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# Should Firms Lower Product Price in Recession? A Review on Pricing Challenges for Firms in Economic Downturn

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### Abstract

Recessions often result in the temptation of price cuts. For a firm to prosper despite a slow economy, a more holistic plan is required. Firms reduce their prices to increase sales volume. However, with an appropriate pricing strategy, a business may compete and even prosper during slow economic conditions. This study is an effort to shed light on pricing challenges for firms in recession. We posit that although buyers want to save money in a recession, price is generally a secondary consideration in the majority of buying decisions. When customers make buying decisions, other variables such as quality, service, variety, availability, ease, recognition, trust, and support typically take priority even in a recession. Purchasing inertia is high in the domain of recurring business-to-business transactions, and customers form long relationships with the items, suppliers, and processes they use to make repeat purchases. Switching costs are high, and unless there is a major service breakdown, it is uncommon for a customer to defect for a little price difference. Because cutting prices has large influence on profit, it is rare that low prices produce enough more demand to generate extra profits. Firms should avoid allowing a slow economy to diminish their value and should instead focus on non-price ways of assisting customers in difficult economic times. This study concludes that slashing prices in a recession is rarely a proven strategy to boost profits.

**Keywords**: Economy, Firm, Recession, Price cut, Purchasing behavior

***Declarations***

Competing interests:

The author declares no competing interests.



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# 1. Introduction

When there is an economic crisis, studies showed that customers' purchasing habits shift (Jasiulewicz, 2012; Mansoor & Jalal, 2011; Sharma & Sonwalkar, 2013). As consumers' purchasing habits evolve, businesses adapt their business practices and strategies to match the changing needs of their customers (Civi, 2013). There are three common marketing responses to recession (J. M. R. Salazar, 2018). While each business responds uniquely to a difficult economic environment, the following three "solutions" are often considered (Deleersnyder et al., 2004; Deleersnyder & Others, 2003; Latham & Braun, 2011; Mathur et al., 2012): a) Attempting to salvage sales by lowering pricing b) Cost reduction in order to sustain profitability b) Doing nothing and remaining neutral (Juan Manuel Rojas Salazar, 2017b, 2018).

a) Price reductions: Discounts and promotions are often seen as a simple short-term way to acquire sales in an effort to reduce friction (Gollier, 1999; Masarrat & Jha, 2015; Rouziek, 2009). However, without a sound pricing strategy, cutting prices might result in critically low-profit margins. Marketing methods are not exclusive to the current economic context. Pricing techniques such as reductions and special offers to entice people to purchase are used in both strong and weak economies. According to Michael Porter, businesses have three potential alternatives: distinguish themselves, compete on price, or specialize in satisfying the demands of a niche (Harrigan & Porter, 1989; M. Porter, 1980; M. E. Porter, 1997).

While increasing sales is critical throughout a recession another strategy for maintaining new levels is to increase pricing. Given the limited pool of purchasers, this may be a strategy to maintain income levels by concentrating on clients who truly require what a business has to provide and are prepared to pay a premium (Chernatony

& Knox, 1992; Civi, 2013). Finally, decreasing prices, a reactionary measure rather than a long-term strategic move, assume that clients are price purchasers, which is not always an valid assumption to make (Anderson, 1996).



A decline in demand may result in price wars since recessionary markets are more price-sensitive and price-driven. Thus, price reductions are a common response to recessionary pressures, as too many suppliers compete for too little demand, resulting in price competition. Reduced prices are the quickest and most direct way to increase sales in the short term. This requirement for an immediate increase in sales.

Reducing prices would be more of a technique than a strategy, as it is frequently a very short-term strategy, with price increases following as quickly as possible (Purlys, 2009). And it is risky because many businesses that aim at reducing their prices do so with a prior assumption of their market's price elasticity, i.e. how price sensitive the market is (H. M. Oliver, 1947; Van Heerde et al., 2008).

