# DOES IT EXIST AND CAN WE USE IT: COMPETITION AMONG CONSUMERS? (Pricing a real novelty: the Austrian point of view)

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*The attainment of those initial sales is often the hardest part of marketing a new innovation... One of the most important strategic goals of pricing, especially when the product is innovative, is to obtain trial (Nagle 1987, p. 139 and p. 196).*

## I. Introduction

You do not doubt there's competition among producers. But among consumers? And with competition I mean what it once meant in economic science and still means in everyday language: active rivalry. Of course when you -as a consumer- look in the mirror you see things you do and don't like. And, maybe, one of the things you don't like, is that urge in you to keep up with the Joneses. That's rivalry for sure. And then there's the way you behave when you buy you weekly groceries: you try to get in the shortest line with your shopping cart. That's rivalry too.

The first form of rivarly is well known. It's studied by the sociologist and one of the principles of marketing. Doesn't advertising heighten conspicuous consumption? The second form is, since the days of Adam Smith, studied by the economist: the laws of supply and demand. If there's a shortage, you did up the prices -or what ever it takes to compete: a quick move with your shopping cart for instance.

That second form of rivalry -is it still active today? I want to look at economics: the market process, not sociology: the behavior of conspicuous consumers. Except for my shopping cart behavior every Thursday, and when buying or selling a house once or twice in my life, I nearly never feel that I have to compete. There's enough for everyone; the producer competes (Udell 1964, p. 45; Dickson 1992, p. 71; Hunt and Morgan 1995, p. 8).

But then so what if there is or isn't competition among consumers? First, suppose there isn't. Is, in the modern market, competition one-sided? First, suppose there isn't. Is, in the modern market, competition one-sided? Do, as a rule, only producers compete? Second, suppose there is competition among consumers. If we know the why and is thereof, maybe we can use it in marketing too. Are you -as a producer- using competition among consumers?

## II. Free entry: the why and is of competition among producers

Let's start at the beginning. Why is competition a problem among consumers but isn't among producers? For the producer the question isn't difficult to answer -if he doesn't, he's out of business in no time. He offers a product that competes with others. Something we can see and is independent of the market situation. A shortage, a surplus, or an equilibrium - the producer competes. To sell a product in a world of scarcity and change it has to be the best.

And if there's free entry, the why implies the is of competition. A condition Smith was already aware off. "The exclusive privileges of corporations, statutes of apprenticeship, and all those laws which restrain, in particular employments, the competition to a smaller number than might otherwise go into them, have the same tendency, though in a less degree. They are a sort enlarged monopolies..." (Smith [1776] (1974), p. 164).

I give another answer. It isn't based on something we can see, but on a deduction from a self-evidence- man act: we try to improve our situation. What's otherwise the use of acting? We search for new ends and means - the entrepreneurial element in human action. The self-evidence is the fundamental axiom of the Austrian School of economic thought. But "[e]ntrepreneurial activity from being competitive? Israel Kirzner says, "is always competitive and ... competitive activity is always entrepreneurial"

(Kinzer 1973 p. 94). For what would stop entreprenewrial activity from being competitive? "Competition ... is at least potentially present so long as there exist no arbitary *impediments to entry*. So long as others are free to offer the most attractive opportunities they are aware of, no one is free from both the urge and the need to compete" (Kirzner 1973 p. 97). And if a competitor seeks to outdistance his rivals this means transcending, entrepreneurially, a given ends-means relation.

## III. Competition among consumers: the why not

But competition among consumers isn't that obvious. the billboards on Times Square show the consumer as a sovereign king, way above all down-to-earth competition. To speak of a chocolate or steel king, however, is misleading. For the producer, pride comes before a fall. The producer competes, the consumer chooses. Serving-the-customer is a basic normative idea of our society.

In other words, if the consumer doesn't compete, he isn't out of "business" in no time. "[T]he masterful housewife," as Wesley Mitchell said, "cannot win away the husbands of slack managers as the masterful merchant can win away the customers of the less able" (Mitchell 1912, p. 274). The Amish in Pennsylvania, who are living the way their ancestors did, are still alive. The producer has to please someone else, the consumer only himself. If no one may steal a march on me, free entry is absent.

