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Optimal Pricing for a Firm in Recession Periods Producing a
Conspicuous Product

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Abstract:

This paper considers the pricing problem of a firm producing a conspicuous product
while facing a recession period. The firm faces a demand function that includes de-
mand being increasing in brand image (cf. fashion, hotels, expensive cars, etc.) and a
zero-one variable indicating a demand reduction at times of recession. We analyze
how this firm should deal with a recession period. Generally speaking, the choice is
between keeping prices up, implying low revenue but high brand image, and allowing
for discounts, which leads to higher current revenues but a reduction of brand image.
Taking into account that during a recession it is more difficult to borrow money, we
impose that the firm is self financed during the recession period.

The problem is formulated as a two stage optimal control model, where stage 1 is the
recession period, while stage 2 is the "normal" period. It is assumed that the reces-
sion period ends at an uncertain point in time, which satisfies a Poisson arrival