Danish University Colleges

The Market - between Marketing and Economics

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Abstract

We all know what a market is, but when it comes to theorizing about markets and modelling them, there are differences within the fields of economics and marketing management. Here we shall try to locate the cause of these differences, and discuss when the economic concept of an ideal market is applicable in real life situations. Furthermore we shall discuss implications of the global disintegration of production, and the growing content of intangibles (experiences) in the goods we consume, for our understanding of the market. This takes us to a plausible theoretical explanation of the smile of value creation.

1 Introduction - The Essence of Markets

Markets are amazing. In modern economies they assure, that virtually any material craving you may have can be fulfilled. Feel like Pizza? Just have a look at your smartphone, and any urban area will provide you with a wide variety to choose between. You don’t even have to go to a physical market to fulfill your craving. This reminds us that the most important thing to notice about markets is not their physical or digital form, but their organizational form - to economists the market is a principle regulating economic transaction. Today we have almost forgotten that there are other ways of organizing economic transactions. Other coordination methods witnessed by history are hierarchies (command economies) or social networks (corporative economies). But todays economies are market economies - supported by the concept of private ownership and dominated by the market as a coordination mechanism for economic transactions.

How much faith can we place with the market as a coordination mechanism? Providing the goods is one thing - but does the market also guarantee that your pizza will come at a fair price, and that the society as a whole makes good use of all available resources? These are the main research questions posed by the economic science. Economics is about understanding economic system and suggesting ways of improving the wealth of nations understood as the sum of the wealth of people inhabiting the nation. From orthodox economics the short answer to both questions is: YES. A pizza place that does not sell at the right (market) price will go out of business, since consumers will go to other pizzerias if the price is too high, and the
pizzeria will go bankrupt if the price is too low. If the market price in an area leaves the pizzerias with an above normal profit, more pizzerias will open and force down the price of pizzas. Furthermore economic resources will flow to the economic units that are willing to pay the most - i.e. the places where they are most useful. These are the cold facts of the competitive market mechanism. To get to this answer, however, economics have had to answer several subquestions:

1. What determines the inner or true value of products and resources used in production? (what is a fair price?)

2. What determines market prices?

3. Can market prices deviate from inner value?

4. Do markets redistribute value among participants? (do I risk losing some of the value I possess by participating in the market?)

Obviously, marketing management does not have the same research questions. Marketing management is not about helping nations become wealthier - it is about helping businesses get wealthier. But the questions of economics should interest marketing management as well: when we help businesses get wealthier, do we do it at the cost of the consumers, or do both consumers and businesses get wealthier from our insight in markets? From its emergence in the early nineteenth century, marketing management has been perceived of as “applied economics”, and has as such been able to hide behind the conclusions of economics. As a profession, it is argued, marketing management helps both the producer and the consumer, since they provide information for both parties. They help the economy allocate scarce resources to their optimal uses.

But if you consult modern books of marketing management, the answer is more ambiguous. Marketing tend to think about markets as marketspaces - as collections of buyers and sellers. Since they do not focus on markets as an organizational principle, they do NOT start out from ideals, but observe actual markets with all their imperfections. Pizzerias in an area may have different price setting strategies, and the right marketing may allow a pizzeria to earn an above normal profit. For example, a pizzeria that use online marketing to have its name appear on the top when googling “pizza”, may succeed in selling more pizzas than its competitors, even if its price is a little higher or its quality a little poorer. We shall argue that it is a dilemma of marketing that on the one hand, marketing likes to assume that markets are of the ideal market type - on the other hand, marketing is about taking advantage of the fact that markets are NOT of the ideal type.

The answers you get from economics and marketing are different because economics and marketing use different assumptions when modeling what goes on in real markets. Economics assume that agents are rational and that they have unlimited information. In such a world it should not matter which pizzeria turns up first at the google list, since agents will look through the whole list - or in a less perfect world,
Table 1: The 4 P’s of marketing...and economics

<table>
<thead>
<tr>
<th>4P’s</th>
<th>marketing management</th>
<th>economics</th>
</tr>
</thead>
<tbody>
<tr>
<td>PRODUCT</td>
<td>find your own quality</td>
<td>one quality for each market</td>
</tr>
<tr>
<td>PRICE</td>
<td>competitive (relate to quality)</td>
<td>one price for each market</td>
</tr>
<tr>
<td>PLACE</td>
<td>choose the best place</td>
<td>one market for each place</td>
</tr>
<tr>
<td>PROMOTION</td>
<td>help the consumer find you</td>
<td>no need - the consumer knows</td>
</tr>
</tbody>
</table>

In time they will realize, where to buy the best pizza at the best price. In its original form, marketing was mainly seen as helping consumers in their search process. But today marketing is very much about adapting you product to the market - about choosing the marketing mix that will secure you a place on the market (See Table 1).

Thus on the one hand we have economics with the ideal market, and on the other hand we have marketing as a profession helping businesses take advantage of the fact that markets are not of the ideal perfect competition type. To understand markets, we shall start out with the ideal market, and take a tour of real world markets through history.

2 The Ideal Market

In orthodox economics, the market is the most central institution, since all economic activity is seen as exchange. When you go to work, you exchange some of your spare time for the goods you can buy for your salary. When producing, the owner of a firm exchanges wear and tear of his capital goods for a profit (and eventually goods for his own pleasure).

All these exchanges take place at market clearing prices. In its ideal form economics explains the functioning of the market by using a fictitious auctioneer. The auctioneer calls out a trial price: who wants to sell pizza at 50 D.kr. a piece, and who want to buy? If there is excess demand - more buyers than sellers - the auctioneer will raise prices. Who wants to sell pizza at 60 D.kr. a piece, and who wants to buy? If there is excess supply - more sellers than buyers - the auctioneer will decrease the trial price. You probably got the point by now. The auctioneer must perform this exercise for ALL goods simultaneously!

In this ideal form, nobody gets to buy or sell pizzas before a market clearing price is found - a price where supply is exactly equal to demand. This mechanism is very powerful and from it economics prove two theorems that have had tremendous consequences for the way we perceive economic system: Competitive markets tend toward an efficient allocation of resources. This statement is known as the first theorem of welfare economics. Efficient is defined as a situation where you cannot make one or more agents better off without leaving at least one agent worse off (Pareto optimality). An efficient allocation is therefore not necessarily a good or a fair allocation, but government need strong arguments for redistribution in a Pareto optimal situation. The second theorem of welfare economics is concerned with fairness. It may be proved that in the settings of ideal markets, market do not redistribute wealth. You may join the market redistribution of goods without
running the risk of being “robbed” or cheated by the market.

Economics make use of a set of assumptions to ensure that the market maker will be able to find a set of prices that will clear all markets, i.e. prices that will make supply exactly equal to demand in all markets. We are so familiar with these assumptions that we hardly think about them. Let us try to have a look at the supply and demand curves (Figure 1).

