"PAYMENT": THE FIFTH "P" OF MARKETING MANAGEMENT

Farrokh Safavi, Western Washington University

After publication of McCarthy's acclaimed text of Basic Marketing: A Managerial Approach, the acronym "Four P's" was popularized as a general framework for marketing management analysis. All controllable factors of marketing management were effectively grouped into the four strategic processes of Product, Place, Promotion, and Price. Consumer credit was classified as a part of pricing strategy, since it was a facilitating factor in market transactions and since its cost had been reflected in the price of the product. Since interest rates in the 1960s were generally low, consumer financing did not play a significant role in consumer marketing.

In the late 1970s, however, soaring interest rates severely dampened demand for housing and durable goods. Manipulation of the classical "4 P's" was no longer effective in maintaining the past level of demand for some product categories. It was not until recently that innovations in consumer financing such as Easy Credit Plans (ECP) and Differentiated Payment Plan (DDP) by General Motors Acceptance Corporation (GMAC) and Sears significantly enhanced sales. When GMAC reduced financing charges on all GM cars from an average 18.5% to 13.8% Annual Percentage Rate (APR) on July 28, 1981, sales of GM cars increased in the following two months by 300% in California and by 210% in Washington State over the same period in 1980. On October 19, 1981, GMAC introduced a DPP whereby some models could be financed at 12.9% APR. That strategy increased sales of those models by 25% in California and Washington. Sears reported the same success with its DPP in favor of home fixture products where the 12% APR was charged in contrast to 18% APR for all other merchandise.

The term "payment" (short for payment plan) deals with consumer credit from the point of view of cash-deficient consumers. An Easy Payment Plan (EPP) is low-cost consumer credit which is tailored to buyers' preferences for down payment and pay-back period. EPP usually implies that a portion of the credit cost to customers is absorbed by the firm.

To the credit buyer, the cost of the Payment Plan is a function of price, the down payment, interest rate, payback period, and risk (credit rating of the buyer). The cost of the Payment Plan may thus be written as:

$$P_p = \sum_{j=1}^{N} (LB)_j * i$$

where:

Pp = cost of the payment plan to credit buyers

LB = Loan balance at the end of the jth period. The initial loan is equal to (P-D) where P is the product price and D is the down-payment.

i = interest rate on the loan, assumed to be the yield on 91-day

treasury bills plus a risk premium to credit buyers.

j = number of payments.

To the firm, however, the gross cost of financing credit sales would amount to the interest (or finance charges) which it pays to financial institutions for maintaining a target level of customers' accounts receivable. The gross cost of financing is in turn a function of the loan size and interest rate charged to the firm.

Once the firm has determined the utility of absorbing a portion of credit financing over other sales-oriented marketing strategies like price cutting, enhanced promotion, elaborate customer and product services, etc., it can decide on the magnitude of net credit cost which it is willing to undertake. At this time it would be possible to design various payment plans with fixed finance charges, but different magnitudes of relevant variables (down payment, interest, payback period, and risk).

GMAC management asserts that their innovative payment plans have been more effective than all price rebates that GM has been giving for the past ten years. Surveys of consumer opinions which have been conducted by the author every spring in Whatcom County, Washington, have revealed a steady growth in the purchase of those durable goods which are marketed with EPP. In the 1981 survey, 36% of the households who made the negative response to the test products changed their position to a definite purchase when possibility of EPP was offered. The corresponding percentage in the 1975 survey was only 14. It appears that at the present time of economic slowdown, marketing managers can manipulate the four elements of Payment (downpayment, interest rate, payback period, and the buyer's risk) more successfully to increase sales than the classical "4 P's" of marketing management.

REFERENCES

Fisk, George and Bertam W. Zumeta, "Financing," in S. N. Britt (ed.) Marketing Managers Handbook, Chicago; The Dartnell Corporation, 1973, pp. 917-928.

Hayes, Rick S. (1979), Credit and Collections: A Practical Guide, Boston: CBI Publishing Co. Inc.

Jaffee, Dwight M., Credit Rationing and the Commercial Loan Market: An Economic Study of the Structure of the Commercial Loan Market, New York: John Wiley & Sons, Inc., 1971, pp. 15-68.

McCarthy, E. Jerome (1960, 1981), Basic Marketing: A Managerial Approach, Homewood, Illinois: Roehard D. Irwin, Inc., pp. 42-46.

Mises, Ludwig Von, Ludwig Von Mises on the Manipulation of Money and Credit, Dobbs Ferry, New York: Free Market Books, 1978, pp. 215-226.

Paris, Alexander P. The Coming Credit Collapse: An Update for the 1980s, Westport, Connecticut: Arlington House Publishers, 1980, pp. 147-173.

(The remainder of references are in the text.)