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THE DESCRIPTION ANALYSIS OF THE INFLUENCE OF THE FACTORS AND THEIR IMPACT ON THE PERCEPTIONS OF THE VALUE

Adrian MICU
Angela-Eliza MICU

Universitatea “Dunarea de Jos”Galati
Facutatea de Stiinte Economice
Catedra de Management-Marketing
mkdradrianmicu@yahoo.com
angelaelizamicu@yahoo.com

Effective marketing efforts can position a brand as a good value by targeting customers with a high frame of reference for comparison. In personal selling, the reference price effect implies that the salesperson should begin by first showing customers products above their price range, even if the customers will ultimately look at cheaper products as well This tactic, known as top-down selling, is common in sales of products as diverse as automobiles, luggage, and real estate. Direct-mail catalogs take advantage of this effect by displaying similar products in the order of most to least expensive. Within a retail store, the order effect has implications for product display. It implies, for example, that a grocery store may sell more low-priced (but high-margin) house brands by not putting them at eye level where they would be the first to catch the customer's attention. Rather, it may be preferable to have consumers see more expensive brands first and then look to the house brands.

Key words: decision, pricing, cost.

The goal of value-based pricing is to maximize a company's ability to capture the economic value it creates in the profits it earns. If purchasers knew everything about the products offered and their own needs, if they could easily determine how the products would help them satisfy their needs, and if they did not believe they could influence the seller's prices through negotiation, then economic value would exactly predict their purchase behavior. In the real world, there are obviously many reasons for gaps between buyers' willingness to pay and the value they receive. Uncertainty, fairness, vanity, and expectations all play roles that mitigate the power of value to drive prices. Value-based pricing strategy involves managing customer perceptions proactively to influence that gap between price paid and value received.

Most companies ignore value in pricing, and set prices in reaction to what customers are willing to pay without understanding what drives it. In doing so they miss the opportunity to actively influence customer perceptions in ways that can increase their own profitability and their customers' purchase satisfaction. To do so, marketers must first understand what causes the gap between value and willingness to pay. There are nine "effects" that influence willingness to pay and cause buyers to be more or less sensitive to the difference between price and value when making purchase decisions. For each factor, there are tactics that suppliers can use to reduce the gap between the value they offer and the prices they must charge to win business.

Step 1: Identify the cost of the competitive product or process that the customer views as the best alternative.

Restate the cost of the alternative in terms of units of the product for which you are calculating economic value. This is the product's *reference value,* or value if it were functionally identical to the current product. For example, if one unit of your product replaces two of theirs, then the reference value for your product is the cost of two units of their product.

Step 2: Identify all factors that differentiate your product from the competitive product or process. For example:

- Superior (inferior) performance
- Better (poorer) reliability
- Additional (reduced) features
- Lower (higher) maintenance cost
- Superior (inferior) reliability
- Higher (lower) startup costs
- Faster (slower) service

Step 3: Determine the value to the customer of these differentiating factors. Sources of value may be subjective (for example, greater pleasure in consuming the product) or objective (for example, cost savings, profit gains).

The positive and negative values associated with the product's differentiating attributes comprise the *differentiation value.*

Warnings

- Consider only the value of the *difference* between this product and the alternative. For example, both products may be highly effective, but only the difference in their effectiveness is differentiation value. The economic value of anything that is the same is already captured in reference value.
- Measure the value of the difference either as costs saved to achieve a particular benefit *or* as extra benefits achieved for a given cost. Don't add both; that's double counting.
- Do not assume that the percentage increase in value is simply proportional to the percentage increase in effectiveness of your product. That usually produces a gross underestimation of the actual value to the customer.

Step 4: Sum the reference value and the differentiation value to determine the *total economic value,* the value that someone would pay who was fully informed and economically rational when making the purchase decision.

Determine the selling price, recognizing that new products must usually be priced below economic value as an inducement to purchase. The prices of established products that already have the customer's business can include a "reputation premium," analogous to the inducement that the newcomer must offer. When buyers have little ability or interest to determine economic value, or when the cost of switching suppliers is high, the factors affecting the "inducement" or "premium" may, in fact, be more important for pricing than the economic value.

