PRICE MANAGEMENT PARADOXES IN THE ROMANIAN ECONOMIC CRISIS

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ABSTRACT
The effects of the global economic-financial crisis are felt in Romania mostly at price level. Prices rose paradoxically and affected the whole country. In this perspective, a new approach of the price strategy consisting in a better insight, understanding, control and review of the original and newly emerged elements that underlined or will be taken into consideration in the pricing decision can substantially contribute to solving this problem.
After the 1990, we have seen only atypical aspects regarding the pricing process. That was possible only due to the Romanian market characteristics specific to that period.
However, ***a price growth, in a crisis context, has been and can be a suicidal act for any company.***

KEYWORDS: *price making decision paradoxes; price strategy; sales internationalization; price harmonization; price differentiation.*

JEL CLASSIFICATION: *D24, L21, M21, M31, O12*

1. INTRODUCTION

For how long will this crisis take effect in Romania? What will be the actual final effects of the crisis in our country? These are only two questions whose answers are still uncertain for the moment. What is certain is that Romania has felt and still feels the crisis. Its effects were normal and predictable in Romania, due to the fact that our country is a EU member and due to the market globalization phenomenon. Major companies from Romania have experienced a decrease in their production (Dacia), or have reduced their production capacity (Oltchim) or started to produce on stock. Some companies have liquidated their business or are in the process of liquidation (Mechtel). Others have moved their activity into other countries (Nokia), or had significant worker layoffs. Banks have tightened credit granting procedures. More than that, they try to minimize any losses on the backs of old customers, unilaterally changing their contracts and increasing the cost of credit (aspect which leads to the presumption of illegal practices, which in turn made the Competition Council trigger an investigation on certain banks, on the basis of a possible anti-competition agreement). These are only a few examples to which we can add tens of thousands of gone SMEs that reflect the true extent of this phenomenon.
As we cannot act on the causes that generated the crisis, it seems natural to ask: what can be done in the context of the crisis, to overcome it as fast as possible and reduce its devastating effects - these aspects are the fundamental objective of the current period.

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2. SCIENTIFIC SUBSTANTIATION OF PRICES

Judging from this perspective, at commercial companies level, regardless their size, a new approach to pricing strategies through a better **insight**, **understanding**, **control** and **review** of the original and newly emerged elements that underlined or will have to be taken into consideration in the pricing decision can substantially contribute to achieving these objectives. So far we have seen only atypical matters regarding prices on the Romanian market, made possible by the Romanian market characteristics. At European level, on many markets, parallel imports and the internationalization of sales have determined in recent years an erosion of prices, their shrinking as a result of product flows from countries with low rates to countries with high prices, in which they are resold.

Or, if we refer to Romania, the paradox is that we have witnessed the reverse situation as a result of entry into the EU, i.e. flows of goods from countries with high prices in a country with low purchasing power and lower prices led to an increase of prices on the market. In many sectors in our country, countering the aggressive offensive of sales internationalization and parallel imports could have been countered by domestic producers, but their lack of performance from all points of view made it impossible at start, and **once they were privatized and internationalized there was no interest in a "price war" between competitors (out of which, as is known, only the customers can benefit), but rather in increasing market price (which will earn benefits for all competitors).**

Another trend observed in Europe, and which has left its mark on the Romanian market, is the development of large sales networks and an increase of their power in determining pricing strategy. Sales networks such as Carrefour (which, for example, owns in France a market share of over 28%), Auchan, Cora, Real and so on have imposed on our market their marketing strategies (by default their pricing strategy too) dedicated to the European market. **Often linked to the pricing strategy, the vision of these great sales networks is to impose Europe-wide the best prices available.** These large networks advocate lowering prices, putting increased pressure on the manufacturer (taking into account the balance of forces, the latter has no chance to impose a price on its reseller), the aim being to obtain higher profits out of volume.

This aspect of the pricing specific to these large sales network could be considered, at a first glance, beneficial for Romania, on the consumer market, but the demand specifics of our country, different from those in other EU countries, cause a normal phenomenon for Germany, for example, to seem totally absurd (in the client's view) in Romania (it is absurd that a customer from Romania to pay 15% more than one in Germany for Aquafresh toothpaste, while his income is 10 times lower). (Deac, 2009)

Occupying *target-stores* positions for a large number of buyers and offering an increasingly large range of products, hypermarkets tend to become the only shops visited by customers, and the power of a brand, even a significant one, which attracts customers into stores is low. Consequently, **these retailers realize that they have the power and use it in direct negotiations with manufacturers; thus, in reality, they set the price of products,** minimizing the profits of producers (according to the producers). Given that these retailers are constantly increasing their number of locations and widen their range of offered products it is easy to understand that entering the Romanian market was very profitable, paradoxically, higher prices and excess demand in Romania allowing them to increase profitability.

