Vertical Restraints: Economics vs. Draft Guidelines

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Economic Review of the Current Regime and of the Draft Guidelines

- Hardcore Restrictions
  - Resale Price Maintenance
  - Selective Distribution and the Internet
- Buyer Power
  - The Applicability of the 30% threshold for the distribution sector

Resale Price Maintenance

- **Current Regime: Per se Illegality**
  - No recent cases in Europe, but quite a few in France.
    - Conseil de la Concurrence: *Brown Goods* (05-D-66, December 2005), *Children videos* (05-D-70, December 2005), *Perfumes* (06-D-04, March 2006), *Toys* (07-D-50, December 2007), ...
  - No discussion of efficiency defense in these decisions.

- **Economic Theory**
  - Effects of RPM (especially when compared to non-price restraints) are not so clear-cut.
  - Seems to be a contradiction: tough stance against RPM, soft approach towards non-price restraints.

Economic Analysis of the Effects of RPM

- Rey and Vergé (2008), "The Economics of Vertical Restraints", in *Handbook of Antitrust Economics*, P. Buccirossi Ed., MIT Press.

- **Intra-brand Coordination**
  - Double marginalization, retail services, free-riding, ...
  - Price and non-price restraints have similar effects.

- **Inter-brand Competition**
  - Not necessarily favourable to non-price restraints (e.g., competing vertical structures).
  - **Upstream collusion (RPM as facilitating practice).**
  - **Interlocking relationships.**

RPM as facilitating practice

- Jullien and Rey (*Rand Journal of Economics*, 2007).
- RPM facilitates collusion because it helps firms to detect any attempt to "cheat" by one of the participants.
- Trade-off between gains from enhanced collusion and losses due to rigid retail prices.
- **Overall effect of RPM on consumer surplus:**
  - Shocks on retail costs: higher prices on average (☹) and rigid prices (☹).
  - Shocks on demand: higher prices on average (☹) but rigid prices (☺). **Ambiguous overall effect**, although it is **more likely to be negative** (because manufacturers tend to favour RPM when it substantially increases average prices).

RPM as facilitating practice

- Other practices are less likely to facilitate collusion.
  - May exacerbate price fluctuations (e.g., quantity restrictions when demand is uncertain) or prove less effective than RPM.

- But, RPM reduces welfare only if products (i.e., manufacturers are sufficiently differentiated.
  - See Draft Guidelines, par.(220): “This negative effect is in particular plausible if the manufacturers form a tight oligopoly.”

Interlocking Relationships

- Rey and Vergé (mimeo, 2009).
- Competing manufacturers sell their products through the same competing retailers.
- **No retail bottleneck**
  - In the absence of RPM, unique equilibrium with “relatively competitive prices.”
    - Using the same retailers softens competition, but not totally.
    - Trade-off between low wholesale prices (to use the common retailers as effective means of coordination) and high wholesale prices to offset the effects of intra-brand competition).
  - With RPM, possible to sustain the monopoly outcome
    - RPM eliminates intra-brand competition.
    - Using common retailers is an effective way to eliminate inter-brand competition if the right wholesale price can be chosen.

Interlocking Relationships

- **Retail bottlenecks** (i.e., “buyer power”)
  - Analysis is trickier.
  - Without RPM, usually no equilibrium where all the channels are active.
  - With RPM, many equilibria including one with the monopoly prices for a large set of the parameter values.
  - **Overall, difficult to conclude on the effects of RPM**
    - Fewer products without RPM. At which prices?
    - Which equilibrium is more likely to be ‘played’ with RPM?
    - Some empirical evidence on the effects of RPM based on French data (Biscourp, Boutin and Vergé (2008) and Bonnet and Dubois (2007, 2008)) suggest a negative effect.

Resale Price Maintenance

- **Draft Guidelines**
  - RPM remains a hardcore restriction, and there is little to suggest that firms have a real chance to propose an efficiency defence. (see par.(47)).
- **Economic Theory**
  - Although there are some recent theories suggesting that RPM may have a negative effect, these do not always apply.
  - What if RPM is used by a small manufacturer only, or when inter-brand competition is fierce?
- **When is RPM actually used by firms?**
  - Standard of proof ? (E.g., French authorities / courts' decisions)

Selective Distribution and the Internet

- Selective distribution is an effective way to improve the distribution of some products.
  - When the type of product is such that pre-sales services have to be offered by the retailers.
  - Product-specific investments have to be incurred by the retailers.
  - Free-riding on those services and/or investments is an important issue.

