

# A Review of The Effect of Pricing Strategies on The Purchase of Consumer Goods

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**Abstract**— This study examined the effect of pricing strategies on the purchase of consumer goods. Also examined in this research is the effect of internet (online presence) on informed purchase decision. The research intended to answer questions on the extent to which competitor's price affects purchase of products, how customers perceive the value-based pricing concept of firms and the extent to which online pricing inform customer purchase decision. This paper being descriptive and historical relied heavily on secondary sources of information. The research utilized a descriptive and historical method and relied heavily and solely on secondary instruments as sources of data. Findings from the data obtained indicate that consumers have a perception of value reflected in prices of firms' products. It also shows that competitors price affect the purchase of firm products and that online pricing informs and affects purchase decision. This study contributes to knowledge in series of issues associated with pricing strategies and purchase decision process. This research recommends that as much as firms should focus on communicating value to customers through prices, firms should also be on the watch for competitor's prices and examine how much it affects purchase of their products.

**Keywords**— Pricing behavior, products, online presence, competition, perceived value

## I. INTRODUCTION AND BACKGROUND OF THE STUDY

In the face of rapid economic and technological changes, today's consumer is more curious, more educated and conversant with what he/she exactly wants. These changes also affect the needs of firms. According to Ehmke et al (2005), marketing your business is about how you position it to satisfy your customers' needs. Borden (1984) stated that marketing manager must weigh the behavioral forces and then handle marketing elements in his mix with focus on the resources with which he has to work when building a marketing program to fit the needs of a firm. For

marketing to effect a change either in a new product or reinvigorate a new brand there are elements that remains constant which must be incorporated in the marketing mix and this is called the "Four P's". These four P's are product, price, promotion and place (Ehmke et al 2005). In the context of this paper, the emphasis will be on price; hence the need to elucidate more on meaning of price to both customers and firms.

Price is the amount a customer pays for a product or the sum of the values that consumers exchange for the benefits of having or using a product or service (Bearden et al 2004). Price means different things to different people; it is interest to lenders, COT or service charged by the banker (lenders), premium to the insurer, fare to the transporter, honorarium to the guest lecturer etc, (Kotler et al 2008). According to Rosa et al (2011), the importance of price as a purchase stimulus has a key role in price management since not only does it determine the way prices are perceived and valued, but it also influences consumer purchase decisions (Rosa, 2001; Simon, 1989; Vanhuele and Dreze, 2002). Studies have shown price as an important factor in purchase decision, especially for frequently purchased products, affecting choices for store, product and brand (Rondan, 2004).

The greater the importance of price in purchases decisions, the greater the intensity of information and the greater the amount of comparisons between competing brands (Mazumdar and Monroe, 1990). Considering the nature of the consumer products (frequently purchased and consumed products, implying medium-low level of consumer-supplier interaction), the basic is, the customers who usually purchase are more frequently in contact with prices. Pricing strategy is paramount to every organization involved in the production of consumer goods and services because it gives a cue about the company and its products, a company does not set a single price but rather a pricing structure that covers different items in its line (Kotler et al, 2001). According to Hinterhuber (2008) pricing strategies vary considerably across industries, countries

and customers and can be categorized into three groups: cost-based pricing, competition-based pricing, and customer value-based pricing. These will be discussed in detail in the next section.

Choosing a pricing objective and associated strategy is an important function of the business owner and an integral part of the business plan or planning process. It is more than simply calculating the cost of production and adding a markup (Roth 2007). Therefore, assigning product prices is a strategic activity and the price or prices assigned to a product or range of products will have an impact on the extent to which consumers view the firm's products and determine its subsequent purchase. However, it is less clear how pricing activities can be guided by the marketing concept. Certainly, customers would prefer paying less, in fact, they would even prefer to pay nothing but it is simply not feasible to give products without price (Sagepub.com 2009). An organization that does that will run dry and out of business and would not be able to create value for the customers. Subsequently these constitute problems that have provided a purpose for this research and they will be discussed subsequently.

The crux of this study is to understand the extent to which customers perceive the cost oriented pricing strategies of firms. It is dangerous to assume that customers perceive a particular pricing strategy as fair; furthermore it is also out of place to state that customers believe that whatever price is set is a reflection of the cost of producing a product. Backman (1953) points out that "...the graveyard of business is filled with the skeletons of companies that attempted to base their prices solely on costs". More so, other pricing strategies used by competitors also interfere and have an effect on products. Another problem is rooted in consumers not understanding the value-based pricing strategy of the firm and it is a strategy that is adopted by a few firms (Hinterhuber 2008). If a firm thinks it is communicating value via its prices and customers on the other hand do not perceive value as relating to the set prices then the pricing objective of the firm is defeated. Lastly the only constant thing which is change especially in the technological environment has also posed its own challenges within the corridors of pricing strategies.

The web has come into existence and businesses have gone online and pricing of products and services have also taken another form. Presently, the exposure of customers to online and offline prices have a significant influences on their purchase decisions. The new technologically advanced distribution channels permit anyone to receive the most up-to-date multimedia information on the best connections, and at the best prices (Keller 1996).

## II. REVIEW OF RELATED LITERATURE

According to Agwu and Carter (2014), "among the four Ps, price is the only income generator and it is the value attached to a product. Furthermore, price is the amount of money charged for a product or service. It is the sum of all the values that customers give up in order to gain the benefits of having or using a product (Kotler et al 2010). Baker (1996) noted that price is the mechanism which ensures that the two forces (demand and supply) are in equilibrium. According to Santon (1981) price is simply an offer or an experiment to task the pulse of the market. It is the monetary value for which the seller is willing to exchange for an item (Agbonifoh et al, 1998). Ezeudu (2004) argues that price is the exchange value of goods and services. Schewe (1987) defines price as what one gives up in exchange for a product or service.

