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PRICING PRACTICES OF THE TEXAS

SMALL BUSINESSMAN

By

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B.B.A., University of Texas, 1970

Presented in partial fulfillment of the requirements

for the degree of

Master of Business Administration

UNIVERSITY OF MONTANA

1976

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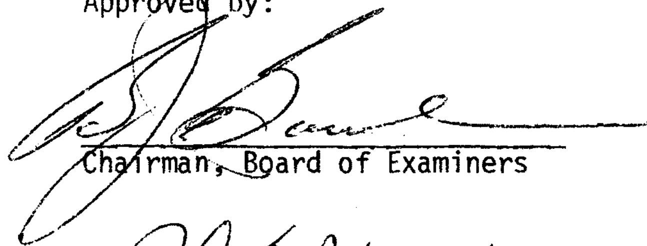

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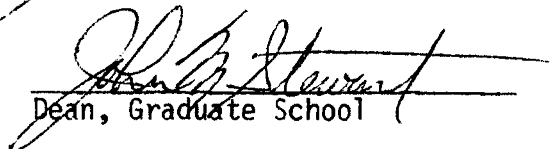

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TABLE OF CONTENTS

ACKNOWLEDGEMENTS ii

Chapter
I. INTRODUCTION 1

Scope and Purpose 1
Data Collection 2
Assumptions and Limitations 2

II. PRICING DECISIONS BY BUSINESS FIRMS: DOCUMENTED STUDIES 3

Studies of Large Firms 3
Studies of Small Firms 4

III. BRIEF REVIEW OF APPLICABLE PRICING LITERATURE 6

Pricing Objectives 6
Parties to Consider Prior to Setting Prices 7
Cost, Demand and Competition Oriented Pricing 8
Market Structure of the Firm 11
Full Cost Versus Marginal Cost 13

IV. CASE STUDIES 14

Nurseries 14
Printing Firms 20
Hardware Stores 26
Manufacturing Businesses 30
Miscellaneous Service Firms 35

V. RESULTS AND FINDINGS 41

VI. CONCLUSION 48

. . . .

APPENDIX 50

SELECTED BIBLIOGRAPHY 53

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CHAPTER I

INTRODUCTION

The study of pricing behavior is certainly not a new subject. Literally hundreds of volumes have been written that explore all aspects of pricing decisions, however there appears to be a sizeable difference in the amount of literature available on the corporate sized firm versus the smaller less complex business.

Haynes did not draw specific conclusions about this lack of data on the smaller firm, but he did imply that the modern researcher was ignoring the small businessman.[1] Perhaps they felt that results would only produce evidence of mechanical, unsophisticated pricing practices. The findings presented by Haynes after an intensive study of the small business firm did not support these views. These findings will be discussed in detail below.

The Haynes study was performed in 1964. There is little indication that current literature adds much if any additional knowledge to this neglected segment of pricing theory.[2]

The purpose of this study was to examine the pricing practices of the small business firm, specifically within the Houston, Texas area.

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[1]Warren Haynes, "Pricing Practices in Small Firms," The Southern Economic Journal (April 1964):315.

[2]A search of existing data did not produce evidence of any additional research accomplished after the 1964 study by Haynes.

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The intent of the paper is more one of description and comparison, rather than analysis of actual pricing practices discovered. Hopefully research findings will reduce the paucity of literature currently available on the small business firm.

Data were collected by means of personal interviews with selected businesses in five major categories. The personal interview research method was chosen because of the normally poor response experienced with mail surveys, and because the interview method was expected to allow a greater flexibility in data collection. A structured questionnaire was prepared for use in these interviews, and initial tests revealed that it was a good tool if properly adapted to the type business being studied. The Appendix contains a copy of the questionnaire used in the study.

The initial test surveys also indicated a reluctance on the part of many small businessmen to discuss their pricing practices in detail. Therefore, the sample of businesses included in this study does not represent an adequate statistical sample from which population estimates may be made. It does reflect the pricing policies of businesses of a specific size and type for this area.

One major limitation of a study of this type should be noted. Data collected for this paper are based upon what the small business firm says or aspires to, and not necessarily what in reality it does. Measurement of this possible discrepancy would be extremely difficult. For purposes of this paper, the assumption will be made that all responses by the small business firms are accurate descriptions of actual pricing practices.

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CHAPTER II

PRICING DECISIONS BY BUSINESS FIRMS: DOCUMENTED STUDIES

Probably two of the more noted examples of research into pricing decisions by the business firm, are Lanzillotti's study of corporate size business firms and Haynes' research of the small business firm.

Lanzillotti conducted his interviews with the corporate giants such as: U.S. Steel, General Foods and General Electric.[3] A total of twenty companies were interviewed over a period of several years with the specific purpose of identifying actual pricing techniques employed by these firms.

Pricing objectives of the large firms discovered by Lanzillotti were basically divided into four categories: 1) Pricing to achieve a target return on investment 2) Stabilization of price and margin (i.e., firm should charge a fair price and receive a just return) 3) Pricing to achieve a target market share and 4) Pricing to meet or prevent competition.

The target rate of return was the most frequently mentioned pricing objective, and primarily by those firms considered leaders in a

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[3]Robert F. Lanzillotti, "Pricing Objectives in Large Companies," The American Economic Review (December 1958):921-940.

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protected market. Those specifying target market share as an objective were more typically firms marketing products in other than monopolistic markets.

Lanzilloti concluded from his research that: 1) Large companies have a fairly well-defined long range pricing goal 2) Decisions relating to price, cost and product characteristics are made simultaneously within consideration of a firm's other products and markets 3) Pricing decisions are closely related to and serve as a check against a company's overall objectives. These pricing policies will reflect the priorities set by management.

Haynes conducted a study of pricing decisions by eighty-eight small business firms because he felt that the smaller firm had not received adequate emphasis. Haynes concluded that contrary to his findings on the larger firm, the smaller firm did not appear to emphasize cost-plus pricing.

Full cost or cost-plus pricing has been variously described. Haynes presents three basic types of full cost pricing: 1) Full cost plus a single predetermined markup 2) Full cost plus multiple predetermined markups and 3) Full cost plus variable markups.

> The arguement so far is clear: The use of full costs may be mechanical in a minority of small firms but permits considerable flexibility in pricing in the great majority of cases.[4]

Haynes contended that the majority of small firms in the nation may be cost oriented, but show considerable flexibility in responding to changing market conditions.

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[4]Haynes, "Pricing Practices in Small Firms," p. 324.

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He found that about half of his sample firms did not rely on full cost pricing because of the difficulty in defining "full cost". Most were heavily influenced by suggested price structures from manufacturers or wholesalers.

One of the major conclusions drawn by Haynes is that most small businessmen use what he termed "partial marginalism" in pricing decisions. Specifically this could be separated into: 1) Trial and error pricing 2) Variable markups reflecting different demands 3) Varying markups over time to reflect changing market conditions and 4) Imitative pricing of successful competitors.

