Can service customers handle price complexity?

Sabine Kuester
Sven Feurer
Monika Schuhmacher

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Executive Summary

Key Learnings

Dividing one all-inclusive price into price components is often assumed to have favorable effects for firms. However, a large number of price components renders pricing schemes complex. This price complexity is difficult to handle for customers. There is need to investigate how customers react to price complexity that arises from different pricing schemes.

→ Price complexity has a negative effect on customers’ perceived price fairness and attitudes towards the offer. Splitting up prices in multiple components may have serious drawbacks for firms.

→ Customers with a low predisposition to enjoy complex thinking and problem-solving („need for cognition“) show strong negative reactions to complex prices; customers high in need for cognition show positive reactions.

→ Service providers should carefully consider pricing practices that are perceived negatively by a large customer group.

Relevance of Topic

Dividing one all-inclusive price into price components is often assumed to have favorable effects for firms. However, a large number of price components renders pricing schemes complex. This price complexity is difficult to handle for customers.

→ There is need to investigate how customers react to price complexity that arises from different pricing schemes.

Investigated industries

Complex pricing schemes are often found in service industries in which customers enter into an ongoing formal relationship with the provider, e.g. telecommunication, insurance, B2B services etc.

→ The present study uses the example of a mobile service provider.

Study Characteristics

Goal: Understand the impact of price complexity on perceived price fairness and attitudes towards the offer.

Method: Online experiment with 260 customers who were asked to evaluate two-year mobile phone offers that differed in the degree of price complexity.

Investigated industries

Complex pricing schemes are often found in service industries in which customers enter into an ongoing formal relationship with the provider, e.g. telecommunication, insurance, B2B services etc.

→ The present study uses the example of a mobile service provider.
Importance of complexity for customer behavior

Complexity poses “high cognitive demands are placed on the task-doer”, but individuals’ capabilities are generally limited.

(Campbell 1988, p. 43; Miller 1956, Malhotra 1982)

Research has shown that complexity can exhaust customers’ information processing capabilities, leading to negative consumption experiences and dysfunctional decision making with negative consequences for firms.

(Iyengar and Lepper 2000)

→ Splitting up prices in multiple component may cause complexity that burdens customers in their evaluation of prices.

→ Little research has addressed price complexity and its effect on customer behavior.
Researchers agree that the way in which price information is presented influences customers’ value perceptions as well as customer demand.

(Bertini and Wathieu 2008; Iyengar et al. 2011; Schlereth, Skiera, and Wolk 2011)

→ Whether the effect is positive or negative remains unclear, but previous research indicates that customers may have difficulties in evaluating multiple price components.

(e.g. Estelami 1997, 1999)

So far, previous research has not accounted for the complexity that customers face when they encounter pricing schemes with multiple components (see example).

→ Can prices be complex such that they exhaust customers information processing capabilities?

Prices may be cognitively demanding!

Example: Phone tariff of a German mobile service provider

Source: www.t-mobile.de (accessed 08/2011)
### Key Question 1

What is the effect of price complexity on customers’ evaluation of prices?

### Key Question 2

Are there customer groups who can handle price complexity better than others?
Key Question 1
What is the effect of price complexity on customers’ evaluation of prices?

Because price complexity is cognitively demanding, the general effort exerted to evaluate such a price can be interpreted as “costs of thinking”.

(Shugan 1980, p.100)

→ How does this affect customer’s evaluation of prices?

**Perceived price fairness is an important determinant of customer satisfaction, (re)purchase intention and a firm’s long-term profitability.**


**Attitudes influence behavioral intentions.**

(Aizen and Fishbein 1973)

**Attitude toward the offer is a global assessment of the attractiveness of an offer at a particular price.**

(Monroe 1979)
“Costs of thinking” are highly subjective. They should depend on the extent to which price complexity is perceived as a burden by customers.

→ How does this affect customer’s evaluation of prices?

Need for cognition (NFC) is a personality trait that may affect how customers perceive complexity. This should alter their perceptions of price fairness.

**NFC refers to an individual’s tendency to engage in and enjoy thinking.**

(Cacioppo and Petty 1982)

*Individuals high in NFC tend to have positive attitudes toward complexity and tasks that require problem solving; individuals low in NFC lack intrinsic motivation and therefore avoid complexity.*

(Haugtvedt, Petty, and Cacioppo 1992; Kim and Kramer 2006)
Main Study

Data collection:
- Online experiment. An email with an invitation to participate voluntarily along with an embedded link to the study was sent to a graduate student panel.
- Mobile phone tariff was used as stimulus.
- Every participant was provided with a consumption pattern (see slide 10), then randomly allocated to one of the experimental conditions and asked to evaluate the (mobile phone) tariff.
- Three experimental conditions of price complexity: low vs. medium vs. high price complexity. In all conditions, the monthly cost of the offer was 50€ (see slide 10).

