

A Critical Review of Consumers' Sensitivity to Price: Managerial and Theoretical Issues

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Abstract

Consumers' price sensitivity is an important input to strategic and tactical decisions. Price sensitivities depend on various factors for which our purpose of this paper is to explore consumers' price sensitivity and innovativeness as well as to contribute to diffusion theory by adding information on price sensitivity. This research reviews how consumers demonstrate their sensitivities to price on their product purchase decisions. Consumer's sensitivity to price has a significant impact on product innovativeness as most of the product purchase decisions are being made based on price rather than the brand or accessibility. Our discussions and findings will have important implications for managers and researchers. Managers may get guidelines for taking their pricing decisions to achieve maximum earnings while researchers can go for further study.

Keywords: Consumer, Price sensitivity, Innovativeness, Product quality, Perceived benefit

Introduction

Price sensitivity is one of the key factors affecting to companies pricing choices as well as its ultimate profitability. Nowadays, customers are well informed about product or service alternatives, product benefits, features, qualities and prices through advertising, family members, peer groups, opinion leaders, social networks, public information sources, and newspapers.

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Customers are not too blind to buy a product without searching information about a product or service. Actually, consumers are sensitive to the prices because they want to get maximum benefits of using their money and time. Consumers are very rational to judge what they are getting from buying a product or service in exchange of their payments for it.

Price Sensitivity

Price sensitivity is an individual difference variable describing how individual consumers show their reactions to changes in price levels. Price Sensitivity is the awareness of the consumers to what they perceive about the cost within which they will buy a particular product or service. Each customer will have a certain price acceptability range and different customers have different limits in their perceptions of what price is within their ranges. Customer perceptions of price and their responses to price indicate whether a market is very price sensitive or not. Generally, marketers and researchers are familiar with the concept of price elasticity. If the changes in price have a proportionately greater impact on demand for a product then it is known as elastic demand. On the other hand, inelastic demand narrates the situation where changes in price have a little effect on the demand. The concept of price elasticity illustrates the aggregate response of a market segment to price levels. Pricing strategies and buyers' responses to prices have received a great deal of scholarly attention (e.g. Monro, 1990; Nagle, 1987), but most of these researches have focused on the aggregate response of the market, price elasticity, and not on individual consumer response (Gatignon, 1984; Kanetkar et al., 1992).

Price Sensitivity According to Some Research

Price sensitivity refers to the extent to which individuals perceive and respond to changes or differences in prices for products or services (Monroe, 1973). Price research has typically focused on routine decisions in response to changes in price (Bucklin, Gupta, & Han, 1995), price format (Dhar & Hoch, 1996), or price framing (Lichtenstein & Bearden, 1989).

More than fifteen years ago, Rao (1984) reviewed the "state of the art" of pricing research in marketing and found that it typically focused on groceries in general and on consumer packaged goods in particular. This focus has largely remained unchanged, with little work conducted with regard to goods or services purchased outside the grocery store.

In some recent studies, some researchers have examined price sensitivity as independent variable with regard to services (Lee & Ng, 2001) and prescription drugs (Gonul, Carter, Petrova, & Srinivasan, 2001). Bundled pricing also makes the partitioned components more important than when the prices are not bundled (Chakravarti et al. 2002). Customers with moderate usage are least sensitive compared to low-end users (Tuha, 2005). Higher perceived price shows greater monetary loss for customers, which leads to lower purchase intentions (Hee, & Darren, 2006).

Perceived Benefits and Price Sensitivity

Most of the literatures suggest that consumers' evaluation of the value of a good or service is based on their perceptions that what they actually receive and what they expected of having it (Monroe 1990; Zeithaml 1998). Therefore, perceived value, usually defined in the literature as the ratio of the perceived benefits of the goods or services to the perceived sacrifice in acquiring them (Monroe, 1990). This is positively influenced by benefits and negatively influenced by price (Dodds, Monroe and Grewal, 1991; Monroe, 1990; Woodruff, 1997; Zeithaml, 1988). Consumers might perceive the benefits of a good or service from different angles, such as functional, social, emotional, and conditional (Sheth, Newman and Gross, 1991; Sweeney and Soutar, 2001). For instance, functional benefits come from the instrumental usefulness of the good or its ability for delivering functional, utilitarian, or physical role.

