

A STUDY OF CONSIDERATIONS THAT PERMIT THE EXISTENCE
OF DISCOUNT HOUSE OPERATIONS IN VIEW OF
RESALE PRICE MAINTENANCE LAWS

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PREFACE

There are innumerable works on fair-trade legislation and discount house operations. Much research has been conducted by private and public organizations to determine the extent of discount house operations. However, very little information is available in one volume that shows the underlying factors which permit the coexistence of discounting operations and legislation prohibiting such operations.

This study is made on the basis of published material found in the Oklahoma State University and Oklahoma University libraries. The purpose of this study is to bring together information that reveals the combinations of forces responsible for the existence of a recent trend in retail distribution--the development of the discount house, in view of the history of resale-price maintenance legislation.

The following criteria were used in selecting the listed items among the hundreds of articles, pamphlets, and books written on retail discounting and resale-price maintenance legislation. (1) Standard college texts in marketing, retailing, and government regulation of business were omitted, since this information is usually of a general nature. (2) Long and well-documented articles were considered more useful than short reports lacking citations. (3) In general, well-grounded articles and journals received somewhat more attention than trade journals, and the latter were preferred to popular magazines. (4) A few important articles appearing in Retailing Daily, the newspaper serving the industries most directly affected by discount competition,

were included. (5) Recent materials have been emphasized, although some older sources are included because of their historical importance or contribution to the development of marketing thought. (6) An effort has been made to obtain citations from diverse sources representing different trades and industries.

Undoubtedly some worthwhile materials have been inadvertently omitted because of the broad range of the subject under consideration.

The writer is indebted to the staff members of the Department of Business Administration who have offered advice and encouragement during the preparation of this study. Indebtedness is acknowledged to Professor George Hill for his invaluable aid and suggestions given during the course of this study. His keen interest and generous grants of time are thankfully acknowledged. Special thanks is given to the writer's wife for her patient help and cooperation during the preparation and typing of this thesis.

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CHAPTER I

INTRODUCTION: THE PROBLEM AND ITS IMPORTANCE

The discount houses sell their merchandise at a discount regardless of the resale-price maintenance laws, which empower manufacturers with the right to establish the retail list price of their trade-marked products.

Need for the Study

Resale-Price Maintenance Laws, which were initially presumed to be desirable legislation from the social standpoint, are rapidly losing their force and effect in the United States. As is true of much legislation, the passage of time brings about changes in our society and economy that make inoperative or obsolete legislation previously considered desirable. Also, some legislation, although still desirable to society, fails to serve the intended purpose because of the lack of effectiveness in the enforcement machinery.

Resale price-cutting of price-maintained goods by discounters is one of the most prominent problems facing our distribution system today. This is evidenced by hundreds of articles on the subject in trade journals serving many different industries. Writers of marketing textbooks are recognizing the problem by the inclusion of general information on the subject in their works.

The writers of these texts and articles have divulged many different reasons for the continued existence of discounting of resale-price

maintained goods. Their reasons are usually based upon the legal and/or marketing considerations.

This study is a compilation of the considerations given in leading publications available in most college or university libraries.

Many students of marketing who have been only partially exposed to the subject of discounting and resale-price legislation are under the false impression that the breakdown of "fair-trade" laws is due to lack of enforcement. This, of course, is true to a certain extent in any legislation which operates imperfectly. However, there are underlying reasons why the enforcement of laws break down. One purpose of this study is to study and analyze considerations other than purely legal ones to suggest the reasons for the enforcement breakdown. This writer makes no claim for originality in these considerations. This is a compilation of the factors in the economy today of which most students of marketing are aware but fail to consider when expounding on the relative lack of enforcement of "fair-trade" laws.

Hypothesis and Basic Assumptions

Before a person can approach a problem of this nature, he must first pose an hypothesis that will be the possible solution to the problem itself. The hypothesis of this study is as follows: the breakdown of the resale-price maintenance laws is chiefly a result of the transition from a sellers' to a buyers' market.

This hypothesis, of course, requires the introduction of certain basic assumptions. One of these assumptions is that Newton's Law of Action and Reaction is a natural law that is applicable to marketing. This law applies when businessmen overestimate their markets and

demand slackens. A reaction sets in and prices are cut to move the products.

Another assumption is that when the consumer's disposable income increases, especially in conjunction with widely available supplies of goods and services, he ordinarily has more bargaining power in the market place.

Scope of the Study

This study is not concerned with mandatory resale-price legislation such as exists in some states on the resale of liquor. This study is concerned only with the permissive resale-price maintenance laws as originally passed by forty-five of the forty-eight states.

This study seeks to define the areas in which discount houses violate the resale-price maintenance laws and analyzes the factors which permit the continued operations of these "price-cutting" retailers.

Further along in this study, the writer has considered the history of the enactment of the so-called "fair-trade" laws; the nature of discount house operations; the enforcement of the price maintenance laws; and the marketing considerations which have been and are influential in enabling the discount houses to operate successfully.

Definition of Discount House

In practice, the terms "discount selling" and "discount house" embrace a wide variety of retail selling techniques, such as differential pricing, diversion of trade from conventional channels, and non-compliance with manufacturer-set-minimum prices, all of which have important implications for marketing strategy and economic analysis.

The latter, noncompliance with manufacturer-set-minimum prices, will be the definition adhered to in this study.

Procedure of the Study

The enactment of the resale-price maintenance laws has first been discussed in order to give the reader a better understanding of the road the laws traveled from their inception to reach their present position. No critical analysis of the laws has been undertaken because the writer has viewed this aspect as being primarily beyond the scope of the subject. The study of the enactment of the resale-price maintenance laws encompasses all important legislation and decisions from 1931 through 1952. In 1952 the McGuire Act, which was the last major enactment concerning these laws, was passed.

The subject of discount house operations has next been presented in order to bring out the inherent characteristics of such retail outlets which have placed the discounter in such an advantageous position today. An attempt is made to show that the discount house is a natural phenomenon, arising out of the structure of the laws themselves.

Next, the enforcement machinery which the manufacturer or wholesaler has at his disposal to enforce the price-maintenance laws has been presented. A thorough examination of the enforcement procedure has been proffered so the reader will realize that the law has provided the policing groups with means to enforce the laws if they so desire.

Following the legal procedure there is an analysis of our distribution system. The rise of the "common man" and other competitive considerations which have encouraged policing groups to be lax in enforcement are observed.

The writer has tried diligently in this study to show no bias toward any group interest. In keeping with this, the phrase "Resale-Price Maintenance Laws" was preferred to "Fair-Trade Laws" because the latter phrase has ethical implications. Furthermore, the terms "legitimate" or "illegitimate" dealers were avoided as much as possible and when any such controversial terms have been used they are placed in quotation marks.

CHAPTER II

RESALE-PRICE MAINTENANCE LAWS

Resale-price maintenance statutes were enacted in the decade before World War II to protect trade-mark owners, distributors, and the public against injurious and uneconomic practices in the distribution of articles of standard quality under a distinguished trade-mark brand or name.¹

An examination of the history of resale-price maintenance laws is necessary before an analysis can be made of the areas of violation.

History of the Enactment of Resale-Price Maintenance Laws

After 1900 the increased sale of specialty products with distinctive brands and trade-marks gave rise to efforts on the part of certain manufacturers to control the resale prices of their products. Since such products were often unique and distinctive, their manufacturers often were in a good position to control prices; and attempts were made in some cases to regulate and possibly maximize profits by establishing prices at the wholesale and retail levels.

Government agencies responsible for the enforcement of antitrust laws, however, declared that vertical agreements to maintain resale prices were an illegal restraint of trade.²

¹"Fair Trade Laws and Discount Selling," Harvard Law Review, Vol. 64, (June, 1951), p. 1327.

²Mund, Vernon A., Government and Business (2nd ed.), (New York: Harper, 1955), p. 462.

Some retailers soon found that they could increase their business volume by cutting prices on trade-marked brands. The manufacturers, feeling that this price-cutting would endanger the reputation of their brand names, soon started resale-price maintenance movements to prevent this. Small retailers took over the fight for price maintenance, however, as a weapon against the large chains and other "price-cutters."³

Measures that would legalize resale-price maintenance were introduced into each session of Congress between 1914 and the year of their adoption, 1937.

New Jersey enacted a law in 1916 permitting price maintenance "by notice," but the first really modern price-maintenance law was enacted in California in 1931. The 1931 California law and its 1933 amendment was promulgated in the drug and pharmaceutical associations of that state. As a result of the peculiar characteristics of the drug trade and of persistent and effective organizational pressure, it has had more experience under price-maintenance laws than any type of business. Hence, we must look to it for the main body of evidence concerning the nature and the consequences of resale-price regulations.⁴

The most successful area for resale-price maintenance has been in drugs. The consumer has little knowledge of drug and cosmetic products and hesitates to take chances on a product not backed by the brand of a leading pharmaceutical house. The demand for drugs is relatively inflexible, and price may not be so powerful as habit in guiding demand. In

³Seib, Charles B., "Fair Trade Faces Showdown," Nation's Business, Vol. 43, (March, 1955), pp. 34-37.