It is one of the most important elements of the marketing mix as it is the only one that generates revenue for the firm unlike the others that consume funds (Agwu and Carter 2014). Lovelock (1996) suggested that pricing is the only element of the marketing mix that produces revenues for the firm, while all the others are related to expenses. Diamantopoulos (1991) also argued that, "price is the most flexible element of marketing strategy in that pricing decisions can be implemented relatively quickly in comparison with the other elements of marketing strategy". It is capable of determining a firm's market share and profitability. Kellogg et al., (1997 p.210) point out: "If effective product development, promotion and distribution sow the seeds of business success, effective pricing is the harvest. Although effective pricing can never compensate for poor execution of the first three elements, ineffective pricing can surely prevent those efforts from resulting in financial success".

Typically, pricing strategies that are investigated in the marketing literature consist of analyzing aggregated prices (Tellis 1986). For consumer goods, this is applicable unlike the several types of disaggregate pricing strategies that are utilized to promote products as favorably as possible (Eliashberg et al 1986). These consumer products usually have small prices that are paid up at once. Disaggregate pricing means paying in bits for instance reframing a ₦500 expense into ₦1.40 a day expense diminishes the enormity of the expense, and therefore, eases the decision process for the consumer. This however does not apply at all to consumer goods therefore appropriate pricing strategies which are aggregate must be adopted to ease the decision making process of consumers. Traditional pricing strategy by definition is incapable of harmonious associations, but it needs to become a more socially conscious, collaborative exercise. Bertini and Gourville (2012) stressed that businesses should look beyond the mechanics of just fixing prices they feel is suitable for a

product having estimated cost and profit still relevant but no longer sufficient and recognize that harmonization of the way they generate revenue can open up opportunities to create additional value. This study therefore has dual purposes which are to assess the effect of pricing strategies on the purchase of consumer goods and how the advent of online pricing interferes in the above.

*A) Conceptual Framework*

A key assumption in economic theory is that consumers tend to rather intensively process the prices of products they buy. Here we intend to intensively explain the various aspects of pricing.

*B) Pricing objectives*

xenfeldt (1983) cited in Avlonitis and Indounas (2005) stated that pricing objectives provide irections for action, "to have them is to know what is expected and how the efficiency of operations is to be measured". Objectives can be short term and long term. According to Weber (2000) a firm ought to decide upon the objectives of pricing before determining the price itself and some of the main objectives are as follows:

*1) Achieve target return on investment or on net sales*

Kotler and Armstrong (2008) described this as building a price structure designed to provide enough return on capital used for specific products so that the sales revenue will yield a predetermined average return for the entire firm. This objective is usually used by most firms for short run periods (Ezeudu 2005) whereby a percentage markup on sales is set. This set percentage covers anticipated operating cost plus desired profit for the year.

*2) Stabilize prices*

Another pricing objective could be to stabilize prices. This is mostly found in industries where there is a market leader and prices fluctuate frequently. "Price leadership does not necessarily imply that the objective of stability is reached by having all firms in the industry charge the same price as that set by the leader (Stanton 1981). It only means that some regular relationships exist between the leader's price and those charged by other firms" (Sean 2005).

*3) Maintain or improve target share of the market*

Most companies have their pricing objective to be to increase or maintain market share (Stanton 1981). Increased market share is a result of effective long term pricing strategies. Any firm who has this as a pricing strategy must be ready to operate and plan on the long run. It is quite different from target return which might

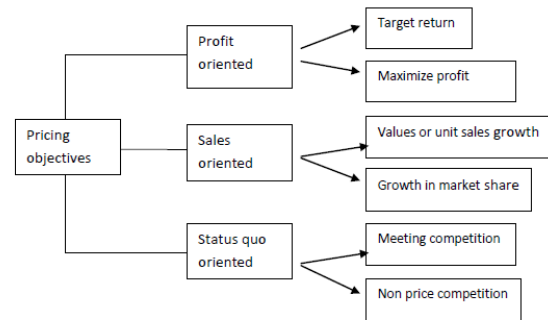
be deceptive because a firm could be earning but losing market share gradually (Lancaster, et al., 2002).

*4) Meet or prevent competition*

Lancaster, et al., (2002) stated that organizations may try to meet up with competition by reducing prices or even prevent it by adopting what is called 'follow the leader' policy (a policy whereby companies price products based on competitor's price).

*5) Maximize profits*

This pricing objective is used by countless firms. The problem with this goal is that it is often connected in the public mind with profiteering, high price and monopoly although there is nothing wrong with it (Ezeudu 2005). If the profit is high due to short supply in relation to demand new capital will be attracted into the field.



Source: Perrault et al (2005)

Fig 1. Pricing objectives

*B) Price Setting Decision Process*

The step by step process in the diagram below presents a logical approach for setting price

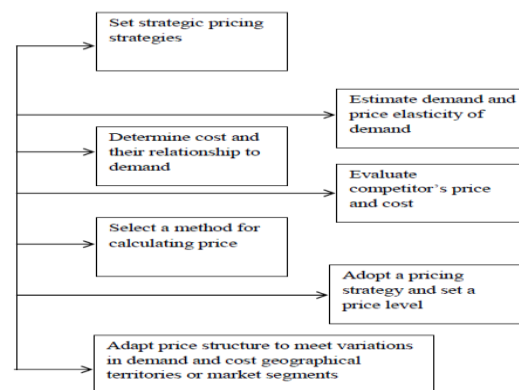


Fig 2. Price setting decision process

Source: Bearden, Ingram and Larfforge (2004)

### C) Importance of Price Decisions

According to Munroe (2003), pricing a product or service is one of the vital decisions management makes. Pricing has been viewed as the major pressure point for managerial decision making hence its importance. Munroe examined the environmental pressures that allowed for an increased pressure on the importance of pricing. The importance of pricing can be examined with faster technological progress, proliferation of new products, increased demand for service, increased global competition, the changing legal environment, and economic uncertainty.

