# MARKETING FUNCTIONS AND COSTS AND THE ROBINSON-PATMAN ACT 

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The several types of legislative restriction on freedom in pricing, including the Robinson-Patman Act, state "fair trade" (resale price maintenance) acts, and various laws actual and proposed to prevent selling below cost, and to restrict or prevent the use of so-called loss leaders in retail selling, all have a common social ancestry. They stem broadly from the sentiment for protecting the small merchant against his larger competitors. They belong, in other words, to the same family as the discriminatory chain store tax measures. In an era when security is the watchword, these laws represent the determined drive of certain groups of retailers and wholesalers to improve their economic position and make it secure against the stresses of competition. ${ }^{1}$ There are, of course, other strains in the ancestry of these measures, but the urge to obtain security for the little fellow is the predominant one.

The average business man, unless he belongs to a group benefited by these laws, is likely to characterize all these restrictions on his pricing freedom as governmental interference and regimentation, objectionable outgrowths of the New Deal. Actually, however, these particular developments are quite alien from one aspect of the New Deal, namely, the trend towards economic planning and state socialism, as exemplified, for instance, in the Tugwellian philosophy. The thoughts of the economic planners run more in the direction of permitting the development of large businesses to the point where the state can assume control of key production and distribution industries without having to direct the destinies of hundreds of thousands of small enterprises. But the Robinson-Patman Act was not fundamentally a New Deal measure. In fact the sentiment which fathered this Act and its various blood relatives has in it more that is reminiscent of the beginnings of the Nazi movement in Germany, where the same zeal was displayed to protect the small business man

[^0]from his large competitors. Ultimately, perhaps, both roads may lead to the totalitarian state; but at the outset they fork in different directions.

Such speculations take one far afield. Possibly a more realistic observation would be to this effect: government having to an increasing extent abandoned its impartial rôle of umpire in favor of one of partisan interference, small retailers, aware of the tariff favors bestowed on manufacturers in previous years and more recently observing the benefits distributed to farmers, have now organized themselves to exert pressure with a view to making their own economic position more comfortable. Of course it goes without saying that all these seekers of advantage march boldly forward with good conscience under the banners of public welfare.

These various legislative measures attack the pricing problem in two places. One approach is the regulation of pricing practices as between business sellers and buyers in wholesale markets. The other approach is the regulation of pricing from the retail selling end. The first of these approaches has resulted in the Robinson-Patman Act. The proponents of this measure, skilfully taking advantage of the sentiment in Congress against monopolies, used the monopoly argument (although as applied to retailing it will not bear careful examination) as a stalking-horse and thereby succeeded in attaching the Robinson-Patman Act to the Clayton Act, where it does not belong. ${ }^{2}$ The other approach, the regulation of retail selling prices, has taken two avenues: (r) extension of the resale price maintenance privilege to owners of trademarks by means of "fair trade" acts now on the statute books of 30 -odd states and (2) the prohibition, either by state law or by trade practice agreement, of selling below cost. ${ }^{3}$ The California Unfair Practices Act, ${ }^{4}$ for instance, a practical
${ }^{2}$ See Learned and Isaacs, The Robinson-Patman Law: Some Assumptions and Expectations (Winter, 1937) 15 Harv. Bus. Rev. 137.

A price differential becomes a discrimination when it is made between parties who are in such circumstances and have such common interests as to be entitled to equal treatment, for instance, manufacturers or merchants who compete with one another in the direct or indirect resale of particular goods. The price discriminations which are outlawed by this Act (unless they can take refuge under some of the enumerated defenses) are those made between different purchasers of commodities of like grade and quality in interstate commerce "where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or the customers of either of them . . ." Robinson-Patman Act, §1(a).

The important phraseology here added to that of the Clayton Act is that italicized above. As Professors Learned and Isaacs point out, "Here we have obviously departed from the old philosophy and tried to save men from the ravages of competition. But once more the draftsmen of the Act have been very adroit. They do not condemn in words the injury of certain competitors. They still talk as if the thing condemned is injury to competition. It is unlawful to engage in price discrimination . . . the effect of which may be to injure, destroy, or prevent competition-with certain persons. What is the difference between hurting the corner grocer as an incident of competition with the chain and hurting his competition with the chain? If the corner grocer must lop five cents off the marked price of a can of peas is mect competition, he is hurt, but is his competition hurt within the meaning of the statute? If the answer is 'yes,' then the wording of the statute is grossly misleading. It is an anti-competition statute slipped into the anti-trust laws. And since it stops competition at the level where it is most effective in American business, the only level where aggressive buying makes inroads on fixed prices, it amounts to a repeal of the anti-trust policy in a very important part of American business." Learned and Isaacs, supra, at p . 139 .
${ }^{1}$ Such restrictions apply both to manufacturers and to distributors, but apparently are aimed principally at retail distribution.
${ }^{4}$ Cal. Stat. 1935: pp. 1546-1551.
duplicate of which is now on the statute books of at least five other states, provides that it shall be unlawful to sell below cost, this term as applied to distribution cost to mean invoice or replacement cost plus the particular distributor's cost of doing business, defined to comprise labor (including salaries), rent, interest, depreciation, selling expense, maintenance, delivery, credit losses, licenses, taxes, insurance, and advertising. Virtually similar provisions are found also in the Trade Practice Rules for the Rubber Tire Industry promulgated by the Federal Trade Commission. Other legislative remedies, less drastic in character, contemplate prohibition of sales either below invoice cost or below invoice cost plus some stated percentage, such as $6 \%$. Proposals along these lines have been endorsed, in fact, by such organizations as the National Retail Dry Goods Association and the Associated Grocery Manufacturers of America.

