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Pricing and Marketing Communications: The Noneconomic Factors*

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How and when should price be used as a communications cue to consumers? At a minimum and under all circumstances, price communicates the firm's asking rate of exchange for its product. However, there are circumstances in which a firm might use price to communicate status, snob appeal, "quality," low purchase risk, or economy.

The firm ideally should set its price at the point where its marginal revenue is equal to its marginal costs; however, businessmen seldom, if ever, know their products' demand or cost functions. Instead, in practice, marketers have used cost-oriented pricing, profit-based pricing, competition-oriented pricing, and demand-oriented pricing [1].

Although these practices are useful and necessary approaches to the pricing problem, they should not be viewed as the ultimate answer. The pricing manager should consider the characteristics of the product, the characteristics of the consumer, the objectives for the marketing communications strategy, and the means at his disposal to desensitize the consumers to the price variable. In general, the executive must consider both economic *and* noneconomic factors in

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arriving at a final price for the product. The purpose here is to examine the noneconomic factors which influence the pricing decision and to discuss the circumstances under which price becomes an important communications cue to quality.

ECONOMIC VIEW OF PRICE

Traditionally, price has been viewed as a rate of exchange. It is the amount a seller asks for the product and the amount a buyer is willing to give up to own the product. For an exchange to take place, the buyer and seller must agree upon an amount. This interaction between buyers and sellers of a commodity is summarized by economists in their law of demand which says that as the price of a commodity rises, the quantity demanded by consumers declines, and vice versa.

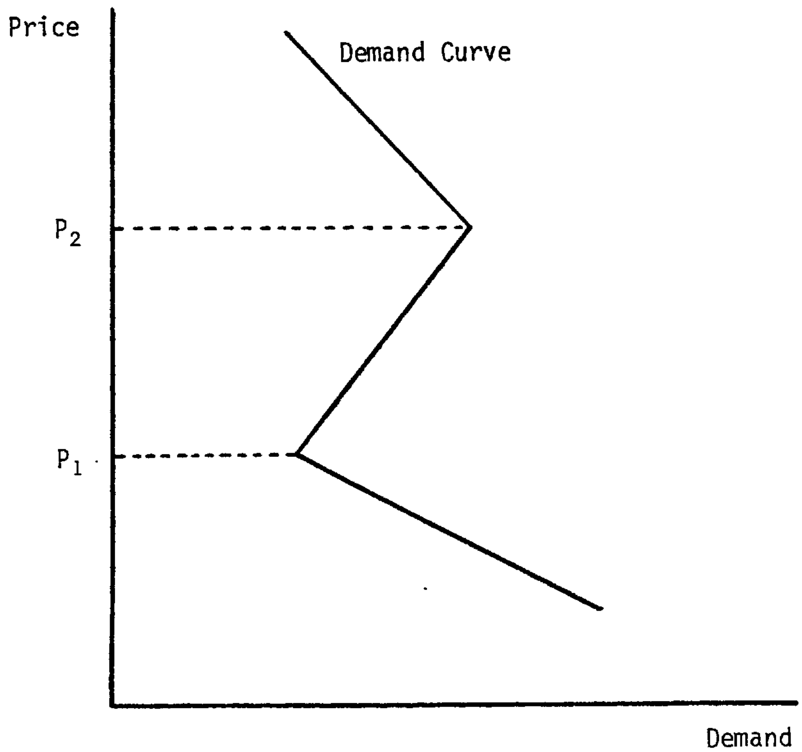
Although this economic law generally is applicable to most products in the market place (particularly for undifferentiated products like many agricultural commodities), this traditional economic viewpoint fails to consider the impact of many modern-day marketing practices upon consumer demand. In our complex market system, firms have learned how price can be used as a communications cue to differentiate product offerings and to satisfy the informational and psychological needs of consumers. When viewed in this manner, demand curves take on quite a different look from the one constructed by economists.

Quite often, consumers use price as an indicator of quality. [2] Under such circumstances, the demand curve for a product might look like the one shown in Figure 1. Note that part of the curve is positively sloped (P_1 to P_2) and indicates a direct relationship between price and quantity demanded over some portion of the price range; that is, a higher price is related to a high demand for the product. This phenomenon often is found for luxury items such as furs and jewelry.