⁴Grether, E. T., Price Control Under Fair Trade Legislation, (New York, 1939), p. 83.

the drug field even the chain stores go along with the "fair-trading" of the leading trade-marked items. At the same time the drug chains feature their own lower-priced brands of drug products. The existence of powerful trade associations working closely with the trade press has been an added factor in maintaining the discipline of "fair-trade" pricing in drugs.⁵

No new developments immediately followed the passage of the price-maintenance law of 1931. The price-maintenance law of that year was not adhered to for the following reasons: (1) the inherent nature of the Act as a voluntary contractual statute providing no basis for control over noncontracting parties; (2) the impossibility of regulating noncontracting parties when prices were controlled only in California and goods were easily accessible outside the state; (3) the fact that the depression had not as yet moved into its most critical state, and there was the general belief that prosperity was in sight; (4) the concern of manufacturers with volume of sales rather than price stabilization in the retail market; and (5) the lack of concerted persistent efforts by retailers to exert pressure upon manufacturers and wholesalers to employ the act.⁶ It might be noted at this point that several of the same reasons given in that era for the ineffectiveness of resale-price maintenance laws are present today.

Prior to the passage of state and federal resale-price maintenance legislation, the courts permitted various practices that assisted in

⁵Kaplan, A. D. H., Small Business: Its Place and Problems, (New York, 1948), pp. 199-205.

⁶Grether, E. T., Price Control Under Fair Trade Legislation, (New York, 1939), p. 84.

maintaining retail prices. The actions that were allowed and often enabled manufacturers to control retail prices were:

1. Announcing recommended resale prices.
2. Announcing an intention to refuse to sell to dealers who do not follow suggested prices.
3. Refusal to deal with firms that have cut prices.
4. Using reasonable (not coercive) methods of collecting information about price-cutters and in working with them.
5. Employing a bona fide system of agency under which title does not pass to the buyers.⁷

In 1933, an amendment to the California price-maintenance law of 1931 carried the fight to legalize resale-price maintenance closer to victory. That amendment, upheld by the Supreme Court in 1936, read:

"Willfully and knowingly advertising, offering for sale or selling any commodity at less than the price stipulated in any contract entered into pursuant to the provision of Section I of the Act, whether the person so advertising, offering for sale, or selling is or is not a party to such contract, is unfair competition and is actionable at the suit of any person damaged thereby."⁸

This amendment, commonly known as the nonsigner clause, compelled third parties to comply with agreements between other retailers and their suppliers. In effect, one retailer could make an agreement that bound other retailers who might be opposed to the agreement; therefore, this agreement greatly simplified the problem that manufacturers faced in getting widespread compliance with their minimum retail prices.⁹ A total of fourteen states had adopted similar legislation by 1936.

Theories of Resale-Price Maintenance

There are many ideas concerning the appropriateness of resale-price

⁷Oxenfeldt, Alfred R., Industrial Pricing and Market Practices, (New York), pp. 422-429.

⁸Ibid., p. 424.

⁹Ibid., p. 425.

maintenance. All the views may be classed into two basic competing concepts. These may be designated as the monopoly theory and the good will theory. The former stresses the importance of price competition; the latter, the right of a trade-mark or brand-name owner to protect himself from unfair competition.

Mr. Justice Sutherland in the Old Dearborn Distilling Company versus Seagram Distillers Corporation Case in 1936 said:

"The sale of identified goods at less than the price fixed by the owner of the trade-mark is an assault upon the good will and constitutes what the statute [he is referring here to the Illinois resale-price maintenance statute] denominates 'unfair competition'."¹⁰

He also added in the next paragraph of his opinion:

"There is a great body of fact and opinion tending to show that price-cutting by retail dealers is not only injurious to the good will and business of the producer and distributor of identified goods, but injurious to the general public as well."¹¹

Also, in 1936, a federal statute, the Sherman Act, supported the "monopoly theory." Mr. Justice Hughes, as early as 1911, speaking for the Supreme Court in the Case of Dr. Miles Medical Company versus Park and Sons Company had said:

"The advantage of established retail prices primarily concerns the dealers. The enlarged profits which would result from adherence to the established rates would go to them and not to the complainant. It is through the inability of the favored dealers to realize these profits, on account of the described competition, that the complainant works out its alleged injury. If there be advantage to a manufacturer in the maintenance of fixed retail prices, the question remains whether it is one which he is entitled to secure by agreements restricting the freedom of trade on the part of the dealers who own what they sell. As to this, the complainant can fare no better with a plan of identical contracts than could the dealers themselves if they formed a combination and endeavored to establish the same restrictions, and thus achieve the same

¹⁰Bowman, Ward S., "Resale Price Maintenance--A Monopoly Problem," Journal of Business, Vol. 25, (July, 1952), pp. 141-144.

¹¹Ibid., pp. 141-144.

result Agreements or combinations between dealers, having for their sole purpose the destruction of competition and the fixing of prices, are injurious to the public interest and voice. They are not saved by the advantages which the participants expect to derive from the enhanced price to the consumer."¹²

The outcome of the controversy over resale-price maintenance was, until 1951 and the Schwegmann decision, a victory for the good will theory. This is not to say, however, that the monopoly aspects of the problem were completely ignored. Horizontal agreements among competitors were never sanctioned.¹³

Miller-Tydings Act and Appurtenant Court Decisions

Pressure for federal legislation declined after 1933, as resale prices were established under the codes sanctioned by the National Industrial Recovery Act. However, agitation was again revived when the National Industrial Recovery Act was declared unconstitutional. The conflict between the state law and the federal law was resolved, or at least so it was thought, by a 1937 amendment to the Sherman Act. This amendment, the Miller-Tydings Act, changed the Sherman Act to exempt resale-price agreements in interstate commerce when commodities are shipped into states in which such contracts are legal. The amendment further declared that the making of resale-price contracts shall not be regarded as unfair competition. The amended Act also stated, "That every contract, combination in the form of a trust or a conspiracy, in restraint of trade or commerce among the several states or with a foreign

¹²Ibid., p. 143.

¹³Ibid., p. 144.

nation is hereby declared to be illegal."¹⁴

With the apparent removal of antitrust obstacles, forty-five states had enacted fair-trade laws by 1941.

A manufacturer desires to maintain price identity and sizable margins for his distributors in order to secure many outlets for his product. Also, when several producers of the same class of commodities "fair-trade" their products, each is protected by legislation against loss of sales to the other because of severe competition at the local level. By maintaining local prices, manufacturers may also maintain their factory prices. Higher final prices provide a large source of profit for each segment of distribution.¹⁵

The effectiveness of resale-price contracts was restricted by the Supreme Court decision in the Schwegmann Brothers versus Calvert Distillers Corporation Case in 1951. Schwegmann Brothers operated a large supermarket in New Orleans, Louisiana. They sold Calvert Whiskey for \$3.25 per fifth, but the resale-maintained price by Calvert Distillers was \$4.37 per fifth. The Louisiana Resale-Price Maintenance Act contained the nonsigner clause, and Calvert brought suit to prevent Schwegmann Brothers from selling at a lower price.¹⁶

In defense, Schwegmann contended that the use of the nonsigner clause in interstate commerce violated the Sherman Act. The lower courts

¹⁴Weston, Glen E., "Resale Price Maintenance and Market Integration: Fair Trade or Foul Play?" George Washington Law Review, Vol. 22, (June, 1954), p. 675.

¹⁵Mund, Vernon A., Government and Business (2nd ed.), (New York, 1955), p. 471.

¹⁶Senate Committee on Interstate and Foreign Commerce: Hearings on H. R. 5767 (Resale Price Fixing), (Washington, 1952), p. 605.

rejected this defense. Schwegmann appealed to the Supreme Court, which upheld Schwegmann and declared that the Miller-Tydings Law does not sanction the nonsigner clause. This clause does not appear in the 1937 law, and the court said that it would not read the nonsigner provision into the Miller-Tydings Law. Justice Douglas speaking for the Court in regard to the Miller-Tydings Amendment said:

"The Act sanctions only 'contracts or agreements.' If a distributor and one or more retailers want to agree, combine, or conspire to fix a minimum price, they can do so if state law permits. Their contract, combination, or conspiracy--hitherto illegal--is made lawful When they seek, however, to impose price fixing on persons who have not contracted or agreed to the scheme, the situation is vastly different. That is not price fixing by contract or agreement; that is price fixing by compulsion. That is not following the path of consensual agreement; that is resort to coercion."¹⁷

Therefore, the Miller-Tydings Amendment applied only to persons who signed the resale-price contract and not to nonsigners, even though they had notice of the fixed prices.

The Sunbeam Corporation versus Wentling Case in 1950 had previously weakened the resale-price maintenance law. Wentling, a mail-order dealer, and also a nonsigner, in Pennsylvania, had been making both intrastate and interstate sales of Sunbeam electric shavers at less than the price Sunbeam had stipulated. In the suit Sunbeam brought against Wentling, the Court of Appeals in its first decision said: "The Pennsylvania statutes cannot govern sales by Pennsylvania retailers to consumers in other states." Therefore, Sunbeam was denied protection against Wentling in making interstate sales at less than the maintained resale price for Pennsylvania. In 1951, shortly after the Schwegmann decision, the Court of Appeals declared in a second decision in the

¹⁷Mund, Vernon A., Government and Business (2nd ed.), (New York, 1955), p. 472.