In summary, the major findings of this study of the small business firm were: 1) Studies did not support the theory of strict adherence to full cost pricing, but rather flexible adaptations to a changing market. 2) Small firms who stressed cost, emphasized full cost rather than incremental cost, but were marginalists to the extent that they were willing to experiment in the market. 3) Small firms unlike larger corporations do not admit to target return as an important pricing objective. 4) Small firms are often concerned with the ethics of pricing and with their relationship to the community.

The two studies briefly outlined above point to radical differences in the manner in which large and small firms go about pricing their products. These differences will be explored further in the chapter examining individual case studies of numerous small businesses.

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CHAPTER III

BRIEF REVIEW OF APPLICABLE PRICING LITERATURE

In his chapter on price decisions, Kotler explained that pricing is important in four situations: 1) When a business must set a price for the first time 2) When market conditions warrant consideration of a pricing change 3) When competition initiates a price change and 4) When a company markets varied products that have interrelated demands.[5]

Kotler's presentation of pricing emphasizes it as an integral part of a firm's marketing process. He has consolidated into a brief analysis, some of the major variables associated with pricing decisions by business firms. The principal points of his analysis will be used here to lay the groundwork prior to examining the case studies presented in Chapter 5.

Pricing Objectives

Key to any sound pricing policy is the determination of an objective. Kotler classified pricing objectives into five categories: 1) Market penetration objective 2) Market skimming objective 3) Early cash recovery objective 4) Satisfactory rate of return objective (Satisficing) and 5) Product line promotion objective.

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[5]Philip Kotler, Marketing Management (Englewood Cliffs: Prentice-Hall, Inc., 1967), pp. 519-523.

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These objectives are not classified as specifically attributed to large or small business firms, but rather as general statements pertaining to businesses of all sizes.

Parties to Consider Prior to Setting Prices

Pricing decisions cannot be made in a vacuum. There are numerous variables that influence pricing aside from product related decisions. Before a firm sets its prices, it should give full consideration to its customers. Pricing policies will differ based upon whether the customer is a wholesaler, retail firm or an individual consumer. Second, the firm must always consider its rival competitors before embarking on price decisions. Pricing decisions ignoring competition would be foolish indeed. A key aspect of pricing decision relies upon the pricing policies of firms supplying the business with its goods. Discounts, cost-markup structures and suggested price schedules strongly affect many firm's pricing decisions.

The government is undoubtedly a key factor in pricing decisions. The larger firm is perhaps discriminated against in this respect, but it is perhaps because the larger firm can affect much more through its pricing decisions than the small firm. The Federal Trade Commission (FTC) has become the watchdog over big business pricing practices, and it has been left primarily to the state and local agencies to monitor small business pricing. At the local level, the Better Business Bureau and the city and state Consumer Fraud agencies have assumed this responsibility.

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Finally, a company must consider its own objectives and other company personnel in determining pricing policy. Pricing decisions cannot be determined alone so that they will not mesh with overall company objectives.

Cost, Demand and Competition Oriented Pricing

Kotler classifies business pricing practices into three types: cost oriented pricing, demand oriented pricing and competition oriented pricing.

Cost oriented pricing is basically of two types, markup pricing and target pricing. Markup pricing simply explained is adding a fixed percentage to a product's unit cost. This type of pricing is common in the retail business firm. One of the requirements for use of a rigid markup scheme is that the firm has constant costs and a thorough knowledge of its demand elasticity. Its popularity is attributed not only to the simple nature of price decision making under this scheme, but also to the fact that determination of costs seem to be less confusing than is the measurement of demand. In addition, the use of this pricing scheme by rivals will insure comparable pricing levels by all similar businesses.

Target pricing is another type of cost oriented pricing. The business firm attempts to set a price that will give it a specified rate of return on total costs and based upon a standard volume. Break even analysis is often an integral component of target pricing.

Target pricing has a serious flaw. It relies upon estimated sales volume upon which to derive price levels, however economic theory

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tells us that sales itself is a function of price. This can result in circular reasoning unless estimates of sales volume can be accurately forecasted.

Demand oriented pricing as its name implies, links price levels to the intensity of demand. Assuming that the firm's supply curve is relatively fixed, higher levels of demand will result in higher price levels, and lower demand levels lower prices.

The concept of the price elasticity of demand is also an integral part of the study of demand oriented pricing. Briefly stated, price elasticity of demand measures the percentage change in quantity sold to a specific percentage change in price. If price elasticity is equal to zero, this is termed perfectly inelastic demand. In this case a change in price would not bring about a change in quantity sold. A perfectly elastic demand describes a condition where the demand curve is flat (elasticity of infinity). The firm is obliged to sell at the market price because at a higher price it will sell nothing. Finally, when the percentage change in price equals the percentage change in quantity, elasticity is said to be unitary. The elasticity (slope of the demand curve), in this case is equal to one.

The importance of each of these concepts is emphasized as their effect upon total revenue is measured. If elasticity is greater than one, total revenue will increase as price declines. However, if the price elasticity is less than one, total revenue will fall as price declines.

Firms in homogenous product markets must possess not only an accurate estimate of their demand picture, they should also know how

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the market will react to their own price changes as well as the effects of their actions on competitive pricing. Will these changes affect the firm's market share and/or demand picture?

Initiating price changes in modern markets can be complicated further by the interrelated demands of classes of products. Price changes on one product may well affect the volume purchased of substitute or similar products.

The third type of pricing scheme is labeled competition oriented pricing. Two types will be discussed here, going rate pricing and sealed bid pricing.

Going rate pricing is used in many business firms where costs are difficult to measure. The firm's pricing decisions are made by imitating the pricing of its more successful competitors. By using this method of pricing, the firm stands to gain from the collective experience and knowledge of the market. Going rate pricing is most often used by firms in homogenous product markets. Oligopolistic markets also rely upon this method of pricing because of a belief in a "kinked demand curve." Pricing at any other level than the market price would only cause the firm to lose money.

Markets characterized by product differentiation have somewhat more latitude in price determination and thus less reliance is placed upon the going rate scheme.

The second type of competition oriented pricing is sealed bid pricing. This pricing practice is prevalent in the large type firm selling large volumes of a homogenous product or one of a kind items such as construction contracts, etc. Contracts awarded on a basis of sealed bids are normally totally price conscious.

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Market Structure of the Firm

Determination of price is affected by the type of market structure in which the firm is operating. Market structures may be divided into four basic types: 1) Pure competition 2) Oligopoly 3) Monopoly and 4) Monopolistic competition.

Pure competition may be described as a rare situation in which there are numerous buyers and sellers, homogenous products and free entry and exit from the market. Perfect knowledge of market price is also a key element of this structure. Pure competition in the strictest sense allows no pricing decisions. The business firm must price at the market price. If the firm sticks to the market price, it can sell all it desires. At higher price levels the firm will sell nothing. There are few if any business firms operating under these market conditions and thus its relevance to pricing studies is more theoretical than practical.

Oligopoly presents a market structure with a small number of firms competing in the same market. Two types of oligopoly may exist: firms that sell a homogenous product, and firms selling a slightly differentiated product. The steel industry is probably the best example of a homogenous oligopoly, whereas the automobile manufacturers operate within what might be termed a differentiated oligopoly. There is an aspect of interdependence among the business firms because the action of each is likely to affect all of the others. Probably the most popular description of workings within the oligopolistic market is the kinked demand curve theory. Briefly summarized, this theory states that all businessmen in an oligopoly will sell at the market price.

