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CCP CENTRE FOR COMPETITION POLICY

Sept 2010

Market-Share Contracts as Facilitating Practices

CCP Policy Briefing

Market-Share Contracts as Facilitating Practices

BACKGROUND

- Recent antitrust decisions on both sides of the Atlantic have sparked interest in the appropriate treatment of rebates and discounts that do not reflect a firm's cost structure.
- Of particular interest and concern are rebates and discounts that apply to all units purchased by a retailer once the retailer's purchases reach some threshold. These may be based solely on how much is purchased from the supplier or they may, in addition, be linked expressly or implicitly to the supplier's share of the retailer's overall purchases.
- Contracts that depend only on how much a retailer purchases of a suppliers product are known as own-supplier contracts.
- Discounts that are based on the supplier's share of purchases are known as market-share discounts, and the contracts that give rise to them are known as market-share contracts.

METHODOLOGY

- The authors investigate how the use of market-share contracts may affect competition.
- The authors model the case of a dominant supplier that distributes its products through retailers that also sell substitute products. There is both intra- and inter-brand competition in this setting: each good is sold by multiple competing retailers, and each retailer sells multiple competing goods. The dominant supplier's problem is how to choose its contract terms to maximise its profit given that the two types of competition present very different challenges.

KEY FINDINGS

- It is found that in the presence of own-supplier contracts, both intra- and inter-brand competition cannot simultaneously be dampened.
- However, competition on all goods can simultaneously be dampened when market-share contracts are feasible.
- Compared to own-supplier contracts, the use of market-share contracts increases the dominant supplier's profit and, if demand is linear, lowers consumer surplus and welfare.

POLICY ISSUES

- The results imply that market-share contracts that stop short of requiring full exclusivity are not simply weaker versions of exclusive-dealing arrangements and, as a result, less worrisome from a policy perspective. In some settings, they may be *more* worrisome.
- The results also imply that a policy of banning the use of own-supplier contracts that offer non-incremental discounts would have no effect in the setting described by the authors, unless the prohibition were also to extend to contracts that condition the retailer's payment terms on its purchases of the competitively-supplied goods.

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THE CCP

The ESRC Centre for Competition Policy (CCP), at the University of East Anglia, undertakes competition policy research, incorporating economic, legal, management and political science perspectives, that has real-world policy relevance without compromising academic rigour.

FOR MORE INFORMATION

The full working paper (10-13) and more information about CCP and its research is available from our website: www.uea.ac.uk/ccp

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