

The Structural Problems of Pricing Approach in Hungary

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SUMMARY

This paper examines the two main problematic fields of Hungarian pricing approach with respect to the change of the national base of knowledge: as economic- legal system regarding the formation of price-information on the cost-side is not equivalent of the market economy's system in many respects. The second problem is that Hungarian ownership companies have considerable methodological lags in the field of profitability qualification of prices formed on the market, and in the field of estimation of product-profitability driven from price-information.

MAIN CHARACTERISTICS OF THE HUNGARIAN MARKET ECONOMY KNOWLEDGE

At the time of the change of regime Hungary belonged to the firsts regarding the existing market economy knowledge owing to the two decades long indirect economic control system. Although from the point of view of a quick close up it did not seem to be enough. The main inducement of the market economy is the capital, and their main scene of organization is the market, but *exactly the basic practical knowledge concerning the real capital and real market were missing from the national base of knowledge.*

In the developed countries the market economy knowledge has *become a deep social knowledge as an effect of a many decades long experience.* (Their lawn is beautiful because they have cut the grass for a hundred years - says the saying of the Hungarian economists.) This knowledge has been formed along with the validity of the market regulations, which are technically carefully worked out and are finally adjusted to the actual level of advancement, and is built on the wide knowledge of coherence generating changes. The actual rules and regulations are not an analogous adaptation of some objective range of criteria; it has been formed by a kind of public will – *with differences based on the countries and depending on the national culture.* (That is another question, that nowadays we can witness a unifying tendency of the main rules as a consequence of the interactive coherence of globalization. The gradual unification of rules within the European Union can be *considered a natural part of development.*)

To exploit the short-term potential advantages of the change of the economic system there would have been need for valid market economy knowledge, mainly for capital and market operational knowledge both on micro- and macro-level. Although the learning, which aim was to compensate for the lack, took place on many levels and in many forms with big efforts and considerable foreign help, a deep social knowledge did not emerge from one day to another. The learning process, which was affected by different shock events, was decelerated by a relative slowness and uncertainty of the economic-legal regulation needed for the fine adjustment of the operation and by the lack of the law-supporting behavior of the economic actors. The Hungarian economy needs some improvement to designate as a real market economy.

The related company level of knowledge can be considered diversified even today. The main task of the Hungarian owned companies was a basic change of approach and methodology, but the working capital flowing in from the high developed countries brought with the practical knowledge of market economies. For these latest the ruling system of the Union is also known along with the deep knowledge of modern economic management. After joining the EU it will be new for some companies that their behavior set to the characteristics of the transitional economy must be substituted by an attitude set to the features of the Union. Probably it will need some time. The enforcement of a law-supporting behavior assumes, for example, a further development. Today the foreign and mixed ownership companies - along with the national companies - also excel in negligence of some national laws. A typical example: although law regulates that companies are bound to deposit their balance sheet at the Court of Registration, many companies ignore this regulation even

today. Thereby, law-supporting companies may get into competitive disadvantage against their competitors, who can keep their secrets successfully.

After joining the EU, the quality of the competitive environment also changes, which may bring new conditions mainly for the institutions and professional experts (for example practicing economic lawyers) of the macro economy and for the national small- and medium sized enterprises.

A considerable improvement of knowledge would be required in the field of operating and managing local public services, which operate together with the competitive sphere. We have less disadvantages concerning the demonopolization of the separable business shares of the non-local natural monopolies ('linear' companies), since we learn it partly together with the developed market economies. However, to compensate for Hungarian disadvantageous base of knowledge, a stronger research and analyzing preparedness is needed.

DIRECTIONS FOR PRODUCT COSTING

There are two main characteristics of the directions regarding product costing of the competitive sphere:

A, companies can make a decision regarding a band of costs, whether to rank it as direct or indirect in the official statements,

B, the obligation for product costing extends to the level of direct costs.

Both characteristics emerged in the eighties.