Brief Discussion about Price Sensitivity According to the Articles

To know about customers' price sensitivity is really a crucial part for a company because price affects company's profitability. Marketing executives make decision considering the supremacy of the customers who can pull the company to its success. That is why; many companies are coming out with the market research before launching its product in the market. On the other hand, some other companies depend on the existing research and scholars' opinio

Service Quality and Price Sensitivity

According to Tuha Munnukka, University of Jyvaskylia, Finland- a customer's price sensitivity can be significantly explained by a customer's level of satisfaction to operator's service regarding mobile service.

He added that intensive and low-end users are most sensitive to price changes while moderate users are less sensitive. Moreover, a customer's price sensitivity can be significantly explained by a customer's price perception. Perception is the process by which people translate sensory impressions into a coherent and unified view of the world around them. We can also define that perception is the process by which customers select, organize, and interpret information to form a meaningful shadow of the relevant things. Related to price perceptions and adoption of innovations, Goldsmith and Newell (1997) found shopping innovators to be less price sensitive than laggards.

Loyalty and Price Sensitivity

When customers are satisfied with the products or services, they buy the product again and again. These customers become loyal to the company as well as its brand. Loyal customers are very necessary for a company to build brand equity and to survive in the market by holding a good portion of market share. Loyal customers are price insensitive to the price changes while non-loyal customers are sensitive in making decision about a brand (Kanghyun and Thanh, 2011). Their findings also give us the idea about the loyal customers. According to research, neither 99.9 percent nor 0 percent cutoff level is optimal in segmenting the market into loyal and non-loyal consumers assuming that the market consists of two kinds of consumers i.e. loyal and non-loyal. Some other literatures also support that loyal consumers are price insensitive and non-loyal consumers are sensitive to the price changes when they make decision to purchase (Brown, 1974; Webster, 1965; Krisnamurthi and Raj, 1991; Massy and Frank, 1965; Wernerfelt, 1991). In the loyal segment, some consumers aim to purchase the same brand repeatedly because of its nonmonetary features, whereas others do the same in response to the attractive promotional offers. As an example, Ailawadi, Neslin, and Gedenk (2001) illustrate that the first type of loyal consumers—namely, value conscious loyals—pursue specific brands because of their unique values and features. Chan, Narasimhan, and Zhang (2008) find that some brand loyals respond to price promotion by stockpiling. Eventually, Krishna (1994) and Sun, Neslin, and Srinivasan (2003) show that loyal consumers are more likely to accelerate purchase timing decision than disloyal. Their findings suggest that loyal consumers might show value-conscious as well as deal-prone loyal behaviors.

Consumers in the non-loyal segment frequently switch brands as a result of either the desire for variety (McAlister and Pessemier, 1982; Seetharaman and Chintagunta, 1998) or the chase for promotional benefits (Brown 1974; Schneider and Currim, 1991).

Innovativeness and Price Sensitivity

Price sensitivity may also be varied to the innovativeness of the products. Innovators seem to be less price sensitive than later buyers, i.e. early majority, late majority and laggards. Innovators play a crucial role in the diffusion of the products (Foxall, 1984). Innovators typically influence the later buyers as opinion leaders (Gatingnon and Robertson, 1991). Consumer innovators are the earliest buyers of new products. Their role in the diffusion process is important because they provide revenue and feedback to firms who launch new products; they influence the spread of the new product to later buyers via word of mouth; and their rejection of a new product may spell its demise (Foxall, 1984; Gatignon and Robertson, 1991; Kotler, 1994). A great deal of research has been devoted to describing and explaining innovative behavior (Rogers, 1983), and several sound empirical generalizations have been proposed. Goldsmith and Flynn (1995) provide a brief summary of much of these findings. Innovativeness is domain specific; that is, consumers tend to be innovators for specific product categories. Innovators are thought to be not only opinion leaders, but also more knowledgeable about new products, more involved in the product category, have greater media exposure, and are heavier users of the product category.

Situational Price Sensitivity

Price becomes less sensitive for hedonic products or services that are consumed in hedonic occasion. In addition, high income leads to less price sensitivity for hedonic goods or services, compared to functional goods or services (Wakefield, and Inman, 2003). The more hedonic the perceived product or consumption occasion for, the less the price sensitivity. Research suggests that consumers are likely to respond differently to price changes in different product categories (Gardner, 1971; Monroe, 1973). For instance, in Tellis (1988) found that price elasticity varied substantially across product categories.

He suggests that these differences (compared to pharmaceuticals) are the result of higher product risk in pharmaceuticals than the other categories studied (i.e., detergents, durable goods, food, and toiletries).

