CHAPTER - V

ROLE OF PRICING IN E-RETAILING

The Internet has created a fluid and challenging pricing environment. It has empowered buyers with purchase information and more choice to transact with sellers with few geographic restrictions. In many product categories customers are more price sensitive, especially users who browse through price comparison sites like Kelkoo which has become an important international online brand in its own right operating right across the European Union.

Rapid price changes are driven by dynamic pricing software. Consumers are reacting in different ways and perceive unfairness when sharp price rises push up the selling price at short notice. Consumers tend to expect online prices to be up to 20% lower than offline, largely through the removal of intermediaries. However, Meriden (2002)\textsuperscript{75} suggested that Internet inflation was running at twice the level of the economy as a whole. This indicated that the heavy discounting of the dot. com era was over.

The Internet has changed organizational cost structures and provided the capability to maximize profits. Conventional pricing strategies and tactics are relevant online, but marketers must swiftly develop an insight into buyer-seller interactions. With greater price transparency than ever before, frequent monitoring of competitor prices is critical.

5.1 ONLINE PRICING STRATEGIC GUIDELINES

McKinsey Marketing Practice (2000)\textsuperscript{76} in their paper, Internet Pricing, A Creator of Value - Not a destroyer posits three fundamental ways in which online marketers may benefit from the flexibility that electronic pricing provides:

\begin{itemize}
    \item McKinsey Marketing Practice (2000) \textit{Internet Pricing, A Creator of Value - Not a Destroyer}.
\end{itemize}
- Precision in price levels and price communication whereby companies can identify customer sensitivities to price movements within a range.

- Time adaptiveness in response to market changes with real time reactions to shifts in demand.

- Segmentation of prices with the overlay of multiple sources of customer data to segment the market with greater precision and then price to the specific segment.

McKinsey argues for the following elements to be present if an online pricing strategy improves return on investment:

- Identify degrees of freedom consistent with strategic objectives and brand values, so whilst online pricing provides greater flexibility it supports overall corporate objectives such as entering new markets and market penetration.

- Build appropriate technological capabilities to support e-pricing, which are relevant, and responsiveness to changes in customer demand like dynamic pricing.

- Build an experimenting and nimble pricing organization based on constant testing and monitoring of demand shifts resulting from price changes and customer reactions to promotions.

While technology is now available for organization to improve profit maximization online, consumers also have more tools at their disposal and have become more powerful in the search for products and information that represent value to the individual.

5.2 INFLUENCES ON PRICING STRATEGIES AND TACTICS

It goes without saying that price is the only revenue-earning element amongst the marketing mix elements. Customers demonstrate their propensity
to pay for the value offered by the product or service. Price should be developed as part of a cohesive and consistent offering with the other P's, and carefully positioned in the consumers mind to meet the needs and aspirations of the target market.

Revenue determines the health and wealth of an organization in terms of its profitability. Organizations must not neglect opportunities to maximize profit in circumstances where the customer may be willing to pay more than the intended selling price. As Doyle (2002)\textsuperscript{77} observes, 'Low prices rarely provide a sustainable basis for competitive advantage in today's competitive markets', as most organizational objectives should aim to develop the 'added value' package and brand positioning. In simple terms, a high quality product-that is retailed at below average prices will invariably do three things:

- It will not generate sufficient revenue for the organization.
- It will generate suspicion and confusion amongst the target market.
- It is likely that it will only attract price conscious bargain hunters who provide little opportunity for repeat business at attractive margins.

Whilst technology is now available for organizations to improve profit maximization online, consumers also have more tools at their disposal and have become more powerful in the search for products and information that represent value to the individual.

However in the online world, the core product may often be significantly cheaper compared to traditional channels but other revenue streams such as affiliate marketing contribute effectively to total revenue. Probably the most well-known affiliate scheme is run by Amazon but any organization can participate.

Unfortunately, many businesses, especially SMEs, rely on safe but restrictive cost plus method of pricing. Understandably, cost focus is a fundamental concern for fledgling businesses aiming to be lean and mean in

their formative years. However, cost-plus is applied in an inflexible way with prices often being set over many months. This can have a detrimental effect on profitability as changes in current or future consumer demand, materials price and inflation are largely ignored and opportunities for price maximization missed. A walk into any high street retailer or supermarket provides hundreds of price applications designed to seduce, persuade and coerce the consumer into parting with their cash or plastic, most have online applications also. Value means different things to people or segments, and marketers have to wrestle with the problem of unearthing motivations and desires of potential prospects. For the product or service provider, the headache comes when attempting to establish the right price in the chosen market place. Will the consumer give you the thumbs up or down. Has the Internet really brought about a mass market of bargain hunters or do consumers seek other benefits from it.

5.3 SETTING PRICES

Whether it is on the web or on the high street, there are key considerations that apply in establishing price.

The pricing objectives related to broader corporate and marketing objectives are:

- Pricing strategies often determined by market sophistication and segmentation
- Customer value and perception
- External and competitive influences

An organization may adopt a penetration pricing strategy online to achieve a dominant share of the market or to attract a significant list of prospects or affiliates. Typical tactics involve things like free membership e-mail sign-ups in return for specific member discounts and offers.

5.4 PRICING OBJECTIVES

Pricing objectives must be consistent and inextricably linked to broader corporate objectives that set specific and measurable targets such as sales and
profit figures, market share in new or established markets. Price can have a significant influence on the attainment of such objectives.

Many leading writers cite four main strategic objectives to influence price setting:

5.4.1. Maintaining Market Share is crucial where there is longer term potential in the sector or perhaps a channel has to be defended. Despite consumer expectations of cheaper online prices, John Lewis a famous brand often price more aggressively in-store to defend its position against local high street competitors.

5.4.2. Growth is often achieved by aggressive, penetration pricing such as in the case of Tesco.com.

5.4.3. Harvesting in mature markets when competition has intensified but core segments remain loyal, the strategy seeks to maintain price or increase volume whilst market share declines. Amazon often sells products at competitive prices but they tend to be higher than those offered by newer partners in the Amazon Marketplace.

For some companies, the Internet provides an important revenue stream for those facing stiff competition in traditional markets. Attracting new customers via a new channel may enable the company to maintain its overall market share.