### D) Three Levels of Pricing Management

The pricing puzzle is more manageable when taken in pieces. Price management issues, opportunities, and threats fall into three distinct but closely related levels (Michael and Robert 1992):

1. Industry strategy
2. Product/Market Strategy
3. Transactional Strategy

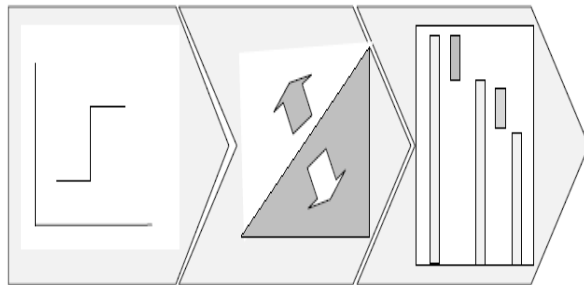


Fig 3. Levels of price management.

Source: Walter et al (2008)

### 1) Industry supply and demand

Etzel et al (1997) stressed that this is the highest level of price management; the basic laws of economics come into play. Changes in supply (plant closings, new competitors), demand (demographic shifts, emerging substitute products), and costs (new technologies) have very real effects on industry price levels. It is the broadest and most general level of price management. The objective is to determine the current and expected future state of key market place dynamics in order to establish pricing strategies and deal with other key strategic issues (Walter; et al., 2008). Managers who examine prices in this context must understand the pricing 'tone' of the market (Michael and Robert 1992). This is the overall direction of price pressure whether up or down and the critical marketplace variable fueling

that pressure. This will help managers to predict and exploit broad price trends and foresee likely impact of actions on industry price levels.

### 2) Product/ market strategy

This is concerned with how customers' perceive the benefit a product offers and related services across available suppliers. It is focused on getting the right position for price in relations to competitor's price at the product, market and segment. The product/ market strategy issues mirror a marketer's view on how customers compare prices and benefits of one product against competitive offerings (Roegner et al 2005). If a product delivers more benefit to customers, then the company can charge a higher price versus its competition (Michael and Robert 1992). All that is needed is an understanding of what factors of the product and service package customers perceive as important, how the company and its competitors stack up against this factors and how much consumers are willing to pay for superiority in those factors.

### 3) Transactional strategy

The transactional level is the most granular level of price management and the critical issue is how to manage the exact price charged for each transaction or customer (Walter; Michael; and Craige 2008). The transaction price issues reflect the sales representatives concerns for coming up with the right price for each sale (Roegner et al 2005). This level focuses on the exact price that each customer pays including discounts, payments terms and incentives (Walter; Michael; and Craige 2010). It is the most complicated and expansive level of price management. At this last level of price management, the critical issue is how to manage the exact price charged for each transaction i.e., what base price to use, and what terms, discounts, allowances, rebates, incentives, and bonuses to apply (Michael and Robert 1992).

### E) Cost oriented pricing strategy

Cost based-pricing approaches determine prices primarily with data from cost of production. Its main advantage is that data is readily available but at the same time a disadvantage stands. It does not take competition into consideration. It also does not examine customer's willingness to pay (Hinterhuber 2008). Two methods are normally used here, they are cost plus method and direct or marginal cost pricing (Jobber 2004).

a) *Cost plus method*: One simple and common approach to price determination is the naive cost plus method. It involves the addition of a predetermined margin to the full unit cost of production and distribution without reference to prevailing demand conditions (Ezeudu

2005). This consists of adding a “reasonable” markup to the cost per unit (Chaneta 2011).

*b) Mark up pricing:* according to (Farese, Kimbrell and Woloszk 2003) markup is the difference between the price of an item and its cost that is generally expressed as a percentage. The whole essence of markup is for it to cover the expenses of running the business and include the intended profit (Farese, et al., 2003; Kevin, et al., 2004)

*c) Competitors oriented pricing strategy:* It is using competitor’s price as a starting point for price setting (Blythe 2005). This is done when companies set prices chiefly on the basis of what its competitors are charging. Competition based pricing uses anticipated or observed price levels of competitors as primary source for setting prices (Hinterhuber 2008). It may seek to keep its prices lower or higher than competitors because it does not seek a rigid relation between its price and its own demand (Kevin, et al., 2004). Its main strength is that data is readily available and weakness is that it does not take the consumer into consideration.

This can also take two forms.

*1) Going rate pricing:* it is setting a price for a product or service using the prevailing market price as a basis. Going rate pricing is a common practice with homogeneous products with very little variation from one producer to another, such as aluminum or steel (Kevin, et al., 2004). Going rate pricing is a pricing strategy where firms examine the prices of their competitors and then set their own prices broadly in line with these.

Going rate pricing is most likely to occur where:

1. There is a degree of price leadership taking place within a particular market.
2. Businesses are reluctant to set significantly different prices because of the risk of setting off a price war, which would reduce profits to all firms.
3. There is a degree of collusion taking place between firms.