What's the answer of the Austrians-making, again, a deduction from a self-evidence? Aren't their central ideas: discovery, entrepreneurship, and alertness? Ideas bound up with competition. And didn't the older Austrians put the consumer instead of the producer at the center of their theory? Value was no longer governed by past resource costs but by judgements concerning future usefulness in meeting consumer wants.

Acting implies --as we saw- entrepreneurship: choosing ends and means. But the ends and means aren't given, they have to be discovered. Being human, however, both producer and cosnumer err. Choosing implies making errors. An error isn't always a calculation mistake, solved with better calculation. Either is it always the result of a lack of knowledge, solved with knowledge that exists and we can search for. There's also the possibility of a entrepreneurial error: an opportunity-costlessly available- is overlooked. We don't see the ten-dollar bill laying in front of us-for free. And it's the correction of these errors that interests the Austrians. Errors solved with the entrepreneurial element in each of us: alertness. Alertness is "the propensity ... toward fresh goals and the discovery of hitherto unknown resources" (Kirzner 1973, p. 34).

But now the Austrians have the same problem. Thought the consumer discovers, errs, and is alert the quetion still is: Why should he do this rivalrously? The answer isn't as obvious as it was for the producer. There are differences in free entry. In theory the producer can fulfil his entrepreneurial role without any means. He acts in between two markets: a buying and a selling market. Pure arbitrage is possible. Entry is free; rivalry is fierce. The consumer, on the other hand, acts in a buying market only. He has to possess means, entry isn't free.

## IV. Competition among consumers: the why

Let's not give up our discussion of the market. There's rivarly when a consumer looks over his shoulder. He wants to know what opportunities others are about to embrace in order to embrace an at least as attractive one. Discovery and adjustment are two-fold. It is explicit rivalrous behavior: I try to steal a march on my fellow consumers. But it also includes - as is said for the producer- various, hardly secondary, degrees of cooperation and copycat behavior. "[I]mitation can be an extremely entrepreneurial act, particularly if it entails the opening of new markets for the innovative product" (Baumol 1993, p. 157; cp. Hunt and Morgan 1995, p. 8). "I remember him [Sam Walton, the founder of Wal-Mart] saying over and over again: go in and check our competition... If you get one good idea, that's more than you went into the store with, and we must try to incorporate it into our company" (Walton 1993, p. 81). Why does this count for the consumer as well?

Firts, if I look at what others do, and at least not make a worse offer, I increase my chances to gain. I use the knowledge of others and gain by buying what everyone else does, through lower prices, a greater efficiency.

Second, I am not only hopeful of the gains I get if I imitate, but, just as important, fearful of the losses if I don't. Suppose I stick to my consumption pattern. Consumption patterns, however, change. Heating is no longer done by coal but by gas. Getting coal becomes difficult and expensive.

Third, I feel a certain urge to watch others. If I don't, the gains are lower: I will give up potential utility. Still not to use a washer is an example.

Consumers cooperate and imitate. If you want to survive, you have, if not to set, at least to confirm a trend. Trends, fashions, and fads are the expressions of a competitive error-solving process. They are the work of the producer as well as of the consumer. In disequilibrium, imitation can be a way to discover opportunities. The risk, the cost, of doing everything on one's own may be too great. For the producer, "imitation may by able to achieve a given increase in productivity far more cheaply, in terms of real resources consumed in the process, than can be done by innovative effort" (Baumol 1993, p. 165). For the consumer, imitation replaces single high-cost consumers by groups of low-cost consumer. Consumers join together into retail cooperatives or different competing trends.

Competition isn't a contest with one winer. Less successful consumers aren't eliminated; they are removed to a more modest place. Competition among consumers is niche competition. There's a place for everyone-even for the Amish. Niche competition, Lester Thurow says, is win-win. Competiton among consumers in the old days and the exception I noted in these days are forms of head-to head competition. "Head-to head competition is never win-win, at best it is win-lose, and everyone can see it as potentially lose-lose" (Thurow 1992, p. 58).