5.4.4. Repositioning in the market place is essential where companies may desire to go up or down market, change image or appeal to a new target market. For example, lower Internet costs enabled the traditional financial services giant, the Prudential, to reach a younger, affluent market with the launch of Egg.

For some companies, the Internet provides an important revenue stream for those facing stiff competition in traditional markets. Attracting new customers via a new channel may enable the company to maintain its overall
market share. The Internet has proved to be an ideal vehicle for companies following rapid growth strategies. The low cost airlines such as easyJet and Ryanair where the Internet has been a primary component in their cost efficiency and revenue generation strategies, has allowed them to achieve their objectives. The Internet can be used effectively to harvest profits by making archive material available to interested parties. A specialist IT reseller could reposition itself by revamping its web site as it starts attracting a wider audience rather than just the IT savvy customer. This would give greater buying power and more scope for variable pricing on a more extensive product and service range.

5.5 PRICE AND ECONOMIC THEORY

Classical economists made the assumption that the laws of demand and supply determine price. In a perfectly competitive world, if one supplier raises price then the market becomes more attractive and profitable. Other suppliers outside of the industry enter to capture some of this extra profit. On the other hand, a fall in market demand will reduce the number of suppliers because they will be operating at below economic profit. The less financially viable will 'go to the wall' and the market becomes a less attractive proposition. Over time, the market will settle and a position of equilibrium will emerge where quantity consumed will match the quantity supplied and firms will only make 'normal' returns.

The scholars rely on a number of suspect assumptions that should be appreciated by marketers. The demand and supply model assumes that:

- Perfect market knowledge exists and that the consumer knows where to purchase the best deals. Price comparison sites have improved consumers' search abilities. In addition, powerful search engines and growing customer experiences will enhance market knowledge.

- Consumers buy more of a product when it is cheaper and this ascertains that price is the motivating factor in all purchasing
decisions. The myth that web shoppers are a homogeneous group of bargain hunters has been dispelled by numerous studies, which identify various non-price factors influencing purchase behavior, such as time, convenience, brand image and product availability.

- Suppliers are offering identical products in the marketplace. In markets such as books and CDs this is the case, as they are selling a homogenous commodity. However, in the majority of markets there are many product variants within the same product category. In the personal computer market which is extremely competitive, direct manufacturers such as Dell, Mesh and Evesham may offer different components such as motherboards, game cards, scanners and printers across similar bundled or price ranges on the web. Conversely, many buyers like to customize their PC online to meet specific 'personal or business needs.

The price charged for a product will normally reflect the 'value' placed on the item by the buyer and depending upon the circumstances at that time such as urgency and scarcity. For marketers and sales forecasters alike, setting price levels to satisfy both buyers and sellers can either be methodically researched or a result of gut feel or entrepreneurial inspiration. The price set can have a significant impact on demand and growth as the product moves through key stages of its lifecycle.

For economists and marketers, the information generated from demand and other marketing research activities attempts to estimate the effect of price movements up or down on the sales volume of a particular commodity. The subsequent demand levels have a knock-on effect with suppliers, distributors externally as well as having internal financial and other resource implications for the organization.

Both price setters and economists want to evaluate demand at any given price and its effect on sales volumes as price changes. The measurement of
such changes is referred to as price elasticity and indicates how sensitive buyers are to price movements. So the question is if the prices of for instance CD's are increased by 10% do sales decrease, remain static or even increase. Some product categories or segments can be very sensitive to price changes with resultant shifts in demand. This inevitably leads to a point that further price falls will not influence demand.

If demand is inelastic then raising prices will lead to an increase in total revenue. Few consumers actually know the exact price of many necessities, hence this gives the retailer the opportunity to vary and often maximize price without alienating the consumer.

5.6 WORLD OF PERFECT COMPETITION

- Products are identical
- Free entry/exit: no barriers to entering or leaving the market
- Large number of buyers and sellers
- Full information about supply and demand
- Customers are perfectly informed: no search costs, no time wasted seeking the right product
- Every buyer would be matched with the supplier that could best meet his/her needs
- Prices would be at exactly the level that would keep supply and demand in equilibrium
- Sales are priced at the marginal cost of production and access to online marketplaces all have the potential to distort the market, making the hypothetical dream of perfect competition in the digital world a distant dream.
5.7 PRICING METHODS

The approach to price setting may be influenced by the organization’s focus of influence internally, whether it is cost driven or market driven, or both. Alternatively, the focus of its price setting could be the effect on demand on competitor prices where competition is intense and aggressive. Consequently, there three main determinants or approaches to price setting:

- Cost orientated pricing
- Competition based pricing
- Market oriented pricing

5.7.1 Cost Oriented Pricing

Revenue is inextricably linked to some cost factor and an understanding of the organizational cost structures and how they behave in different market situations will influence the price set. Marketers should have a fundamental understanding of the main cost concepts.

Many normal business costs also apply to online businesses such as rents, rates, electricity, sales, and marketing, administration and distribution costs. Marketers must be aware of some cost nuances for an online operation and how they may impact on the final selling price. For budgeting purposes, the organization will have to assess the current and future importance of the Internet in relation to offline channels, if appropriate and weigh the budget accordingly. Many marketers are playing follow the leader and allocating a certain percentage, say 15%, of the promotional budget based on other players in the market. Strauss, Ansary and Frost (2003)\(^\text{78}\) put forward the useful distinction between the upward and downward pressure on prices created by different web related costs such as fixed cost (rent, rates etc.), variable cost, marginal cost and total cost (fixed and variable cost).

UPWARD PRICE PRESSURE

- **Distribution**: Particularly for many online retailers, like online food retailing, both niche and mainstream, the distribution function is a significant element in their cost structure. Naturally the cost will depend on the product category but you can expect at least 10% of the selling price for a physical good to be taken up by the elements of distribution such as warehousing, inventory control and delivery. In UK, the failure of merchants to meet delivery promises in the early dot com era caused considerable customer disenchantment resulting in the loss of repeat business. Marketers must be aware of customer responses to excessive delivery charges that could just be a decisive sting in the tail when they reach the site's checkout and decide to spend their cash elsewhere. It is apparent that some online operators charge delivery rates above the carrier's costs in order to recover their distribution costs, it can make a useful additional revenue contribution. Whilst it is acknowledged that distribution can force up the total cost to the customer, they may not react adversely to the delivery charges if it means that either, they have still made a significant cost saving against the alternatives, or the distribution provides some other key benefit to them such as time saved. The speed of distribution can create competitive advantage in certain markets and to certain customers.

