
MARKET OPERATIVE PRICING AND PLANNED OBSOLESCENCE: THE NEW BUSINESS TOOLS

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Transactions of consumer durable goods are generally made on Maximum Retail Price or MRP. But as the markets are glutted with various brands offered by various companies, the dealers find it easy to rely on price competition for selling their own brands and generate revenue. Such a competition becomes more intense when a product arrives at the maturity level of Product Life Cycle (PLC), a Saturated market on the one hand and the presence of a large number of close substitutes on the other make the situation worse. Moreover, at the maturity stage, the manufactures face another serious problem from the point of product differentiation. Diffusion of technological know-how and continuous improvisation of the product over a long span of time make perceived difference between different brands of the same product category narrower. In the next section, it is our endeavour to explore the concept of Market Operative Pricing along with its possible consequences. The second section will introduce a new strategic tool, known as Planned Obsolescence, and in the last section, a few strategic postures have been suggested based on Planned Obsolescence.

Market Operative Pricing

In this competitive environment, the sellers do not take the chance of depending on the non-price moves because such competitive postures have weaker influences on sales as compared to undercutting. A new pricing tool, called Market Operative

Price (MOP), has been evolved to win the market. Generally, MOP lies between MRP and the dealer price and is determined by the attitude and the bargaining skills of the buyers. Before quoting the price, the dealers try to anticipate the willingness of the potential customer and the probability of spot

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purchase. If they find that the customer is ready with hard cash and is aware of MOP, they will disclose the MOP[7]. Dealers believe that non-disclosure of MOP makes the customers unable to compare different MOPs offered by different dealers.

Generally, dealers do not lose by accepting MOP. To increase, or at least maintain the existing market share, the companies announce various target-linked schemes and the dealers keep a part of it and pass the rest to the consumers. This way dealers can compensate the apparent revenue loss by selling the product at MOP, which is less than MRP.

Here, it is interesting to note that the loss-neutralizing power of the dealers is not scale-neutral. Only those dealers with considerable units of sales per period can accept such a risk. If the dealers cannot fulfill the required target, they will not qualify for the scheme and consequently it will be different for them to make up the loss revenue by selling the products at MOP.

From the strategic point of view, such a price competition may create serious limitations to the brands. Firstly, Kotler (1997) has mentioned that price-cut may ultimately lead to a declining market share. Secondly, determination of optimum price-cut is difficult and in the long run, withdrawal of such offers may entail negative impact on brands.

The manufacturing companies also do not derive such a practice to continue. In this context, a statement made by the Managing Director of LG Electronics can be quoted, "We received complaints that our biggest dealer in Delhi was selling at wholesale prices, and stopped supplies. He learnt his lesson and we've now resumed supplies." (ET, 9.5.2001)

Planned Obsolescence

In the 'durable' goods market, another problem makes the situation more complicated, especially for the new entrants, i.e., the durability of the product. Once the consumers implement a 'purchase decision'

regarding these 'durable products', these products remain with them for quite a long time and the chances of new sales decrease. This problem gets worsened when the growth of a product is slow or moves towards stagnation. Sometimes, to eschew such a problem, large multinationals intentionally shorten the planned life of the 'durable' products, which is known as Planned Obsolescence. In order to cover up the cost of the latest innovation and to enhance the existing market share, firms offer special attractive discounts to the old users, as for them the incremental utility of the new version is less as compared to the new users (Lee and Lee, 1998). Discount on the latest products not only ensures the sales of state-of-the-art technology but also increases their total customer base, which, in turn, reduces per unit cost of innovation. High market share of a firm can also be considered as an added advantage from a different point of view. Caminal and Vives (1996) are of the opinion that the high market demand of a product sends a signal to the customers that the product is of high quality.

Subramaniam (1999) differentiates Planned Obsolescence from other forms of Obsolescence. Physical Obsolescence refers to deterioration in value of a product due to wear and tear. Functional Obsolescence of a product does not necessarily mean that it is physically obsolete. Generally, functionally obsolete products are unable to perform at its full rated capacity. In case of economic Obsolescence, the products become obsolete due to external factors, whereas, technological Obsolescence occurs when a product faces threat from its own improved variety. The concept of 'Planned Obsolescence' is similar to what Subramaniam has characterized as technological Obsolescence.

