

PRICING STRATEGIES IN SERVICES : ISSUES AND INSIGHTS

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ABSTRACT

Service sector has become a dominant sector in every economy around the world. The contribution of services to the overall development of the economy has become more in recent years not only in developed countries but also in developing countries. The contribution of services to Indian GDP has been more than fifty percent during previous decade. The expanding economy and markets opened the doors for many business houses to start their venture in service sector. Because of having unique characteristics, services are posing challenges to the marketers in formulating strategies. Apart from other marketing strategies, pricing strategies of services has very critical for the service organizations. Selecting the pricing strategy and assigning the price for the services become complex task to the firm. In today's cut-throat competitive market, the pricing strategy of services will decide the firm's future. The past research works revealed that the setting of price for service is influenced by firm's internal and external information. Even though the some organizations depend on strategies like target price method, mark up pricing etc., but, most of the service firms did not purely rely on these methods. The service firms collect more external information, related to the market structure, competitors and customers, for pricing of the services. The purpose of the present paper is to review the previous research works, which were intended to explore the pricing objectives that service companies pursue along with the pricing information that they collect in order to price their services. The research studies revealed that the objectives and pricing information vary across the different service sector.

Key Words: Service, Pricing, Service Pricing.

INTRODUCTION

Pricing is very crucial for marketing strategy, because it determines the revenue of the company. A considerable number of authors have stressed the significance of pricing for a company's survival and success in the market. According to Potter (2000), pricing is the only element of the marketing mix that produces revenue to the firm. Moreover, Kurtz and Clow (1998) have suggested that price is the most flexible element of marketing strategy because, pricing decisions can be implemented relatively quickly in comparison with the other elements of the marketing strategy.

Despite this significance of pricing, the empirical studies that have been conducted on pricing are very limited. The lack of empirical research is even more evident in the case of services when compared with physical products. As Doctors et al. (2004) have suggested "pricing of services has long been given less attention than product pricing.

However, as service sector has become an increasingly important part of any economy in both developed and developing countries, the service sector became a bigger source of profit for many service organizations. From all these facts, understanding of service pricing has grown among service businesses."

The fact, the distinctive characteristics of services necessitate different pricing strategies for services and products. The research works concentrated on both theoretical models and empirical investigation (Hoffman et al., 2002; George, Indounas et al., 2007) for finding optimal method of pricing for the services. Based on some selected research works, this paper tries to present review by investigating the pricing objectives that service organizations pursue and the pricing and the pricing information that they collect in order to set their prices. Further, an effort is being made, in this paper, to examine the extent to which the pricing objectives and the pricing information are interrelated.

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A comprehensive review of the existing literature revealed that these two have been investigated in isolation (George, Indounas et al., 2007; Meidan and Chin, 1995; Morris and Fuller, 1989; Schlissel, 1977; Tzokas et al., 2000).

REVIEW OF LITERATURE

Pricing Objectives

Pricing objectives provide directions for action "to have them is to know what is expected and how the efficiency of the operations is to be measured" (Tzokas et al., 2000). Certainly there have been many theoretical contributions on price-decision making over the years, which also endeavor to investigate the context that may lead to adopting specific pricing objectives. Diamantopoulos (1991) presents a thorough description of these contributions. The conventional neo-classical price theory was, historically, the first one to examine this issue. Under this theory profit maximization (i.e. the point where marginal cost equals to marginal revenue) is the reason of existence of any company and relies on finding an equilibrium point that maximizes profit under different market structures (i.e. monopoly, oligopoly, monopolistic competition, and perfect competition).

Industrial organization theory presents a different school of thought, focusing on the relationship between market structure, business behavior and business performance. Within this context, price behavior (and thus pricing objectives) is a function of the unique characteristics of a market. They are consumer's price elasticity, suppliers' bargaining power, product differentiation, market growth, technology, regulation, intensity of competition, market concentration, among others. However, even with in this paradigm, profit maximization is considered to be the main pricing objective that triggers price decision making. Authors such as Clarke and Sawyer (1982) have contributed to the development of the specific theory.

Managerial theories present another attempt to examine a firm's pricing objectives and its origins can be traced back to authors such as Baumol. Its premises relies on the separation of ownership and control characterizing firms and, thus, they suggest that firms may formulate a variety of pricing objectives, other than profit maximization, such as sales revenue maximization, output maximization, growth maximization, and utility maximization.