## V. Disequilibrium: the is of competition among consumers

Now we know why consumers compete. They do it because they make errors, and try to correct them-disequilibrium phenomena. A disequilibrium points to market ignorance. From the ignorance emerge profitable opportunities competitive-entrepreneurial alertness exploits (Kirzner 1979, p. 30). All that's necessary to let this happen, is that we live in a disequilibrium: a world of change. Which of course we do. So the why and is of competition among consumers are the same. There's competition at all times and places. Competition among consumers isn't bound up with a shortage. Just as competition among producers isn't with a surplus.

What about free entry? Is there no role for it here as there was for it in competition among producers? Sociologically and psychologically there are costs to change a consumption pattern. I am not looking, however, for a change in prefernces. What Veblen describes can of course -as I did in the beginning- be called competition but it doesn't fit in here, it's sociology. Likewise Robinson Crusoe had to be competitive. Competitive he had to be towards his own ideas. Ideas competing for recognition (Dewey 1933, p. 103). But that's phychology and not my interest either. Nor, assuming stable preferences, I am looking for a change in relative prices or in income that could explain a change in consumption. I am looking for a competitive market process set in motion by unexploited opportunities. So again: What about free entry?

It all depends on how one looks at it. Though for the producer entry is free for pure arbitrage it isn't for imitaiton. For the producer imitation is stifled by patent protection-patent litigaitons enough. A protection that's unknown to the consumer. The producer has an advantage in arbitrage, equalizing prices, the consumer in imitation, equalizing utilities.

## VI. The marketing mix

Indeed the end of the bidding up of prices by consumers since the days of Smith is one thing. But as long as they make entreprieneurial errors they compete when they try to solve them. The question is: if there are entrepreneurial errors and consumers try to solve them competitively, how to use this for pricing?

Why pricing? Because of all the P's of marketing, pricing is less thought of from the point of view of competition among consumers. A producer prices a product from as little as possible to whatever the traffic will bear. He thinks about costs, competitors, and -in modern marketing- especially customers. Product, place and promotion, however, don't only put the customer first, but use competition too. Not only, just as pricing does, do they use competition among producers. Aren't there cooperative, adaptive, opportunistic, and predatory prices (Nagle 1987, p. 86)? But they also use competition among consumers. They use the first form of rivarly, I noted in the beginning: to keep up with the Joneses. And they try to stimulate the consumer's entrepreneurial alertness. "*The advertiser* [for istance] *has, as it were, injected a pleasant surprise into the world of the consumer.* The consumer finds that his world, his range of options, is a little richer than he dared anticipate" (Kirzner 1988, p. xx).

Price, in the 1970s, was the last P to include the consumer: his price sensitivity (Nagle 1987, p. xi; cp. Monroe 1990, p. 368). The emphasis, however, still is on the price-sensitive consumer per se: his entrepreneurial alertness -not on his competitive- entrepreneurial alertness. The reasons is probably the one I started with. Today, competition among consumers -the bidding up of prices- in dormant. So, if it doesn't exist, and there's nothing else to replace it, what's there to be used?

To put it differently. Pricing tries to harvest the value the other P's sow the seeds of (Nagle 1987, p. 1). "[P]rofits, not just sales, ...[are] the objective" (Hunt and Morgan 1995, p. 11). We know, however, that a price creates value too. A high price can fill status needs. But there's another way to create value-use the competitive-entrepreneurial consumer. Price can be used as an instrument of communication. It brings to the attention: it creates value for competing consumers. Then price doesn't only harvest but sows the entrepreneurial process too. It induces immediate overt behavior by strengthening the announcement of the offer (cp. Waterschoot and Bulte 1992, p. 89).

## VII. Pricing a real novelty

I look at the introduction of an innovative new product - a real novelty. Something that's a potential mass product. How to price if there isn't a market yet? That's where entrepreneurial consumers come in. Then the consumer's entrepreneurship, the discovery of new means and ends, is paramount. The product has to be discovered, information diffused. The producer needs all the help he can get. Just as in the days of Smith, he can use competing buyers. Then it couldn't hurt, either, to bring the buyers together and organize the bidding.

Pricing a new product is one of the most difficult pricing problems. "The newer the product, the greater the uncertainty associated with the key [marketing] variables" (Oxenfeldt 1975, p. 176). There's no price sensitivity you can use. When told of a new product, those who buy it do it often "whatever" the price is (Nagle 1987 p. 139). Price sensitivity comes afterwards.

