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Perception of price fairness in state sponsored firms in Seychelles

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by

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Abstract

This report examines the perceptions of clients to fairness of a price increase due to various factors such as declining government subsidies, internal and externally influenced cost increases. The public may not like price increases for whatever reason as they may think the firm is taking advantage to increase its profits. What do they think if a price increase is as a result of reasons that a firm cannot avoid? This report investigates certain circumstances where a price increase can be successfully justified. Theoretical models like dual entitlement principle, attribution theory, and procedural justice are used to understand the meaning of fairness and to predict how consumers may behave in different pricing context. The focus is on state sponsored firms using data collected in Seychelles.

The results are obtained from a scenario based questionnaire administered in four major educational institutions in Seychelles. The result from data analysis is mainly consistent with propositions put forward for the study. The conclusions from the findings are analysed and recommendations given to guide pricing policy. The key findings of this study are that price increases justified by cost increase is acceptable for government subsidised organizations. This has confirmed previous findings on dual entitlement principle, though with a conflicting result that even cost justified price increase can be considered unfair if the historical behaviour of the firm is made available to consumers. The study has reinforced the belief that consumers are concerned about the consistent behaviour of firms with regard to price increase and decrease.

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To my colleagues at the Seychelles Institute of management who provided valuable feedback on the questionnaire at the design stage, special mention to Dr.Honore Koutatouka. I also thank my supervisor Professor Smit AJ for constant valuable comments at all stages of the study and Ms Arien Strasheim of the University of South Africa for her insight on research projects.

This report is dedicated to my wife Sandy and children Tracy and Maureen in recognition of their moral support during the long journey.

I certify that, except as noted above, the report is my own work and all references used are accurately reported.

Signed



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List of abbreviations

ALDEC - Adult Learning and Distance Education Centre

DE – Dual entitlement principle

NIE – National Institute of Education

SIM – Seychelles Institute of Management

SPF's – State sponsored firms

SR – Seychelles Rupees (currency)

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CHAPTER 1

INTRODUCTION

1.1 Introduction

One aspect of price that has been shown to influence purchase decisions is fairness. Buyers' perception of a fair price has been considered a determinant of consumers' willingness to buy (Kahneman, Knetsch & Thaler, 1986a). Increasing price to cover for increasing costs or reduction in government subsidies may not be a simple solution for companies affected. Maxwell (1999a) has demonstrated how mistrusted business is when it comes to pricing. The public will not like price increase as they may think a firm is taking advantage. The big question is how to effectively manage price increase in a manner that will have limited damage to consumer impressions. Who do consumers blame whenever there is a price rise? Maxwell (1999a) describes three possible reactions from consumers:

- placing the blame on the "profiteering" business;
- Accepting that price rises result from circumstances outside the control of the business;
- Seeing the price rise as justified because of added value from the product or service.

In Seychelles the public sector plays a vital role in providing service to various sectors of the economy ranging from education, transport, news media, tourism, banking among many others. It would be useful to identify how consumers view pricing issues in the public sector.

Price increase occurs from time to time in a business environment. The factors that cause price increase range from those within the control of a firm to others where it has no control at all. To a consumer a price increase may be considered fair or unfair depending on certain factors and circumstances. The question then is what should an organization do to present price increases in a manner that can be acceptable? This question can be tackled

more effectively if a firm understands how consumers perceive a price increase and what factors influence their perceptions.

1.2 Problem statement

Organizations may face problems when they have to increase prices. This is why a price increase needs to be presented in a way that counters the consumers' tendency to place blame on the seller. It is therefore beneficial to provide alternative explanations for the cause of the increase, where it is applicable; otherwise buyers tend to blame the seller for the price increase.

A fundamental attributional bias is the tendency for attributors generally to underestimate the influence of impersonal, situational or environmental factors and to overestimate the influence of human factors in controlling behaviour. What should an organization do to present price increases in a manner that can be acceptable? Can principles learned from Dual Entitlement (DE) be universally applicable?

This problem of negative perception to a price increase especially when a government subsidy is removed is evaluated in the research. Consumers' price perception is important because it affects their purchase decisions and this therefore important to a firm decision making process.

1.3 Objectives and purpose of the research

1.3.1 The first objective of this study is to establish how consumers perceive the fairness of a price increase in State Sponsored Firms (SSF's). When a State Sponsored Firm faces a decrease in subsidy from government, cost increase or externally influenced factor, how do clients perceive an increase in price that may result? In achieving this objective the study would like to ask the following questions:

- Is Dual Entitlement (DE) principle the dominant norm of price fairness?

- To what extent is the fairness of a price increase inferred from a firm's motive and inferred relative profit?
- Can attribution of responsibility for a price increase be used to justify fairness of a price increase?
- Does a consumer judge the fairness of a price increase in terms of the social acceptability of the price in relation to community standards?

1.3.2 The second objective is to recommend from the findings, various strategies that practising managers and policy makers may use to justify a price increase in a manner that is acceptable to clients.

1.4 Propositions

A proposition is defined as a statement about a concept that may be judged as true or false if it refers to observable phenomena (Cooper & Schindler, 2003:50).The theory presented in this research paper provides a basis from which to understand issues related to pricing fairness. The researcher has formulated the following propositions to guide the study.

1.4.1 Proposition 1:

Consumers use altruistic motivation assumed in dual entitlement principle as a norm (motive) in perceptions of price fairness for state sponsored firms.

The study uses the framework presented in figure (2-5) to explore this proposition. The theoretical grounding for this proposition is discussed in the literature review in paragraph (2.15) and the methodology is discussed in chapter 3.

1.4.2 Proposition 2:

It is fair for a state sponsored firm to increase price to protect its reference profit especially when a government subsidy is eliminated.

Both experimental and survey research have identified pricing situations that consumers perceive to be unfair (Kahneman et al., 1986a, 1986b). They indicated that consumers often feel that it is unfair for firms to increase a price over the existing price charged to the consumer just to increase profits. Consumers may however feel that it is fair to raise price in order to protect the reference profit of the firm. This finding is evaluated in this research to see if the same principle can apply to subsidised firm when a subsidy is removed. Scenario one is manipulated to indicate that the government subsidy is eliminated and participants are asked to suggest a new fair price with SR470 as a reference price (Appendix 2.4).

1.4.3 Proposition 3:

A price increase that is cost-justified is perceived to be fair as long as the firm has been fair and consistent in the treatment of cost changes.

When examining the robustness of DE principle, a factor to consider in the formation of perception on fairness is whether or not the firm behaves in a consistent manner with respect to price increases and decreases (Kalapurakal, Dickson & Urbany, 1991). To study this issue subjects were presented with scenario three (Appendix 2.6). This scenario fully describes the application of DE principle. The researcher examines if the same principle can be applicable to state sponsored firms and formulate recommendations for this sector. The previous research that developed the principle (Kahneman et al.1986a, 1986b) was concerned with profit making firms.

1.4.4 Proposition 4:

Attribution of responsibility for price increase influences perception of price fairness.

Price increases driven by external factors will be perceived as fairer than those driven by internal factors (Vaidyanathan & Aggarwal, 2003). In attribution theory it is believed that the result of an action is felt to depend on factors within the person (internal locus) or factors within the environment (external locus). From the pioneering research by Kahneman et al., (1986a, 1986b) and Folkes (1984), we expect that customers would perceive externally driven price increases to be fairer than those driven by internal causes.

To test this proposition four, two scenarios are presented, one showing an internal cause for the price increase and the other depicting an external cause (Appendix 2.7).

1.5 Importance of the study

While a manager is formulating a company pricing policy the question of what cost to include in the prices is difficult to resolve especially in a state sponsored firm. If we assume that state sponsored firms operate to make profit, then prices, must be set to recover total cost, provide for future enhancement and provide a suitable return to the investor.

Attribution theory has helped in explaining that biased attributions of a price increase are a problem in society. Consumers react not only to the greater sacrifice required by the higher price but also to socially unacceptable pricing practices of the seller perceived to be responsible for that increase (Maxwell, 1999a). A price increase needs to be presented in a way that counters the consumers' tendency to place blame on the seller. It is beneficial to provide alternative explanations for the cause of the increase; otherwise, buyers will

blame the seller. The study will identify ways in which price increase may be presented in an acceptable manner

1.6 Delimitation of the study

1.6.1 Although scenario-based experiments are a common method of experimental research in fairness; an actual choice of a real life price increase situation would highlight more valid results. It has been documented in a previous research that, the use of scenario has some limitations (Campbell, 1999a). Scenario experiments can enable close careful examination of the factors of interest; they also involve some artificiality (Campbell, 1999a). The scenarios can normally lead to an increase in artificiality of the situation by having subjects react to a series of written experiments. By asking respondents scenario led questions may have increased the sensitivity of respondents to concerns about fairness, thereby creating a demand artifact.

1.6.2 The use of non probability sampling method and choice of sample population may not lead to generalization of the results to the population.

1.7 The study's expected contribution to existing knowledge

1.7.1 DE principle is cited in the literature as the most important discovery in pricing behaviour. The research that developed this principle was carried out in a developed economy using profit oriented firms as a basis of study. It is yet to be tested in different parts of the world to assess if it can be universally applied. This study tests this principle in state sponsored firms; specifically where subsidy is involved. Can the principle apply in this environment especially in a transition economy in a developing country?

1.7.2 Practicing managers need a framework to assist them in designing a pricing policy. How can they deal with the difficult issue of

increasing a price without loosing the loyalty and trust of their customers? This study will recommend various methods to justify a price increase in a manner that can be acceptable to consumers of state sponsored firms.

1.8 Assumptions of the study

1.8.1 The researcher assumes that perception based evaluation of a price increase is possible since a consumer will be able to organise and interpret their sensory impressions of various pricing scenarios which reflect what happens in practice and give an opinion.

1.8.2 It is assumed that the concept of "price perception" may be defined as a process by which consumers translate prices into meaningful cognitions (Liechtenstein, Bloch & Black, 1988).

1.8.3 It is also assumed that SSF's operate under pressure from market competition and so the objective of decision makers in SSF's (either as managers or politicians) in transition economies is similar to those in private firms, i.e. to maximize profits.

1.8.4 Economic principles alone do not adequately explain consumer behaviour in pricing issues; sociological perspective is critical in understanding fairness in pricing behaviour.

1.9 Organization of the study

The study is organized in six main chapters. Chapter one identifies the research problem and objectives. The study's research propositions are also introduced here, together with definition of key terms, importance and delimitation of the study.

In chapter two, the literature review is covered, after which chapter three presents the research methodology. Chapter four reports on the research

findings by reporting on the empirical data collected. This includes reporting on: the responses to the questionnaire, the various statistical techniques used to analyse the data and a brief comment on the findings.

Chapter five, explores the key issues arising from the literature review, and ties the findings in chapter four with the literature. The findings from the empirical data are then evaluated based on previous research. Chapter six then concludes by giving recommendations from the study to practicing managers and policy makers.

CHAPTER 2

LITERATURE REVIEW

2.1 Defining fairness

How do consumers determine the fairness of a price increase? To answer this question the literature review will explore the concepts and theories that define fairness. Distributive and procedural justice; equity theory, dual entitlement principle and attribution theory have been used to explain the meaning of fairness.