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Prices will remain rigid at this level, resisting changes brought about by changing patterns of demand or cost. If an individual firm attempts to raise its prices, other firms will be hesitant to follow. This will eventually force the firm back to the market price because the demand curve above the market price is highly elastic. In this situation a price increase would only result in decreasing total revenue and profit levels. If the firm instead attempts to lower its price, all of its competitors will follow this action. This will lead to reduced profits for all of the firms. The explanation for this is that the demand curve below the market price is highly inelastic. The lower price level might induce additional sales, but the total profits would be smaller than realized at the market price. Eventually all firms would follow which would in effect produce a new kink at a lower market price. Therefore it is suggested that these actions will produce a "kink" in the demand curve at the existing market price.

Although the kinked demand curve theory postulates that price competition is not feasible within an oligopolistic market, it certainly does not imply that there is no competition. Ingenious methods of non-price competition have emerged within these markets that produce spirited competition.

One additional model of oligopoly discusses a situation termed "price leadership." This represents basically a follow the leader pattern in which either a dominant business establishes price levels that are accepted by competitors, or in certain cases where a smaller firm sets new price levels based upon its knowledge of the market factors. The smaller firm bases its move on the assumption that competitors will follow. This is known as "barometric price leadership."

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There are very few real world examples of a pure monopoly condition except perhaps for the public utilities. The remainder of the real world examples fit a structure more accurately termed monopolistic competition. This refers to markets where the business firms are numerous and the product of each is differentiated from the products of other firms. In a market characterized by monopolistic competition, the business firm has a great deal of control over price levels and has a good picture of its demand at varying price levels. Without the fear of a competitive market, the firm will price at a level to meet a desired level of sales.

Full Cost Versus Marginal Cost

Full cost pricing means pricing at a level that recovers total cost, overhead and a predetermined markup. Marginal cost is best described by Haynes in his contrast of full cost pricing and marginal pricing theory.[6] He states that marginal pricing best describes business firms displaying a flexibility in adjusting to changing demand. Full cost pricing will not allow this flexibility. Marginal pricing looks to marginal costs as relevant costs. Full cost pricing relies more on average costs than incremental costs. Finally, Haynes says that marginalism takes into account the structure of the market and the nature of competition before price levels are determined. Full cost pricing will usually not take these factors into consideration.

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[6]Warren Haynes, Managerial Economics: Analysis and Cases (Dallas: Business Publications, Inc., 1973), pp. 328-329.

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CHAPTER IV

CASE STUDIES

The following case studies represent a good cross section of the typical small business firm. Eleven firms were examined in this section, and the primary purpose of each study was to identify actual pricing practices in effect. The eleven firms were grouped into five major categories: nurseries, hardware stores, printing firms, small manufacturing businesses and service oriented firms. The wide range of business categories researched identified multiple variations of pricing practices employed by the small firm. All business names used in this study are fictitious to protect the identity of the firm supplying specific information on its individual pricing practices.

Nurseries

The three sample nurseries included in this study revealed how important business size, location and competition were to pricing policy. The first nursery studied was a moderate size business operating in a highly competitive market very close to pure competition. The result was strong price competition, heavy advertising and a constant vigilance of the market. The second firm experienced light competition and preferred to "imitate" its more successful counterparts while retaining a certain amount of flexibility in its price determination.

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The third example revealed a firm operating in what might be described as a monopolistic situation. However, because of its long time location in a small city, the nursery had adopted a social consciousness that strongly influenced its pricing decisions.

ABC Nursery

ABC was a moderate sized nursery specializing in both commercial and retail sales of plants, trees, shrubs and related garden products in three Houston, Texas locations.

Competition

Competition in the Houston market was quite intense. There were ten to fifteen major nurseries and scores of small independents and discount nurseries. Price competition was common among area nurserymen, but ABC was convinced that service was key to a successful sales volume. The owner cited lack of adequate service by the discount stores and larger nurseries as a key factor in the growth of his business. The owner observed that customers sought professional advice, and were willing to pay a little more to get it.

Pricing Practices

The owner felt that his greatest asset to establishing price guidelines was his many years of experience. His keen knowledge of nursery costs had come from working with large commercial nurseries. The owner was convinced that his success was largely a result of imitating their pricing methods. There were very few industry standards in the nursery trade, however one that seemed prevalent was the use of a multiplier factor. The factor varied between two and three (ABC used 2½ times delivered cost to get a suggested retail price). Then this

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price was altered up or down based upon: season of the year, competitive pricing, health rating of the plant and numerous other factors. The 2½ multiple may appear at first glance to be a substantial markup, but average costs reported by this nursery showed that operating overhead ran 30 to 35 percent of sales price, and promotion 5 to 10 percent of sales price. Houston area nurserymen expected nursery stocks to be physically wiped out completely once every ten to twelve years due to natural disaster (storm, flood, etc.). Therefore they also built a 10 percent loss factor into their cost picture each year.

Costs were found to be important to the owner of ABC, but his only attempt to segregate costs was to separate overhead into garden and commercial landscaping accounts. The implication was that where possible, costs of related crops of delivered plants were recorded and used as a guide to pricing. However market conditions would not always allow cost differentials to be reflected in the firm's price levels.

ABC attributed the failure of many young nurseries to inexperience with respect to actual operating costs. These firms began with pricing levels much too low expecting to take customers away from the established nurseries. The end result was usually financial failure.

Valley Landscaping Nursery

Valley Landscaping Nursery was located on the western edge of the city of Houston. It enjoyed a prime location due to the increasing home and industrial market in this area. Sales were evenly mixed between retail and small commercial accounts. The business was owned and operated by two brothers working out of a small one story barn-like

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structure. The primary products were standard nursery stock, but Valley also handled limited stocks of garden related products such as potting soil, fertilizers and stepping stones.

Competition

Valley had few competitors in the immediate vicinity. The owner did not feel that he was in direct competition with the Houston area nurseries, but he kept a close watch on trade developments within the city. His primary business came from the suburb developments on the western side of Houston.

Pricing Practices

Prices were generally set close to what other nurseries in the Houston area charged. As a general guideline, the owner used a factor of 2½ times delivered cost for canned plants such as shrubs, and a factor of 3½ times cost for balled plants (trees). Since this was a raw price estimate, a judgement factor was added that would increase or decrease the price of the plant based upon numerous factors: plant quality, discounts received on stock purchased, market conditions, and other considerations.

It was acknowledged that the costs of maintaining a nursery were on the rise (taxes, fertilizer, stock costs, etc.), but prices were based upon the delivered cost of the nursery stock and not the total cost. This was because the owner had not found a reliable method upon which to relate total costs to a favorable price structure.

Most customers of this nursery were estimated to be evenly divided among price and quality conscious shoppers. It was estimated that a price reduction would probably not increase sales appreciably,

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but it was interesting to note that the owner felt that general price levels could have been increased by as much as 40 percent without fear of substantial sales reductions. The owner thought that even the price shoppers put a price tag on service, and perhaps built this into actual price comparisons. Price was considered to be only one factor in the nursery business, according to the owner.