Before we can even draw these curves, we need to have a more specific idea of what a market is. Again we must be aware of differences between economics and marketing. For the economist, goods sold at a given market need to be homogenous - they need to be the same. This implies that we cannot talk about a market for beer. Instead we need to talk about a number of different beer markets - one for each label consumers can identify, and have preferences over. Once we have established our beer market, we also need to take into account the concepts of time and space. A beer at midnight in Jomfru Ane Gade\(^2\) is something different from a beer Monday morning at your local supermarket. Suddenly we have had to transform what, within marketing management, we thought of as one market - the beer market - to thousands of different markets defined by the beer label, and when and where it is (time and space).

Now, let us consider the demand curve. What assumptions do we need in order to be able to draw this negative relation between price and quantity? Remember that the market is made up of a number of individuals that may consume different quantities of beer at different prices. We assume that at higher prices fewer people will buy smaller quantities of beer. At lower prices more people will buy larger quantities of beer. The argument behind this assumption is decreasing marginal utility - the idea that you get more pleasure from the first beer, and less pleasure from your tenth beer. Therefore you are willing to pay more for your first beer than for beer number ten.

If beer was really a homogenous and anonymous good, this assumption appears

\(^2\)Jomfru Ane Gade is the street with the longest continuous stretch of restaurants and bars in Denmark.
to be reasonable. As the price of beer increases, more people will substitute some of
the beer they would have liked to drink for water, or some other less expensive drink.
But in some markets, consumers may have a hard time distinguishing between the
price of a good and its quality. At a higher price, they may believe that the beer is
of better quality, or is more exclusive, and they may end up buying more beer at a
higher price, than they would have bought at a lower price. In this case we cannot
be sure that the relation between price and quantity is negative, and we cannot be
sure that a market-clearing price exists.

Then, what about the supply curve - is it obvious that the relation between price
and quantity from the perspective of the producer is positive? If you run an orchard
with apples, the relation makes sense. At a low price of apples, you don’t want to
go through the hassle of picking the apples at the top of the tree, but only pick the
apples that are easily reached from the ground. At a high price of apples you are
willing to climb to the top of the tree to get all the apples to the market. This gives
us low supply at low prices and high supply at high prices.

Growing up at a farm, I personally had a hard time grasping the supply curve
as a student. Among farmers I witnessed a situation where only big farms could
survive. Small farms were too inefficient to supply farm goods to the market with
a profit. This is called economies of scale - the larger the scale of your production,
the cheaper you are able to produce, since you are able to take full advantage of
fixed capital costs like a tractor and other machinery. But my economics book made
the opposite claim: producing the first unit is cheaper than producing unit number
1000 - i.e. decreasing returns to scale.

To get the positive relation between price and quantity assumed on the standard
market, you have to consider capital as given. With the machinery you have today,
how much would you supply at various price levels? The decreasing returns to scale
arise because there is a limit to how much you can produce with a given stock of
capital - no matter how much labour you put into production. Again, you have to
assume the positive slope to make sure a market clearing price exists.

Another thing worth noting about our ideal market is that our suppliers and
demands are anonymous - they only interact and communicate through the market
(or the fictitious auctioneer), and thus they only respond to prices. Uncertainty is
not considered (or is tamed by applying probability theory), and thus there is no
need for trust or any other personal trait. Participants on the market are anonymous.

Furthermore it is important to note that supply and demand curves are independ-
ent in this understanding. This implies that producers cannot create new needs for
the consumer. The consumer is born with his preferences - they cannot be influenced
by the producer. The task of the producer is to fulfill demands already existing.

I may not have been aware of my need to display photos of my everyday life to
friends and family before Facebook made me aware of this need. But according to
the orthodox view, Facebook did not create this need - Facebook only revealed an
innate need I was born with. If you are not comfortable with this understanding
of the relation between supply and demand, you cannot draw the demand and the
supply curves as two independent curves. If you believe that producers can affect
demand, you have to move the demand curve every time you draw a new supply
curve, for instance due to a new technology.
Finally, preferences of consumers must be independent. If you have agents with preferences that depend on the preferences of their neighbours, the neoclassical ideal market breaks down (Fölmer (1974)). This is important to notice for marketing management where we tend to think of consumer preferences as interdependent (if all the girls in my class wear high heels, I tend to develop a preference for high heels as well). But if they are interdependent, we cannot draw our demand curve.

The ideal market of economics is a theoretical construct developed to demonstrate how free markets may regulate themselves through changes in prices. It is not developed to help marketing managers take advantage of the free market. Economics is interested in optimizing social welfare (consumer surplus + producer surplus), whereas business economics is interested in maximizing producer surplus. But in their attempt to maximize their surplus, the ideal market demonstrates that producers may also leave consumers with a higher surplus, thus making the cake to be shared between all citizens, the social welfare, larger.

3 The Value of Goods and the Ideal Market

Above we argued that prices are adjusted in order to equilibrate supply and demand on the ideal market. Thus it is the market that finds the “correct prices”. But are these prices also fair prices? It is obvious that in order to be able to discuss this question, we must have a method for calculating the true or inner value of goods. With a different phrase we can argue, that we need an objective theory of value in order to discuss the fairness of prices - a calculation that gives the same result, no matter from which perspective it is performed. It appears that the producer and the consumer must agree on the objective inner value of a good.

3.1 The objective labour theory of value

Classical economists as A.Smith and D.Ricardo used the labour content of goods to determine their value. If it takes twice the number of labour hours to produce one kilo of bread as it does to produce one kilo of wheat, then it makes sense, that the value (and price) of bread should be twice the value (and price) of wheat. This makes the national income of a country equal to the number of labour hours put into production within that country. Although not perfect, this is a very sensible way of thinking. Everything that goes into production originates from labour - whether it is labour to produce tools and machines or labour to extract natural resources.

But is an hour of labour a good measure of value? It may have been in describing early industrial economies - but in today’s economies we quickly realize, that there is a huge difference in the price of a labour hour. For some jobs you get a minimum wage below 100 D.kr. - for other jobs you make well above 1000 D.kr. - thus it is not possible to trade one hour of work within cleaning for one hour of work within lawyer consultancy. And the spread between low paid jobs and high-paid jobs is increasing. Why? We cannot use the labour theory of value to explain this. This makes it difficult to use the labour theory of value to discuss fairness.
3.2 The subjective utility theory of value

Neoclassical economists circumvented the problem stated by the classical economists by arguing that we do not need an objective theory of value to explain market economies. That the value of goods is necessarily related to the subjective evaluation by consumers. A tailor may have spent a thousand hours designing and sewing a collection of winter coats - but if they are so ugly that nobody wants to own them, they have no economic value. Value is assigned to goods at the market because someone wants to buy them - value is not assigned in the production process.