2.2 Fairness in an exchange relationship

The concepts of distributive and procedural justice provide guidance in defining fairness. The concept of distributive justice suggest that fairness occurs when all parties involved in an exchange relationship, directly (i.e. buyer and seller) and indirectly (i.e. two buyers purchasing from the same seller), share the same ratio of profits to investment (Cox, 2001 quoting Homans, 1961). A discrepancy in any one of these comparisons or unequal ratios of contributions to rewards result in perceived injustice by both parties. Additional work by other researchers' expanded on the idea of distributive justice and concluded that both buyers and sellers compare price to:

- The prices paid by other customers for the same products or services (Martins & Monroe,1994); and
- The individual economic outcome and social utility derived from what each party invests and receives (Maxwell, 1999a).

2.3 Fairness determined by society norms and behaviours

Procedural justice defines fairness as a process determined from society norms and behaviours. Procedural justice is often discussed on both an objective and subjective level. It bases judgements of fairness on process derived from society norms.

The research done by Dickson & Kalapurakal, (1994) reveals that the process by which a firm determines its pricing structure determines how consumers perceive the fairness of the firm's prices. A price increase resulting from a process that does not meet society norms and expectations will lead to complaints and possible punishment by consumers such as switching to a competing service or product.

2.4 Equity theory

Equity theory explains that individuals (who are similar to one another) gauge the fairness (or equity) of an exchange by comparing the ratios of their contributions to a particular exchange versus the resulting outcome. Perceived fairness or equity occurs if all parties in the exchange receive the same outcome or ratio, whereas disparate ratios result in social tensions that leave the "short-charged" individuals angry and benefiting party feeling guilty (Cox, 2001:266).

Once inequality within an exchange is noted the parties engage in activities that reduce the tension and move the relationship back toward an equitable position. Martins (1995) outline the following four key methods by which to reduce inequality:

- Change the quantities of inputs and outcomes for one or both parties;
- Alter the perceived importance or weighting of either party's input and/or outputs;
- Leave or end the exchange relationship and;
- Change the reference other.

2.5 Fairness as a dual entitlement

The principle of dual entitlement builds on equity theory and suggests that fairness perceptions depend on the reference transaction, the outcomes of

the exchange parties, and the exchange context. Buyers and sellers believe that they are entitled to a reference price and reference profit respectively (Kahneman, Knetsch & Thaler, 1986a). If either party does not receive its entitlement, the relationship will be perceived as unfair.

2.6 What is Price?

Price has traditionally been conceptualized as a uni-dimensional construct-capturing expensiveness or cheapness of a purchase and measured by a single-item scale reporting price level perception. (Padula & Busacca, 2005:30). In the traditional approach, emphasis on price level perception implies a price evaluation process that is exclusively focused on purchase cheapness.

Purchase cheapness implies the judgement about the economic convenience of the transaction. Padula & Busacca, (2005) used equity theory to extend the price construct from the traditional purchase cheapness to variety and price fairness on the overall price judgement. Using data from an empirical study on the mobile phone industry, they showed that price is a multi-dimensional component of value, made up of three dimensions:

- Fairness – the extent to which price is perceived to enable an equitable exchange among parties;
- Cheapness – the perceived economic convenience of the transaction carried out by a customer to purchase a product or service and;
- Variety – the extent to which a customer may choose among several price options, each corresponding to different and specific service uses (or customer needs).

A construct is multidimensional when it refers to several distinct but related dimensions treated as a single theoretical concept. The utility of multidimensional constructs has generated considerable debate. The advocates of multidimensional construct argue that it provides holistic

representations of complex phenomena, allow researchers to match broad predictors with broad outcomes, and increase explained variance.

2.7 Economic and social view of fair price

Part of economic theory of supply and demand suggests that as an item becomes scarcer; its price should go up. Like so many other economic theories, however, this one fails when applied to many real world situations. Three researchers contend that these pricing strategies, which do not reflect economic theory, are based on meeting a popular notion of fairness.

Kahneman, Knetsch & Thaler (1986a) suggest that fairness in pricing is, in fact, a constraint on profit seeking. For example, restaurants and airlines often end up fully booked (with customers standing by for a table or seat), but rather than raise prices, they turn away business. The literature will look at both the economic and social view of a fair price. If considerations of fairness do restrict the actions of profit-seeking firms, economic models might be enriched by a detailed analysis of this constraint (Kahneman, Knetsch & Thaler, 1986b).

2.7.1 Economic view: a fair price as a low price

"Fair" has generally been taken to be a global measure of price acceptability (Maxwell, 1995:21). Traditionally, the basis for determining a fair or acceptable price has been assumed to be purely economic. The neoclassical economic assumption is that consumers are motivated by utility maximization. Consumers are assumed to make decisions based on their own self-interest. Therefore, a fair price is a low price, i.e. one that is economically acceptable and benefits the consumers. Huppertz, Arenson & Evans (1978) indicated that the lower the price, the more equitable it was perceived to be. Their research suggests that a "fair" price is simply a "cheap" price. In the economic model, demand converges to the lowest supplier price for an identical

good. Thus fairness is not an issue in a competitive market, which by definition will not support super-normal profits.

2.7.2 Sociological view of price fairness

An alternative view to price fairness is based on sociological considerations. In this perspective, price is regarded as a tool of exchange which operates according to the rules of the given society (Maxwell: 1995). When the community accepted rules of pricing are followed by the seller, the price gains legitimacy in the eyes of the consumer. According to this view, a fair price is one that is socially acceptable. Kahneman, Knetsch & Thaler, (1986a: 299-300), strongly believe that the absence of considerations of fairness and loyalty from standard economic theory is one of the most striking contrasts between this body of theory and other social sciences.

Sociological theories hold a different view that buyers are not only self-interested but also socially conscious. They may judge the economic acceptability of the price magnitude in relation to their own self-interest, but at the same time they judge the social acceptability of the price in relation to community standards or rules (Kahneman Knetsch & Thaler, 1986b). Maxwell (1995) demonstrated that a price can be perceived to be fair even when it is not cheap in economic sense due to social considerations. She and other researchers have demonstrated this influence on several studies as illustrated below.

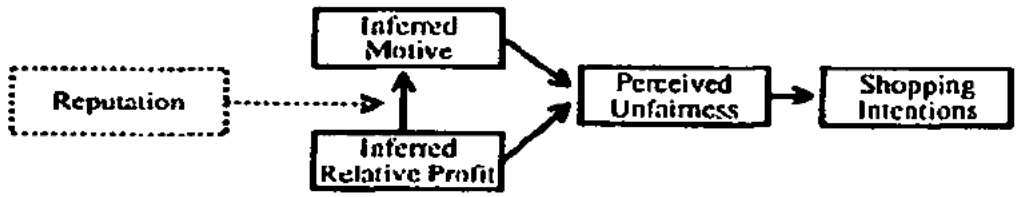
In one study Maxwell (1995) rated perceived fairness when the posted tag price for the item (a socially acceptable pricing practice) was higher than the scanner price (an economically acceptable price). Despite the higher posted price being against their economic self-interest, 75% of the respondents judged it fair to be charged the higher price since that was what had been posted on the shelf.

In a second study (Campbell, 1995) showed how consumers respond to a firm's imputed intent. When it was explained that a price increase after an earthquake had been previously planned, customers were much less resistant. Just the fact that the firm's intent was something other than taking advantage of increased demand resulted in greater perceived fairness of the price increase. They have also reported that it was not considered unfair by some consumers to have to pay higher prices than those charged for necessities sold to consumers considered disadvantaged, like the elderly.

2.8 Inferred motive and perceptions of price fairness

Studies indicated above provided further evidence that consumer inferences of the motive for a price increase influence the perceived fairness of the increase (Campbell, 1999a). Campbell demonstrated that when it was inferred a firm had a negative motive for price increase, the increase was perceived less fair. In addition, Campbell showed that a firm's reputation can influence the inferred motive. Firm's with good reputation get customers' benefit of doubt when inferring motive. Two factors are identified that directly affect the perceived fairness of a price change: (1) inferred relative profit and; (2) consumers' inferences about the firm's motive for price change. Reputation indirectly affects perceptions of price fairness by influencing the inferred motive. Likewise, if the price is attributed to a positive or benevolent motive, such as to aid a good cause or equitably distribute a scarce good, it will be perceived as fair (Campbell, 1999a:189).

Figure 2-1: Relations among antecedents and consequences of perceived unfairness



Source: Campbell, Journal of marketing research Vol.35, May (1999a: 187-199).

2.9 Reputation: a qualitative element beyond inferred motive

One benefit of finding that inferred motive influences perceptions of price fairness is that this provides a new way to consider other factors that are likely to affect perceived fairness (Campbell, 1999b:150). We can improve understanding and prediction of perceptions of fairness by considering factors that are likely to affect the inferred motive. One such factor is the firm's existing reputation.

Campbell suggests that one of the benefits of a good reputation is that there is "goodwill" value that tempers consumers' responses to the firm. It is possible that when there is some doubt about what the motive for a price increase might be - consumers will be less likely to infer negative motive for a firm with a good reputation. A firm with a poor reputation is not likely to be given the benefit of the doubt in the same way.

2.10 Reference points as a determinant of price fairness

Research inspired by the principle of dual entitlement (Kahneman et al., 1986b), argues that fairness perceptions are governed by the belief that firms are entitled to a reference profit and customers are entitled to a reference price. Changes in status quo price should not be made arbitrarily or merely for the purpose of increasing the firm's profit. At the same time a firm is entitled to protect its profit when threatened by events such as rising costs.

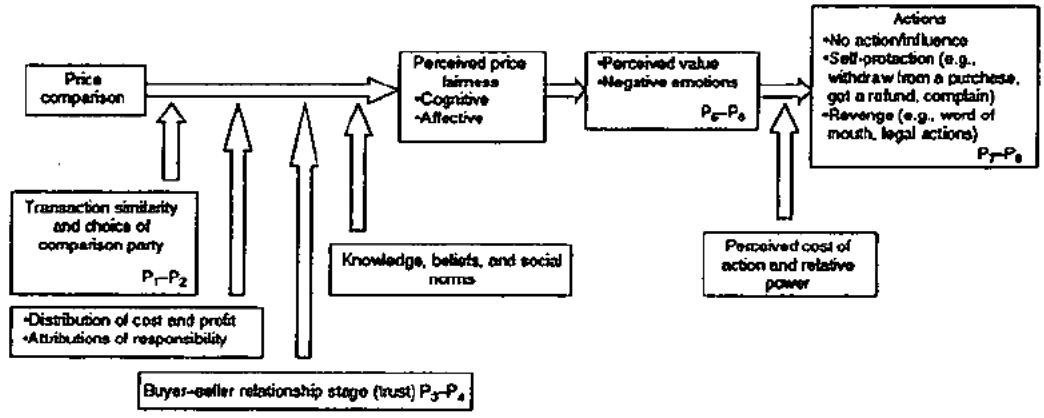
Bolton, Warlop & Alba, (2003) have clearly indicated that reference points which consumers appear sensitive to include: past prices, competitor prices and cost of goods sold. They characterized these reference points as looking back over time (at past prices), looking across firms (at competitor prices), and looking within the firm (to costs). The assumption in their reasoning is that once a reference point has been evoked, consumer judgement is guided by attributions regarding the difference between the target price and the reference price. This comparison process drives profit perceptions and price

fairness judgments. Prices that compare favourably with the reference point are deemed fair; and those that compare un-favourable are deemed unfair.