Miller's Flower Shop & Nursery

Miller's was a family-owned one location business operating in a small city of approximately twelve thousand people. The firm was located about thirty miles southwest of the city of Houston. The nursery had its beginnings some twenty years ago, and since had split into three distinct operations: 1) Nursery 2) Garden Shop, which handled insecticides and garden material and 3) the Gift Shop, specializing in flowers and small gifts for special occasions.

Competition

Miller's enjoyed an almost monopolistic control on this city's nursery and flower business. There were only two other small businesses which offered competition of any kind, and this was minimal.

Pricing Practices

Although the recommended practice was to mark up prices to about three times delivered cost, the owner felt that a multiple of 2 to 2½ was adequate to produce acceptable profits for both the Flower Shop and Nursery.

This nursery had done business with many of its customers for twenty years and felt a strong responsibility for fairness and community obligations.

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Markups on items in the Garden Shop were primarily based upon retail suggested prices with the average suggested markup being about 60 percent.

The combined business sales of all three shops in 1974 had tripled the sales level of 1973, and yet the total business earned less profit in 1974 than in 1973. The owner attributes this to radically higher operating costs in 1974. An attempt was being made to separate costs and sales to each separate cost center (shop), however the owner expressed doubt about ever being able to utilize costs as a guide to pricing in the nursery business.

It was felt that price was important to the nursery, but that service was the key to its long success. It was estimated that prices could probably have been increased as much as 20 percent before sales would have declined, but the owner thought that a 10 percent decrease in prices would have required double the sales volume. This was based upon past trade studies.

It is interesting to note that although the owner spoke of sales volume and price as being directly related, the observations of this researcher were that profit margins on nursery stock were standardized and varied very little with respect to "low" or "high" turnover items. This is in direct contrast to a hardware store type operation which has stocks (nuts, bolts, etc.) that are sold at a very low margin, but which through high volume sales produce a substantial portion of the store's income.

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Comments

It was interesting to note that one feared competitor of small and large nurserymen alike, was the giant discount chain store. The favorable buying position of these stores and lower operating costs allowed them to initiate "cut-throat" price levels on nursery stock. However, the nurseries interviewed commented that these discount stores were driving customers away because of a lack of qualified personnel. Service and information was a key to the nursery trade, and the large discount store was not equipped to provide these services.

Although the use of multiple factors was mentioned by all three of the businesses studied, it was apparent that this practice was not inflexible. Prices were constantly being adapted to changing market conditions. This raised some doubt as to the validity of an established factor. It appeared that the factors were used primarily as guidelines, however, deviations of 20 to 50 percent were not uncommon.

Printing Firms

The two printing firms chosen for this study illustrated the extremes in price decision making. The first firm was a member of a national franchise organization which based its pricing decisions upon past experience and favorable buying position in acquiring low price stocks for its members. Its primary market was small retail sales.

The second firm was engaged in high volume printing work for primarily manufacturing businesses. Pricing decisions were fairly complex and based upon individual experience and actual operating costs.

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XYZ Printing

This printing firm was a member of a national chain of retail printing outlets. The store was located within the city of Houston, and employed about two other full-time helpers in addition to the owner. Primary sales were in the retail area consisting mostly of small jobs in standard print sizes. Limited orders were processed requiring high volume printing.

Competition

XYZ Printing was in direct competition with literally hundreds of other printers in the Houston area, ranging from small independents to franchise operations like itself. In fact, it was also in direct competition with some thirty additional locations of the same franchise operation throughout Houston. Competition was termed "cut-throat" and was considered highly price oriented. Location was important to the small printer whose operation could be compared to that of a small convenience food store. Customers wanted a fast convenient service requiring a minimum of travel. Price shopping comparisons were normally accomplished by telephone before the customer traveled to a particular store.

Pricing Practices

Pricing decisions in the printing industry were critical, but for XYZ Printing centers they were somewhat simplified. The individual owners were provided with a list of recommended charges for all types of printing jobs. This owner relied almost completely on this recommended schedule because he did not feel that he had the necessary experience to deviate.

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The schedule of prices was based upon average costs of labor, machines and materials computed by the XYZ Printing organization, and allowed for an approximate 35 percent markup over cost for profit.

Each XYZ Printing center was responsible for buying its own equipment and was free to purchase paper supplies where they could be obtained at the lowest price. Therefore actual costs may have been higher or lower than those costs on the recommended schedules, but the owner only infrequently adjusted his prices. Occasionally a special buy on paper stock allowed him to pass on savings to his customers. A 10 percent discount was sometimes provided to his better customers.

The following is an example of how the printer priced his jobs. For a standard job, 8½ inches by 11 inches, 20 pound paper and black ink, the schedule outlined a minimum charge. For twenty-five copies the charge was $3.00. Beyond this volume, the price per copy was reduced until a maximum reduction at about the 25,000 copy level.

The owner felt that his average customer was more price conscious than quality-service conscious, but that all three were an important mix to good business. A good price without the other two ingredients would not make a printing firm successful in the long run.

Custom Printing Company

Custom Printing was basically a one man operation that had been in business for approximately ten years. The owner explained that there were basically two types of printers: 1) Service oriented printers who specialized in small retail sales and 2) Manufacturing printers who handled larger orders on longer delivery schedules. Service in the

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second type of business was secondary. Even the equipment was different from that of the service oriented printer. Therefore, the two printers rarely competed for the same business.

Custom Printing Company fell into this second category. The firm handled very few small orders. It specialized in volume work and large size printing requirements. All work was performed on two large and rather expensive printing presses.

Competition

Most of the business handled by this firm was awarded on a contract basis. The owner felt that he was only in direct competition with three or four other manufacturing printers because the smaller printers were not set up to compete with his high volume-low cost operation. Even their equipment was rarely suited for the jobs that he bid on.

Pricing Practices

Custom Printing utilized a somewhat complicated cost approach to pricing. Based upon actual experience over a ten year period, the owner had adopted a budgeted hourly cost rate that was applied to each job run. The budgeted rate was based upon a combination of labor, materials and an equipment use factor that included depreciation and pro-rated use of facilities based upon square footage the machine occupied.

To determine the machine cost per hour, the installed cost of a machine was pro-rated over the estimated number of lifetime productive hours that the machine would be available. This was determined by multiplying 40 hours per week times fifty-two weeks less vacation

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time to get a net productive hours available per year. Industry experience revealed that equipment required maintenance which reduced productive hours to between 65 and 75 percent. The percentage factor chosen was multiplied by the net available hours and this figure represented the actual predicted available machine hours per year.

The same principle was used to determine an operating cost factor by machine. The estimated total operating cost (utilities, taxes, insurance, etc.) was divided by the available machine hours and pro-rated by the relative square footage this machine occupied in the shop.

The rate applied to labor included an actual hourly wage rate and a factor for miscellaneous labor costs such as unemployment insurance, social security and medical insurance. There was also a factor included that represented the cost of the average 40 minute set-up time required for each machine.