Under what circumstances can marketers use prices as a cue to quality? In the following sections, aids to answer this question will be provided by looking at product and consumer characteristics and other factors which are favorable to utilizing price as a communications cue. Moreover, other psychological effects of pricing and marketing factors which desensitize consumers to price are discussed.

Figure 1

Demand Curve With Positive Price-Quantity Relationship



CHARACTERISTICS OF THE PRODUCT

For some categories of products, price serves as an important communications cue for consumers. Several useful generalizations can be stated concerning the relationship between price as a cue to quality and the characteristics of a product. Three product characteristics affect the role of price as an important informational cue for consumers in evaluating a brand and in making a brand choice decision.

Perceived Variance in Product Quality

When consumers perceive a high brand-to-brand variance in quality within a product category, they are inclined to use price as a cue to quality in evaluating the brands. [3] Consumers perceive salt, for example, as having little or no quality variation across brands; that is, one brand of salt is about the same as another brand. In this case, price would not serve as an indicator of quality and, thus, consumers would very likely select the lower-priced brand of salt.

Cosmetics and medicines are products which consumers perceive as having wide brand-to-brand variations in quality. Most consumers believe there are important quality differences between brands of cosmetics, for example, even though the differences may not be perceptible. One facial cream might be the same as another, yet women who are very concerned about skin care will be likely to select a high-priced brand because they believe the higher price reflects "hidden qualities" in the brand.

The Product As A Component

When a product is used as an additive, ingredient, or component of another product, the consumer may rely on price as an important cue to quality. "If a consumer is cooking a roast, she probably is aware that both the meat and the spices will affect the quality of the finished roast. The quality contribution of the spices may, however, be perceived as much higher than the cost contribution. Thus, by using quality spices, the housewife can decrease her risk of a poor finished product without significantly increasing the cost." [4] When a component or its use contributes significantly to the quality of the final product, the consumer will be inclined to use price as an indicator of quality.

The Product As A Gift

Some products are purchased as gifts more frequently than others. For these products, a high price serves to reduce the purchaser's risk of embarrassment in giving a poor quality gift to another person. A man who decides to give his fiancee a bottle of perfume for her birthday will be inclined to use price as an indicator of quality in making his brand-choice decision. Of course, the price of the perfume is only one cue amoung several, such as fragrance, brand name, and package. But price becomes an important informational cue in the selection of a gift item, such as perfume, because the gift-giver feels that the higher price gives him greater assurance that he will gain the desired approval of the recipient. In other words, the higher-priced gift affords the giver a means of protecting and, hopefully, enhancing his self image.

Another class of gift products is one which is used for special occasions or served to guests in the home. Consumers often will purchase "special" products for holiday occasions, parties, or when guests are invited for dinner. Such products include expensive cheeses, wines, liquors, snack foods, and so on. By purchasing higher-priced brands, particularly those conspicious in nature such as wines and liquors, a person can enhance his self image of "being a good host."

Brand Name

Another variable which affects the importance of the price cue is the familiarity and strength of the brand name. Where brands of a product are physically homogeneous and brand names are unfamiliar to consumers, price becomes a powerful cue for consumers in evaluating the quality of a brand. [5] However, a familiar brand often is as important as the price cue in communicating product quality. This observation is particularly true for most grocery products and beverages. [6] Basically, then, price becomes a strong communications cue in the absence of other product cues, such as brand name.

New Products

A new product offers the marketer an opportunity to use price as a communications cue for his product's quality. Since the product is new, it has no traditional price and is likely, therefore, to be assessed by the market primarily on the basis of its initial price.

Marketers often use a pricing strategy known as "skimming" in the introductory stage of a product's life cycle. Skimming refers to the strategy of setting a sufficiently high price to catch the upper portion of the demand curve. This strategy can be effective particularly in the product's introductory stage when demand tends to be fairly inelastic. If the strategy is successful during this period, the firm can gain a quick payback on its initial investment. Furthermore, if consumers perceive the high price as an indicator of product quality, the firm can continue to use this strategy to reinforce consumer's beliefs about its quality. If the market rejects the product because of its high price, the firm still is in a position to lower its price and stress the "value" of its product offering.

At the other end of the continuum is a pricing strategy referred to as "penetration pricing." In this case, the firm introduces the product at a low price because its management believes that demand is fairly elastic. The communications value of price in this case is quite low except to tell the consumer that the product is either a "popularly-priced" brand or a "value" brand.

