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PRICE-SETTING PRACTICES FOR NEW PRODUCT INTRODUCTIONS: EVIDENCE FROM BULGARIA

Abstract

This paper presents the importance of the price-setting practices in the Bulgarian companies. According to the published research, the pricing, including that for the new products at their introduction into the market, is one of the most complex decisions in the company. When setting the price for a new product, the companies apply three price-setting practices: value-based pricing, competition-based pricing, and cost-based pricing. Results of empirical study amongst Bulgarian companies reveal that the most important price-setting factor for the tangible products are the prices of competitors' products, and for the services – the fit between price and product parameters.

Key words:

New product introduction; price-setting practice; value-based pricing; competition-based pricing; cost-based pricing.

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1. Literature overview

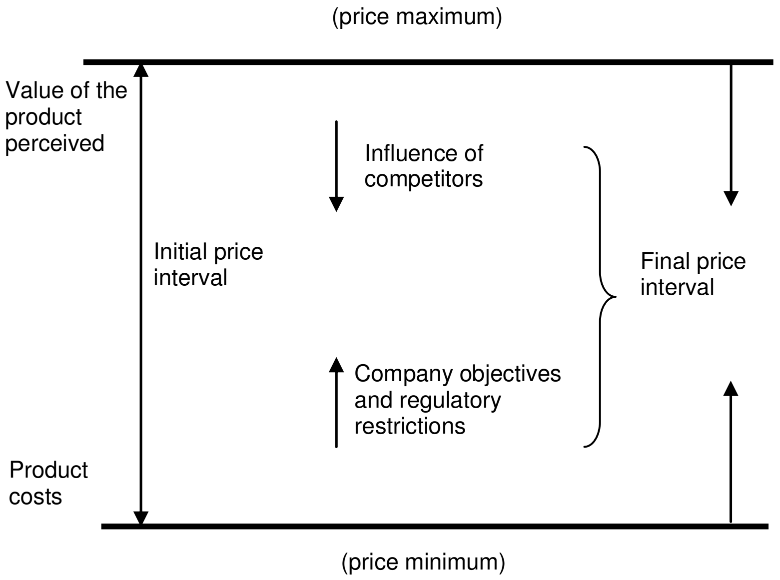
Pricing is one of the most complex operations in companies practice. In order to be successfully carried out, apart from analyzing all the primary information available, companies stick to certain pricing practices. The latter are a set of operations performed by the organization managers which lead to decisions being taken for a certain price. Pricing practices arise in the context of an organizational process within which information is collected, shared and interpreted. And whereas price strategies and tactics are visible on the market in the form of changes in prices, using package prices, introducing various price level for products of one product line, etc., pricing practices remain hidden within the organization (Noble and Gruca, 1999). Some studies (e.g. Tzokas et al., 2000) call pricing practices pricing methods in order to refer to the operations companies perform to set prices. Insofar as pricing methods are interpreted as alternative and mutually exclusive operations, a number of more recent studies prefer the term pricing practices due to empirical evidence that companies use simultaneously various types of information when taking a decision for the price (Ingenbleek et al., 2003).

Monroe suggests a concept for the price decision which is presented in Figure 1 (Monroe, 2003). When setting the initial price interval, the maximum price depends on consumers' perceptions of the value of the seller's offer. Direct variable costs indicate the price minimum. A suitable price is found in the interval between the maximum and minimum price. The complexity increases if the company tries to select the final interval within which it can change the price. Competition may decrease the price maximum and the company objectives to cover part of the indirect costs as well as certain regulatory requirements may increase the price minimum. Monroe notes that after all these factors have been taken into consideration, the price interval becomes significantly narrower. Depending on the type of product and peculiarities of demand and competition the final price interval may be too big or not exist (Monroe, 2003).

From this perspective setting a suitable price for the new product may be considered as establishing the final price interval. It follows from here that pricing practices of the companies need to be targeted at collecting those pieces of information that assist them in establishing the price interval. As information ultimately depends on the product and market peculiarities, then company pricing practices need to be related with these peculiarities.

Figure 1

Monroe's price-setting concept



This report focuses on three pricing practices which are respectively based on information on value for the consumer, on competitors and on costs.

Pricing based on value for the consumer gives an answer to the question «What is the consumer's perception of the company product value?» As T. Netseva-Porcehva notes, the value may obtain a quantitative dimension through an evaluation of the amount of money which consumers are willing to pay for the benefits perceived which they would receive if they accepted the offer of the market (Netseva-Porcheva, 2011).

Pricing based on competition gives an answer to the question «What price do competitors set for the benefits they offer? Considering competitors» prices in connection with their market positions allows assessing quantitatively the relative position of the company. For example, if the new product of the company provides fewer benefits compared to a competitor's product, then with this pricing practice the price of the new product most probably would be lower than the competitor's price.

Cost-based pricing may lead to setting the price through setting the amount of variable and fixed costs related to development, production and launching the new product on the market. This practice can answer the question: Which is the lowest possible price that the company can offer so that it is profitable? The information on fixed and variable costs is required so that the final price interval can be determined. Fixed costs can be determined only after a precise assessment of the expected volume of sales (Nagle and Holden, 1995).

