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## **The impact of private labels on welfare and competition**

- how retailers take advantage of the prohibition of retail price maintenance in European competition law

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## **Abstract**

Contracts stipulating consumer prices between retailers and suppliers are illegal under European competition law. Without control of prices, the branded goods industry cannot communicate coherent marketing strategies. Retailers, though, control prices, promotions and presentations for industry's brands and for private labels. These unequal conditions help to explain the recent surge of private labels that has regionally reached more than 40% of food turnover and for new ways in which private labels are used against brands. Issues of competition and welfare are discussed in the context of private labels to support the argument against the prohibition of retail price maintenance.





# 1. Deviating chances in competition between branded goods and private labels are rooted in pricing policy

For some years the market share of private labels (retailer labels) in the consumer goods industry has been steadily increasing (Olbrich 2001a, 2001b). This trend is accompanied by an ongoing and marked price competition in the retail sector. Superficially it could be assumed that the increased spread of private labels is nothing more than a reflex of the supply side to an increased demand for lower-priced goods. This paper shows that the competitive chances of private labels in comparison with the industry's branded goods are considerably different and very much favour private labels. In its core this phenomenon is rooted in the prohibition of resale price maintenance which weakens the industry's set of pricing policy instruments and which in return has practically helped the pricing policy options for private labels to come to full flower (for a discussion of this regulation cf. Horst 1992 and Glasow 2000 and, pertaining to private labels, Olbrich 2001a: 65; Olbrich 2001b: 263). Along with the fundamental options that have been opened up to the retail business by the prohibition of resale price maintenance (freedom of price fixing throughout the whole assortment), and the advantages this has opened up for aggressively pricing companies in the retail sector's concentration processes (for the potentials of crowding out of specific company forms cf. Olbrich 1998), this prohibition also lays the foundation for special pricing policy options for the retail business. Retail companies have far more options in acting for their private labels than the branded articles industry ever had for their brands (*including* the situation before the prohibition of resale price maintenance).

In particular the following options that retailers have for private labels must be taken into account: 1. Controlling and fixing the prices to the ultimate consumers throughout the distribution network in the retail company; 2. adjusting the price differences to the branded articles and to the company's other private labels and 3. adjusting the 'manufacturer's recommended retail price', which is indicated by retailers to generate 'artificial price differentials' to the prices which are actually demanded.

Section 2 contains a brief overview of the rules governing the prohibition of resale price maintenance in the law of the European Community (EC). The appropriate regulations will in some cases be contrasted with the German regulations, because

Increasing market share of private labels

Better competitive chances for private labels against branded products because:

Resale price maintenance

Ability to market products coherently

Retailers' options

Organisation of the paper

at present the seventh Amending Act to the German Restraint of Competition Act is in the pipeline and corresponding reforms are already being discussed. The experiences gained from the regulations which were previously valid in Germany can certainly provide some help for the development of European competition law. Section 3 takes a look at the latest results of the discussion on the welfare effects of private labels. Section 4 describes the generation of price sceneries as a strategy of the retail sector to factually get round the prohibition of resale price maintenance. Section 5 makes clear how this and similar attitudes by the retail sector prevent effective competition, and section 6 pinpoints possible outcomes for this trend. The findings are summed up in a final section (section 7) and implications for the legislative are formulated.

## 2. The prohibition of resale price maintenance in European law

In general, the law on competition in the European Community only applies to agreements between companies which have a cross-border effect within the territory of the Community, i.e. which affect economic transactions between two or more member states. This restriction is, however, interpreted very widely, because European competition law attempts to protect not only actual but also potential competition. Even an agreement between two companies from the same member state of the EC which concerns only the national relationship between these two companies can therefore possibly lie in the scope of application of EC competition law. This would be the case, for example, if it were suspected that such an agreement could impair the business relationship of a third company from another member state to one of the contracting companies. In this situation the agreement under discussion would lead to the danger of a restriction of cross-border trade in the European Community.

Applicability of European competition law

The prohibition of resale price maintenance is regulated in article 81 of the EC Treaty. This article states in section 1, among other things: "[A]ll agreements between undertakings" which "have as their object or effect" to "directly or indirectly fix purchase or selling prices" vis-à-vis third parties "shall be prohibited as incompatible with the common market".

Resale price maintenance in the EC Treaty

Just like the other provisions of this section the prohibition of resale price maintenance can be declared to be not applicable in accordance with Article 81, section 3 under certain circumstances: To be valid an agreement must serve, for example, the objectives of increasing the benefits for consumers or of advancing technical progress. At the same time, however, it must not impose any restrictions on the companies that are not essential for the realisation of these goals or open up any opportunities of eliminating competition for a considerable part of the affected products. Exemptions of this type are usually issued either on request in single-case decisions or a whole group of agreements of a similar kind is governed with comprehensively in block exemption regulations (BER).