Wentling Case that a party not signing a price-maintenance contract cannot be subjected to the nonsigner provision of a state law on sales made within a state where interstate trade is involved.¹⁸

It seems that the main effect of the Wentling decision was to give a nonsigning, mail-order house in one state the legal right to sell and ship into another state at prices below the locally maintained prices.

Both manufacturers and retailers found the decisions of the Schwegmann and Wentling cases very disturbing. If a manufacturer wished to maintain resale prices thereafter, he had to make and police individual contracts with his many retailers in each state. This situation, of course, placed a hardship upon the manufacturers. Mail-order houses selling in interstate commerce dealt local retailers a great deal of price competition. Mainly because of these circumstances, Congress had pressure exerted upon it to amend the Miller-Tydings Act by adding the nonsigner clause and making the resale-price agreement established in one state applicable to sales in other states.

McGuire Act

In 1952, the McGuire Act was passed which removed the basis of the Schwegmann and Wentling decisions and made permissible the use of the nonsigner clause within a given state, in accordance with the legislation of the state, by manufacturers selling in interstate commerce. This act also authorized the fixing of stipulated resale prices. Enforcement action, however, was authorized only for sales below the

¹⁸"Fair Trade: A Half-Hearted Comeback," Readings in Marketing, ed. J. H. Westing, (New York, 1953), pp. 287-290.

stipulated prices. The essence of the McGuire Act was to enable a manufacturer to require all retailers in a "fair-trade" state to observe the minimum or actual prices which are fixed in a written contract made with one retailer in that state.¹⁹

The Act also declared that neither the authorized agreement nor the nonsigner agreements "shall constitute an unlawful burden or restraint upon, or interference with, interstate commerce." This clause was designed to remedy the mail-order loophole left by the Wentling decision. The provision was intended to restrain mail-order houses from quoting prices to out-of-state buyers which are lower than the maintained prices in the state in which the mail-order house is located.²⁰

The fight for the McGuire Bill was led by the Bureau of Education on Fair Trade and the American Fair Trade Council, both of which were backed largely by large drug concerns and druggists' associations.

At the present time the McGuire Act is in force. It has been challenged several times, but the Supreme Court has not rendered any decision concerning the constitutionality of this Act.

¹⁹"Use of Resale Price Maintenance by Integrated Manufacturers--A New Loophole for Abuse of Monopoly Power," Yale Law Journal, Vol. 64, (January, 1955), pp. 428-430.

²⁰Ibid., pp. 431-432.

CHAPTER III

THE DISCOUNT HOUSE

The terms "discount house" and "discount selling" cover a wide variety of retail selling techniques, such as differential pricing, diversion of trade from conventional channels, and noncompliance with minimum prices set by a manufacturer, all of which are important considerations for marketing strategy. This study pertains mainly to retail discount selling through establishments openly offering merchandise at a price lower than the manufacturer's "regular" dealers ask for the same merchandise.

A discount house is a retail establishment that sells all or most of its merchandise at a discount from the manufacturer's listed retail price or at prices substantially lower than those at which other types of retailers sell.¹

Types of Discount House Operations

Discount houses take so many forms they are hard to define. Besides, there is so much back-door selling by otherwise "legitimate" retailers, it is hard to identify the discounter.

Dealers Who Operate Entirely on a Discount Basis.

This form of discount house encompasses all the characteristics of

¹Raymond, Robert S., "The Discount House and Fair Trade," The Pennsylvania Business Survey, Vol. 49, No. 9, May 13, 1955, p. 4.

the operation of true discount houses. The clientele of this operation are usually members of some business, professional, or social organization who have established "buying clubs" for the procurement of merchandise at a discount through these discount houses. An authorized identification card is necessary before a person is admitted to the showroom to make purchases. This type of operation ordinarily renders none of the usual services, such as credit, wrapping, and delivery. Also, no guarantee of service or performance is made.²

The following types of discount houses represent deviations from the ordinary discount operations in that they serve customers who buy at the regular list price and groups who buy at a discount.

Ordinary Dealers Who Stress Discount Sales.

This type of a discount house serves customers who pay the regular list price as well as those who are allowed discounts because of certain buying groups of which they are members. Discounters selling through this type of an operation perform the various services with which the ordinary discount house dispenses.³

One of the oldest forms of discount operation is an informal discount business in which the retailer allows a discount to his friends.

Dealers Who Conduct an Informal Discount Business.

This method of discounting is widespread, but its impact in sales volume is felt less than that of other types of "price-cutting" operations. The discounting of a set price in this manner is usually limited to the friends of the retailer. This type of operation does a very

²Gilchrist, F. W., "The Discount House," Journal of Marketing, Vol. 17, (January, 1953), pp. 267-272.

³Ibid., p. 268.

substantial discount business.⁴

In addition to the above-mentioned types of discounters, there are many smaller and less significant forms of discount house operations, but the types mentioned above account for the greatest volume of sales attributable to discount houses; therefore, for the purpose of this study, those analyzed in the preceding paragraphs are sufficient.

Although the discount houses may vary in types, their selling operations generally conform to a set pattern.

Operating Characteristics of Discount Houses

Stephen Masters, President of Masters, Incorporated, one of the nation's largest discount houses, explained how a discount house can sell below list prices and still make a profit. He said that the formula which his firm follows is low overhead, quick turnover, and smart buying.⁵

Mr. Masters, in 1954, cited a comparison of his expense figures against the average department store's figures. (Based on the National Retail Dry Goods Association's 1953 published report.) Quoting Mr. Masters:⁶

<u>Expense Category</u>	<u>Department Store</u>	<u>Masters, Inc.</u>
Salary and Wages	17.7%	5.7%
Store and Selling	6.5%	2.1%
Warehousing and Shipping	2.2%	1.9%
Office and General	4.5%	1.5%
Total Expenses	30.9%	11.2%

⁴Ibid., p. 269.

⁵"Discount House Costs Explain Its Low Prices," Business Week, October 30, 1954, p. 52.

⁶Corbin, A., "The Economics of Discount Selling," Changing Patterns in Retailing, ed. J. W. Wingate and A. Corbin, (Homewood, Illinois, 1956), pp. 126-127.

Thus for every \$100 of sales, the department store expends \$30.90, while Masters can do the same volume at a cost of only \$11.20. Obviously, Masters can operate on a 15 per cent margin and make a reasonable profit, whereas a department store operating on a 15 per cent margin would suffer a heavy loss, unless it could generate sufficient additional volume and cut its service enough to bring its expense ratio into line.⁷

Extent of Discount Selling.

Discount houses are found almost exclusively in cities of some size which have large retailing centers. Discounting does not make much directly local inroads in smaller towns, since local retailers cannot afford to grant such favors without regular customers soon finding out. Discount sales of major appliances represent over 25 per cent of total sales in many metropolitan areas.⁸

One estimate places the total number of discount houses between 6,000 and 10,000.⁹ A survey in New York disclosed seventy-seven discount houses and thirty-three wholesale establishments which make their showrooms available to customers of discount houses.¹⁰

In 1955, the sales of the nation's largest discount house, Polk Brothers of Chicago, were reported to be about \$30 million a year.¹¹

⁷Ibid., p. 127.

⁸Raymond, Robert S., "The Discount House and Fair Trade," The Pennsylvania Business Survey, Vol. 49, No. 9, May 13, 1955, p. 4.

⁹Breon, Hervert, "Discount Houses," Life, August 9, 1954, p. 52.

¹⁰Rosenthal, H., "Don't Discount the Discount House," Retailing Daily, December 7, 1948, p. 1.

¹¹Ralph S. Alexander and Richard M. Hill, "What to Do About the Discount House," Harvard Business Review, Vol. 33, (January, 1955), p. 53.

The National Retail Dry Goods Association claims that 95 per cent of all electrical appliance sales in New York City are made by discount houses. Retailing Daily reports that between 55 per cent and 70 per cent of all higher-priced electrical appliances are sold through discount houses; and a large distributor of electrical appliances in Chicago declared that about 70 per cent of all electrical appliances sold in that city were distributed by discount houses.¹²

Sources of Merchandise.

The discount house gets its merchandise for resale from whatever source it can. Some manufacturers are willing to sell to it directly. Many manufacturers, however, are too fearful of the resentment of their regular retailers to do so. Some manufacturers have established dummy distributors under the disguise of export houses, and the like, through which they can supply the discount house without appearing to do so. Regular distributors, however, constitute one of the largest sources of supply to the discount house. Wholesale outlets are often a good source for the discounters, especially when the manufacturer has established a high quota which the distributor must sell in order to retain his franchise. So widespread is the practice of transshipping from wholesalers and retailers to discount houses that special agents, known as transshippers, do a good business arranging such transactions.¹³

Brands Sold.

The usual brand preference patterns prevail in most of the discount

¹²Ibid., p. 54.

¹³"The War on Price Cutting," Business Week, July 5, 1952, pp. 40-42.

houses. The discounters carry such well-known brands as RCA, General Electric, Westinghouse, Sunbeam, and Frigidaire. The discount operator can ordinarily offer a larger reduction, for example, on a Sylvania or Crosley than he can offer on a Philco or an RCA television set. Consequently, he will sometimes push brands in which he has confidence, but which have not achieved a high degree of consumer acceptance. Only the well-policed brands cannot be found at most discount houses.¹⁴

Customers Served.

