Retail Power, Slotting Allowances, and the Countervailing Power Hypothesis

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All interested are welcome
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Abstract

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We assess the competitive effect of upfront payments such as slotting allowances in a situation where a manufacturer faces a polarized retail sector which consists of a dominant retailer and a competitive fringe retailers. In contrast with the received wisdom that such upfront payments are anticompetitive, we show that the upfront payment demanded by the dominant retailer, although as a consequence of increased retail power, increases social welfare and consumers surplus. But the gains are neither profits extracted from the manufacturer nor passed onto the consumers. Banning such upfront fees may result in exclusion of fringe retailers. In addition, we show that vertically integrated profits can realize in equilibrium even without exclusion. This is because that the optimal three-part tariff contract eliminates the distortions induced by the vertical and horizontal externalities. The model’s predictions do not rely on uncertainty, asymmetric information, or retail effort etc. The paper offers a theoretical basis for Stigler’s criticism (Stigler, 1954) on the concept of “Countervailing Power” proposed by Galbraith (1952).

Keywords: retail power; backward vertical control; upfront payment