Governing Energy

No Longer Relevant

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As one who dines out in the Houston metropolitan area on a regular basis, it is hard not to notice that the restaurant prices are increasing and in some cases dramatically. Also noticeably, the eateries do not seem as crowded and reservations are easier to get.

In one case, the price of a hamburger at an upscale bistro increased by approximately 30% in a very short period. For some establishments this may be a death spiral.

Cost of food and labor are the usual culprits.[i] However, seemingly passing along such large increases likely suppresses demand. The third leg of the triumvirate is the oil and gas recession which may be decreasing the supply of diners; especially those with expensive accounts.

Interest rates, the price of various commodities (oil and gas), many professional services (legal, medicine, etc.) and other goods we routinely procure are fungible. That is, they are available from a variety of sources. Examples of this phenomenon include the rise of Shale Oil and the continuing decrease in the price of electronics.

One can make the case that most restaurants fit this definition as well. A large city will have many choices. Moreover, diners can be finicky and change on a whim.

Many, especially the political class believes that cost increases can simply be passed along to consumers in the form of higher prices. This conventional wisdom has persisted for generations. But is this true?

Economist first codified the Supply and Demand model over 300 years ago and by the late 1700s the construct was fairly mature.[ii] Today, this model is readily available and easy to use.

In most cases, demand is *elastic* and will decrease as prices increase.[iii] How much lower is a function of a number of economic variables such as customer buying power and level of fungibility. Another, difficult to evaluate is the buyers' emotion.

If a purchaser feels that she is being taken advantage of, this can evoke a level of buying resistance and even anger in extreme cases. A tip jar at the counter of takeout coffee or other fast food can seem as if the company is trying to shame customers to pay even more of their labor cost. One wonders how many customers tipped once and never went back?

Surviving companies in the oil industry has dramatically reduced drilling and production break even points using technology and organizational transformation processes. However, as of this writing, some of the time honored tools to reduce production and thus keep prices up are no longer working.[iv]

As one politician famously said, “the 1980s called and want their foreign policy back.” So it is with management science as well.

It is unlikely that anytime soon we will be in gasoline lines such as we were in the 1970s—twice![v] Moreover, the “real” (adjusted for inflation) price of a gallon of gasoline in the United States in 2015 was on par with 1931--$2.36 vs $2.65 then.[vi]

One current discussion regarding goods exported to the United States is that a potential tariff will automatically be passed to consumers. The likelihood is that consumers will resist, with a likely decline in the demand.

Passing costs along to your valuable and hard won customers will not grow markets. This business model is no longer relevant! The better model is to drive the cost structure down systemically.

Tariffs, transportation costs, meeting the target country’s regulatory requirements etc. are part of the cost of doing international business. Management should work to lower these costs as well; however, expectations that costs can be passed to contemporary consumers are misguided.

Most readers are generally familiar with the basic Supply and Demand model. However, how many have actually used this template to assess business opportunities?

Going forward, we are making this blog more interactive. Readers can expect to not only find critical reviews of various organizational governance issues but new tools and techniques to use on a daily basis.

Our first solution is our Supply & Demand Model.[vii] Instructions are contained with the model’s QuickStart Guide. It will show you conclusively how important your pricing model is to your success.

Finally, answer a few questions and hit “Submit.” We will get back to you with our insight into the issue you are facing—No charge or obligation!

Automatically passing costs on to customers in the form of price increases or reducing the volume in same size packaging are methods that belong in the past.[viii] Today’s purchasers are more sophisticated and will not respond kindly to the usual tricks.

Is Your Pricing Model Relevant for Today’s Markets?

About the Author

Dr. Scott M. Shemwell has over 30 years technical and executive management experience primarily in the energy sector. He is the author of six books and has written extensively about the field of operations. Shemwell is the Managing Director of The Rapid Response Institute, a firm that focuses on providing its customers with solutions enabling Operational Excellence and regulatory compliance management. He has studied cultural interactions for more than 30 years—his dissertation; *Cross Cultural Negotiations Between Japanese and American Businessmen: A Systems Analysis (Exploratory Study)* is an early peer reviewed manuscript addressing the systemic structure of social relationships.

Free Economic Value Proposition Matrix version 2.0 (Realize the value of your investment)

End Notes

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[i] https://www.ers.usda.gov/data-products/food-price-outlook/summary-findings.aspx
[ii] http://www.investopedia.com/ask/answers/030415/who-discovered-law-supply-and-demand.asp
[iii] http://www.investopedia.com/terms/d/demand-elasticity.asp
[iv] http://energyfuse.org/u-s-rig-count-soars-helps-temper-opec-cuts/
[v] http://www.npr.org/sections/pictureshow/2012/11/10/164792293/gas-lines-evoke-memories-oil-crises-in-the-1970s
[vi] http://inflationdata.com/articles/inflation-adjusted-prices/inflation-adjusted-gasoline-prices/
[vii] http://tinyurl.com/jueprpb
[viii] https://www.wsj.com/articles/how-do-companies-quietly-raise-prices-they-do-this-1434041940