The strictly terminated category of direct costs was modified in connection with the introduction of the price-reform in 1980 – as to improve “the authenticity of costs”-, and the possibility of accounting the “extended” direct cost was introduced. According to this, beyond the traditional direct costs (direct material costs, direct wages costs and its contributions, production and sales extra costs¹), machinery costs and within costs of depreciation could be considered among the other direct costs depending on the decision of the company. (All the costs of a one-product factory could be accounted among the direct costs.)

It is worth mentioning, that in the rating possibilities of the cost of depreciation a complete change happened in two steps within a short time. This characterizes partly

the quality and depth of the collective professional knowledge, and partly the change of power of certain professional groups. The sum of the change: the pattern of extending possibilities of direct costs had been changed since 1985. They were working from the principle that the cost of depreciation is essentially fixed cost because of the crucial importance of the time-proportionate depreciation systems, so it does not change according to the change of volume, so this element was taken out from the elements of “extended” direct costs. (Companies, which had chosen the extension earlier, had to put back the cost of depreciation to the factory overhead costs.) It can be easily seen that the conformation to the change of the volume had theoretically improved with this modification, but on the other side the authenticity of costs had injured, that is the information how much the product really costs. This step shows, that the decision-makers did not unequivocally know the connection, that a legally specified cost-accounting version in its given form cannot become an information-carrier suitable for all purposes. Since 1988 the establishment of the possibility of cost-authenticity had been emphasized again. Factory depreciation was put back to the items accounted among the direct costs (and a cost version, which is less expressive regarding the change of volume, was restored again.)

Until 1984 costing to be made for the total costs - along with a considerable simplification of the appropriation of operational costs made meanwhile, and the above mentioned extension possibilities of the direct costs. The effects of appropriation of indirect costs based on the known scheme kept back the advantages of volume-increase and distorted the rates of net costs; therefore it had an unfavorable influence on decision making of the companies. This recognition led to a specific step. The solution was not seen in the refining of the method, but in the elimination. As a consequence, a crucial change happened in the compulsory documented cost-informational system. Since 1985 costing have to be made only until the level of direct costs according to the main rule of accounting regarding the competitive sphere. The widespread application in the world of market economies was mentioned as the main reason of the introduction of the method.

We can state in the mirror of literature that the main argument could feed from quite odd information. It can be surprising, but the direct costing² started to diffuse in the United States only from the end of the seventies and

¹ *Later as a consequence of the calculation making obligation reduced to the level of direct costs and the reduction of functions officially set to the direct costs to one function (supply data for the evaluation of production) the extra costs of sale was taken out from the direct costing scheme.*

² *Direct costing is a cost accounting method, according to which only direct or variable costs are charged for the product. Other costs are accounted directly against the revenues. Publications about the system saw the light first in the United States in the thirties. It has given rise to much controversy ever since. Even its name is controversial. Direct costing means literally direct cost-calculation. The method – originally and theoretically - does not charge the direct, but the variable costs for the products. Even so the practice and many pieces of literature tell about only the charging of direct costs. Some American authors – expressing their displeasures regarding this “degeneration”- try to eliminate even the expression from their vocabulary. They talk about alone the conception of variable and marginal cost calculations, and direct costing is only mentioned in brackets – as a terminological slip. In connection with the application of direct costing the question is whether fixed costs are costs of the product, and whether it is important to know, how much of it charges each of the products. Those understanding the method emphasize that without fixed costs*

(precisely its content) production would be impossible. Differentiation of the two costs is needed in order to become clear what kind of (and how much) costs are changing along with the volume. A number of experts emphasize the important role of the method, which it plays in the economic philosophy.

mainly as a component of the information basis made only for inner use of the companies, and not in the cost accounting systems made for official purpose³. In market economies the average cost as accurately documented information can be very important mainly from competition supervising aspect. (Decisions can be made based on this, whether our rival produces as cheaply as the price of its product shows, or any market disruption can be assumed.) Therewith it can be considered as very important documented information from the aspect of *tax control and the arrest of illegal income re-arranging activities* of enterprises belonging to the same orbit.