If there is one price leader and firms are tending to follow the prices set by the price leader, then they will often feel frustrated that they are not able to mark themselves out by reducing their prices. To compensate for this, they may try, through their marketing strategy, to establish a strong brand identity. This will enable them to differentiate themselves from the competition

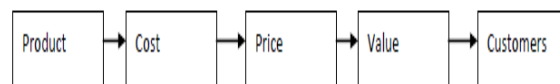
*2) Competitive bidding:* the most usual process is the drawing up of detailed specifications for a product and putting the contract out to tender and potential suppliers quote a price that is confidential to themselves and the buyer (sealed bids) (Jobber 2004). All other things being

equal the buyer will select the supplier that quotes the lowest price. It is used mostly when firms bid for jobs (Kevin, et al., 2004).

*3) Demand based pricing:* Demand based pricing looks outward from the production line and focuses on customers and their responsiveness to different price levels (Brassington and Pettitt 2006). They are prices based on the customers’ demand for a product. Here prices are set with demand and market considerations in mind (Lancaster and Withey 2005; Holbrook, 1994). When this method of pricing is used the price set must be in line with the customer’s perception of the product or it will be priced too high or too low for the target market (Farese, Kimbrell and Woloszk 2003).

*4) Value based pricing:* Customer value-based pricing uses the value that a product or service delivers to a segment of customers as the main factor for setting prices (Hinterhuber 2008). Customer value-based pricing is increasingly recognized in the literature as superior to all other pricing strategies (Ingenbleek et al 2003). For example, Monroe (2002, p.145) observes that: “. . . the profit potential for having a value-oriented pricing strategy that works is far greater than with any other pricing approach”. Similarly, Cannon and Morgan (1990) recommend value pricing if profit maximization is the objective, and Docters et al. (2004) refer to value-based pricing as “one of the best pricing methods (p.98”.

#### Cost based pricing



#### Value based pricing



Fig 4. Cost based pricing versus value based pricing.

Source: Kotler, Armstrong, Saunders and Wong (2001)

*5) Prestige pricing strategy:* This involves applying a high price to a product to indicate its high quality. According to Cannon and Morgan (1990) "... to some target customers, relatively high prices seem to mean high quality or high status". If prices are dropped a little bit, these customers may see a bargain. But if the prices

begin to appear cheap, they start worrying about quality and may stop buying". According to Brassington and Pettitt (2006) customers use prestige pricing as a means of assessing quality i.e. the high price attracts the status-conscious consumers and the discerning customer for whom price is no object.

6) *Dynamic pricing*: Haws and Bearden (2006) defined dynamic pricing as a strategy in which prices vary over time, consumers, and/or circumstances. It can also be referred to as adjusting prices continually to meet the characteristics and needs of individual customers and situations (Kotler and Armstrong 2008). Elmaghraby and Keskinocak (2003) distinguish between two dynamic pricing models: price posted mechanisms and price-discovery mechanisms. With price-posted mechanisms, frequent price changes are offered as take or leave prices, that is, the company is still in charge of setting the price. With price-discovery mechanisms, such as eBay, Priceline, or similar negotiated approaches, consumers have input into setting the final price.

7) *Predatory pricing*: This is a pricing policy in which a firm deliberately charges lower price with the intention of driving out competitors from the market while remaining the dominant or even monopoly firm in that industry after which it will start the actions characteristic of a monopoly (Lamb, Hair and McDaniel 2004; Brassington and Pettitt 2006). Sometimes prices are pitched below the cost of production. The purpose of this is to bankrupt the competition so that the new entrant can take over entirely (Blythe 2005). This usually favors the consumers since they get so much value for their money.

8) *Differential pricing*: Differential pricing involves selling the same product to different buyers under a variety of prices (Bearden, Ingram and Laforge 2004) which means different prices are used for different segments (Brassington and Pettitt 2006). It is the same as discriminatory pricing policy especially when the cost of production and selling of the product are essentially the same.

9) *Psychological pricing*: A pricing approach that considers the psychology of prices and not simply the economics; the price is used to say something about the product (Kotler and Armstrong 2008). Psychological pricing refers to applying prices that appeal to the customer's emotions (Blythe 2005). Psychological pricing is very much a customer based pricing method, relying as it does on the consumer's emotive responses, subjective assessments and feelings towards specific purchases (Brassington and Pettitt 2006). An aspect of

this type of pricing is the reference price, it refers to prices that buyers carry in their mind and refer to when looking at a given product.

10) *By-product pricing*: It is setting a price by products in order to make the main product's price more competitive.

11) *Bundle pricing*: Bundle pricing has to do with including several products in a single package that is sold at a single price (Farese, Kimbrell and Woloszy 2003). Brassington and Pettitt (2006) see it as assembling a number of products in a single package to save the consumer the trouble of searching out and buying each one separately.

12) *Odd even pricing*: It involves using price ranges that are usually in odd numbers just under even numbers which are more appealing to consumers (Businessdictionary.com 2013). The psychological principle at work here is that odd numbers (₹79, ₹9.95, ₹499) convey a bargain image (Farese, Kimbrell and Woloszy 2003).

13) *Product line pricing*: Companies who use product line pricing set price steps between various products in a product line usually based on cost differences between the products, customer evaluations of different features and competitors prices (Kotler et al 2001).

#### F) Pricing Strategies for New Products

##### a) Price skimming

It is a pricing policy whereby a firm charges a high introductory price, often coupled with high promotion (Lamb et al 2004). It refers to setting the highest initial price that customers really desiring the product are willing to pay (Kerin, Hartley and Rudelius 2004). Customers involved here are not price sensitive instead the quality and ability of the product to satisfy their needs appeal to them. It involves setting high prices for new products in order to skim maximum revenues layer by layer from the segments that are willing to pay the price allowing for the company to make fewer but more profitable sales (Kotler et al 2001). Agwu (2013) argued that the firm could combine high prices with high promotion whereby it seeks to maximize profits as much as possible.

