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Implementing price increases in turbulent economies: Pricing approaches for reducing perceptions of price unfairness☆

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ABSTRACT

Consumer frustration over having less money in their pockets and, at the same time facing higher prices for products and services in the marketplace, arises during turbulent economic times (e.g., post-2007). Sellers suffer increased costs and pass along increases by raising prices to consumers. The current article discusses trends in the pricing literature and in practice that sellers utilize in limiting perceptions of price unfairness, particularly when increasing price in turbulent economic times. Specifically, engaging in transparency in pricing by revealing information about price changes to the consumer during poor economic times potentially reduces perceptions of price unfairness. Using industry-common price-setting practices, shrinking product volume, providing automatic rebates promotions, or offering price-matching promotions also likely reduces perceptions of price unfairness.

1. Introduction

The deteriorating U.S. economy of 2007 led to an eighteen-month recession and a lingering turbulent economy affecting countries around the globe. This global economic crisis devastated many including, among others, households, firms, and banks, increased unemployment, and collapsed investments and financial systems (Rochon & Rossi, 2010). The National Bureau of Economic Research (2010) confirmed June 2009 as the official end of the U.S. recession, however, the following months and years remained turbulent, as large and small businesses struggled for survival in an economy with reduced consumer demand and increased costs of doing business (e.g., increased costs of energy, food, and raw materials). Small business owners in particular, who accounted for almost 60% of the job losses in the recession, struggled with securing loans and providing employee healthcare (U.S. Small Business Administration, 2010).

Turbulent economic times strain sellers' profitability and call for price increases for sellers facing increasing costs. However, consumer frustration abounds, with less money in their pockets and higher prices in the marketplace. Consumers feel squeezed from both ends: poor interest rates, stock-market chaos, and unemployment or reduced salaries on one end; and paying more for consumable staples, such as food on the other end (Consumer Reports, 2008). The challenge facing sellers is the need for higher prices while remaining sensitive to consumers' own economic difficulties, all while minimizing negative consumer reaction.

While consumers understand a seller must increase price when the seller's costs increase (Bolton & Alba, 2006), consumers also want fair pricing. Particularly during times of economic distress or other disruptions (e.g., natural disasters), consumers' concerns about sellers taking advantage often result in government intervention. For example, higher gasoline prices following Hurricane Katrina generated accusations of price gouging. A Federal Trade Commission investigation found justified price increases due to higher cost of the supply of gasoline because of hurricane-damaged crude oil production and fluctuating market competition (Federal Trade Commission, 2006). Although extensive media coverage revealed hurricane damage to oil refineries and infrastructure (i.e., cost increase to the seller was salient), consumers remain suspicious of significant jumps in gas prices (Ferguson, Ellen, & Piscopo, 2011).

2. Perceptions of price fairness

Perceptions of price fairness represent consumer assessments and associated emotions regarding whether the seller's price, compared to a comparable other, is reasonable, acceptable, or justifiable (Xia, Monroe, & Cox, 2004, p. 3). Consumers who perceive a price as unfair experience negative attitudes toward the provider (Gebhardt, 2008), engage in self-protection behavior, such as complaining or leaving the relationship (Monroe & Xia, 2006), and/or engage in revenge-seeking behavior such as switching to a direct competitor (Monroe & Xia, 2006). In addition, prices perceived as unfair negatively impact demand in the marketplace (Anderson & Simester, 2008). Perceived price fairness influences consumers' shopping decisions and shopping

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expenditures (Daskalopulou, 2008). Daskalopulou (2008) findings suggest that consumers perceive an increased price as more fair and, consequently, pay more for transactions when sellers increase price specifically due to higher incurred costs. Therefore, sellers should ensure the highest level of perceived price fairness when executing a price increase.

Price increase implementation presents challenges because price increases often generate negative consumer responses (Homburg, Hoyer, & Koschate, 2005). Sellers raising price in a turbulent economic marketplace should attempt the reduction of negative consumer responses, particularly responses from consumers already experiencing financial constraints and using more discretion in making purchases. The current paper examines the global economic crisis marketplace in which price increases are a necessity. In addition, the current paper reviews trends in the pricing literature and in practice that sellers employ in reducing perceptions of price unfairness when increasing price during turbulent economic times. The objectives of this article are to examine marketplace approaches for implementing price increases and to propose strategies for reducing perceptions of price unfairness for sellers increasing prices during turbulent economic times. Specifically, the pricing approaches propositioned in the current paper include: providing transparency in pricing; implementing common price-setting practices; shrinking product volume, and utilizing price promotions including automatic rebates and price-matching.

3. The global economic crisis marketplace and necessary price increases

Firms weathering an economic downturn encounter unforeseen business cost increases. The global economic crisis marketplace is complicated and hinders recovery, particularly when firms, faced with additional costs due to inflation, natural disasters, or man-made crises, pass along increased costs to consumers in the form of price increases. Devastating natural disasters including earthquakes (e.g., New Zealand in 2011), tsunamis (e.g., Japan in 2011), and poor harvests (e.g., Columbia's cocoa in 2010, Russia's wheat in 2010) hamper economic growth in the regions affected and cause increased raw material, energy, and food costs across the globe. For example, McDonalds announced an increase in menu prices due to commodity price increases, including wheat and meat products (Ziobro, 2010). Additional crises (e.g., conflicts in the Middle East) result in higher energy prices that bring about higher fuel and transportation costs for firms. Multiple airlines, including American Airlines, imposed airfare increases in late 2010 and early 2011 due to fuel cost increases (Dallas Business Journal, 2010).