In some cases literature overemphasizes the characteristic of the average cost according to which it contains elements of fixed costs. Of course it cannot be arguable, that – containing a part of incurring fixed costs per unit of production - *the total net cost is inappropriate to determine the additional cost emerged from the additional volume or to estimate the additional profit.* This is only a characteristic, which restricts the application possibilities of the indicator. Taking into consideration that a universal product cost category cannot be constructed, every product cost category could be eliminated because of any kind of information-carrier feature. These disadvantages actually do not lower the value of the indicator, only estimate the effort, which wished to use a cost category containing fixed costs at the quantity determination of the effects of additional volume.

It is also not practical to identify the traditional total cost-accounting practice (which has significant information-distortional effects) with the total cost-accounting. On one hand *the method of total cost-accounting fitting into the system of accountancy can be refined (this is shown by the method of activity based costing), and on the other hand companies can work out estimating methods carrying good informational quality also for the total costs for their own purpose and set to their private characteristics.*

It is useful to see it clearly, if costs based on direct costing become the only cost-information of the product and the company does not change to the “extended” direct costing, it is a case of the blind leading the blind. The bigger the standard of mechanization, the more the material costs become the dominant element of direct costs, and the less the information can be driven from the accounting system, how much the given product really costs. Because of this characteristic of the state-dictated system, a part of the Hungarian ownership companies quantity-determinate the traditional total costs – for want of something better - for their own purpose.

From the literature the conclusion can be drawn, that in the developed market economies the required compulsory record system regarding the product cost usually embraces a wider category that the category of direct

costs. Meanwhile in some countries the different official bodies release different costing and recording recommendations. The information got so far from the literature is very random and heterogeneous. *Expedient and systematic researches should be made towards a stable close up in knowledge in a way to find out what kind of costing and recording requirements are prescribed in general and for the different company groups and what kind of recommendations are released in the developed market economies; and knowing these, it should be surveyed what kind of advantages could the differences from the Hungarian regulation assure from the aspect of acquaintance of the companies and the regulating and inspectoral bodies.*

PRICE THAT MIGHT PERFORM PAY BACK REQUIERMENTS

It is an understood thing, that purchase prices and sales prices have defining importance in companies’ lives. Deep knowledge of their details and developing them into the right direction are essential fundamentals of companies’ proper operation. Today, it is clear for every counterpart of the competitive market, compared to the reversed view of our former barrier supply conception, that marketability is dependant on the price, set to the conditions and approach of the market, and that well-stated prices are also needed in order to “produce income”. The company-specified method about maintaining market requirements in a systematic, price-based way developed in a comparatively short period of time. *Although, we can find remarkable disadvantages when looking at the suitability of prices regarding the producer side’s qualification of pay back requirements.*

In order to make good decisions we should create product cost information excels, that show relatively correct numbers of how performing pay back requirements at certain prices. This information *shows the limit of costs under the production of a given product would be profitable for a company.* This means a kind of price-information for the company, and is not equal to the offered price. *The offered price on which we offer our products for sale to the costumers – depending from the market conditions and the sales policy decisions – might be lower or higher than the price that might performs pay back requirements.*

The price that might perform pay back requirements can be calculated from the point of view of both the production start and change in the volume. Both calculations are easy in the case of a single product company. In the case of a multi product company, starting from considering the connections of using up resources, we can use different simplifying possibilities.⁴

³ Ralph S. Polimeni – Frank J. Fabozzi – Arthur H. Adelberg: *Cost Accounting. Concepts and Applications for Managerial Decision Making*. McGraw-Hill, Inc. 1986. (pages 62. and 493.)