Cutting prices is not a long-run solution, particularly if it is a reactionary measure rather than a long-term business strategy response (Dunkelberg et al., 2010; Piercy et al., 2010). By doing so, businesses implicitly assume that their segments of the market are price purchasers, which is a risky assumption to make. Indeed, customers do not purchase solely on the basis of price but also on perceived usefulness, i.e. the trade-off between the value of a product or service and the associated price tag (Kotler & Caslione, 2009; Pearce & Robinson, 2002).

Slashing prices is frequently a desperate attempt by businesses to increase sales and stay competitive. However, without a commercially solid pricing strategy, price reductions might result in critically low-profit margins.

b) Cost minimization: When earnings are threatened, cutting the expenses is often a simple way to mitigate the situation (Plansky et al., 2016). Numerous marketing expenses, such as advertising, promotions, market research, and sponsorships, are discretionary (J. M. R. Salazar, 2017; Juan Manuel Rojas Salazar, 2017a). Campaign planning and content creation are often seen as relative assets (Grundey, 2009). This results in the marketing team often being the earliest to slash expenditures in an effort to save money (Crandall et al., 2009).

Another reason the marketing budget is the first to be cut is that it is a simpler cost-cutting measure than cutting customer service, eliminating sales agents, or delaying product delivery. To maintain a superior customer experience, management is often forced to decrease discretionary marketing, contractor, and even staff spending (Brent, 2006; Lipsey & Harbury, 1992).

There are cost savings in marketing that are precisely the ideal instrument for immediately responding to a crisis and rethinking priorities. The key is to remove extra expenses, not the fundamental ones. Marketing skills require time to develop and generate results, and once the economy has slowed, it might take some time for it to restart. As with price reductions, cost-reducing may be deadly if it impairs or entirely eliminates the company's capacity to generate sales for its products in the near future (Besanko et al., 2007). It is vital to identify which proactive marketing initiatives should be maintained during the economic downturn in order to achieve profitable outcomes.

c) Inactivity: Some businesses adopt a relative state of stasis in reaction to a recession, failing to counteract or even gain from the conditions. Inaction may be harmful for firms because some of the firm’s rivals remain stationary. There are relatively few instances of businesses that followed this approach and emerged better from the crisis. In a downturn, competitive pressures intensify as competitors attempt to preserve or expand their consumer base. A business risks failure if it does not join the recovery struggle in recession.

## 2. Recession and its pricing challenges

There is no formal definition of recession, however, it is widely accepted that the term refers to a time of economic activity fall (Brian & Patrick, 2010). Recessions are not defined by very brief periods of downturn. Most studies define a recession as two consecutive quarters of fall in a country's real GDP—the total worth of all goods and services produced (Abberger & Nierhaus, 2008; Leamer, 2008). Although this definition is a good starting point, it has certain limitations. A focus on GDP alone is too limited, and it is frequently advisable to use a broader range of economic activity measurements to establish if a nation is in fact experiencing a recession (Keilis-Borok

et al., 2000). Other indicators may also give a timelier picture of the status of the economy.



Understanding the causes of recessions has long been a focus of economic study. Recessions happen for a multitude of causes. Some are linked to abrupt variations in the pricing of inputs used in the production of products and services (Kliman, 2012). A sharp rise in oil costs, for example, may signal the start of a recession. As energy prices rise, so does the total price level, resulting in a decrease in aggregate demand (Koo, 2013). A recession may also be caused by a country's choice to use deflationary fiscal or monetary policies to lower inflation. Excessive adoption of such measures might result in a drop in demand for products and services, ultimately leading to a recession (Kornai, 1994; Sherman, 2009; Verick & Islam, 2010).

Some recessions, for instance, the one that started in 2007, are caused by issues in the financial markets (Verick & Islam, 2010). Sharp gains in asset values and quick credit growth often correspond with rapid debt buildup. As firms and people become overextended and struggle to satisfy their debt commitments, they curtail investment and consumption, resulting in a decline in economic activity. Not all credit booms end in downturns, but if they do, these recessions are frequently more expensive than others. Recessions may be caused by a drop in foreign demand, particularly in nations with large export industries (Palley, 2011). The negative impacts of recessions in big nations are quickly felt by their regional trade partners, particularly during globally coordinated recessions (Jagannathan et al., 2013; Palley, 2011).

