

A Comparison of the Wholesale Model and the Agency Model in Differentiated Markets

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BACKGROUND

- In modern times, goods often pass through more elaborate supply and distribution chains. While the wholesale model remains common in the bricks-and-mortar environment, the agency model becomes predominant in online markets, with giant online platforms such as Amazon, Apple, eBay, Google and various booking websites adopting it.
- In the (in)famous *Apple* case, distinctions between the wholesale model and the agency model were highlighted and concerns were raised over the latter, contrary to the verdict in the earlier case of *Schwinn*.
- In *Schwinn*, restraints involved in the wholesale model (under which the ownership of goods was transferred during transactions) were ruled to be *per se* illegal; but the transactions using the agency distribution under which the ownership of goods were retained by manufacturers were deemed legal. In other words, the same vertical restraints were treated differently under wholesale and agency models, and the judicial reasoning hinged on the legal ownership of property. This reasoning was heavily criticised by economists.
- While the linear price wholesale model is well-understood in economic theory, there is a lack of systematic analysis of the agency model as well as detailed comparison between the two, which constitutes the basis of understanding the changes in vertical relations.

METHODOLOGY

- We examine the wholesale model and the agency model that characterise a vertical relation in a bilateral duopoly framework.
- We compare the equilibrium outcomes of the two models, and interpret how relevant and useful they are for the understanding of the nature of the agency model, as well as the antitrust treatment of restraints of this kind.

KEY FINDINGS

- In symmetric equilibrium, retail prices are always lower under the agency model relative to the wholesale model.
- Manufacturer profits are always higher under the wholesale model, whereas retailer profits are higher under the agency model unless manufacturers' goods are close substitutes.
- Manufacturers and retailers' incentives are better aligned under the agency model.

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- Given the results of the analysis, if courts were to distinguish between restraints involved in wholesale and agency distributions, as they did in *Schwinn*, the verdict might be more reasonably based on how the welfare impacts of restraints differ in these two scenarios – the agency model is more beneficial to consumers – instead of the legal ownership of property.
- Relative to the wholesale model, the higher consumer surplus and better alignment of incentives under the agency model constitute a conflict. The evolution of the antitrust treatment of vertical restraints from *per se* rules to the rule of reason suggests the scope of applying the rule of reason in treating restraints of this kind.
- From the social planner's perspective, when the wholesale model, rather than the agency model, is adopted as the vertical contract, there is a considerable probability that higher industry profits are obtained at the expense of using the "wrong" vertical contract.
- The popularity of the agency model in some markets implies the powerful position of retailers in those markets.

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ABOUT THE AUTHOR

Liang Lu is a Research Associate (specialising in Economics) at the Centre for Competition Policy at the University of East Anglia.

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