Even costs computed by the methods outlined required an estimate of volume. The owner found that to achieve a reasonable quality required that he operate at a lower per hour volume than indicated by industry standards and thus he could not rely on the industry cost schedules. He compiled his own statistics indicating hourly production by machine and relied on these data.

Once all of these cost factors were determined a budgeted hourly cost was applied to all jobs. If this cost were estimated at $10 per hour and the job took three hours to produce, the total estimated cost would be $30. To this the owner would add his standard 33 percent markup for profit.

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Once this budgeted hourly cost had been determined for each machine, very little adjustment was made unless favorable supplies purchasing actions allowed the owner to be more competitive in his bidding. Since most contracts were awarded to the lowest bidder, this flexibility could be important. However, the owner commented that he would be foolish to bid on a job that would not adequately reimburse his costs.

Price competition within the manufacturing printing business was found to be keen and required a close eye on what was happening within the printing industry. The owner felt that knowing and controlling ones costs were a critical element to success. He attributed the high number of failures within the printing industry to new printers either ignoring or being unaware of their operating costs.

Comments

The two printing firms examined indicated that the printing industry basically tied its pricing policies to total costs whether based upon industry established standards, or individual business developed data. Despite the critical importance of price to printing firms, the aspect of service and quality still ranked high, particularly to the smaller retail printing firm.

It was interesting to note that the manufacturing printer had attempted to measure actual costs because he felt that industry data were not accurate for his operation. However, the end result of his efforts was to produce a formula based upon forecasted machine life, operating costs and hourly volume.

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Hardware Stores

The hardware stores included in this study were probably more typical of the average small retail business than the other businesses examined by this study. This is not to imply that price decision making is uninteresting or inflexible in the hardware industry, but they are faced with selling a much more homogenous product than are firms in many other trades such as the nursery or printing business. Products are provided to their competitors at basically the same costs and recommended for sale at the same price. This is the fact that makes the hardware industry highly competitive and challenging. A businessman must by some means differentiate his products and his business from that of his competitors.

Ashford Hardware & Garden Center

This hardware store was a small business located in the northwestern area of Houston. The staff varied during different times of the year, but averaged about ten to fifteen full-time employees including field salesmen. The primary business was retail sales, but the firm was leaning toward developing its wholesale business. Eventually the intention was to phase out the retail sales entirely.

Competition

The closest retail hardware firm offering direct competition was approximately five miles away. The sales manager expressed a concern over the increasing presence of the discount stores which were driving hardware profit levels down. Although the area in which the store was located was a rapidly developing upper-middle class area, it was felt

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that the new growth would bring in additional competition. The switch to wholesale emphasis was being accomplished because the profits were thought to be better and the business less seasonal. It had been this seasonality of hardware sales that had forced many hardware stores to become in effect general merchandise stores, stocking sporting goods, photographic equipment and other lines unrelated to hardware goods.

Pricing Practices

All hardware stores were provided detailed schedules of both the manufacturer's cost to the retailer and his suggested markup. This markup usually averaged about 40 percent. This structured price list was usually followed completely with only infrequent variations for special sales and loss leader advertising campaigns. The sales manager explained that the only difference between his actual price levels and those suggested by the manufacturer were that all items followed an odd number pricing scheme. If for example the suggested retail price were $5.00, the store would mark it up for sale on the shelves at $4.99. Although this on the surface appeared a small variation, the sales manager was convinced of its effectiveness. On occasion the owner was known also to have given quantity discounts and special discounts to large wholesale customers.

Price competition within the hardware industry was described as keen, but it was felt that most stores accepted the suggested price structure and thus firms competed basically on special sales and non-price competition. Service was rated as extremely important to the hardware firm. The sales manager attributed the fact that the discount stores had not been more successful to their lack of adequate service

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to their customers. Customers always seemed to return to his store after discovering that price shopping did not always lead to the best deal, especially if additional information or service were required after the sale.

Westheimer Home Center

The Westheimer Home Center was a small hardware store specializing in retail sales of a full line of hardware products. It enjoyed a prime location on one of Houston's busiest streets. Although this firm was an independent dealer, it belonged to a cooperative chain of merchandisers who were supplied by the True Value Hardware organization. True Value promoted its own line of tools and hardware, and in many cases offered better prices than may be obtained through normal hardware distributors. In return for these services, the firm was required to pay a yearly membership fee. This membership in no way obligated it to buy through True Value. If distributors offered better prices, this store often used them as alternative sources of supply.

Competition

Competition was described by the owner as being very intense, but he felt that he had a strong position in the area market. Discount stores were only perceived as a limited threat due to their considerable distance from his firm. The discount stores did on occasion run special sales on items purchased in lot quantities, and the owner did not feel that in these instances he could come close to competing. One example cited was a new lawn edger being marketed. Westheimer Home Center was selling the edger at the recommended markup, $89.95. The following week

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a local discount store ran the identical item for $69.95. The owner said that during these special sales, the small hardware dealer was hurt, and could do nothing until the discount stores special stocks dry up.

Pricing Practices

Prices in this firm were set in much the same manner as was done in all hardware stores. Manufacturer's suggested retail prices and distributor's suggested retail prices were closely followed. This allowed for an average markup over delivered cost of about 40 percent. The owner was very concerned with the pricing policies of his competitors and felt that he was forced at times to sell selected items at or below cost to spur sales. Loss leader pricing was common in this store, but the intent was to acquaint new customers with the generally low prices throughout the store. The owner was convinced that most of his customers were quality-service conscious, and that good customers were not lost to special sales campaigns by other dealers.

The store did not provide quantity discounts, but it was a common practice for the owner to offer discounts to long-time customers and personal friends.

Comments

Hardware stores, as evidenced from the studies of these two firms, competed on both a price and non-price basis. There was within this trade a structured price arrangement accepted by most dealers. Sales and loss leader campaigns were accepted promotional methods and did not represent actual deviations from this basic policy.

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Both firms studied were keenly aware of their competition and the general nature of the demand for their goods. When asked how much the general price levels could be raised without seriously affecting business, both owners responded with an estimate of 5 percent. Even this was viewed as subject to chance and could be considered "price gouging," a practice unacceptable to the dealers. Similar responses were also received from the two firms on the question of the general lowering of price levels. It was not felt that the lower prices would stimulate adequate new business, and would be frowned upon by other dealers. If these price decreases were matched by other dealers, everyone would lose in the long run.

Manufacturing Businesses

Small businessmen in the manufacturing area are presented with pricing decisions somewhat unique, and their analysis should therefore be separated from the small retail businesses previously discussed.

The two firms selected for this portion of the study contrast a very small manufacturing operation employing about four individuals to a larger operation employing one hundred. The larger business was classified as a "small" business within its industry, and yet its pricing decision making policies reflected a sophistication that might be directly related to its size and sales volume. The resulting contrast between the two firms was interesting.

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R.P.M. Products

R.P.M. Products was a small manufacturing business engaged in the small scale production of lawn stepping stones, pea gravel pots for outdoor shrubs and flowers and miscellaneous concrete garden structures. The operation was located in a small warehouse shared with another business and employed one foreman and two laborers in addition to the owner. The owner also worked for a firm producing a special cement used in concrete products. This was where he discovered the idea for his own business. He obtained approval from the company to use the cement and purchased all stocks directly from them.