⁴ *This subject is deeply elaborated: Mária Illés, “Vezetői gazdaságtan” (Kossuth Kiadó, 2002. Budapest) pp. 368-444.*

As practical experiments show, those companies with Hungarian ownership have a huge disadvantage regarding the application of this price information calculating method. The results of this kind of calculations in the developed market economies are rather kept in secret. Some price assessment, though, let us conclude to the fact that most companies, in order to be perspicacious enough, apply fine calculation methods, which take the companies' individual features into far-reaching consideration to *ground their decisions*.

Consequently, significant changes are needed in the field of calculating price information practices. These are even more required by the changing features in the conditions of the competition situation when the country's joining the EU. It is a fact, *that new Hungarian companies, who just entered the field of market economy, get comparatively few help of methodology while being under the pressure of conforming to the market. They get less help in respect of choosing the appropriate method to be the basis of calculating the price information from the point of view of pay back.*

The basic problem is that general methodology is so complex and every company has to simplify it to its own features. As above mentioned, the applicable methodological solutions differ in every case. There is no recipe for simplifying.

Those companies which operate in developed market economies will not provide us solutions as – according to their well known interest – they rather treat these results and calculations as secret, moreover, there is only a very narrow range of authorized persons inside the company structure, who have access to see them. This is another question that they give certain schemes for the price calculating to the authorized employees of price- and marketing departments. These schemes are mostly composed that they are able to mediate all the aspects of price policy, but even the applier of the method can not “roll back” to the given (and regularly variable) parameters to the level of price policy considerations. (In each case the lines can look enigmatic in themselves.) The defining of the offering price has definite product-specific features as well.

So, the “price calculating scheme” is usually a guide which includes price political considerations hidden in it.

MARKUP PRICING

The term pricing in itself refers to a calculating scheme where the seller defines the price of his product on the basis of this given scheme. For this procedure, usually pricing and cost accounting schemes and formulas are used. As mentioned before, in a case where the schemes are composed prudently it is hard to conclude back to a

company's price political considerations. Study materials often fill this gap with the scheme of markup pricing.

Markup pricing in the common language means a kind of price norm calculating which shows the needed sales price to be reached, first of all, in order to refund the costs of the product and the profit expectations. Markup rates are usually built up from profit expectations, or from the sum of certain costs and profit expectations.

Markup pricing can be regarded as an *ancient* method of price calculating in trade. The method, in principles, conforms to the rules of trade sector's features very well, follows the system where capital rate and profit acquisitiveness is perceived on the basis of capital precept by the more money is in capital, the biggest amount it ties up. A wide ranged method is to differentiate trade profit rates by groups of products.

In the literature are mostly mentioned trade companies as well as an example for the practical usage of markup pricing. In spite of this the general subscription of the method places it into the line of generally applicable methods. As a generally applicable method this will not stand out though. Its result will differ from the reality as both a supply price calculating method and as a bid price calculating scheme too. Moreover the markup price does not show the pay back requirements. From the point of view of profit calculating and profit layering capital is an active part, it moves according as to find the place where it can make bigger profit. The product's cost structure and equity requirement structure show big differences, except in trade sector. In the producing sector, for example, the regular markup pricing is widespread *and those passive material costs – from the viewpoint of the profit layering – deform the expected profit per product.* (The more material cost there is the biggest profit requirement burdens onto the product). *The profit rate, containing the coverage, can deform according to the specific work and technology used as well.*

As a calculating scheme of the supply price the method also mediates a kind of strictness and defines a price by not regarding the market conditions (moreover this price does not even reflect the return interests of the producer). If the calculated price is too high considering the market conditions, the product's opportunities for sale will decrease. *The literature in the developed market economies introduce the disadvantage of markup pricing that the method does not consider market conditions, but do not refer to the fact that it does not reflect the pay back requirements an appropriate way.*

Before the political transformation in Hungary, the background of this method developed in a very special conscious way. For example in 1988, a pricing expert by a company declared that he would always have gratitude to his acquaintance, who had had whispered him the “great secret” of price calculating. With this secret in

their pocket and adopting the company practice of his acquaintance, they now calculate their prices according to the 30 per cent rate of coverage to the direct cost, and as he saying this way it works very well. As is turned out from the previous discussion, the question of changing the markup rate did not even emerge, because of the possible differences in the costs of material or the state of mechanization. It is not hard to concede that this 30 per cent markup rate could have easily dragged the 'copiers' into a deficit beside a much more mechanized production process or products which need less material. (At that time, the market did not correct this kind of price enforcement besides its controlled price features and the period's conditions of reduced domestic range of supply.)

