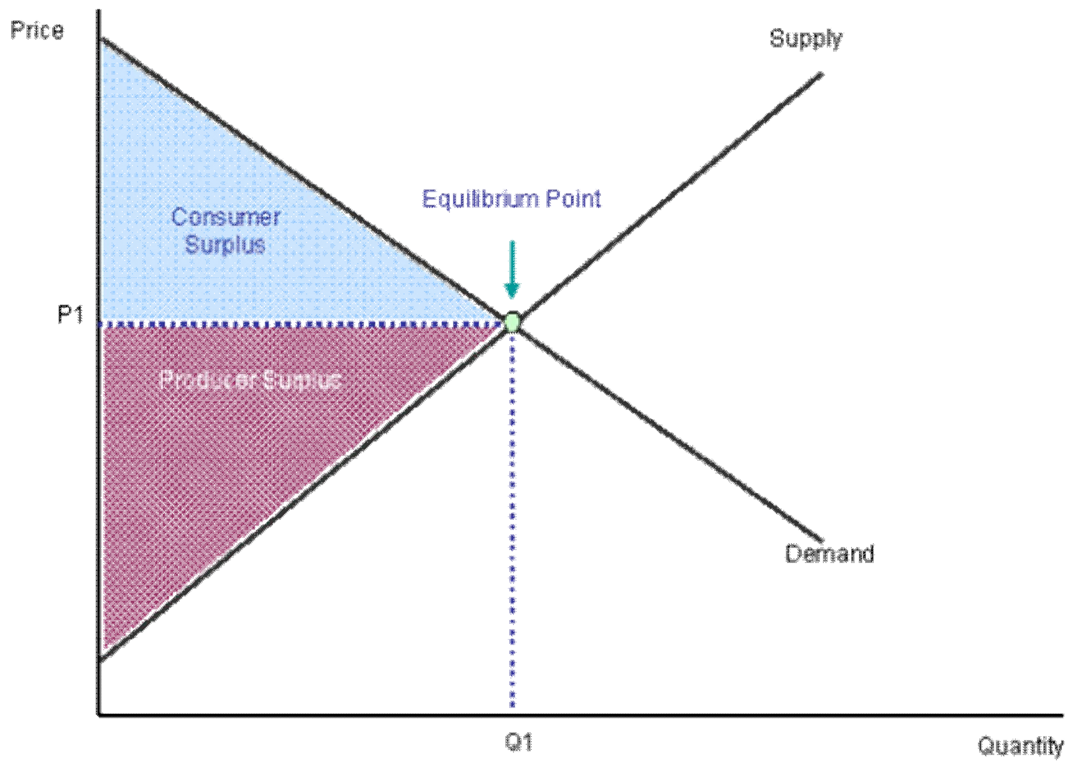
MGT610 Assignment no.1 Solution Spring 2013 (2-5-2013)

Some ethical issues are extremely easy to understand: don't steal, treat others with respect, and always put down the toilet seat for your lady friends. However, when it comes to the market, the concept of what is right and wrong is a bit blurrier. Of course you can't exploit children for a lbaor force, but Is it a business's right to price however they want? After all, if the number is too high or the marketing too egregious, then consumers won't buy right? Well, not exactly. Over the years, governments have put laws on the books for the most heinous of fraudulent pricing strategies, but even then some tactics are considered quite unethical, and you may be committing these missteps without even knowing. We touched a bit on the ethics of natural disaster price optimization in a previous post, but in order to fully understand the scopes of pricing ethics let's take a look at a brief overview before diving into five main concepts you should stay far away from in your business.

Pricing: More ethics than legality

There is a general consensus that marketing strategies must not infringe on values like honesty, transparency, and autonomy. As such, the main crux of pricing ethics concerns the establishment of a balance of power (through information) between the producer and the consumer. In a completely free market, producers often have the upper hand because they are in control of their products and processes. This potentially lead to unethical practices (using cheap or harmful materials, lying about benefits, etc.), which are deemed harmful for society as a whole.

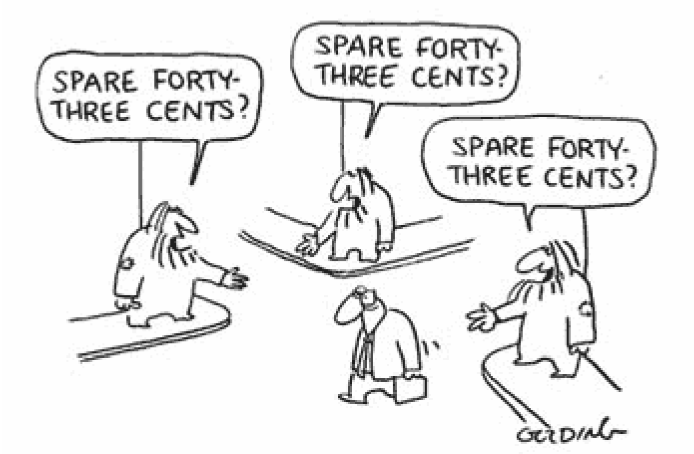


Interestingly enough though, even with this possibility only a handful of pricing practices are regulated by the government, mainly because you're not really sure someone had broken a pricing law until you see results. For example, while predatory pricing, aka pricing extremely low to drive competitors out the market, is illegal, it's difficult to prove that the price

decreases had such an intention and were not simply the result of competitor based pricing. It's like telling a child that he can have a cookie only if he finishes his vegetables, but with no way to discern if the kid ate the peas or if they were slipped to the dog. Essentially, most laws blindly attempt to curb motivations for doing things, rather than results.
As a result, pricing ethics and legality sit in a grey area, constantly ebbing and flowing between right and wrong. To better protect you and your business, here are some of the most common pricing practices that sit on a razor's edge of ethics and legality.