EXHIBIT ; Steps in Economic Value Estimations

Reference Price Effect

Economic value is recognized accurately only by customers who are fully informed about the alternatives. In the real world, customers are rarely so informed: they often flounder in a sea of information. This reality has important implications both for segmenting customers and for influencing their price sensitivity. The *reference price effect* states that buyers are more price sensitive the higher the product's price relative to the prices of the buyers' perceived alternatives.

The key word here is "perceived." Perceptions of the available substitutes and their prices differ widely among customers and across purchase situations. Customers new to a market are usually less aware of the discount brands than people with more experience. Consequently, they usually pay relatively high prices and buy from the most visible suppliers. In a similar vein, restaurateurs in resort areas face far less pressure to compete on price, despite the greater concentration of restaurants in those locations, because their transient clientele is usually unaware of better alternatives. Local residents view restaurants near resort hotels as "tourist traps," precisely because they can charge higher prices than restaurants less visible to tourists but patronized by a more informed clientele.

A buyer's reference price is also influenced by recall of prices seen in the past. This has important implications for pricing new products. Many marketing theorists have argued that new products should be priced low to induce trial and thus build a market of repeat purchasers, after which price can be raised. However, if the low initial price lowers buyers' reference prices, it may actually adversely affect some repeat sales. This is precisely the result that some researchers have found. In one well-controlled study, five new brands were introduced to the market in two sets of stores. During an introductory period, one set of stores sold the new brands at a low price without any indication that this was a temporary promotional price; other control stores sold the new brands at the regular price. As expected, the brands sold better during the introductory period where they were priced lower. During the weeks following the introduction, however, both sets of stores charged the regular price. In all five cases, sales during the postintroductory period were lower in the experimental stores than in the control stores. Moreover, total sales for the introductory and postintroductory periods combined were greater in the control stores than in the stores where the low price initially stimulated demand. This, and other studies showing similar results, demonstrates the importance of dealing tactics such as coupons, rebates, and special packages that minimize this effect by clearly establishing a product's regular price and offering lower prices only as special discounts. Otherwise, initially low promotional prices can establish low reference prices for judging the value of later purchases.

A customer’s perception of the available substitutes is not necessarily based on awareness of specific brands and exact prices. Given the number of product categories and brands from which most people make purchases, maintaining awareness of such a vast amount of information would be impossible, even for the most educated and diligent customer. Consequently, for many product categories, a customer simply maintains a general expectation of a price level that seems reasonable. Psychologists call this expectation the customer's *reference price expectation* for the category.

We know from managerial experience and controlled experiments that these reference price expectations are manageable at the point of sale. For example, a business machine company with three models in its line found the sales of the top-end model disappointing. The company believed that many customers who should have valued the extra features of this high-production machine were instead buying the mid-priced model.

Management's initial assumption was that the high-end model must be overpriced. After talking with customers in the appropriate segment, however, they learned that most did not think that the product was overpriced. They simply could not overcome the objections of the financial officer that the company did not need "the most expensive model." The solution: The company added a fourth, even more expensive model to its line. The new model sold very poorly, but sales of what was previously the top-end model increased dramatically.

In some cases, a buyer's reference price depends on his or her expectation about future prices. The effect of future price expectations on a buyer's current reference price will be positively related to that buyer's ability to delay purchase into the future. Products maintained in inventories that can be temporarily drawn down, and durable goods for which there is some discretion regarding when to replace them, will often meet this criterion. Auto companies experienced this when they offered temporary "rebates" on car prices. Initially, the rebates appeared to drive up demand much more than simply reducing prices. The reason for that appearance, however, was that the rebate made the lower prices explicitly temporary. Consequently, they caused people to accelerate purchases they would have eventually made at higher prices. By using rebates repeatedly, auto companies educated auto buyers to wait for the next rebate, even when they otherwise would have purchased sooner at a higher price.

Companies in business markets sometimes create this same downward pressure on prices when they regularly discount prices at the ends of a quarter or year in order to meet sales goals.

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