Some houses still place considerable emphasis on the identification card which they require the customer to have before he can buy, although usually such cards are issued by the house itself on the basis of information supplied by the customer as to the name and address of his employer. The primary purpose of this requirement is probably to impress the customer with the notion that in being permitted to buy from the discount house, he is a member of a specially favored group. Many discount houses serve all customers without any preliminary formalities at all.¹⁵

Costs of Operation.

Discount retailers seek to do away with services which large groups of consumers are willing to do without and to operate on the premise of reducing costs. In New York, Masters has been able to organize its operations so that three fourths of its employees are engaged in serving customers as compared with only about one half in the average

¹⁴"Fair Trade Laws and Discount Selling," Harvard Law Review, Vol. 64, (June, 1951), pp. 1327-1338.

¹⁵Gilchrist, F. W., "The Discount House," Journal of Marketing, Vol. 17, (January, 1953), pp. 269-270.

department store. The combination of reduced costs and quick turnover makes it possible for these concerns not only to sell at discounted prices but to operate profitably on a much smaller gross margin and net profit than the regular retailer can afford.¹⁶

Inventory.

Some houses carry little or no inventory. They sell from catalogs and advise customers who desire the merchandise to visit the nearest department store or wholesaler's showroom, obtain the desired information, select the make and model they wish to buy, and report these identifying data to the discount house which will procure the merchandise to be picked up and paid for by the customer at a later date. Others carry display samples and either provide for delivery by a distributor or obtain the goods from a distributor for later pickup by the consumer. However, many others maintain complete stocks. Practically all of them make a point of delivering merchandise packed in the original factory sealed cartons as an assurance of quality.¹⁷

Warranty and Repair Services.

Since much of the merchandise sold by the discount house is mechanical in nature, warranty, repair, and maintenance service are important. Most houses look upon the warranty as a matter between the consumer and the manufacturer and have little or nothing to do with its practical details. The same is true of repair and maintenance service. The majority of houses make little effort to render such service. They take the

¹⁶ Brecher, E. M., "Discount Houses, How Can They Afford The Discounts They Offer?" Consumer Reports, Vol. 14, (October, 1949), pp. 469-472.

¹⁷ "Should You Buy From a Discount House?" Changing Times, Vol. 7, (October, 1953), p. 15.

position that the buyer must rely on the manufacturer's service installations or service facilities maintained by regular retailers to keep in working order the articles he buys from the discount house.¹⁸

Location.

Many discount houses operate in low-rent locations, often on the upper floors of office buildings; their furniture and fixtures are many times cheap, scant, and unattractive. Others carry on their business in locations that are adequate but out of the high-rent retailing districts.¹⁹

Auxiliary Services.

Most discount houses give little of the service which is usually taken for granted as a part of the retailing business, such as demonstrations, delivery, and credit. An increasing number make arrangements for delivery, many making an extra charge for it. A very small number grant credit. A growing number make arrangements with banks or consumer credit firms to finance their customers' purchases, probably because they have found this can become a lucrative phase of their operations.²⁰

Turnover.

All discount houses strive for a rapid turnover. This is achieved primarily by the price appeal. Many houses also seek to gain rapidity of turnover by limiting their stocks or carrying none at all. Since

¹⁸"Target: Discounters," Hardware Age, March 29, 1956, pp. 60-64.

¹⁹"Adventures in Shopping: The Discount House," Sales Management, Vol. 73-74, June 15, 1954, pp. 42-44.

²⁰Gilchrist. F. W., "The Discount House," Journal of Marketing, Vol. 17, (January, 1953), pp. 267-272.

most of the items they handle exhibit a rather slow rate of turnover in the regular store, this is a very significant advantage.

Reasons for Growth of Discount Houses

Reasons Out of Manufacturers' Control.

Much of the time since 1940 we have been in a sellers' market. Price competition at all levels of the distribution system has been sparse. In the last few years, the market has switched in favor of the buyer. As a result, price competition has come into play. To be exposed to such competition comes as a shock to many retailers unaccustomed to it since the early 1940's. Furthermore, some retailers have never had such severe competition facing them.

Through the "fair-trade" laws, the Robinson-Patman Act and other devices, our judicial system has tried to sew up price competition, especially at the retail level. The discount house is one of the forces that was created, or came into being, as a result of an attempt to eliminate price competition in the competitive economy.²¹

Production has recently been catching up with demand. During World War II and the years immediately following, most manufacturers could sell all they could produce unless their products did not satisfy people's needs. In recent years, this situation has been reversed, and many manufacturers, especially of hard goods, have been faced with the problem of disposing of their output. As a result, many manufacturers have come to realize that if they are to market their products above the break-even point, they must sell through whatever outlet they can

²¹Ralph S. Alexander and Richard M. Hill, "What to Do About the Discount House," Harvard Business Review, Vol. 33, (January, 1955), p. 58.

move the goods into the hands of the consumer. The discount house has answered the need of the manufacturer, and as a result, many manufacturers have developed a friendly attitude toward the discounters.²²

The consumers' reluctance to pay the increasingly rising prices has played its part also. Although personal incomes have been rising faster than prices, consumers are becoming disgusted with the constant price increases. Buying through discount houses has helped the consumer ease the situation.²³

It is difficult to measure the worth of this next reason although it does have some significance. The greater amount of leisure time of the average worker brought about by legal limitations upon the number of work hours per week has given consumers more time to compare retail prices. It usually takes time to shop at a discount house. Often two trips are required to the discount house and one trip to the regular outlet to determine the brand and model desired.²⁴

Also, the redistribution of personal income during the past fifteen years has helped to clear the way for the discount house. As a result of the shift of the income from the higher-income to the middle-income groups, there is a concentration of buying power in the hands of people who have not been accustomed to the services with which retail establishments have pushed their merchandise. Many of the members of this new middle-income group have been in the habit of buying in unattractive surroundings and of carrying their purchases home with them.

²² Ibid., p. 60.

²³ Ibid., p. 60

²⁴ Ibid., p. 61.

Therefore, they see no reason why they should pay more to buy in a pleasant atmosphere or to pay for services they do not particularly need. At the same time, those with higher incomes have felt the pressure of progressive taxes on their income, and to broaden their purchasing power, many of them have turned to the discount house for their purchases.²⁵

The "do-it-yourself" fad has also had an effect upon the trend toward purchasing from discount houses. The experience consumers have had in buying food and other items in self-service supermarkets has proven to the consumers their own ability to judge the quality of merchandise. They have extended this ability into the semi-technical merchandise such as appliances. The leisure time, previously mentioned, has also enabled consumers to make installations and do repair work which formerly they expected from the retailer.²⁶

Consumers have confidence in manufacturers' brands, and this has made it easier for the discount house to sell its products. An electric mixer with Sunbeam's name on it and in the original factory carton is the same whether purchased from a discount house or a franchised Sunbeam dealer.²⁷

Reasons Within Manufacturers' Control.

Manufacturers have encouraged dealers to overstock by various sales promotion devices designed to push their products to the distributors. Dealers, when overstocked do not have a ready outlet for this surplusage

²⁵Ibid., p. 61.

²⁶Ibid., p. 62.

²⁷Ibid., p. 63.

of products at regular prices. Quantity discounts have made it profitable for the medium-sized dealers and small dealers to buy in the amounts necessary to earn the maximum discount. They have to move this surplus either by cutting prices to their regular customers or by reselling at a small markup to a discount house.²⁸

Another of the sales promotion devices is the quota system, whereby the dealer must dispose of a volume fixed by the manufacturer in order to keep his franchise. In order to achieve his quota, the dealer sometimes sells to discount houses.

The policy of overstocking dealers so they will try to move the particular manufacturer's brand rather than his competitor's, plus the heavy pressure on the manufacturer's salesmen to load up the dealers, in turn forces the retailers either to cut prices or to sell to a discount house.

Brands advertised widely by manufacturers help the discounter build his business. Consumers, thereby, rely on the manufacturer's product quality instead of the retailer's knowledge and judgment for assurance of satisfaction in the use of the product.²⁹

The manufacturer's warranty or guarantee which he has placed upon his product has given consumers confidence that faults in material and workmanship will be taken care of by the manufacturer. This warranty gives the customer assurance that even though he buys through a discount house he will receive guaranteed performance. Many discount houses take advantage of such warranty programs by telling customers

²⁸ Ibid., p. 62.

²⁹ Ibid., p. 63.

that they will, for a fee, arrange to have services performed. However, they further state that by taking the product to a certain repairman the customer may himself have the repair work done without payment of the middleman's fee.³⁰

When a manufacturer puts a new model of his product on the market, the retailer is under pressure to dispose of all the old models they have on hand; therefore they tend to dispose of the old models to discount houses.³¹

The attempts of the manufacturer to control the price at which his product is to be sold at retail is actually beneficial to the discount house, whose chief selling appeal is price comparison. By fixing a retail price, the manufacturer provides a base price with which the discount house price may be compared; he establishes a "regular" or "conventional" price from which discounts can be allowed.³²

In many cases, manufacturers attempt to prescribe retail margins which are more liberal than conditions justify and in so doing play into the hands of the discount house. Sometimes this is done with the idea of gaining the loyalty of the retailer and getting his cooperation in promoting the sale of the product. In other cases, it occurs as a result of failure to review such margins from time to time, or reluctance to change them to fit changing conditions. If retail margins are small and cover only the reasonable cost of rendering the actual service which

³⁰Ibid., p. 63.