CHARACTERISTICS OF THE CONSUMER

As with product characteristics, several generalizations regarding consumer characteristics are important in price communications. This section discusses those generalizations.

Experience With Products

Consumers have varying degrees of experience with products. For consumers who lack experience and information about a product, price becomes an important informational cue for evaluating the product.

A wife who wants to buy her husband a fishing rod and reel for his birthday may not have the slightest idea why one rod and reel is better than another. If she is shopping in a store where there is no personal selling assistance, the price becomes important to her in evaluating the quality of the product. Even in stores where she receives help from a sales representative, the price may serve to reinforce this advice.

Products which are affected by rapid changes in technology or products which are subject to changes in style and fashion are ones which confront the consumer with a new learning situation. Major changes in product features, functions, or style place the consumer in a less-informed position than before and, thus, make him more sensitive to other informational cues (such as price) in order to evaluate product quality.

Snob Appeal

Some consumers use the price of a product as a means of exhibiting "snobbishness." The price cue may express the purchaser's desire for status or prestige. "A person may know that the more expensive model is no better than the cheaper one and yet prefer it for the mere fact that it is more expensive. He may want his friends and neighbors to know that he can afford spending all that money, or he may feel that his prestige and social position require that he should always buy the most expensive of everything." [7] Products which are conspicuous in nature are more likely to be purchased because of their status, prestige, or snob appeal. The Ford Motor Company, for example, made a decision to price its Continental Mark III above Cadillac in order to appeal to high-income consumers who want to exhibit these characteristics.

Confidence in One's Judgment

A consumer who has little confidence in his or her ability to make a good product choice decision will rely on price and other cues to a greater extent than a more confident person. In purchasing a component stereo system, the confident and knowledgeable consumer will not rely on price as an indication of quality, whereas consumers who are unsure of themselves will tend to rely more on price in making an evaluation of the stereo system's quality.

Those who tend to be the least confident in their ability to evaluate products are the poor and the uneducated consumer. "Unfortunately, it seems that the poor and the uneducated are highly susceptible to price connotations. They would be the least capable of analyzing most products, and they would be strongly risk-averse." [8]

PSYCHOLOGICAL EFFECTS IN PRICING

There are a number of observable, yet unsatisfactorily explained, phenomena of price effects on demand. They run contrary to the traditional economist's explanation of the price-demand relationship. Furthermore, they do not fall into the price-quality category discussed earlier. These effects are described here.

The first effect is the quantum effect in pricing, which is observed when increases in price up to some point do not result in a loss of sales volume, but a price beyond that point produces a rapid drop in sales. The point at which this quick change in sales occurs is called the quantum point. Consumers are insensitive to prices up to the quantum point, but are highly sensitive to prices even slightly above this point. For example, a product can be priced at $9.55, $9.65, $9.75, or up to $9.95 without a drop in retail volume. However, a price of $10.05 results in a drastic drop in sales volume. In this case ten dollars is the quantum point. [9]

Another effect of price on demand is observed in the clothing industry—reverse direction price perception. As the name implies, consumers reverse the numerical price scale and perceive lower prices as being higher than higher prices. For instance, a price set at $1.95 may appear lower than a price set at $1.45. This phenomenon can be explained in terms of reference points. Rounded dollar figures serve as reference points and tell the consumer that

\$1.95 price is 5¢ below \$2.00. On the other hand, the \$1.45 price is 45¢ above \$1.00. Thus, one price may appear higher and the other lower because of their relationship to their reference points.

Another psychological effect in pricing deals with what consumers perceive as a fair price for a product. Consumers develop in their minds a "fair price" for a product which serves as a fair price standard; and even for new products, consumers use similar products to judge what a fair price range should be. A price above the market's conception of the fair price standard will result in lower sales. A price below the fair price standard is considered to reflect poor quality and also results in a low sales volume. The most acceptable price is the one which falls within the consumer's fair price range, closest to the fair price standard.

Finally, another psychological aspect of price is the cost price standard. When a consumer believes he can judge the producer's cost of a product, he develops a fair-price estimate based on his judgment of the producer's cost plus a "reasonable profit." For many industrial products, buyers have knowledge of the approximate costs in producing the product and refuse to pay a price above their estimate of the cost plus a reasonable profit. This also is true for some consumer products such as automobiles. Well-informed consumers can determine the cost of the automobile to the dealer and offer, say, \$150 above dealer cost for the car they want. Publications such as Consumer Reports often assist buyers in their evaluation of a "fair price."