Although there is a common social sentiment behind all these measures and although. they have been sponsored and pressed for enactment by substantially the same business groups, ${ }^{5}$ the logic of laws giving owners of trade-marks the privilege of resale price maintenance is quite clearly a different logic from that which runs through all these other laws and proposals. It is a logic which disregards costs (indeed one of the chief arguments against price maintenance is the fact that it takes no account of differences in the cost of distribution), whereas the logic of the Robinson-Patman Act and of such measures as the California Unfair Practices Act rests very largely on costs; costs are taken as the criterion of fairness or unfairness.

This emphasis on costs is understandable. The notion that price should typically be based on cost plus a fair profit is quite thoroughly ingrained in the minds of many business men. Although from a strict economic standpoint there is no reason why price differentials should not be as readily explainable by factors on the demand side of the equation as by factors on the supply side, the business man not infrequently seems to have some sense of guilt about selling at a price which cannot be "justified" on an ordinary accounting basis; and the same feeling that price differentials ought always to be explainable in terms of costs undoubtedly is a natural one on the part of the buyer who fails to receive as low a price as.his competitor. Some of the responsibility for the prevalence of this point of view attaches also to the marketing experts who have steadily urged the virtues of price stability and longrun "scientific" price policies. Observing the general success of the one-price, nonhiggling policy in retail business, these authorities have advocated a similar policy to govern dealings in wholesale markets. Accountants must also share in the responsibility, because of the importance which many of them have attached to cost accounting as a major basis for price determination. Both the marketing experts and the accountants, of course, have been substantially aided and abetted by trade association executives in the promulgation of these ideas. It is therefore not surprising that even prior to the N.R.A. the very term "price cutting" carried with it a

[^1] infra, p. 375. ED.
connotation of opprobrium, and that in the enthusiasm of the early N.R.A. period a view gained wide acceptance to the effect that the unfair practice of selling below cost was retarding recovery, that "price cutters" and "chiselers" made it difficult, if not impossible, for honest men to do business at a fair profit.

Actually the doctrine that the only fair prices are those which are based on costs, and that price differentials which cannot be justified in terms of costs are therefore unjustly discriminatory, is bad economics and impossible accounting. It is essentially a denial of the economic function of price; it leaves pricing a one-sided matter, with the price-making function largely in the hands of the seller, and the edge removed from the demand blade of the pricing scissors. Developments in the direction of requiring that the prices of particular goods be based on average accounting costs for the period are, on the whole, conducive to something less than full employment and to failure effectively to explore the potentialities of elasticity in lower strata of demand; for numerous situations exist where there is unused plant capacity or where industries are subject to decreasing costs, and where consequently a discriminatory price policy makes possible larger output and larger employment. (This principle is, of course, well understood in the public utility business.)

There is also the point that seller-administered prices are conducive to price rigidity. Logically, perhaps, there is no need that this should be the case, no necessary conflict between that form of price stability represented by an administered, one-price policy and the desirable degree of price flexibility to accommodate changing business conditions. In theory a manufacturer maintaining close touch with his market ought to be able to effect the necessary changes in his own price schedule without at any time indulging in price discrimination. Practically it does not work out that way. A manufacturer who has developed a one-price policy is usually very loath to change his price. He necessarily is taking a rather long-run view of the situation; and so he insulates himself to a considerable degree from the impact of market forces, believing that he can maximize his profits over a period by adhering to his established price. Keeping the price unchanged is the path of least resistance. It avoids potentially troublesome adjustments with wholesalers and retailers with respect to stocks of goods already in hand. It avoids also any difficulty which might be encountered in raising prices later in the event of a change in market conditions. Manufacturers frequently hesitate to make downward price changes for fear of "spoiling the market" in case demand proves to be inelastic, and they commonly do not differentiate between a change in relative prices and an adjustment to a changing price level. At best there are many factors which are likely to retard price changes, and as a practical matter these factors are strongly reinforced by a one-price policy. As abundantly demonstrated during the depression, there are numerous manufacturers who will resort to many expedients before they will change prices; they will even in some instances reduce production and lay off labor first. This kind of price policy is already far too prevalent among American business men; and the Robinson-

Patman Act and other fair trade laws, with their emphasis on cost as the criterion of fairness and their consequent encouragement of one-price policies, promise to make a bad matter worse. American business has already worshipped too long at the shrine of price stability.
. It is frequently inquired why, if the one-price system, that is, the same price to all comers, with no higgling, works so admirably in retail business in America it would not be similarly advantageous to place wholesale prices on the same basis. Superficially, the analogy seems to be good; but there are vital differences. For one thing, consumers are not actuated by the profit motive; they are not buying for resale. Also, consumers patronizing any particular retail store for the most part stand on a fairly similar basis as to quantities, services required, and the facilitating functions which they themselves are prepared to perform. But among customers of a wholesaler or manufacturer such a similarity is not to be found; it is probably less likely to be found today, with the evoluticnary changes that have taken place in the system of distribution, than it was 40 or 50 years ago. Again, the technical ability of consumers to look out for themselves is by no mèans comparable to that of commercial buyers; the admonition "caveat emptor" has properly fallen into disuse in enlightened retail circles. Furthermore the one-price system of retailing prevails principally for goods on which the potential saving that a consumer can obtain by higgling is, on the whole, not worth the time required; but in the case of consumers' goods of high unit value, automobiles, for instance, where the potential saving bulks larger, the practice of higgling still rules, in the form of shopping for the best trade-in allowance. Price is essentially two-sided; there are two sets of motives and two sets of calculations. Price is what the market will pay and what the seller will accept. In a great majority of retail transactions, particularly the small ones, this two-sided character of price is waived by mutual consent; but this fact does not mean that we can safely dispense with the process of bargaining in the whole economic structure. When consumers waive the bargaining privilege, they in effect commission retailers to do their bargaining for them. Hence the substantial elimination of individual bargaining in retail trade is a fact which strengthens rather than lessens the need for bargaining as between retailers and their suppliers.