Exemptions from the prohibition of vertical agreements

The currently valid BER for vertical agreements (European Commission 1999; referred to below as 'Vertical BER') states explicitly in article 4 that the exemptions from the prohibitions in article 81 which it contains do not apply to those vertical agreements whose purpose is "the restriction of the buyer's ability to determine its sale price". The guidelines for the Commission's dealings with

Resale price maintenance is exempt from possible exemptions

vertical restrictions state further in Note 47 (European Commission 2000: 11) that along with direct price fixing by way of contractual terms the prohibition also covers indirect price fixing, which is effected, for example, through certain systems of contract terms or quite simply through threats by one of the companies.

Differences between German and European competition law

Since the current Vertical BER came into force partly different rules apply on the levels of European and German law. For example, fixing maximum sales prices by suppliers is delimited in the Vertical BER from the circumstances of fixing minimum or fixed prices for retail, which is still prohibited, and must be regarded as allowed under the wording of the provision (article 4; this follows changes in the way US courts treat this issue, e. g. US Supreme Court, judgment dated 04.11.1997, No. 96-871, *State Oil v Khan*). This applies as long as a fixed maximum price does not actually work as a minimum price and therefore on the whole as a fixed price, for example, by being set so low that it would be uneconomical for the retailer to reduce the price still further (cf. European Commission 2000: 44).

Possible impact of these differences

With regard to the major manufacturers of branded articles it is easy to see that their possibilities for contractual arrangements influence cross-border trade among member states of the European Community, which then brings the Vertical BER into action. This would at least enable these manufacturers to fix maximum prices without any restriction, which means they could counter the practice of 'umbrella pricing' by the retail industry. However, such maximum prices cannot be used to prevent low price strategies of retailers in the field of branded articles, which are used by retailers, among other things, to attempt to bring the perception of the quality of the private labels closer to that of branded articles.

In fact often the smaller and medium-sized manufacturers of branded articles are particularly affected by the blurry legal situation, because they would probably have considerable difficulties to prove that their activities have an effect on cross-border trade. If they do not succeed in proving this only the German Restraint of Competition Act would, circumstances permitting, apply to them at present; this Act prohibits all resale price maintenance in its paragraph 14. This Act exceptionally permits non-binding price recommendations, which are in principle forbidden in paragraph 22, only under certain circumstances (paragraph 23, clause 1). For example, approved recommendations of this kind must be "issued in the expectation that the recommended price corresponds to the price that will probably be demanded by the majority of the addressees of the recommendation." (Translation by the authors.) A stipulation of this kind leads to considerable legal

uncertainty, because approval or prohibition is not made to depend on the nature of an action itself but on the way third parties react to this action. The term "branded articles", to which the exception in clause 1 of paragraph 23 applies, is defined more closely in clause 2 of the same paragraph.

In the interests of legal certainty and the equal treatment of major and less significant manufacturers of branded articles it is to be urgently recommended that German law be adapted to European law in this point. These circumstances are taken fundamentally into account in the current government bill for the seventh Amending Act to the Restraint of Competition Act, which provides in part for a word-for-word adaptation of German competition law to European competition law.

German and European law should not contradict each other



### 3. The latest results of the discussion on the welfare effect of private labels

Against the background of the pricing policy options for retailers that were sketched briefly in section 1, the retail trade, and particularly food retailing, has for some time seen an increasing impairment of competition through private labels with simultaneous circumvention of the prohibition of resale price maintenance through 'contracts from the end of the value chain': private label programmes frequently comprise closely regulated relationships between the retail company and the manufacturers with the aim of ensuring that the products are found only in the sales structures of the respective trader at prices fixed by this trader.

Impairment of competition through private labels

For some time different studies have seen a risk of restricted competition between retail companies and a reduced choice for the consumer which is also caused by these developments. Dobson *et al.* (1997: 428) regard the growing supplier power of the retail distributive sector as a problem especially if the assortments of competing retailers cannot be seen as substitutable: private label programmes, however, represent an attempt to weaken this very substitutability (a similar opinion is stated by Dobson *et al.* 1999: 142).

Supplier power of retailers

Dobson, who acts as an expert for the European Commission on the overlapping subject area of 'Buyer Power and its Impact on Competition in the Food Retail Distribution Sector' (Dobson 1999), provides a detailed analysis of conceivable competition-promoting and competition-restricting consequences of the growing use of private labels (Dobson 1998: 20). He comes to the conclusion that the effects of private label programmes on welfare are to be classified at least as dubious. He fears in particular that investments in the branded articles industry will only take place to a much lesser extent because of the reduced profit opportunities, which could in the end lead to a further weakening of the brands and, in the long run, even to their complete disappearance (Dobson 1998: 34).