Because recessions may have a variety of reasons, forecasting them is difficult. Patterns of multiple economic factors, including credit quantity, asset values, and the rate of unemployment, have been documented around recessions; however, while they may be the cause of recessions, they may also be the result of recessions (Ng & Wright, 2013; Nyberg, 2010). This phenomenon is called “endogenous to recessions" (A., 2013; Ravn & Sterk, 2017). Despite the fact that economists employ a vast number of indicators to estimate the future pattern of economic activity, none has shown to be a credible forecast of whether a recession would occur (Dominguez & Shapiro, 2013;

Gogas et al., 2015). Changes in some variables appear to be effective in predicting recessions, such as stock prices, the unemployment rate, certain interest rates, and consumer sentiment (Chatterjee & Dinda, 2015; Stock & Watson, 2003).



Recessions are uncommon but expensive. Between 1960 and 2007, there were 122 documented recessions in 21 major economies (Claessens et al., 2009; Kose et al., 2008). Although this may seem to be a large sum, recessions are uncommon. Although each recession is distinct, recessions often have few characteristics. First, they usually last approximately a year and have a considerable production cost. A recession, for instance, is frequently linked with a 2% drop in GDP. During severe recessions, the usual production cost is close to 5% (Buti et al., 1997). Although the reduction in consumption is frequently little, the losses in industrial output and investment are often bigger than the decline in GDP. Second, they often coincide with declines in international commerce, since exports and, in particular, imports fall dramatically during times of slowing. Third, because total demand for products and services is reduced, the unemployment rate nearly always rises and inflation decreases somewhat. Recessions are often connected with financial market turbulence, in addition to the deterioration of home and equity values.

In many areas, demand will diminish, at least in the short term, and enterprises will experience pressure to cut prices to attempt to make up for the shortage (Cynamon et al., 2013). Businesses may even see rivals decreasing prices to struggle for their own deficits. While this is a tough topic, organizations should endeavor to avoid the impulse to discount needlessly. This is essential to consider alternative levers to boost the value offered to the customer, possibly via service characteristics that make it simpler for customers to conduct business with them. Customers will enjoy price transparency and quick pricing information since it improves confidence and enhances purchase relationships.

Fig 1 and 2 show that businesses are expected to experience a decline in demand and unsold products during an economic slump. This offers an incentive for price reductions. Second, demand is expected to become more price elastic during a recession (more sensitive to changes in price). As a result, a business might be able to

boost income by lowering its prices. In a recession, a price reduction may result in a greater percentage gain under demand than it would in normal circumstances.



