected by RPM from Internet retailers' lower prices eventually they will no longer provide pre-sale information; frustrating manufacturers' promotional efforts and harming consumers in the process.

<sup>7</sup> This view subscribes to the logic that even in the context of dual distribution a manufacturer would not voluntarily adopt RPM unless the uniform higher prices that result increase its sales – if not, it would make little sense for the manufacturer to provide excess profits to its retailers and higher prices to consumers.

distribution is also said to make the anticompetitive use of RPM less likely given a manufacturer who is also a retailer credibly demonstrates its ability to avoid the exercise of retailer power including abuses of RPM. In addition, manufacturer owned retail outlets are said to act as a competitive check on competitive abuses of RPM by independent retailers.

*Thus, as previously described, the extent to which manufacturers and consumers interests in adopting RPM may diverge provides an important starting point for understanding RPM including its competitive effects within dual distribution arrangements. Research which attempts to understanding the motivations for dual distribution and the use of RPM within such arrangements should be helpful in this respect. A critical question is under what circumstances and to what degree does a manufacturer's role and interests as a retailer impact its decision to adopt RPM? As well, does a manufacturer's role as a retailer demonstrate its ability to avoid the influence and abuse of RPM by dealers? What role do a manufacturer's own retail outlets play in safeguarding against such abuses?*

### **OTHER TOPICS FOR RESEARCH**

A number of additional topics are also important and should also be considered for future research addressing RPM. These include:

- Measuring and assessing effects: *Tests and criterion.*
- Moderating effects: *Single brand versus multibrand retailers.*
- Moderating effects: *Independent versus integrated distribution.*
- Interaction effects: *Effects of RPM and other restraints.*
- Subversion of RPM: *Product diversion and arbitrage.*