- **Affiliate marketing**: these schemes have become a powerful tool in creating a vital net- work of intermediaries who can drive traffic and generate sales. Commission is then paid to the affiliate for the link, which takes their site visitor through to the sponsor's site with payment made, usually by the number of visitors or actual sales. The cost consideration is the level of commission paid which can be as low as 3% and as high as 70%. Amazon, with 400000 affiliates *(Smith & Chaffey, 2002)*\(^79\) generates over a quarter of its revenue through

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such schemes and pays 15% commission. The 15% commission must be carefully factored into their pricing in what is already a price competitive market. Amazon openly welcomes anyone from portals to individuals to become affiliates. This 'mass affiliate' approach will differ from sayan author's e-book on a specialist subject that would depend upon carefully selected partners with credibility and standing within that domain. Commission rates given for this type of knowledge based product will usually be lower as the end-user will place a higher value on the information contained within so 5% of 149 generates more than 15% of 16.99. The monthly running total of affiliate commissions must also be monitored carefully against our cash flow.

- **Site Development and Maintenance Costs**: These also impact upon the final selling price and will be dictated by the complexity of the site and the need for frequent updates and management of the site. In UK, web sites with no dynamic content can be bought for around 1,000 but if dynamic content is deemed a necessary you can start at around 7,000 with no upper ceiling. Other costs includes site maintenance charges though with training this can be done in-house with the likes of Dreamweaver and web hosting packages which can start from as little as 1.99 plus VAT depending upon the level of service support necessary. Some web hosting operations specialize in the needs of industry sectors which provide packages for the hotel industry.

- **Search Marketing Costs**: This is an important factor in the online marketer's promotional cost calculations. Organizations must evaluate the traffic generated by specific search engines against the cost and decide which sites they must submit to. These could be the main search engines such as:
  - Google
  - Yahoo
  - MSN
New revenue models seeking to achieve improved return on investment are replacing the old models of free submissions to search engines. Now, pay for inclusion, pay-per-click (PPC) and search engine list bidding have all to be costed in and their importance will depend on how many people arrive at your site via a search engine. For those companies submitting sites, it is vital that they effectively forecast site traffic and budget accordingly otherwise a surge in unexpected site traffic could cost the company dearly. Agencies now incorporate a pay-for-performance element within their schedules for clients. This model enables better budgetary control in the customer acquisition process as the agency lodges fixed amounts with the fee or bid price deducted from the budget allocation every time a lead is generated.

- **Fiscal and Anti-Competitive Measures**: These will impact either upwards or downwards, but organizations must be aware of their effect. The introduction of new European Tax Laws referred to as the Directive on the Taxation of Digital Sales which requires non-EU based companies selling digital content to charge Value Added Tax (VAT) depending upon the country where the customer lives. The Directive seeks to reduce the customer's opportunity to go outside of the EU to access downloads of music, e-books and other information 'goods' which placed EU based companies paying VAT, at a disadvantage. If an EU resident purchases digital content from a non-EU based seller, say in the US, then the seller would have to add VAT to the invoice price at the rate applicable in the specific EU country. So some of the perceived benefits of the global market are undermined, as consumers will be hit by higher prices. Awareness of such legislation is essential. They may
also be affected by regulatory bodies, such as Oftel in the UK who monitor anti-competitive behavior such as excessive price-cutting by dominant market powers.

DOWNWARD PRICE PRESSURE

The application of information technology has been a primary driver to streamline business processes and reduce costs. Some of the cost benefits of digital technologies over offline processes are briefly considered below.

- **Transaction Costs of Order Processing** are significantly lowered online, with estimates of around one-tenth of the offline costs associated with staff costs and paper based administration. In B2B trading exchanges, the cost of data flows between trading partners is reduced. Electronic data Interchange (EDI) provides a lower cost method of exchanging transactional records. This is not without its technical problems, many of which have been overcome with the growing adoption of extensible Markup Language (XML). Not surprisingly many companies are actively encouraging customers to transact online to the benefit of both parties. For example, many low-cost airlines offer customers a 10% discount if they book online. British Airways previously charged customers 10 more if they visited www.ba.com for flight information and then booked offline. The use of 'e-tickets' via e-mail provides a fast and efficient distribution method when compared to traditional methods via the postal service.

- **Online Customer Service** is becoming more refined and adept at handling customer queries in a more customer focused way that the early FAQs on web sites. Companies like Right Now Technologies are providing tailor-made online customer service solutions for both private and public sector organizations that not only reduces the cost of customer handling but frees up call contact Centre staff to deal with more specific customer service issues as the web handles most of the regular queries.
Online Direct Mail is appreciably cheaper, more flexible and faster than its traditional offline counterpart. E-mail 'the killer app' mailing costs are around one-fifth of those sent by ordinary postal services, though the effect of spamming on response rates will influence ROI. The production costs associated with the printing of product catalogues is again cheaper with the online equivalent, for once the front end costs have been amortized, the running costs and maintenance of an online catalogue is minimal.

Overheads of online businesses will be lower than those faced by a bricks and mortar retailer. The online business has lower distribution and warehousing costs, and, as location is not an issue with them, cheaper business premises and rates can often be sourced where links to key transport networks exist, improving cost efficiency further. With better logistics operations and real time deliveries, stockholding costs are at a minimum. In some cases, the inventory does not exist until orders are received.

Digital Delivery now allows many products such as music and software publications to be made available online or digitally via downloads, which is much cheaper than the production and delivery of these products in their physical form. Online surveys also provide marketers with a major saving in their research activities. The advent of data collection software removes the need to draft surveys, speeds up and increases data entry accuracy.

5.7.2 Competitor Based Pricing

The organization bases its prices on what the competition charges for products similar to their own rather than focus on its costs or market demand. This assumes that most buyers will make both product and price comparisons before arriving at the purchase decision. The comparisons usually revolve around 'the evoked set', which are the main competitors in that product category. For example someone considering the purchase of a new vehicle may
consider the offerings from Vauxhall, Ford, Peugeot and Honda before making their initial brand choice. From here they are likely to search out the best pricing options amongst dealerships offering which specific manufacturer's model.