This implies that the market value of goods is all we know, and therefore the market price of goods cannot be wrong. The market price cannot be different from the true value, since the true value is the market price. Therefore markets cannot fail. Markets are like the little boy in the fairytale by H.C. Andersen, “the emperor’s new clothes”, they are the ones that reveal the truth. The incompetent tailor may have persuaded the bank to lend him money with his new coat design as collateral, convincing the bank that the design is the latest fashion. But if the coat design fails, it is the market that holds the truth - not the bank, and not the tailor.

A further implication is that it becomes impossible to talk about fair prices. If marketing strategies help a company get higher prices for their goods, this is not cheating, or taking advantage of consumers. This being said, the rationality of agents, the voluntariness of exchange, and private ownership (including ownership of your own labour), is claimed to take care of the fairness question. Workers cannot be allured into selling their labour too cheap, since they always have the option of finding another employer. If the cleaner gets 100 D.kr. an hour and the lawyer gets 1000 D.kr., this is not unfair due to the assumption of free entry to all markets. The cleaner is free to invest in education and enter the market for lawyers rather than staying at the market for cleaners. If the cleaner does not have the brains to become a lawyer, it still does not make the price difference unfair according to this perspective. Brains should be regarded as a scarce resource of the economy, along with oil and gold. A high price of such resources is a result of the free market mechanisms, and it ensures that the scarce resources find their optimal uses. It would be bad for society if citizens with brains should choose a career as cleaners, since it would make the cake to be shared among citizens smaller. The case is the same with respect to oil: it is bad for society if we use our scarce oil resources to drive inefficient cars or use inefficient heating systems. A high price of oil guarantees us that the oil is used where it is most useful for society.

But if employers are taking advantage of the fact that some workers are so poor that they will do almost anything for a meal - can we still talk of fairness? We may, if another assumption of the ideal market applies: free access to capital markets. If the starving worker had access to borrowing money to educate themselves, or to move to another area of the world where labour is scarce, the apparent unfairness disappears. However, free access to borrowing money is a very strong assumption. Clearly it does not hold in the real world. But the employer is not to blame, and he will claim, that he has to take advantage of the fact that labour can be hired very cheaply in certain regions of the world - otherwise other employers will, and force any “decent” employer out of the market. True. But can we talk about the market as an organizational principle promoting justice and fairness? In theory conclusions
3.3 The usefulness of the ideal market for marketing management

The idea of the ideal market can be used for explaining the usefulness of marketing in optimizing social welfare. When marketing emerged as a profession and as a science, it was viewed as “applied economics” in the sense that marketing accepted the framework laid out by orthodox economics. As a profession, marketing could help companies identify the demand function of the neoclassical model. Marketing wanted to reveal consumer preferences for companies - not create them. By doing so, marketing could help companies profit optimize to the benefit of both consumers and producers. Figure 2 illustrates a situation where producers underestimate the demand function (guess), resulting in either excess demand at price $p_1$ or an extraordinary profit for producers at price $p_3$. This situation cannot be permanent, but the faster producers are at identifying the correct TRUE demand, the larger the surplus for consumers as well as producers.

Figure 2: The true demand curve found by marketing

This role of marketing could, however, only justify the market analysis part of marketing - not the marketing of products and branding. Marketing was criticized for misleading consumers, and for making products more expensive. Marketing argued that consumers had less than perfect information - and maybe also less than perfect cognitive capacity. Therefore marketing aimed at making consumers more informed on their choices. Marketing merely displayed consumers their options, making them aware of their preferences by asking questions like; *Do you merely want a bar of soap, or do you want a bar of soap that will keep your skin young* (Henningsen og Hartman-Olsen p.12). In short, marketing claimed to help consumers make the best choices.

If we look at the situation today, how useful is the ideal market as an abstraction and as the contribution of economic theory to the field of marketing management? If we look at the curriculum of marketing management programs around the world, the neoclassical ideal market plays a predominant role. However, the founders of marketing relied on a different economic understanding (Jones and Monieson (1990)). An understanding placing less emphasis on individual rationality and more weight on empirical studies and institutions. This is not the place for dwelling on the history of
marketing, but it serves as a notice that in fact there are other ways of approaching the market concept than the neoclassical perception of the ideal market.

One approach that may inspire marketing management is the work by Benoit Mandelbrot (2004) and Alan P. Kirman and Nicolaas Vriend (2000). There are a number of stylized facts of markets that conflicts with the ideal market— even markets that we would expect to come very close to the neoclassical ideal. Mandelbrot is famous for his study of markets for cotton back in 1963, and Kirman and Vriend took up this tradition in their study of the Marseille fish market. Kirman and Vriend argue that the market has been assumed away from economic analysis by the neoclassical approach. Rather than studying actual markets and actual behaviour on these markets, neoclassical theory rely on the fictitious auctioneer principle and a description of human rationality based on mathematics rather than observation of human decision-making. This does not appear to be a sound base for marketing management.

From their observations of the Marseilles fish market, Kirman and Vriend model a simplified behaviour of traders and generated the stylized facts from Marseille in an agent-based model\(^3\). They came to understand, why price dispersions can exist in real world markets, and why traders seem to develop loyalty to certain partners. Kirman and Vriend do not dispute the existence of a negatively sloped demand curve per se, but claim that it is obtained by a multitude of agents having different reservation prices, and not by rational agents with independent preferences and decreasing marginal utility.

These results indicate, that within marketing management we need not deal with the ideal model - we do have alternatives. Our business it not to apply a specific ideal model to the real world - it is to understand the real world and navigate the real world. Before deciding on the usefulness of the ideal market, we need to consult actual markets.

4 The Multiplication of Markets - Disintegration of Production and Globalization

As we leave the neoclassical ideal market behind us, we turn to the historical development of markets. So far we have made our argument in terms of very simple products - a tailor making a winter coat, the owner of an orchard picking his apples etc. However, the character of many of the products we produce and consume seems to have changed. Here we shall argue that the way products are produced have also changed, which again affects the role of the market.

Let us first go back to the ancient economies. In ancient times, most economic units were self suppliers. The majority of households would produce what they consumed. In this case there is no need for a market. We should also note, that in this case it is impossible to talk of a supply curve independently of a demand curve. What is demanded is produced, if it is within the constraints or the boundary of the family. Or vice versa: the family produces what it is capable of, and consumes it.

\(^3\)For a general discussion of agent-based modeling see Bruun (2007) for economic applications and Rand and Rust (2011) for marketing applications.
At some point households began to specialize. In a village, one household would specialize as a black schmidt, one as a miller etc. At the beginning specialization took place without any huge capital investments. You can imagine two neighbors figuring out, that one has a talent for working with iron, another for working with leather. If they realize that trading goods (or services) would make their collected production of iron goods and leather goods increase, then there is a gain from the specialization. Also today households have this type of considerations. Should I spend my Saturday moving my lawn and cleaning my house, or should I take in extra work as an external examiner, and spend the money I earn making someone else clean my house and move my lawn? That is exactly the same calculation made by members of a village a thousand years ago. Should I make my own tools for leather work, or should I trade some of my leather goods for the tools I need?