The globalization of trade in goods is influenced simultaneously by two opposing forces: the harmonization and differentiation of prices, as shown in Figures 1 and 2. (Deac, 2009)

If in other EU countries price alignment factors have become increasingly important, requiring the careful supervision and adaptation of pricing strategy for the exploitation of potential opportunities in price differentiation, our country registered a totally paradoxical behavior.

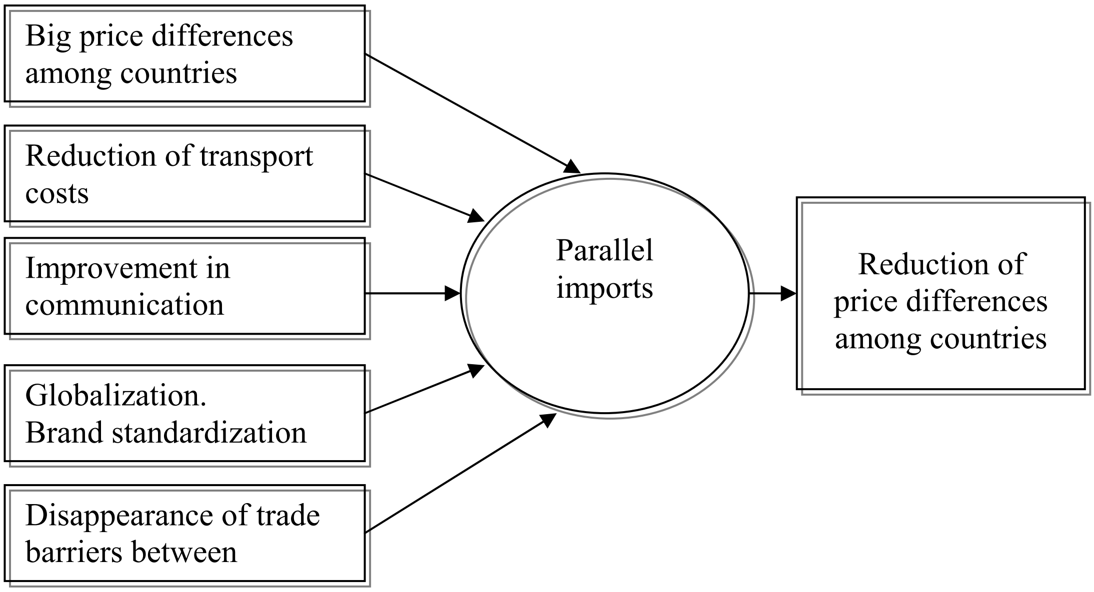

Figure 1. Main factors of price harmonization
Source: adapted from Deac (2012)