There are two main forms of competitor based pricing: Going Rate Pricing and Competitive Bid or Sealed Bid Pricing.

Going-rate pricing is where firms charge more or less the same as other players in the market, though there is an element of follow the leader if a dominant player exists in the marketplace. If the product in question is basically a commodity, the firm may seek to develop some form of differential advantage that appeals to the buyer. So for an online CD merchant, differentiation may come from better site design, superior delivery service, better customer ratings or a wider catalogue of artists which result in superior sales when compared with the competition. Despite greater price transparency and comparison-shopping resulting from better software technologies, a number of studies have suggested that price dispersion exists online.

In Competitive Bid or Sealed Bid Pricing, contracts are won or lost on the basis of pricing work to meet a buyer's specifications. Whilst some entrepreneurs may have a gut feel for pitching at a price to satisfy both parties in the process, business modeling has been used to determine the expected profit from such contracts and the likelihood of being successful in a bid tender. This is derived from the bid price minus costs multiplied by the probability of securing the contract.

However, as with many models, the expected profit concept has limitations, the primary one being the need for quality information regarding the competitors and their past and current bidding intentions, which in reality is not the easiest of tasks.
A number of issues have arisen over online protocol in sealed bid auctions. **Liao and Hwang (2001)**\(^80\) questioned the assumption that the auctioneer is fully trusted by those involved in the bidding process, though there may be new participants in the auction so trust may not be established. Traditional auctioneers like Sotheby's have a proven track record that instills confidence in the participants. Similarly, eBay, with its strict online auction protocols has established trust. Liao and Hwang also highlight a number of key differences with online and traditional offline sealed bid auctions such as the physical opening of bids in the presence of the bidders that is not possible online. They argue that auctioneers colluding with bidders to secure a contract with the lowest bid could leak submitted bids. The authors cite various papers on sealed bid auctions, which identify four key criteria for their success.

- Privacy to ensure no conspiracy could occur.
- Fairness to ensure that all bids remain confidential and the winning bidder guarantees their bid.
- Efficiency and Security to ensure that no eavesdropping can take place which could lead to the interference of bids during the process.

As players on both sides of the online sealed bid process become more experienced and comfortable with the protocol, the concerns over the above criteria should be reduced.

### 5.7.3 Market Oriented Pricing Policies

Once an organization has set its pricing objectives, it should now be in a position to consider its pricing policies and how they support the other marketing objectives and mix elements. Some of the traditional market oriented pricing mechanisms, which remain valid for online markets.

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Skimming

This refers to the price set for a new, innovative product, which usually has a technological advantage over existing competitor offerings seeking to maximize short-term profits. To recoup research and development costs and to 'position' the product to reflect its uniqueness, the price will be set high initially and targeted to the company's profiled 'innovators'. Once demand has been satisfied within that customer layer, the price is adjusted, usually downwards, to meet the demand of the next layer who would be the 'early adopters'.

Certain conditions must be in place for this policy to be effective. There should be a reasonable lead-time before competitors can produce a similar product, market entry for competitors is not easy and product quality and image should generate sufficient demand so profits outweigh cost substantially. Price skimming was possible with the introduction of DAB (digital audio broadcasting) radios.

Penetration Pricing

This is where the organization identifies long-term market potential and sets a low price initially in order to penetrate the market and build up a critical mass of customers from short to medium term. Many companies implemented this strategy during the web's infancy with incentives and discounts well below high street retail prices to drive consumers online in the hope that they would stay there and generate repeat purchases. As mentioned earlier a low cost strategy is rarely sustainable in the medium term unless efficient purchasing policies exist.

Psychological Pricing

As the term suggests, this plays on the psychological, subjective and emotional responses that the buyer has to a purchase rather than a rational, economic approach. This represents fundamental differences in consumer and organizational buyer behavior so psychological pricing is prevalent mainly in
consumer markets, especially retail. The ethics of psychological pricing can be questioned. It creates cynicism in some and confusion in other customers. A recent article in a reputable US online marketing newsletter, which shall remain nameless, recommendations such as 'charge a staggering high price and they'll think it's better; create a fake price and then give a fake discount'. Marketing draws from social sciences but with many observers suggesting that the modern consumer is more sophisticated and discerning, perhaps there is a need for more intelligent pricing which does not leave the customer feeling deceived.

➢ **Prestige/Status Pricing**

This plays on these psychological and emotional responses to justify higher prices which buyers deem to be key indicators of quality. It is strange what goes on in the deepest recesses of the consumer's mind - sometimes rational, sometimes irrational, and sometimes a combination of both but the perceived value to the individual which reflects the quality of the product is often derived from the brand image, the purpose of the product and its overall usage. Rare and expensive malt whiskies have found a niche online, especially in export markets, to satisfy connoisseurs of the 'tartan medicine.

Brand power and image have taken on a greater importance in the last two decades, with market leaders and innovators such as Nike, BMW, Callaway and Diesel persuading consumers that are some inherent product qualities that will enrich the individual's life in some way. Such high-ticket products may prove difficult for some customers to pay in full by credit. However, a number of third party finance intermediaries like Able2Buy and V12 Finance provide fast interest free credit approval to facilitate such transactions.

➢ **Odd-Even Pricing**

This predominantly sets prices below key pricing points in an attempt to influence the buyer perception that the product is significantly cheaper than it is. Pricing with odd numbers is more common than pricing with even numbers.
eg 9.99 instead of 10. However, Wilson (2002) states that studies by direct marketers have found that sales are better at key pricing points such as 197, 297 and 397 when compared with prices set marginally higher or lower.

➢ **Bundle Pricing**

This is a technique that lends itself to online marketing for the time-starved, cost conscious consumer. Verma and Varma (2003)\(^8\) suggest that numerous online suppliers 'are aggressive users of bundling'. Some may bundle a product and a service together such as a game with free online support. Others may offer more than one product, often complementary, sold as a package to the benefit of both buyer and seller. Online retailers of digital photographic equipment such as Pixmania and Warehouse Express bundle cameras, memory cards, batteries and other accessories together.