One could argue that in these first pre-industrialization markets, it was not really the physical product that was important but rather the process of turning metal into tools or wheat into flour. It was first and foremost an exchange of what we today would call services. People would bring their own wheat to the miller, their own metal to the black schmidt and their own wool to the weaver. Tangible goods were not what changed the economy - it was the specialization of work processes - of services. Furthermore, prices were not essential in the communication between the producer and the consumer. There was communication between the two parts on how exactly to transform the raw material. Every good was unique and produced to order.

One thing worth noting about this pre-industrial specialization is that it led to the emergence of more markets, or the multiplication of markets. The more specialized we get, the more markets are needed. Our forefathers would not dream of a market for walking your pets or a market for homework tutoring for children. But today such markets thrive because some people have made the calculation - should I spend a little more time on my specialized trade (e.g. marketing management) and spend a little less time on things I am not very good at (helping my children with their homework). Outsourcing by companies is part of the same story. Should I spend more time on what I am good at as the manager of my company (e.g. develop new products) and less time on the things I am not so good at (e.g. doing the books for my company) by outsourcing the bookkeeping to an external accountant. Today tasks like that are taken to the extreme. You find examples of companies that have their employees sending their receipts for travel expenditures to an agency in India to be checked, the actual travel expense account to England to be entered into the books, while a Danish company make sure that they money is paid to the employee. Before there was no markets for dealing with travel expenses of employees because it was handled internally by a secretary employed by the company. Today there are at least 3 markets, and most likely we can come up with many more, like the travel agency etc.

If we return to our ancient economies, there was a limit to how large advantages villagers could gain from such specialization, because one essential ingredient was missing: THE ANONYMOUS MARKET. Villagers did produce to others, but they did not produce to an anonymous market. When Jensen needed a new carving knife, it was produced to him - but the black schmidt would not produce a hundred
knifes, since he did not know, what kind of knife the next customer would need - and maybe he did not have the raw material to make more knives. Furthermore, some goods were so rarely demanded within the community, that the opportunity to specialize was not big enough. Things did not change dramatically until people started to produce for an anonymous market - started to produce things they did not know the buyer of.

This also meant that the product and its price became the center of attention. Now production was for an anonymous market and communication between producers and consumers was limited. Consumers no longer had to bring their own raw material, and they no longer had a saying in how exactly the product was made. Products were standardized, and thus their price was an important signal to consumers on where to buy.

A. Smith cherished specialization, and described the working of a pin factory during the early industrialization. In A.Smith's factory, workers did not follow the production process from metal to pin - workers would specialize as metal cutters, pin drawers, rollers, finishers, etc. They would all work together in order to increase productivity and thus the wealth of society. He also used this division of labour to describe international trade, using the principle of absolute advantages in trade. If Denmark is more efficient (i.e. use less labour) in producing bacon, and England is more efficient in producing cloth, then both England and Denmark would become wealthier (be able to consume more cloth and bacon) by specializing and trading.

Technology in production, communication and transportation has multiplied the number of markets in our economy. Why should the different steps in Adam Smith's pin production take place at the same production plant? And why should they be controlled by the same company? This has given rise to a multitude of B2B markets. A market for all the different metal semi-finished products, and even markets for the service of assembling the final product.

So far we have discussed markets as a meeting place for producers and consumers, but with the defragmentation of production, we need to also consider B2B markets, i.e. markets where producers are both sellers and buyers. Neither economics nor marketing have paid a lot of attention to these markets, and one can make several arguments why they are not very interesting:

**Ideal markets** If one holds the belief that the world is dominated by ideal markets inhabited by rational individuals, it is not really important whether one is dealing with a B2C or B2B market - either one will come up with the correct price.

**Boundedly rational consumers** Consumers are often seen as more irrational (or boundedly rational) than producers. Marketing can be argued to help consumers by providing them information that will help them make the best choice. Similar arguments are rarely made with respect to producers, since they are often perceived as more rational than consumers. They do not need help collecting or processing information. From this perspective, B2B marketing becomes an oxymoron.

“Purchases on the market for consumer goods are emotional and perhaps also less rational, while purchases on B2B markets are econom-
ically motivated and therefore rational” (Henningsen og Hartmann-Olesen (1984))

Exchange Orthodox economics perceive economics as exchange of goods and services. Exchange on markets where supply and demand meet at market clearing prices. From this perspective, what goes on between producers, is not very interesting. The gain for society is where producers and consumers meet to generate consumer and producer surplus.

From any of these arguments you may conclude, that there is not much extra profit to be made within the sphere of production. Whether basing your theory of value on objective or subjective grounds - on B2B markets you expect prices to reflect the value of the good. But with the defragmentation of markets, this approach to B2B markets seems very careless.

Specialization and defragmentation of production processes, however, is only one out of two forces that have multiplied the number of markets in the economy. Branding or diversification has also multiplied the number of markets we need to consider.

- specialization - defragmentation. New technology and economic forces create more markets. First production technology, then information technology.

- Branding - differentiation - diversification. New technology also means that more diverse products can be produced. We develop taste for special goods, and we can communicate the tastes to the producers. We hold preferences over certain goods which puts the price mechanism out of work.

Branding has had a tremendous impact on the role played by marketing in the economy, and we therefore need to have a closer look at the branding phenomenon that exploded in the mad men era of the 1960’s.

5 Understanding markets with strong brand preferences and limited information

In the case of the ideal market we had to make a number of assumptions to draw nice looking supply and demand curves. When it comes to modern markets with strong brand preferences and limited information on the exact content of the products, we end up in conflict with the assumptions of the ideal market:

- In the ideal market there must be a large number of suppliers, and these suppliers need to be price takers, i.e. be so small that another producer will take over if someone sets the price over market clearing price.

- Consumers cannot hold preferences over the products of different suppliers. A beer is a beer, and the producer will always buy the cheapest beer.

Clearly these assumptions do not hold for most markets today. Even for simple goods as ketchup, consumers hold strong preferences for specific brands. And
Furthermore, the products we consume generally become more and more complex and less and less tangible. Think of your average monthly spending - how much do you spend on things that have no tangible form? There are “classics” like banking service, insurance, entertainment etc., but also new consumption goods like internet and phone connection, software, in game purchases etc.

Furthermore, you pay an overprice for many of the tangible products you buy. You buy Heinz ketchup at 25 D.kr., but could have bought a no brand ketchup for 10 D.kr. - this could be viewed as an intangible purchase of 15 D.kr.. You could have bought a pair of jeans at the local Fotex for 150 D.kr., but chose a pair of branded jeans for 1500 D.kr. That is an intangible purchase of 1350 D.kr.. This intangible purchase can be interpreted as the purchase of an “experience”.

