

Towards New Frontiers in Pricing*

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*Gábor Rekettye – Jonathan Liu:
Pricing – The New Frontier
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Gábor Rekettye, Professor Emeritus at the University of Pécs, can look back on a rich professional career.¹ He is the author of several books in Hungarian on the subject of price marketing, which is a crucial field, but is incomprehensibly neglected by domestic researchers. Nothing demonstrates the author's undying merits better than the fact that while working towards filling this gap, he satisfies a highly relevant need, seeing that amidst the turbulent economic conditions in our world and with the increasing globalisation of competition, pricing in a professional manner has become a particularly important tool for achieving company objectives. Moreover, the accelerating pace of technological development, the saturation of markets and the spread of the Internet put the question of pricing in a new context and present new challenges for managers who are compelled to throw out previous "masterstrokes".

The fact that his latest book on this subject co-written with *Jonathan Liu*, a professor of Malaysian and Chinese origin at *Regent's University London*, was published by *Transnational Press London* represents the completion of Mr Rekettye's mission and underlines the international recognition of his work. Published in English and produced in both colour and monochrome versions, the book is available in shops not only in the United Kingdom, but also in Hungary, Germany, Norway, France, Italy, Spain, the USA – and even in Japan and Australia. It is also accessible via paid applications on Google Play, Amazon.com and Kindl Ebook.

While the work represents an unquestionably high professional level, it is also an enjoyable book to read, since the authors facilitate the understanding of the

* The papers in this issue contain the views of the authors which are not necessarily the same as the official views of the Magyar Nemzeti Bank.

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¹ During his career, Gábor Rekettye worked in industry, in foreign trade and in international trade diplomacy, and he has also had a career in higher education. The landmarks of his work include several books and textbooks, along with more than 300 scientific publications.

subject by means of numerous examples, case studies and charts. It is perhaps no exaggeration to say that thanks to the success of their efforts, even a layman can get the gist: on the one hand, the nature and interrelationship of domestic and international factors as well as micro- and macroeconomic factors influencing pricing; on the other hand, strategic drivers, methodology or ad hoc – though representing progressive approach – rules of thumb, tricks and knacks of correct pricing adopted in response to the challenges of this fast-changing environment.

Bridges between theory and practice

The book's unique merit is that, while it tries to give readers an understanding of the *techniques and strategies* shaping the development/establishment of prices and to explore the backgrounds and business milieu thereof, it also undertakes to bridge the gap between practical and theoretical approaches to this subject. It is a very rare attempt to consciously link the categories of marketing, market theory and pure (theoretical) economics and to apply them to each area, thereby giving practical substance to abstract, general microeconomic models. It is not by chance that the work of Mr Reketye and his co-author may be of interest to all readers whose activities relate to *business areas, education or theoretical fields*.

What are the most typical manifestations of the aforementioned theory-practice dichotomy? First of all, while in theoretical economics prices are generally *indicators* influencing allocation decisions, according to the concept and practice of marketing, prices are *decision variables*. In light of the fact that the concept of the efficiency of an "invisible hand" ensuring the proper functioning of the price mechanism is regarded as a romantic myth *on real markets*, even the reviewer who is versed in the theoretical fields of economics must acknowledge that the approach of marketing is more relevant here. After all, in the increasingly multidimensional world of business generating situations of partial monopoly and interdependences, *everyone* is endowed with the ability *to set the price* and it is only reasonable to use this power. (This is so even if economic operators are *price takers*, since this behaviour is also a result of a decision, a consequence of the *positioning decision* of the management.)

The contradiction between theoretical and practical approaches can also be perceived if we observe that, while in well-known mainstream (basic) models profit-oriented actors on the supply side endeavour to determine the *output* level (or the unit price, often interpreted as its implication) corresponding to the point at which marginal cost intercepts marginal benefit (the so-called *Cournot point*), this method appears to be completely absent from corporate marketing *practice*, which mainly concentrates on *pricing decisions*. Is it perhaps deficiencies in the corporate information system that enforce the application of "rules of thumb" which are

nowhere near the “theoretically optimal” decision? We have to ask the question at this point. Or is it the case that the apparently more down-to-earth and profane terminology and methods of the management responding to realities which are always more complicated and complex than models – even if only unconsciously or instinctively – will eventually result in a situation close to the maximum level of profit.