Weakened incentives for investment

In a recent study Ward *et al.* (2002) show empirically that the variety of products offered by the manufacturers of branded articles decreases with an increase in the market share of private labels. Bergès-Sennou *et al.* refer to the frequently unrealistic assumptions on which model calculations are based that make an increase in welfare through more private labels appear obvious (Bergès-Sennou *et al.* 2003: 18, 20): In particular when the question of the competition between different retailers is taken into account and in a long-term analysis Bergès-Sennou

Contradicting results from models and surveys

*et al.* are of the opinion that a negative assessment of the effects of private labels could dominate. Lately, the discussion of the welfare-directed effects of private labels was lively if inconclusive (cf. e.g. Bontems *et al.* 1999; Gabrielsen *et al.* 2000; Gabrielsen *et al.* 2001; Sayman *et al.* 2002 and Pauwels *et al.* 2003).

Impact of retail  
concentration

In view of the concentration in the retail sector and the increasing dependence of particularly the small and medium-sized branded articles manufacturers on the demand from this sector, it is no wonder that the number of manufacturers who can still refuse to produce private labels is diminishing (Dobson 1998: 17; Dobson *et al.* 2001: 277): private label programs not only lead to outlets being sealed off, i.e., to a growth in the retailers' supplier power, but also naturally to growing buyer power vis-à-vis the manufacturers. Competition laws and policies have not as yet acknowledged this circumstance sufficiently (Vogel 1998: 1166; Olbrich 2002). Even with regard to the remaining manufacturers of strong branded articles the retail sector can use successful private labels, for which 25% more cover margin than for branded articles can frequently be assumed (Narasimhan *et al.* 1998: 591), as a negotiating argument: even very powerful manufacturers of branded articles can thus be driven to price discounts which they otherwise would not be able to grant (similar arguments are stated by Bergès-Sennou *et al.* 2001: 3; Steiner 2002: 10 and Olbrich *et al.* 2003).



#### 4. Price sceneries as a new form of retail pricing policy – a factual circumvention of the prohibition of resale price maintenance

It is particularly significant that the retail sector is increasingly taking the initiative in the formation of vertical contracts, and thus the fixing of consumer-aligned prices in retailers' assortments is increasing to the same extent in which the market share of private labels is increasing. The market share of private labels is growing strongly because the competitive chances of branded articles have been considerably weakened since the abolition of the possibility of resale price maintenance and in the recent past have been further undermined through new pricing tactics in the retail sector.

The term 'price scenery' is used for the complete set of prices for a retail assortment. The term emphasises the fact that the prices of private labels and branded goods are deliberately set by the retailer to convey to the consumer a particular price image for the assortment as a whole without regard to the prices the branded goods industry would like to see. Because of this it sometimes seems to be justified to use the attribute 'artificial' in connection with price sceneries. The use of price sceneries can be described in stages (figure 1):

Price sceneries

Stages	Positioning of private labels	Price sceneries (examples)
Stage 1	Private labels in the entry-level price range Delisting C brands	Direct contrast of branded articles and private labels in the shelves (price campaigns, umbrella pricing intrastore)
Stage 2	Private labels as allegedly direct competitors for A and B brands Delisting B brands	Massive diversion of demand through advertising support for the price comparisons (umbrella pricing interstore)
Stage 3	Exclusion of intrastore competition between branded articles and private labels Delisting A brands (pure own brand ranges)	Artificial creation of price comparisons through setting recommended prices

Fig. 1: Price sceneries in the retail sector

These stages show possible pricing policy tactics which are ideal-typical and certainly not conclusive, which the retail trade can use and which at the same time

mark the increasing impact on competition that the delisting of branded articles has. A certain time sequence results from the fact that first of all C brands, e.g., branded goods with weaker market shares, have to give way to private labels (stage 1), before the stronger B brands (stage 2) and finally the strongest branded goods (A brands) have to give way (stage 3).

#### Umbrella pricing

Umbrella pricing plays a special part in this context (Olbrich 2001c). Here branded articles are not used as special offers in a familiar and in part aggressive way in order, for example, to generate an advantageous price image for the whole assortment on the part of the consumer (for the practice of selling below cost prices cf. Ahlert 1983, 1986, on brand erosion as a consequence cf. e. g. Klante 2003: 202; Klante *et al.* 2003 and Heil *et al.* 2003, and on the effects of promotions on exclusive distribution Mela *et al.* 1997). Instead, the prices for branded articles, which in some cases are increased artificially, are used to make private labels in the same market segment (and even on the same shelf, in other words intrastore, i.e. in the outlets of one specific retailer) appear particularly low-priced (stage 1).