Notice that I am not arguing that the branded jeans are not worth 1500 D.kr. That would be the argument if I applied the labour theory of value. I am arguing that this kind of behaviour makes it impossible to use the supply and demand model of markets to understand the functioning of modern markets. A further implication is that we cannot apply the subjective utility theory of value because of its dependency on the assumptions of the ideal market. What we can say is, that to some consumers, a branded pair of jeans are worth 1500 D.kr., and then we can look at the implications of such statements.

It may appear rather innocent to change the way we model markets for consumer goods, but here we must remember that the way markets are modelled have a close relation to the way we perceive value in economics. The supply and demand model does not only help us determine the price of a good - that price also reflects the inner value of the good. If a producer should try to cheat the consumer by asking more for a product than its value, that producer will not stand a chance on the ideal market, because other producers will supply the good at the “correct price”. But once producers learned to differentiate and brand their products, they started cheating or surpassing the market mechanism.

For simple products, there is a limit to how much extra producers can make consumers pay for a branded good. As a consumer you have some idea of the reasonable price for a bottle of ketchup. You can easily estimate how much money and effort it would cost you to make your own ketchup. To some degree you can apply the labor theory of value - what is the labour content of a bottle of ketchup? But for many of the goods we consume today, making such a calculation is impossible. For instance we devote a growing rate of our income to multimedia. But how much labour goes into a computer game, and how large a fraction of the development cost is it reasonable for you to pay? The utility theory of value does not apply either, because there is only one supplier of the exact game you want to buy.

One should also note, that the assumption of diminishing returns to scale no longer holds. Computer games need very small tangible capital investments, and once they have been developed, the cost of selling 10 units and 10,000 units are practically the same. The primary cost is development cost. This removes the positive slope of our supply curve.

The question remains whether there is any mechanism at all that prevents producers from charging “too much” for their goods - or whether it is sensible to ask such a question at all. If a game producer can make consumers pay 80 Euro for
a game, although the marginal costs of the game is only one Euro, then the game must be worth 80 Euro. Furthermore, if the company that developed the popular game and made a huge profit on it, spend that profit developing 99 other games on which they lost money, it seems unfair to blame them for taking advantage of their position.

6 Experience Goods and Price-Quality Relations

Adequate consumer information about price and quality is essential for the proper functioning of the competitive system. We already argued that the supply and the demand curve cannot be treated as independent if consumers use price as a quality signal, i.e. if consumers believe that a higher price reflects a higher quality. If, on the other hand, consumers believe that quality is always the same, and just opt for the cheaper of two goods, we get the unfortunate consequence that bad quality goods will drive out high quality goods from the market. If, in the eyes of the consumer, a sausage is a sausage, why pay 5 D.kr. a piece, when you can get sausages at 1 D.kr. a piece? To understand price-quality relations we must take time and branding into consideration.

6.1 The product life cycle and the price-quality relation

Some people argue, that the ideal market does function well - if given time enough. This argument can be made using the product life cycle which explains how new goods are adapted by the market. That, at a certain point of time, you may see negative relations between quality and price - high quality products priced lower than low quality goods or vice versa. But if you observe the market over a longer time span, you will find a convergence where, in the long run, prices correctly reflect quality. Producers will learn to set their prices at the correct level - or they will have to leave the market because consumers have learned what quality to expect at what price. In the long run consumers will not pay high prices for low quality.

The fact that time is needed for producers and consumers to learn the correct quality/price correlation, reflects the fact that producers do not have perfect information on consumer preferences, and may choose different strategies when introducing a new product at the market.

Klepper and Graddy(1990) use heat blankets as an example. Let us go back to the 20’s where there was no mature market for heat blankets yet. The technology is there, and several firms decide to put heat blankets at the market. One of these firms, maybe the firms that invented the heat blanket together with hospitals that saw a need for heat blankets to save nurses time. This firm may look upon heat blankets as medical equipment and its target group would be hospitals and very rich people. Maybe another firm enters the heat blanket market from consumer electronics. This firm is experienced in producing lamps or radios for mass consumption, and adds heat blankets to its selection of consumer electronics. These two firms may analyze the market for heat blankets completely different. The first firm may set its price so that the costs of developing the blanket are covered even if they sell only a few blankets. The other firm may price the blankets for mass consumption, i.e. price it
much lower. But having experience with consumer electronics, the cheaper blanket may have a better quality.

Such a perversity may exist on the market for quite some time - the market for heat blankets did not mature until the 60's. Hospitals and consumers searching for medical equipment, may not be aware that there is a much cheaper and better blanket available at the consumer electronics department. But as the product life cycle of heat blankets mature, all consumers will realize what a reasonable price and quality of heat blankets is, and stop buying the more expensive blankets. In the longer run, the market has proven its strength in coordinating supply and demand so that limited resources find optimal uses. But within marketing, relying on the long run is not good enough. If you are out too early in the product life cycle with the right quality at the right price, people may not realize it, and you may not be able to sell your blanket.

It is always hard to reject arguments starting with if given time enough... Whether you choose to buy into this PLC based argument or not, we shall search for other explanations of price-quality dispersions in markets.

6.2 The “Lemon Squeeze”: Price-quality relations in non-branded markets

The argument that bad quality goods may drive out good quality goods from the market was first made by Akerlof (1970) on the market for lemons (lemon is an expression for a bad quality used car)\(^4\). Today every one that enters the market for used cars will use some online service for estimating the correct price of a used car. These prices are generated from known market exchanges. If I am a buyer at the market for used cars, it makes sense not to pay more for a used car than the price suggested by the online evaluation service. If I want to sell a used car, on the other hand, I may have some private information on the quality of the car. If it is a bad quality car I want to sell, I’ll be happy getting the price suggested by the online service, and it should not be too difficult for me to find a buyer. If, on the other hand, my car is well above the average standard on the used car market, it may be very difficult for me to find a buyer willing to pay for the extra quality of my car, since I would ask a price above the price suggested by the online service. The potential buyers cannot immediately see or feel the extra quality of my car - it is my private information. With a high quality car, I may end up leaving the market and decide to keep the car.

If owners of high quality cars all leave the market, the average quality of used cars will fall, and eventually the average price of cars may drop. This will make even more owners of high quality cars leave the market. We are at a race to the bottom - both quality and price decreasing with time. If we are not sure that we will get better quality if we pay more, we will not pay more. This may also happen at other markets - for instance markets for food. If, as consumers, we cannot distinguish between the quality of sausages, producers of poor quality sausages may drive producers of high quality sausages out of the market. From the point of the producer this means, that

only producers that can produce at the price people are willing to pay, will offer the goods for sale. Only bad quality products will enter the market.