- **Trade-off between:**
  - Effective distribution system (increased demand, quality, ...).
  - Reduction of intra-brand competition.

Economic Analysis of Selective Distribution

- Even when the upstream market is monopolised, if it is <u>possible</u> that selective distribution increases:
  - The vertical structure (manufacturer and its retailers) joint profits.
  - Consumer surplus.

- Inter-brand competition makes it more likely that manufacturers adopt a selective distribution system only if the effect on consumers is positive.
  - If (on average) consumers prefer low prices – low services to high services – high prices, a firm adopting the latter strategy would see its profit decrease substantially.

How does the Internet change things?

- **Lower entry and distribution costs:**
  - Possible to serve many local markets without the need to open a brick-and-mortar store in each of them.
  - Centralised distribution platform. Higher volumes.
- Therefore, ability to set lower prices than brick-and-mortar shops.
  - **Reinforces the free-riding problem when it is an issue.**
- "Pure-players" (but also "click-and-mortar" stores in some circumstances) threaten any selective distribution system.

Selective Distribution and the Internet

- Should selective distribution networks be forced to sell to “pure-players”?
  - Wrong question.
  - Question should be “what is the competitive effect of not selling to “pure-players”?
    - Important reduction of intra-brand competition, since it blocks the entry of low cost retailers *(but then it is not so different from selling to distance-selling)*.
    - Strong inter-brand competition should prevent any anti-competitive effect.

- **Is selective distribution justified in the first place? On which grounds?**

Selective Distribution and the Internet

- The draft guidelines have tried to identify a middle-ground
  - It is possible to refuse to sell to “pure-players”.
  - However, it is not allowed to prevent an approved dealer from selling online as well as in a brick-and-mortar store.