#### Explicit price comparisons

The explicit comparison of the prices of certain branded articles and private labels in flyers or the print media has to be mentioned as well. This type of comparison can be found again and again. In this case the intended effect of the comparisons aims not only at the direct increase in the sales of the private label articles but also at the retailer's profile in comparison with that of other retailers (interstore) who still offer branded articles on a large scale (stage 2).

#### Artificial creation of distorted price configurations

The artificial creation of distorted price configurations through setting recommended prices which in reality are set by the manufacturer of private labels (in conjunction with the retail company) and are then undercut by the retailer for the purposes of a special promotion, is a particularly subtle misleading of the consumer which must be taken very seriously. This type of price scenery can not only be used with pure private label product ranges but in these cases is particularly interesting from the retailer's point of view because it eliminates the possibility for customers to compare prices of private labels and branded goods (stage 3).

#### Different competitive conditions with regard to pricing

With regard to pricing there are therefore unequal competitive conditions between retailers and manufacturers because of the prohibition of resale price maintenance (Köhler 2003a: 39, 2003b: p. 40). From the manufacturer's point of view not only arbitrary price differences for the purpose of promoting private labels can be

objected to, because they distort the competition to the disadvantage of the manufacturer and in this way lead to reduced sales for branded articles. Even more important is the question of the image of the manufacturer's brand in general: explicit price comparisons which are used for advertising purposes can in particular lead to brands as such suffering damage in the way of sinking market values (Köhler 2003a: 40).



## 5. Sealing off competition through private labels

Even now, without any great difficulty to provide justification, it is possible to support the statement that sales of private labels are already considerably sealed off from competition. All that is required is a glance at the central competition areas of the products in the retail sector (figure 2):

		Competition between products in retailing	
		Intrabrand	Interbrand
Competition between retailers	Intrastore	No competition at the level of private labels	No competition between different private labels  Increasing sealing off through delisting branded articles
	Interstore	No competition because private labels are only represented in one retailer's outlets	Increasing sealing off through business concentration (private labels are merged)  Increasing sealing off through delisting branded articles

Fig. 2: Competition fields of private labels in the consumer goods sector

The exclusion of *intrastore-intrabrand* competition is executed directly for private labels, because the retailer directly controls the market entrance of these products. In addition, the market appearance of the branded article in the retailer's outlets is controlled by the retailer itself. Intrastore-intrabrand

*Interstore-intrabrand* competition does not in fact take place because private labels are only represented in the respective retailer's distribution network. Interstore-intrabrand

The exclusion of *intrastore-interbrand* competition between private labels is given through the direct control of the respective retail system. The sealing off Intrastore-interbrand

from competition between private labels and branded articles is now driven even further by delisting B and C brands.

Interstore-interbrand

The exclusion of *interstore-interbrand* competition between different private labels of various retailing systems is coming closer and closer as a consequence of business concentration (private label product ranges are merged). In addition, delisting branded articles takes effect here as well and furthers sealing off.

In contrast to this, branded articles are subject to intensive competition in all four competition fields which is even partly distorted in favour of the retailing trade through its pricing behaviour as sketched above (figure 3):

		Competition between products in retailing	
		Intrabrand	Interbrand
Competition between retailers	Intrastore	<p>Branded articles over time are subject to a market appearance controlled by the retailers</p> <p>(in particular through changing marketing strategies of the retailers)</p>	<p>Branded articles compete with each other and with private labels</p> <p>(in particular through competition for shelf space and misuse as a price umbrella for private labels)</p>
	Interstore	<p>Branded articles are subject to pricing competition between retailing systems</p> <p>(in particular through price promotions and loss leaders)</p>	<p>Branded articles compete with each other and with private labels</p> <p>(in particular through profiling strategies of the retailers and as a price umbrella for private labels)</p>

Fig. 3: Competition fields of branded articles in the consumer goods sector

Intrastore-intrabrand

*Intrastore-intrabrand* competition is controlled by the retail sector and leads to the problem that branded articles are positioned differently depending on the retailers' strategies. With this stands and falls the possibility for coherent sales policy strategies of the branded articles industry.

In the *interstore-intrabrand* competition branded articles are subjected continuously to the retail sector's pricing competition. Interstore-intrabrand

In the *intrastore-interbrand* competition a branded article is in competition not only with competitive branded articles but also with private labels along with corresponding pricing policy tactics. Intrastore-interbrand

In addition, in the *interstore-interbrand* competition the branded article can be used either as a profiling instrument or as a price umbrella as well, depending on the retailer's strategy. Interstore-interbrand





## 6. Competition scenarios in the consumer goods sector

If we look at further developments, the following scenarios are heralded at present:

**Scenario (A):** Artificial price sceneries come to apply to pure private label assortments. Private labels dominate more and more product groups. A brands are hard-pressed in spite of superior product features. Proprietary B and C brands are largely crowded out. The following central question arises here for the future: Will it be possible for retailers to maintain price sceneries even with pure private label ranges?