³¹Ibid., p. 64.

³²Ibid., p. 64.

the retailer performs plus a reasonable net profit, the discount house has little area within which to operate in granting allowances to its customers. It is one thing to offer a consumer a 30 per cent to 40 per cent discount for doing without the regular retailing services in his buying; it is an entirely different matter to ask him to do so for an allowance of 5 per cent or 10 per cent.³³

It is obvious that the resale-price maintenance laws have actually aided the discount house.

³³Ibid., p. 64.

CHAPTER IV

ENFORCEMENT OF RESALE-PRICE MAINTENANCE LAWS

Proponents of resale-price maintenance laws say that discount houses violate the laws, inasmuch as they cut a manufacturer's established price on his product which results in damage to the reputation of the manufacturer's product.

Discounters do not deny the fact that they violate the resale-price maintenance laws. These laws which appear to have brought prosperity to discount houses were enacted by forty-five of the forty-eight states ostensibly to eliminate such price-cutters. It is not a criminal offense to sell goods below the fixed price. The police departments, the county and state prosecuting attorneys, and other public officials have no authority to enforce price-maintenance laws. Instead, selling below the manufacturer's established price resembles what is called a "tort" or a private injury to the manufacturer.¹

The decision of a manufacturer to fix the resale price of his product necessarily involves not only the choice of a resale pricing system but also the selection of an enforcement program designed to implement that choice. The wide range of possible enforcement policies and of variations in channels of distribution creates substantial differences in marketing policies among those classified as "fair-traders."

¹"Fair Trade Laws and Discount Selling," Harvard Law Review, (June, 1951), pp. 1327-1338.

As mentioned previously, resale-price control laws do not provide for enforcement by the public authorities. Any legal action must be taken by individuals or corporations who believe they have been injured. Some manufacturers, such as General Electric, establish special departments to enforce the price-maintenance programs. In other instances, trade associations assess dealers for funds to police the programs and prosecute violators.

Enforcement Procedures

The enforcement of resale-price arrangements is based primarily on persuasion. Every effort is made to convince discount sellers that the established price is necessary and beneficial. When persuasion fails, resort is made to litigation. In 1953, the Sunbeam Corporation sued Masters, Incorporated of New York for selling certain appliances below Sunbeam's established resale prices. The court ordered Masters to pay Sunbeam \$8,284.89 as follows: \$330 for net profits on discount sales; \$3,404.56 for auditors' fees paid in examining Masters' books; \$3,900.33 for the legal services of Sunbeam's attorneys; \$650 for Sunbeam's investigating costs. Also, Masters had to pay \$1,316 for stenographic services and \$6,930 as a fee for the special Juror who heard the case. Masters own legal fee was \$16,530.89.²

Source of Complaints.

Manufacturers receive complaints about violations of retail "fair-trade" prices from three principal sources. These sources are: the manufacturer's own salesmen, wholesalers, and retail competitors of the

²Mund, Vernon A., Government and Business (2nd ed.), (New York, 1955), pp. 728-730.

alleged violator. Some consumers who have not been fortunate enough to purchase price-maintained goods at a discount sometimes submit complaints to the manufacturer. The salesmen usually check counter prices and local newspaper advertisements in an area where maintained prices have been cut. Manufacturers, however, are usually reluctant to use their own salesmen to police "price-cutting," because then they cannot make as many calls a day as they normally would.³

The largest source of complaints, however, is the individual retailer or retailers' associations. Many retailers' associations in large cities actually engage in enforcement activities.⁴

Complaints against "price-cutting" come mostly from large cities and often come in cycles. The manufacturers receive complaints from the larger cities constantly, and many manufacturers feel that the volume of complaints does not accurately reflect the extent of resale-price discounting in these cities. Some retailers in these cities, however, are so accustomed to "price-cutting" that many no longer bother to complain but meet competition by lowering their own prices.⁵

Disposition of Complaints.

When the manufacturer receives a complaint, the procedure followed is fairly standard. A registered or certified letter is sent to the alleged violator telling him of the manufacturer's maintained resale prices, requesting that the cutting of these maintained prices stop

³C. I. Kanter and Stanford G. Rosenblum, "Operation of Fair Trade Programs," Harvard Law Review, (December, 1955), p. 318.

⁴Ibid., p. 318.

⁵Ibid., p. 318.

immediately, and perhaps warning of eventual suit if the "price-cutting" does not stop. The violator is then "shopped" by an agent of the manufacturer who attempts to buy the product at a discount in order to substantiate the truth of the complaint. If the discounting has continued, either a stern letter is sent to the violator, or he is contacted personally. In the personal contact, an effort is made to convince the retailer that a high profit margin is advantageous to him and to show him the risks of starting a price war; however, if persuasion appears likely to fail, a threat to cut off the retailer's supply of the product may occasionally be made. (Some manufacturers never threaten such action, since they think such a threat might violate the antitrust laws.) The alleged violator is then "shopped" again. If the price-cutting has continued, suit is brought. The time from receipt of a complaint until suit is usually two to eight months, but occasionally suit is very swift.⁶

Anticipation of Defenses.

Since a manufacturer cannot predict which violations will require litigation, the standard procedure for handling complaints is not only designed to stop violations before a lawsuit, but it also serves to eliminate many possible defenses available to the discounter. The manufacturer, by sending the first warning letter by registered mail, has evidence that the discounter received notice of the established retail price. The manufacturer can avoid the defense that a clerk charged the wrong price by shopping the discounter-defendant's store several times.

⁶Rosenblum. M. P., "Efficiency Makes Transshipping Streamlined Distribution Method," Retailing Daily, June 10, 1952, p. 1.

Since the retailer is not bound by "fair-trade" prices on merchandise purchased by him without notice of these prices, most manufacturers usually shop the discounter until he has received the registered letter and thereafter bought new merchandise.⁷

Enforcement Action Available.

Resale-price maintenance can be enforced or resale-price violations may be remedied by two types of action. One is an action for damages for breach of the resale-price maintenance contract. This type of action is available only to a party to such a contract. Its purpose is to recover a monetary loss incurred because of a party selling a "fair-traded" commodity at a price less than that established in the resale contract and is available to either of the parties. Suits can be based on contractual liability in any state or locality in which the contract is legal.⁸

The second type of action is for injunctive relief and is based upon the unfair competition provision of the state resale-price maintenance laws. Although damages may be recovered in such actions, the main purpose of this type of legal proceeding is to enjoin present and future violations of the maintained resale prices. In the essence, the resale-price maintenance laws provide that:

"Willfully and knowingly advertising, offering for sale, or selling any commodity at less than the price stipulated in any contract entered into pursuant to the resale-price maintenance law, whether the person so advertising, offering for sale, or selling is or is not a party of such contract, is unfair competition."

⁷C. I. Kanter and Stanford G. Rosenblum, "Operation of Fair Trade Programs," Harvard Law Review, (December, 1955), p. 310.

⁸"Fair Trade Enforcement Suits," Trade Regulation Reports, (Commerce Clearing House, 1954), pp. 4721-4722.

Such unfair competition may be enjoined or a damage suit may be based thereupon. The usual remedy under this provision is injunctive relief. It is under this provision that persons who have not signed a resale-price maintenance contract but who have notice of the maintained price can be forced to adhere to the restrictions of price maintenance contracts between other persons.⁹

Suit Against Discounters.

The only persons who can maintain an action for breach of the resale-price maintenance contracts are the parties to the contract. However, an action based upon the unfair competition provisions of the state resale-price maintenance laws can be brought by any person damaged. Therefore, the owner of the trade-mark or a person in competition selling the same product may bring suit. This may be the manufacturer, distributor, wholesaler, or retailer.¹⁰

Under a nonsigner clause, the cause of action against any person violating the maintained price is in the nature of a "tort" for unfair competition. Since this cause of action is given to any person damaged by "price-cutting," the courts have allowed retailers as well as manufacturers to sue. Some manufacturers who do not wish to rely entirely on the nonsigner clause distribute their products exclusively to wholesalers who contract to sell only to retailers signing price-maintenance contracts with the manufacturers. (The McGuire Act specifically authorizes such a practice when state statutes permit.) A manufacturer may also have a cause of action against nonsigning retailers for interference

⁹Ibid., pp. 4721-4722.

