Islamic and ethical aspect in pricing decision economics essay

Economics

Abstract

Muslim is encouraged to participate in various economic dealings as it is a social responsible act, and it does not only satisfy the needs and wants of marketer, but consumer needs and wants are also met. In dealing with daily economic and business transaction, Muslim must conduct them in ethical and responsible manner and any forms of activities that will harm others are prohibited in Islam. Considering the growing importance of global economy and commerce, marketer especially Muslim marketer must be familiarize with the Islamic marketing; ethical aspect for Muslim in dealing with everyday business transaction. Hence, Muslim marketer need to ensure that in the process of marketing its product, several elements must be considered and one of the most important element that is worth giving attention to is pricing decision.

Introduction

Twelve relevant articles have been selected for the purpose of this review. Main issue that will be discussed is pricing. Pricing is one of the elements of the 4Ps of marketing mix and price is an essential mechanism, it does not only reflect the value of the product but price is a key determinant for consumer purchase decision. There are many underlying causal or factor that drives marketer in making pricing decision , though it is apparent that seller motives is to increase its gain and minimize its loss, thus it is only logical that marketer will adopt several technique in order to ensure its goal to be accomplished. However, Muslim marketer must critically assess various aspects before making its pricing decision. Due to that, Islam provides guideline for marketer in dealing with commerce decision including decision in pricing. Islam do encourage free operation of market an allow flexibility in adjusting price as long as it within the bound and limits given by the shariah. The objective of this paper is to focus on one the elements marketing mix (4ps) particularly of pricing by analyzing the findings by various scholars from Islamic and conventional view on pricing aspect. This paper also attempts to investigate the underlying principle of pricing from Islamic perspective as well as the prevalent issue that strikes marketer. The next objective is to compare the pricing decision that guides the marketer especially in terms of its ethical aspect. In order to fully understand the subject matter in this paper, the following section of this paper attempts to discuss several unethical aspect of pricing that is prevalent. The ethical issue of pricing is divided into a number of sections which the first section of this paper critically evaluate the findings by researchers on relationship between price and quality, the second section evaluates the monopolize market. This is one of the crucial aspect to be dealt with as monopolize market means firm has a market power, and those who have this market power will have the control over price and quantity. The next section discuss about the predatory pricing, an unethical practice by marketer to eliminate competitors in market by lowering its price. The following section dealt with riba' , marketer must ensure transaction is free from riba. One controversial issue worth mentioning here is price control which will be critically discussed on the last section of this paper.

Price and Quality

Consumer purchases and choice of product in the market often drives by their perception of price quality and value of the products Many research under this subject matter have been conducted by numerous scholars in trying to study the relationship between price and quality as indicator of buyers purchase decision in market.(Monroe , Rao, and Zeithml) found that buyers believe that higher price indicates higher quality.(Dodds 1985) review that price of the products is positively correlated with brands. Though the correlation is unclear, but observation made by Dodds reveals that branded item signal the higher quality of the product and hence its higher price is deemed reasonable as it reflects the higher value. Study by (Zeithaml 1988) includes the buyers perception on branded items, consumer tend to purchase branded item as they perceive it to be higher in quality and thus consumer is willing to pay more for that item. Review by (Qiang Di 2009) raise the issue on the factors that affect buyers’ decision to purchase luxury or branded goods despite the fact that its price is so much higher relative to other items available in the market. The justification for higher price is however vague as it is not easy to determine the factors contribute to the excessive price charge by the seller and thus the study regarding that matter is inconclusive. In one study by Qiang Di, to determine the factors of consumer purchase of luxury goods, indicates that, customer will evaluate the product prior in making purchase decision, and customer evaluation of such luxury goods in terms of its value is high and since the value are higher than cost of acquiring the goods, customer thus decide to purchase such luxury goods after doing cost and benefit analysis. Empirical studies by