→ The experimental conditions differed ONLY in complexity:
  - low complexity: basic price only (implying an all-inclusive price)
  - medium complexity: basic price, four usage-dependent surcharges
  - high complexity: basic price, four usage-dependent surcharges, charge for the handset

Sample size:
- 260 students participated in the experiment (42% female, and 49% in the modal age group of 25-29 years)
## Experimental condition and consumption pattern

<table>
<thead>
<tr>
<th>Experimental Price Complexity Conditions</th>
<th>low</th>
<th>medium</th>
<th>high</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic price per month</td>
<td>50.00 €</td>
<td>23.00 €</td>
<td>9.99 €</td>
</tr>
<tr>
<td>Provision charge</td>
<td>-</td>
<td>-</td>
<td>No charge: save 24.95 € !</td>
</tr>
<tr>
<td>HSDPA usage</td>
<td>inclusive</td>
<td>inclusive</td>
<td>inclusive</td>
</tr>
<tr>
<td>WLAN Flatrate</td>
<td>inclusive</td>
<td>inclusive</td>
<td>inclusive</td>
</tr>
<tr>
<td>Price per minute for calls</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Landline numbers</td>
<td>free of charge</td>
<td></td>
<td>0.09 €</td>
</tr>
<tr>
<td>- T-Mobile Numbers</td>
<td>free of charge</td>
<td>free of charge</td>
<td>0.11 €</td>
</tr>
<tr>
<td>- Other network providers’ numbers</td>
<td>free of charge</td>
<td>free of charge</td>
<td>0.09 €</td>
</tr>
<tr>
<td>Price per SMS</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- To T-Mobile numbers</td>
<td>free of charge</td>
<td>free of charge</td>
<td>free of charge</td>
</tr>
<tr>
<td>- To other network providers’ numbers</td>
<td>free of charge</td>
<td>free of charge</td>
<td></td>
</tr>
<tr>
<td>Price per MMS</td>
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<td></td>
<td></td>
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<tr>
<td>- To T-Mobile numbers</td>
<td>free of charge</td>
<td>free of charge</td>
<td>free of charge</td>
</tr>
<tr>
<td>- To other network providers’ numbers</td>
<td>free of charge</td>
<td>free of charge</td>
<td></td>
</tr>
<tr>
<td>Contact duration</td>
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<td>24 months</td>
<td>24 months</td>
</tr>
<tr>
<td>T-Mobile G1 Smartphone</td>
<td>inclusive</td>
<td>inclusive</td>
<td>24.24 €</td>
</tr>
</tbody>
</table>

### Given consumption pattern

**Calls (per month):**
- Landline numbers (100 minutes),
- T-Mobile network numbers (100 minutes), and
- Other numbers (100 min.).

**Messages (per month):**
- T-Mobile network (100 SMS)
- Other numbers (100 SMS), and
- Zero MMS.
Results (1/2)

What is the effect of complex prices on customers’ evaluation of prices?

Price complexity shows a significant negative impact on both perceived price fairness and attitude towards the offer.

*) Price Fairness was measured on a 7-point scale with 1 indicating “very unfair” and 7 indicating “very fair”. Attitude towards the offer was measured on a 7-point scale with 1 indicating “very unattractive” and 7 indicating “very attractive”.
Results (2/2)
Are there customer groups who can handle price complexity better than others?

- Customers low in NFC: The higher the complexity, the lower the perceived price fairness. 
  → Price complexity has a strong negative effect on customers’ price fairness perceptions.

- Customers high in NFC: The higher the complexity, the higher perceived price fairness. 
  → Price complexity has a weak positive effect on customers’ price fairness perceptions.

*) Price Fairness was measured on a 7-point scale with 1 indicating “very unfair” and 7 indicating “very fair”.

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Learnings for Managers

**Learning 1**
Multiple price components render a price to be complex. This complexity is cognitively demanding for customers.

**Learning 2**
Since customers information processing capacity is limited, this has an impact in customer evaluations of the prices. On average, price complexity has a negative effect on customers’ perceptions of price fairness and attitudes towards the service offer.

**Learning 3**
Customers with a low predisposition to enjoy complex thinking and problem-solving (“need for cognition“) show strong negative reactions to complex prices due to high “costs of thinking”. Customers high in need for cognition show a reversed (however weaker) effect pattern because they tend to enjoy complexity and do not perceive it as a cost.

**Learning 4**
Splitting up prices in multiple components may have serious drawbacks for major customer segments. Service managers therefore should carefully consider such practices.
References


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If you are interested in further information or have any questions, please contact us at:
Institute for Market-Oriented Management  
University of Mannheim  
L5, 1  
68131 Mannheim / Germany  
Phone: 0621 / 181-2388  
E-Mail: feurer@bwl.uni-mannheim.de  

or visit our website at: [www.imu-mannheim.de](http://www.imu-mannheim.de).

**The Authors:**

**Prof. Dr. Sabine Kuester** holds the chair of Marketing III at the University of Mannheim. She is also Director of the Institute of Market-Oriented Management and Academic Director of the Fulltime MBA Program at the Mannheim Business School.

**Dipl.-Kfm. Sven Feurer** is Teaching and Research Assistant at the chair of Marketing III at the University of Mannheim.

**Dr. Monika C. Schuhmacher** is Associate Professor at the chair of Marketing III at the University of Mannheim.