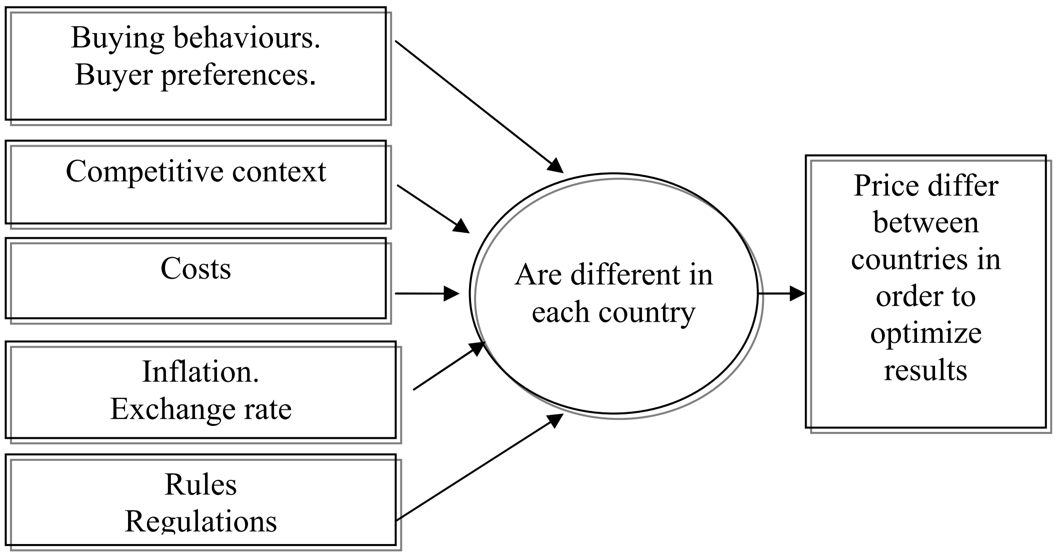

Figure 2. Main factors of price differentiation
Source: adapted from Deac (2012)

3. PRICE DIFFERENTIATION

In general, **a differential pricing strategy by country brings more benefits than a single international price strategy.** A pertinent analysis of the demand curve given the perceived value and customers' willingness to pay based on price levels in each country will allow maximization and profit margins, even with a price reduction strategy, a simple and less expensive solution. Complete freedom in pricing causes a greater price differentiation between countries, an interesting method for maintaining the price differential in practice is to define a "**price corridor**" in which prices in different markets may fluctuate.

Figure 3 shows the evolution of European companies' price starting from a "**catastrophic scenario**" of price convergence to their lowest level, to the definition of a "**European price corridor**" in Figure 4. (Simon et al., 2006)

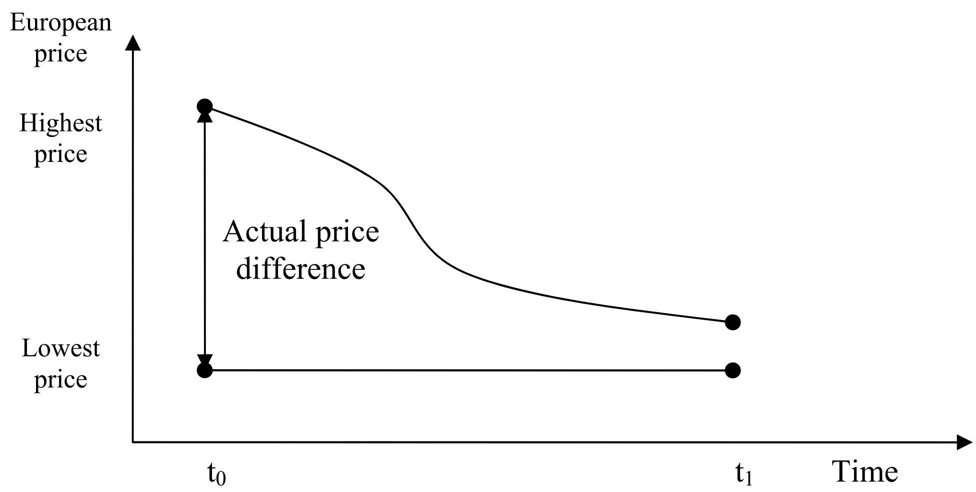

Figure 3. „Catastrophic scenario"
Source: adapted from Deac (2009)

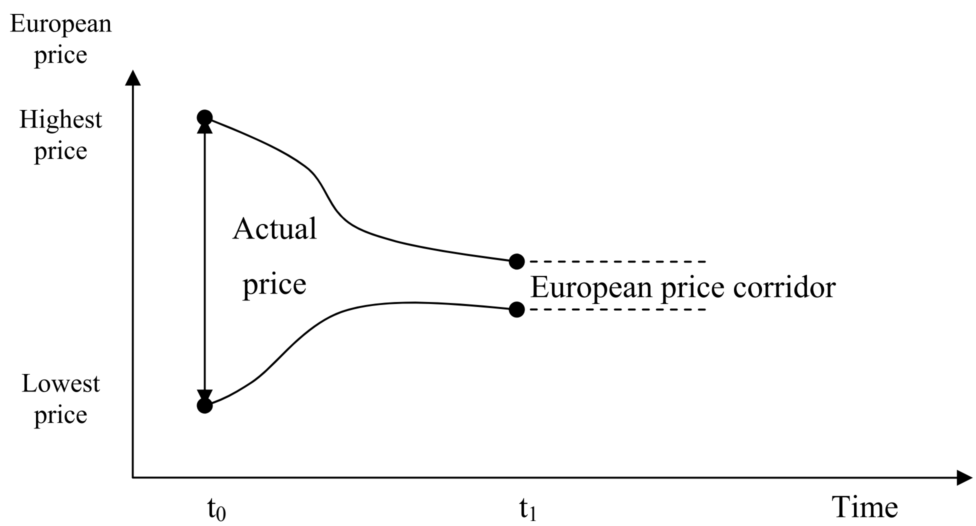

Figure 4. „European price corridor scenario"
Source: adapted from Deac (2009)