Such a “lemon-squeezing” process is best witnessed on food markets - especially unprocessed food. For many consumers, a pork roast is a pork roast, and high quality pork producers have a hard time convincing consumers that their meat has a superior quality. However, markets for high quality products still exist. To understand why we need to have a closer look at branded products.

6.3 “The Mathews Effect”: Price-quality relations in branded markets

The sausage market may be one extreme, where bad quality drives out good quality. For other markets, it may be possible for producers to sell bad quality at a high price, because consumers believe they get higher quality at a higher price. There is an information problem: how do producers of quality goods inform consumers about the quality of their products, and how do consumers avoid the trap of buying low quality goods that are marketed as high quality? Tellis and Wernerfelt (1987) identify 3 important variables in determining the price-quality relation. They expect to find stronger price-quality correlation in markets for (tangible) durables, unpackaged products and products sold over a wide price range. However, they do not discuss services or experience goods, which I believe should be added to their list:

**Price range** Consumers will spend more effort checking quality on markets if the spread between prices at which the product is sold, is high.

**Packaged products** Consumers information level can only be high if they have a chance of inspecting the product before buying. Often not possible with experience goods, and this property can also be argued to hold for goods sold on the internet. Correlation expected to be low.

**Durables** The correlation between price and quality is expected to be higher for durables because people spend more time and effort searching for durables.

**Services and other intangibles** Correlation expected to be low. The classical example of a service within behavioural economics is a visit to a restaurant. How can you inspect the quality of the food without buying it and eating it?

The fact that the quality of a product is not always easily checked, and the fact that the facets of a good to which consumers attach value is unobservable, makes objective studies of price-quality relations impossible. By branding their product, producers adds value to the product, but it is a value that cannot be explained if focus is solely placed on the tangible product.

When producers start adding intangible or experience value to their products - can we still argue that they sell at a fair price? Can we expect to find a positive correlation between price and quality? With respect to experience goods it is particularly difficult to argue, that prices will reflect quality. Consumers are presented with a very clear price signal, but a very vague quality signal. In a very conservative world with a limited number of products, consumers may learn the quality of
different products over time (the argument made with the product life cycle). But
in a world, where any decent supermarket has a selection of at least 20 different
laundry detergents and a steady stream of new varieties, how are consumers ever
going to learn the quality of each detergent? Consumers have to apply some method
for guessing the quality of a detergent, and one obvious short cut is to use the price
as an indicator of quality. If producers of low quality detergent take advantage of
this fact, the positive correlation between price and quality will break down.

According to some writers, the tendency for consumers to hold preferences over
different varieties of goods, is just one sign out of many that the character of markets
is changing. That the industrialization epoch with its focus on the standardized
tangible commodities, mass production and prices as the only communication signal
is at its end. It can be argued that the new markets are quite similar to the pre-
industrial markets with its exchange of services.

Focus on the process rather than the product More and more of the goods
consumed today are intangible. Many refer to them as services, although it
is not necessarily service in the original sense of the word. In the early days
of marketing, we mentioned that marketers would pose the question, Do you
merely want a bar of soap, or do you want a bar of soap that will keep your
skin young. But today's marketers are more prone to ask the consumer, Do you
merely want a lamb chop, or do you want a lamb chop from free range sheep
kept at the local marsh?, i.e. they have shifted their focus from the end product
to the process ending up with the product. Today producing goods is easy
whereas producing goods by a process that appeals to the consumer, is very
difficult. The moment the consumer pays attention to the process producing
the good, every good is associated with a service - the service of producing the
good in a more or less appealing way.

Personal rather than anonymous markets Communication technology and in-
dustrial robots has made it possible to adapt products to the individual con-
sumer.

Co-creation Product development in interaction between producer and consumer.
Consumer preferences are so complex and unpredictable, and communication
and prototyping so cheap that producers developing new products together
with consumers gain advantage.

Let us try to ask, whether there is a positive correlation between quality and
price on the market for ketchup. When Heinz charges up to ten times the price or
the cheapest ketchup, can we assume the quality is also ten-fold?

Let us first ask, what would happen if the consumers had no knowledge of the
different labels of ketchup? In this case we would only have one price for ketchup,
and applying Akerlof's idea of the market for lemons, the market would probably be
dominated by rather poor ketchup at a low price. This is the $Q^*$ line of Fig. 3 below.
Producers will only supply better quality ketchup, if they can get a higher price,
and to get a higher price they need to inform consumers that they supply better
quality ketchup. They need to "tilt" the curve and create a positive correlation
between price and quality. The model was made to describe the correlation between
price and quality on the market for wine (Roberts and Reagans (2007)), and on this market $P_1$ and $P_2$ was defined as:

$P_1$ The likelihood that critics will publish quality ratings for the product

$P_2$ The likelihood that consumers will observe and internalize the quality ratings

However, public ratings and “objective critics” are not common for all goods. Other studies suggest, that status may be important to both the steepness of the curve and where producers are placed on the quality scale, and thus what price they may get for their products. As noted by Kim (2001)

The argument is that because of the inherent uncertainty surrounding product or service quality, potential consumers often rely on the status of the producer’s (provider’s) past or existing transactional partners as a proxy for the focal actor’s capacity to deliver high-quality goods (services). From this he deduces a Mathews effect - give more to those who already have. This could be a possible explanation of the smiling curve. Products of apparently equal quality may have different prices because of status - a status that on some markets can be built by branding - in others by having relations to the right firms.

Status is gained by having status, and by participating in networks because network status may be used by consumers as a measure of quality. As noted by Burt and Merluzzi(2013), *Network status is a visible characteristic of your position in a network, from which inferences about you can be drawn* (p.5). If we return to Ketchup, there is a limit to how different the qualities can be. Apparently, quality cannot explain the difference in price. But Heinz has been on the market for a long time, and has paid much attention to its role as a market leader. Therefore Heinz
can charge more for its ketchup. Other companies may benefit from this position of Heinz. When McDonalds started their international expansion, they did not use an anonymous ketchup for their fries on overseas markets - they made sure to inform us that they use Heinz ketchup (which was already well known in Europe). In doing so they hoped that the quality we relate to Heinz would have a spill over effect on the hamburgers of McDonalds. In this sense McDonalds gained a network effect, but there is also a feedback to Heinz who will gain an even higher status. This is the Mathews effect - Heinz get more status because it already had high status.

This story of the cooperation between McDonalds and Heinz also tells us, that branding and status is important, not only on the B2C market, but also on B2B markets. The fact that producers of final consumption goods tend to put labels on their products as “Intel inside” or “powered by Duracell” tells us that the B2B market is not as rational and immune to concepts as branding, trust and status, as older marketing textbooks likes to tell us. With the immense disintegration and globalization of production, producers cannot rely on one optimal decision when choosing subcontractors or suppliers - the informational requirements for such an optimization is simply too large. Subcontracts cannot rely on being masters of whatever they do - they need to inform the world of their existence and their competencies. And procurement employees may be as susceptible to the tricks of marketing as any consumer.

