Who benefits from resale-below-cost laws?

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Abstract

In retail markets, loss-leader promotions (below-cost prices) work as one of the important marketing tools to attract customers. In this paper, we investigate how banning resale-below-cost influences consumer welfare and the profitabilities of firms including retailers and manufacturers. We consider competition between two retailers with heterogenous bargaining positions to a monopolistic manufacturer. Each retailer sells two goods: one is procured from the monopolistic manufacturer and the other from a competitive manufacturer. We show that banning resale-below-cost can *decrease* the prices of the retailers in equilibrium. We also show that the ban can benefit the weak retailer in terms of bargaining position and increase the total consumer surplus although it always harms the dominant retailer and the monopolistic manufacturer. We further extend the model to the case where the weak retailer is horizontally separated. This extended model captures a case in which a large Big Box retailer competes with a shopping mall organized by independent (weak) retailers. In this setting, the ban benefits the monopolistic manufacturer and the weak retailer trading with it although the ban harms the other weak retailer and the dominant retailer. The results imply that the effect of the ban on the profitability of the monopolistic manufacturer crucially depends on the market condition in the retailer level.

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