1. Price fixing: Collusion at its worse

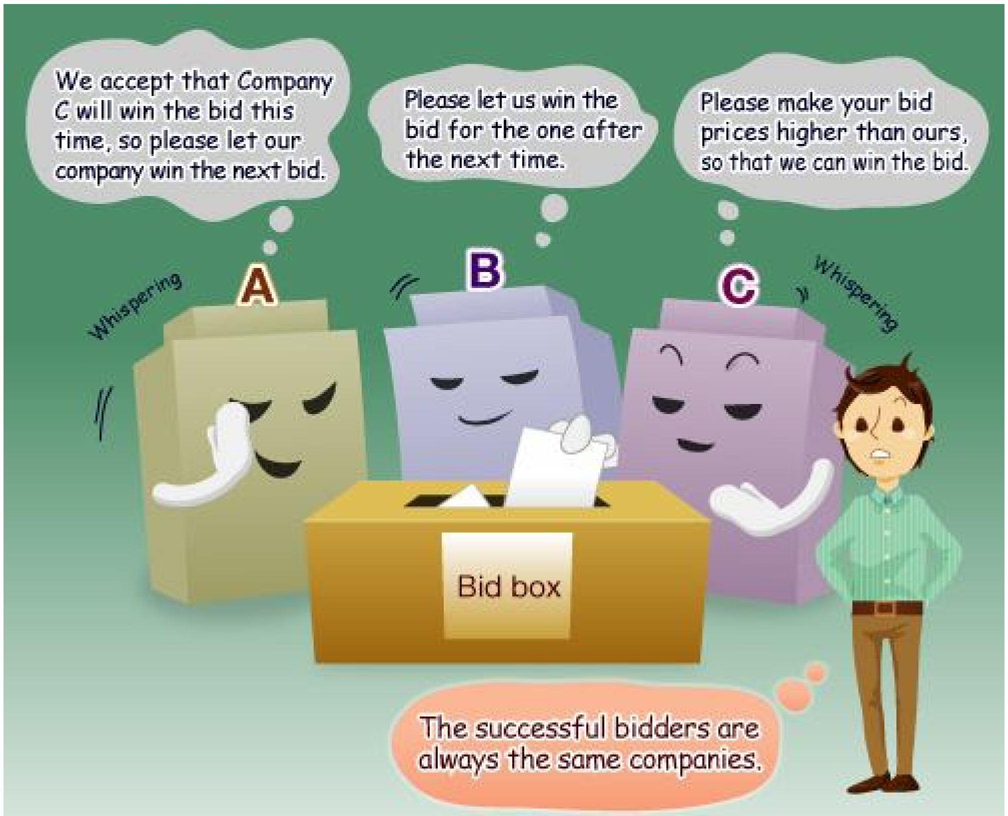
Price fixing involves the an agreement between a group of people on the same side of a market to buy or sell a good or service at a fixed price. Typically, competition between these participants for consumers drives down prices for goods. Yet, imagine a world where every ice cream shop in America vowed that all single scoops were now $15. Consumers would lost out, because we'd find alternatives or shell out an exorbitant amount of cash, as we couldn't go to another neighborhood joint to battle the high prices/low quality offering of another.



The potential blow to consumers is why horizontal price fixing is illegal, which means corporations on the same level of the supply chain cannot agree on a target, maximum, or minimum price (among other things). This form of fraud can be prosecuted under the Sherman Anti-Trust Act. The Supreme Court did rule, however, that vertical price fixing is allowed. For example, wholesale companies can limit how much retailers charge for clothes.
The bottom line: Look at your competitors to understand the market, but don't get in a room with them and try to take advantage of consumers. Check out more about competitor based pricing.

2. Bid rigging: Favoritism

This one's more for the proposal crows, but bid rigging involves promising a commercial contract to one group, even though you make it look like multiple parties had the opportunity to submit a bid. Not only is this a moral no no, but it's also one of the few the government follows up on, especially within their own ranks, because of the number of bids and contracts the government deals with on a yearly bases. This practice hurts consumers considerably, because the best producer doesn't receive the work necessarily.



There are many variations of this offense, and all include some pre-determined agreements between corporations involved in securing a contract. Considered a form of collusion, big rigging is illegal under the Sherman Act, our government's rockstar market regulator.
The bottom line: Even if "you know a guy" keep the bidding process honest on both sides. Everyone will end up better off.

The Prisoner's Dilemma
The Prisoner's Dilemma is a classic example of games theory, an area of mathematics whose foundations were laid down by John Nash.
The Prisoner's Dilemma shows that, in certain circumstances, if the members of a group trust each other, they can choose a course of action that will bring them the best possible outcome for the group as a whole. But without trust each individual will aim for his or her best personal outcome - which can lead to the worst possible outcome for all.
In the Prisoner's Dilemma two players act as prisoners who have been jointly charged of a crime (which they did commit) but questioned separately. The police only have enough evidence to be sure of a conviction for a minor offence, but not enough for the more serious crime.
The prisoners made a pact that if they were caught they would not confess or turn witness on each other. If both prisoners hold true to their word they will only be convicted of the lesser offence. But the dilemma occurs when the police offer each prisoner a reduced prison term if they confess to the serious offence and give evidence against the other prisoner.