Pure private label assortments

This question can be answered positively, 1. if alternative distribution channels for branded articles remain and interstore umbrella pricing is successful (circumstances permitting with advertising support); 2. if the consumer does not see through 'artificial price recommendations'; 3. if the consumer does not recognise those articles which have artificially increased prices to serve as reference products instead of delisted branded articles, as belonging to private labels.

The clear consequence of a development of this type would be: Price sceneries would mislead consumers.

Originally with the prohibition of resale price maintenance legislators aimed at enabling intrabrand pricing competition at the retail stage. This aim is not achieved any longer. In the private labels sector there is in fact a widespread exclusion of pricing competition. At the intrabrand level this exclusion is both intrastore and interstore. The exclusion is also found intrastore at the interbrand level. Given a rise in retail concentration an increasing exclusion of the pricing competition can be reckoned with at the interbrand-interstore level.

**Scenario (B):** There is a competition between different price sceneries. Should horizontal (eliminatory) competition in the retail sector come to a standstill in addition to the developments as shown in scenario A with an increase in concentration in the retail sector, there is a danger of non-competitive behaviour of the remaining retailers. The clear consequence of a development of this type would be: Price sceneries are moved to a higher price level. In the long run competition in the retail sector melts into a competition of price sceneries.

Competition between different price sceneries

Developments of this nature have been discussed for some time. Dobson, for example, argues that growing consumer binding to the stores in a specific retail

system, which is supported by private label product ranges, is accompanied by a reduction of brand loyalty to branded articles (Krishnan *at al.* 1997: 53). If this binding is successful, it will no longer be necessary for the retail sector to price its products (private labels and branded articles) with an eye on the competition's prices (Dobson 1998: 23, 30). In the long term this could lead to the developed price sceneries being displaced to a higher level. If many large retailers are able to bind their customers in this way, and react with the end of proper pricing competition, a situation of non-competitive behaviour would have been achieved.

## 7. Summary

Vertically organised systems are created on the initiative of retailers which generate artificial price sceneries and are even favoured in this through a legal regulation. Retailers not only circumvent the legal prohibition of resale price maintenance, they can also use recommended prices, once a concession of the German Restraint of Competition Act addressed to the branded article industry, in order to generate price sceneries. The branded article industry lacks an equivalent instrument for a sales policy which could restrict concentration and promote performance competition in the retail sector.

Manufacturers lack the means to resist marketing tactics of retailers

Pure private label product ranges would in the end make competition vanish almost completely (figure 4).