There is also grave difficulty from an accounting standpoint in making costs the criteria of fairness or unfairness in pricing. Even the manufacturing costs of a particular commodity, especially one produced in conjunction with other items, do not have by any means the precision and validity which legislators seem to suppose; and when it comes to distribution costs, the allocation of overhead items to particular products is largely meaningless. Even if distribution cost accounting were not in its present rudimentary state, the expense of the record-keeping necessary to enable a wholesale grocer, for instance, to determine with any approach to accuracy the cost of handling the XYZ brand of canned peaches might easily be prohibitive. The numerous and varied interrelations of commodities from a sales standpoint, and the
large proportion of the distributor's expense which is overhead in character, i.e., not incurred directly and solely in the purchase, storage, handling, and sale of any one particular commodity, make itemized distribution cost accounting largely a fallacious procedure. Essentially a merchant's profit is derived from his whole output of sales over a period; it is his total dollar gross margin on that output less his total dollar expense for the period. To endeavor to regard net profit as a sum total made up of individually calculated net profits, over and above allocated costs, on each item or line of merchandise handled, is repugnant both to good economics and to good management.

Aside from these economic and accounting difficulties, of which this brief mention has been made, there is another serious objection to a program of legislative reform of trade practices which tends in the direction of outlawing price differentials not based on ascertainable differences in costs. This objection, which applies particularly to the Robinson-Patman Act, grows out of the great variety of marketing functions and the constant shift and change in the grouping of those functions; and it is with this part of the problem of costs that this paper is particularly concerned.

It is no longer possible to take a simple institutional view of the marketíng field. Any marketing text book today which proceeded merely to describe and define the principal institutions engaged in distribution, such as the manufacturer's sales organization, the broker, the wholesaler, and the retailer, and to assign definite groups of functions to each of these would, if it went no further, be dangerously unrealistic. Indeed, there probably never has been a time when such a purely static view would have been adequate; but at a somewhat earlier period in the nation's history it was more nearly true than it is today that a certain group of functions belonged rather definitely to the manufacturer, another group to the wholesaler, and still another to the retailer. The manufacturer, for instance, determined what was to be made, designed the product, owned the trade mark, manufactured the goods, advertised them to consumers or to members of the trade, and employed salesmen to sell the goods to wholesalers. Wholesalers bought goods in large quantities, usually from a number of manufacturers, carried stocks from which to fill orders, and sent out a salesforce to solicit business from retailers. Retailers, in turn, bought in smaller quantities from a number of wholesalers, maintained a variety of goods for selection, arranged them in suitable displays, perhaps advertised to consumers, and employed salespeople to stand behind the counters and wait on customers.

This very elementary picture never was wholly true even in the horse and buggy days; but certainly in the years before igro it came somewhat nearer to being an adequate representation of the state of affairs than it does today; and, unfortunately, the pseudo-simplicity of this A B C marketing structure seems to have commended it, in the minds of many people, as the suitable and appropriate arrangement, any deviations from which are to be discouraged.

Obviously one major break in this simplified structure occurred when some
manufacturers, dissatisfied with the services of the existing wholesale middlemen, themselves undertook the performance of wholesale functions, sending out a substantially augmented salesforce to sell directly to retailers in small quantities, and arranging to carry stocks of finished goods for immediate delivery either at the factory or in branch warehouses. Naturally these manufacturers sold to retailers at prices higher than those at which they formerly had sold to wholesalers, in order to cover the costs of the additional functions which they had assumed. Another break in the traditional institutional picture of marketing came when some wholesalers began to use private brands. With respect to goods sold under these brands they were assuming the merchandising function: they owned the brand; they did the advertising; they laid down the specifications for the product, buying, perhaps, from a number of different manufacturing sources; and they assumed the responsibility for the quality of the goods. Here also the costs shifted along with the functions; the wholesaler selling under a private brand naturally paid lower prices, since the manufacturer was released from the advertising and other costs which the wholesaler had to assume by virtue of his private 'brand policy.

Even more important than the development of private brands by wholesalers has been the assumption of a number of wholesale functions by various types of retailers. Consider the difference between the position of the small neighborhood store and that of the large department store or chain. The proprietor of the small store buys to a considerable extent from wholesalers; but whether he buys from wholesalers or manufacturers, it is characteristically the case that the vendors come to him, rather than that he goes to them. The regular salesmen of manufacturers and wholesalers, the window dressers, the truck delivery men, all come to the stores. The proprietor need scarcely stir from his establishment to look over the complete range of merchandise which he might conceivably offer his customers. This situation is in marked contrast to that of the large department store, for instance, sending its buyers at regular and frequent intervals to visit the important markets, not alone in the United States but throughout the world. The big retailer typically goes to the vendors, many of whose marketing functions are thereby performed in a reverse manner, so to speak. When manufacturers or other vendors deal in this way with their customers, they have relatively small selling expenses. Instead, the customers have large buying expenses. In the one instance the cost of certain marketing functions is a vendor's selling expense, and consequently appears as part of the cost of goods to the retailer; whereas in the other instance the cost of the equivalent marketing functions appears as part of the retailer's expense of doing business.

This reaching out by the large retailer to embrace in his scope of action a wider sector of the marketing task is particularly well illustrated by the operations of large grocery chains. These concerns are essentially combination retailer-wholesalers; they have integrated the retailing and wholesaling functions. ${ }^{6}$ They buy $90 \%$ or more

[^2]immediately from manufacturers and other direct sources and their agents; ${ }^{7}$ take deliveries, frequently in carload lots, in their own warehouses; break bulk; carry on packaging operations; ship assorted smaller quantities by truck to several hundred of their own stores on requisition from store managers; advertise to consumers through a variety of media; apply their own brands to many products; maintain effective direction and control of store managers by means of an elaborate organization of supervisors and superintendents; and frequently conduct such manufacturing operations as baking bread or roasting coffee. Their warehouses and merchandise distribution systems on the physical side, their organization of supervisors and superintendents on the personnel side, and their private brands and advertising on the promotional side-all these clearly are the counterpart of the wholesaler.