➢ **Differential Pricing**

This is when the seller charges different prices for the same product to buyers in different locations, different segments or by purchase quantity. The variations may take into account additional distribution costs such as transport or postal costs to different 'regions'. In the case of the Internet, the regions may be different continents and normally the extra charges should be passed on to the consumer and reflect the different cost structure. However, location can provide significant cost advantages with more cheaper labour costs and attractive fiscal regimes.

➢ **Price Lining**

This refers to the method of applying a limited number of prices to products within a specific range (budget) and higher prices in the next band (mid-range) and top prices for the top of the range items (premium range). The

price differences are sufficiently distinct as part of a careful positioning strategy to meet the needs of specific segments. For example, many tyre manufacturers, such as Dunlop, brand their products in this way with the India and SP ranges. Similarly, processor manufacturers such as Intel (Pentium and Celeron) and AMD (Athlon and Duron) and producers of digital memory cards combine product and price to meet the performance requirements and propensity to buy of their different segments.

Price lining assumes that demand for products within each range is relatively inelastic with buyers rarely responding to any price alterations. It assumes that buyer behavior changes little but buyers may acquire more market and product knowledge, or simply over time they have more disposable income and move up a range. On web sites, many products are grouped by price, as well as product category, to make the purchase decision easier for consumers influenced by certain price brackets. The drop down price menu is a fundamental part of web design.

Consumers may limit their purchase selection by price due to income limits or the value they place on the product. In this case, many web sites offer price as a key search criteria.

Promotional Pricing

This is the meeting of two of the four marketing mix variables, Price is different to the other mix elements as it is a revenue generator whilst the others are costs, It is also linked to the promotional element, as many pricing policies are promotionally driven, especially sales promotion. Numerous promotional pricing techniques exist in the marketer's armoury and a few preferred options will be explored. Price lenders are when a firm applies low prices usually below their normal mark-up, possibly at cost on a limited and carefully selected group of products. The aim is to entice customers into a store be it on, or offline, in the hope that the customer will buy other merchandise at normal or
above average mark-ups. The effect of this tactic is to compensate lost profits on the price leader with an overall increase in revenue from other purchases.

Other techniques include special event pricing or time specific mark down pricing where organizations will link price to special situations such as seasonal sales, end of season or one day events which can generate significant consumer interest, reduce the risk of purchase' for the customer and increase total sales volume. The Financial Times uses e-coupons to increase the purchase frequency of FT Weekend by occasional buyers. Alternatively, some merchants may use such price promotions as a means of rewarding customer loyalty based on past purchases or for purchase quantities. Amazon (www.amazon.co.uk) used this to encourage multiple purchases at Christmas 2004. If the customer purchased goods that totaled more than 39 they would receive free delivery. The result is a win-win situation for both buyer and seller. The offer has the effect of tying in the customer to the one site instead of web site hopping to save a pound or euro here and there especially as Amazon seek to develop itself as a one-stop shop for gifts. They have identified a minimum purchase figure as a key threshold. It would be interesting to find out what percentage of customers who normally spend below this amount subsequently spend just enough to take advantage of this seasonal offer. Internet service provider Pipex offers loyal users of their broadband service an Xtras Reward scheme, highlighting customer lifestyle.

Another promotional pricing strategy is referred to as experience curve price when a company is confident of its ability to have a significant cost advantage over the competition and to maintain this advantage as it becomes leaner and meaner through knowledge and experience. So for some e-commerce operations, first-mover advantage was Significant in their survival and consolidation phases. For example, Lastminute.com went through a steep learning curve initially but now has the brand dominance in their sector to achieve economies of scale and significantly pull in more partners to make the last minute proposition even more attractive.
5.8 PRICING AND MARKET SOPHISTICATION

Prices will also be influenced by the degree of market sophistication both on the part of the product and the target market. Two classic marketing concepts provide useful tools for marketers when establishing prices, namely the Product Life Cycle Concept (PLC) and the Diffusion of Innovation Model (Rogers 1962)\(^8\) often referred to as the Product Adoption Model variety of strategic and tactical reasons, as the product moves through different phases of its product lifecycle. If a company introduces a product that has apparent technological advantages over the competitors' offerings and research suggest that there is a demand for it, then the marketing effort will be targeted towards 'Innovators' during the 'Introduction' phase. The 'Innovators' usually possess both the resource in the form of disposable income, and the desire for the product. Hence, they are usually willing and motivated to pay the higher prices for reasons such as prestige, status, 'street cred' or even snob value as well as the superior product performance. Organizations are naturally keen to target this group in order to recoup as much of their promotional, research and development costs as possible in the early stages of the PLC. ADSL or broadband connections were initially expensive to the individual and the costs outweighed the benefits. The target markets were business users who benefited from the faster connections and capabilities. Another example is where Ford customers were willing to pay above the intended market price on advanced orders for the trendy new Ford StreetKa as product availability was controlled.

Such markets are less-price sensitive at this stage, as the product is a 'must have item' for the target group. However, presuming the product is well received by the marketplace, as it moves into its 'growth' phase it will become more desirable to 'early adopters', 'early majority' and so on who tend to be more price sensitive. The organization will generally reduce prices to continue the sales momentum. The price reduction is balanced out by an increase in sales volume as the product reaches mainstream markets. Prices

face ongoing downward pressure until a point is reached where sales begin to decline. At this stage, marketers may extend the PLC, often by product modifications or increased promotional spend. Alternatively, products often 'past their sell buy date' will be sold at heavily discounted prices, sometimes below cost to reduce inventory costs and improve cash flow. The Internet has provided merchants with a fast and flexible outlet for getting rid of end of line items such as end of season clothes, bin end wines or other warehouse clearances.

The use of PLC and the Production Adoption model in relation to pricing and other mix elements focuses marketers minds on the value placed on the product or service by different customer groups.

5.9 PRICE AND CUSTOMER VALUE

The Oxford English Dictionary provides one definition of 'value' as 'the material or monetary worth of a thing'. Dibb and Simkin (1997)\(^83\) discuss value for money as 'the benefit consumers perceive to be inherent in a product or service, weighed against the price demanded'. In the majority of purchase decisions, the buyer reflects upon the total product offering and assesses whether or not the package offered by one organization is superior to the bewildering array of other product and brand choices from other suppliers in the sector. Customers seek to obtain the maximum amount of value from a purchase as they consciously, or subconsciously, ask 'What's In It for Me?' As we are in the Age of Celebrity with many of the public is consuming celebrity gossip and admiring their idols, online fashion retailer ASOS has capitalized to offer value presenting the stars' outfits and the latest gossip.