2.11 A Conceptual framework for perceived price fairness

Xia, Monroe & Cox (2004:3) provide a conceptual framework for perceived price fairness. They define price fairness as "consumer's assessment and associated emotions of whether the difference (or lack of difference) between a seller's price and the price of a comparative other party is reasonable, acceptable, or justifiable" They present a conceptual framework for price fairness that integrates the conceptualisations and organizes existing price fairness research (figure 2-2).

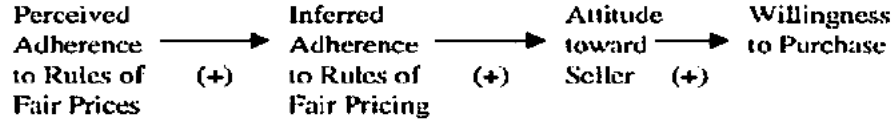
Figure 2-2: A conceptual framework of price fairness



Source: Xia, Monroe & Cox, Journal of marketing 68(2004:1-15)

Fairness has also been defined as a judgement of whether an outcome and/or the process to reach an outcome are reasonable, acceptable or just (Bolton, Warlop & Alba, 2003). The cognitive aspect of this definition indicates that price fairness judgements involve a comparison of a price or procedure with a standard, reference or norm. Maxwell (2002) has designed a rule based model, which depicts a causal-chain reaction as shown in figure (2-3). In the model, a perceived violation of the rules of a fair price affects willingness to purchase through the mediating effects of inferred adherence by the seller to the rules of fair pricing and the buyers' attitude toward the seller (figure 2-3).

Figure 2-3: Direction of relationships in a rule based fair price model



Source: Maxwell, Journal of economic psychology 23(2002:191-212)

In the model, consumers infer that price setting process has been done fairly and no rule has been violated when the actual price is the same as the reference price. As Kahneman et al., (1986a) point out; people have high expectations of conformity to rules of exchange. When these rules are not met, people judge it as unfair and apply sanctions. For example, Kahneman et al., (1986a) asked respondents what they would do when a drugstore raised its prices after another nearby drugstore had been forced to close. They found that 68% of respondents would rather travel an additional five minutes than patronize such a seller. The rating of price fairness in their study was done and is depicted below (table 2-1):

Table 2-1 : Rating of fairness by Kahneman

Q1. A hardware store has been selling snow shovels for $15. The morning after a large snowstorm, the store raises the price to $20. Please rate this action as 1.completely fair, 2. Acceptable, 3. Unfair, 4. Very unfair. In this example, 82% of respondents (N = 107) considered it unfair for the hardware store to take advantage of the short-run increase in demand. Scale 1 and 2 were grouped as favourable (fair), and scale 3 and 4 were considered unfair.

Source: Kahneman et al., The American economic review: 76: (1986a:729).

2.12 Attribution theory

In developing a pricing strategy for any market, managers have to consider how consumers process information on prices. Attribution theory is used to explain how consumers interpret price increases.

This theory explains how humans act as naïve psychologists to explain causal relations. It is a rich collection of theories explaining how everyday person in everyday situations explains why something did or did not happen. The theory conceives of human beings following some sort of internal logic or personally rational model, sometimes called "common sense".

2.12.1 Fundamental attributional bias

Maxwell, (1999a) believes that the process of attribution is affected by various biases and distortions of judgement which can result in misinterpretation of the situation. A fundamental attributional bias is the tendency for attributors generally to underestimate the influence of impersonal, situational or environmental factors and to overestimate the influence of human factors in controlling behaviour. So, rather than to blame abstract market forces, consumers would tend to attribute the cause of a perceived price increase to a human agent (Maxwell, 1999a:10).

The inclination to blame another person is explained by egocentric bias of attributors. Attribution theory explains that there is a tendency to attribute failures or negative outcomes to external causes and successes or positive outcomes to internal causes. External causes are all the forces outside the individual making the judgement. Internal causes are all the actions under the control of the individual actor. So in attributing the cause of a negative outcome such as a higher price, the expected tendency of consumers would be to blame the seller.

2.12.2 Price increase resulting in less positive attitude

Given a price increase, it is anticipated that buyers will attribute the cause to the actions of the seller (Maxwell, 1999a:13). They will infer that sellers have not complied with social norms of the seller's role and

are expected to have a less positive attitude toward the seller. This relationship is depicted in a model (figure 2-4) of a price increase.

Figure 2--4: Model of attribution of a price increase

price (same/increased)	→ (–)	attributed seller actions: inferred compliance to socially approved pricing practices	→ (+)	attitude toward seller

Source: Maxwell, Journal of consumer marketing 16(1999a:9-23)

2.13 Dual entitlement principle

The principle of dual entitlement (DE) suggests that fairness perceptions depend on the reference transaction, the outcomes of the exchange parties, and the exchange context. If either party does not receive its entitlement, the relationship will be perceived as unfair. A price which violates the buyer's entitlement to the reference price will be considered acceptable only if it is perceived to be necessary to protect the seller's reference profit. This implies that a price increase that increases the seller's profit beyond its reference entitlement will be deemed unfair. According to DE principle, it is considered fair if the company completely compensates its cost increase. It is also consistent with fairness norms not to pass cost decreases to the customer, since, in this case the seller's profit increases without violating the buyer's reference price entitlement.

Kahneman et al., (1986a, 1986b) in two influential papers proposed **"dual entitlement"** as the dominant norm of price fairness. They stated that buyers and sellers recognise each other's entitlement according to the terms of some reference transaction – buyers to a reference price, sellers to a reference profit. Consumers use reference price as an anchor point to evaluate own gain and losses, and they use their knowledge about a firm's reference profit to evaluate gains or losses of the transaction counterpart. Kahneman says consumers have "community norms" of fair behaviour. Both the seller and the buyer are entitled to a "normal" profit and price, respectively. This norm is established in relation to a **"reference"** transaction, typically the most recent

or an average transaction. Kahneman et al. (1986a:732–734), used scenarios shown below to drive the point home (table 2-2).

Table 2-2: Scenario illustrating fairness

Scenario 1: Suppose that, due to a transportation mix-up, there is a local shortage of lettuce and the wholesale price has increased. A local grocer has bought the usual quantity of lettuce at a price that is 30 cents per head higher than normal. The grocer raises the price of lettuce to customers by 30 cents per head. **Scenario 2:** A severe shortage of Red Delicious apples has developed in a community and none of the grocery stores or produce markets has any of this type of apples on their shelves. Other varieties of apples are plentiful in all of the stores. One grocer receives a shipment of Red Delicious apples at the regular wholesale cost and raises the retail price of these Red Delicious apples by 25% over the regular price.

Scenario 1 was considered fair and the Scenario 2 as unfair.

The DE principle concludes that cost-justified price increases are perceived to be fair. This principle has received some empirical support in the literature (Urbany et al., 1989). Others have provided theoretical grounding for DE principle using attribution theory (Vaidyanathan & Aggarwal, 2003).

2.14 Providing theoretical ground for Dual Entitlement principle

Vaidyanathan & Aggarwal (2003) have provided theoretical grounding for DE principle using attribution theory. They used attribution theory to understand consumers' perceptions of fairness of price increases. Using the DE principle, researchers have concluded that price increases will be perceived as fairer if they are cost-justified. Vaidyanathan & Aggarwal (2003) empirically demonstrated that this is not universally true. They conducted three experiments to examine the fairness perception on two attributional dimensions: locus of cause and locus of controllability.

2.14.1 Locus of cause and controllability.

They made very interesting findings that even cost-justified price increases can be perceived as less fair when the locus of causality is internal to the seller and/or when the price increase is within the volitional control of the seller. For example, they concluded "when competitors' prices stay the same or when the cost increase is directly attributable to the seller's actions, even cost-justified price increases are seen as less fair"

2.14.2 Locus

This refers to whether the cause of an action is "internal" to the actor or "external". The locus is determined based on who is responsible for a given action. Folkes (1988) and other researchers have shown that consumers react unfavourably if the locus of causality of a negative outcome can be linked to a firm (an internal locus of causality). An internal locus is associated with a feeling of anger towards the seller. Based on this, it would be expected that a price increase would be evaluated as less fair if the locus of causality is perceived to be internal to the seller.

2.14.3 Controllability

Controllability is concerned with whether an action was in volitional control of an actor or not. An action is considered volitional or controllable if it was perceived to be undertaken as a wilful choice. For example if a manufacturer raises its price when there are no cost based reasons to do so and every other competitor in the market continues to sell at the old lower price, buyers are likely to infer that the price increase was within the volitional control of the seller. Controllability also affects how consumers' perceive a firm's action. Other researchers have shown that consumers feel angry and want to hurt a firm when they attribute a product failure to a firm's controllable

actions (Folkes, 1988). With this finding, the researcher would expect that consumers would evaluate a price increase to be less fair if the cause of the increase was perceived to be within the volitional control of the seller.

2.14.4 Temporal stability

Temporal stability refers to whether a cause remains stable over time or is a temporary phenomenon. For example, if a seller raises price to increase its profit margin, the cause behind the change will be seen as more permanent, whereas a raise in response to a short labour strike will be seen as temporary.

2.15 Fair price judgement for state sponsored firms

Research by Warlop & Novoseltsev (2000) has suggested that the rules for fairness judgement are different when applied to subsidized firms as opposed to non-subsidized ones. Consumers see the role of subsidized firm's in a different context and tend to be compromising to price increases by subsidized firms' as opposed to non-subsidised firms.

2.15.1 Role of prices in public sector

Worldwide, almost all state owned enterprises (SOE's) face a critical choice: whether and when to privatise (Li, Ouyang & Zhou, 2005:37). They assert that State Sponsored Firm's privatisation choice is often complicated by the unique characteristics of transition economies. While market economies feature clearly defined and relatively stable rules of market competition and property rights, in transition economies these factors are evolving and uncertain. The use of prices to generate resources for state firms is not clearly defined.

Jimenez (1987) has clearly pointed out that prices have generally played a minor role in generating resources for SSF's in developing countries. Instead the public sector has traditionally relied on general revenues from taxation for financing. These revenues, in turn, are financed through direct or indirect taxes, or budgetary deficits supported by domestic and foreign borrowing. Tightened budgets have forced many countries to make choices regarding the financing and provision of certain goods and services in the public sector. Competition for scarce government resources is becoming more intense. Unless they find alternative sources of funding, policy makers must either scale down their expectations regarding how much their economies can devote to these good/services or dilute quality. Jimenez has strongly proposed the use of prices to distribute certain goods and services.

