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Collusive Effects of Three-Tier Multi-Channel Distribution

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Most commonly, manufacturers of consumer goods make us of retailers to distribute their products to consumers. Thereby, they basically choose between selling their products directly to the retailers (integrated distribution) or indirectly through an intermediary, such as a distributor or a wholesaler (disintegrated distribution). Alternatively, a manufacturer could also opt for multi-channel distribution by combining – in the same market – the direct delivery to the retailers with an indirect delivery through an intermediary.

We analyze the rationale for a manufacturer's use of a multi-channel distribution system and its implications for downstream competition. Thereby, we account for the fact that the terms of delivery are private information to the contracting parties or could be secretly renegotiated. With private contracts, a monopolistic manufacturer delivering directly to competing retailers faces an opportunism (or commitment) problem, which prevents the manufacturer from exerting its market power. The reason is that it cannot credibly commit to supply contracts that induce the maximization of the overall industry profit, i.e. supply contracts with input prices above marginal cost or with low quantities (Hart and Tirole 1990; O'Brien and Shaffer 1992; McAfee and Schwartz 1994).

While the manufacturer's commitment problem can be relaxed in an infinitely repeated game (Hardt 1995), we show that the use of an intermediary to deliver to a subset of the retailers reduces the manufacturer's commitment problem even further. That is, a multi-channel distribution system can help the manufacturer to overcome the commitment problem for a wider range of discount factors than would be possible under integrated or disintegrated distribution. The reason is that multi-channel distribution reduces the deviation incentives from the collusive equilibrium path by limiting the number of retailers available to deviate with.

The strategic use of multi-channel distribution decreases downstream competition at the cost of consumers.