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## Indiscriminate pricing

**Companies often find it profitable to vary their prices according to customers' willingness to pay. But not always**

"NO DISCOUNTS, we promise," may sound a strange sales pitch. But Saturn, a division of General Motors, swears by its no-haggle policy. Retailers such as Bloomingdale's offer a similar commitment—"everyday low pricing"—rather than frequent sales and discounting. And firms such as Procter & Gamble and General Mills have tried to eliminate money-off coupons. Why do some companies find it worthwhile to pledge to charge everybody the same price?

Most firms, after all, prefer not to. Varying prices to match customers' readiness to pay is usually a more profitable strategy. Airlines, for instance, charge free-spending businessmen more than price-conscious tourists. They make bigger profits from businessmen and get more tourist passengers than if they had a single price for everybody.

Airlines would, of course, lose from this if many businessmen chose to fly economy instead. So they make cheap seats narrower and more uncomfortable, and they impose restrictions on tickets that are more likely to deter businessmen than tourists. Any company that sells at different prices in different countries faces a similar dilemma. Most cheered when the European Court recently outlawed "grey imports"—so that British supermarkets may no longer import cheap Levi jeans from Bulgaria and sell them at a discount to normal British prices.

Yet even if firms can discriminate successfully, and so boost initial profits, they could still end up worse off if rivals retaliate. A branded-cereal maker that offers too many coupons may steal sales from a maker of own-label cereals, provoking price cuts for all customers that hit both firms' bottom lines. To deter such competition, the branded-cereal maker may pledge not to offer discounts. In effect, the branded cereal would cede the most price-sensitive segment of the market to the own-label cereal, in the hope that the own-label firm will keep its prices up. That would allow the branded company to support its prices, and hence profits, in the less price-sensitive bit of the market.

In some cases, a commitment not to offer discounts may not boost profits. Take America's long-distance telecoms firms. They offer big incentives to each other's customers to induce them to switch provider. But that in turn means they have to cut prices for existing clients, so as not to lose them. As a result, all firms make lower profits than if none had offered discounts. And no firm has an incentive to commit itself unilaterally to uniform pricing, since that would not prevent rivals coming after its clients. Nor can firms get together to agree not to discriminate, since cartels are illegal; besides, each firm would have an overwhelming incentive to cheat.

Yet in some cases, companies can credibly pledge not to offer discounts, without colluding with their rivals, as a new paper\* by Kenneth Corts of Harvard Business School explains. This occurs when each firm would like to offer discounts to the other's clients but only a single group of consumers can be targeted.

Consider a department store. Some of its customers are impatient buyers who would rather pay full whack, say, for a suit than wait for the sales. Others are bargain-hunters willing to wait so as to pay less. If the department store wants to pinch custom from discount retailers whose low prices attract bargain-hunters, it may hold sales more often. But the discounters may retaliate with their own price cuts, leaving both with lower profits. So it may be profitable for the department store to promise not to hold sales more than, say, twice a year, if at all. Such a commitment can be effective because, whereas the department store can aim its price cuts at bargain-hunters, the discounter cannot offer price cuts to impatient buyers without offering discounts to all its clients.

There are other reasons why firms may wish to offer a single price to all. Some are keen to point out that "everyday low pricing" leads to smoother sale patterns than seasonal sales, reducing costly production spikes or stockholding and distribution bottlenecks. A "no-haggle" policy may appeal to customers who dislike being expected to bargain with shifty car dealers. And guaranteeing the same price to all may tempt customers of big-ticket items such as cars to buy now, rather than wait to see if prices fall.

### **Everyday high pricing?**

Should competition watchdogs worry about price discrimination—or a lack of it? Not usually. In the telecoms case, both consumers and the economy are unambiguously better off, since price discrimination spurs price cuts for everyone, which encourages people to call more. As for airlines, they may earn higher profits by discriminating. But consumers are not necessarily worse off, since businessmen pay more but tourists pay less. And since price discrimination should encourage more people to fly, the economy as a whole ends up better off.

Commitments not to discriminate are a trickier antitrust problem. Last September Procter & Gamble agreed—without admitting wrongdoing—to pay \$4.2m to settle antitrust charges brought by New York state's attorney general over its elimination of coupons. The trustbusters apparently believed that the consumer-health giant was colluding with rivals, because eliminating coupons "only works if everybody goes along with it".

But that is not necessarily true, according to Mr Corts's theory. And in the absence of collusion, there should be no antitrust worries—companies are not, after all, obliged to offer coupons. Consumers who are miffed at not getting them can always shop elsewhere. The problem, if there is one, is more one of presentation. "Everyday low pricing" sounds good, but consumers are often paying more than they would with frequent discounting. Perhaps Procter & Gamble should have replaced its "no-coupon" policy with a "no-haggle" pledge instead.

\* "Third-degree price discrimination in oligopoly: all-out competition and strategic commitment". *RAND Journal of Economics*. Summer 1998.

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