2.15.2 Implementation of cost recovery by using prices

For subsidized firms the introduction and use of prices for cost recovery can be implemented within certain framework. In cases where these resources were highly subsidized, the basic cost recovery strategies can be designed and accepted for implementation within the following framework (Humphrey, Keppler & Montes-Negret, 1997:2):

- Partial cost recovery, where the provider aims to recover only a proportion of its development and operational costs;
- Full cost recovery, where the prices are set at a level which are designed to recover the full development and operating costs
- Planned growth cost recovery, where the price is set to recover the full costs and provide funds for the next purchase of capital equipment
- Profit, where the prices are set to recover total costs, provide for future enhancements and provide a suitable return to the owners of the system for the capital invested.

2.15.3 Consumer price perception for state sponsored firms

Warlop & Novoseltsev (2000) investigated how fair price judgements are affected by consumer knowledge of government sponsoring. They presented three norms or motives which individuals may use in their fairness judgements. These norms are based on justice, altruism and self-interest motives. They did four experiments and asked consumers to suggest a new fair price for a firm that has experienced an increase in costs.

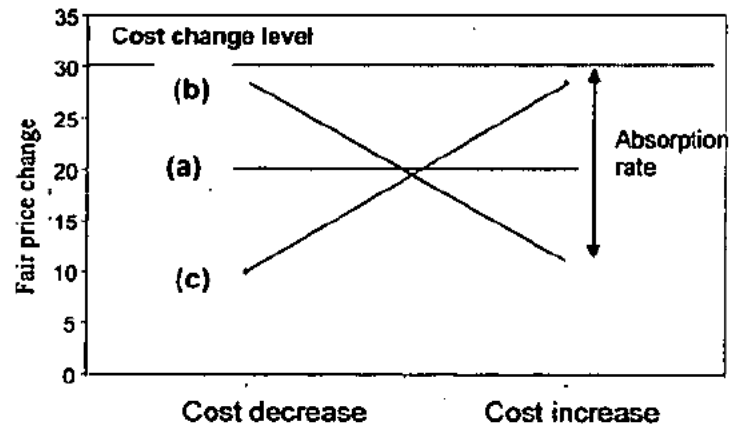
For non-subsidized firms, subjects' reason according to the principles of distributive justice, disconfirming the predictions based on the dual entitlement. When the firm is subsidized, dual entitlement principle is supported. When they did a follow up studies, they found that dual entitlement principle effect for subsidized firms is limited to:

- Situations in which respondents are impartial observers, rather than the firm's own customers;
- Situations where the stakeholders are affected in their long term (tax-payer) interest;
- Situations in which the customers do identify strongly with the objectives of the subsidized company.

The DE principle is presented in the current research literature as the dominant principle for price fairness judgments (Campbell, 1999a). This principle describes a consumer as a spontaneously **altruistic person**. This idea does not look very intuitive and requires further exploration. The relative fairness perception of other cost-based rules has also been examined in a number of studies. Some of them support the dual entitlement principle (Kahneman et al. 1986a, 1986b), but others present evidence for the greater perceived fairness of rules based on a more symmetric treatment of cost increases and decreases (Kalapurakal, Dickson & Urbany, 1991; Dickson and Kalapurakal

1994). The combination of both cost increase and decrease results in an overall set of price fairness principles which people may use when seller's costs change (Figure 2-5).

Figure 2-5: Theoretical patterns of price fairness judgments principles



Source: Warlop & Novoseltsev, Fordham University Pricing Conference Proceedings, May (2000: 1-36).

Warlop & Novoseltsev (2000) presents a framework (figure 2-5) which summarizes the principles consumers may use when determining the fairness of price changes. When costs change, the consumers will infer the new fair price on the basis of their perceptions about profit the company is entitled to make. In other words, consumers make normative judgments about the supplier absorption rate – the share of cost change the company should (or is allowed to) keep. For instance, when unit costs increase by SR30 (Seychelles Rupees), there are several options:

- First, the firm may be allowed to fully compensate its cost increase by setting a new price SR30 higher than the old one. This situation implies a **zero absorption rate**.
- Second, for some reasons it may not be considered fair for the firm to compensate its cost increase and to increase the price. In this case the absorbed amount will be maximal and equal to SR30.

- Third, the company may be granted the **partial compensation of cost increase**, which leads to different values of absorption levels between SR0 and SR30. The same situations may occur when costs go down.

The fairness norms may require a company to decrease its price following the cost decrease **(zero absorption-rate)**. Alternatively, the company is allowed to keep all extra profits and keep the price at the old level (maximum absorption rate), or transfer some benefits to consumers (absorption rate is between zero and maximum value). The combination of both cost increase and decrease results in an overall set of price fairness principles which people may use when seller's costs change (Figure 2-3).

The **first principle is symmetric** and based on the distributive justice principle of equity (line (a)) (figure2-3): suppliers ought to grant the customer a share in both the burden of a cost increase and the pleasure of a cost decrease (Warlop & Novoseltsev, 2000). This principle implies equal absorption rates, independent of whether the cost change is an increase or a decrease. At the extremes, this principle will translate in a **'buffering' rule**, when all cost changes are absorbed by the supplier (absorption rate is maximum), or in a **cost-plus rule** when all changes are transferred to the consumer (absorption rate is zero). Several intermediate rules may be thought of, depending on the proportion of the cost change which is absorbed or transferred, but they are all symmetric because the absorption rate is the same for cost increases and cost decreases.

Two alternative **principles may be asymmetric**. According to the first asymmetric principle the supplier should absorb all cost increases, but transfer all cost decreases to the customers (line (b)) (figure 2-3). From the customer perspective this principle implies self-interest motivation. Consumers require the company to decrease the price when costs go down. At the same time consumers protect their

interests and do not allow the company to increase the price in order to compensate its cost increase. The second asymmetric principle suggests that the supplier is permitted to increase price whenever it is justified by a cost increase but is allowed to keep a share of benefits when supplier costs decrease (line (c)) (figure 2-3). This situation reflects the altruistic motivation of consumers assumed in the dual entitlement principle. Instead of sharing benefits and burdens consumers allow company to benefit out of both situations of cost increase and decrease.

Absorption rates for cost increase and cost decrease situations are two characteristics which help to distinguish one principle from another. Identical absorption rates describe the symmetrical price fairness judgment pattern. When the absorption rates are different, they imply either a **self-interest principle** or an **altruistic principle** (Warlop & Novoseltsev, 2000).

2.16 Summary and conclusion

A rich collection of literature exists to explain why traditional economic theory cannot be relied upon to explain how customers behave in pricing matters. The issue of fairness ignored in economic literature is now a significant factor to consider in a pricing strategy. The problem however, is that there is no agreement on how to define and measure consumer perception of fairness, but there is a lot of theories explaining what it is. This research report will borrow from the theories presented in this chapter to study the research problem. The theoretical framework presented in this chapter is used to design the research questionnaire and to interpret the results from the empirical study.

CHAPTER 3

RESEARCH METHODOLOGY

3.1 Introduction

In the previous two chapters, the study outlined the objectives, established the theoretical background and formulated the research propositions. In this chapter, the researcher will briefly present approach used in gathering the primary data, drawing extensively from Cooper & Schindler (2003).

3.1 Research design

This report is designed to explore the perception of consumers to fairness of a price increase in state sponsored firms in Seychelles. The fieldwork for the study was conducted in August and September 2005. In a typical research situation the total population of the elements to be researched is too large for study and so a manageable sample is selected. The sample selected should have characteristics of the population if the results are to be generalized (Cooper & Schindler, 2003). The targeted population in the study is consumers of goods and services offered by state firms in Seychelles. To capture this group the study used four institutions of learning as data collection points.

3.2 Unit of analysis

The research is based on information obtained from students and employees of four main educational institutions in Seychelles (Seychelles Institute of Management, Adult Learning and Distance Education Centre, Seychelles Polytechnic and National Institute of Education). This information includes their perceptions regarding the price increase under stated scenarios in a questionnaire.

3.3 Sampling method

The ultimate test of a sample design is how well it represents the characteristics of the population it purports to represent (Cooper & Schindler, 2003:181). They conclude that in measurement terms, the sample must be valid. The validity of a sample depends on two considerations: accuracy and precision.

Accuracy refers to the degree to which bias is absent from the sample. When the sample is properly drawn, some elements underestimate the population values being studied and others overestimate them. Variations in these values offset each other; this counteraction results in a sample value that is generally close to the population value (Cooper & Schindler, 2003).

The second criterion of a good sample is precision of estimate. As Cooper & Schindler (2003:181) recommends, no sample will fully represent its population in all respects. The numerical descriptors that describe samples may be expected to differ from those that describe populations because of random fluctuations inherent in the sampling process.

3.3.1 Sample selection method used in the research

Members of a sample can be selected on probability or non-probability basis. Probability sampling is based on the concept of random selection – a controlled procedure that assures that each population element is given a known nonzero chance of selection. In contrast, non-probability sampling is arbitrary (non-random) and subjective, but has been used in research for the following reasons:
(1). It has been chosen because of cost and time constraints; (2). Non-probability sampling is a feasible alternative with modifications (Cooper & Schindler, 2003:200).

3.3.2 Non-probability sampling

Non-probability samples that are unrestricted are called convenience samples. Convenience sampling is used because the sampled population will depend on their availability for the study. The researcher selected convenient places, i.e. institutions of learning mentioned in (paragraph 3.3) where large groups of people could be located for the questionnaire. A random sampling method was used to determine the actual participant in the study and a table of random numbers was used to pick the participants from a list provided by the institutions to eliminate the bias often associated with this method.

3.4 Data collection procedures

A written permission was required to carry out research in the institutions chosen to participate in the research. A cover letter to request for permission was sent out to all the three institutions and their approval was confirmed in three weeks. The cover letter has been used to solicit the cooperation of institutions and show the purpose of the study. The letter was sent to the heads of the institutions and not to individual participant: (A copy is attached in Appendix 3).

A questionnaire (Appendix 2) was sent to 200 participants. The questionnaires to sampled respondents were hand delivered through the lecturers in the institutions (courtesy of the researcher's existing relationship). This meant all questionnaires were received. However, in an effort to increase responses, a telephone contact was made with the lecturers after one week. This strategy worked well since a total of 152 questionnaires were received back representing a response rate of 76%.

The participants were asked to participate in a short survey related to pricing policies of state sponsored firms. The questionnaire was issued at the start of a regular class lecture and collected at the next lecture session. The subjects are asked to carefully read a paragraph containing the experimental manipulations (a scenario) describing a pricing action, and to answer the

question about the new fair price the company should set or choose from the ratings given. No other measures were taken. The study utilises scenarios in which hypothetical firms are chosen and shown to make a pricing decision that affect the customer. The scenario is written down and presented to the participant, who then evaluates the fairness of the action.

The questionnaires contained a set of four pricing scenarios. In each scenario, the context was systematically manipulated by presenting different scenarios describing a seller's pricing decision to subjects in different treatment conditions. Subjects read the scenario and then responded to a series of scales or questions about perceived fairness of the pricing action taken by the seller. The order of presentation of scenarios has been found to have no effect on the subjects' responses in pricing issues (Kalapurakal, Dickson & Urbany, 1991:799; Warlop & Novoseltsev, 2000).