Although formerly the institutional labels "wholesaler" and "retailer" may have carried with them the connotation of certain groups of functions, at the present time any merely institutional view of the marketing procedure is wholly inadequate to bring into perspective such an integration of distribution functions as is represented, for instance, by the operations of the J. C. Penney Company in buying cotton in large quantities, laying down specifications for the goods to be manufactured, having the manufacturing done on a contract basis, affixing its own brand name, and promoting the sale of the goods through some 1,400 of its own stores.

It is in this integration of the marketing tasks that some of the principal opportunities for economy in distribution are to be found. When salesmen for a number of competing wholesalers are calling on small retail outlets throughout a territory, each crossing and recrossing the other's tracks, and many of them taking small orders from the same concerns, there is obvious lost motion and waste of man power. Contrast this situation with that of a chain: the store managers draw all their merchandise from a single source; the quantities delivered at a single time are substantial; the tasks of ordering goods, supervising stocks, checking displays, and so on, are regularized to reduce lost motion to a minimum; supervisors, superintendents, and traveling auditors have their appointed tasks; and all goes forward according to routine. It is principally because these dual functions of the wholesaler and the retailer can be accomplished at lower costs when combined in a single organization that chain stores can sell at lower prices, even after the difference in services rendered, such as credit and delivery, is taken into account.

To illustrate, the following figures, based principally on reports of the Census of American Business: 1933, ${ }^{8}$ show that consumers can realize a saving of approximately 15 cents out of the sales dollar by patronizing chain drug stores rather than independent drug stores.

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## Consumer Saving by Chain Distribution in the Drug Field

 $\$ 1.00$| 54 cents <br> Manufacturer <br> Costs, Selling Expense, and Profit | 12 cents <br> Whole- <br> saler <br> Expenses <br> \& Profit | 34 cents <br> Independent Retailer Expenses and Profit |
| :---: | :---: | :---: |



The calculations in round figures on which the above diagrams are based are as follows:

Subtract \begin{tabular}{lll}
32 cents

$\quad$

\$I.00

 

Consumer's dollar spent at independent retail drug store <br>
Expense of operating independent drug store ${ }^{9}$
\end{tabular}

Assuming that chain buys same product from manufacturer at same price:
Add

| $\$ .54$ | Cost of goods to chain <br> .31 |
| ---: | :--- |
| $\$ .85$ Chain's price to consumer ${ }^{14}$ Chaind profit of chain ${ }^{18}$ |  |

afford more reliable figures for selected samples in particular years, but figures from these sources for all three types of distributors, namely, wholesale druggists, independent retail druggists, and chain drug stores, are not available for any one recent year. The comparison here shown also is likely to be somewhat more conservative, that is, less favorable to chains, because of the probability that errors in the Census data tend to cause understatement of the independent retailer's expenses.
${ }^{\circ}$ Total operating expense for independent drug stores in $1933=\$ 31.80$ per $\$ 100$ of sales. See U. S. Bureau of the Census, Census of Americin Business: 1933, Retail Distribution: Drug Retailing (May, 1935) 9.
${ }^{10}$ Estimate of $2 \%$ profit based on several private surveys.
${ }^{11}$ Total expenses of wholesalers of drugs and drug suadries in $1933=17.3 \%$ of sales. See U. S.

These figures show that in situations where chains buy directly from manufacturers and combine the wholesale and retail functions under one overhead it is possible for a substantial saving to be effected. This illustration, furthermore, does not take into account the probable saving in selling expense which the manufacturer may realize through dealing directly with a large chain. That the theoretical saving arrived at by the above calculations is in no sense an exaggeration is attested by such studies as that described in the final report of the Federal Trade Commission on the Chain-Store Investigation, in which it is stated with reference to retail drug prices that "the geometric average of chain and independent prices, when weighted by chain and when weighted by independent volume, indicates that the prices of independents are from 14.527 percent (Detroit) to 22.72 percent (Washington) higher than those of the chains in the four cities studied by the Commission. . . ."15

Integration of functions rather than large buying power is the principal source of chain store economies. The fact that the wholesale function when combined with the retailing job can be performed at a much lower cost is definitely indicated by the findings of the Census of American Business: 1933, again relating to the drug trade. The costs of operating the central office and warehouses of chain drug companies were stated to be $\$ 3.30$ per $\$ 100$ of sales, ${ }^{16}$ whereas the operating costs of wholesale institutions handling drugs and drug sundries were found to be $\$ 17.30$ per $\$ 100$ of sales. ${ }^{17}$

A broadly similar line of reasoning applies to advertising allowances. The closely knit organization of a chain not infrequently can accomplish certain parts of the sales promotion function more economically than can a manufacturer. It has long been recognized that consumer advertising loses greatly in effectiveness unless it is supplemented by advertising, display, and promotion at the point of sale. Hence many manufacturers make large expenditures for dealer helps, displays, circulars,

[^4][^5]window-trims, and so on. When such efforts are applied to a large number of independent retailers, however, there is much lost motion; and it was early discovered that a chain can utilize its own supervisory and promotional organization, its advertising copy, hand bills, displays, window-trims, bulletins to managers, and so on, to accomplish the same results more effectively and at a lower cost than a manufacturer could do it for himself. Recognition of this fact has led some manufacturers to relinquish part of their promotional functions to chains, a price differential naturally resulting. In other words, in the case of chains and some other large-scale retailers there clearly exists an economic basis for bona fide advertising allowances. (This is not to assert, of course, that all advertising allowances are bona fide in character.)