DESENSITIZING THE CONSUMER TO PRICE

Many conventional economic notions about pricing are not appropriate to a total understanding of a consumer's response to price in our complex marketing system. In many cases, consumers seem to be insensitive to variations in prices for brands of the same product category. Under various circumstances, consumers use price as an indicator of quality, particularly in the absence of other meaningful cues. However, there are other conditions which affect consumer response to price. These conditions are the result of marketing activities which desensitize consumers to price. In these instances, consumers tend to ignore price to some degree in arriving at a purchase decision. This behavior accounts for the less-than-perfect elasticity of demand for a product.

One marketing activity which desensitizes consumers to price is point-of-sale effectiveness. An effective sales representative often can sell a product whether it is priced at \$24.95 or \$29.95. The price difference is overcome by the persuasiveness of the sales representative. [10]

Another desensitizing factor is the effectiveness of local promotion and services. Although the product is supported by a standardized advertising and sales promotion, local variations and supplements often can provide the additional impact necessary to make the sale, even though the brand may have a higher price than those of competitors. The same kind of influence on the level of price sensitivity can result from variations in local service. Many consumers are willing to pay the higher price because a firm is willing to provide local service for the product. For example, a consumer may be trying to decide between Sansui and Pioneer stereo receivers of comparable quality. Although the Pioneer is priced $30 higher, the consumer decides to purchase it after learning that it can be serviced locally whereas the Sansui would have to be shipped back to the factory. [11] Similarly, the reputation of serviceability of one local firm versus another is a desensitizing factor. If one automobile dealership has a much better reputation than others in town, a higher price for the car will become a less important factor in the buyer's purchase decision.

Certainly, variations in product design, styling, and perceived benefits desensitize consumers to price, as do variations in advertising appeals. Furthermore, a manufacturer's reputation can effectively desensitize consumers to higher-than-competitive prices. These factors contribute to the development of consumer loyalties which desensitizes consumers to price. For example, consumers purchase Del Monte food products even though they are fully aware of the lower prices of store brands for the same products.

In many cases, there are identifiable desensitizing factors which should be considered in arriving at a pricing decision; the estimation of price-demand elasticities is only one step in pricing decisions.

THE PRICING DECISION: SOME CONSIDERATIONS

Mechanical pricing approaches and formula for determining the "correct" price for products are common today. Such methods provide decision makers a certain sense of security, psychological comfort, and confidence in this difficult task. However, these methods often are quite naive and usually do not take into account the behavioral and, specifically, the communications dimensions of price.

Certainly costs of production, packaging, advertising, personal selling, and other product-related costs and expenses are important in the pricing decision. Breakeven analysis, incremental analysis, and other financial and economic tools are useful inputs in arriving at a pricing decision. However, even these techniques are ones which rest upon a qualitative and subjective assessment of both economic and noneconomic sets of information. The chief concern here is with the noneconomic kinds of information that are useful in the pricing decision. A thorough evaluation of the market target should be made to answer questions such as the following:

1. To what extent do consumers perceive brand-to-brand variation in quality within the product category?
2. Is the product an important ingredient or component of another product?
3. Is the product purchased as a gift? If so, how frequently and when?
4. Is the product perceived by our consumers as a new product? If so, how new?
5. Is our product purchased for special occasions? If so, for what occasions and when?
6. How strong is our brand's image within our market?
7. How knowledgeable and experienced are our consumers with the product?
8. Does our brand have snob appeal and status possibilities for our consumers?
9. How complex do our consumers perceive the product to be?
10. What price does our market expect to pay for a product like ours?

These questions represent the kinds of information a firm should seek and consider in determining its brand's price.

The marketing manager also must consider what role price is to play in the total communications effort as well as the effects of other communications variables on price. For example, what price will be supportive of the intended brand image? And, on the other hand, what marketing activities can or will be used to desensitize consumers to a price differential? The marketer must remain aware of the potential psychological effects in pricing, such as the quantum effect and reverse direction price perceptions.

The pricing decision is considerably more complex than manipulating cost and profit figures. The questions and behavior insights offered here should provide some useful guidelines in developing a pricing strategy as well as specific prices. Each pricing decision must be considered according to the communications intended for the consumer as well as the return on investment intended for the firm.

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