3.5 Sampling frame

Sampling frame is the list from which the sample is actually drawn. Ideally, it is a complete and correct list of population members only (Cooper & Schindler, 2003:188). In Seychelles, the state firms offer goods and services in sectors like education, communication and transport, wholesale and retail, health, banking, among others. From the four chosen institutions for the study, a random sample was used when selecting from the list of students and professional staff who actually received the questionnaire.

3.6 Measurement instrument

The relevant data is collected by means of a survey. A structured survey by means of a questionnaire is conducted on employees and students in the four institutions that have a national outlook. The questionnaire helps to determine responses to questions relating participants' perceptions to price increases.

3.6.1 How scenario one is rated

Scenario one was designed specifically to study **proposition 1** which stated that: consumers use altruistic motivation assumed in Dual Entitlement principle as a norm (motive) in perceptions of price fairness for state sponsored firms. The theoretical grounding for this proposition is discussed in the literature review paragraph (2.15). This proposition is studied with two scenarios; scenario (1a) which indicates a price increase while scenario (1b) investigates responses to price decrease. An illustration of the scenarios is presented in the tables below.

Table 3-1: Scenario (1a) examining cost increase with a subsidy

An Institution X offers education and training services in Mahe, Praslin and La Digue. The business of the Institution is partly subsidized by the government. The average cost of training per student is **SR500**.
These costs include salaries, maintenance costs, overheads, and so on. Due to subsidies from the government the price for the training charged by Institution X is only **SR470**.
It happened that costs of the company operations have increased. As a result, the costs for the training have risen from **SR500 to SR 530 (SR 30 increase)**.
According to your opinion, what should be a new fair price for the training per student?
The new fair price for the training should be SR .....

Table 3-2: Scenario (1b) examining cost decrease with a subsidy

An Institution X offers education and training services in Mahe, Praslin and La Digue. The business of the Institution is partly subsidized by the government. The average cost of training per student is SR500. These costs include salaries, maintenance costs, overheads, and so on. Due to the subsidies from the government the price for the training charged by Institution X is only **SR470**. It happened that costs of the company operations have decreased. As a result, the costs for the training have fallen from **SR 500 to SR 470 (SR 30 decrease)**. According to your opinion, what should be a new fair price for the training per student? The new fair price for the training should be SR .....

On (Figure 2-5), Warlop & Novoseltsev, (2000) presents a framework which summarizes the principles consumers may use when determining the fairness of price changes. When costs change, the consumers will infer the new fair price on the basis of their perceptions about profit the company is entitled to make. In other words, consumers make normative judgments about the supplier absorption rate – the share of cost change the company should (or is allowed to) keep. These principles are used to interpret the responses from scenario one. In the model, absorption rates for cost increase and cost decrease situations are two characteristics which help to distinguish one principle from another. Identical absorption rates describe the symmetrical price fairness judgment pattern. When the absorption rates are different, they imply either a **self-interest principle** or an **altruistic principle** (Warlop & Novoseltsev, 2000).

3.6.2 How scenario two is rated

Scenario two was specifically used to test **proposition 2** which is stated as follows: it is fair for a state sponsored firm to increase price to protect its reference profit especially when a government subsidy is eliminated. The responses are rated as done in other previous studies on price perceptions by Kahneman et al., (1986:729):

1. Completely fair
2. Acceptable
3. Unfair
4. Very unfair

The two favourable and the two unfavourable categories are grouped to indicate the propositions of respondents who judge the action acceptable or unfair. As Kahneman et al. (1986: 729) did in their study, this study also uses the perceived fairness or otherwise as simply an abbreviation for "substantial majority of the population studied think it is fair. In this study the scenario is formulated as follows (table 3-3):

Table 3-3: Scenario 2 examining pricing behaviour when subsidy is eliminated

Firm X offers public transport and taxi services in Mahe, Praslin and La Digue. The business of the firm is subsidized by the government. The average cost of s ticket per trip is **SR5**. These costs include salaries, maintenance costs, overheads, and so on. Due to the subsidies from the government the actual price of a ticket per trip charged by firm X is only **SR4**.
It happened that the government subsidy has been removed as the firm has been given autonomy to operate, sustain itself and generate revenue from its services. The firm now charges **SR 5** per ticket.
According to your opinion, rate this pricing behaviour:
1 - Completely fair
2 - Acceptable
3 - Unfair
4 - Very unfair

3.6.3 How scenario three is rated

Scenario three tested **proposition 3** stated as follows: a price increase that is cost-justified is perceived to be fair as long as the firm has been fair and consistent in the treatment of cost changes. The rating scales are similar to the ones used in scenario two above.

Table 3-4: Scenario 3 examining pricing behaviour in the face of a cost increase

A state owned supermarket in Mahe has been buying a toy for SR 100. The standard pricing practice used by the supermarket is to price toys at double their cost so the selling price of the toy is SR 200. This covers all the selling costs, overheads and includes a profit. The supermarket can sell all the toys it can buy. Suppose because of changes in foreign exchange rate the cost of the toy rises from SR 100 to SR 120 and the selling price is increased to SR 220. As a result of another change in currency exchange rates, the cost of the toy falls by SR 20 back to SR 100. The supermarket continues to sell the toy at SR 220. According to your opinion, rate this pricing behaviour: 1 - Completely fair 2 - Acceptable 3 - Unfair 4 - Very unfair

3.6.4 How scenario four is rated.

This scenario was used to study the **proposition 4** which states that: attribution of responsibility for price increase influences perception of price fairness. Two scenarios are formulated and methodology is similar to scenario two and three.

Table 3-5: Scenario 4(a) examining attribution of responsibility

A large supermarket in Mahe discovers that it is required to make a large tax payment penalty to the government as a result of poor record keeping of invoices that resulted in accounting oversight. As a result of this increased cost, the supermarket decides to increase the selling price. According to your opinion, rate this pricing behaviour: 1 - Completely fair 2 - Acceptable 3 - Unfair 4 - Very unfair

Table 3-6: Scenario 4(b) examining attribution of responsibility

The supermarket in 4(a) above imports its fresh fruits from South Africa, where currently there is a shortage. The supplier abroad has increased its price. As a result of this higher import price, the supermarket decides to increase the selling price. According to your opinion, rate this pricing behaviour: 1 - Completely fair 2 - Acceptable 3 - Unfair 4 - Very unfair

3.7 Validation of instrument

The questions adopted in the questionnaire were pre-tested to selected professional staffs at SIM who are senior lecturers in a management training institute. The full questionnaire was then tested on selected employees from SIM and part time lecturers at SIM. The comments received were incorporated in the preparation of the final questionnaire.

3.8 Summary and conclusion

The research methodology used is based on what previous similar pricing research used, but with modification to suit the local needs. Moreover, care has been taken to avoid the identified weaknesses from previous studies. The results from empirical study will be compared with what the literature says in similar areas in chapter four and five; and conclusions will be derived in the chapter five.

CHAPTER 4

RESEARCH FINDINGS

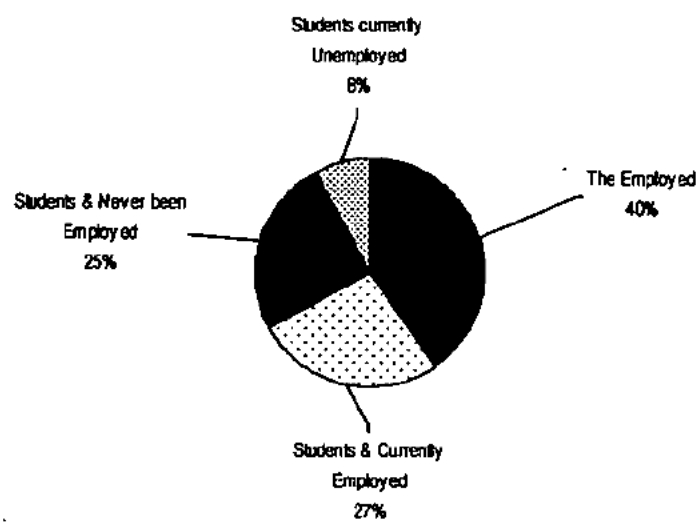
4.1 Introduction

The purpose of this chapter is to report on the empirical data collected in Seychelles. This includes reporting on: the responses to the questionnaire, the various statistical techniques used to analyse the data and a brief comment on the findings.

4.2 Structure of the sample

In summary, the structure of respondents is illustrated below (figure 4-1). The respondents comprised; the employed 40%; students who are also currently employed 27%; students who have never been employed 25%; and students previously employed but now unemployed 8%.

Figure 4-1: The structure of the sample.



4.3 Profile of respondents

The characteristics of the respondents are shown below (table 4-1).

Table 4-1: The profile of respondents

Base: 151 respondents	Percentage
Age	
18 – 29 years.	52%
30 – 39 years	27%
40 – 49 years	16%
Over 50 years.	3%
Gender	
Male.	40%
Female	60%
Employment status	
Employed & (not a student)	40%
Student & (currently employed)	27%
Student & (Never been employed)	25%
Student & (currently unemployed)	8%

4.4 Scenario one results

Scenario one is designed specifically to study proposition 1 which states that "consumers use altruistic motivation assumed in Dual Entitlement principle as a norm (motive) in perceptions of price fairness for state sponsored firms." The combination of both cost increase and decrease is assumed to result in an overall set of price fairness principles which consumers may use when a firms costs change. The aim is to look at how the presence of information about subsidies influences pattern of price fairness judgments. A total of two scenarios are used, where scenario (1a) tested a price increase while scenario (1b) tested a price decrease.

4.5 Variable and measures

Perception of fairness due to cost increases. This was measured by asking respondents to suggest a fair price SR(x) if the cost increases by SR30. It is assumed that SR470 (i.e. the price without the subsidy) is used by respondents as the reference price and the responses (x) are then compared to the reference price. Past studies have used a similar indicator to measure the responses (Warlop & Novoseltsev, 2000). The total value and mean of responses (SR(x) – SR470, where (x) is the new price suggested) is calculated as shown in (table 4-2).

Table 4-2: The mean of respondents for cost increase with government subsidy

Total The sum of (SR(x) – SR470)	Mean (Total) divided by 146
SR 5,074.6	SR 34.75

[1] The mean is based on 146 respondents

Perception of fairness due to cost decreases. This was measured by asking respondents to suggest a new fair price if the cost decreases by SR30. It is also assumed that SR470 (i.e. the price without subsidy) is used by respondents as the reference price and the responses are then compared with the reference price. This procedure is similar to one used in price increase above. The total value and mean responses is calculated and summarized below (table 4-2).

[1] (x) is the new price suggested by respondents. The numbers of respondents were 152, three did not suggest any new fair price, while the other three displayed lack of understanding of the scenario. So a total of 146 responses were accepted.