The heavy promotion is to develop product acceptance even at a high cost. This strategy is recommended when potential buyers are sizeable enough to justify the efforts. The firm could also adopt the high price and low promotion strategy. This can be used when the market is small in size and the market is

aware of the product. The firm makes maximum profit and due to this, potential competition is imminent.

*b) Penetration pricing*

According to (Kerin Hartley and Rudelius 2004; Lamb, Hair and McDaniel 2004) it is referred to as setting a low initial price on a new product to appeal immediately to the mass market. It is the opposite of skimming. The company could penetrate the market with low price and high promotion. This strategy brings the fastest market awareness and results in increased or large market share. For a firm to enjoy this strategy it must have manufacturing or a sustainable competitive advantage that would result in company's unit.

The firm can also penetrate the market with low price combined with low promotion (Lamb et al 2004). It works better in high price elastic market. It also works better in minimum promotion elastic and a competitive market. When the aim of the company for its new product is to set a low price so as to attract large number of buyers and a large market share, it is using penetration pricing (Kotler Armstrong Saunders and Wong 2001). Here the firm also has two alternatives as discussed above.

		Promotion	
		High	Low
Price	High	Rapid Skimming	Slow Skimming
	Low	Rapid Penetration	Slow Penetration

Fig 5. New product launch strategies

Source: Jobber et al (2003)

*c) Online pricing*

Currently, pricing has developed in small steps towards a more online driven business (Meckes 2007). With the growth of the online marketplace, pricing has gained new interest among practitioners and academics, and online business models and digitally consumed goods allow for the creation of new pricing mechanisms (Dolan and Moon 2000; Doctors et al. 2010). Participative pricing mechanisms represent such new pricing vehicles as they involve consumers in the price-setting process (Kim, Natter, and Spann 2009; Chandran and Morwitz 2005) and they can effectively be used in online environments.

Price and pricing decisions is one major area that has been affected by the growth of internet marketing

(Lancaster and withey 2005). The online marketplace differs from physical markets in a number of significant respects. One of the most important of the differences is the ease with which online consumers and rival retailers may access comparative information about seller characteristics and prices (Baye et al 2007). According to Agwu and Carter (2014), the explosive growth of the internet promises a new age of perfectly competitive markets, with perfect information about prices and products at their fingertips, consumers can quickly and easily find the best deals. In this new world, retailers' profit margins will be competed away, as they are all forced to price at cost (The Economist 1999).

Agwu and Carter (2014) further states that online markets are considerably more fluid than their offline counterparts because consumers are increasingly searching for specific models of products and the number of rivals selling a particular product and their prices change almost daily. Adding to the dynamics, for many products sold online the pace of technological change translates into dramatically shortened product life-cycles (Baye et al 2007). Snyder and Ellison (2010) categorize this market as one with a large number of firms, ranked by price, with highly visible and prices that are easy to change making it one with high level of transparency. Online markets also provide numerous opportunities to conduct price experiments, either by altering the price available to all consumers over time or by simultaneously offering different prices to separate subsets of consumers.

*d) Customer perceived value*

Perceived value has its root in equity theory, which considers the ratio of the consumer's outcome/input to that of the service provider's outcome/input (Oliver & DeSarbo, 1988). The equity concept refers to customer evaluation of what is fair, right, or deserved for the perceived cost of the offering (Bolton & Lemon, 1999). Customer-perceived value comes from an evaluating the relative rewards and sacrifices associated with the offering. Customers are inclined to feel equitably treated if they perceive that the ratio of their outcome to inputs is comparable to the ratio of outcome to inputs experienced by the company (Oliver & DeSarbo, 1988). Companies are able to measure a company's ratio of outcome to inputs by comparing it with its competitors.

Customer value is "the fundamental basis for all marketing activity" (Agwu 2013) and high value is one primary motivation for customer patronage. Some customers associate high value with high price. Monroe (1979, 1990) has led an intellectually productive research stream that has its origins in the study of price. The first study is focused on the categorization and analysis of the quality-price relationship. This led to the initial conceptualization of value as the psychological

trade-off between perceptions of quality and sacrifice (Munroe et al 1985). According to this view, external cues (such as price, brand name, and store name) influence perceptions of product quality and value and the price has a negative effect on a product's value but a positive effect on perceived product quality (Dodds, 1991).

According to this perspective although value is formally defined in terms of the quality-price relationship, these elements are treated as antecedents rather than formative components of value. Some studies have used the methodology of perceived value mapping to develop value maps most of which have been based on the quality-price relationship (Ulaga et al 2001). Thaler (1985) points out two kinds of values. The acquisition utility kind of theory (Thaler 1985), represents a comparison between perceived benefit and actual product price while the second (in terms of transaction utility) represents a comparison between the internal reference price of the consumer and the actual price offered by the supplier. This perspective is thus grounded in pricing theory and posits consumers' price perceptions as the key determinant of value.

#### G) PURCHASE DECISION PROCESS

According to Phillips (2007) the buying center includes all members of the organization who play any of seven roles in the purchase decision process. The first role is the initiators; these are the people who request that something be purchased. This is followed by the users; those who will use the product/service. Next are the influencers who influence the buying decision. The deciders are those who decide on product/service requirement and the approvers authorize the proposed actions of deciders or buyers. The buyers are people who have formal authority to select the suppliers and arrange terms. The last role is played by the gatekeepers; those who have the power to prevent sellers or information from reaching members of the buying center. This is the most critical and most times the most difficult with whom to deal.