¹⁰"Fair Trade Enforcement Suits," Trade Regulation Reports, (Commerce Clearing House, 1954), p. 4721.

with advantageous relations when he maintains such a system of contracts. The manufacturer may have this cause of action, since a nonsigner in order to obtain merchandise possibly induced some wholesaler or retailer to break his contract with the manufacturer.¹¹

Enforcement Difficulties

Discounting of products under the jurisdiction of resale-price maintenance laws is hard to detect because discount houses do not ordinarily advertise their bargains and usually sell only to customers whom they can identify. Furthermore, the cost of policing these violations is very expensive to the manufacturer. An example of this is the Sheaffer Pen Company who spent two million dollars over a period of two years and discontinued selling to some 700 dealers because of their discount practices. However, the cost was high, as evidenced by a decrease in sales for the first half of 1955 of 9.5 per cent as compared with the same period in 1954. Earnings for the same period decreased 35 per cent.¹²

In addition to this, there is the possibility of undesirable publicity for the distributor who enforces higher prices. Distributors in many cases have little or no enforcement help from manufacturers because the discount houses provide the manufacturer with a means of distributing their expanded output in a buyers' market. Resale-price maintenance is particularly difficult to enforce when the manufacturer sells

¹¹C. I. Kanter and Stanford G. Rosenblum, "Operation of Fair Trade Programs," Harvard Law Review, (December, 1955), p. 318.

¹²"Retreat of the Fair-Trader," Time, December 19, 1955, p. 90.

through wholesalers and has no continuous direct contact with all his dealers.¹³

Ineffectiveness of Lawsuits Against "Price-Cutters."

Court suits to enforce compliance with "fair-trade" laws are far from effective because the damages levied against discounters are not large enough to make them discontinue selling at less than stipulated prices. An example of policing difficulties is exemplified in the case of General Electric which hired the services of five Pinkerton detectives to investigate the selling activities of New York City discount houses selling General Electric's automatic electric blankets at an average of \$6.84 below the minimum retail prices designated by the company. The net effect of two years of detective work and legal action was \$650 in fines and a general resolution on the part of discount houses to be more careful about selling General Electric goods to Pinkerton detectives.¹⁴

In 1955, General Electric filed 853 suits against discounters. But despite General Electric's policing efforts, discount houses have continued to sell General Electric's products at a discount.¹⁵ So profitable has the violation of resale-price maintenance laws been that discounters are willing to pay periodic fines as a regular cost of doing business.¹⁶

¹³Corey, Raymond, "Fair Trade Pricing: A Reappraisal," The Harvard Business Review, September 10, 1952, p. 50.

¹⁴Brecher, E. M., "Discount Houses, How Can They Afford the Discounts They Offer?" Consumer Reports, (October, 1949), p. 471.

¹⁵"G. E.'s Heavy Blow at the Discounters," Newsweek, January 9, 1956, p. 53.

Consumers Uncooperative in Providing Proof of Violation by Retailers.

Because scattered violations of price-maintenance laws are hard to detect, the cooperation of the consumer in reporting these violations to the manufacturer is necessary. The consumers, however, do not naturally have an incentive to report these violations to the manufacturer for action because the reduced prices are of obvious benefit to the price-conscious consumer. The consumer who is unfortunate in not possessing an admission card to a discount house is the most likely consumer to report such violators. However, these persons are usually unable to provide proof of the discounter's violation.¹⁷ Furthermore, discounting is becoming so widespread that almost anyone can purchase price-maintained goods at a discount.

Discordance in Resale-Price Maintenance Legislation.

The fact that all states have not adopted price-maintenance laws has created discordance in court decisions. These court decisions pertain to the loophole of price-maintained items involved in shipment between states not having resale-price laws and a state which does have. A second loophole pertains to the resale-price laws' most powerful weapon, the nonsigner clause.

Resale-price maintained goods involved in interstate commerce.

There is a legal question of whether a discount house can use a state where there is no price-maintenance statute as a base of operations from which to advertise and ship "fair-traded" items into a "fair-trade"

¹⁶"Fair Trade Laws and Discount Selling," Harvard Law Review, (June, 1951), p. 1328.

¹⁷Ibid., p. 1330.

state at discounted prices. The courts have placed interstate commerce above the price-maintenance laws. The proponents of resale-price maintenance tried to plug this loophole by saying that such statutes of one state apply to goods shipped into another. However, several discount houses have set up offices in states not having these laws and are doing a large mail-order business in price-maintained goods without effective court action against them.¹⁸

The other loophole in the price-maintenance laws centers around the nonsigner clause which makes it mandatory for all retailers of identical products in the state to abide by a manufacturer's list price if one retailer in the same state agrees to do so.

Legality of the nonsigner clause. The McGuire Act states that retailers not signing a resale-price maintenance contract have to abide by stipulated prices; however, several state courts have held that a retailer who does not actually sign a resale-price contract does not have to abide by maintained prices. To date, thirteen states have either ruled their resale-price maintenance laws unconstitutional or have handed down decisions making the laws inoperative. Courts have often refused to grant injunctions against nonsigner-discounters unless the manufacturer can show that he has diligently tried to police his distribution system.¹⁹

When the Supreme Court in the Schwegmann Case held that the

¹⁸"Price War Counterattack," Business Week, September 4, 1954, p. 135.

¹⁹C. I. Kanter and Stanford G. Rosenblum, "Operation of Fair Trade Programs," Harvard Law Review, (December, 1955), p. 321.

Miller-Tydings Act did not exempt nonsigner clauses from the antitrust and unfair-competition laws, Congress retaliated by passing the McGuire Act. The Supreme Court has several times refused, on grounds of lack of a substantial federal question, to hear appeals challenging the constitutionality of the McGuire Act. Although no states have repealed their laws, several state courts have recently held the nonsigner clauses invalid under state constitutions. Nonsigners are now bound by maintained resale prices in about thirty-two states.²⁰

The following discussion of marketing considerations brings forth the underlying factors that make ineffective the resale-price enforcement machinery.

²⁰Weston, Glen E., "Resale Price Maintenance and Market Integration: Fair Trade or Foul Play?" George Washington Law Review, Vol. 22, (June, 1954), p. 675.

CHAPTER V

MARKETING CONSIDERATIONS

For some manufacturers, enforcement of resale-price maintenance laws is not economically expedient. Some lack the financial capacity to bear the expense of a resale-price maintenance enforcement program as well as the heavy consumer-advertising program which is necessary to control the resale price of certain types of products. Some manufacturers do not maintain the resale price of their products, because they believe such an approach is impractical or inferior to price competition at the retail level. They are willing to direct their marketing programs primarily toward the price consciousness of consumers. Their decision is founded on the theory that the manufacturer's selling price is not greatly affected by retail discounting or that, since a lower retail price will usually produce a larger volume of sales, profits may be greater than they would be if the product were "price-maintained." These manufacturers believe that the gain to be derived from selling whenever and wherever possible outweighs the possible advantages of a resale-price maintenance program.¹

Some writers say that the growth of the discount house resulted from the discounters cutting "fair-trade" prices while most retailers were maintaining these prices. But the fact is that "fair-trade" goods

¹C. I. Kanter and Stanford G. Rosenblum, "Operation of Fair Trade Programs," Harvard Law Review, (December, 1955), p. 340.

usually comprise only a very small part of the stock of discount houses, and the presence of numerous discount houses in areas not under the jurisdiction of price-maintenance laws indicates that their success is attributable partly to the public's willingness to accept fewer services than are provided by some other retailers. Their success may also stem from the use by discount houses of more efficient merchandising techniques which reduce overhead. Nevertheless, since the public is likely to be familiar with the designated, or "list," price of resale-price maintained products, discounting on such products probably only enhances the discount house's reputation for offering bargains on all merchandise.

The Mechanics of Distribution

Historically, progress toward higher living standards was made through more efficient production and technological progress. Therefore, the distribution system has been under little pressure to change its basic form. Although it is true that periods of depression have resulted in temporarily lower profits and higher rates of business failures among retailers, the basic structure of the distribution system had remained almost unchanged before the close of World War II. The structure of the distribution system followed a fixed pattern. Raw materials were converted into a finished product by a manufacturer or a series of manufacturers. They were then shipped to a jobber or wholesaler where they were sold and reshipped to a retailer. Finally, they were sold to the ultimate consumer. Each step in this process from raw material to consumer involved additions to basic cost represented by the expense of handling plus profit. Although each step in the

distribution process was a necessary function in the distribution mechanism, the system as a whole was inefficient in terms of the relationship between the actual cost of goods and their final price to the consumer.²

Shortly after the end of World War I, a few retailers, inspired by the customary profit motive, recognized the possible benefits of the volume-purchasing power which might accrue to a retailer who operated a group of stores. The result of this recognition was the development of the chain store, although some chain stores had previously been known. One of the significant aspects of the chain store was its virtual elimination of the jobber and wholesaler in the chain-store segment of the distribution process. Manufacturers could now sell their products directly to retailers and thus eliminate one step in the handling of merchandise and also one sharer in the profits. Some of the saving thus obtained was ultimately passed on to the consumer in the form of lower prices, thus providing an advance in living standards as the result of increased efficiency in the distribution system. The operation of chain stores was not prevalent in all fields. Goods such as electrical appliances, furniture, jewelry, china and glassware, household goods, sporting goods, and automobiles were still sold by manufacturers to individual retailers to be resold at advertised prices.³

At the end of World War II, the backlog of consumer demand for merchandise which had been scarce was quickly exhausted by two factors.

²James, Anthony, "Consumer Revolution," Journal of Property Management, (Spring, 1950), p. 188.

³Ibid., p. 189.