Consumers experience price increases in many industries, including financial services, during turbulent economic times. For example, the current financial crisis sparked regulations aimed at reducing predatory lending and preventing financial firms from taking advantage of consumers. Congress designed the Credit CARD Act of 2009 to protect consumers against unfair credit card fees or policies (e.g., limitations on increasing interest rate) (Federal Reserve Board, 2010a), but the Act also curbs some credit card firms' profitability. To offset the new rules, some credit card firms, including Citigroup, added annual fees to select existing accounts (Saha-Bubna, 2009). Similarly, 2010 Federal Reserve rules give consumers the opportunity for opting-out of overdraft protection and resulting fees from banks (Federal Reserve Board, 2010b). Some banks (e.g., Bank of America) initiated fees, such as adding fees to previously free checking accounts (Reckard, 2011), with the goal of replacing the revenue lost by overdraft fees.

U.S. consumers are not alone in experiencing price increases in a global economic crisis marketplace. U.K. consumers saw food prices rise 8.3% in 2008 (BBC News, 2008), increasing electricity and gas prices in 2010–2011 (BBC News, 2011), and increases in clothing prices due, in part, to increases in raw materials, freight, and labor costs in 2011 (Mintel, 2010). Taiwanese and Chinese consumers experienced price increases due to higher food prices, inflation, clothing costs, and transportation costs (Bloomberg News, 2011; The China Post, 2010). Greek consumers experienced higher prices with the addition of higher taxes on fuel and consumer products necessary for repayment of the 110 billion-euro Greek bailout from the European Union and International Monetary Fund (Bloomberg BusinessWeek, 2010).

In addition to external forces spurring firms increasing prices, consumers' attitudes change during turbulent economic times. Lower consumer trust of firms resulted post-2007 due to firms' lack of transparency in fees and misleading pricing (Hedges, 2010). According to Pew Research Center for the People, 2011, 46% of U.S. adults possessed a very or mostly unfavorable opinion of business corporations, and, according to a Bloomberg Poll, 2011, 38% of U.S. adults felt that banks needed more regulation and that banks still endanger the economy with risky acts. Consumer complaints against banks in 2010 were at an all-time high, even after banks began adhering to the new overdraft rules (Gogoi, 2010). Consumers became more price-sensitive according to a Gallup Poll, 2008, that found 81% of U.S. adults made a greater effort to find the cheapest price for products they bought.

4. Pricing approaches to limit perceptions of price unfairness

Sellers' decisions for setting or changing price are not limited to times of recession or turbulent economies. Instead, sellers make decisions about price-setting throughout business cycles. Table 1 presents select price-setting practices that firms engage, including during product introduction (e.g., penetration pricing, price skimming), when products are risky to the seller (e.g., risk-based pricing), and during periods of market fluctuation (e.g., anticipated demand price-setting and anticipated supply price-setting). (For a review of pricing strategies, see Tellis (1986)).

Although price-setting is a common business occurrence, in times of high unemployment, limited demand, increased inflation, and other crisis factors, sellers must cautiously decide strategies of implementation of price increases. Compounding the poor economic situation facing sellers, consumers face difficult personal financial situational factors (e.g., lost wages, less discretionary spending) and consumers' attitudes and behavior worsen (e.g., less trusting, more price sensitive). The unique mix of recession-weathered businesses and cash-strapped consumers requires seller prudence. Sellers anticipating perceptions of price unfairness for an impending price increase benefit by engaging in certain pricing implementation approaches. Table 2 presents pricing approaches for implementing price increases in a turbulent economy, including, providing transparency in pricing, using common price-setting practices, shrinking product volume, and by engaging in pricing promotions such as automatic rebates or price-matching.

4.1. Transparency in pricing

The publicized case of Amazon.com's dynamic pricing strategy to charge higher prices for the same DVD based on consumer characteristics, such as past purchases, demonstrates negative consumer responses to pricing decisions (Austin & Gravelle, 2008). Amazon originally kept the pricing strategy quiet, but once exposed, consumer outrage and backlash were so severe Amazon ceased the dynamic pricing strategy and publicly apologized. Sellers take a risk using price-setting practices deemed socially unacceptable in the marketplace because such practices risk revelation to consumers, even if the seller attempts at keeping the price-setting practice concealed.

Transparency in pricing occurs when the seller reveals to the consumer price-setting or price-changing information (e.g., designated mark-up, motive for impending price increase). Consumers require information about prices for products or services for making informed decisions, but consumer knowledge about how sellers set and change prices helps consumers empathize with seller pricing decisions, and, potentially, helps consumers accept price increases with less negative