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Comments on "The Economics of Markets: A Simple Model of the Market-making Process"

Using a simple two-trader model which considers the market-making process in an endogenous manner, Gould (this issue) attempts to answer questions such as: (1) Who will undertake the activity of market making; that is, who will take the initiative in getting individuals together for trade? (2) Which markets will come into existence and which markets will fail to emerge? (3) What determines the nature and characteristics of various markets? (4) What is meant by the "extent" of the market? (5) What determines the use of brokers and middlemen in the making of markets? (6) What role do resale price maintenance and exclusive sales franchises play in market making?

While all six questions are of interest to marketers, questions 3, 5, and 6 are of particular interest in terms of marketing decision making. In this paper, Gould primarily concentrates on answering questions 1, 4, 5, and 6.

From the viewpoint of a marketing researcher, what is striking about this paper is the simplicity of the basic model and scenario. For example, only two traders are considered in the analysis. This approach is in marked contrast to many model-building approaches in marketing, where several relationships are specified between sales and the various marketing-mix variables such as price, advertising, and distribution. The specified relationships are then estimated using a combination of econometric techniques and managerial judgment (see Little [1975] for a typical example). What Gould's paper demonstrates is that a very simple model can lead to a rich set of implications.

Many of the paper's interesting implications flow from an analysis of figure 7. In Section VI of his paper, Gould shows how some well-accepted results in economics need not necessarily follow if one considers the cost of market making in the analysis. For example, monopoly under certain cases could increase output. Or, minimum-wage laws need not always increase unemployment. The analysis,

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however, depends heavily on where g_A, the gain to trader A, is located on the X-axis of figure 7. Different implications follow depending upon the location of g_A relative to g_1, g_2, g_3, g_4, and g_5. However, the paper does not provide us with much insight on the conditions under which g_A will be, for example, between g_2 and g_3 or between g_4 and g_5. This is clearly an area for further research.

Basically, however, Gould's paper provides a theoretical framework for many of the strategies already being practiced by marketing managers. To illustrate, consider two important aspects of Gould's model: (1) the magnitude of the gains to a firm in making markets, and (2) the efficiency with which firms spend their resources (which affects their likelihood of finding appropriate traders). What do marketers do when the gains to the firm are high? In the context of a new product introduction, this means that the firm believes that it has a superior product. In such a case, the firm will advertise a lot, will offer the product at deal prices in the introductory period, and will provide many free samples (see, e.g., Parfitt and Collins 1968). The basic idea underlying these actions is to persuade the consumer to try the product. If it is indeed a superior product, the consumer will like it after trying it and will become a repeat purchaser (similar ideas underlie the work of Nelson [1974]).

Similarly, what do marketers do regarding the efficient use of their resources? They target their marketing efforts to specific consumer segments that are most likely to buy their product (see Frank, Massy, and Wind [1972] for a general overview of market segmentation). This involves the definition of the specific segments, identification of the demographic characteristics of the segments (see Blattberg et al. [1978] for an example), and the design of specific products and advertising copy for each of the target segments (see Haley [1968] for a discussion). Finally, to increase the efficiency of their resource expenditures, marketers are careful in their choice of advertising media. The media are chosen to best deliver the advertising message to the target segments (see Little and Lodish [1969] for an example of a sophisticated media-selection model).

Overall, the paper provides a very useful framework for understanding existing marketing practices (e.g., the suggested explanation for the existence of brokers and middlemen in Section VIII of the paper) and for the optimal allocation of marketing resources. This framework will be even more useful once we understand more about the factors that determine the specific values of the model's parameters.

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