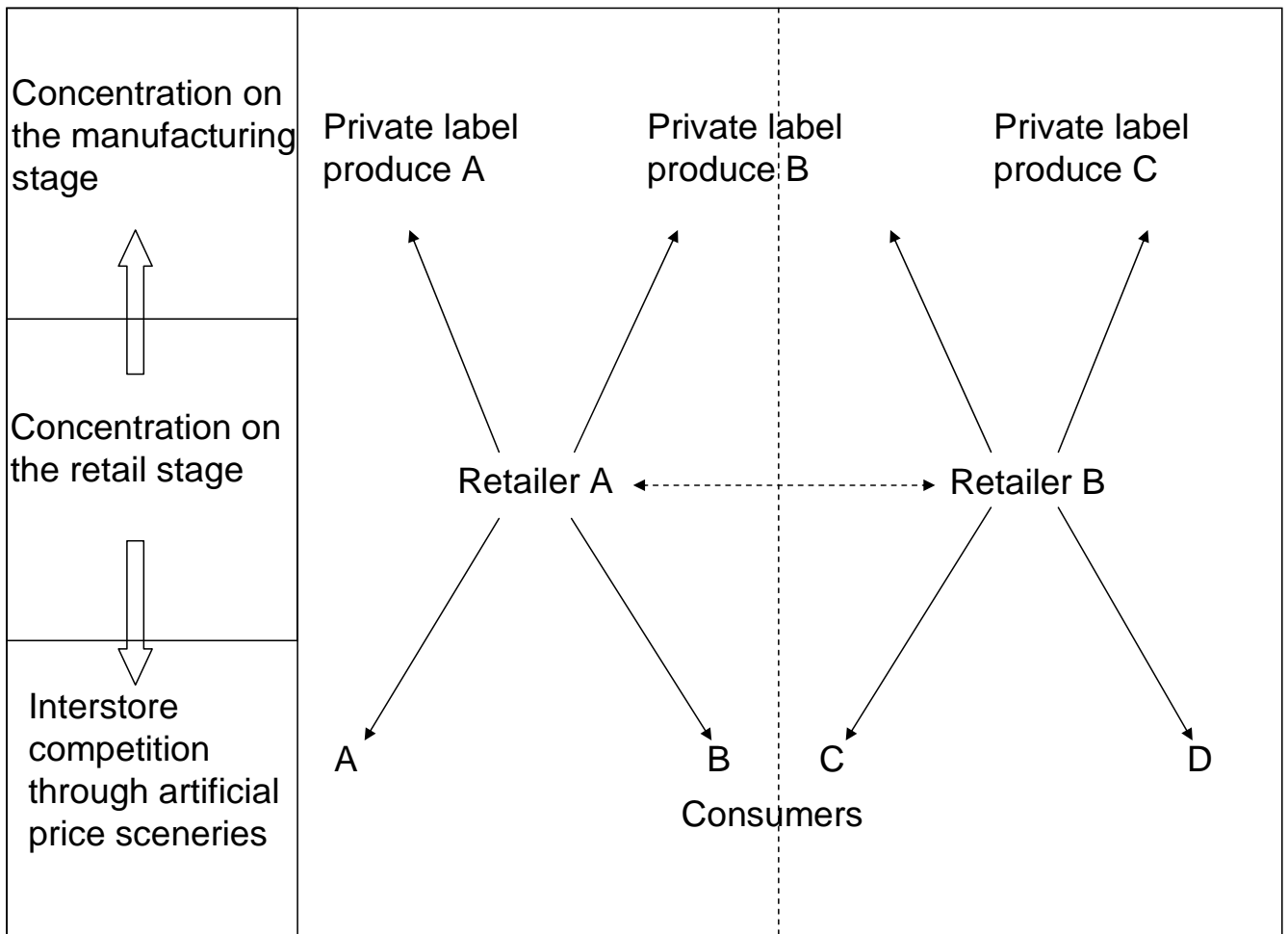


Fig. 4: Distribution of 'private labels' (sealing the competition fields off)

On the one hand, the intensity of vertical contracts would increase and this would make retailers and their suppliers to a great extent similar to proper vertical distribution systems. On the other hand, at the retail stage artificial price sceneries between the private label product ranges would superficially suggest good prices. The rigid vertical organisation between retailers and manufacturers would advance the process of concentration on both sides of industry still further, beginning at the retail level.

Only a competing branded article distribution system with fixed prices could put a brake on these developments (figure 5).