(Gerstner 1985) reveal that though buyer perceives higher price is tie to higher quality that remains as perception the actual relationship between the price and quality is not strong. This suggests that higher price do not necessarily indicates superiority and lower price does not too reflect inferior quality of the product. Pricing must reflects the value of the product quality; Pricing in Islam must be fair and just in that, producer is not allowed to charge price that is inconsistent with its quality. Charging higher price for relatively low quality products is thus prohibited in Islam. This also means, quality of products sold must reflects the real value. Producer are allowed to charge price higher than the cost of producing it(mark up) but a same time, producer must ensure that the price it charge is not exorbitant (Mohammad Saeed et al 2001). Islam allow marketer to freely charge its price in respond to the demand and supply of the goods in the market as long as the price charge is reasonable and justifiable. Marketer who plans to increase or reduce the quality of the goods must also raise or reduce the price so that there will be no unjustified gains as unjustified gains will resort to Maisir. Maisir is earning without hard-earned means when seller earn its profit without giving so much of its effort, labor or capital. Hence this kind of earning is prohibited in Islam. Free from Maisir is one of the principles that need to be considered by marketer in making pricing decision. (Al-Buraey 2004). Al-Buraey acknowledge that this practice can also resort to tatfif in which the price changes without adjustment of the quality, value inherent in the product or without altering the amount of goods sold. When changes in price are not followed by changes in either one of these, it is tatfif. Seller however is allowed to adjust its price in situation such that it is required as tool of self operation in the market. Means the price is altered automatically. This is allowed as it encourages healthy competition among sellers in the market and thus the gain earned by seller is justified. (Mohammad Saeed et al 2001).

Monopoly

(Predescu et al 2009) review that there is a distinction of monopoly that is product monopoly and brand monopoly but the most prevalent is the product monopoly and as indicated, the pre-requisite of monopoly is when the seller has control of the price and quantity of the goods to be supplied in the market and when seller have this market control, seller can enjoy the power to rise its price or reduce its supply of good without having to compete with other seller. Monopoly firm are able to control the market price as there are no other competitors and hence the goods is non-substitutable. Due to this, finding a substitute for the goods is essential as it will reduce the monopoly power by only one firm and buyer will be a able to find substitute for the product elsewhere in the marketIn Arabic , ihtikar (monopoly) derived from the word hakr which means collecting and controlling goods. It is unjust and thus it is prohibited in Islam. Though there is no direct mention of monopoly in the The Holy Quran, there is a specific mention on hoarding gold and silver. The Prophet Muhammad (pbuh) has condemned those commit monopoly; he said: " Whoever hoards food (in order to increse its price), has certainly erred." (narrated by Muslim) and also: " Whoever strives to increase the cost (of products) for Muslims, Allah, the Exalted, will place him in the center of the Fire (narrated by Ahmad and Al-Haakim). Furthermore, according to (Al-Buraey 2004), in view of Islamic perspective, monopoly can be defined as a total control over the quantity and the price of products with motive to reduce the supplies in the market, in order to signal the artificial need for prices increases. In Islam, (Saeed, Ahmed and Mukhtar 2001) monopoly is prohibited due to its profound impact not only to individual but to the society as whole; Competitive market as oppose to monopoly is hence discourage when monopoly prevails. All Islamic jurists had agreed and outlined the dual criteria for outlawed monopoly, which are; (1) the product affected must be a necessity (victuals), (2) the monopolistic action must put the general public in a straitened situation (Zarka, 2010). Based on the bounded criteria, it shows that outlawed monopoly has several disadvantages; it leads to price increase, a probable misuse of financial resources, neglect in production processes and eliminating competition (Al-Buraey, 2003: 176; Inayah, 1991: 60). Basically, the aim of the one who hoards (monopolist) is to create artificial scarcity, thus when shortage of the products occurred and people are in need of the products, seller will then increase the price of the products Since this situation will favor the producers side and burden the consumers, thus it is strictly against the Islamic teaching where to safeguarding the public interest. Islam also encourages Muslims to practice purely competition so that the producers will have the spirit of competitiveness and the consumers also have variety options in selecting the products offered by the producers. In order to curb the monopolistic, the intervention of the government is very important to stabilize the market. The role of Vezir (prime minister), Kadi (canonical judge) and other experts are crucial in fostering an atmosphere for a liberal economy. One option that the government can do is to buy up the surplus supply in order to keep them in stock and use it when there is an excess in demand to avoid the price from increasing (Oguz and Tabakoglu, 1991).