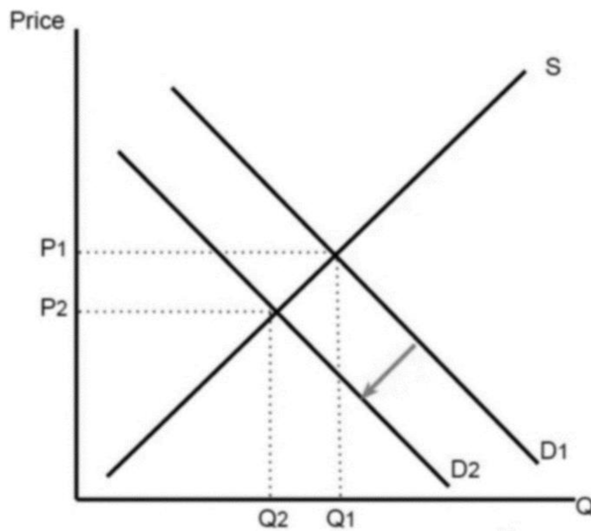


**Figure 1. A drop of demands in recession**

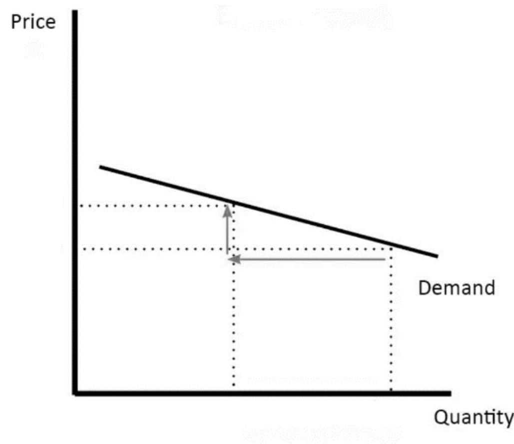


**Figure 2. Price elasticity in recession**

Another challenge is the disruptions in the supply chain. As demand remains unclear in the coming months, businesses will undoubtedly struggle to deploy the necessary resources to secure the flow of products and services through their supply networks (Prasad et al., 2012). It is very feasible for businesses to be disrupted by external factors

over which they have no control. These possible interruptions may eventually be seen as service faults by clients who are unaware of the bigger picture. And service failures often serve as the justification and justification for customer discount requests and maybe customer defections. It is critical that businesses do not let the possibility of service failure define their pricing approach (Oladosu, 2009). A price that has been given away as a result of a service failure is extremely difficult to recover, and it incorrectly places emphasis on the price instead of the service resolve. Communication with clients may be quite beneficial in this situation, as it demonstrates that businesses are aware of the danger and are taking additional steps to reduce supply chain interruptions, particularly those outside their control.

Due to the economic turbulence, businesses may decide to re-evaluate the advantages of current commercial ties. Things tend to function on inertia in the bulk of B2B relationship-based businesses until something creates a disturbance, and a large pandemic might absolutely be that disruption. This reevaluation process may entail asking competitors to compete on the business that has already been awarded to organization.

With switching fees on the line, this is an excellent chance for incumbent providers to emphasize the value of existing partnerships. Existing consumers appreciate factors like trust, intellectual capital, and organizational momentum. By contrast, working with a new vendor would almost certainly include more setup work, uncertainty about service expectations, unexpected learning and adoption issues, and a slew of hazards that might possibly interrupt typical company operations. The incumbent providers' advertising & distribution materials should emphasize these value components. However, avoid the urge to artificially reduce prices. Rather than communicating a cheap price, it is preferable to indicate that pricing will continue to be "fair." This kind of messaging tends to shift the attention away from pricing and onto the factors that are most important to clients.

The economic difficulties faced by customers can lead them to price slashing requests. Due to the economic difficulty that some customers may face, it is probable that they will want price concessions since the sustainability of their own firm is in doubt. However, if not properly managed, price reductions could become the new status quo,

which will be difficult to reverse. In certain instances, it may appear to make sense to assist suffering clients by offering them a discount. However, rather than changing the price, a better strategy could be to offer them a "donation" of merchandise. Rather than providing a client with a demanded discount rate, a business might make a gift equal to the requested rate of the units a customer would usually purchase over a certain time period. This preserves the price figure and makes it simpler to avoid creating a recurrent expectation that may survive the present economic crisis.

## 4. Price cut in recession and buying behavior

E.H. Weber performed significant research that gave birth to the examination of price and its effect on customer purchasing decision making (Sirvanci, 1993; White & Vilmain, 2015). Consumers' perception of difference is restricted, according to his rule, and any change in a given stimulus may be seen only when it surpasses a threshold, reported as a percentage of the starting value. Weber's Law may also be used for pricing strategies. (Shigemoto, 2003). According to this theory, it is required for an effective pricing model to remain below Weber's fraction when raising the price and to surpass the fraction while decreasing the price (Henderson Britt, 1975; Kamen & Toman, 1970). However, reality reveals that following these kinds of guidelines does not always result in the intended customer behavior, since the purchasing decision-making process is impacted by a broad range of circumstances.