The ability to maximize price may be limited by two key factors: first, the search costs involved in identifying products in the evoked set, a selection of brands from which the individual or organization may make their purchase decision. Search costs may involve time and money in traditional markets as

consumers may move from store to store or city to city to make the comparison. Secondly, the purchase decision may also be affected by the buyer's market knowledge, which could be less than perfect as they lack awareness of all product offerings that exist across the sector.

The Internet has caused a fundamental shift in the power possessed by any buyer as various shopbots allow an immediate comparison of product attributes and prices enabling rapid search facilities, with regard to searching for the best personal loans, the best rates on credit cards available or price 'flights. In addition, most shopbots provide a direct link to the specific lender allowing rapid application processing that previously could have taken many days. A further development of interest has been the emergence of cross border shopbots across Europe. www.bookchecker.com compares the prices of books across nine European countries including shipping costs. Another shopping agent, www.ukpricemind.com compares consumer electronics prices in the UK, Denmark and Sweden. Various surveys have suggested that people in EU countries are comfortable with the euro since its introduction in 2002. From an e-commerce perspective, this multinational currency lends itself ideally to the concepts of price transparency and online comparison.

Collier recognizes that price is only one of a number of factors in the 'value for money' assessment process and that the buyer will consider both objective and subjective factors. To a certain extent, these factors mirror the left-brain right brain appeal where logic and emotion may combine to arrive at a purchase decision. The personality, motivations and other traits will influence whether an individual responds more to a logical promotional appeal or one that is more emotive. Therefore, a fundamental understanding of the target market is essential for site design and content. The objective factors relate to those dimensions that can be measured such as price and performance whereas the subjective elements are more often personal to the individual such as reputation, brand image, product styling and the customer experience. Furthermore, online issues such as trust, fulfillment and site usability may significantly influence the price the consumer is willing to pay.
5.10 PRICING AND SEGMENTATION

During the formative years of e-commerce, online merchants used price as the basic competitive weapon as they sought to build up a viable customer base by price penetration. Iyer et al (2002) argue that web users are no longer a homogeneous group of bargain seekers and convenience shoppers, the obvious implication being that people go online for a diverse range of reasons. They go on to suggest that there is a need for better systems of segmentation to allow a better appreciation of Internet users' need and wants.

Technologies already provide a range of segmentation tools such as sophisticated lifestyle systems and log analysis to segment and target in ever decreasing clusters of consumers. Companies continue to search for the holy grail of Peppers and Rogers one-to-one marketing ideal with data mining techniques enabling promotions on an individual level as personalization and customization programs offer tailored products. Collaborative filtering is a primary technology applied for more effective customer profiling and matching of buyer behavior patterns. This links your profile to the profiles of similar customers and makes product suggestions based on recent historical transactional data of those with similar profiles.

These future product projections, based on the sophisticated analysis of back data, should generate offerings that resemble individual tastes and interests and more importantly, willingness to spend.

In some markets, price discrimination has occurred as online merchants have deployed price segmentation deepening upon the consumer's route to the checkout. Selling prices are often cheaper via a price comparison site as visitors to such sites are more price sensitive.

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5.11 PRICING STRATEGIES AND TACTICS: THE NEW INFLUENCES ON DYNAMIC PRICING

Srivastava (2001) defines dynamic pricing as 'the buying and selling of goods and services in free markets where the prices fluctuate in response to supply and demand.' Wind, Mahajan and Gunther (2002), in their seminal text, Convergence Marketing, refer to the two distinct angles in dynamic pricing as:

- Flexible Seller-Initiated Pricing where prices are raised and lowered in real time in response to the buyer's price elasticity. As they point out, the fundamental constraint with this model is the buyer's reaction to these changes and their willingness to accept them.

- Buyer-Initiated Pricing where the customer sets the price agenda making bids or offers through various new technology-driven models such as auctions and exchanges.

In recent years, both academics and practitioners have focused mainly on how dynamic pricing has been applied in the new digital business models with particular reference to the various forms of online auctions such as eBay and QXL, and Business-to-Business (B2B) exchanges like Covisint in the automotive sector. In fact, many observers suggest that these real-time, convenient and innovative processes are the real drivers of the new Internet economy for both buyer and seller alike.

A broader definition of dynamic pricing comes from Kannan and Kopalle (2001), who refer to dynamic pricing as 'a pricing strategy in which prices change either over time, across consumers, or across product/service bundles.' On closer examination, this is how traditional pricing strategies have

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been applied in the physical world, certainly for most of the twentieth century under the guise of variable pricing or a form of price discrimination. Prices should change over time for a whole variety of internal and external reasons such as inflation, changing consumer tastes and material prices. Marketers will price for different consumer segments, perhaps on the basis of disposable income or location where differential pricing is applied with different prices to different countries, assuming that price transparency does not exist otherwise customers may react badly. Manufacturers may also change prices as they bundle or unbundle product packages depending upon their objectives.

The essence of dynamic pricing in the virtual world lies in its speed, flexibility and responsiveness for improved communications, tracking of competitor prices and reactions to shifts in demand resulting from recent advances in technology. Dynamic pricing can make significant improvements in yield as part of revenue management processes designed to improve ROI from different customers and often for the same product at the same location, such as a hotel room. Some may be paying full business rates, some taking advantage of last minute deals, others may be discounted as a result of a members' club rewarding loyalty. Unless you engage everyone in the hotel over dinner and ask them individually what they paid, the consumer is often none the wiser with regard to such differential pricing applications, as transparency does not exist. For the hotel, though, it can increase it revenue streams by customer category. Dynamic pricing allows more precise tailoring of offers with mass customization.