We shall now turn to the claim by Kim(2001) that this may cause a smiling curve.

7 The Smile of Value Creation

The smile of value creation, first proposed by Stan Shih (founder of Acer), is one of those ideas that first came up as a fast drawing to make an argument without theoretical backing, but later made it into the world of theory. However, providing sound theoretical backing for the proposition is not an easy matter. The smiling curve is very meaningful when it comes to explaining developments in international trade during the last 5 decades, yet the curve is not consistent with orthodox economic theory. It is like the Phillips curve of the 1960's - it may be observed, but not theoretically explained. We shall apply our two market concepts; the lemon squeeze and the Mathews effect to come up with an explanation of the smiling curve.

The smile of value creation builds on the idea of Porters value chain (1985). Porter discusses how customer value accumulates over the production process. The idea of customer value is however a complex concept. As noted by Ravald and Grönroos (1996), the concept of value is multifaceted. Also in discussions of the smile of value creation, what is meant by value creation, is not clear. When I pay 5 D.kr. for a bottle of ketchup, how much is actual production cost, how much is devoted to developing the ketchup and its bottle, and how much is devoted to marketing, logistics etc. That is, from where did this bottle of ketchup get its value?

To be able to be specific about the smile of value creation in this context, let us

\footnote{In this feedback loop, Heinz ended up being the weaker part, since McDonalds recently ended their cooperation with Heinz after more than 40 years.}
apply a monetary theory of value. Because we are to talk about costs of production, it may look like the labour theory of value, but there is an important difference: we will be using money (or money units of account) as a measure NOT labour hours. Because there is a huge difference between e.g. the wage of a Danish researcher within medicine and a Chinese production worker, this will make a difference. Apart from that we can apply a similar method of analysis for studying value added.

If we count labour hours added to a product over the value chain, there is no smile of value creation. But when we multiply labour hours with the hourly wage, a smile emerges since the more expensive labour is used in the first steps of the value chain (R&D, Branding and design) and in the last steps (marketing, logistics and sales/services). Today the typical consumer good goes through many processes. The argument of the smile of value creation is that the processes that have to do with actual production, the processes where the worker gets dirty hands or need to wear a hard top - are the processes that are rewarded the least, and thus adds the least value to the final product.

You might ask, whether this is something new - there has always been white collar workers with a higher pay check than their blue collar counterparts. There is wide documentation that inequality is increasing. The spread between low wages and high wages is increasing (Oecd(2011, 2015)), and with the international division of labour, we have to compare high wages in the western world with the lowest wages in developing countries. This may have happened because production workers have fallen into the squeeze of Akerlof's lemons - they are not branded or diversified, and one may replace the other. Following, the market will always opt for the cheapest available labour. Danish workers, on the other hand, have avoided this trap by diversifying themselves through education etc. Therefore they have more than a price signal to send to employers, and therefore they gain a Mathews effect rather than a lemon squeeze.

**Blue collar lemon squeeze** Earlier we argued, that if consumers do not differentiate between different quality of sausages, Akerlof's lemon squeeze would result in a situation, where only poor quality sausages enter the market, since only they could make a profit on the sausage market. This argument could also be applied to the international market for unskilled labour. Production of most goods require some processes that involve unskilled labour. Of course Danish workers that have at least 10 years of schooling may also perform such processes. But no company would supply such services to the international market using Danish labour, because it has a higher price. One might argue that Danish labour has a higher quality, but the higher quality need not be identifiable at the level of the individual. Danes are not stronger or more intelligent than the population in countries with lower average wages and education cannot fully explain the gap. We need to take into account social mechanisms as well, particularly the concept of social capital to explain the difference in wage levels (Keeley (2007)) \(^6\). Danish labour has been driven out of the international market for unskilled labour just as good quality cars my

\(^6\)As a side effect low quality labour, primarily defined by the individuals willingness and ability to adapt to social norms of society, have fallen out of the labour force in countries as Denmark.
be driven out of the market by bad quality used cars (lemons). There is a race to the bottom going on, where companies search for the cheapest available unskilled labour, that will set the international price of unskilled labour. Unfortunately this also involves the use of children as labour. As long as this process takes place, the middle part of the smiling curve will move closer to zero value added.

**White collar Mathews effect** If you want to impress your girlfriend by getting her a nice bucket of flowers, you do not search the market for the cheapest bucket. A good advice is, not to look for the best quality flowers either. You want to go to the best florist’s shop that will know the latest fashion. Your girlfriend will know which florist is the best in town, and you should be willing to give a little extra for a bucket from this specific florist. If people of the town get wealthier, more people will afford flowers from this specific shop, which can turn up its prices. But this should not affect the price of the cheap buckets from the supermarket since it is not flowers per se people demand - it is flowers from this particular florist. The popular florist will be able to pay the best florists a higher pay, and would be willing to do so. Just as big companies are able to, and willing to, pay high salary for top designers, top CEO’s, top marketing people etc. Those who already have, are able to get more - but there is no reason that this should trickle down to wannabe designers or to workers in the flower fields in Africa. Applying this to the world economy means that as the world get richer, it is the same small number of international brands that people will show an interest in. As soon as people can afford it, they start demanding Coca Cola, Heinz, McDonald, etc., and even providing at a much lower price, local brands stand no chance against these international giants.

Given time, these two effects, the lemon squeeze and the Mathews effect, will result in a smiling curve. The workers involved in developing the concept of a product (branding, R&D, design etc.) can get higher wages, as can workers involved in logistics (marketing, sales, services etc.), whereas workers involved in the actual fabrication have to compete with the cheapest labour of the world.

![Figure 4: The Smile of Value Creation](image.png)
Let us return to the jeans example. You all buy jeans, and you know that you can choose between jeans from the supermarket, where they can be found at prices starting at 150 D.kr., or jeans from high street shops, where the easily cost 1500 D.kr. You have this information, and still many of you will buy jeans at 1500 D.kr.. Why? At what level of the value chain, or the production process are the additional 1350 D.kr. added (the price premium). From the value chain we know that it may be in the R&D, the production of the jeans or in the marketing. But all jeans, no matter the price, are produced in low wage countries. Thus the price premium must originate in either the pre-production phase (design and branding) or in the marketing phase. These two phases are typically performed by workers of the Western world.

