services to customers.[15] Consequently, it is in the manufacturer's interest to provide the retailer with sufficient retail margin (i.e., the retailer price is in excess of the wholesale price) to perform the necessary promotional services.

In a situation where the manufacturer senses that the dealers do not optimally promote the product, the manufacturer may configure the incentive structure in a way that induces retailers to choose the adequate level of promotional services, after sales services, retail price and so on. The manufacturer can build in additional vertical restraints in its contracts with dealers.

(1) *Resale price maintenance* (RPM) can be used to preserve a larger dealer margin that generates downstream incentives to engage in promotional activities. Moreover, a restriction on price competition (i.e., a floor price) makes it difficult for a low-service dealer to free ride on a high-service dealer, because it limits the ways in which the low-service dealer can attract consumers away from the other dealer (e.g., through price cutting). In this way, RPM both protects a high-service dealer and gives a low-service dealer an incentive to raise his service level.[16]

(2) One other arrangement, which does not come without its costs on the manufacturer, would impose *exclusive territories* (ET), under which the final market is divided into non-overlapping geographic segments with one dealer in each segment. ET are also a way of preserving the dealer's opportunity for return on incremental investment developing the territory since it assures that the dealer will reap the benefit of that investment directly.

(3) In addition, the manufacturer can use *customer resale restraints* to block free-riding directly. This method of non-geographic customer restraints can work much like exclusive territories to prevent free-riding. Faced with customer restrictions, a dealer is prevented from stealing the business of a consumer in whom another dealer has invested time and money in making a sales pitch or providing other customer-specific promotional services for the manufacturer's brand.

[15] In situations where this not true, the manufacturer could simply perform this function and there would no longer be a need for the vertical restraint.

[16] Frank Mathewson and Ralph Winter, "The Law and Economics of Vertical Restraints", in Frank Mathewson, Michael Trebilcock and Michael Walker, eds., *The Law and Economics of Competition Policy*, Vancouver, B.C.: The Fraser Institute, 1990.