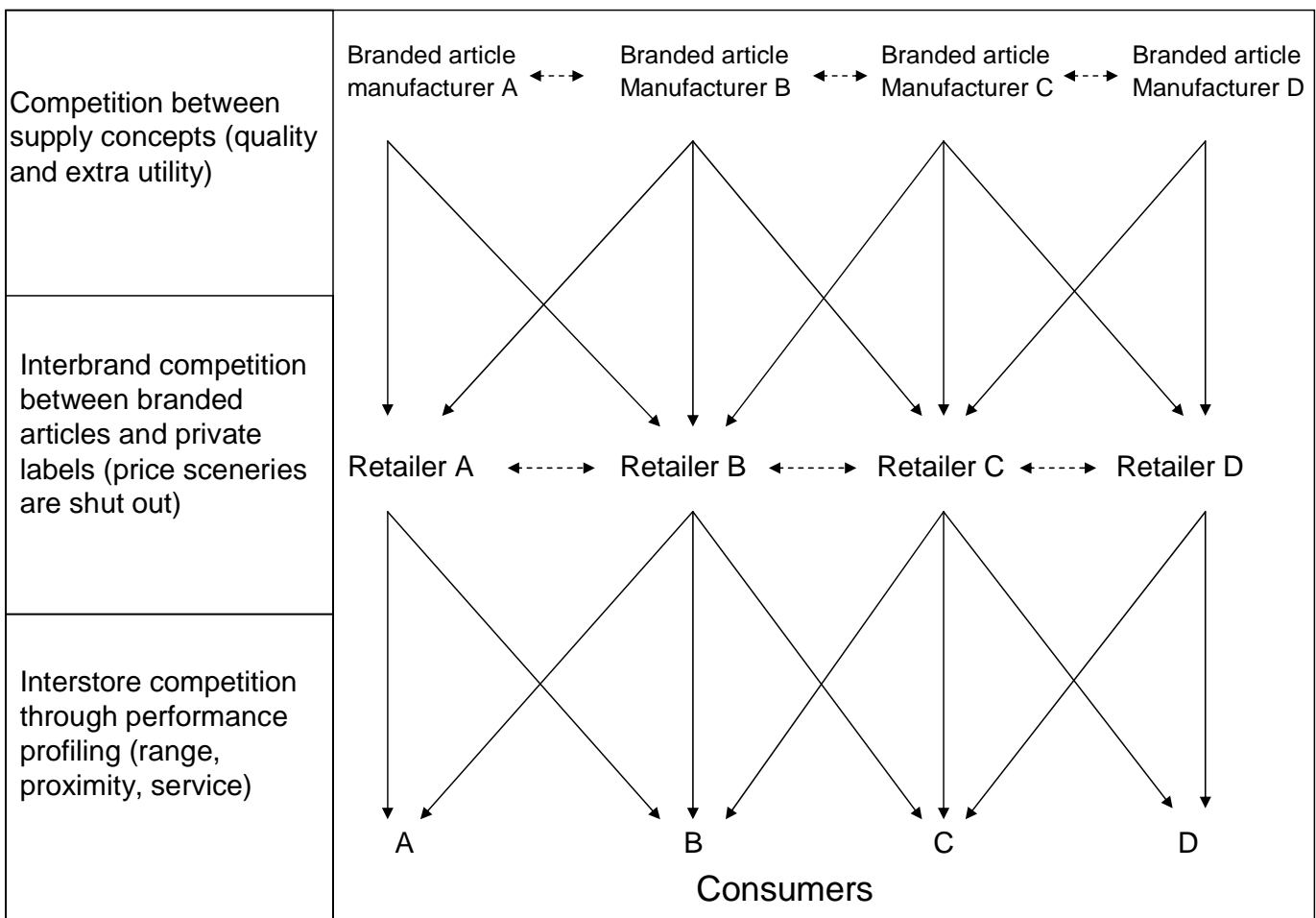


Fig. 5: Branded article distribution system with fixed prices

Positive effects through prevention of extreme price sceneries

In this case extreme price sceneries, which distort the pricing competition one-sidedly in favour of the retail stage, are shut out to a great extent on the retail stage. Interbrand competition between branded articles would once again be able to refer more to the performance components 'quality' and 'extra utility', whereby a

pricing competition between branded articles, triggered by the industry, would also be promoted, because the industry could then advertise a defined price which is contractually agreed with the retailers. At the same time, at the retail level elements of performance profiling (such as, e.g., a broad, differentiating product range and local proximity to the consumer, and services, e.g. more customer service) could once again gain importance.

It is true that even with a relaxation of the prohibition of resale price maintenance or even a reintroduction of the price-fixing option for the retail sector it would still be possible for retailers to make use of umbrella pricing and to avoid various competition fields. However, the extreme excesses, such as the artificial 'rise in price' and the 'price knockdown' of branded articles, would not be found any longer. This makes it clear that even a reintroduction of the price-fixing option for the branded goods industry would only be a certain compensation for disadvantages it has now. Against the background of the mature and still very marked eliminatory competition in the retail sector this compensation for disadvantages promises to strengthen those competitive forces which affect the readiness to innovate and invest on the part of the industry and the performance profiling on the part of the retail sector. Finally, because of the retail sector's pricing policy tactics shown here, a general increase in prices would not have to be reckoned with as a consequence of fixed prices in parts of the retail assortments, because extreme price umbrellas would be avoided and, from the point of view of the branded goods industry, the price difference to the private labels would have to be carefully observed.

The reason why the prohibition of resale price maintenance is so sensitive is because it has an effect against those it is intended to protect, namely the consumers, as a result of the practices which rest upon this regulation.

It is by no means undisputed in academic discussion that the market regulation of the prohibition of resale price maintenance leads to an increase in welfare. In fact, numerous studies arrive at the contrary conclusion: the Chicago School of Antitrust Analysis, which is influential in questions of cartel law, argues insistently against the general prohibition of resale price maintenance (Glasow 2000: 229), because convincing reasons for this intervention in the market cannot be derived from economic theory. On the basis of an economic analysis of the law, and without a deeper discussion of private labels, Glasow concludes quite clearly: "Economically speaking, the prohibition of resale price maintenance in European law is incomprehensible." (Glasow 2000: 231, translation by the

Legalising resale price maintenance makes the playing field more level

Academic discussion has been critical of the prohibition of resale price maintenance for some time

authors). Stumpp comes to the same conclusion: "A general ban, in other words a prohibition per se, cannot optimise the market results from an economic point of view, because it means that all positive effects which are achievable through the application of price maintenance would be prohibited or only realisable in another way at greater cost." (Stumpp 1999: 197, translation by the authors). As long ago as 1992, on the basis of an analysis of market processes Horst argued against the prohibition of resale price maintenance and warned "that the competition policy tabooing of resale price maintenance is an unsustainable situation which it is essential to resolve through a discussion free of prejudice and ideology." (Horst 1992: 285, translation by the authors).

No convincing reasons for upholding the regulation

In view of the global change experienced by the power relationship between retailers and manufacturers in the last 30 years, and because of the accompanying negative effects on competition, which this study has only examined in part, it is no longer clear today, in particular when looking at this sector of the economy, what the reasons for not changing the prohibition of resale price maintenance might be.