The book by Mr Rekettye and his co-author makes for excellent reading, among other things because it presents us with these contrasts and concepts in approach/methodology. Therefore, it is expressly recommended, even as a learning tool, for readers who are perhaps familiar with the abstract fields of micro economy and market theory (industrial organisation), but are less confident in the practical world of business. (The reviewer – setting a good example – recommends the book for students attending his microeconomics courses as a useful supplement to the curriculum converting the very substance thereof into a reading that provides a “visceral experience”.) And while reading through the chapters dealing with the *concrete and genuine* steps, mechanism and considerations in the development/establishment of prices, we find the answers to the above-mentioned questions, either implicitly or hidden between the lines. For example, we cannot help wondering: is the frequent occurrence of *volume-based* decisions in microeconomic models indeed realistic? Could it be that a distributor offers a newly marketed product without specifying a unit price – thus leaving this task to the demand side?² We don’t have to think too hard to figure it out: perhaps only in the case of certain types of auctioning, which appears to be far from a general, dominant sales method.

From the book we also learn that in the course of price formation (calculation), a very high proportion of companies in the European Union still apply the method of adding a predetermined margin or “expected” *markup* (a sort of *normal profit*) to the unit cost. However, it is a positive but not yet sufficiently widespread practice to use *value-based pricing* seen by the authors as being progressive and worthy of implementation. The whole point of value-based pricing is that the upper limit of possible pricing decisions (essentially the *reservation price*) is defined by ascertaining (and, if possible, influencing) the customer’s perceived value (pp. 94–100). The contrast of these two formulas may be read as the opposition between the objective and subjective theories of value (and the theories of price based thereon) known from the history of science, however, the reviewer believes that in practice, the two principles can coexist. On the one hand, costs and a margin can only be factored into the price to the extent that the company is able to acquire a market and customers to accept them. On the other hand, the lower limit of the zone of possible pricing decisions is eventually determined by expenditures.

² This subject is dealt with, among other things, by the theory of supply shocks and market cleansing. See e.g. Carlton, D.W. – Perloff, J.M. (2003): *Modern industrial Organization*. Panem Kiadó, Budapest, Chapter 17.

Turning back to economic theory, it is relevant to note here: in a case where business expectations are not fulfilled (estimation of demand curve is wrong or overly optimistic, i.e. *ex post* price is below *ex ante* acceptable threshold value), the price can also perform a *guidance* function. This can be explained by the fact that outstanding costs and/or lower margins than expected can force out companies (investors) from the industry, and vice versa.

However, some research findings³ suggest that the relevance of the demand curve itself is often dubious, i.e. there is often no close, structural correlation between prices and the volumes intended to be purchased. After all, demand intention is influenced by a number of psychological, social and institutional factors that are also mentioned in the work by Mr Rekettye and Mr Liu, which – although they are caused by price changes– trigger uncertain, unpredictable, and sometimes atypical customer reactions as a result of their complex interrelations. In such circumstances, pricing considerations certainly cannot rely on mainstream recommendations; instead, other aspects outlined in the book (e.g. the relationship between price and quality, tying arrangements, references, attitudes towards competitors) motivate pricing decisions and determine the orientation thereof.

It is certainly not the case that the intended prices do not affect the achievement of company objectives, demand, revenue, margin, etc. due to reasons described above – if it were so, research in the area of pricing would become meaningless. However, it is important to realise that factors determining effectiveness exercise their impacts in a complex, multidimensional context, which is also replicated in the diversity seen in corporate price strategy. It is a credit to the authors that they warn against the automatic application of any price calculation method; instead, they urge practitioners to recognise, consider and comply with decision criteria, which are becoming extremely complex and are often interconnected in a turbulent way.

The basic context of pricing

The following section reflects on the major topics of the book consisting of 14 chapters, noting that the presentation of the monograph exploring almost the entire repertoire of price marketing can only be incomplete and the weighting of its messages – reflecting the reviewer’s specific approach – subjective.

Part 1 (covering Chapters 1–5) deals with the basic context of pricing. Chapter 1 discusses today’s trends and changes in the economic and natural environment which have led to an increased importance of price function and placed pricing objectives in a context that differs from the past. The authors point out that the

³ E.g. Zsombor Heindl (2011): *The role of the social networks in the utility function-based consumer behaviour*. Thesis, University of Pécs, Faculty of Business and Economics, Pécs.

changes in consumer habits (increase in price awareness) and the globalisation of competition have narrowed the leeway for price policy, while the increasingly composite product structure and the growing share of services in consumption result in a more complicated price structure.