Yield Management (YM) techniques, which have been applied predominantly in the airline sector in years gone by, are now being applied across a number of sectors. Kimes (1989)\(^{88}\) defines yield management as 'allocating the right capacity to the right customer at the right time and at the right price in order to optimize revenue or yield'. The process lends itself to those sectors where there is a fixed capacity or supply, either of a product or a

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service, and the revenue potential of the item will diminish over time, It assumes that the early purchasers are more price sensitive than later buyers. YM as an application is also appropriate in those markets that are very competitive and there is an early-anticipated demand. Iyer et al (2002) cite the online holiday markets where incentives are given for early bookings. Similarly, with CDs and DVDs, many merchants offer discounts for prerelease orders that help anticipate demand whilst generating early revenue, which in turn can improve buying power. They argue that integrating dynamic pricing with inventory control and production offers significantly improve opportunities for profit maximization and improved supply chain management.

5.12 CUSTOMER REACTION AND PERCEIVED FAIRNESS

Adamy (2000)\(^8^9\), cited in Kung, Monroe and Cox (2002) highlights the potential problems and PR disasters with differential or dynamic pricing. In America, Amazon's customers exposed the e-tailors pricing practice of selling the same products (DVDs) at different prices to different customers based on their purchase history, For a full season set of X Files DVDs, prices varied between 80-100. The company was deluged with complaints but stated that it was just testing customer responses to different price levels. Amazon was stung by the adverse reaction and removed its differential pricing and made refunds to those who had been charged the higher prices. Interestingly though, Kung et al suggest that it was not just the issue of the different prices being charged that caused the furor but the fact that personal shopping patterns had been applied in this exercise which was deemed to be an intrusion of privacy and thus unethical.

Merchants will have to be more sensitive to customer reactions if they are going to implement price applications in this way otherwise trust, which is essential for online success, could be destroyed. Online businesses should note that many consumers are getting wiser. Huang, Chang and Chen (2005) gave

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a fascinating insight into customer perceptions of pricing fairness amongst consumers in Taiwan. Most online pricing mechanisms such as auction models and discounting to loyal customers were deemed to be fair. However, rapid price changes effected by yield management and price discrimination where surfers received best prices via shopbots were deemed unfair. Respondents also believed online prices to be fair if they were around 8% lower than offline. As customers become more knowledgeable, they may question the ethical dimension of an organization’s rapid price changes and discrimination and take their business elsewhere. Marketers must seriously consider customer reactions to online pricing tools and how it impacts upon sales and loyalty.

5.13 OTHER INTERNET PRICING INFLUENCES

Affuah and Tucci (2003)\(^90\) posit that there are five main types of pricing and suggest the influence of the web upon these models:

- Menu pricing
- One to One bargaining
- Auction pricing
- Reverse auctions
- Barter

5.13.1 Menu Pricing

This presets the prices of goods and services and there is no scope for negotiation on the price so the fixed price is the price everyone has to pay. Due to the costs associated with changes in prices such as printing and administration, many organizations, particularly in the retail sector, alter prices fairly infrequently. A key weakness with fixed pricing is that it does not always enable price maximization as the buyer may be willing to pay more, or have expectations to pay more than the set price, hence vital revenue could be lost. Alternatively, without an understanding of consumer expectations the price

could be set above their pricing points. Consequently, customers and prospects could decide to take their business elsewhere.

Price set is largely dependent upon the rules of demand and supply and for an offline business the process of monitoring price sensitivities can be both time consuming and cumbersome in a physical marketplace. Testing might take place against every 30 or 50 customers on site visits to help forecast sensitivities. Karman and Kopalle (2001) argue that the Internet is well suited to dynamic posted pricing strategies as many online retailers change price at least on a daily basis aided by price comparisons of competition and falling menu costs, but when do posted prices become dynamic. The customer is likely to have certain expectations about how long the price will remain static but this will vary from sector to sector and partly due to customer knowledge and awareness of those sectors. If the frequency of price changes is greater than the customer expectations, the more there is the likelihood of customer alienation and trust breaking down.

A number of pricing practices of the airline industry that along with commodities like CDs and books, have been the learning ground for online marketers. Merchants have to consider customer reactions and sensitivities to rapid price movements. How many customers may then alienate when a product price is reduced significantly within hours of that customer's purchase being made. To what extent will it change their purchase behavior perhaps by speeding up or delaying their decision based on previous experience and judgment of the merchants price movements. Various authors have outlined the importance of branded sites that people return to time and time again but perhaps as the customers become more web-wise and sophisticated they may become less loyal and switch as many people have done offline with financial services products.

5.13.2 One to One Bargaining

Affuah and Tucci posit that one-to-one bargaining is when the buyer and seller negotiate to reach a point at which the consumer pays the price that, in
their eyes, reflects the value that they are receiving from the good. This naively assumes that the seller is familiar with each buyer's demand curve. In an online world, web metrics provide the data for individual customer analysis enabling better yield management.

5.13.3 Auctions and Exchanges

Auctions and exchanges, especially in the B2B marketplaces, have warranted significant attention from academics and practitioners alike, as they exemplify the streamlined benefits of speed, efficiency and reduced costs that digital technologies purport to provide for both buyers and sellers.

Whilst dynamic pricing aims to achieve optimized prices for all parties, they inevitably force downward pressure on prices to the point where margins may be so low that it is not viable for suppliers to participate in such activities. Chris Philips, European marketing director of e-marketplace company, Commerce One says, 'There is nothing like savings of 15 to 20% to focus the mind' but 'you are not going to see savings of 20% the next year and the year after that; the supplier market will not bear it'. In addition to the B2B, C2B and B2C markets, online auctions are now reducing the public sector procurement bill with everything from basic stationary, computers to energy supplies up for more competitive sourcing.

For any player considering involvement in an auction or exchange it is imperative that they are conversant with the trading protocols and rules applicable in the chosen marketplace, as this should influence their strategies and tactics employed. Klein (1997)\(^9\) cited in Chaffey (2002) illustrates four potential roles or applications for auctions:

- **Price Discovery** - whereby the offer or bid prices submitted may determine a market price where the seller may have been uncertain as to the market's willingness to pay a certain price.

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Efficient Allocation - Mechanism - online auctions provide an ideal channel for disposing of excess stock such as discontinued lines that offline utilize valuable floor space. Comet have established their own auction, for such purposes and interestingly have achieved selling prices close to those of the original retail price.

Distribution Mechanism - organizers of auctions may use the process to draw up a list of approved suppliers who are capable of meeting the order specification. This saves time on filtering out those organizations submitting bids when they are unable to fulfill some aspect of the order such as volume, speed or product specification. Supplies readiness to the requirements of online auctions is acknowledged problem and buyers often offer 'process' training to suppliers.