In practice, simply being aware of a price decrease or rise does not necessitate a change in purchasing patterns (Haghshenas et al., 2013; Mirabi et al., 2015). Furthermore, Weber's percentage should fluctuate based on the consumer, product, and a variety of other situational factors. However, proper management of consumers' pricing perception may lead to enhanced product value perception and greater readiness to purchase. As a result, sales managers are less concerned with the barely discernible improvement and more concerned with the price shift that would entice consumers to modify their purchasing choices.

Many variables impact purchasing behavior at many levels, ranging from broad cultural and societal effects to deep-seated individual motives, beliefs, and attitudes (Mirabi et al., 2015). In general, internal elements that drive buying behavior may be distinguished from external factors at play. Internal influencing variables are further classified into four categories: cultural, societal, personal, and psychological influences (Kidane & Sharma, 2016; Ramya & Ali, 2016). Cultural influences are those that have an impact on the behavior of bigger groups of customers. Groups including, family, relatives, social role, and consumer status are examples of social influencing variables (Gajjar, 2013). Personal characteristics impacting purchasing behavior include the consumer's age, occupation, money, lifestyle, and personality or self-image (Ward, 1974). Psychological variables include each consumer's own desire, mindset, perception, and learning behavior (Sethi & Chawla, 2014).

While buyers seek reduced costs, pricing is often a minor factor in the majority of purchasing choices. Other factors such as quality, service, variety, availability, the convenience of doing business, recognition, trust, and support generally take precedence when clients make purchasing choices. Customers want pricing to be both reasonable and comparable to those charged by other competing sellers.

In the realm of repeated business-to-business sales, purchasing inertia is strong, and buyers develop "relationships" with the goods, providers, and procedures they employ to make repeat purchases. Switching costs are substantial, and it is rare that a customer would defect for a slight price difference unless there is a big service failure. In summary, if a firm gives excellent service, clients will not abandon it even if its rates are somewhat more than those of its rivals.

According to (Kotler, 2003) the cost of retaining a frequent client is far cheaper than the expense of acquiring a new customer. Lowering customer defection and raising repurchase intent may assist save corporate expenses and boosting enterprise profit. In consumer behavior, repurchase intention denotes the desire to make repeat purchases; it is part of behavior loyalty and may or may not imply emotional connection (R. L. Oliver, 1999). Previous research on consumer loyalty has been predicated on client satisfaction; however, repurchase motivation is not only determined by customer pleasure. Loyalty in behavior may be a symptom of inertia.

According to (Colgate & Danaher, 2000), inertia is a characteristic of humans. Customers who are habituated to a certain item may not have a significant drive to explore alternate options (Palmatier et al., 2006). This activity may be the source of repurchases intent. Inertia is a circumstance in which a buyer passively repurchases the very same product in a generally unconscious way without deliberation.



Wieseke et al. (2014) expand on the Social exchange theory, predicting that customer loyalty does not imply a customer is less price-sensitive, and hence a corporation cannot charge a higher price for their goods. They think that loyal clients are rewarded with higher discounts. This is made feasible by the relationships they have developed with firms, which allow them to demand compensation for their loyalty, giving them more bargaining power. The study's findings were ambiguous — loyal clients are prepared to pay a premium yet eager to spend less. In addition, some businesses provide loyalty discounts. The "loyalty discount cycle" (Wieseke et al., 2014) indicates that a company's pricing policies are being compromised to promote loyalty. There are, however, alternative strategies to promote loyalty that do not involve lowering prices. These are less expensive alternatives like personalized treatment by sales employees, expedited service, or awards when the customer's perceived value exceeds the company's financial cost (Bowen & Chen, 2001). These incentives might take the form of free items or components. Finally, price sensitivity may be mitigated by providing excellent customer service (Wieseke et. al.,2014). Customer-oriented service, on the other hand, is more likely to work with items that have been around for a long time and have a solid reputation, which may help buyers recognize that they are acquiring a high-quality product (Baumann et al., 2012).