Predatory pricing

(Al-Buraey 2009) acknowledge that the practice of penetration pricing is forbidden; Lowering the price below cost to get rid of other competitors in the market is unethical practice. Marketer followed this practice attempt to capture more buyers by lowering its cost and since buyers found that the similar products are lower in price, they then move away from other competitors who charge relatively higher price. (Mohammad Saed et al 2001) reported that once when Hatib bin Abi Balta'ah sell raisin and Umar Al-khatab passed by him, Umar Al-Khattab found that he sold the raisin at a much cheaper price in order to defeat his competitors. Umar told him to either raise his price or he must stop selling. It implies that penetration practice is unethical and unlawful especially if the seller act is purposeful, that is to defeat its competitors. Islam discourages this form of unhealthy competition as it will reduce the incentive of other producers in the market because other competitors will react by quitting and exit the market. The conventional marketer has similar view for predatory pricing to protect the other competitors in the market (Gome, Goercee and Holt 1998) review that predatory or penetration pricing is unnecessary as there are other methods available that will not undermine competitors in the market. (Gome, Goercee and Holt 1998) concluded that marketer attempt to penetrate the market to predatory pricing is hence unreasonable act based on the ground that 1) marketer can use means that are more reasonable and profitable without having to reduce its revenue and consequently result in lower profits. 2) By increasing the price in the future will draw new entry.

Riba'

In evaluating the prohibition of practice of riba in business transaction, Islamic Banking and Financial Institutions is needed as benchmarking, as many of this unethical practice is obvious in this service sector. In addition to that, since research paper of riba on trading of goods is not as abundant as riba on Islamic Banking, Islamic Banking and Financial Institutors hence can be the best framework as it operates similarly if it were to be applied on trading goods.(Mohd Azmi Omar et al 2010) reviewed Islamic finance has been using conventional finance benchmarks to regulate its own cost of funds and consequently, its return to financial investments. They are using the conventional finance benchmark because Islamic finance has always served the customers as the financial intermediary for surplus and benefit units. However, Islamic finance has not yet come up with an Islamic Pricing benchmark (IPB) to determine its cost of capital. There is such an essential for having Islamic Pricing Benchmark that will be comprehensive and different with the conventional finance benchmark because they rely heavily on the interest rates that Islam prohibited the most. In (Mohd Azmi Omar et al 2010) review, Islam does not restricts to what amount profit should be taken in the trade transactions since there is verses of Quran that discouraged the merchants to trade without any profit. Allah said in the Quran, in surah Al-Baqarah verse 16," These are the people who have bought error at the price of guidance; so their trade has brouhjt no gain, nor they have reached the right path" It can be seen that Islam based on the principle of ‘ adil or justice in the distribution of profit. One of the example from the hadiths, the Prophet (SAW) allowed the profit to be 100 percent and some of the companions did receive profit that exceed 100 percent. Furthermore, in order to offer another option for the model to benchmark pricing for Islamic banking, we need to know what Muslim jurists view on this issue. The common discussion among the jurists is fixing a price on financial transaction and it is due to the Overnight Policy Rate by the central bank (Bank Negara) which has some influenced in the process of structuring Islamic Pricing Benchmark. If the OPR changes, it also affect Islamic benchmark rate. Therefore, having such benchmark will help in determining the profit rate and as well as the application for the minimum and maximum price. The objective of constructing the Islamic pricing benchmark is to formulate another pricing benchmark option that can be used to estimate profit margin as an alternative opposed to interest rate (Mohd Azmi Omar et al 2010). Moreover, the major reason for introducing the new benchmark for Islamic pricing is the prohibition of the riba’ itself. The Islamic financial institution should abolished this riba’ as soon as possible because using riba’ in the permissible transaction is not desirable and it does not have any impact on the system of the distribution. The riba’ or the modern day term interest rate is not determined by the real economy because the same interest rates are use based on the credit risk of the investors. As an example, if an investor’s credit history seems to be risky, he is charged a higher rate. In a nutshell, the conventional financial institution charge the interest rate based on base rate determined by the OPR and a mark-up charge on the perceived risk of the fund. On the other hand, Islamic financing are all real such that the assets are linked and secured to the real economy and the profit and the opportunity cost also being determined with the economy. Consequently, the Islamic benchmark has to be based on these two variables whish are profitability and riskiness and also ought to be based on the market risk. There is also a hadith said by the Prophet (SAW), " To cheat the easy-going customer constitutes illicit gain (riba’)" (Ibn Taymiya 1982: 62-68). It is reported in (Saeed, Ahmed, Mukhtar 2001) review, this hadith prohibits the marketers from implementing price discrimination between buyers and sellers via selling the same merchandise to them for different prices. It is can be seen that injustice had been served to the customers since they have the rights to bargain the price. Besides that, marketers in understanding the process of price decision, they must avoid all aspect of usury or riba’. The Quran contains a lot of verses that forbids the practice of riba, and one of the most important verses is as follows. Surah Al-Baqarah verse 275" Those who take riba (usury) will not stand but asas stand one whom the demonhas driven crazy by his touch. That is because they have say: " sale is but like Riba" but Allah has permitted trade and forbidden usury. So whoever receive an advice, from his Lord and desist, then what has passed is allowed for him and his matter is up to Allah . As for the ones who revert back, those are the people of Fire . They will rmeian forever" Thus, Allah dislike those who use riba’ in their business transaction and consequently, harsh punishment will wait for them in the Hereafter.