The above three theories have been clearly developed within the economics discipline. Disciplines such as organizational behavioral theories (e.g. the stake holder theory), traced back to authors such as Simon. Here, the concept of "bounded rationality" is introduced, where maximization models are abandoned and the issue of "satisfaction" is coming into the foreground. Moreover, the emphasis is placed on actual price-decision making, leaving, thus, away, the normative perspective characterizing all the aforementioned theories. Companies need to satisfy their various stakeholders' interests and potential conflicts. The business houses need to satisfy customers, share holders, government pressures and thus, their pricing objective is characterized by a multiplicity of pricing objectives, which may not always be compatible with each other since the objective of sales maximization could lead to lower profits, while an excessive emphasis on profits could be in contrast with satisfaction of customer needs.

From the above analysis it is clear that the efforts to develop a theoretical framework of pricing behavior in general and pricing objectives in particular can be historically attributed to disciplines other than marketing. The marketing discipline can be considered as an amalgam of all these theoretical perspectives mixed with sociology and psychology. However, particular attention to identify how firms actually behave when setting prices rather than they should behave. Within this context, firms supposed to formulate a variety of pricing objectives, which may be qualitative and quantitative in their nature or short term and long term, while there have been some few efforts to examine the issue of pricing objectives from an empirical point of view.

When it comes to the services sector in particular, the few studies that have been conducted have tended to suggest that quantitative objectives are regarded as being more important than qualitative ones with a particular emphasis being replaced on profit considerations. Specifically, by studying 43 pest control companies in the USA, Schlissel (1977) found that the most popular objective was profit maximization followed by the achievement of a satisfactory profit. Similarly, Morris and Fuller (1989) investigated the pricing behavior of 71 US accounting companies and found that the achievement of a satisfactory short-term profit was the most popular objective among the companies in their sample.

Other significant objectives were the achievement of a long-term profit along with the "determination of competitive prices". Within the same context, Meidan and Chin (1995) investigated the pricing practices of 45 building societies operating in the UK and concluded that the vast majority of the companies (more than 80%) considered the objectives associated with cost as being the most important ones.

Table 1 summarizes the main pricing objective that have been found in the services marketing literature on pricing (e.g. Avlonities and Indounas, 2007; Pillien, 2003; Yelkur and Dacosta, 2001; Langeard, 2000; Zeithmal and Bitner; 1996). All research works carries three major criteria involved in pricing of services i.e. cost, competition, and objectives (strategic or tactical).

Table 1: Pricing Objectives of Service Firms

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|---|---|
| <ul style="list-style-type: none"> ● Profit maximization ● Sales maximization ● Market share maximization ● Market share increase ● Return on investment (ROI) ● Coverage of the existing capacity ● Price differentiation ● Distributors' needs satisfaction ● Price stability in the market ● Sales stability in the market ● Discouragement of new competitors' entering into the market ● Maintenance of the existing customers ● Determination of "fair" prices for customers ● Long-term survival | <ul style="list-style-type: none"> ● Achievement of satisfactory profits ● Achievement of satisfactory sales ● Achievement of satisfactory market share ● Cost coverage ● Return on assets (ROA) ● Liquidity maintenance and achievement ● Service quality leadership ● Creation of prestige image for the company ● Price wars avoidance ● Market development ● Price similarity with competitors ● Customers' needs satisfaction ● Attraction of new customers ● Achievement of social goals. |
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The previous research works reviewed for the present article are summarized in the Table 2.

Table 2: The Research Works Selected for Review

| S. No. | Author and Year | Research Outcome |
|--------|-----------------------------|---|
| 1 | Indounas, K. (2009) | Pricing-competent firms have developed a "holistic" and multi-faceted pricing approach, paying attention to company- and market-related pricing objectives, methods, policies, and information. |
| 2 | Avonitis and Indounas, 2007 | Pricing objectives are vary across different industries |
| 3 | Doctors et., al; 2004 | Service pricing growing importance in the present economy. |
| 4 | Hoffman et.,al; 2002 | This paper discussed the retail service pricing is unique from the pricing of retail goods. Researcher framework for the discussion is based on demand, cost, customer, competitive, profit, product, and legal considerations. |
| 5 | Langeard, 2000 | Described customer orientation philosophy |
| 6 | Tzokas et., al;2000 | 15 pricing information components identified |