Despite the trend of price harmonization at European level, in most cases, there is an interesting differentiation potential, which varies from country to country. **For example, if we consider the retailer Carrefour, in France it should choose a strategy of high prices, taking into account the particularities of the French market, and in Romania, based on the particularities of the Romanian market, a strategy of lower prices and not vice versa (another paradox).**
Within the European Union, given that some countries did not want the changeover and the new member states have not yet passed to the Euro currency (see Romania), **another key problem that must be taken into consideration in designing the price strategy is the exchange rate fluctuations between the Euro and the other currencies.**

The fluctuations in foreign exchange must be integrated in the price strategy because they can significantly modify the price positioning as a competitive element and they can unbalance the markets. In case of significant exchange rate fluctuations, maintaining a constant price in the customer's foreign exchange is not an optimal solution, as trying to keep the same margin in the provider's currency is not recommended. **The optimal solution is, most often, a compromise between the two actors, so that the customer and the provider can share risks and potential gains.** If the provider's currency is strong, the price expressed in the currency of the buyer must be moderately increased (argument that justifies partially the price growth in Romania), and reverse, if the buyer's currency is stronger, the price must be reduced (unregistered situation on the Romanian market; given that the Romanian currency has appreciated against the Euro, the prices rose, increasing the sellers' profits, this aspect being another price paradox in Romania, a member of the EU).

Many companies have been forced to raise prices during the last years. They do this even though they know that such measure can have negative effects on relationships with customers, distributors or their own sale force. **The most important factor, that needs to be taken into consideration when deciding the price growth is communicating this growth to the clients; they need to understand the reasoning that led to this growth and they must be convinced that the new prices are fair.** Perceived fairness is one of the strongest factors that determine sensitivity to the price and if it is done right it can have significant effects.

Given that there are different reasons for changing the prices, there are different approaches to communicate this fairness. **Inflation through costs represents one of the determining factors of price growth.** The rising costs of the producing companies (especially due to rising input prices and salary growth) reduce the profit margins and push the companies in the vicious cycle of price increases (Chetochine, 1997). Often in anticipation of the rising costs, companies increase prices more than the costs growth (for instance, before announcing the price growth for electricity, natural gas or gasoline, the price of the products on the shelf is increased). To avoid the impression that they deceive the buyer, these increases are sustained by a excessive communication supported by all the media channels where they "explain" to the clients in general terms the "objective reason" of these increases (communication "model": "excises growth by their calculation at a higher rate in 2013 will increase prices of all the products"). **Making a direct link between price growth and costs increase like:** "fuel price increased by 25%, fuel expenses represents 20% of the price, therefore, the price is about to increase by 5%" **is necessary for proper communication.**

Perceiving fairness of price growth is much enhanced if the clients know that these prices will go back down in the case of a decrease in input costs, but this is not happening on the atypical market of Romania (see the gross oil price reduction impact on gasoline price at the pump).

Excess demand, as occurred in our country after the 90s **represents another price increase factor** (why not increase the price if possible?!). Accustomed to the permanent price increases (what other option is there?), leading to astronomical prices on the individual consumer goods market ("the luck of the customers was that the National Bank of Romania has cut off four zeros" (Deac, 2009)), many hoped that once the big retailers penetrate the Romanian market the prices will go down but, as previously shown, in our country these retailers practice higher prices.

