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Outline

- Introduction
- Recent Theory
- Empirical Evidence
- Policy Implications



Problem

Introduction

Point of Departure

- Retail Price Recommendations (RPRs) are ubiquitous (e.g, automobiles, software, apparel, food, books, electronics, watches, medicines, etc.).
- The economic rationale for making RPRs is not very well understood: Why do manufacturers make RPRs if retailers are free to ignore them?

Policy towards RPRs

- Varies considerably across jurisdictions.
- **Suspicion**: RPRs serve as a substitute for (unlawful) Resale Price Maintenance (RPM), with similar pros and cons.

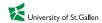


Example: The Economist

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Example: The Economist cont'd

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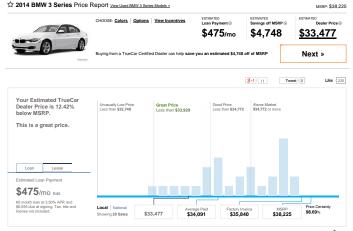
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Example: Truecar.com

Introduction

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Antitrust Approaches Towards RPRs

- **US**: "Rule of reason" (*Leegin*).
- **EU**: "Pressure or incentives"?
- **Switzerland**: *Hors-Liste Pharmaceuticals* ("RPRs amounted to RPM").

New Economic Research

- RPRs directly affect the willingness to pay of (behavioral) consumers.
- RPRs communicate private information from manufacturer to retailer to improve supply chain efficiency





Consumers suffer from **loss aversion** (Tversky & Kahnemann 1991) if the **retail price** p **exceeds the RPR** \tilde{p} .

- **Setting**: Chain of monopolies (1 manufacturer, 1 retailer).
- Loss aversion implies that the **demand jumps down** for any $p > \tilde{p}$.
- The downward jump induces the retailer to set the **retail** price equal to the RPR $(p = \tilde{p})$.
- This leads to a shift of profits from the retailer to the manufacturer.



Consumers perceive behavioral losses when purchasing above the RPR $(p > \tilde{p})$, and gains when purchasing below the RPR $(p < \tilde{p})$.

- **Setting**: 1 manufacturer, *n* horizontally differentiated retailers.
- Due to gains and losses from retail prices that deviate from the RPR, the manufacturer has an incentive to manipulate consumer demand.
- In equilibrium, retail prices are lower than the recommended prices $(p_i < \tilde{p}_i)$, such that consumers are faced with **(pseudo)** bargains.
- RPRs may be employed to manipulate the retail market.



Lubensky (2012)

RPRs provide information about aggregate market conditions to consumers who search.

- **Setting**: 1 manufacturer, continuum of retailers, costly consumer search.
- RPRs help consumers avoid the search cost of learning about aggregate market conditions (informing them whether they are offered a "good deal" or should go on searching).
- Retailers anticipate the searching consumers' reaction to the RPR.
- In equilibrium, RPRs influence both retailers and consumers.

In a long-term supply relationship, RPRs communicate private information from manufacturer to retailer which is indispensable for maximizing supply chain profits.

- **Setting**: Chain of monopolies (1 manufacturer, 1 retailer).
- Retail **demand** $D(p, \theta)$ is a function of price p an quality θ .
- The manufacturer has **private information** about marginal cost c and quality θ .
- The manufacturer makes RPRs to inform the retailer about the surplus-maximizing retail prices.
- Extension: If the RPR directly affects demand $D(p, \tilde{p}, \theta)$, the combination (p, \tilde{p}) must maximize supply chain profits (e.g. "moon pricing": $\tilde{p} \gg p$).

Synthesis

Introduction

Various Roles for RPRs

- RPRs may directly manipulate the willingness to pay of behavioral consumers.
- RPRs may provide information about aggregate market conditions to consumers who search.
- RPRs may serve as a communication device, allowing firms to improve supply chain efficiency.

Challenges

- How relevant is the behavioral element?
- Generalize analysis to "more realistic" settings with multiple retailers and manufacturers.
- Work out clear-cut policy recommendations.





Faber and Janssen (2011)

RPRs help **coordinate intra- and interbrand prices** in the Dutch gasoline retail market.

- Setting: In the Netherlands, oil companies make daily RPRs to gasoline retailers (data on almost all Dutch gasoline stations are used).
- RPRs contain extra information relative to publicly available spot market prices which explains changes in retail prices.
- Many stations charge a retail price below the RPR, but changes in retail prices are similar to changes in RPRs.



De los Santos et al. (2013)

The removal of RPRs has reduced consumer search and increased retail prices for processed food in South Korea.

- Setting: Policy experiment in South Korea. RPRs were banned in 2009 for several processed food categories and (surprisingly) reinstated in 2011.
- There was a general impression that prices increased after the ban.
- Retailers did not consistently display prices.
- Many consumers felt uncomfortable without RPRs.



Synthesis

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Assessment of Empirical Evidence

- Some evidence that RPRs may facilitate collusion in the retail market.
- Some evidence that the removal of RPRs reduces consumer search and increases retail prices.
- No robust evidence available on whether RPRs are anticompetitive.

Challenges

- Get access to micro data on RPRs, retail prices, and wholesale prices.
- Exploit or construct quasi-experimental settings to allow for causal inference.

Policy Implications



Policy Implications

- **1** RPRs may **improve supply chain efficiency** or **inform** consumers who search, i.e., a ban is inappropriate.
- 2 RPRs may cause anticompetitive effects (fairly similar to RPM), i.e., general permission is inappropriate.
- **3** Economic analysis calls for a "rule of reason" approach.
- In practice (legal uncertainty, enforcement cost), we must put more structure on the rule of reason approach (e.g., generous safe harbor).
- **5** A note of caution on the **EU approach**: Pressure and incentives may well be implicit.





References

Introduction

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