The case of Product Obsolescence also echoed in the writings of Fishman and Rob (2000). The efficiency of a firm depends on two factors- judicious price discrimination between the first-time buyers and repeat-purchasers and secondly, shortening (artificially) the physical life of the durable-good products what they called 'Planned Obsolescence'. In

their analyses, they have assumed that every innovation shows development over the previous model and physical Obsolescence is slower than planned Obsolescence.

In this context, the role of R& D should also be considered. According to Waldman (1996), an investment decision in R&D must be consistent with the objective of the firm. The R&D choice that maximizes the current profitability of an organization does not maximize its overall profitability.

Planned Obsolescence can also be considered as a tool to implement Porter's (1980) differentiation strategy. As pointed out by Porter, differentiation helps the business houses to charge higher prices and widen the revenue-cost gap. But the concept of Planned Obsolescence underlines two important characteristics. First, the difference in perceived benefits between two successive models offered by the same company should be so great that the latest version can be recognized as an altogether different product. Secondly, the new model offered by a company must also possess remarkable improvements over the existing varieties of the rival firms. At the same time, it must also be mentioned here that continuous change in a product definition or rapid obsolescence of a product may discourage buyers and increase the threat from substitutes that can be upgraded.

The most desirable strategic move would be changing the product definition by making modifications in the older variety. Such an upgradation is expected to be more acceptable to customers than changing the entire product, because the latter option presumes sale of the existing outdated product at a very low price and silently challenges the 'durability' of the durable products. Another characteristic of Planned Obsolescence lies in its continuity. As compared to simple product differentiation, which helps in building competitive advantage, Planned Obsolescence becomes instrumental to sustain in it. One of the major advantages of Planned Obsolescence lies in recapturing market share. Generally, the late-movers

succumb to this strategy with an intention to dismantle the existing market share of the incumbents. The effectiveness of this strategy depends on the degree of perceived changes made in the new variety over the older version.

For coming out of this MOP trap, manufactures may offer non-monetary incentives or ensure that target-linked incentive schemes cannot be converted into cash. Incentive schemes are expected to yield desired results as long as the schemes are dealer-specific, non-transferable and non-encashable-otherwise, it would be very difficult to stop this practice. However, in reality, it is also quite difficult to formulate such incentives, which can yield the same impact on sales as would be achieved by implementing MOP. Obviously, Planned Obsolescence seems to be a better choice.

Planned Obsolescence and Marketing Strategy

When a new version of a durable product arrives in the market, companies may follow two strategies for two different customer groups – existing and new. With the arrival of an improved version of a product in the market, non-availability of spare parts and high maintenance cost of the old models may silently persuade exiting buyers to go for the latest variety.

However, for the users of the older variety of the product, the incremental perceived benefits of the new models do not justify the price of the new versions. On the other hand, the resale value of their old models is also very low. In a such a situation, manufactures may adopt a price skimming strategy and set the price of their new models slightly higher than their normal price and offer exchange schemes. The objective of this scheme is to attract the existing users of the older version of the product by offering higher-than-the-market resale value of it. The 'apparent 'gain' for the customers (by selling his old model to the company at a higher price) can be siphoned off by the manufacturing company as it will sell the new version of that product to the same

customer at a higher price under exchange offer schemes. Now, the question is why the new customers (who do not possess the old model to exchange) accept the new version at a higher price? There is no denying the fact that for the first user's marginal benefit is high. For them, the company must try to identify the reason that may attract the first users effectively. It may be logical to believe that the new customers could not purchase it earlier because of their budget constraint. To allure this particular group of customers (i.e., the new users) companies may offer interest free installment facilities on the latest model. The interest burden of this installment scheme will be borne by the companies (as the customers pay no or negligible amount as interest), which will offset the 'extra' price collected by the company from these customers. The customers should not be given the option to avail of both – exchange offer and low or zero rate of interest on loans.

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