There are three price strategies; penetration, skim, and neutral pricing (Nagle 1987, p. 113). You can set a price relatively low, relatively high, or equal to the ecnomic value of most of the potential buyers. In other words, price sensitivity is important, isn't important, or isn't relavant. All three strategies have their drawbacks.

The first strategy, a low price, is often thought to be the most effective, though costly, deal to introduce a new product. It tries, as Alfred Oxenfeldt says, to "overcome the reluctance of people to buy new products by offering special inducements" (1975, p. 190)? But is there nothing more to do, then to give these usual inducements: "a combination of low price - effective for only a limited, and often specific, period- and specially easy return privileges" (Oxenfeldt 1975, p. 190). And for the rest to rely there on that "[m]ost of what individuals learn about innovative products comes from seeing and hearing about the experiences of others" (Nagle 1987, pp. 138-139). There's no price sensitivity yet. A low price for a new product by the inexperience of the buyer is no bargain. So it's role can't be that great.

The second strategy, to set a high price because the first group of buyers you try to reach are price insensitive, has its drawbacks too. Who are they? It's said, they are the innovators, consumers who try the new product early and "to whom the later adopters, or 'imitators', look for guidance and advice" (Nagle 1987, p. 139). And where can you find them? It seems natural to turn to the places where money doesn't count. In Beverly Hills, rivalry among the rich and famous, because of 'free entry', is fierce. At Rodeo Drive, if you have to ask for the price, you can't afford it. That, indeed, comes close to being price insensitive. Though in the very poor neighborhood of South-Central Los Angeles competition can be as fierce. Trends needn't be expensive. Money plays no role, either because one has or hasn't enough of it. The extremes meet. These are the places for a producer to send his trend-watcher. If he wants to see what rivalrous consumers are discovering.

That's one thing, for sure. What, however, if the situation is a "reversal of a 'follow the leader' strategy" (Dixit and Nalebuff 1991, p. 10)? If everyone considers you a leader, a trend-setter, the surest way to keep that position is to play monkey. The best strategy is to follow the trend once it's adopted by the majority. In their eyes you can't loose. So, again, in economic competition the winner doesn't take it all. There's a place for everyone-even for the imitating trend-setter. Our problem becomes: If the innovators some-times, somehow don't lead, but imitate the imitators, how to reach the imitators - your future mass market?

Finally, the third strategy, to set a neutral price, doesn't look that great either. It's a passive strategy. It's one you use because of the default of the other more activist ones. And it's a negative strategy. It's the surrender of price to the other P's (Nagle 1987, p. 120). Still, it's the strategy I propose. However, I add some promotional pricing. Something that makes it the better world of the other two. The emphasis on and the sharp dichotomy between a skimming and a penetration price -as is used in the marketing literature (Dean 1976, p. 147; Kotler 1964, p. 44; Monroe 1990, p. 292)- clarifies. But not without a cost.

## VIII. The rule of competitive-entrepreneurial pricing

When you want to use competing consumers, what price tactic to add to that neutral price? In other words, if the utter ignorance of means and ends creates entrepreneurial errors, how to use them for pricing? I give the rule of competitive-entrepreneurial pricing.

A competing consumer is error-solving. He's alert to price signals and watches others. By doing that and at least not to offer a worse bid he increases his chances to gain and minimizes those to lose. The producer can use this. For the producer the trick is to make it look as if the price signals a trend. For this, a simple sweepstake will do. The tactic might be to give a gift to every one hundredth who orders with a certain mailorder house, buying a product hitherto not sold by post. Or, to give a lottery ticket to every buyer who books a trip to a new destination with a certain travel agency. These tactics simply suggest that the buyer - isn't alone. He's riding a trend: solving an error. This is the rule of competitive-entrepreneurial pricing.

It's essential not to give the gift to everyone. Give it every one hundredth buyer, or -if it's a prize- make the chance to win one out of thousand. Otherwise it looks, at worse, as an ordinary cut in prices, valid for everyone-without any suggestion of a trend, at best, as the tactic of selling a new product with a gift of known value. The last, indeed, helps selling the first. You're speeding-up the discovery process. Just as you speed-up the consumer's economizing process by making the sale for a limited period or as long as supply lasts. It's better, however, to compare the rule with pricing a known product below the equilibrium price. The resulting signs of a shortage: waiting lines, delays in delivery, and the ticket scalper signal a trend too-not, however, of an unknown bu of a known product.