Although the literature of the markets attaches great importance to the suggestion of markup pricing, the deeper analysis and mainly, the practical prices point to use a totally different kind of price calculating by the production and service.

1. From the 1970's the gradual revival of foreign trade at home attracted attention to the analysis of the price of similar products in the economically highly developed countries, which resulted in some remarkable information. For example in the case of electric motors it was shown, that the prices of the Hungarian products (calculated with profit rate price) followed more steeply, the increase of capacity (and material costs) in the country to the products made by partners.
2. Also experience without any detailed analysis refers to the divergence of the projective basis and by any chance to the difference of theories as well. The wool industry gave example, when the tenuous yarn with same quality exported to the western markets was all bought up, but the traders got saddled with the thick ones. The reason could be the fact that in case of the Hungarian co., profit expectation was divided by the projective base including material costs, while its competitors applied some base not including them.

This one fact could explain that the Hungarian thin yarn, which contained less material, was qualified as an over-cheap product and the thick yarn containing extreme profit expectations because of the high material costs, as high-priced.

3. The fact that in the highly developed countries usually a regulate sum and a variable depending on the changing amount compose the bank charges of money-exchange, but unto these days, in this country, conversion is simply calculated as a percent of the exchanged sum of money, points to different attitudes as well.
4. We may gain some interesting experience with looking into the ice-cream prices as well. In 1986, Vienna, the prices and the clean-cur structure from them were the following.

Prices:

1 cone	= 7 ATS	(4+3)
2 cones	= 10 ATS	(4+3+3)
3 cones	= 13 ATS	(4+3+3+3) but these were in more cases offered for 12 ATS

On the other hand in Hungary just till these days the single price multiplied by the numbers of cones gives the total price of an ice-cream.

Of course these mentioned examples do not substitute the systematic research of the economical price relations. *The better cognition of actual calculating processed and pricing methods, the systematized exploration of profile-specific particularity could give a significant help by giving complement in gaps. Because of this ticklish theme, the direct exploration could be probably not bid fair to succeed. From the point of the scanned theme also the qualified group wouldn't be easy attainment. For all that, this way would be worth trying. From the nature of these, using the indirect methods (followed back from the recoverable profile-specific price-inherences) could also be effective.*

Összefoglaló

Az előadás magyarországi tudásbázis alakulásával összefüggésben tekinteni át az üzleti árszámítás két fő problémacsoportját. Egyrészt rávilágít, hogy a költségoldali árinformációk (és árkontroll információk) képzésére vonatkozó gazdasági-jogi szabályrendszer több tekintetben eltér a fejlett piacgazdaságokétól, másrészt rámutat, hogy a hazai tulajdonú cégeknek jelentős módszertani elmaradásaik vannak a piaci körülmények között kialakuló árak jövedelmezőségi szempontú minősítése, illetőleg az árinformációkból kiinduló termék-jövedelmezőség becslése terén.

Резюме

Статья описывает две группы проблем связанных с ценами бизнеса с венгерской базой знаний. С одной стороны показывает как информация цен (и контрольные информации цен) и их экономико-юридическое определение отличается от тех определений, которые действуют в странах с развитой рыночной экономикой. С другой

сторона показывает то, что предприятия, которые находятся в венгерской собственности имеют значительные недоработки по определению оценки качества доходности и по информации цен исходя из оценки доходности продукта (товара).