Price control

Price control in Islam has been a debatable subject since early seventh century (AD). Price control is not encouraged in Islam; In fact (Ahmad Bashar

1997) have justified price control, if the price is made fixed by authority without allowing it to change, when natural scarcity occur, this situation is thus unfavorable and unfair for the seller as the price remain low and can't be raise. On the other hand, the burden will fall on the buyer in a situation when economic of a country is boom or prosper, with abundant of resources, seller can produce goods at lower cost and since the cost of producing is low, seller can charge a much lower price, but with the presence of price control by the authority, that the price of the goods cannot be change in any circumstances, and thus, buyer will be harm in this situation, and seller will gain as the buyer still have to pay the same amount even when the cost of producing the good is low. Thus, price control is deemed undesirable and price in the market should follow the natural order of demand and supply. Price control is criticized based on several grounds , price control drive the price to rise in the market, it encourage monopoly or hoarding which will consequently have adverse affect on consumer in the market therefore the buyers need and wants are not met by the sellers. However, price control is not necessarily banned in all situations; (Ahmad Bashar 1997) under the circumstances such that there is natural scarcity of goods in the market, price control is hence necessary to protect the market. There is a situation in which price control is not only allowed but it is essential for the well functioning and to protect the interest of the public. When seller hoard it's good to create scarcity, so that the price can be raise in the future, means the seller refuse to sell, and when this happened, authority has the right to force seller to sell as people are in needs of the goods and seller must sell it at a market price, means the price is control by the authority. (Ahmad

Bashar 1997) have reported the advantages as well as disadvantages of price control. Advantages as concluded by (Ahmad Bashar 1997) 1) a tool to curb inflation as when there is a rise in price of goods in the market, investment will reduce as return is low, price control is therefore important in keeping the price from rising. 2) avoiding any means of price war between sellers as with price control, sellers will not be able to charge lower or higher price than it should and hence will protect the interest of many. 3) stabilizing the value by setting the price to some level 4) less market power by one firm as the monopolize firm will not have freedom in charging its price as they wish. 5)Price control by authority will protect interest of those of labor, capital and entrepreneurship by ensuring their just return 6) reducing the information cost 7) price control can neutralize the impact during the crisis or emergency 7) ensuring fair and just distribution in receiving benefit and forgoing cost. Shortcoming as concluded by Ahmad Bashar (1997) includes 1) will result in market imbalance which is belief due to to the practice of hoarding. 2) Economic imbalance. Therefore, advantages and shortcoming of price control implies that, price control can only be implemented in certain situation and not necessarily that price control is prohibited in all circumstances. Though the marketer has no direct control on the issue of price control, it is important for marketer to be aware of this issue as it will affect operation of the marketer.

Conclusion

In conclusion, the pricing decision by marketer must be fair and just in that marketer must consider numerous factors before setting a price of its product. In setting the right price, marketer must ensure that the price charge will provide benefit to the greatest number of people following the principle of maslahah al-mursalah (public interest). Hence marketer must not set its price solely based on pursuit of profit maximization but marketer must take into consideration the spillover benefit and cost resulting from their decision. Based on the review above, conclusion can be draw, are monopolize market must be avoided in ensuring the healthy market operation, marketer must ensure that any changes made in the quality or quantity of the product must be followed by the changes in price either increase or reducing it, the act of lowering price with the intention to eliminate competitor is unethical practice and thus must be avoided. Lastly, usury which is one the mist gravest sin condemned by Allah must be strictly avoided in ensuring that seller will earn lawful earning without taking up others right. Government plays a major role in ensuring the regulation of price in the market is free from any elements that may prohibit the nature of free market where buyer and seller can interact freely in setting up the price and quantity. Among measure that can be taken by government is either giving subsidies to producer or consumer. Subsidies to producer provide incentives for them to produce more at a lower cost and consequently will charge lower price to consumers. Government can provide subsidies for consumer as well, so that the price paid by buyers is lower as it is been subsidized by the government. Either way it will benefit both producer and consumers.