Some shifting of functions also has occurred with respect to brokerage. The broker's task is a genuine marketing function, that of establishing contact between buyers and sellers. In some lines of business, textiles, for instance, the brokerage function commonly is performed by independent concerns having no regular or permanent affiliations either with buyers or with sellers. In other fields, notably the food trades, the broker is essentially a manufacturer's sales representative having close relationships with a number of manufacturers whom he serves by finding customers. In these same trades the opposite situation also is to be observed, where the brokerage function is integrated with the buying side, the broker's job then being that of seeking out prospective sellers. Since the brokerage function per se is that of arranging contacts between buyers and sellers, there is no essential reason why a broker who is part of a chain grocery store organization does not perform as typical a brokerage function when he establishes contacts with canners who have a certain grade of fancy canned corn available for delivery as some other broker regularly retained by these canners might perform in seeking out chains which were in the market for that particular commodity. ${ }^{18}$ Under such circumstances there is

[^6]nothing inappropriate in compensation paid by a seller to a broker who is a subsidiary of the buyer. (Again the caveat must be entered that this explanation by no means guarantees the bona fide character of all brokerage allowances.)

The sum and substance of the matter is that under the stress of competition a majority of the marketing functions are susceptible of being shifted; there are scarcely any of them which can be regarded as the inalienable property of any particular marketing institution. Hence any purely institutional view of the marketing scene is woefully inadequate. Rather than looking simply at institutions, one must look to see where the functions are performed; and of course the costs go broadly with the functions.

In all this shifting and realignment of marketing functions and the consequent changes in the attributes and character of institutions, many manufacturers inevitably find themselves with a problem of scrambled distribution. Their goods move through a variety of channels, and there may be little uniformity among the several patterns of distributive functions performed. For part of his output a manufacturer may carry on an extensive group of marketing functions; for another part only a limited group. The Goodyear Company, for instance, sold its own brands of tires to selected independent tire dealers throughout the United States. It laid down the specifications, designed the products, advertised them extensively, employed a large force of salesmen to call on retail dealers, maintained wholesale branches at which stocks were carried for immediate deliveries, and undertook a broad program of dealer assistance. These tires were one part of its output; but there was another part, the tires sold on contract to Sears Roebuck. For these, Sears laid down the specifications, owned the brand, did all the advertising, assumed responsibility for the quality, and performed the handling functions through its own warehousing, mail-order, and store organization. The price differentials in this case, therefore, were related to differences in functions far more than they were to differences in quantities.

Some commentators, viewing these scrambled distribution situations, have been inclined to ascribe them to a mania for volume sales on the part of both manufacturers and distributors and have suggested that a wise manufacturer would in general adhere to one fixed pattern of distribution and thereby avoid complications. This clearly is too static a view. It overlooks changes in conditions affecting distribution, the rise of new institutions, and the continual search under competitive pressure to find more economical groupings of functions, all this taking place against a background of distribution costs that are advancing inevitably in response to the evolution of the industrial and social system. A manufacturer, as a practical

[^7]matter, frequently is forced to straddle. Perhaps most of his merchandise still goes through wholesalers and small independent retailers, but in view of the increasing importance of chains he will cut himself off from too large a part of his consumer market if he does not sell some of his goods through them; and, looking to the future, he does not dare place sole reliance on a single channel of distribution which may conceivably dwindle and dry up.

Among the earliest straddles of this type were those made by manufacturers who decided to sell part of their output directly to retailers while continuing to sell the rest of it through wholesalers. The trade discount was the characteristic pricing device used to meet the requirements of this situation. The trade, or functional, discount is a percentage reduction from a list price offered to a particular classification of customers and differing from the percentage reduction granted to some other classification of customers. For instance, if the list price is the suggested resale price to consumers, a discount of $331 / 3 \%$ may be accorded to retailers making direct purchases and a discount of $331 / 3 \%$ less an additional $20 \%$ may be given to wholesalers. Trade discounts have no direct relation to the quantities involved; at times, for instance, a wholesaler may place fill-in orders no larger than those typically received by the manufacturer from retailers, but the wholesaler is nevertheless "protected" by the trade discount. This pricing device has proved most useful in selecting customers and shaping distribution policies.

The relation of trade discounts to costs is not a simple one. When wholesalers are accorded a trade discount of $20 \%$ of their selling prices to retailers, the implication is that a $20 \%$ margin is sufficient to cover the operating costs of the wholesalers and leave a net profit. This is an average mark-up which the wholesaler seeks to obtain from as many manufacturers as possible, and in a competitive situation manufacturers who are seeking the services of this wholesaler to handle their products are almost certain to be more strongly influenced in naming a rate of trade discount by the general requirements of that particular class of wholesaler than by the substantially less tangible estimates of what it would cost them to do the same work. This will surely be the case when, as often, the wholesaler, already carrying a wide line of products, is in a stronger bargaining position than the manufacturer, seeking outlets for his single line of merchandise.

Or consider the case of a shoe manufacturer who, following the usual practice in the shoe trade, sells direct to, retailers and who wishes, for the sake of more complete market coverage, to sell both to independent retailers and to department stores. The department store is a different type of retail institution from the independent shoe store, with a different organization, different methods of doing business, and con. sequently a different cost of operation, a higher cost, as it happens. Therefore the department store expects a higher trade discount, even though in the particular instance the shoe manufacturer sends the same salesmen to call with about the same frequency on both department stores and independent shoe stores. Thus a trade
discount is a functional discount because it takes cognizance primarily of the costs of the functions performed by the particular class of distributors to whom it is given. The connection is closer with the costs of the buyer than with the costs of the seller.