Ingenbleek et al. note that the effect of one or another pricing practice on the results of the new product is mediated by the product and market peculiarities (Ingenbleek et al., 2003). Scientists bring these peculiarities down to whether there is a relative advantage of the product and what is the intensity of competition. The relative advantage of the product refers to the relative advantage of the new product over competitors' products (Atuahene-Gima, 1995). As many studies show (Evanschitzky et al, 2012), the advantage of a product is a factor that has a strong effect on the results of the new product. Competition intensity refers to the conditions of the market where the new product is introduced. Studies show that competition is among the main forces that limit the capacity of the company to make use of the value for consumers it creates (Achrol, 1991; Day and Montgomery, 1999; Homburg and Pflesser, 2000).

2. Methodological aspects

In order to improve market performance of the new product, pricing studies recommend using information for its value for the consumer [Anderson et al., 2010; Monroe, 2003; Nagle and Hogan, 2006]. This recommendation is based on studies on price perception according to which consumers' intentions for purchase arise as a result of correspondence between product quality and price (Grewal et al., 1998; Zeithaml, 1988).

Value-based pricing provides information to managers on how their consumers arrive at this correspondence. Since correspondence may be different for the different market segments and purchasing conditions, this information allows managers to increase the likelihood that correspondence which customers arrive at leads to the product being purchased. This also includes the cases when consumers perceive price as a signal of quality. Since consumers seek a balance between quality and price regardless of the market situation, a hypothesis may be formed for a positive effect of value-based pricing on the new product market performance.

The bigger the advantage of the product is and the lower the price of the product is, the bigger is the correspondence between quality and price which consumers arrive at. For example, Tversky and Kahneman defend the view that since people are not inclined to lose, they are sensitive to low prices when taking a decision to purchase (Tversky and Kahneman, 1991).

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Companies widely use this dependence and set prices which consumers perceive as profitable, as a good deal and which probably will stimulate product performance on the market. In this sense, competition-based pricing is appropriate as it demonstrates the best prices of competitive offers which consumers may use as a benchmark. Companies may use the information collected for the purposes of competition-based pricing in order to set lower prices compared to those with which consumers compare which in turn increases the likelihood that consumers will purchase the new product. This reasoning is valid for stable markets where suppliers' offers do not vary much in time. On such markets competitors' reference prices are not largely affected by state-of-affairs factors which are difficult for companies to track (Mazumdar et al., 2005). Competition-based pricing is expected to stimulate product market performance if competition intensity is very low. Nevertheless, on many markets information on competitors' prices gets outdated too quickly so as to be used by consumers as a reasonable benchmark (Mazumdar et al., 2005; Rajendran and Tellis, 1994). On such markets cost-based pricing is a better practice for companies since it helps the company to choose how low its price may get. Therefore, the assumption may be made that in the conditions of a bigger advantage of the product and lower intensity of competition, competition-based pricing leads to a better market performance of the new product; respectively in the conditions of a bigger advantage of the product and higher intensity of competition, cost-based pricing leads to a better market performance of the new product.

3. Results obtained

At the end of 2016 an empirical study was conducted among 304 managers of companies which operate on the territory of Bulgaria and are active in developing new products (they have at least 2 new products over the last 2 years before the study). A main method for data collection is the structured personal interview.

In order to study pricing practices following the approach of Ingenbleek et al. (Ingenbleek et al., 2013), the following empirical indicators have been used (Table 1). The participating managers were asked the question «What is the main thing that has been taken into account when setting the price of the latest new product launched on the market by your company (up to three answers)?» Interviewees' answers are provided in Table 2.

Table 1

Empirical indicators for pricing practices study

Pricing practice	Empirical indicators
Pricing based on value for the consumer	1. Advantages of the new product for consumers
	2. Correspondence between product price and parameters
	3. Advantages of the new product compared to competitive products
	4. Value of the product perceived by the consumer
Competition-based pricing	5. Competitive products prices
Cost-based pricing	6. Costs for the new product

Table 2

Distribution of the answers for the pricing factors applied

Pricing factors	What is the main thing that has been taken into account when setting the price of the latest new product launched on the market by your company (up to three answers)? (%)
5. Competitive products prices	57,6
6. Costs for the new product	51,6
2. Correspondence between product price and parameters	49,7
3. Advantages of the new product compared to competitive products	31,3
1. Advantages of the new product for consumers	28,9
4. Value of the product perceived by the consumer	26,6
Other	1,6

These results show that competition-based pricing is the predominant pricing practice applied in more than half of the Bulgarian companies studied. Cost-based pricing is second in terms of importance. Our expectations for the strongest spread of pricing based on value for the consumer are not met. The reasons for these results need to be studied further but certainly the greater complexity when applying value-based pricing matters.

Interesting is the difference between tangible and intangible products (services) regarding the main pricing factor (Table 3). As for tangible products, the order of pricing factors follows the one that is typical of the whole sample where the importance of competition-based pricing and cost-based pricing is even greater. As for services, the product price and parameters correspondence is the most widespread pricing factor, although a bit more than the others.

Table 3

Distribution of the answers for the pricing factors applied for tangible products and services

Pricing factors	What is the main thing that has been taken into account when setting the price of the latest new product launched on the market by your company (up to three answers)? (%)	
	A new tangible product	A new intangible product (a new service)
5. Competitive products prices	63,6	49,2
6. Costs for the new product	59,5	40,8
2. Correspondence between product price and parameters	49,7	50,0
3. Advantages of the new product compared to competitive products	30,1	33,1
1. Advantages of the new product for consumers	23,1	36,9
4. Value of the product perceived by the consumer	24,3	29,2
Other	2,3	0,8

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