4. PRICE SUBSTANTIATION IN A CRISIS CONTEXT

If in the economic circumstances before the start of the crisis we could, most often, paradoxically, perceive higher prices even in the launch phase of a product, a process of rising prices in a crisis context is much less advisable, representing a suicidal approach for a company. This was also highlighted by a study conducted by Dan Orenstein, an expert in finance and taxation, which analyzed the results of 304 commercial companies (that achieved in 2011 a turnover of 109 billion euros, or about 88% of Romanian GDP) and showed that **the biggest mistake committed by managers of many of the said companies at the beginning of the crisis was to increase prices and increase margins to offset the decrease in sales.** With increased prices without restructuring the business, many of these companies have been at a loss in 2011 and continued to lose money. The study shows that there were companies that, although raised their prices, remained profitable in the long term, due to the high degree of market penetration and consumer dependence on their products and services (businesscover.ro-1.11.2012). But even a price reduction approach, based on the idea of obtaining a competitive advantage by making price the main reason why consumers should choose you instead of other competing companies may be doomed to failure for the simple reason that all competing companies have access to a pen. And with that pen they can reduce prices whenever they want, sweeping away your advantage (Trout, 2006).

As shown by M. Porter, reducing prices is usually crazy if competitors can reduce as much or even more than you. Although improving operational efficiency is required to increase performance and consequently to reduce prices (e.g., Japanese companies were those that used operational efficiency to its best in competition with competitors from the West in the 80s; they had exceeded their competitors by so much that while they offered lower prices they could afford higher quality as well), it is not-sufficient, because all competitors can easily reproduce management techniques, entering, in fact, what is called a “destructive competition.” The biggest strategic mistake is to compete with competitors in the same direction. This leads to escalating rivalry, which in turn leads to lower prices and higher costs. Companies should set their aim, in order to avoid going into this spiral, to “*be unique*.” This requires managers to ask themselves “how can I deliver a unique value that can meet an important set of needs of a significant customers segment?” (Porter, 2008). We believe that such a vision is necessary, especially in a crisis context.

The boosting sales through an intense campaign of promotions approach raises, in a context of crisis, questions regarding its positive effect. Extensive international research has shown that, generally, in a normal context, after the end of the short-term promotions, sales return to previous levels. Recent studies have demonstrated the positive effects of promotion are recorded during the time period it takes place in, and so management teams have been hoping in vain that there will be post-effects, at least in their case (Trout, 2006). However, in the current crisis, companies’ imagination in promotions, often taken to the extreme (remember promotions of companies in the automotive industry - the most affected by the current crisis - that stated buying a luxury car earns you a house by the sea) often had the anticipated short-term positive effect. Equally true is the fact that the construction sector, which plays an important role in the Romanian economy as a whole, with a constant of 8-10% of the country’s GDP, and which by 2008 represented the main factor of economic growth (Simion-Melinte, 2013), failed recovery despite significant price reductions (which amounted to even 50%).

Even the fundamental question that underlines the strategic pricing approach: “**What should be the price of the company's products for it to be competitive on the market?**” has to be reformulated in a context of global crisis, seeming more natural to ask: “**What should be the price of the company's products for it to stay on the market?**” A single word is changed but that involves many major changes in the assessment of factors that cause a certain level of market price.

Both in a normal context, but also in a crisis one, pricing must consider three elements: **customers (and the perceived value)**, **production and distribution costs**, between which there are interdependencies, since the pricing mechanism is very complicated and subtle; in a crisis context **we need a better understanding, control and review of the mentioned items and more than that, we need to change pricing perspective from a routine one to a strategic perspective.**

Pricing difference between conventionally and strategically pricing is the same as the difference between the response to market conditions (as many banks in Romania did when they increased credit costs, without registering a real financial crisis) and managing them in a proactive manner. In the case of conventional pricing approaches each functional department imposes certain constraints, given the department’s own objectives, but in the absence of a strategic perspective, these constraints may be contradictory, with direct implications on the profitability or survivability during a delicate crisis period. For example, financial departments may require products to obtain a minimum coverage margin, or the price to cover at least the average cost, and by doing that the company could miss opportunities such as: reduced coverage margin/higher volume of sales or maintain sales during the crisis, with direct effects on profitability. Marketing departments fail in trying to design and strengthen effective pricing methods, while the sales team lacks motivation to prepare and negotiate effectively with powerful customers; these issues diminish performance within pricing.

Strategic pricing perspective requires more than a simple change in attitude, **it requires a change in the timing, method and persons involved in pricing decisions.** Pricing strategy involves anticipating the price levels in the early stages of the product development process in order to better understand what are the concepts that can create and maintain enough value to justify costs.