First, there had been a tremendous increase in the productive capacity of the United States, both during and shortly after the war. Second, wartime and postwar inflation caused sharply higher prices and thus cut into the effective purchasing power of the consumer. Both of these factors combined to produce a technical oversupply of most goods by the end of the year 1948, and of nearly all goods by the end of 1949. This was particularly true as applied to less-favored brands of goods. It was thus that the consumer revolution began.⁴

The Consumer Revolution

By the consumer revolution is meant the determination of the consumer to maintain and broaden his real purchasing power--even at the expense of convenience, comfort, and buying habits.

An example of the consumer revolution is exemplified in the C-54, an airplane used by the army during the Second World war. This plane was known by commercial airlines as the DC-4. It was an aircraft whose worth was proved by millions of miles of safe flying. At the end of the war, the large airlines purchased these planes and put them to work on their regularly scheduled lines. The large airlines had spent thousands of dollars advertising these airplanes; therefore, the civilian public was sold on their reliability. Furthermore, thousands of veterans were sold on the plane through their own wartime experiences with this aircraft. Since the United States Bureau of Civil Aeronautics strictly supervises both the flight personnel and the mechanical maintenance of all United States aircraft, and since all aircraft in flight

⁴Ibid., p. 190.

over government controlled and maintained airways are likewise under close supervision, it made little difference whether one rode with one airline or another. All were flying identical airplanes over identical routes under moderately identical operating conditions. Whereas individual company policies might vary, certain minimum safety standards were required. Recognizing this basic standardization, venturesome young men purchased some of these aircraft and set themselves up in business as nonscheduled airlines. By sending out their planes only when well filled, by crowding more passengers into the same space, and by eliminating some of the frills of deluxe service, they reduced travel fares to an amazingly low level. This is an example of the fundamentals of the consumer revolution: a standard product and a standard value available at a sharply lower cost but often at a considerable sacrifice in comfort and convenience.⁵

So great was the public response to "discount" air travel that almost every major airline is now offering so-called air-coach travel. The air-coach revolution in travel standards and costs is only one small example. The same trend is going on in almost every segment of the economy where standard merchandise of advertised and generally known value is available.

Also, during the war, millions of members of the armed forces caught a glimpse of what might happen in a consumer revolution through their purchases at Post Exchange (PX) Stores. They carried this experience in their minds after they returned to civilian life.

As merchandise became plentiful in the postwar period, there were

⁵Ibid., p. 191.

men in fields other than airlines who recognized that standard products and standard values could be made available to consumers at below the regularly advertised retail price. If people would risk their lives in airplanes simply because they were standardized, they would surely buy standard brand merchandise through new channels. If people would sacrifice personal comfort and convenience to save money in travel, they would certainly do the same thing to get a washing machine or a wrist watch at lower prices.

Social and Economic Changes

Newton's Law of Action and Reaction is a powerful natural law which cannot be legislated out of existence. Periods of economic adjustment are not just accidents. Such periods usually develop out of excesses practiced during periods of scarcity as well as periods of plenty. Businessmen become too "bullish." They may misjudge the future. They frequently overestimate their markets and the size of the consumers' pocketbooks. So when demand slackens, a reaction sets in and soon almost everybody cuts prices to move the products.⁶

In recent years, several significant changes have come over our economy and our society. In the first place, to an increasing extent we have moved over from emphasis on production in our economy to a heavy stressing of consumption. Prosperity is increasingly dependent on expanding consumer purchasing power. To meet this end, we have developed an extensive system of consumer financing and a broad program of consumer welfare. Producers are no longer thought of as benefactors but

⁶Babson, Roger W., "Fair Price," Commercial and Financial Chronicle, March 11, 1954, p. 1107.

as beneficiaries. The consumer is now the benefactor.⁷

Also, the rise of the "common man" has contributed to the change in the economy. Since the "common man" is the consumer in a mass-production society, he has come to recognize his importance and his place in the economy. Out of these feelings has grown the consumer's belief that he is entitled to a higher standard of living.⁸

During the time in which these political and economic changes were taking place in the United States, a combination of circumstances in several lines created a slow-down in the movement toward more lower-cost production. This was due partially to a decrease in the rate of improvement in technology. However, the principal causes were more effective labor organization and a higher level of taxation. The increased taxes not only increased the direct cost of goods, but also (through income taxes) discouraged the activities of "profit-hungry" producers. In many classifications of production it appeared as though wider distribution could not be attained through lower costs of production. This meant that higher living standards, in many cases, must come out of increased consumer income or out of more efficient distribution. Since higher incomes can come only from increased production, a likely way to broadened consumption is more efficient distribution.⁹

The American population has an income of about \$340 billion, with personal consumption expenditures reaching \$270 billion. Today, according to the Department of Labor, the average family of four persons

⁷James, Anthony, "Consumer Revolution," Journal of Property Management, (Spring, 1950), p. 186.

⁸Ibid., p. 187.

⁹Ibid., p. 188.

should be spending approximately \$4,200 a year to maintain a minimum standard of living on a basis of health and decency. Yet 63 per cent of all families in the United States have a total money income of under \$5,000 a year. In fact, 1,000 families with incomes of \$10,000 a year and over spend as much for consumer goods and services as do 3,281 families with incomes between \$4,000 and \$5,000, or 4,111 families with incomes between \$3,000 and \$4,000.¹⁰ Even so, income disparity is becoming less significant than was once the case.

The consumer is often mortgaging his future income to secure the automobiles, appliances, clothing, homes, and other goods and services he wants. He has gone into debt by an amount of \$40 billion. By this process of lifting himself up by his bootstraps, the consumer is able to extend or accelerate the utilization of his buying power by a sum which exceeds 10 per cent of the total income.¹¹

To the extent that the consumer has a share in the national prosperity and in maintaining the boom, he has the task of buying, using, wasting, and destroying a constantly increasing volume of goods. The gross national product in 1939 amounted to \$91 billion, but in 1955, it reached \$390 billion. We are now producing at the rate of well over \$400 billion annually. Between 1947 and the present, the fixed investment of American business in commercial and industrial construction amounted to some \$75 billion, while producers' durable equipment, which means productive machinery and modern labor-saving devices, amounted to

¹⁰Lebow, Victor, "Crisis in Retailing," Journal of Retailing, (Spring, 1957), pp. 17-55.

¹¹Ibid., p. 18.

over \$220 billion. Thus a population whose income may not be rising fast enough is faced with the necessity of consuming a great deal of merchandise being produced at a constantly accelerated pace.

Considerations for Changes in the Nature of Competition

For decades the pricing system in many United States industries has been based on a system of "functional discounts" which are specified allowances for performance of specified functions at each level of distribution. The retailer gets a certain allowance for his contribution to the distribution of goods. For his contribution--bulk buying, holding of inventory, reselling to dealers--the distributor gets another amount. Traditionally, the manufacturer starts by setting a retail list price and working backward from this, giving discounts for services rendered at each distributive level. This situation was recognized and written into law by the Robinson-Patman Act about twenty years ago.¹²

General Electric, in expressing its action in its decision to discontinue factory-set retail prices said, "When you set a retail price, you hold an umbrella over the weaker portion of your distribution system." In the past few years, the nature of the competition in the appliance industry has changed markedly. These are some of the considerations today.¹³

Mass Production.

Appliance makers, like the automobile makers, have forced into the

¹²"Who Is Going to Set the Price?", Business Week, November 27, 1954, p. 26.

¹³"The War on Price Cutting," Business Week, July 5, 1952, pp. 40-42.

market the vast quantity of goods they must manufacture in order to keep the mass-production system working right. The existence of a surplusage of goods has been brought about by manufacturers forcing goods on distributors, who in turn must force them on to retailers.¹⁴

Discount Houses.

These are the inevitable product of the foregoing system. Manufacturers must have big low-cost volume. The discount houses give it to them, so they can't do much about fighting the discount house. These "discounters" have helped to slash marketing costs of appliances.¹⁵

Inventories.

Dealers are reluctant to buy in large quantities because it is expedient for them to let the manufacturer or distributor assume the burden of holding inventories. The fast transportation system of today permits the retailer to let the manufacturer hold the stock until it is needed.¹⁶

Mixed Carload Shipments.

Dealers who have big enough volume are ordering mixed carloads of appliances straight from the factory. In such cases, distributors become mere order-takers.¹⁷

Trade-in Transactions.

As with the automobile business, the very existence and variability of "trade-ins" makes it virtually impossible for any manufacturer to police prices.¹⁸

¹⁴Ibid., pp. 40-42.

¹⁵Ibid., pp. 40-42.

¹⁶Ibid., pp. 40-42.

¹⁷Ibid., pp. 40-42.

¹⁸Ibid., pp. 40-42.

Trends in Retail Distribution

Some schools of thought believe that discount houses are here to stay and are strong evidence that something is drastically wrong with the present distribution system and current retail-profit margins. This group maintains that under the free enterprise system discounters are entitled to as much opportunity as any other businessmen.