In regard to the seller's situation, the trade discount is at best only a broadly generalized reflection of costs. In the individual instance, if a retailer and a wholesaler should each place an order at the same time with a manufacturer for a carload of the same product, consequent upon a single call by a salesman, it would be difficult indeed to detect any difference in the manufacturer's costs with respect to the two orders. Over a period of time, however, it certainly would cost the manufacturer more to sell to retailers than to sell to wholesalers. He would have to carry larger stocks, send out a greatly augmented salesforce to make more frequent calls on a much larger number of customers, give more dealer helps, ship in smaller quantities, possibly provide local distribution points, and so on. These additions to the manufacturer's marketing costs might be approximately the same as the wholesaler's costs; they might be less; or they might be more. A manufacturer of a single line of products of relatively low unit value commonly is at a serious disadvantage if he tries to do his own wholesaling over any extensive territory; his costs will be far greater than those of a wholesaler who is able to spread his costs, particularly his salesforce expense, over a large number of items. This is a common situation in the grocery, drug, and hardware businesses. Where the unit of sale is larger, or the manufacturer's line of products more extensive, no great disparity may exist between the costs of independent wholesalers and those of manufacturers' wholesale branches; and where, in addition to these conditions, specialized knowledge or technique is required, a manufacturer may be able to apply these to the performance of his own wholesale function with resulting lower costs than might be incurred by an independent wholesaler.

A trade discount, of course, does not merely cover the buyer's costs. Ordinarily there is some allowance for profit. How large this allowance shall be depends partly on the policy and needs of the seller. A manufacturer may desire to build up his distribution through certain trade channels and consequently may offer (indeed may find it necessary to offer) a large profit margin in his trade discount in order to induce these particular middlemen to handle his product. Similarly he may wish to make a large profit allowance to encourage distributors to devote more promotional efforts to his product. On the other hand, a manufacturer may be in the process of shifting his distribution channels and have a desire gradually to reduce the proportion of his goods going to a certain class of middlemen. Hence he may lower the trade discount accorded to this group.

Even if there could be shown a stronger thread of economic connection between trade discounts and sellers' costs, it is doubtful whether differences in these costs are of that tangible character envisaged by the Robinson-Patman Act as suitable justification for price differentials. A manufacturer selling part of his output to wholesalers,
part to chain stores, and part directly to independent retailers, and granting different trade discounts to each, presumably has different costs for each of these channels; but these are difficult to segregate and apportion. Sales to the chain stores may be made on an annual contract basis; and to arrange these contracts may require two weeks' time of one of the most important executives in the company. How much is the selling expense? Sales to the wholesalers and independent retailers may be made in part by the same force of salesmen, some of whom also may call occasionally on the individual stores of chains to check on the movement of the company's product. How is the salesforce pay roll and traveling expense to be allocated? Perhaps, in the future, distribution cost accounting will be improved to a point where better answers to these questions are possible; but in the past both the expense of such refinements in accounting and doubt as to the utility of the information for management purposes have been deterring factors. This constitutes an additional reason why trade discounts have exhibited a much more nearly traceable relation to buyers' costs than to sellers' costs.

The trade discount is an effective pricing device so long as a manufacturer is dealing with only two or three simple classifications of customers, each performing a substantially homogeneous group of marketing functions. But the extent of the shifts and realignments appearing in marketing functions and the consequent breakdown of many of the strictly institutional categories have created numerous situations in which segregation of customers into a few classifications for pricing purposes is not sufficient. There are too many different problems, too many different combinations of functions-perhaps for some manufacturers almost as many different combinations of functions as there are customers. Not even two large chains in the same line of business, for instance, necessarily perform the same distributive functions. One of them may receive all purchases of merchandise from manufacturers in large shipments at central warehouses where the merchandise is carried in stock for subsequent shipment to the stores; whereas the other may carry reserve stocks primarily at its stores and consequently require the manufacturer to make shipments in smaller quantities to the individual stores. Such differences in functions lead naturally to price differentials. Hence an important reason for the increase in socalled price discrimination in recent years is to be found in the difficulty of adjusting trade discount classifications to a manifold variety of combinations of marketing functions. Too many special situations have arisen which could not be fitted into a preconceived schedule of trade discounts. If in the future a manufacturer seeks to use trade discounts in place of the out-and-out varying price policy which is clearly banned by the Robinson-Patman Act, he presumably will find it desirable not to establish too elaborate a set of customer classifications, if there is any way by which it can be avoided.

But are trade discounts still permitted under the Act? This is a point on which there is difference of opinion. Trade or functional discounts are not specifically
mentioned in the Act. Therefore, some commentators have held that the situation with respect to such discounts is no different from what it was under the Clayton Act prior to the passage of the Robinson-Patman Act. Old Section 2 of the Clayton Act was silent on the matter of trade discounts. The Federal Trade Commission in the well-known case of the Mennen Company ${ }^{19}$ ordered the latter to "Cease and Desist from discriminating in net selling prices, by any method or device, between purchasers of the same grade, quality or quantity of commodities, upon the 'basis of a classification of its customers as 'jobbers,' 'wholesalers,' or 'retailers,' or any similar classification which relates to the customers' form of organization, business policy, business methods, or to the business of the customers' membership or shareholders, in any transaction in, or directly affecting interstate commerce, in the distribution of its products. . . ." If this order had been sustained, the practice of using trade discounts would have been ended as contrary to the provisions of the Clayton Act. The Circuit Court of Appeals of the New York District reversed the Commission's order in this case, ${ }^{20}$ but on different grounds, namely, that the practice of the Mennen Company was not unfair competition under the Clayton Act because it did not injure any competitor of the Mennen Company. The Supreme Court refused to review this decision. ${ }^{21}$ Later, however, the Supreme Court in another case ${ }^{22}$ essentially overruled the grounds of the lower court's decision in the Mennen case. In none of these decisions, however, did a court pass judgment on the specific contention of the Federal Trade Commission that trade discounts were outlawed under the Clayton Act. Therefore the use of such discounts has continued; and it is argued that the Robinson-Patman Act, since it omits any mention of trade discounts, does not alter the situation which has existed for so many years under the Clayton Act.

