The Logic of Vertical Restraints, Revisited *

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Abstract

We revisit Rey and Tirole (1986)'s classical paper by assuming that retailers' costs are private information. When undifferentiated retailers are risk averse, competition among them creates uncertainty, and obliges the manufacturer to pay them a risk premium. The manufacturer will offer exclusive territories (ET) so as to eliminate uncertainty and the premium. Retail Price Maintenance (RPM) also reduces uncertainty, but is less efficient. Rey-Tirole's results (obtained under the assumption that retailers know each other's costs) are therefore reversed, with ET being chosen when retailers are risk averse and Competition being chosen when they are risk neutral. However, we confirm their general conclusions that ET and RPM are not necessarily substitutes, and that vertical restraints are not necessarily welfare-improving.

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