Primary sales were to retail nurseries and nursery distributors. Most of the goods sold were picked up by the customer directly from the warehouse.

Competition

One of the prime reasons that the owner established his business was the lack of suppliers in the stepping stone and garden structure business. Nurseries sold large volumes of these items and yet adequate supplies at reasonable prices were not always available. Currently there were only a handful of competitors producing stepping stones and most of them were also small scale businesses. The pea gravel pots were sold with relatively little or no competition.

Pricing Practices

R.P.M. Products basically priced on a cost plus a percentage markup basis. The formula for determining sales price was: labor cost plus overhead cost plus material costs plus a predetermined percentage markup. The employees of this firm were paid on a piece rate basis averaging about 25 cents a block (stepping stone).

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The estimated overhead cost had been pro-rated over an annual estimated volume and thus 10 cents per piece (block) had been determined to be an adequate charge.

Material costs were determined on the basis of batches produced. If one batch of cement and pea gravel would produce fifteen molds, the total material cost was divided evenly among these fifteen molds regardless of size or shape. However, the more common practice was to mix one batch and make all the same size mold (example: 15 inch stepping stones).

The markup applied was based upon the going rate for competitive products. The markup averaged between 25 and 33 percent, but rarely dropped below 25 percent. These percentage factors were developed from the owner's previous experience in the wholesale market for similar products.

Markup was also dependent upon whether the firm delivered the products or they were picked up directly from the warehouse. There was no set guideline for the additional charge applied for delivery, but the owner attempted to recover cost in relation to volume delivered.

Although this scheme of pricing was based upon fairly rigid formulas, the owner was forced to maintain pricing flexibility. His prices had to be competitive with other manufacturers of similar products. High prices might well have resulted in nurseries looking to alternate suppliers, or worse yet, deciding to produce their own pea gravel products.

The owner did not advertise his business, with the one exception of a small ad in the Yellow Pages. Primarily he has relied upon the

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many contacts he had made throughout his many years of business experience. He traveled extensively showing samples of his products to area nurserymen and distributors.

Pinewood Products

Pinewood Products was a medium sized furniture manufacturing company specializing in dinettes and bar stools. Although the company employed approximately one hundred persons and had an annual sales volume of approximately two million dollars a year, it was still considered "small" in comparison to the leaders in the furniture industry. Sales were divided between wholesale and retail outlets with the most profitable customers being mobile home manufacturers and apartment houses. The company operated from a single Houston warehouse and served the major portion of a six state area.

Competition

Since Pinewood Products distributed in a six state area, it not only experienced competition from the fifty plus furniture manufacturers within Houston, but also from eight larger firms servicing the same six state region. The manager termed price levels critical to the success of the business. Service and quality were not considered to be key factors, assuming that the quality did not differ substantially from that of the competition. Most of the mobile home manufacturers and apartment houses wanted large volumes of furniture at the cheapest price.

Pricing Practices

The manager of Pinewood was one of the few businessmen interviewed in this study that stated a specific pricing objective. Years of

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experience had revealed that a 10 percent profit level was a realistic target, and this was the specific objective of Pinewood. The recent troubled economy had left the company short of this goal in 1974, but the manager was optimistic about 1975 expectations.

The furniture industry had extensive data available for the manufacturing firm, however Pinewood preferred to price on a basis of its actual costs. Industry standards were based upon regional data which were not felt to be appropriate to the Houston market.

Basically prices were set in the following manner. A total material cost was determined less a waste factor. To this was added a direct labor cost by taking the estimated annual direct labor hours, dividing by the total payroll, producing an average hourly rate. This same hourly wage rate was applied to all products produced. Pinewood had made use of detailed time studies on its manufacturing operation to determine standard labor hours expended on different types of operations.

Overhead expenses applied to a product were based upon a predetermined percentage of direct labor cost. The manager declined to comment on the actual percentage or how it was determined.

Added to these combined unit costs (material, labor and overhead) was a variable markup. A specific percentage markup was not identified, however the manager did say the exact markup was determined through examination of numerous market factors. The goal of this markup was as stated previously, a 10 percent profit.

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Comments

The diverse nature of the two manufacturing operations studied make it difficult to generalize. However, it would appear that small manufacturing businesses are much more cost oriented than are small retail businesses. Perhaps it may be that costs are more easily measured in a manufacturing operation. Still there are indications that even the manufacturing businesses must maintain an element of flexibility within their pricing decisions. The furniture manufacturer attempted to markup prices to achieve a specific goal, but was unable to rigidly follow this policy. The business manufacturing stepping stones had a defined system for pricing based upon actual cost, but this owner also knew the importance of maintaining pricing flexibility to be competitive.

Miscellaneous Service Firms

Up to this point, this study has been primarily confined to those small businesses marketing a physical product. However, those businessmen who sell a service of one type or another also comprise a large sector of the small business community. Included in this type of business are the television repair shops, laundries and cleaners, pet groomers and literally hundreds of other customer services.

The nature of pricing within the service oriented business firm is in most cases unique. Unlike businesses previously discussed, the primary product that must be priced by these businesses is the value of the service they provide as perceived by the customer. The materials used in the performance of the service normally account for only a minor percentage of the total cost of the service.

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Two businesses were selected for this portion of the study. The first a small up-and-coming termite and pest control business, and the other a small town automobile paint and body shop.

Longhorn Termite and Pest Control

Longhorn was a small exterminating firm employing about five persons. The owner had been in business for about 2½ years but still looked upon himself as a newcomer to the exterminating business in the Houston market. The business provided two basic services: 1) pre-treating concrete slabs of new homes and buildings and 2) extermination service on existing homes and buildings.

Competition

The exterminating market within Houston was extremely competitive. Although the number of exterminators operating within the city of Houston (over 100) did not appear unusually high for a city of 2.5 million people, the owner commented that a new firm had a hard time staying in business. He found it hard to compete with the larger pest control services who offered a full line of pest control work, and engaged in retail sales of insecticides and other related products. In addition, many of Longhorn's competitors had found methods of offsetting the seasonality of the exterminating business. Longhorn had been unable to do this successfully.

Pricing Practices

The majority of work performed in the pest control business was done on a bid basis. A prospective customer contracted three or four exterminators, who in turn inspected the job and delivered estimates. It was usually the low estimate that secured the job.

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Before he established his business, the owner of this firm called all of the major firms in the area and collected price information. His initial goal was immediate market penetration and therefore he set his prices lower than the majority of his competitors.

Extermination work was normally priced by square footage to be treated. The going rate for pretreating concrete slabs was about 3 cents a square foot, and for treating homes from 6 to 10 cents a square foot. The owner of this firm decided to price at 2 cents for concrete slabs and 5 cents for homes.

He was fully aware of the rising operational costs such as chemicals, labor and operation and maintenance of his limited number of vehicles, but he felt that he had little flexibility in setting his prices. Once he had established himself in the market, he felt this flexibility would increase.