Table 4-3: The mean of respondents for price decrease with government subsidy

Total (the sum of (SR(x) – SR470)	Mean ((Total) divided by 146)
SR 2,146.2	SR 14.7

4.5.1 Manipulation of scenario 1

This scenario is manipulated to show an increase or an equivalent decrease in costs when the firm is subsidized by the government. The dependent variable is the absolute difference between the current price and the new fair price. The cost increase is SR[2]30and the decrease is also SR30. The reference (absolute) price is SR470 and this is used to find the difference with the price suggested by consumers. As shown (table 4-2) the mean of the difference was SR34.75. This is plotted as point (b) (figure 4-2) for the cost increase. The mean of the difference for price decrease is SR14.7 (table4-3) and is also plotted as the lowest point (a) (figure 4-2). When the two points are joined together, it gives the absorption rate that reflects what consumers think about the pricing behaviour in scenario one.

4.5.2 Meaning of consumers response to scenario one.

The consumer response is designed to measure the absorption rate. In other words, consumers make normative judgments about the firm's absorption rate – the share of cost change the company should (or is allowed to) keep. For instance, when unit costs increase by SR30, there are several options; the firm is allowed to increase the price to SR34.75, which is SR4.75 more than the actual increase. When the price decrease by SR30, the firm is allowed to decrease the price up to SR14.70, where the consumer gains SR 15.30 and the firm retains

[2] SR means Seychelles Rupees. 1$=SR5.3 at the time of writing.

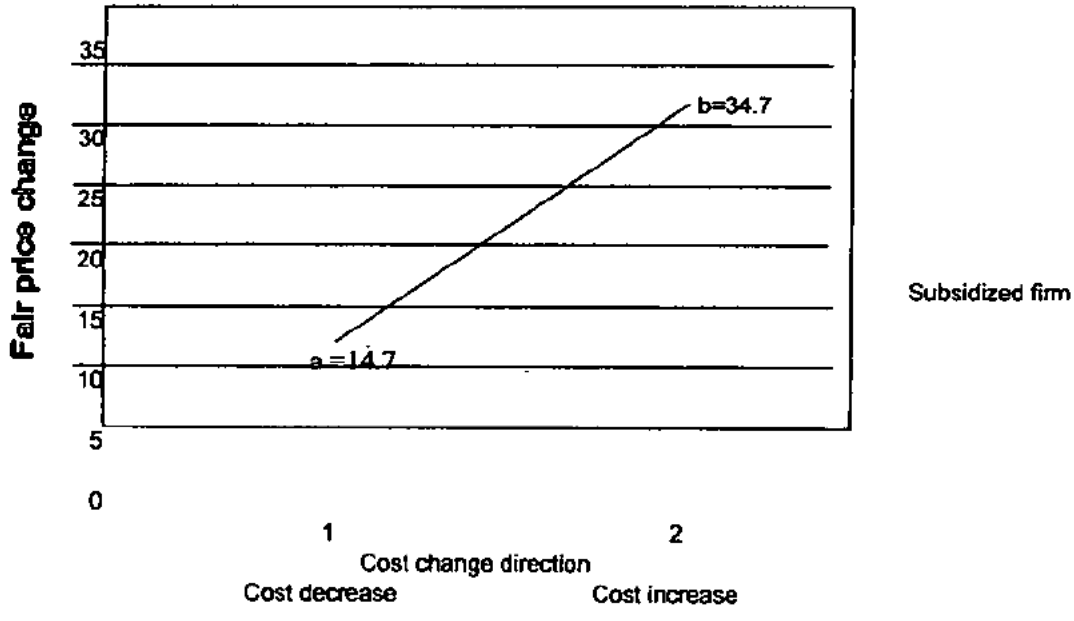
SR14.70. The expected price decrease is not the full amount of SR30 decrease.

Table 4-4: Means of absolute difference between current and new fair price

Type of reason	Type of company	Direction of costs change	
		Decrease	Increase
Internal	Subsidized	**SR14.7**	**SR34.75**

To give meaning to these two means (table 4-4), they are plotted (figure 4-2) and interpreted according to principles of equity as explained below.

Figure 4-2: Absolute fair price change as a function of cost change direction (Plot of means from table 4-4)



Absorption rates for cost increase and cost decrease situations are two characteristics which help to distinguish one principle of price judgement from another. Identical absorption rates describe the symmetrical price fairness judgement pattern. When the absorption rates are different, they imply either self-interest principle or an altruistic principle (Warlop & Novoseltsev: 2000).

4.5.3 Explanation of findings from scenario one.

How is consumers' response (figure 4-2) interpreted? The absorption rate above is categorized as **asymmetric (line a-b in figure 4-2)**. The consumers have responded according to the second asymmetric principle (Warlop & Novoseltsev: 2000), which suggests that a subsidized firm is not only allowed to increase price whenever it is justified by a cost increase but is also allowed to keep a share of benefits when its costs decrease.

The consumers surveyed have **altruistic motivation** assumed in DE principle. Instead of sharing benefits and burdens, consumers allow companies to benefit out of both situations of cost increase and decrease. The findings confirms the study's proposition 1 which postulated that consumers use altruistic motivation assumed in dual entitlement principle as a norm (motive) in perceptions of price fairness for state sponsored firms.

4.6 Scenario two results

This scenario was designed specifically to experiment proposition 2 stated that: *"it is fair for a state sponsored firm to increase price to protect its reference profit especially when a government subsidy is eliminated."* The experiment has two main objectives: (1) to find out how consumers perceive a price increase; and (2) to consider how consumers react to the reason given for the price increase, more specifically where the justification is removal of a government subsidy.

4.6.1 Variables and measures

The scenario was measured using scales developed by Kahneman et al., (1986b). The scales were (1) Completely fair; (2) Acceptable; (3) Unfair; and (4) Very unfair. Scale 1 and 2 were considered fair (favourable) in the final analysis, while 3 and 4 are categorized as unfair (unfavourable). The responses are then grouped in this study to

indicate the proportions of respondents who judge the action acceptable or unfair.

Table 4-5: The levels of perception to price increase justified by falling government subsidy in Scenario 2

N	Age range	Level of perception				Total %
		Completely fair	Acceptable	Unfair	Very unfair	
82	18-29	25	50	6	1	55.4%
39	30-39	9	27	2	1	26.3%
22	40-49	9	12	1	0	14.9%
5	50 and above	1	4	0	0	3.4%
148		44	93	9	2	100%

[3]**Respondent: Fair 92.6% and Unfair 7.4%.**

In this scenario, 92.6% of respondents (N=148) considered it fair for the firm to increase the price to cover up the removed government subsidy. As indicated earlier, completely fair and acceptable ratings are together considered as fair response and the other two ratings are unfair. With this analysis, only 7.4% rated this behaviour as unfair.

4.6.2 Explanation of findings from scenario two

The finding indicates that it is acceptable for firms to protect themselves from losses resulting from an elimination of government subsidy even if the consumer has to bear the resulting price increase. In this case the firm is not increasing the price to earn more profit, but only to cover for the subsidy that has been removed. The near unanimity of responses to this question indicates that actions that help a firm to continue in operation when subsidy is eliminated are highly welcomed. It is however important to note that the framing effect discussed in paragraph (4.6.2) may have influenced the way respondents answered this questionnaire.

[3] Completely fair and acceptable are treated as fair i.e. (44+93)/148 = 92.6%. Unfair and very unfair are both treated as unfair i.e. (9+2)/148 = 7.4%.

4.7 Scenario three results

This scenario is designed to test proposition three which is stated as *"a price increase that is cost-justified is perceived to be fair as long as the firm has been fair and consistent in the treatment of cost changes."* It presented a full set of scenario that looked at past behaviour to test the DE principle as confirmed in scenario one.

4.7.1 Variables and measures

Testing the robustness of DE principle. The scenario is intended to test the robustness of DE principle. Is DE principle indeed a principle (basic truth, law or doctrine that embodies community norms of fairness?). A way to explore the robustness of DE principle is to examine the effect of different perspectives on subjective perceptions of fairness (Kalapurakal, Dickson & Urbany, 1991:789). To do this effectively, a factor to be considered in the formation of judgments about fairness is whether or not the firm behaves in a consistent manner with respect to price increases and decreases. The key question here is; are consumers concerned about fairness and consistent treatment of cost changes?

Even the father of DE principle, Kahneman admits that judgments of fairness are subject to framing effects (Kahneman, 1986b:740). In scenario 1 questionnaire there is room for framing effect, so the scenario 3 questionnaire will attempt to eliminate this. As illustrated in the questionnaire (scenario 3), fluctuating foreign exchange rates is cited as the reason for both an initial increase in cost and a subsequent decrease in cost of toys. The results indicates that 87.9% of the respondents (N=149) considered it unfair while only 12.1% thought the firm's behaviour was fair and is tabulated below (table 4-6).

Table 4-6: Results when the consistency of a firm's behaviour is tested by considering the robustness of DE principle in Scenario 3

N	Age range	Level of perception				Total%
		Completely fair	Acceptable	Unfair	Very unfair	
81	18-29	1	11	35	34	54.4%
40	30-39	0	1	16	23	26.8%
23	40-49	0	4	13	6	15.4%
5	50 and above	0	1	1	3	3.4%
149		1	17	65	66	100%

[4]Respondent: Fair 12.1% and Unfair 87.9%.

4.7.2 Explanation of findings from scenario three.

This result provides support to the research claim that judgments of fairness are based on historical perspective rather than on the present situation alone. The consistent application of cost increase and cost decrease is considered much fairer than a rule which only applies to cost increases and so favour the firm. The DE principle is affected depending on how the information is presented to consumers. When in scenario 1 only half the information about the behaviour of the firm is presented to consumers, DE principle was supported. In an alternative case (scenario 3), when the full information is available about the firms past behaviour, then DE principle is not supported.

Previous research by Kahneman and Tversky (as quoted by Kalapurakal, Dickson & Urbany, 1991), with their famous prospect theory concluded that the context in which decision problems are presented can give rise to different preferences. This illustrates that judged fairness of pricing rules are indeed subject to contextual effects. By comparing how responses to scenario 1 and 3 give different results about DE principle, then one explanation can be this factor of framing effect.

[4] Fair is calculated as (66+65)/149 = 87.9% and unfair (17+1)/149 = 12.1%.

4.8 Scenario four results

The same criterion used to analyze responses to scenario two and three is also used to evaluate participants' response to this questionnaire. The objective of this study is to examine if consumers perceive a price increase caused by the firm (internal locus of causality) to be more (or less) fair than a price increase driven by external locus of causality. The proposition 4 stated as: *"attribution of responsibility for price increase influences perception of price fairness,"* is investigated here.

4.8.1 Variables and measures

The study conducted two experiments to examine the fairness perception on two attributional dimensions, i.e. locus of cause and locus of controllability. Locus refers to whether the cause of an action is internal to the actor or external. Locus is determined based on who is responsible for a given action. Controllability is based on whether an action was in volitional control of an actor or not. While scenario 4(a) test locus of cause, scenario 4(b) examines locus of controllability. The results are reported below (table 4-7).

