and raising industry profits. Moreover, if all other manufacturers demand exclusive dealing, then an individual manufacturer has no real choice. Consequently, the entire industry will be characterized by exclusive dealing contracts.

(2) Some analysts also argue that *RPM restraints* weaken interbrand retail competition. Under RPM, each brand has a single final price, which is easy to monitor. Retailers that cheat on such collusive agreements can be disciplined. Contract provisions that improve monitoring may thus facilitate collusion.

Stylized Scenario: Strategically Foiling Rivals

(1) A standard argument in the vertical restraints literature points to the role of foreclosure through *exclusive dealing* arrangements as a means of raising a rival's costs. Suppose that there are economies of scale and scope in distribution. In this case, a system of exclusive dealers raises the distribution costs of smaller firms by more than it raises the distribution costs borne by larger firms. Consequently, smaller firms are put at a disadvantage by this industry configuration. The net effect may be to raise the profits of larger firms, even though their costs of distribution are raised as well.

Moreover, by demanding an exclusive dealing arrangement, a manufacturer with a large market share may be able to tie up the good dealers (e.g., retailers with locational advantages or who enjoy the greatest economies of scope).[23]

(2) A manufacturer can take advantage of the knowledge of the sales contracts or franchise agreements among dealers selling other manufacturers' brands. The manufacturer can make his dealer a more aggressive competitor in the retail market by setting his wholesale price below marginal cost, when other manufacturers set their wholesale price at or above marginal cost. Faced with a more aggressive rival, the other dealers lose sales, which raises the profits of the first dealer. That dealer's manufacturer then appropriates the profits through a fixed *franchise fee*.[24]

[23] In a model where two manufacturers of substitute goods compete for a single potential dealer, if the demand for one of the goods is larger than the other, then the manufacturer of that product may demand an exclusive arrangement with the retailer. See G. Frank Mathewson and Ralph A. Winter, "The Competitive Effects of Vertical Agreements: Comment", *American Economic Review*, (77) 1987: 1057-68.

[24] C. Fershtman and K.L. Judd, "Equilibrium Incentives in Oligopoly", *American Economic Review*, (77) 1987: 927-40; and Thomas W. Ross, "When Sales Maximization is Profit-Maximizing: A Two-Stage Game", working paper CIROU 87-01, Carleton University, 1987.