Saylor (2009) outlines six stages in the consumer purchasing process. At every given point in time someone is probably in some sort of buying stage. These stages include need recognition, search for product information, product evaluation, product choice and purchase, post-purchase use and evaluation and disposal of the product.

*Need recognition:* here customers realize they have need for a product (Bruner 1988). The task of marketers is to anticipate customers' needs and appeal to that need even when they do not realize they have that need (Saylor 2009). Previews at movie theaters are an example.

*1) Search for product information:* in this stage if customers are not already aware of what they want they would probably begin to gather information from various sources (Cohen 2013). These sources include friends, family, neighbors, and magazines, websites etc (Engel et al 1993, Agwu 2013). Independent sources like websites are usually preferred and non-neutral sources like advertisements are also used.

*2) Product evaluation:* At this stage customers examine different brands available to them and they develop what is called evaluative criteria to help narrow down their choices (Ehmke et al, 2005; Agwu and Carter 2014). Evaluative criteria are certain characteristics that are important to the consumer such as price, color, size etc (Cohen 2013). Here marketing professionals will try to convince the customers that what they are considering as evaluative criteria reflect the strength of their product. This they do through advertisements, magazines etc.

*3) Product choice and purchase:* This is the stage where the consumer decides to make a purchase (Bearden et al., 2004). Besides the product he or she is purchasing the consumer is probably making other decisions such as terms of payment, location, etc.

*4) Post purchase use and evaluation:* At this point in the process the consumer decides whether what he purchased is everything it was supposed to be. If it is not, the consumer, according to Bertini and Gourville (2012) suffers what is called 'post-purchase dissonance', where he regrets purchasing the product and most times tell other people about his or her experience. Companies/marketers must do everything possible to prevent this. In cases of large products, warranty would be of help.

*5) Disposal of product:* Products that are disposable are another way in which firms could drastically reduce the amount of time between purchases. Most companies do this in what is called planned obsolescence (Saylor 2009). This is a company's deliberate effort to make their product obsolete or unusable after a period of time.

### III. NINE LAWS OF PRICE SENSITIVITY AND CONSUMER PSYCHOLOGY

According to Kellog et al. (1997), the intensity of consumer participation has a major influence over price sensitivity. Particularly when consumers intensively participate in the purchase process, buyers acquire greater knowledge of the value of the product or service and, therefore, their price sensitivity increases (Stoel et al, 2004). In their book, *The Strategy and Tactics of Pricing*, Nagle and Holden (2002) outline nine laws or



factors that influence how a consumer perceives a given price and how price-sensitive is likely to be with respect to different purchase decisions:

*Reference price effect:* Buyer's price sensitivity for a given product increases based on the higher the product's price relative to perceived alternatives. Perceived alternatives can vary by buyer segment, by occasion, and other factors (Stoel et al 2004).

*b) Difficult comparison effect:* This is different from reference price effect. Here buyers are less sensitive to the price of a known / more reputable product when they have difficulty comparing it to potential alternatives (Nagle et al 2002; Lichtenstein et al 1993).

*1) Switching costs effect:* it states that the higher the product-specific investment a buyer must make to switch suppliers, the less price sensitive that buyer is when choosing between alternatives (Yang et al 2004).

*2) Price-quality effect:* this law states that buyers relate high price to high quality (Lichtenstein et al 1993) and are less sensitive to price the more that higher prices signal higher quality. Products for which this effect is particularly relevant include: image products, exclusive products, and products with minimal cues for quality.

*3) Expenditure effect:* Buyers are more price sensitive when the expense account for a large percentage of buyers is available income or budget. It simply means that when the expense account of most buyers is constrained due to income, they tend to be more price sensitive.

*4) End-benefit effect:* The effect refers to the relationship a given purchase has to a larger overall benefit, and is divided into two parts which include derived demand (the more sensitive buyers are to the price of the end benefit, the more sensitive they will be to the prices of those products that contribute to that benefit) and Price proportion cost which refers to the percent of the total cost of the end benefit accounted for by a given component that helps to produce the end benefit (e.g., think CPU and PCs) (Bruner 1988). The smaller the given components share of the total cost of the end benefit, the less sensitive buyers will be to the component's price.

*a) Shared-cost effect:* The smaller the portion of the purchase price buyers must pay for themselves, the less price sensitive they will be. Customers pay a small portion of purchase price (Holden et al 1998) which reduces their price sensitivity.

*b) Fairness effect:* Buyers are more sensitive to the price of a product when the price is outside the range they perceive as "fair" or "reasonable" given the purchase context (Bolton and Lemon, 1999).

*c) Framing effect:* Buyers are more price sensitive when they perceive the price as a loss rather than a forgone gain, and they have greater price sensitivity when the price is paid separately rather than as part of a bundle (Naple et al., 2002).

*c) Consumer good*

Rix (2004) stated that consumer goods are those goods bought by final consumers to satisfy their personal and family needs. Marketers, according to Ulaga and Chacour (2001) classify them into three groups which include convenience, shopping, specialty and unsought goods.

*1) Convenience goods:* these are goods or services that the consumer usually purchases frequently, immediately and with minimal buying effort (Rix 2004) e.g. soap. It can be further divided into three:

*a) Staple goods:* they are goods bought regularly and with minimal buying effort (Lancaster et al 2002) such as soap, toothpaste, salt, etc.

*b) Impulse goods:* these are goods purchased with minimal little planning effort (Bearden et al 2004). They are available at traffic hold.

*c) Emergency goods:* are goods purchased in cases of emergency e.g. first aid box:

*1) Shopping products:* these are products which consumers in the process of selecting and purchase characteristically compare on such bases as quality, price etc, (Blythe 2005).