Table 4-7: How attributions of responsibility affect perception of fairness for price increase in Scenario 4(a)

N	Age range	Level of perception				Total
		Completely fair	Acceptable	Unfair	Very unfair	
82	18-29	0	12	31	39	54.7%
40	30-39	3	0	14	23	26.7%
23	40-49	0	4	6	13	15.3%
5	50 and above	0	1	2	2	3.3%
150		3	17	53	77	100%

[5]Respondent: Fair 13.3 % and Unfair 86.7%

Results for scenario 4(a) suggest that even cost-justified price increases can be perceived as less fair when the locus of causality is internal to the firm. A

[5] Fair is calculated as (3+17)/150 and unfair (53+77)/150.

large proportion of respondents (86.7%, N=150) find it unfair for the firm to increase price as a result of an action within its control – poor record keeping. The fact that the firm has to incur a large tax penalty cost is irrelevant since, it was within the firm's control to manage good record keeping, so avoiding the tax penalty. This result illustrate that there are conditions where DE principle cannot hold true, especially when attribution of responsibility is within the firm's control.

Scenario 4(b) illustrates that a price increase is perceived to be uncontrollable if the product in question is imported and there is a shortage from the country of importation. The responses shows that 87.2% (N=149) felt that it was fair to increase price in such a situation (table 4-8). Thus, consumers' perception of controllability is determined largely by examining if the actor could have done otherwise.

Table 4-8: How attributions of responsibility affect perception of fairness for price increase in Scenario 4(b)

N	Age range	Level of perception				Total%
		Completely fair	Acceptable	Unfair	Very unfair	
82	18-29	24	49	4	5	55%
39	30-39	7	26	3	3	26.2%
23	40-49	6	13	1	3	15.4%
5	50 and above	1	4	0	0	3.4%
149		38	92	8	11	100%

Respondent: Fair 87.2 % and Unfair 10.7%

4.9 Conclusions and summary of findings

The analysis of the findings show some mixed results. The reaction to scenario one is that price increases justified by cost increase is acceptable especially for subsidized organizations. This has confirmed the DE principle. This contrasts sharply with the findings in scenario 3, which gives a conflicting indicator to the assumption in DE principle. It leads to a conclusion that even cost justified price increase can be considered unfair if the historical behaviour the firm is taken into consideration by the consumer. When scenario three

mentioned how the firm had behaved previously when trying to justify a price increase, then consumers become aware and formation of fair price judgments is influenced by the consistent behaviour of the firm. It emphasizes that consumers are concerned about the consistent behaviour of firms with regard to price increase and decrease.

Any justification for price increases to protect a firm's reference profit has been confirmed especially where the reason given is removal of a government subsidy. The consumers seemed more sympathetic to state sponsored firms survival in the face of government cut back on support in terms of subsidy. The scenario two presented a clear case of a firm just increasing price to recover the subsidy and there is unanimous positive response to that pricing behaviour.

The summary of data results are:

- If consumers infer that a firm had a negative motive for a price increase, the price is perceived to be unfair relative to when the consumers do not infer that the firm had a negative motive.
- Consumers use altruistic motivation assumed in DE when making fairness judgments for subsidized firms.
- A cost-justified price increase is perceived to be fair as long as the firm has been consistent it its treatment of cost increase and decrease in the past. If consumers know how the firm had acted previously, then they tend not to follow the DE principle where they notice the firm was not consistent with its treatment of cost decreases.
- Consumers allowed state sponsored firms to protect their reference profit in the face of declining government subsidy. Firms that increased their cost to cover the eliminated subsidy were considered to have acted fairly.
- Attribution of price increase also influences perception of fairness. Consumers look at the cause of the increase and view unfovourably

causes within the firm and controllable that are used to justify price increases.

CHAPTER 5

INTERPRETATION OF FINDINGS

5.1 Introduction

This chapter explores the key issues arising from the literature review, and ties the findings in chapter four with the literature. The findings from the empirical data are then evaluated based on previous research.

5.2 Fairness judgement for subsidized firms

Scenario one has confirmed the proposition that consumers use altruistic motivation assumed in DE principle when forming judgement of fairness for state firms. It has been mentioned in the findings in chapter four that consumers evaluated the firm according to DE principle. This result is consistent with prior suggestions that subsidised firms are evaluated according to DE principle (Warlop & Novoseltsev, 2000). In their research they concluded that "when consumers evaluate price fairness from a distance they tend to follow either altruistic (in case of subsidized companies) or distributive justice (for non-subsidized firms) principles for fair price judgements". In paragraph (2.15.3) these were discussed this in detail.

5.2.1 Conditions where DE principles apply

In a previous study conducted by Warlop & Novoseltsev (2000) in Belgium, they concluded that when the firm is subsidized, DE principle is supported under certain conditions:

- Situations in which respondents are impartial observers, rather than the firm's own customers;
- Situations where the stakeholders are affected in their long term (tax-payer) interest;

- Situations in which the customers do identify strongly with the objectives of the subsidized company.

This research borrows from this insight to explain the motivations of respondents in Seychelles. This calls for a close look at how scenario one was framed and the structure of the respondents. First, Scenario one questionnaire specifically referred to a training institution as being affected by the pricing decision. More so, the respondents were asked to answer the question as if they were consuming the service whose price was being increased or decreased.

Second, the structure of the respondents (table 5-1) also tends to support the study proposition that they identified strongly with the objectives of hypothetical subsidized institution portrayed in scenario one. They were either students in an institution that offers education and training services, or were employees in such an institution. With this background there is a possibility that they responded in a manner that suggest that they identified strongly with the objectives of the subsidised firm (Warlop & Novosettsev, 2000).

Table 5-1: Structure of respondents

Employment status	Percentage
Employed & (not a student)	**40%**
Student & (currently employed)	**27%**
Student & (Never been employed)	**25%**
Student & (currently unemployed)	**8%**

5.2.2 Meaning of Altruistic Motivation

The DE principle describes consumers' as a spontaneously **altruistic person**. It was explained how absorption rates can be analyzed to give meaning to consumer response (figure 2-5). In the figure line (b)

represents the first asymmetric principle where the firm is allowed to absorb all cost increases, but transfer all cost decreases to the customer. From the customer perspective this principle implies self-interest motivation.

The second asymmetric principle suggests that the supplier is permitted to increase price whenever it is justified by a cost increase but is allowed to keep a share of benefits when supplier costs decrease (line (c)) in (figure 2-5). This situation reflects the altruistic motivation of consumers assumed in the dual entitlement principle. Instead of sharing benefits and burdens consumers allow company to benefit out of both situations of cost increase and decrease. Consumers in Seychelles have responded in altruistic way to scenario one.

The next question is what makes consumers reason an altruistic way? The economic literature suggests a number of factors which may lead to arousal of consumer altruistic motivation for subsidized companies. Rasinski and Rosenbaum (1987:992) state "in fact... research suggest that the citizen's sense of public responsibility may completely overcome his or her own self interest when making decisions about public services and the funding of such services." They point out consistency of these findings with prior work showing strong public support for policies that benefit the general social welfare. So the factors that may contribute to this behaviour include a sense of civic duty and public regard.

5.2.3 Is DE principle the dominant norm of price fairness?

We have seen so far in this study that DE principle proposes that it is fair for sellers to pursue a pricing rule of raising prices when their cost increase, but not to reduce their prices when cost decrease. The study conducted scenario one which confirmed the DE principle. But there is a weakness in the way the scenario one was formulated since it did not provide the respondents with past behaviour of the firm. The effect of illustrating a complete rule of fairness

(scenario 3) suggests that DE is not the dominant norm of fairness. A complete rule is used here to mean giving the consumer full information on how the firm handled both a cost increase and a decrease.

When only half the rule is presented to the consumers they tend to accept the DE principle (Kalapurakal, Dickson & Urbany, 1991). In a similar study done in Canada, Kahneman et al, (1986b) reportedly found that 76% (N=101) felt that DE principle was applicable when the scenario mentioned half the information about past behaviour of the firm. Providing full information about the consistency of behaviour of the firm in a historical context has completely altered perceptions as results to scenario 3 have indicated. Kalapurakal, Dickson & Urbany (1991), have therefore proposed that pricing decision makers should be more interested in consumers' perception of the application of the complete DE principle. This study concurs with this recommendation, by considering how responses to scenario 1 and 3 have given a mixed result due to the fact that in scenario 1 half the rule was tested and in scenario 3 the full rule was presented. The basic premise of DE principle does not seem to hold true in all circumstances as has been claimed by Kahneman (1986a b).

5.3 Summary and conclusion

The findings from the study are backed by study results from other parts of the world especially with studies conducted in Canada, Belgium and United states. The next chapter will make recommendations to policy makers and practicing managers on how to deal with pricing strategy and issues.

CHAPTER 6

RECOMMENDATIONS

6.1 Introduction

This chapter will make recommendations to policy makers and firms based on conclusions from the empirical study and literature review. The negative consequences of a price increase are inevitable since the customers will be hurt financially. From purely an economic point of view, any price increase will be unacceptable. Managers cannot change that, but they can influence whether an increase is considered acceptable (Maxwell, 1995). The early price fairness research was motivated by the belief that perceived price unfairness constraints firm's attempts to maximize profitability (Kahneman et al., 1986a). The belief was that buyers react in ways that produce negative consequences for firms. The consequences may range from lower purchase intentions, complaints, and negative word of mouth (Campbell, 1999; Huppertz, Arenson, and Evans, 1978).

Therefore, it may be assumed that buyers will try to protect themselves from price increase and try to cope with the negative emotions that may have occurred. In developing pricing strategies, firms have to consider how their consumers will process information on prices. Empirical studies have demonstrated that individuals and groups demonstrate biased attributions towards price increases (Maxwell, 1999).

6.2 Application of DE Principle

The study results have shown that even for cost–based price increases, consumers who view the locus of the cost increase as being internal to the firm were not accepting cost justified increases. The implication of this for policy makers is that a firm can increase the acceptability of a price increase if they justify it not only in terms of cost increase but also in terms of an externally caused cost increase. A cost justified increase that is perceived as

being caused by factors internal to the firm will be perceived as being less fair than one caused by factors external to the firm.

6.3 Influence of attribution factors

When it is not easy for consumers to acquire information about the firm's actual costs and profits, they have no alternative but to make attributions as to who is responsible for price increase. Attribution theory provides insight to the inferences that people make when they wonder why an event has occurred. An unexpected price increase is both surprising and negative and may lead to consumer consideration of why a firm raised price (Campbell1999a). Drawing on attribution theory, this report analyzed both internal and external factors influences on perception of price increase. It has emerged from the study that causal attributions influence people's reaction to price increase (scenario 4). Respondents did not see scenario 4(a) as fair. This demonstrates that the price increase seen as most fair is one whose cause is located external to the firm (Scenario 4b). When complete information on past behaviour of a firm is presented to consumers, the reaction is then based on this additional information (scenario 3). They then did not judge cost justified price increase to be fair based on the firm's past behaviour.

Making the firm's costs salient may reduce people's estimate of a firm's profit margin, thereby decreasing their perceptions of price unfairness (Bolton, Warlop & Alba, 2003). However, not all costs are equally legitimate. Price increases that result from managerially influenced cost increases are perceived less fair than externally caused cost increases (Vaidyanathan & Aggarwal, 2003).