But more important is that the strategic pricing requires a new kind of relationship between key functional departments of a company - marketing, sales and finance. This multifunctional focus requires a balance between the needs of the client to obtain value for the paid price (this ratio changes a lot during a crisis) and the company's need to cover its costs and earn a fair profit (or at least to cover costs during the crisis). But in most companies, determining the price starts a conflict rather than a balance between these objectives (Nagle & Hogan, 2008). If you are aware that, in market economy conditions, pricing approach must have as its starting point the clients, the key objective being to capture the value created for customers then prices should be set by those best able to anticipate that value, meaning the marketing managers. But their efforts will not be effective as long as they do not collect information about customers and competitors needed for estimating. Consequently, actual knowledge of value is achieved when directly negotiating with customers or by displaying the price on the shelf, that being the responsibility of the sales department.

Finally, marketing and sales teams' efforts will not generate profits unless there is some appropriate financial objectives, which in turn require a new financial philosophy. **Rather than try to "recover costs", financial departments should reconsider the costs, the impact of price changes on profitability, to know to what extent the change in costs is influenced by changes in the level of cashing and use this information to create appropriate incentives and guidelines for marketing and sales departments so that they can achieve their own goals in a profitable manner.**

Regarding the evidence on which pricing is based, based on the spirit of market economy, few would have any objections that prices must be based on the value that the product creates to the customer. Analyzing the price taking into account the purchasing behavior of customers, **it is the total economic sacrifice (effort) consented by the customer to buy a product; the customer systematically compares this sacrifice with the value he perceives in the product that he wants to buy. Price and perceived value are the two major foundations of all economic transactions** (Deac, 2009).

Faced with several options, the customer will prefer the product that gives the highest net worth, which is the biggest difference between perceived value and purchase price. Based on this finding, the question arises: *"What actions should the company take to establish a correspondence between value and price?"* The most obvious solution is to gather information necessary to estimate the value that the product provides to the customer (Kotler & Armstrong, 2007).

But this issue is insufficient to determine the price and even more so to formulate a pricing strategy in a context of crisis. Why? This value varies from client to client; it changes depending on different customer awareness (usually it decreases); it changes as the customer gets to know the product (on a second purchase this value may be lower); it changes depending on the situation; and even when customers understand this value, they have a strong financial incentive to negotiate lower prices (imposing the setting of clear and consistent policy of discounts).

But in a crisis context, these value elements acquire new meanings (better information, harder negotiation, greater caution exhibited, better establishment of priorities from the clients). Moreover, even if customers understand correctly the value of the product and in a normal context would be willing to pay the demanded price, in a context of economic crisis this sacrifice could be considered too high and, therefore, they'd end giving up buying the product, although the price is lower.

Considering these aspects, value communication is a key element of the pricing strategy, especially in a crisis context. Value communication, which includes advertising, sales probationary period, warranties, public demonstrations, tasting sessions, possibility of returning the product and any other ways that support the seller's value promise, **increases availability of less informed and experienced customers to pay at the same level of as the "connoisseurs".** The situations in which the customers do not understand the value of a product are not uncommon, because they may not have learned about its new attributes, or not know how to use them (many regulars consider the sophisticated features of new products a "greater bother") or could not understand how a particular attribute satisfies a need yet unfulfilled (Deac, 2009). It is the responsibility of the seller to resolve these issues through effective value and hence price, especially in a crisis context.

5. CONCLUSIONS

Company management is "tested" each time in a crisis context, and only a strong and consistent leadership can keep a straight direction when stakeholders (employees, suppliers, banks, customers and so on) come with all sorts of arguments and new ideas that would lead to a change of options, seeing overcome the current crisis. There is need of a leader more than a manager, a leader inspiring confidence, acting with conviction and that owns real communication skills! (Deac, 2012). It is essential that anyone within the company to understand the manager's efforts to overcome this critical situation and to act accordingly, fact that requires transparency, good communication and persuasion skills.

And, if we take into consideration aspects such as:

- *Plain water has the same price as beer;*
- *Chicken is cheaper than mushrooms;*
- *Romanian nuts are more expensive than coconuts;*
- *Plain milk is more expensive than buttermilk;*
- *Books are cheaper than magazines;*
- *Pepper stuffed olives are cheaper than olive core stuffed olives;*
- *Blank paper (A4) is more expensive than printed paper;*
- *Wine is cheaper than grapefruits;*
- *Pens are cheaper than pen refills;*
- *And the best one **... Uneducated people are more "expensive" than valuable people who "sell" themselves cheap in order to survive;***

the less we understand the behavior of companies regarding prices on the market of our country.

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