Chapters 2–4 are basically theory-oriented and are the closest to the concepts and correlations known from mainstream economics. This is where the relationship of prices and consumer behaviour is presented. However, beyond the interpretation of the demand curve and the elasticities of demand, and beyond the explanation of the basic types of market structures, we can already see here the ability to translate theoretical knowledge into practical solutions. The analysis of factors determining customers' *value perception* (the term refers here to product characteristics), *price perception* and *price sensitivity* (applicable in a much broader context than price elasticity) – and stemming not least from psychological and social embeddedness – brings theory into action, and “infuses life” into the trains of thought described by theory. These chapters also cover the classification of costs and the role of costs in pricing. The break-even analysis presented here provides an interesting comparison with the short-term microeconomic closure model, but greater emphasis should have been placed on the presentation of the limitations of the calculation of the break-even point (e.g. distortions arising from the assumption of *constant* unit costs). At the same time, the application of this method to several products and the close logical connection between linear programming procedures, providing a wider range of applications, are remarkable.

Chapter 5 provides an introduction to the *concrete* methods of pricing. This is where the authors compare the pricing techniques based on the traditional “cost plus margin” formula with market-based pricing, describing the pitfalls of applying the former and the advantages of the latter. Juxtaposing the two techniques clearly underlines Mr Rekettye's and Mr Liu's commitment to a market- and customer-oriented approach; it is highlighted that customers' value judgement is dominant in the effectiveness of companies. (It is also demonstrated that progressive economists in the field of price marketing – characterising them by paraphrasing Oscar Wilde's *bon mot*⁴ – do consider the value in pricing.) Based on this credo, a detailed insight is provided into the techniques of market-based pricing, though they are all based on the same premise: consumers' value judgement (demand decision) is formulated in the context of marginal benefits attributable to the company's offer and customer expenditures. Let us realise: it is ultimately about taking into consideration the principle of optimisation known from theoretical economics (Gossen's law), even if it is not always apparent during the study of price policy considerations replicating the complex and complicated context of real markets. Translating this into the language of theoretical economics: market-based pricing has enough leeway to

⁴ “What is a cynic? A man who knows the price of everything, and the value of nothing.”

affect both consumer preferences (indifference map) and the slope of the budget line, in addition to shifting the cost curves by exploring more effective procedures, and adapting to competitors through ideas that can be best interpreted “in the language” of game theory.

Tactics and strategies of pricing in the distribution channel

Part 2, i.e. Chapters 6–10, forms the backbone of the book and focuses on *price strategy* and *tactics* to be followed in the dimensions of time, customer features and product characteristics. The authors explain the various aspects of the correlation between quality and price level, the elements of pricing policies for launching new products, the possibilities of market segmentation based on price and perceived value, and they also discuss the recommended behaviour towards price competition in the different stages of the life cycle. All of this, of course, is presented with the same attitude: discussing business practice in a theoretically sophisticated manner and exploring theoretical concepts with a practice-oriented approach.

In a separate chapter, the authors discuss the methods of price differentiation (price discrimination, non-linear pricing), indicating that this technique is becoming increasingly significant in parallel with the spread of services. However, price structure (price stratification) is also seen as a strategic issue, which is manifested in practice in the form of pricing the elements of the company’s offer. It may be interesting to compare this with the price policy considerations of *product differentiation*, which puts product range decisions in the context of the company and its competitors. The authors draw the attention to important correlations when they describe the pricing issues entailed by different types of product line stretching or when they address the technique of bundled pricing used in the case of tying.

Part 3 including Chapters 11–14 discusses the context of pricing with regard to different segments of the distributions channel – even a foreign market can be identified as such. It also outlines which actors have the ability to be a price maker, and which ones are forced to act as a price taker, depending on the power situation in a distribution channel. Within the presentation of the types of commercial pricing, a description is provided of the nature of price psychology and price promotion. Issues of online pricing policy which is gaining increasing ground are also examined here.

Presenting the special features of pricing in markets transcending national borders, the authors set out from the impacts of globalisation processes on the international scene. This where the particular dilemma of choosing between global and differentiated pricing (and setting an initial price level when entering the global market) is presented, in addition to the nature of transfer pricing in multinational companies, as a peculiar subject.

The final chapter gives readers an overview of the technique of successful price negotiations, providing good advice on how to apply the knowledge acquired through reading the foregoing in a bargaining process under real conditions, in an interpersonal situation. Therefore, this chapter basically takes a psychological approach, insofar as it covers the psychological aspects of customer types, the adaptation thereto and the process of price negotiations.

The book received endorsements from internationally recognised experts in marketing. The reviewer joins their opinions: he is sure that the book will be a good help for corporate professionals, students and teachers in economic higher education and for all those who are “just” interested in the subject.

The Marketing Subcommittee at the Hungarian Academy of Sciences, according to the votes of its members, selected this book for The Best Publication of the year 2018 in the Category of Professional Books. The Award of Excellence was handed over to the authors at the Conference of The Association of the Hungarian Educators in August 2019.