Slotting Allowances and Scarce Shelf Space

BACKGROUND

- Slotting allowances are payments made by manufacturers to obtain retail shelf space. Manufacturers who offer the best deals obtain shelf space. Those who do not risk being excluded altogether.
- Conventional wisdom suggests that the growth in slotting allowances can be attributed to an imbalance between the number of products that are available for the retailer to choose from at any given time and the number of products that the retailer can profitably carry given its limited shelf space.

METHODOLOGY

- The authors explore a departure from the conventional wisdom. They develop a model which captures the idea that slotting allowances can facilitate rent extraction, and that this effect is enhanced when shelf space is scarce. The choice of how much shelf space to build enters into the model as a strategic decision by the retailer.

KEY FINDINGS

- Slotting allowances allow the retailer to capture more efficiently the value of its shelf space when shelf space is scarce.
- By itself, this effect is welfare neutral. Slotting allowances in this case serve only to transfer rents among the two manufacturers and retailer.
- However, the same mechanism may also induce the retailer to limit its shelf space when shelf space would otherwise be plentiful. This effect tends to reduce welfare and can harm both manufacturers.
    - Welfare decreases when shelf space is scarce because consumers suffer from reduced product choice but do not benefit from lower prices.
    - The manufacturers are worse off when shelf space would otherwise be plentiful because overall profit is lower, but the retailer's profit is higher.
- The authors find there is an inverse relationship between the observance of slotting allowances and a retailer's bargaining power. Conditional on having at least some market power, the more bargaining power a retailer has over its suppliers, the less likely it will feel a need to limit its shelf space as a means of extracting rent.

POLICY ISSUES

- Policy makers have been concerned with whether slotting allowances would lead to higher or lower retail prices, and whether dominant manufacturers might abuse slotting allowances by buying up scarce shelf space in order to foreclose smaller rivals with better products.
- However, in the authors' model, there is no effect on retail pricing, and the better product is always chosen conditional on the availability of shelf space.
- Instead, the authors find that welfare may be lower because slotting allowances may induce the retailer to limit its shelf space. This suggests that slotting allowances may be harmful even if they are not accompanied by exclusivity provisions, the market does not exhibit scale economies in production, and access to capital markets is not a concern.

W: www.uea.ac.uk/ccp
T: +44 (0)1603 593715
A: UEA, Norwich, NR4 7TJ

University of East Anglia
E·S·R·C ECONOMIC & SOCIAL RESEARCH COUNCIL

An ESRC Research Centre
CCP CENTRE FOR COMPETITION POLICY

October 2010

Slotting Allowances and Scarce Shelf Space

CCP Policy Briefing

An ESRC Research Centre

CCP CENTRE FOR COMPETITION POLICY

October 2010

Slotting Allowances and Scarce Shelf Space

CCP Policy Briefing

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 (10-14) and more information about CCP and its research is available from our website: www.uea.ac.uk/ccp

ABOUT THE AUTHORS

- Leslie Marx is a Professor in The Fuqua School of Business at Duke University
- Greg Shaffer is a Professor of Economics, Management and Marketing at the University of Rochester, Professor of Economics at the University of East Anglia and CCP faculty member

W: www.uea.ac.uk/ccp
T: +44 (0)1603 593715
A: UEA, Norwich, NR4 7TJ

University of East Anglia

E·S·R·C ECONOMIC & SOCIAL RESEARCH COUNCIL