But there is one circumstance which casts doubt on this conclusion. The Robin-son-Patman Bill as reported out of the House Judiciary Committee included the following proviso:

Provided, That nothing herein contained shall prevent or require differentials as between purchasers depending solely upon whether they purchase for resale to wholesalers, to retailers, or to consumers, or for use in further manufacture; for the purpose of such classification of customers as wholesalers or jobbers or retailers the character of the selling of the purchaser and not the buying shall determine the classification, and any purchaser who, directly or indirectly, through a subsidiary or affliated concern or brokers, doés both a wholesale and retail business shall, irrespective of quantity purchased, be classified: (1) As a wholesaler on purchases for sale to retail dealers only, not owned or controlled, directly or indirectly, by the purchaser, and (2) As a retailer on purchases for sale to consumers.

The purpose of this proviso evidently was to permit trade discounts applying to wholesalers and jobbers, but to force chains to be classified as retailers (a thoroughly

[^8]unrealistic and unsound limitation, which reveals the animus behind the whole measure) and to establish a dual classification for concerns engaged both in wholesale and in retail business. In the Act as finally passed this proviso was dropped out entirely; and one plausible view of this omission is that Congress desired to take a stand similar to that of the Federal Trade Commission in its order on the Mennen case and close the door entirely to price differentials based on customer classifications (unless, of course, these price differentials were of such a character as not to fall under the express prohibitions of this section of the Act, i.e., not on commodities of like grade and quality; not in interstate commerce; not having the effect of substantially lessening competition, tending to create a monopoly, or injuring, destroying, or preventing competition with any person, etc.). It is of course possible that the courts in their interpretation of the Robinson-Patman Act will nevertheless "read in" permission to give trade discounts, but there seems to be little doubt that the sponsors of the measure desired to have this door closed.

If the door is closed to trade discounts as such, any price differentials as between different classes of customers, provided they fall within the purview of the Act, seemingly would have to be justified either on the basis of differences in the seller's costs or on the basis of lack of competition between the two types of customers concerned and the consequent impossibility of discrimination. As indicated in the foregoing discussion, the first of these bases is not very satisfactory, since trade or functional discounts are likely to bear so much closer relation to the buyer's costs than to the seller's costs; and in any event tangible differences are difficult to determine. The existence of competition or lack of competition is also an unsatisfactory criterion. In the first place there is the uncertainty of application. Who are competitors? Is there more, or less, competition between a retail clothing store in New York City and a retail clothing store in Philadelphia than between a wholesale grocer in New York and a retail grocer in the same city? Is a wholesale grocer in competition with a grocery chain, such as the Great Atlantic \& Pacific Tea Co., which performs both wholesale and retail functions? Is a retailer of one type who handles a very small quantity of a certain product as a side line in competition with a retailer of quite another type who specializes primarily in that commodity? ${ }^{23}$ And then there are all the situations in which a wholesaler carries on a small retail business, and those in which a retailer similarly engages in occasional wholesale transactions. Even more serious is the difficulty that in many instances a manufacturer, in order to cover his market, definitely wishes to sell to several different types of distributors who undeniably are in competition but who nevertheless perform different groups of functions and have different costs. A food manufacturer may

[^9]seek to sell not only to wholesalers but also to independent retail grocers, to chain grocery stores, to department stores, and to supermarkets. In a world in which the importance of distribution is increasing, and the shifts and changes in the grouping of marketing functions are continually producing new merchandising combinations, absence of competition is scarcely a satisfactory basis for price differentials designed to compensate for differences in distributive functions. In practice trade discounts fell far short of meeting the requirements of the situation; but even these seem to have come under the ban of the Robinson-Patman Act, unless the courts assume considerable leeway in interpretation.

So, even if there were no other grounds for dissent, the philosophy of the Robin-son-Patman Act is fundamentally incompatible with a realistic functional view of the marketing process. With no denial that there have been many abuses and cases of injustice in connection with pricing policies and practices, it is still true that the complex and dynamic character of the marketing process demands many price differentials of types condemned under the Act as discriminatory, unless, indeed, we are prepared to accept the idea that competition is an out-moded principle in marketing. But if this be not the case, and yet if the social situation is deemed to be such as to warrant some general law of this type remaining on the statute books, there at least should be some express provision for price differentials based on trade or functional classifications. It may well be that the concept of unfair competition ought to be broadened, but cost is not a workable criterion from the standpoint of either economics or marketing.

If the Robinson-Patman Act is not amended, or is not considerably modified in the process of court interpretation, and if it is rigorously enforced, there will be a tendency towards decline in the number and extent of price differentials, because of the difficulty encountered in justifying them on the basis of tangible differences in accounting costs. There will probably also be some tendency towards simplification of distribution channels, probably in two directions. In the functional changes that have been taking place in the marketing field it is possible to trace two general patterns. The first of these, "manufacturer merchandising," is the situation in which a manufacturer clearly takes the product responsibility; he does the designing, trademarks the goods, assumes the sales promotion task, exercises usually some choice over the selection of retail outlets, and probably maintains or suggests or at least advertises a resale price. The second pattern, "retailer merchandising," is the situation where a retailer takes the product responsibility; he determines what goods are to be offered; perhaps he designs them; he owns the trade-mark and undertakes the promotional task; possibly he buys the raw materials; he may even exercise virtual control over the manufacturer, or perhaps this year he contracts with one manufacturer to make the goods, next year with another. Under price control legislation of the Robinson-Patman type, changes in distribution channels are likely to result in these two patterns becoming more sharply defined. In some instances such a


[^0]:    - A.B., 1916, A.M., r920, Harvard University. Professor of Marketing and Director of the Division of Research, Graduate School of Bùsiness Administration, Harvard University. Author of Retail Method of Inventory (1925); Problems in Retailing (1926) (with D. K. David); Problems in Retail Distribution (1930) (with C. I. Gragg); Problems in Retail Store Management (193I) (with C. I. Gragg). Contributor to Harvard Business Review.
    ${ }^{1}$ This purpose is amply revealed by such statements as that of Representative Patman, speaking at the annual convention of the United Independent Grocers and Food Dealers Association in New York on April 11, 1937: "Chain stores are out. There is no place for chain stores in the American economic picture."