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|---|------------------------|--|
| 7 | Meidan and Chin, 1995 | Concluded the objectives associated with costs being the most important ones. |
| 8 | Moris and Fuller, 1989 | Identified achievement of a satisfactory short term profit was the most popular objective. |
| 9 | Smith, 1995 | Find the importance of pricing information and classified the available pricing information into three categories. |

Pricing Information

According to Smith (1995), pricing information may be classified into three large categories, namely:

1. Information related to cost, profits, production and sales
2. Information associated with competitors and
3. Information related to customers

The complexity of pricing decisions, however, necessitates the gathering of multiple types of information with an emphasis being given on both the internal and external environment of the company. A comprehensive review of the literature on pricing revealed the complete lack of any work focusing on the types of information that service

companies collect in order to set their prices. The only study that has been located was the one by Tzokas et al. (2000), which, however, refers to physical products and not services. Specifically, by studying the export pricing behavior of 178 industrial companies in UK, Tzokas et al. found that the basic information that these companies were collecting were related to their gross profit margin, their contribution margin, their competitors current prices and their variable costs. On the other hand, the least emphasis was given to the sales in different markets and their competitors' market share.

Based on the review of some selective research papers, the pricing information required for setting the price of services companies is given in Table 3.

Table 3: The Pricing Information Gathered by Service Companies to Set Up Price

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| <ul style="list-style-type: none"> ● Customers' attitude towards prices ● Customers' price complaints ● Customers' needs ● Lost customers due to prices ● Demand for the service ● Maintenance of the existing capacity ● Competitors' response ● Competitors' market share ● Competitors' financial position ● Competitors' historical prices | <ul style="list-style-type: none"> ● Competitors' current prices ● Corporate objectives ● Macro-economic environment ● Gross profit margin ● Contribution margin ● Variable costs ● Fixed costs ● Sales in different periods ● Sales in different markets |
|--|--|

For the review of service pricing research studies, the companies taken for research study is given in Table 4

Table 4: The Service Companies taken for Conducting Research on Pricing related objectives and Information

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| <ul style="list-style-type: none"> ● Transportation -shipping companies ● Insurance companies ● Medical services ● Information technology services ● Airlines ● Banks ● Hotel |
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The researchers felt appropriate to focus on

those sectors that may be considered as being significant for every national economy, namely, banks, insurance companies, transportation and shipping companies, airline and hotel companies, information technology companies, medical services and education services.

Some research works (Zikmund, 1999), indicated that prices in the education services sector are highly regulated. So, most of the research works excluded this particular sector from their study (Avlonitis and Indounas, 2007). The research works also indicated that, the researchers concentrate on large service companies for the pricing related

objectives and information due to systematic way of maintaining the records. The small service firms may not have the systematic mechanism to meet researcher objectives.

Research studies clarified that all service companies seem to pursue multi-pricing objectives regarding the fact that the complexity of characterizing pricing decisions necessitates formulating verity of pricing objectives (Diamantolous, 1991). This is further intensified by the fact that the existence of such a multiplicity of pricing objectives gives a company the opportunity to set its prices by paying particular attention to the conditions surrounding both internal environment and the market in which it operates, which have been argued to be a prerequisite for making effective pricing decisions (e.g. Smith, 1995). The research works also indicates that "customer-related objectives" are the most important ones for all sectors with the exception of information technology companies. These companies endeavor to offer high quality service given to importance of quality in business-to-business sectors.

CONCLUSION

The objectives of this review were to provide insights regarding the pricing strategies of service organization by examining the pricing objectives pursued and the pricing information gathered by service companies and researchers. It was found that these companies seem to follow a hierarchy of pricing objectives with their customers being the fundamental in framing the objectives of the service firm.

Similarly, these companies seem to gather more than one type of information with an emphasis again being given to their external rather than their internal environment and especially their "competitors' current prices", indicating the rather competitive environment that exists in the service sectors investigated in the studies. Moreover, different kinds of information were found to be associated with different pricing objectives.

The research studies clarified that, the service firms need to have multiple objectives for service pricing to lead in all type of circumstances. Pricing of services seems to require adapting "situation-specific" according to the unique organizational and environmental characteristics facing a company.

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