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ScienceDirect

Procedia - Social and Behavioral Sciences 148 (2014) 1 – 6

Procedia
Social and Behavioral Sciences

ICSIM

Value Based Pricing: A Research on Service Sector using Van Westendorp Price Sensitivity Scale

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Abstract

One of the significant features of modern marketing is its consumer-oriented approach. Because of the multiple effects of pricing decisions, the importance of the consumer-oriented approach increases. Accordingly, business organizations have to take into account consumers' perception in their pricing decisions. Van Westendorp Price Sensitivity Meter is one of the price sensitivity methods, which is used to measure price sensitivity of consumers. The responses of four questions in the scale are displayed graphically using plots of cumulative percentages for each question in Van Westendorp PSM.
Three important findings related with pricing can be obtained by this method. These are Optimal Price Point, The Range of Acceptable Price and Indifference Price. In this study, the prices are listed as: optimal price 360 TL, indifference price 345 TL and the range of acceptable price 320 TL - 385 TL. These findings show that the price sensitivity of the university students on private dormitories is high.

Selection and peer-review under responsibility of the 2nd International Conference on Strategic Innovative Marketing.
Keywords: Price, Value Based Pricing, Van Westendorp Price Sensitivity Scale

1. Introduction

Price, which is one of the strongest marketing tools, has a great impact on consumers' buying behaviors, which cause a direct impact on sales and profitability of the business organizations (Han et al., 2001: 436). Price can directly affect market share, positioning, segmentation and marketing program of the business organizations. In addition, it is a criterion that consumer use to evaluate product and brand and it also has an impact on perception of the consumers (Yükselen, 2008: 275). Price is perceived not just a negative factor, which consumes consumers'

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Selection and peer-review under responsibility of the 2nd International Conference on Strategic Innovative Marketing.
doi:10.1016/j.sbspro.2014.07.013

resources, but perceived as a positive factor, which gives them clue about the product quality (Lichtenstein et al., 1993: 158).

Price has been the most important factor affecting consumers' preferences historically. This reality is still valid among the customers with low income and in poor countries. Although price is the most important factor that affects consumers' preference, especially nowadays the factors such as quality, promotion and distribution etc. have been becoming more important (Kotler et al., 1999: 682-685).

A business organization should consider consumers' standard of judgment, consumers' demand within different price levels and the reasons of price sensitivity (Saxena, 2006: 324). Price sensitivity can be described as consumers' reaction to the price of products or services (Clausen, 2004: 2). There are different factors effecting price sensitivity. (East, Wright & Vanhule, 2008: 273). One of the important factors is the value perceived by consumers.

Price is the easiest factor to be changed in the marketing mix. Determining the price does not require any investment as it is in advertising, product development and establishing a distribution channel. Price change can be done more easily than product and distribution channel change. The elasticity of demand is higher than the elasticity of advertising. Due to these reasons, pricing decision is one of the most crucial decisions of the marketing managers (Eser et al., 2011: 455).

In practice, managers states price by using three basic strategies such as cost-based, value-based and competition-based pricing (Kotler et al., 1999: 699; Eser & Korkmaz, 2011: 155; Verma, 2012: 82; Rao, 2009: 172; Tek, 1999: 476).

Cost-based price strategy; is an easy to use and common technique. In this strategy firstly, the cost of the product or service is examined. The price of a product or service is measured by adding a certain unit of profit to the sum of the cost items such as labor cost, supply cost, indirect expenses or general expenses (Verma, 2012: 82; Eser et al., 2011: 459; Kotler et al., 1999: 699).

Competition-based price strategy; is related with prices of competitors. This strategy is based on the assumption that the consumers evaluate products of a business organization according to the rivals' prices for the similar products (Eser et al., 2011: 466). In competition-based pricing strategy, business organization prices the products based on competitor's price as a primary resource (Hinterhuber, 2008: 42). There are two situations in which the competition-based pricing is appropriate. Firstly, when whole business organizations offer standard products or services; secondly, when there are a few big businesses in the market, which is called oligopoly (Rao, 2009: 173).

Value-based price strategy; the business organization started to use value-based pricing when the rivalry started to increase in the beginning of 1990's. The important thing in this technique is perception of the consumers. In other words, value-based pricing, based on the value attached to product by consumers, is a consumer-oriented pricing technique (Rao, 2009: 173; Altunışık et al., 2006: 180-181). Increasing number of business organizations prices their products or services based on consumers' perceived value. In value-based pricing, business organizations use consumer's perceived value instead of cost of the products or services. In this technique, marketing managers price the product or service with components of the marketing mix. They do not price the products or services before product design and marketing program. In cost-based pricing, business organizations add a certain amount of profit to total product cost and then price the product. Then they have to persuade consumers that the price is appropriate for that certain product. If the price is perceived to be high, business organization have to decrease the price or they have to accept low sale. In both scenarios, the business organization would be disappointed since they can not gain the profit they had expected. On the other side, value-based pricing reverses this process. Business organizations determine the price of a product based on the consumers' perceived value. In other words, pricing is determined by analyzing the needs of consumers and their value perceptions (Kotler et al., 1999: 702).

In different sectors, most of the business organizations use value-based pricing; however this technique is more common in service sector. The aim of value-based pricing is to determine a price, which is appropriate for the quality of the product. In the market, prices can be observed as neither high nor low. Price is determined by considering the cost of buying a product and benefit that will be obtained. Value-based pricing is used by well-known firms such as Walmart, IKEA and Southwest Airlines. These firms have the capacity to offer products with reasonable prices, since organizations are designed to work with low cost in these sectors. Firm adopting value-based pricing maintains consistent prices over time; they use sales, discounts, and other pricing tactics infrequently. Value-based pricing pull consumers into the organizations since the consumers trust the value of the products or services. Consumers prefer value-based pricing, because this technique helps them to find what they need and want