The real problem, according to Paul H. Bolton, executive vice-president of the National Association of Wholesalers, is not the discount house but the "discount function." Bolton argues that:

"We must educate both manufacturers and the public to understand that our economic future and our American way of life have become the envy of the world--through our present competitive profit system. The function of granting cuts from established list prices will undermine our economics, set us back to the old price haggling of the European marketplace of the Dark Ages unless we wake up."¹⁹

Victor Lebow, in a recent article in the Journal of Retailing said,

"Upon the American consumer is concentrated a heavy propaganda barrage employing every trick and appeal ingenuity can devise. With \$10 billion a year going into newspapers, magazines, radio, and television advertisements, the American has been transformed into a creature whose chief function in life is to consume."²⁰

It is in the conflict between retailers over who gets the consumer's dollar that a great many of the casualties in retailing result.

Between the decline of resale-price maintenance and the rise of the discount house, price competition must increase. This trend will probably be further heightened by the enormous inventories and the high rate of production based on present industrial capabilities.

¹⁹"Should Manufacturers Cut the Flow of Merchandise into Discount Houses?" Tide, September 25, 1954, p. 31.

²⁰Lebow, Victor, "Crisis in Retailing," Journal of Retailing, (Spring, 1957), p. 23.

The rising level of prices, particularly in relation to the lower rate of increase in consumer purchasing power, puts a premium upon aggressive merchandising. New automobiles, new homes, new furniture, and new foodstuffs are all higher in price. Because these purchases leave less of the consumer's income available for further expenditures and because so many of them involve installment buying and the mortgaging of future income, it is pretty safe to guess that the physical volume of goods sold in the near future may well be lower than at present levels. Quite possibly the higher price level will soon force a decline in the physical volume of merchandise sold.²¹ Certainly, inflation is seriously threatening the real purchasing capacity of substantial segments of our society.

Two contradictory trends in retail distribution are presently being observed.

One is the drive for higher markups, spurred by the steadily mounting expenses. The other is the demonstration that even with merchandise that has always sold at fixed and traditional markups, it is possible to shrink the margins drastically. This proof is offered by the increasing number of discount operations in many fields.²²

Given the dynamics of the "American Standard" of consumption, the plain fact is that the retailers frequently represent, in effect, the chief bottleneck in the flow of goods from producer to consumer. They get the largest single slice of that 60 cents or so out of the consumer's dollar that pays for the cost of distribution.

²¹Ibid., p. 24.

²²Ibid., p. 21.

²³Ibid., p. 25.

Decision to Buy at Discount

Discount buying is some trouble for the shopper. He must first be admitted to a buying group that has the contact with the discount house. Then he must usually pick up his selections and pay cash for his purchase. On small items the saving often may not be worth the trouble. If he changes his mind, he cannot always return the goods. There is usually a question of whether he is protected against faulty merchandise. There is also the problems of style, prestige, and institutional backing--all of which are generally lacking in discount merchandise.

On the other hand, there is plenty of evidence that most American citizens will go to almost any ends to obtain and maintain a higher level of consumption. An example is the thousands of women who fill full-time jobs in office and factory then returning home to the presumably full-time job of wife and homemaker. In most of the cases, their only reason for this added burden is to obtain a higher living standard. The inconvenience of searching out discounts to stretch expenditures is one which will cheerfully be endured as compared with the added work load.

CHAPTER VI

SUMMARY AND CONCLUSIONS

Nature of the Problem Summarized

The resale-price maintenance laws authorize manufacturers to establish the retail list price of their trade-marked products. The discount houses violate the provisions of these laws inasmuch as they reduce the manufacturers' stipulated prices below the designated minimum.

The enforcement machinery could minimize discount house operations if there were a concerted effort by manufacturers to do so. There are two types of action available to enforce resale-price violations. One is an action for damages for breach of the resale-price maintenance contract, the other is for injunctive relief.

The enforcement attempts meet many difficulties, however. Discounting is often hard to detect. Also, the cost of policing the distribution system is expensive to the manufacturer. In addition, there is the possibility of undesirable publicity for the distributor who enforces higher prices. Enforcement is particularly difficult when the manufacturer sells through wholesalers and has no continuous direct contact with all his dealers.

In many cases, even though the discounter is summoned to court, the court suits to enforce compliance with the laws are not effective because the fines are not large enough to discourage discounting.

Consumers do not ordinarily have an incentive to report discount

sales to manufacturers for action. Those who do attempt to report violations of the price laws are usually unable to provide proof of such violations.

There are loopholes in the laws which have created discordance in court decisions and further hampered enforcement procedures. One of these loopholes centers around the court decisions pertaining to price-maintained goods involved in interstate commerce. The other loophole pertains to the nonsigner clause, which is the resale-price laws' most powerful weapon.

The source of the manufacturers' enforcement difficulties is principally the discount house. The discount houses came into existence because of combinations of the following reasons:

1. There has been an increase in price competition at all levels of the distribution system.
2. Production has recently been catching up with demand. The discount houses have been able to dispose of the manufacturers' surpluses.
3. The redistribution of personal income during the past several years has helped pave the way for the discount house.
4. The consumers' reluctance to pay the increasingly rising prices has played its part also. Buying through discount houses has helped the consumer ease this situation.
5. The trend toward "do-it-yourself" products has enabled the consumer to make installations and repairs which formerly he expected from the retailer. This trend has fit in well with the discount houses' pattern of operations.
6. Consumers have confidence in manufacturers' brands, which has made it easier for the discount house to sell its products. This

exemplifies the fundamental foundation of discount operations, which is a standard value available at a lower cost and many times at a sacrifice in comfort and convenience.

The philosophy of the discount house--price competition--is not a new phenomenon, but is as old as the competitive system. The only thing new is the particular form it has taken. Discount houses began just about the time of the first price-maintenance laws in the 1930's. They started as small operations catering to a small clientele who had to have special identification cards.

Men and women while in the service became accustomed to purchases below the list price through the Post Exchange Stores and sought out discount purchases after they returned to civilian life.

Furthermore, people take pride in telling their neighbors that they purchased a well-known brand product at a discount. They take pride also in telling their neighbors where they, too, may buy at a discount. A person's desire to prove to others that he has "contacts" has increased the prominence of discount houses.

The chain store brought about the realization on the part of many consumers that the elimination of middlemen in the distribution system would result in a lower price to the consumer. The chain stores' lowered prices made the consumers critical of the distribution cost of some products.

It can be seen that the enforcement machinery has not curbed the discount house operations. The reasons for the breakdown of enforcement procedures, however, are not inherent in the enforcement techniques. Rather, it is a result of the change in the nature of the market.

At the end of World War II there was a great demand for consumer goods. However, the supply soon caught up with the demand and surpluses were created. Mass-production requires mass-distribution techniques. The manufacturers were in need of a type of outlet that could profitably distribute the products to the public at a price the public was willing to pay. The discount house satisfied the requirements of the manufacturers. This type of retail outlet placed the manufacturers in a position of determining whether they wanted the volume the discount house could provide or of risking loss of sales to competitors by continuing distribution to consumers through franchised dealers at stipulated prices.

The enforcement machinery has worked effectively in the past when the discount houses did not enjoy the prosperity they do today.

Many factors have been at work in the economy for the past several years that have created changes in the market. A revolution by consumers to broaden their purchasing power started the movement toward reduced prices on price-maintained goods.

At the time that the "consumer revolution" was gaining momentum, several social and economic changes were taking place. We moved from emphasis on production in our economy to a stressing of consumption. To meet this end we developed an extensive system of consumer financing and a broad program of consumer welfare. The changes all led to one end result and that was a transition from a sellers' to a buyers' market.

Conclusions

The basic hypothesis of this study was that a breakdown of the resale-price maintenance laws was a result of the change from a sellers'

to a buyers' market. In short, the retailer is no longer the benefactor, but the beneficiary. The consumer is now the benefactor.

Policing and enforcement is primarily left to the manufacturer, but he has little incentive to push the enforcement too far, because the discount house is a profitable outlet for the manufacturer. The distributors find discount houses a ready outlet for any surpluses they might have. The retailers realize that consumers are becoming more reluctant to pay the list price. Therefore, with the exception of a few industries with strong organizations, such as the drug industry, there is little encouragement of enforcement today.

The nature of the market is not such that policing groups find enforcement of maintained prices expedient. Therefore, to this extent the enforcement of the laws is ineffective and discount houses continue to exist and flourish.

In view of these conclusions, the reader may wonder if we have more discounting today than we have had in the past even though the market today is more favorable for the discounter.

There are many reasons why we do not have an answer to this question. The volume of consumer sales, both per capita and quantitative total, in monetary and real terms, has increased so much in the last fifty years that any sort of comparison is likely to go astray. Moreover, the problem is complicated by the fact that the total volume has changed during the period, but by how much no one knows. The short span of most of our statistical series does much to hamper research in retailing. The Bureau of the Census, for example, did not begin its annual estimates of total retail sales for this country until 1935. Most of our retail information is grouped according to stores classified

in terms of their principal merchandise lines instead of by any kind of business or by price policy. Also, most of the figures on discounting have emanated from extremely partisan sources. Even though some people may be proud of their ability to buy at a discount, consumer studies of discounting are hampered by the fact that many others are inclined to be rather secretive about it. Furthermore, no two students of discounting seem to have agreed upon definitions.

If discounting goes to the point of a complete breakdown of the price structure, we may not have anything that can really be called "discounting."

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