*2) Specialty goods:* are consumer products which usage characteristics or brand identification for which a significant group of buyers are willing to expend considerable efforts to obtain them (Rix 2004). Buyers actually plea the purchase of specialty product. Buyers exactly know what they want and would not want to go for anything less (Bearden et al 2004) e.g. cars.

*3) Unsought products:* these are goods that consumers usually do not know about and sometimes do know about but do not plan buying unless aggressive selling is used on him (Lancaster et al 2002). Such products could be new products, insurance products etc.

The above definitions were adopted by the American marketing Associations (AMA) committee in 1948. These set of definitions was retained in virtually the same form by the committee on definitions in their latest publications.

#### IV. THEORETICAL FRAMEWORK

Price theory is concerned with explaining economic activity in terms of the creation and transfer of value, which includes the trade of goods and services between different economic agents (Tellis 1986). According to Friedman (1990), it is the explanation of how relative prices are determined and how prices function to coordinate economic activity. The author further outlined two reasons why we must understand pricing theories.

The first reason to understand price theory is to understand how the society around you works. The second reason is that an understanding of how prices are determined is essential to an understanding of most controversial economic issues while a misunderstanding of how prices are determined is at the root of many, if not most, economic errors. According to Nagle and Holden (1995), a market economy is coordinated through the price system. Costs of production ultimately, the cost to a worker of working instead of taking a vacation or of working at one job instead of at another, or the cost of using land or some other resource for one purpose and so being unable to use it for another are reflected in the prices for which goods are sold.

The value of goods to those who ultimately consume them is reflected in the prices purchasers are willing to pay. If a good is worth more to a consumer than it costs to produce, it gets produced; if not, it does not. Having examined the relevance of price theories, other price theories are explained below.

##### *A) Naive pricing theory*

Naive price theory is grounded on the assumption that price will stay the same. The theory states that the only thing determining tomorrow's price is today's price. Naive price theory is a perfectly natural way of dealing with prices if you do not understand what determines them (Friedman 1990). The use of this theory is least plausible because prices change. Just as it makes very little sense to assume that as a baby grows older he/she remains the same size, it makes no more sense to assume that the market price of a good remains the same when you change its cost of production, its value to potential purchasers, or both.

One must understand the causal relations involved. According to Friedman (1990), although the theory may have errors, the alternative to correct economic theory is not doing without theory (sometimes referred to as just

using common sense) but the alternative to correct theory is incorrect theory.

##### *B) Game pricing theory*

According to Ezeudu (2005), it is a collection of tools for predicting outcomes of a group of interacting agents where an action of a single agent directly affects the payoff of other participating agents. It is the study of multi-person decision problems (Gibbons 1992). It could also be referred to as a bag of analytical tools designed to help us understand the phenomena that we observe when decision-makers interact (Osborne and Rubinstein 1994). Myerson (1997) defines it as the study of mathematical models of conflict and cooperation between intelligent rational decision-makers.

According to Diamantopoulos (1991), game theory studies interactive decision-making. There are two key assumptions underlying this theory:

- 1) Each player in the market acts on self-interest. They pursue well-defined exogenous objectives; i.e., they are rational. They understand and seek to maximize their own payoff functions.
- 2) In choosing a plan of action (strategy), a player considers the potential responses/reactions of other players. She takes into account her knowledge or expectations of other decision makers' behavior; i.e., the reasons strategically. A game describes a strategic interaction between the players, where the outcome for each player depends upon the collective actions of all players involved (Bolton and Lemon 1999).

##### *C) Arbitrage pricing theory*

Contemporary, there are two theories of portfolio choices with reference to which risk diversification is more dominant i.e. Capital Assets Price Model (CAPM) and Arbitrage Price Theory (APT).

The APT model states that the forecasted rate of return on assets depends on the unpredictable nature of macroeconomic variables which points out that factor risk takes more significance in assets pricing (Holbrook 1994). APT is comparatively a moderate diverse technique for analyzing the assets prices model.

APT model assumes that the stock prices were influenced partially and uncorrelated with most of the macroeconomics variables and these variables are not multi-collinear with each other. APT defines that expected return on stock prices is composed on the capital gain plus the realization of risk premium (macroeconomics variables risk) during the course time, (Walter et al., 2011).

#### D) Consumer theory

Consumer theory is concerned with how a rational consumer would make consumption decisions (Martijn 2011). The consumer theory arises because the consumer's choice sets are assumed to be defined by certain prices and the consumer's income or wealth.

There are certain assumptions for this theory. The assumptions as stated by Lichtenstein et al., (1993) can be seen below:

The assumption of perfect information is built deeply into the formulation of this choice problem, just as it is in the underlying choice theory (Blythe 2005). Some alternative models treat the consumer as rational but uncertain about the products, for example how a particular food will taste or how well a cleaning product will perform. Some goods may be experience goods which the consumer can best learn about by trying the good. In that case, the consumer might want to buy some now and decide later whether to buy more. That situation would need a different formulation. Similarly, if the agent thinks that high price goods are more likely to perform in a satisfactory way that, too, would suggest quite a different formulation.

1. *Agents are price-takers*: The agent takes prices as known, fixed and exogenous. This assumption excludes things like searching for better prices or bargaining for a discount.

2. *Prices are linear*: Every unit of a particular good 'x' comes at the same price 'px' (Levin et al 2004). This excludes quantity discounts (though these could be accommodated with relatively minor changes in the formulation).