8 Implications

To what we have here chosen to call orthodox economics, i.e. neoclassical theory, the market plays a pivotal role. The market is where all the action of the theoretical construct is. By adapting their supply and demand to price signals sent out by an auctioneer, a set of prices is found that will clear all markets. The volumes of goods supplied and demanded at this set of prices can be shown to be a social optimum. The first and second welfare theorems hold. It is not only a social optimum. It is also fair. No agents can be exploited on a perfect market. For the society as a whole, the things you bring to the market will have the exact same value as the goods you bring home from the market - but as an individual you are more happy with the goods you take home from the market. In this sense subjective consumer surplus is gained at the market.

This ideal picture of the market process, however, rests on a number of assumptions that are increasingly difficult to find in real world markets. It is hard to argue that the average producer is a price taker that can sell any amount supplied at the market price. It is hard to argue that consumers preferences are not interrelated. It is hard to argue the consumers are born with their preferences, and that producers have a free choice between applying capital and labour to their production process. It is hard to keep up this “classroom” vision of the market.

8.1 Implications for marketing as a science and a profession

Marketing holds a much more complex perspective of the market than the neoclassical ideal case\(^7\). Today's markets do not function by simple price signals. Markets, understood as the meeting ground for suppliers and purchases, whether they be businesses or consumers, or places were products are developed and partnerships are entered. The benefit by this complex market understanding can be read from the success of companies that understand how to develop goods together with their purchasers and add experience dimensions to their product.

\(^7\) However, as noted above, marketing as a subject of study started out, not from the Marshallian or neoclassical school, but rather from the German historical school that emphasize a much more positivistic and inductive approach to knowledge.
The marketing profession must, however, be cautious not to re-earn the reputation it had in the early 19th century. Partners in trade can be exploited. Marketing can no longer hide under the magic spell of the theorems of welfare economics. We do not live in the perfect world of neoclassical theory, and we must face the consequences. We have no theory of value, and no way of telling the fair price of a good. There must be trust in the market relation.

“It is hard to overstate the importance of reputation in a market economy. To be sure, a market economy requires a structure of formal rules—a law of contracts, bankruptcy statutes, a code of shareholder rights—to name but a few. But rules cannot substitute for character. In virtually all transactions, whether with customers or with colleagues, we rely on the word of those with whom we do business. If we could not do so, goods and services could not be exchanged efficiently. Even when followed to the letter, rules guide only a small number of the day-to-day decisions required of corporate management. The rest are governed by whatever personal code of values corporate managers bring to the table.”

(Greenspan (2003))

Markets may help develop inequality, internally within nations, and globally. Do not forget, that despite its name the smiling curve is smiling because of the enormous inequality in wages between uneducated labour in developing economies and educated labour in developed economies. We cannot rely on the market mechanism to create equality or even fairness. Poor countries have been waiting for a century for a more equal international distribution of wealth, and no economists have been able to come up with a reasonable explanation of why it has not happened. Kuznets came up with the idea of transitional rise in inequality as structural changes work their way through the economy (Kuznets(1955)), but structures seem to change so rapidly that the poor never get to benefit from the growth promoted by the structural changes.

As a profession marketing is not to blame for this development, but it could prove to be important for marketing to be aware of its causes and possible consequences. Beneath the surface of our (material) status driven world, a new set of values may be ready to take over, and marketing must be ready to capture such developments and act on them.

8.2 Implications for Economics

If developments in real world markets leave the neoclassical ideal market model obsolete and of interest only to the economic historian, what is left for economics to study? There still is an important role for economics to play, as the study of aggregates of markets and the study of interaction between markets. It is not the objective of this paper to outline a research program for a Phenix of economics, but a few developments can be noted.

Institutions Study the emergence of market institutions and behaviour. When A. Kirman spend time studying the Marseilles fish market, he did not do it in
order to develop a business model for Fish traders. He did it in order to understand the market generated by the behaviours of sellers and buyers, and his motivation was a conflict between observed characteristics and characteristics predicted by theory. From his observation he then replicated the Marseille fish market by assuming a simplified behaviour by traders and simulating their interaction. He came to a new understanding of markets and what behaviour generated the observed data.

**Production** Study production as a transformation process rather than an exchange. In the industrial era it may have been useful to think of a good being produced by a variable combination of capital and labour to be chosen by the producer in accordance with the relative price of capital and labour. But for many production processes today, applying any combination of capital and labour is not an option. We need a different model for the production decision.

**Aggregation** Study the properties of the aggregate economic system without implicating behavioural assumptions. In complex dynamic systems the aggregate is rarely just a simple summation of the parts. This was observed by Schelling (1971) when he simulated his famous segregation model in which black and white neighborhoods emerge in a city where all citizens prefer a mixed neighborhood. The accounting system underlying all economic transactions imposes restrictions on the behaviour of individuals in a nontrivial sense. The paradox of thrift is a reality, but it is hard to say exactly who gets to save less because I choose to save more. The stock-flow consistent approach to economics takes its starting point in the accounting system and develops a macro theory based on the interaction between accounts - a macro theory much more capable of understanding real world phenomena as the financial crisis of 2008.

**Micro-Macro interaction** Study the interaction between the parts of the economic system (the individual agents) and the aggregate accounting system. In order to study this interaction, agent-based simulation as applied by Kirman in his artificial fish market must be the core method.

A research program based on these four principles could assist the field of marketing management. The historical hierarchical ordering, where economics held the true deep understanding, and marketing management was merely an application of the insights of economics would be broken down. Economics must learn from marketing management how agents act and which institutions they rely on. On the other hand, economists would be able to teach marketing managers about emergent properties of markets, and which signs of instability to watch out for.

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8 See Bruun (2016) and Dawid et al (2015) for examples of complete macroeconomic agent-based models.
9 Conclusion

The ideal market model may have been a good description or approximation of economic activity in the industrial era. An era where production of tangible goods was in focus. Where producers had a choice between applying capital or labour in the production process. Where the product rather than its brand was in the center of consumers attention. Where many producers supplied the same good to the market. Where consumers had a limited number of goods to choose between. Where blue collar workers outnumbered white collar workers (and thus dominated the wage bill), and where blue collar workers easily could replace each other.

In their market understanding marketing management left the ideal market model decades ago, and in doing so, assisted in developing the new economic order - a new world. A world where most goods are branded goods - today even potatoes have pictures on them of the farmer producing these exact potatoes. As consumers we are happy about this development because it saved us from a world over floated by lemons (goods of poor quality) that the economic logic almost succeeded in locking us into by the end of the industrial era. Today we happily (and for free) help producers develop products to our taste, and call it co-creation to indicate our self-realization. But also a world where we as consumers of the western world are so far away from the production of goods that we have no chance of evaluating their quality. A world where production is outsourced to poorly paid workers in remote places. And a world where we, in the western world, always seem to be one step ahead of the poor countries. First we told them they would reach our standard of living by selling us their raw materials. That did not happen. Then we told them they had to start producing to reach our standard of living. That did not happen either. Now it is about co-creating experiences together with consumers. This story on its own indicates that the pure market model is not a very good model for understanding real world phenomena.

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