Due to the enormous impact, that price has on profit, it is very unusual that just decreasing prices generates enough more demand to yield incremental profits. In summary, decreasing costs is seldom a certain way to increase profitability.

Pricing strategies are broadly classified into two types: static pricing strategies and dynamic pricing methods (Maglaras & Meissner, 2006). Static pricing is a typical pricing method that establishes and maintains prices over lengthy periods of time (Cope, 2007). Dynamic pricing is the opposite of fixed pricing, where the items or services move through several pricing levels, such as airline ticket rates (Cope, 2007).

Price discrimination as a consequence of this pricing approach often leads to lower industry profits and typically benefits consumers. Companies gain from charging varying pricing based on the consumer and the time of purchase. As a result, a suitable pricing strategy is critical for businesses.



Dynamic pricing techniques are further subdivided into two categories. The first is known as posterior price matching, while the second is known as postponed posterior price matching (Harrison et al., 2012; Yan & Ke, 2018). These two tactics are geared toward customers who make smart purchase choices. In this case, consumers opt to exchange their items when they pay lower costs. As a result, impulse purchases are not detected. Both tactics assist businesses in setting higher rates, but it is a matter of determining the sort of consumer firm. When the gap between customers who value the items highly and lowly is quite minimal, posterior pricing is suitable. The deferred posterior price matching hypothesis is the inverse of this.

Firms refuse to decrease prices needlessly and void following rivals' pricing spirals. Generally, it is not essential. Rather than that, strive to make the price fair and reflective of the value (Geruson, 1992). The firms can concentrate their marketing efforts on emphasizing what makes their items genuinely distinctive in comparison to the competition, depending on what matters most to their clients (Lambin & Schuiling, 2012). While this may involve more sales training and enablement, the effect of online message may be larger. With the increasing use of digital technologies, clients will get an increasing amount of information via self-service access to websites or online sources. If managers believe that making compromises or making investments in clients is necessary, firms should avoid allowing them to erode its price and concentrate on non-monetary methods to assist clients, even if it means making a gift (Haisley & Loewenstein, 2011; Marchand et al., 2017; Ou et al., 2011).

Transparency, responsiveness, and consistency all contribute to the development of trust, which consumers will appreciate as a component of value the firms offer (Buell et al., 2017; Stone et al., 1996). Firms can attract new clients with trial offers that are symbolic of service and value aspects they are unlikely to find from rivals, without sacrificing their value proposition. They can also utilize established technologies to

assure sensible and accurate pricing for each consumer category, enhancing the customer experience and establishing confidence in the purchasing relationship.



Pricing items is often delegated to individuals who are not in command of the whole business. They monitor markets and product flows and adjust pricing in accordance with traditional supply and demand principles. This is a sound option in a healthy or rising economy. This strategy is no longer effective during a recession.

## 4. Conclusion

A recession is defined as a phase of negative GDP growth characterized by declining real incomes and increased unemployment. Consumers' incomes are likely to be lower during a recession, making them more price sensitive. Additionally, there is the danger of unemployment, which will make customers less willing to purchase.

During a recession, it may be appealing to lower prices drastically in order to retain clients. Such methods, however, may have a detrimental impact on branding efforts. Many firms consider streamlining pricing, offering special deals apart from other goods and services, and implementing temporary price reductions for struggling long-term customers.

Because consumers are seeking for the best deals during the recession, sometimes they adopt strategies that they would not have adopted previously. They become ready to lower prices with the aim of maintaining existing customers and maybe gaining new ones. And, although price reductions may result in improved income in the near term, they may also spark a price war in the market, having a negative effect on firm's future pricing.

Profit margins and total revenue will be lower during a recession. However, by regaining control of pricing strategy and resisting the temptation to slash prices in order to survive the recession, firms may contribute to the creation of a recession-proof offering by continuing to grow client base. If firms can keep their clients satisfied while maintaining the level of value and quality they expect, it will survive long after the recession is over.

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