3. *Goods are divisible*: means that the agent may purchase good x in any amount she can afford (Mazumdar and Monroe 1990). Note that this divisibility assumption, by itself, does not prevent us from applying the model to situations with discrete, indivisible goods. For example, if the commodity space includes automobile of which consumers may buy only an integer number, we can accommodate that by specifying that the consumer's utility depends only on the integer part of the number of automobiles purchased. In these notes, with the exception of the theorems that assume convex preferences, all of the results remain true even when some of the goods may be indivisible. Furthermore, there are two main features of the consumer theory: *preferences* and *constraints*, and these two theories interact to produce choices.

4. *The Budget Constraint*: consumer's budget constraint identifies the combinations of goods and services the consumer can afford with a given income and given prices (Reynolds 2005). Two factors can cause a change

in the budget constraint and these factors are changes in income and changes in price (Munroe 2003).

5. *Preferences*: it is assumed that consumers have preferences that they are trying to satisfy, so as to maximize their personal satisfaction (Rohani and Nazim 2012). In order to create a model of consumption behavior, certain assumptions about people's preferences have to be made:

A) *Comparability* (given any two bundles, you can say "better," "worse," or "indifferent"). More is better (if one bundle has more of a good than another, and no less of any other goods, then it's a preferable bundle).

B) *Transitivity* (if A is better than B, and B is better than C, then A is better than C).

#### E) Summary of findings

These are findings discovered as a result of the review of the literature, consideration to past research publication on related issues. Findings of this study revealed trends in the use of pricing strategies and purchase decision. Issues such as laws of price sensitivity, factors affecting price sensitivity in the online market, purchase decision and customer perception of value were examined. It was discovered that the pricing strategy used for a product says a lot about the product affects the purchase decision process of the consumer. Price is important to both the buyer and seller.

To the buyer it is important because it is his/her financial outflow for value and to the seller because it determines returns on investment (Brassington and Pettit 2006).

Other notable findings include:

1. Price is the most flexible element of marketing strategy in that pricing decisions can be implemented relatively quickly in comparison with the other elements of marketing strategy (Docters et al., 2004; Agwu and Carter 2014).

2. Most organizations, according to Docters et al., (2004) use more than one pricing strategy which makes it is even more flexible. There are a lot of strategies/policies a firm could adopt ranging from competitive based, value based pricing, prestige, dynamic, predatory, differential, psychological pricing etc. to penetration and skimming for new products.

1. Customer-perceived value comes from evaluating the relative rewards and sacrifices associated with the offering thus customers are inclined to feel equitably treated if they perceive that the ratio of their outcome to

inputs is comparable to the ratio of outcome to inputs experienced by the company (Oliver & DeSarbo, 1988).

2. Consumers are exposed to a lot of information online which affects their price sensitivity and as well shortens the product lifecycle of the product online (Baye et al 2007). It is also unveiled that the more competitors there are for a certain product, the more elastic the product becomes and the more price sensitive, consumers become towards the product.

3. Consumer's choice sets are assumed to be defined by certain prices and the consumer's income or wealth (Agwu 2013).

#### Managerial implications

The analyses of the conceptual and theoretical frameworks throw up a lot of challenges for the management of various organizations.

The imports of these analyses are as summarized below:

1. Analysis of the conceptual framework shows that larger percentage of consumers may purchase various products because they believe it has additional value increase prices as well as demand for products.

2. Analysis also revealed that the prices of competitor's products can affect the demand for a specific organizational product; they may be aware of additional value but will take into consideration the prices of competitors.

3. There is a general consensus among various authors that consistency in prices retains customer's loyalty to organizational products. This means that frequent price changes could encourage brand switch.

4. It was revealed that a larger percentage of consumers do not prefer to shop online because they are cheaper than offline which means that other factors affect their purchase decision. It also means that being exposed to information online doesn't guarantee purchase online but would definitely affect offline purchase

It was also shown that customers' knowledge of prices of products online can affects purchases on online channel or offline channel/ shops. Information is important to customers and consumers, thus, online and offline channels are now at their disposal.

#### *F) Recommendation*

Based on the analyses, the following recommendations have been drawn up to help firms' to effectively price their products.

a. Organizations must consider competitive based pricing and should always be on the lookout for what competitors strategies are in terms of pricing of similar products.

b. To further improve product quality and customer perception of value, firms should improve quality of interaction with customers and rate of research and development. This will inform the company on what customers expect or the benefits they expect to derive from the products of the company.

c. The firm could also reasonably reduce prices of products not to the point of tempering with customer perceived value or not making a profit but to motivate consumers to buy more. Other products in smaller quantities which seem to have lower prices should also be made available at every nook and cranny of the society.

d. In a period of intellectual skills and knowledge and this era of Dotcoms and "information superhighway" it is evident that every organization must gradually adjust its system to fit this new phenomenon.

e. Organizations should not only focus on offline/shops purchases, they should be acquainted with the kind of information the consumer is exposed to online. With this the sales man is not easily blown away by the ever inquisitive and all knowing consumers.

f. The organization must understand that price is not the only factor or criteria customers consider when they make a purchase and must be kept abreast with other factors that affect purchase decision process. Price is only but an element, though major or minor to some consumers, as the case may be, in the purchase decision process.

#### V. CONCLUSION AND SUGGESTIONS FOR FUTURE STUDIES

The study has contributed to knowledge in series of issues associated with pricing strategies and purchase decision process. Issues on price sensitivity as it affects both online and offline channels have been examined. Customers will pay more for a product if they believe it is commensurate with the value they place on the product which may be as a result of extra benefits derived or enjoyed from consumption of the product. Proper pricing strategies or a blend of strategies also increase demand. The rapid growth in technology has added more forms of pricing and has created a platform

for customer's orientation of products. On the other hand, future studies could empirically explore these in connection with specific firms.

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