[^1]:    ${ }^{8}$ Cf. Grether, Solidarity in the Distributive Trades in Relation to the Control of Price Competition,

[^2]:    ${ }^{0}$ For instance, the U. S. Census for 1930 makes the following statement: "Stores are only a part of the activity of chains. . . . Chains combine in the one organization the function of wholesale and retail

[^3]:    distribution" U. S. Burenu of the Census, 15th Census, Census of Distribution, Retail Chains (1933) 8-9.
    ${ }^{7}$ Fed. Trade Comm'n, Chain Stores: Sources of Chain-Store Merchandise, Sen. Doc. No. 30, 72d Cong., Ist Sess. (1932) 15.
    ${ }^{8}$ U. S. Bureat of the Census, Census of American Business: 1933. It is recognized that the expense data in the Census are quite far from being fully satisfactory. There are other surveys which

[^4]:    Burenu of the Census, Census of American Business: i933, Final United States Summary of Wholesale Trade in 1933 (Nov., 1934), Table 2A, p. 8. If wholesaler's sales are 66 cents, $17.3 \%=11$ cents.
    ${ }^{19}$ Conservative estimate, based on common figure for net profit of $1.3 \%$ of sales (over and above interest on investment) for 129 firms in 1924. See Harvard Univ. Bureau of Business Research, Bull. No. 50, Operating Expenses in the Wholesale Drug Business in 1924 (1925).
    ${ }^{13}$ Costs for chain drug stores with fountains in $1933=\$ 32.06$ per \$ioo of sales. U. S. Bureau of the Census, op. cit. stipra note 9, at 9. Profit estimated at $4 \%$. (Net gain of 34 chains reporting to Harvard University Bureau of Business Research $=2.65 \%$ of sales in 1932. See Bureau Bull. No. 94, Chain Store Expenses and Profits: An Interim Report for 1932 (1934), Table 13, p. 20). Gross Margin (32\% + $4 \%$ ) $=36 \%$ of retail sales equivalent to $56.3 \%$ on cost. On a cost of 54 cents, this equals 30.5 cents.
    ${ }^{14}$ Final figures for the Census of 1935 are not as yet available in sufficient detail to permit a precisely. similar computation for the later year. A rough calculation of the same general type based on the Census figures for 1935 (in which an allowance for proprictor's salary is the chief element omitted), but using $4 \%$ of net sales as the estimated profit both of independent drug stores and of chains, indicates a chain selling price in 1935 of approximately 88 cents for goods sold through independent drug stores at $\$ \mathrm{r}$.

[^5]:    ${ }^{15}$ Federal Trade Comm'n, Chain Stores: Final Report on the Chain-Store Investigation, Sen. Doc. No. 4, 74th Cong., Ist Sess. (1935) 31.
    ${ }^{18}$ U. S. Bureau of the Census, Census of American Business: 1933, Retail Distribution: Drug Retailing (May, 1935) 13.
    ${ }^{17}$ U. S. Bureau of the Census, op. cit. supra note in, at 8.

[^6]:    ${ }^{18}$ A report in the New York Herald Tribune for April 16, 1937, of hearings before the Federal Trade Commission on charges that the Great Atlantic \& Pacific Tea Co. and six food packers had violated the Robinson-Patman Act, through special discounts and allowances in lieu of brokerage, described testimony in regard to the services rendered to sellers by A. \& P. buyers:
    "One of the witnesses examined yesterday was J. M. Zoller, field purchasing agent of the A. and P. Company, with headquarters at Baltimore. His purchases for the company, he testified, amounted to about $\$ 1,000,000$ a month, mostly in canned goods, on which formerly he received a brokerage averaging about 5 per cent. Mr. Zoller was a salaried employee of the A. and P.
    "When the Robinson-Patman Act became operative he ceased accepting the brokerage allowances, but, it is contended by the Federal Trade Commission, the A. and P. continued to benefit in allowance from sellers in the form of discounts, although they were held in escrow or in abeyance. Mr. Zoller testified that he ran his office as a brokerage office.
    "Another writness was Ralph Polk, head of the Polk Company, Haines City, Fla., growers and canners of grapefruit, from which the A. and P. has been a large buyer. Asked by Mr. Feldman [counsel for the Great Atlantic \& Pacific Tea Co.] to describe the different type[s] of brokers with whom his company did business, Mr. Polk said that [one] type was the broker 'with accounts more or less steady' and another, a broker who had no regular outlet or supply.
    "'He is a go-between between producer and buyer,' said Mr. Polk. 'I have heard a broker say he didn't know whom he represented. But he has a very legitimate place in the business.'
    "A question by Mr. Feldman that met strenuous objection from commission counsel was: 'Are the

[^7]:    services rendered by Mr. Zoller the same as rendered by independent brokers?" Mr. Polk was not permitted to answer this question.
    " As a matter of sound merchandising policy, was the value in dollars and cents of the services rendered by Mr. Zoller the same as that of independent brokers?' Mr. Feidman asked.
    "'Yes,' replied Mr. Polk."

[^8]:    ${ }^{19}$ F. T. C. Docket No. $606 . \quad{ }^{20}$ Mennen Co. v. F. T. C., 288 Fed. 774 (C. C. A. 2d, 1923).
    ${ }^{3}$ Id., cert. denied, 262 U. S. 759 (1923).
    ${ }^{28}$ Geo. Van Camp \& Sons Co. v. American Can Co., 278 U. S. 245 (1929).

[^9]:    $\$$ The length to which it is possible to go in pursuit of the idea of protecting competition (really meaning thereby the protection of competitors) is illustrated by the measures proposed from time to time in state legislatures to forbid drug stores, department stores, and variety stores to operate luncheonettes. A temporary high water mark in proposals of this general type is represented by the bill introduced into the New York legislature last year providing that the handling of each classification of merchandise in a retail establishment be conducted as a wholly separate business, with a separate entrance from the street.