The owner's experience was that approximately 95 percent of the customers he was servicing were more quality-service conscious than they were price conscious. He justified his comparatively low price levels by the fact that an established clientel must first be built-up and then he was confident that his workmanship and service would maintain this clientel. This theory was put to the test by a recent price increase by this firm. The result was little if any loss in customers.

Eventually the owner would like to bring his price levels up to approximately those prices charged by the leaders in the pest control market. Rising costs would not allow him to maintain the present schedule of prices. He was certain that even an increase of 10 to 15 percent would not be detrimental to his business. The trend

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in the pest control business seemed to be that a customer established a lasting relationship with the firm and maintained a certain level of loyalty unless prices began to substantially differ from the competing firms, or that consistently poor service were encountered.

The only deviation from current price levels were for occasional 10 percent discount advertising campaigns and a special reduced annual rate which required quarterly inspection.

Don's Paint & Body Shop

Don's Paint & Body Shop was located in a small city west of Houston. The shop specialized in all types of automobile repair and painting. The shop employed about three other workers in addition to the owner, who did a substantial part of the labor himself.

Competition

The competition consisted of fourteen similar shops, but the owner said the more successful shops currently had more work than they could handle. Some of this might be explained by the proximity of the Houston market. It was interesting that the owner talked of his competition as if they were not really competing with his business. This was one of the first interviews conducted that revealed a businessman who did not feel unduly pressured by his competition. He also expressed a somewhat lackadaisical attitude to the idea of monitoring what his competition was doing.

Pricing Practices

Pricing decisions by this owner followed a structured pattern. He subscribed to an industry catalog that outlined the number of hours standard for a paint or repair job and the cost of the parts necessary

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for that particular job. He followed this manual almost exclusively. For example, the manual lists the standard paint job as requiring about sixteen hours. The area labor rate prescribed was $10 an hour. Therefore the total cost of the job was priced at $160 plus the actual cost of the material. The owner said that no markup was applied to the material because he felt that he was adequately reimbursed by the standard labor rate.

If a job took longer than the prescribed hours for that particular repair, or additional work were required that was not accounted for in the tables, the owner added an extra hour or two to the total bill. His experience was that jobs take less than the standard hours outlined in his manual, but the standard was the minimum time applied.

The owner was doubtful that his competitors would ever engage in active price competition. They all followed basically the same price guidelines and had a sort of unwritten agreement to stick to these guidelines. Therefore he felt that he could not have increased his prices without causing problems. These problems would probably have come more from his competitors than his customers. He saw no reason to lower prices as long as business was good and everyone was charging the same rates.

The aspects of quality and service were not discussed at length, but it was implied that these factors were important to the owner's business. His business had been an established part of this community for many years, and therefore he felt a responsibility for quality workmanship.

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Comments

The two businesses examined in this section revealed a conspicuous lack of reference to markup pricing. Material pricing was relatively insignificant as compared to the labor portion of the service performed. Both businesses used some type of established standard upon which to base their price levels. The exterminating business relied upon current market price levels, and the auto repair shop followed industry guidelines. Neither of these businesses expressed a concern that their operating costs or labor might be higher than the standards prescribed, or that their business might not fit the pricing guidelines. In addition, neither of the two expressed a specific pricing objective. It was implied that the goal unspoken was to stay in business. The small town businessman did not feel nor did he reflect a sign of concern over competitive efforts. He felt that he had an established business that had not changed much in twenty years, and had no reason to believe that it would ever change. In sharp contrast was the city businessman who was evidently quite concerned about his competition and quite frankly, worried over the possibility of his business failing.

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CHAPTER V

RESULTS AND FINDINGS

An attempt to categorize the pricing practices of the small businesses researched is extremely difficult. Multiple market structures with varying degrees of demand elasticity were identified. Product classifications ranged from homogenous to slightly differentiated. The types of pricing policies discovered also varied from one firm to another, but in general centered around three basic patterns: 1) Marginal pricing 2) Cost plus a standard markup and 3) Cost plus a variable markup.

The nurseries were probably the best example of marginal pricing. Each nursery studied relied upon a multiple factor upon which to base general price levels. However, deviations from this factor to satisfy market conditions were more the rule rather than the exception. It was interesting that the multiple factor was used primarily as an ideal price target. This price was rarely charged due to the nature of changing market conditions. Variations on prices were based upon the owner's feel for the market and the numerous other variables affecting his business. The end result of these pricing policies was a price that only remotely related to the multiple factor initially applied. Thus the aspect of flexibility in the nursery trade appeared to be critical. More than any other type business studied, the nurseries had to maintain a constant vigilance on the market.

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Rather than describing the four classic market structures as exact states, it is perhaps more meaningful to examine them as being distinct points on a continuum. If this were the case, nurseries would fall at a point on that continuum that would be relatively close to the pure competition model.

The nurseyman's product can be considered to be an extremely homogenous product when compared to that of his competitors. It would be difficult to find distinguishable differences between the ligustrum of Nursery A versus the same type of plant sold by Nursery B. Accepting this situation, the nursery owner attempts to find other methods of differentiating his product, that range from providing information to his customers, to the cheerful manner in which he transacts his daily business. These extras are the manner in which the nursery owner attempts to lessen the high degree of elasticity evident in the demand for his goods. He knows that because his demand is highly elastic, pricing decisions may be critical to the success of his business. A failure on the part of this businessman to match market price decreases could lead to a substantial reduction in sales. On the other hand, the owner is aware of the market forces that would lead competitors to match any price decreases that he might wish to initiate. These actions result in a fairly stable price structure within the nursery industry. The stable price levels are also important to minimizing the entry of new competitors eager to reap high profits. It is this additional characteristic of easy entry that provides additional motivation for the nurseyman to closely monitor prices. The capital requirements of a small nursery are low in relation to other types of businesses, and high prices within a homogenous product market would invite additional competition.

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Printing firms and hardware stores best characterize the second category of pricing pattern, cost plus a standard predetermined markup. This does not imply that these firms are not flexible to market conditions. No such rigity was discovered in any business studied. However, the printing and hardware businesses were more closely tied to a fixed markup policy than the other businesses studied. Perhaps this could best be explained by cost structures that are similar for all competitors and accepted industry retail price levels. In the hardware trade for instance, each store received goods at basically the same cost and applied the recommended markup. As long as this procedure was acceptable to all, businesses were adequately reimbursed for their goods. Determination of price did not have to rely on ill-defined demand curves and market characteristics.

The printing firms and hardware stores examined in this study can also be placed on the previously mentioned continuum, at a point very close to the nurseries. These businesses exhibit many of the characteristics attributed to pure competition. The products are relatively homogenous in comparison to those of their competitors. Entry into either business would be relatively easy, however the printing business might require a higher level of skills and limited specialized equipment. Finally, both the printing firm and the hardware store face a highly elastic demand. Neither type of firm is in a position to effectively influence market price levels. However the printing firms, especially the manufacturing printers, exhibit a little more pricing flexibility than that characterized by hardware stores because of the entry conditions previously discussed.