Why settle on the neutral price? It signals the right value. A skimming price, almost by definition, would be contradiction. First, the happy few aren't interested in vulgar lotteries for the many. Second, the innovators aren't generally a random sample of buyers (Nagle 1987, p. 139). A lottery, however, picks the winners at random. They innovators know that. So, it has little appeal to them. And a penetration price isn't necessary. For the consumer the gains are still pure discovery gains. Gains to be compared with the old way of spending. They aren't to be mixed up with the gains by economizing that are possible later on. Try to ride the trend. Don't throw money away by cutting prices.

## IX. How the goevernment stifles entreprineurial pricing

In pricing, next to costs, competitors, and customers there's of course the law. This doesn't seem to be a problem. Isn't, at least since the signing of the Sherman Act in 1890, the government one of the staunch defenders of competition? But though we all know of her trying to improve with anti-trust policy competition among producers, we never hear of her doing the same for competition amongs consumers. In general the latter is thought to be taken care of, first, by the sheer number of buyers: there are many. Second, by a policy to create a more equal distribution of income. Just as on the producer's side of the market, big firms, oligopolies, are suspect, so too on the consumer's side, the big spenders, the wealthy oligarchy. But there's more. There are the specific regulations of the Federal Trade Commissions (FTC). Unfair or deceptive prices are forbidden

(Monroe 1990, pp. 405-406). The producer must be able to compete; attempts to manipulate the competitive structure are forbidden. The consumer must be able to express his wishes; he isn't to be misled.

For the FTC the rule of competitive-entrepreneurial pricing looks deceptive. So it ought -at least potentially- to be banned. By a gift, you lure the consumer to buy a good who's value is unknown to him. And will, indeed the future price -the one without the gift- be unchanged? A gift, to make it worse, only a few will have. It seems the buyer is misled. That, however, can't be. It aren't calculation or knowledge errors we're talking about. Then, indeed, you can lower the consumer's price sensitivity when you make comparison with competing offers difficult. The producer, for instance, uses calculation problems by pricing his eau de toilette 1.25 oz $17 instead of, as his competitor does, 1.50 oz. $20. And doesn't he use knowledge problems by pricing his firtilizer the same as his competitor? Claiming, however, that his fertilizer lasts twice as long. But does it (Nagle 1987, p. 61-62)?

Here, however, it's new ends and means we are talking about. That's what the market is trying to find out. We aren't talking of products that are known and have substitutes, products which aren't that new (Tellis 1986, p. 151-2). The regulations of the FTC stifle the discovery process. A process set in motion by competitive-entrepreneurial pricing.

## X. Conclusion

The good news is that on pricing a real novelty you don't walk alone. Indeed, you have to start from scratch, but you can use competition among consumers in sprending the news. Of course you are serving the customer, but that doesn't mean he can't help you to deliver the message. Where trends are conceived, consumers compete. They discover -create- the market for you. Trends aren't sold by competing producers, they are bought by competing consumers.

How do you do it? By passively relying on word-of-mouth recommendation? No, you can take the steer: You let the consumer know that he, too, isn't walking alone. Give him a lottery ticket when he buys your product. Now he knows, there's a chance he'll be a winner out of sayindeed-thousand other buyers. Then you give him value for money even before uses your product.

Competition among consumers doesn't only help the producer. It helps the consumer to compete: to correct errors, too. Just as competition among producers helps the producer. "[I]f our story," Walton says in his autobiography, "doesn't prove anything else about the free market system, it erases any doubt that spirited competitions is good for business - not just customers, but the companies which have to compete with one another too. Our competitors have honed and sharpened us to an edge we wouldn't have without them" (1993, p. 242).

The government has nothing to do with this tactic. It can't be deceptive. There's, simply, nothing to be deceptive of yet. You help the consumer to discover new ends and means. To ban it the government stifles the discovery process the market is. In pricing new goods the government isn't the solution to spreading information the consumer might value. She's -again- part of the problem: holding him ignorant.


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