Partitioned Product and Price Sensitivity

Partitioned components become more salient due to partitioned pricing (Chakravarti et al. 2002). For instance, partitioning the price of a warranty might raise concerns about dependency more than partitioning the price of another component. Some research explains that consumers will focus more on the price of the component that constitutes a smaller proportion of the total price while some other express reverse of it when evaluating partitioned prices. Weber's law directs us that consumers are likely to be more sensitive to a change in the price of a less expensive component than to a change of the same absolute magnitude in the price of a more expensive component (Monroe, 1971). Some research focused on the relative size of the components while some other emphasized on the nature of the components. Partitioned pricing enables consumers to evaluate each component unambiguously to its respective price (Chakravarti et al. 2002). It encourages the consumers to evaluate the value of the components separately rather than assessing the product jointly.

Tariff and Price Sensitivity

Consumers can choose a wide variety of optional pricing plans, including flat rates, pay-per-use tariffs, or two-and three-part tariffs because consumers' tariff choice affects their usages, the billing rate, and the company's revenues. The best examples are telecommunication, online information. Consumers pay only an access price for a flat-rate tariff, whereas pay-per-use tariffs charge only a usage price. In a two-part tariff, consumers pay both an access price for having access to the service and a usage price for the quantity used (Brown and Sibley, 1986). Consumers get a usage allowance for paying the access price in a three-part tariff, e.g., free minutes on a cell-phone plan, and then pay a usage price only when their usage exceeds the allowance (Lambrecht, Seim, and Skiera, 2007). It is assumed that consumers prefer the tariff that minimizes their billing rate, given their expected usage when choosing among menus of those tariffs, (Brown and Sibley, 1986; Iyengar, Jedidi, and Kohli, 2008). Recent studies show that many consumers choose a tariff that does not minimize their billing rate, but are subject to a flat-rate bias. Consumers select a flat-rate or a tariff with a higher allowance even though they would pay less on a tariff that charges for actual usage.

Alternatively, they may choose a tariff that charges for actual usage even though they would pay less on a flat rate (pay-per-use bias) (see among others Lambrecht and Skiera, 2006; Miravete, 2002; Nunes, 2000; Train, McFadden, and Ben-Akiva, 1987). These results suggest that, in addition to billing rate, choice of tariffs is also driven by consumers' preferences for tariff-specific characteristics, such as a high allowance.

Online Customers and Price Sensitivity

Consumers are becoming online based buyers due to the faster expansion of the online all over the world. It is more convenient for the online buyers to compare the products offered by the various online sellers. It reduces the search cost for customers, facilitated partially by internet shop bots, such as google.com, narrows price variation among the online vendors and ultimately increases the competition (Bakos, 1997). In competing with low customer search costs, many online vendors offer unexpected low prices to attract their customers assuming that customers would buy products from the vendor who offers the lowest price (Baker, et al., 2001). Yet it is known to all that very few Internet vendors can survive by adopting these low-cost strategies (Mahajan, V., Srinivasan, and Wind, 2002). As a result, many of the online retailers filed for bankruptcy and close their operations. This is because intense price competition prohibited them from generating enough profits. In spite of the existence of very low prices, the study also found that even price sensitive customers do not always purchase products from online vendors that offer the lowest prices (Smith and Brynjolfsson, 2001). Pricing is a critical decision for any business, and especially so for Internet vendors. Another research found that trust is a non-price attribute which has a stronger effect than price perception on online purchase intention.

Recommendation

It can be said undoubtedly that there are a lot of studies about price sensitivity. But, most of the researches are related with the products not with the services. We recommend that researchers should emphasize on the service sectors, such as banking, money transfer or remittance, medical or clinical service (doctor and nurse), legal service (advocacy), air services, etc. Hopefully, this deprived service sector will be the emerging sector for the researchers because customers are still switching from one alternative to other alternatives brands or service institutions.

Conclusion

It is not an easy task for the concerned people to take decision about price. Price is not just only an amount that customers pay for utilizing a product or having a service. Price is most influencing factor for buying a product (consumers' view) and for earning profit from selling the product (manufacturers' view). It is most influencing factor for buying because consumers are rational; they have limited income as well as limited budget. On the other hand, company can sustain in the market if and only if they can make profit which totally depends on price. When a company is going to determine price of a product or service, they need to think about the rationality of pricing that might include product's quality, availability of the alternatives in the market, types of product and category of entry into market. If these are not well performed, consumers will show their negative sensitivity towards the product not buying the product or buying the product in small portion. Different consumers behave differently when companies increase or decrease the current price. Truly, consumers are almost insensitive or not negative towards a product when price is reduced. So, consumers' sensitivity in pricing is a most important thing that should be highly treated by the marketing executives as well as company's top executives like CEO.

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