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The third pattern discovered, cost plus a variable markup, was evident primarily in the manufacturing businesses. These businesses had developed an acceptable range of markup on cost, and determined the specific markup to be applied based upon numerous market factors. The manufacturing firms were more concerned with actual costs than were the other businesses studied, and therefore knew what minimum markup was required on their goods to stay in business. The goal was to stay above this minimum.

It is helpful to again apply the concept of a market structure continuum to properly classify the manufacturing businesses researched. These two businesses had the enviable position of being able to differentiate their product through the artistry applied to their work. The design and construction of furniture and even stepping stones and pea gravel pots, allowed for a certain degree of personal touch. This product differentiation would tend to move these firms to a point on the continuum much closer to monopolistic competition than the firms previously discussed. The degree of demand elasticity faced by the manufacturing firms would be somewhat less than the highly elastic demand characterising the nurseries and hardware stores. The furniture manufacturer probably experienced a less elastic demand than did the stepping stone business because it was easier for him to differentiate his products from competitive products, and second because entry conditions appeared more restrictive within the furniture trades. The requirements to set up a small scale manufacturing operation would be minimal in comparison to the specialized skills and equipment required

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to enter the furniture market. In addition, it appeared that the furniture manufacturer was in a much more flexible posture to produce a varied line of products.

The stepping stone manufacturer could have perhaps improved his competitive situation had he considered alternate distribution channels. His primary role was that of a wholesaler, distributing to the area retail nurseries. At this point in time, the competitive pressure was not at a level that would have prevented experimenting with various methods of distribution. Direct warehouse sales has proven to be a popular method of distribution for carpeting, lumber and numerous other Houston area businesses. The customer is willing to step over and around merchandise if it means that he can save some money. Perhaps the stepping stone firm should have taken advantage of this opportunity. Of course, nothing is ventured without an element of risk. This firm might have discovered nurseries retaliating by going to other sources of supply.

The three pricing patterns discussed revealed varying levels of flexibility in price decision making. The extent of this flexibility seemed to be more a reflection of the market the firm was operating in rather than individual firm differences. Each firm's market structure permitted varying levels of pricing control. The amount of this control was largely dependent upon the degree of demand elasticity faced by the firm. Those firms marketing a differentiated product, in a market with comparatively few competitors and in which entry conditions were restrictive, enjoyed a greater flexibility in pricing decisions. Some firms do exhibit more pricing flexibility than do their competitors, but not enough to represent a radical departure from their counterparts.

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The point then, is that the small business firms included in this study differed with respect to their emphasis on cost data as a key to pricing. No evidence was found of any firm willing to rigidly follow full cost pricing practices that ignored the firm's market structure. The fact that the paint and body shop studied came close to this pattern of pricing was more an indication that his market structure allowed him to do so. Increasing competition would more than likely have brought on a much more flexible pricing posture.

Data collected also revealed similar attitudes about the importance of pricing, the relative importance of service and the lack of specific pricing objectives.

Most of the businesses interviewed sought to underplay the importance of price to their business. Price was admitted to be a key variable affecting sales volume, but more emphasis was placed upon the aspect of service and quality. Each businessman feared the possible retaliation of competitors to any radical departure in pricing policy by an individual firm. Therefore to preserve market stability, each firm attempted to gain a competitive edge through various methods of non-price competition. A friendly smile, courteous service and a genuine interest in each customer was aimed at creating that product differentiation that each businessman sought.

Although many pricing practices outlined by this study may appear mechanical in nature, businessmen were reluctant to elaborate about the specifics of their pricing actions. A preference was indicated for the simple pricing methods because it was easier for the small businessman to relate his business operations to these methods.

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This secretive attitude tended to cast doubt upon the businessmen's evaluation of price importance. One owner of nursery proudly admitted that he had developed his own formulas through long years of experience, but he skillfully avoided providing any specific details on these formulas. In this case the owner perhaps felt that his pricing skills had been essential in developing his competitive edge, and divulging these secrets even to a researcher would be foolish.

Service and quality were mentioned by the majority of business firms as being essential to establishing a loyal clientel. The most interesting aspect of these interviews was the constant reference to competition by the giant discount chain stores. The discount stores were driving prices down and making it difficult for the small business firm to compete. However, as long as these discount stores did not provide the quality and service offered by the small businessmen, it was felt that their customers were only lost for temporary periods.

Finally, the lack of specific pricing objectives seemed to characterize all but one or two firms studied. This may not be a fair evaluation since perhaps expressing an interest in just staying in business might be loosely construed as a pricing objective. One of the concepts brought out by this study was that as the size of the business increased, there appeared to be a growth or increasing sophistication applied to pricing methods. The contrast of different size firms in each business category studied seemed to point to more clearly defined pricing practices in the larger businesses. Assuming this to be true, it might be a wise practice indeed for a new small business to consider imitative pricing of its larger successful competitors.

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CHAPTER VI

CONCLUSION

This study perhaps provided an interesting contrast to the very formal analyses of big business pricing found throughout pricing literature. The small businessman may not stress graphs and models upon which to base pricing decisions, but that does not make his decisions any less complex or uninteresting. He recognizes the highly elastic demand that he faces with his market, and rather than attempting to experiment with this elasticity, he instead attempts to find acceptable formulas and standards. These standards provide an aspect of simplicity that the small businessman seeks.

Previous research into pricing by the small business firm has focused on a market structure very close to monopolistic competition. Each market was characterized by a small number of firms selling a slightly differentiated product. However, this study has established that there are also segments of the retail and services markets where this market structure does not accurately describe actual conditions. These segments are characterized by homogenous products, numerous sellers and buyers and a relative ease of entry into the market. Perhaps these firms may be more accurately described as operating within a market structure very similar to pure competition.

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Additional research is needed on the small business firm to explore decision making processes and pricing practices. To the interested and willing researcher, this area of study presents unlimited possibilities.

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APPENDIX

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SAMPLE QUESTIONNAIRE

1. General description of the business - size, number of employees, approximate annual sales volume, competition, and specific characteristics of this business.
2. Who is responsible in the firm for establishing prices?
3. Are there established industry guidelines or personal preferred formulas that are utilized?
4. Does the owner consider that price is the single most important factor to his business? If not, where does it rank on a scale with other factors such as quality or service?
5. Is the firm's sales volume directly related to price? How much could the owner increase his price (%) and still expect to sell about the same volume? How much could he decrease his price before it was reflected in an increasing demand?
6. What is (are) the firm's pricing objective(s)?
7. Could the pricing method used by the firm be described as more of a "going rate", competitive pricing policy or a cost oriented policy?
8. Does this firm use some variation of markup pricing? If so specifically describe the markup used, how it is determined, and whether it relates back to a desired profit margin or an industry standard.
9. Does this firm use some variation of a cost approach to pricing? Describe in detail the method for determining actual or standard costs.
10. Are special discounts, seasonal price changes, and sales used extensively in this business?
11. Does the owner discriminate his price based upon: quantity, preferred customers, etc.?
12. How does the businessman feel about price competition within his trade?

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13. How does he react to price changes among his competition? What does he think his competition would do if he lowered or raised his prices?

14. If the owner thought that he could sell his product for a higher price, would he be willing to charge what the traffic will bear?

15. What aspects of his business does this businessman think that his average customer is most concerned with?

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