Coordination Mechanism - an intermediary can manage the purchase on behalf of a number of buyers. This was the idea behind the now defunct, Energy Auctions Online, who sought to aggregate the utility power needs (electricity, gas, etc) of groups of manufacturers and then seek optimal bids from power suppliers.

5.13.4 Reverse Auctions

An auction occurs when there is a "one-to-many" trading scenario' and usually involves one of two situations: first where there is only one seller and numerous buyers or alternatively one buyer and many sellers, that latter is usually referred to as a reverse auction. Two general types of bidding process can distinguish the auction further:

The English Auction where the initial base price is set below the expected final selling price. Higher bids are submitted, outbidding the last one with the top bid being successful when the auction closes. Most online auctions work within specified time limits. Traditionally, auctions would be held in an auction house at a specific location, Sotheby's or
Christie's for items of high value to a fairly exclusive market. With the Internet platform, the auction goalposts have moved significantly with items of all descriptions and value and few geographic boundaries. Clearing out the cupboard under the stairs and going on eBay get a better price rather than venturing to the car boot sale. The revenues generated in this English auction will reflect the value placed on the single item by the highest bidder.

The Dutch auction is where the auction intermediary sets an initial high price. Lower bids are submitted until a level is reached which is acceptable to the bidder. The main problem for the selling organization is setting the initial price right. It can be problematic when new products are being auctioned or new markets are entered without a full understanding of what the market is willing to pay. The main variation on this model is the Reverse Auction in the C2B market, sometimes referred to as first price sealed bid-auctions, employed by the likes of priceline.com. Consumers bid for items with a limited shelf life and availability such as airline tickets and hotel rooms and submit their credit card details. Bids are submitted and checked to ensure that they are within the partner's pricing structure and against the quota of rooms and seats made available, at certain times. For Priceline, it generates revenue from the ticket commission and a percentage on the product cost and the successful bid price.

The latitude of consumers' bids in this type of model has generated significant interest amongst researchers. With this being a relatively new phenomenon, consumers seem to be going through a learning curve, as they are inexperienced. The resultant bids are spread well above and below the mean price. Where the lowest bid is accepted as the contract, then it follows that margins are likely to be squeezed and this price may become the norm to the point where the item is undervalued. The trick, and key to success for eBay and Priceline is not carry any stock and the associated costs but for the technology to enable their intermediary role.
5.13.5 Barter

This is the ancient practice of trading goods without exchanging money for them. Instead the parties exchanging the goods had to agree to value at a similar rate for the deal to be done. This can be particularly attractive to small firms enduring cash flow difficulties. In the early online days, bartering attracted limited interest but barter exchange web sites are becoming more commonplace on both sides of the Atlantic with intermediaries emerging to facilitate the trade such as the International Barter Alliance.

5.14 ONLINE LOYALTY SCHEMES AND PROMOTIONS

Loyalty schemes have existed in various guises from Green Shield stamps to Clubcard and Nectar though not all have achieved their desired objectives. The successful schemes have adopted integrated database software to track changes in purchasing behavior whilst creating an effective ongoing dialogue. Operators have been desperate to build up a critical mass of regular customers through rewards or loyalty schemes which offer added value through differentiation. E-metrics provides more measurable response data than ever before tracking redemption vouchers coded offline and online e-vouchers, e-coupons, reward schemes and responses to other price-related promotions. These types of schemes are now commonplace amongst e-retailers so they must think again to differentiate themselves further. This requires the development of coherent programmers that engage the target audience. These may be as diverse as simple charity donations of accumulated points to broader rewards based schemes (MyPoints and iPoints) including online auction loyalty programmers involving complementary trading partners. In 2003, eBay took over Fairmarket, a leading technology platform innovator in this sector to offer points as the effective auction currency replacing money. Bidders utilize their accumulated points from third parties in the bidding for the categorized prize type. The customer experience is far more interactive and engaging than ordinary reward schemes and with the prize options limited there is less danger of a Hoover flights scandal. The US experience also suggests that
this is an important brand-building tool that increases site stickiness. The added value represented by such schemes should improve uptake by consumers.

5.15 INFORMATION AND ENTERTAINMENT GOODS

The Internet is a perfect delivery mode for the effective and efficient dissemination of digital content. As Daupa and Kapur (2001) observe, 'information goods are particularly well suited to migrate to online markets' as distribution costs are a fraction of the cost of the equivalent physical good.

A tactic employed by online newspapers and periodicals has been to offer part of the site or its content for free whilst the added value elements are chargeable. Similarly, leading industry research groups offer free executive summaries of key report findings with the aim of persuading the reader that there is sufficient content in the main report to justify the full report price. Online publishers are devising more innovative content tailored to customer needs. Specialized academic publisher of legal books, Cavendish offers chapter by chapter online delivery and purchase of key texts to appeal to the financially challenged student. The costs are front ended and quite high for these content creators but the mode of delivery is both efficient and highly cost effective. Whilst the selling price is reduced, total revenue should grow, as the text is more accessible and sales volumes increase. Many online news and media groups have slowly started adopting e-subscriptions as the preferred revenue model as consumer resistance to charging slowly thaws.

The Internet is also an effective delivery model for entertainment goods such as music and games downloads, at least in the eyes of the public. The buyer behavior of the music listener has changed considerably with a significant decline in the sales of CDs contrasted with the growth of file wapping as copying becomes so user-friendly. It is not so much a case of music declining in popularity but rather that the technology had devalued it. To illustrate the scale of the problem, in 2000, 67 million registered users with

Napster were swapping files. To combat this revenue and price problem, the recording industry has done two things. First, there has been the development of 'copy controlled' discs. Second, like the newspapers, major labels such as Sony, are now adopting subscription models like iTunes. An alternative pricing approach has been applied by Lycos in the games market. For the casual gamer, typical costs of 30-40 per game, are prohibitive. In an attempt to increase take up amongst this segment, Lycos has introduced a 'Pay for Rental Games' model where members can purchase a time limited game DVD which also incorporates e-vouchers to be retained against future online purchases and hopefully move the casual gamer up the ladder of loyalty in due course.

The next Chapter deals with Emerging Problems in E-Retailing.