



Some brief comments on P. Rey / T.Vergé, 2008

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"Pros and Cons of Vertical Restraints"
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Disclaimer

The comments presented here are solely of my own responsibility and in no way necessarily represent those of the Portuguese Competition Authority

(hence any failure to fully understand the paper is my own fault !)

Introduction

- RPM still *per se* illegal in the EU but not in the US anymore;
- RPM can limit interbrand as well as intrabrand competition;
- The present paper shows how RPM can eliminate any scope for effective competition when producers distribute their goods through the same competing retailers.

The Model

- Two manufacturers (two brands) and two retailers in an interlocking relationship; four differentiated goods/services;
- Symmetric demand functions (not necessarily linear);
- Two-stage game in a double common agency market structure; upstream and downstream competition;
- “Market-break down” assumption and acceptance of manufacturers contract offers to retailers is public information.

Some comments

- (1) What if retailers are asymmetric, i.e., final demands are not symmetric?
- (2) Assuming it would be more realistic for retailers' acceptances or rejections of manufacturers offers to be private information, to what extent can we expect significantly different results (possibly less welfare damaging results)?
- (3) On effort level and equilibrium selection, is it always the case that we get a monopoly outcome? Any other equilibrium selection mechanisms?

Some comments (cont.)

- (4) To what extent is it true that retailers will have market power given the increasing multiplicity of retailing channels?
- (5) Competition policy makers might want to assess comparatively two part tariffs with and without RPM in terms of their final effects. Given equilibrium multiplicity under RPM, can one give some advice? The paper seems to say no.
- (6) On the pros and cons of RPM, is the prevention of free riding on the retail side, and other possible welfare enhancing effects, enough to compensate for the negative impact of RPM? Should the EU, and some NCA's, abandon the per se illegality of RPM and go the american way?

The Model

Case A1: Contracts consist of two-part tariffs (wholesale price plus franchise fee) and no RPM; manufacturers have all the bargaining power

Competition at both upstream and downstream levels leads to retail prices **below** the monopoly level since each manufacturer doesn't take into account that a reduction on its prices hurt rival's upstream profits.

If there is no downstream product differentiation, retail prices equal wholesale prices, franchise fees are zero and manufacturers compete directly with each other.

The Model

Case A2: Contracts consist of two-part tariffs (wholesale price plus franchise fee) and RPM; manufacturers have all the bargaining power

Imposing retail prices is a dominant strategy.

There is a continuum of symmetric equilibria with retail prices inversely related to wholesale prices. In particular, there is a (symmetric) SPE in which wholesale prices equal unit production cost, retail prices are set at the monopoly level, manufacturers appropriate all profit and share it equally. In this situation RPM prevents both interbrand and intrabrand competition.

The Model

Two interesting issues:

Bilateral bargaining power (retailers can, instead, have all the bargaining power or, supposedly, both sides can have some).

On retailers' effort levels and equilibrium selection (move away from previous equilibrium multiplicity).

The Model

Case B: Competitive retailers

Under mild conditions, the previous characterization of double common agency equilibrium outcomes still applies in the absence of the so-called “market break down” assumption.

There is a wide range of situations for which monopoly prices (via common retailers and RPM) constitute a likely outcome.

The Model

Case C: Retailers have market power (retail bottlenecks exist)

A manufacturer may try to eliminate its rival by inducing retailers to carry only its own brand.

Because retailers have some market power, manufacturers share their profits with them. Under RPM the latter may favor an equilibrium with retail prices lower than monopoly prices so as to reduce retail rents.

Analysis is restricted to the case of linear demand with intra- and interbrand substitutability.

The Model

Case C1: Contracts consist of two-part tariffs (wholesale price plus franchise fee) and no RPM; existence of retail bottlenecks

Retailers earn positive rents whenever they carry both brands due to their market power.

Due to retailers' market power, there may not exist a "double common agency" equilibrium where both retailers sell both products.

The Model

Case C2: Contracts consist of two-part tariffs (wholesale price plus franchise fee) and RPM; existence of retail bottlenecks

There exist equilibria with RPM and double common agency. Equilibrium retail price is, as before, inversely related to equilibrium wholesale price. Manufacturers prefer the equilibrium with the lowest retail price and retailers the one with the highest retail price, which exceeds the monopoly level.

Some conclusions

- RPM can eliminate effective competition when producers distribute their goods through the same competing retailers (existence of interlocking relationships);
- RPM eliminates competition between retailers; “common agency” eliminates competition between manufacturers;
- Competition policy makers ought to be cautious when faced with price restrictions where rival manufacturers rely on same competing retailers, with or without retail bottlenecks.

Some comments

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