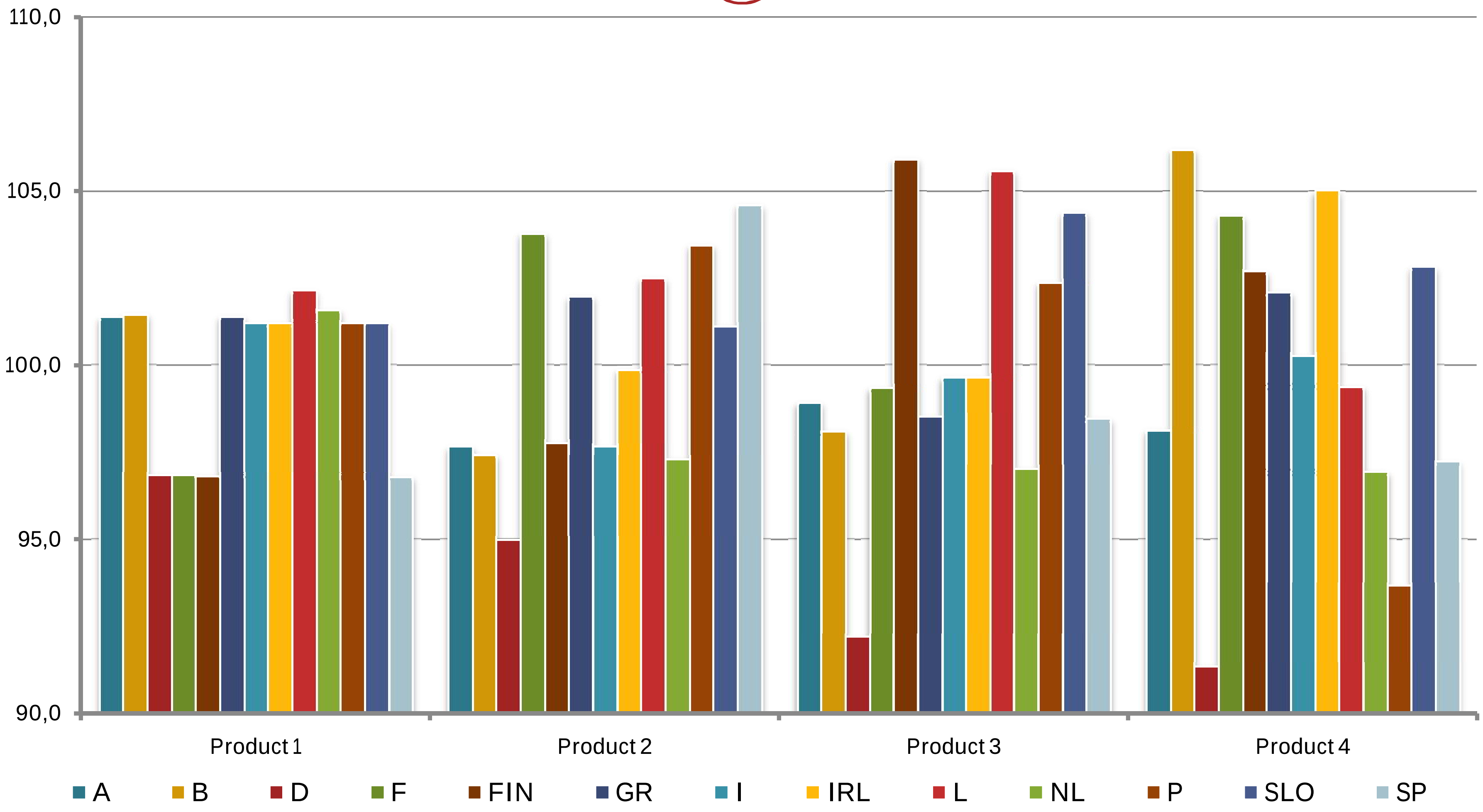
- Another view:
  - Make it clear when selective distribution can be justified and when it cannot.
    - Possible need to review whether existing selective distribution networks are still justified.
    - May call for (more) empirical analysis of the effects of selective distribution.
  - Safe harbour below some threshold market share (is 30% too high?) even for restriction of internet sales by approved dealers.

Some Quick Comments on the Internet

- Lack of proper empirical analysis of the effects of the internet on consumer surplus.
  - Seem to be clear benefits for some categories of products (airline or train tickets, new banking services, ...).
  - Less obvious for many goods
    - Are the goods online sold (at lower prices) really the same?

- **Market segmentation occurs on the internet.**

International Price Comparisons



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- **Some of the "big internet pure-players" are actually subsidiaries of the big brick-and-mortar retailers.**

The most **visited** websites

Overall – 1st Quarter 2009

#	Website	Type
1	Ebay	Platform
2	Price Minister	Platform
3	3 Suisses	Mail Order
4	Amazon	P.P. / Platform
5	La Redoute	Mail Order
6	Fnac	Brick-and-Mortar
7	Cdiscount	Groupe Casino
8	Voyages-Sncf.com	SNCF
9	Vente-privée.com	Pure Player
10	Kiabi	Brick-and-Mortar
11	Pixmania	Dixons Group
12	Rue du Commerce	Pure Player
13	Carrefour	Brick-and-Mortar
14	Spartoo	Pure Player
15	Quelle	Mail Order

Source: Médiamétrie / FEVAD

Buyer Power and the 30% Threshold

- Buyer power is an important economic issue.
  - Therefore considering downstream as well as upstream market shares seems to make sense.

- **But practical difficulties**
  - Contract between a producer and a large retail chain (think of grocery retailing in particular).
  - National market share of that retailer: 15-20%. But much larger market shares (above 30%) on some (possibly many) local markets.
    - Supermarket enquiry (UK), various mergers (Safeway / Morrisons (UK), Carrefour / Promodès (France), ...), ...
  - **How to deal with such a situation?**

Conclusions

- **Still some contentious issues.**
  - RPM, Selective Distribution and Internet Sales
- **Is there not too much regulatory intervention?**
  - Hardcore restrictions (with the difficult to justify efficiency defence) even when market shares are extremely low.
- **Part of the approach seems more "form-based" than "effects based".**
- **Always positive to have more "economic" input.**