Exception for branded goods in retailing as a first step

This paper showed in detail the negative consequences of the prohibition of resale price maintenance under the aspect of product variety, the horizontal competition between retail companies and of the competitive position of branded article manufacturers. A decision in favour of an exception to the prohibition of resale price maintenance suggests itself for branded goods at least, because the possibility for manufacturers of these products to fix consumer prices themselves has to a certain extent the function of encouraging them to innovate. Because in many cases developing new products is only worthwhile in combination with this possibility: a uniform market appearance of a product is an important factor for its success on the market and the price is a significant component of this market appearance.

European competition policy is out of touch with current situation

All the same, European competition policy places great importance on the prohibition of resale price maintenance. Its concern here is that price fixing could lead to intrabrand competition being sealed off. As was shown above with reference to the retail sector, in the recent past it is not the manufacturers of branded articles who have sealed off competition in several fields, but the retail sector itself through the introduction of private labels. The trend towards this kind of exclusion of a large portion of competition through the retail sector is based in part on the deliberate use of branded articles at the cost of the branded articles manufacturers, because the latter are no longer able to achieve a uniform

appearance of their marketing instruments for the final consumers. The opportunity for branded article manufacturers of fixing the consumer prices of their own articles would counter the heavily unequal distribution of the possibilities for action of both stages at one position only. After all, along with setting the price, retail companies have numerous other opportunities for influencing the image of branded articles for the consumer: among other things they decide on the type and location of the placing in the sales area, on special sales promotion measures or on the stock-keeping policy, which, depending on the arrangement, leads to out-of-stock-situations with a lesser or greater probability. Even with the possibility of resale price maintenance branded articles would still be exposed to competition from private labels, such as the price-independent dimensions of the interstore-intrabrand competition (figure 3). These price-independent dimensions especially include the different placings, stockings and advertisings of a particular branded article by different retailers. In the case of private labels, however, these parameters can also be unified for the benefit of these products.

The analysis shows that the two conceivable types of handling resale price maintenance in the retail sector lead to different changes to competition:

A prohibition of resale price maintenance leads to a bundling of the options for action directed at the consumer on the side of the retailer. The growth of private labels and the associated sealing off from competition are caused to a considerable extent by the use of these options.

In contrast to that, the permissibility of resale price maintenance would allow the manufacturers of branded articles to achieve uniform pricing for consumers through suitable agreements with their buyers. The possibility for the retail sector of fixing prices is exactly the area that it can instrumentalise most directly for its goals and at the cost of the brands. The control by the manufacturers of branded articles over the consumer prices of their own goods, and this must be stressed, would be no different to that which every other company can achieve with regard to the actual addressees of its products, provided it is not dependent on a middleman. The simple fact that, on the grounds of expediency (and in the consumers' interests as well!), certain types of products are distributed through a distribution system with middlemen instead of directly, cannot be an adequate reason for placing the manufacturers of these articles at a disadvantage in comparison with the manufacturers of other articles.

Impact of legalising  
price maintenance

Having the practices shown here and the, in part, foreseeable developments in view, it is advisable to clear the German Restraint of Competition Act of its paragraph 14 and allow resale price maintenance agreements in European competition law, particularly because in this way more entrepreneurial freedom (of contract) would once again contribute to developing formerly paralysed competitive forces.

Suggestions for  
lawmakers

With the special exception to the prohibition of recommended retail prices for branded articles in paragraph 23 of the Restraint of Competition Act the German legislator has created a blueprint for a way the conclusions from our analysis could be taken into account: an urgently necessary compensation for the disadvantages suffered by the manufactures of branded articles as against the retail trade could be brought about by exempting these articles from the prohibition contained in the present paragraph 14 of the Restraint of Competition Act (roughly analogous to the exemption for newspapers or magazines in paragraph 15 of the current version of the Act). The government's draft bill for the amended Restraint of Competition Act contains an extra section 5 with special provisions for certain economic sectors in which, e.g., insurance companies are to be exempted from the application of the intended new paragraph 4 (prohibition of resale price maintenance). Suitable account should be taken here of the special requirements of branded articles which are distributed via retailers. Because large parts of European competition law (e.g. the Vertical BER) are to be incorporated in German competition law in paragraph 2 of the planned amendment to the Restraint of Competition Act, a recommendable solution would be a corresponding extension to the Vertical BER, because this would prevent new differences in the business activities of the manufacturers of branded articles in the different EC member states from the beginning. An explicit provision which exempted branded articles from the prohibition of resale price maintenance could then be done without in German law, which is used here as an example, but should anyway, of course, be carried out for the sake of clarity.



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