Studies by other researchers (Vaidyanathan & Aggarwal 2003) also concluded that if sellers want to positively influence consumer perceptions of the fairness of a price increase, they need to highlight the causes behind the increase (i.e. if the causes are external or internal). They have recommended, especially for public policy to watch out on unscrupulous sellers who could mislead consumers into accepting unnecessary price increases by giving phony reasons. Buyers and policy makers need to beware of sellers who may

use external, uncontrollable causes to engage in unnecessary price increases.

In summary, research from the attributional perspective indicates that people make inferences about motives and that whether the inferred motive is positive or negative influences perceptions of the fact (Campbell, 1999a). If a consumer sees an increase and attributes it to a firm's negative motive, the price will be perceived as unfair. In contrast, if the price is attributed to a positive motive, it will be perceived as fair.

6.4 References to inferred motive

Campbell (1999a) had recognized the role inferred motive play in determining unfairness perception. She demonstrated that when it was inferred a firm had a negative motive for price increase, the increase was perceived less fair. For state sponsored firms with the motive of protecting the reference profit has been overwhelmingly accepted in scenario two, where 92.6% felt it was fair to protect reference profit in the face of declining subsidy.

Identifying the antecedents of price unfairness (figure 2-1) will help managers in developing pricing strategy that will be perceived in a favourable manner by consumers. One factor that is important includes the motive for the pricing behaviour. Similarly Kahneman et al., (1986a, 1986b) suggest that consumers respond to the perceived reasons for the price and that one "justifiable" reason for price increase is to protect reference profit. This probably explains why there is a positive response to scenario 2 and 4(b).

6.5 Providing information to consumers

The difference on how respondents reacted to scenario one and three indicates that consumer's perception is radically changed based on how much information they have in regard to the pricing policy of firms. Differences in information availed to consumers might influence motive consumers infer, resulting in differences in perception of fairness.

From the literature review, it was discussed that procedural justice theory, equity theory and principle of DE all agree that information that provides reasons why a certain price is set my influence perceptions of price fairness. Such information may include procedures or processes that lead to observed prices (Xia, Monroe & Cox, 2004: 3). They conceptualized (figure 2-2) among other factors that: first, a price increase may be caused by an increase in costs. Secondly, the type of cost and whether sellers have control over the costs may influence the degree of fairness. Third, consumers may consider more than a particular transaction and make inferences based on their previous experiences. An example would be a consumer who has had a good experience with the firm during repeated transactions may assume that a price increase occurs for legitimate reasons when the reason for the price increase is actually unknown. Fourth, consumers may also rely on their general knowledge or beliefs about the firm's practices to adjust their judgment of price fairness.

What this suggest is, when there is a good reason for a price, tell everyone about it. Marketing communication should also be used to provide explanations for the prices. These explanations can guide the inferences consumers make for the motive behind the price. Campbell (1999b) concludes that telling consumers the reason for a price can lead to greater perceptions of fairness.

6.6 What are the implications for managers?

The importance of price fairness perception and its impact on firm's profitability is well recognized (Kahneman et al., 1986a). A key question is how to make the price increase more acceptable and less likely to evoke unfairness perception. We conclude the report by offering some guidelines for managers to achieve this objective.

6.6.1 Who is responsible?

The discussion so far indicates that it is helpful for consumers to sort out whether the firm is responsible for the price increase or some external factor. It may be useful in a firm pricing strategy and tactics to proactively provide relevant information to influence buyers' attributions for the price increase.

6.6.2 Marketing communications

The study has illustrated how what consumers learn about the firm and what the firms say about their motives influence perceptions. Marketing information can be used to manage consumers' inferences during advertisements, to provide justification for price increase. Recent research work suggests that a consumer's response to marketing can be influenced by inferences about the firm's motive for taking a particular action (Campbell, 1995). Their research confirmed the notion that people look behind the price to the firm's motive. Therefore, pricing decisions should be made with consideration given to the need to communicate the price and the reasons behind it. Campbell (1999a) has pointed out the wisdom of integrating pricing and communication decisions.

In a separate study, Campbell (1999b:150) concluded that one use of marketing communications should be to provide explanations for prices. These explanations can guide the inferences that consumers make for the motive behind the price. All what is implied is that telling consumers the reason for the price can lead to greater perceptions of fairness.

CHAPTER 7

ARTICLE-SUMMARY FOR PUBLICATION

7.1 Article title page

Research Article for publication submitted to

SOUTHERN AFRICAN BUSINESS REVIEW

Research Title

Perception of price fairness in state sponsored firms in Seychelles

Abstract

The purpose of this article is to examine the perception of clients to fairness of a price increase due to various factors such as declining government subsidies, cost increase and external factors outside the control of firms. The public may not like price increases for whatever reason as they may think the firm is taking advantage to increase its profits. What do they think if a price increase is as a result of reasons that a firm cannot avoid? This report investigates certain circumstances where a price increase can be successfully justified. Theoretical models like equity theory, dual entitlement principle, attribution theory, and procedural justice are used to understand the meaning of fairness and to predict how consumers may behave in different pricing context. The focus is on state sponsored firms using data collected in Seychelles. The results are obtained from the scenario based questionnaire administered in four major educational institutions in Seychelles. The data analysis is mainly consistent with propositions put forward for the study. The conclusions from the findings are analysed and recommendations given to guide pricing policy. The key findings of this study are that price increases justified by cost increase is acceptable for government subsidised organizations. This has confirmed previous findings on dual entitlement principle, though with a conflicting result that even cost justified price increase can be considered unfair if the historical behaviour of the firm is made available to consumers. The study has reinforced the belief that consumers are concerned about the consistent behaviour of firms with regard to price increase and decrease.

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Article for publication

7.2 Introduction

One aspect of price that has been shown to influence purchase decisions is fairness. "It was found that buyers' perception of a fair price has been considered a determinant of consumers' willingness to buy (Kahneman, Knetsch & Thaler, 1986a)." Increasing price to cover for increasing costs or reduction in government subsidies may not be a simple solution for companies affected. "Maxwell (1999a) has demonstrated how mistrusted a company is when it comes to pricing." The public will not like price increase as they may think a company is taking advantage. The big question is how to effectively manage price increase in a manner that will have limited damage to consumer impressions. Who do consumers blame whenever there is a price rise? Maxwell (1999a) describes three possible reactions from consumers:

- Placing the blame on the "profiteering" business;
- Accepting that price rises result from circumstances outside the control of the business;
- Seeing the price rise as justified because of added value from the product or service.

Price increase occurs from time to time in a business environment. The factors that cause price increase range from those within the control of a firm to others where it has no control at all. To a consumer a price increase may be considered fair or unfair depending on certain factors and circumstances. What should an organization do to present price increases in a manner that can be acceptable? This question can be tackled more effectively if a firm understands how consumers perceive a price increase and what factors influence their perceptions.

A price increase needs to be presented in a way that counters the consumers' tendency to place blame on the company. It is beneficial to provide alternative

explanations for the cause of the increase, where it is applicable; otherwise, buyers tend to blame the company for the price increase.

The research borrows heavily from available theories that explain how consumers react to unfavourable situations. One such theory is attribution theory, which explains attributional bias. A fundamental attributional bias is the tendency for attributors generally to underestimate the influence of impersonal, situational or environmental factors and to overestimate the influence of human factors in controlling behaviour. In attribution theory it is believed that the result of an action is felt to depend on factors within the person (internal locus) or factors within the environment (external locus). From the pioneering research by Kahneman et al., (1986a, 1986b) and Folkes (1984), we expect that customers would perceive externally driven price increases to be fairer than those driven by internal causes. This understanding will assist a company to present a price increase in a manner that can be acceptable to its clients.

Attribution theory has helped in explaining that biased attributions of a price increase are a problem in society. Consumers react not only to the greater sacrifice required by the higher price but also to socially unacceptable pricing practices of companies perceived to be responsible for that increase (Maxwell, 1999a). A price increase needs to be presented in a way that counters the consumers' tendency to place blame on the seller. It is beneficial to provide alternative explanations for the cause of the increase; otherwise, buyers will blame your company. The study will identify ways in which price increase may be presented in an acceptable manner.

What does"fair" mean in a pricing context and why should a company be bothered about it? "Fair" has generally been taken to be a global measure of price acceptability (Maxwell, 1995:21). Traditionally, the basis for determining a fair or acceptable price has been assumed to be purely economic. The neoclassical economic assumption is that consumers are motivated by utility maximization. Consumers are assumed to make decisions based on their own self-interest. Therefore, a fair price is a low price, i.e. one that is economically

acceptable and benefits the consumers. Huppertz, Arenson & Evans (1978) have indicated that the lower the price, the more equitable it is perceived to be. Their research suggests that a "fair" price is simply a "cheap" price. In the economic model, demand converges to the lowest supplier price for an identical good. Thus fairness is not an issue in a competitive market, which by definition will not support super-normal profits.

Purchase cheapness may also imply the judgement about the economic convenience of the transaction. Padula & Busacca, (2005) used equity theory to extend the price construct from the traditional purchase cheapness to variety and price fairness on the overall price judgement. Using data from an empirical study on the mobile phone industry, they showed that price is a multi-dimensional component of value, made up of three dimensions:

- Fairness – the extent to which price is perceived to enable an equitable exchange among parties;
- Cheapness – the perceived economic convenience of the transaction carried out by a customer to purchase a product or service and;
- Variety – the extent to which a customer may choose among several price options, each corresponding to different and specific service uses (or customer needs).

An alternative view to price fairness is based on sociological considerations. In this perspective, price is regarded as a tool of exchange which operates according to the rules of the given society (Maxwell: 1995). When the community accepted rules of pricing are followed by the seller, the price gains legitimacy in the eyes of the consumer. According to this view, a fair price is one that is socially acceptable. Kahneman, Knetsch & Thaler, (1986a: 299-300), strongly believe that the absence of considerations of fairness and loyalty from standard economic theory is one of the most striking contrasts between this body of theory and other social sciences.

Research inspired by the principle of **Dual Entitlement** (Kahneman et al., 1986a,1986b), argues that fairness perceptions are governed by the belief

that firms are entitled to a reference profit and customers are entitled to a reference price. Changes in status quo price should not be made arbitrarily or merely for the purpose of increasing the firm's profit. At the same time a firm is entitled to protect its profit when threatened by events such as rising costs.

Bolton, Warlop & Alba, (2003) identified that "reference points which consumers appear sensitive to include: past prices, competitor prices and cost of goods sold". They characterized these reference points as looking back over time (at past prices), looking across firms (at competitor prices), and looking within the firm (to costs). The assumption in their reasoning is that once a reference point has been evoked, consumer judgement is guided by attributions regarding the difference between the target price and the reference price. This comparison process drives profit perceptions and price fairness judgments. Prices that compare favourably with the reference point are deemed fair; and those that compare unfovourably are deemed unfair.

The principle of dual entitlement (DE) suggests that a price which violates the buyer's entitlement to the reference price will be considered acceptable only if it is perceived to be necessary to protect the seller's reference profit. This implies that a price increase that increases the company's profit beyond its reference entitlement will be deemed unfair. In the DE principle, it is considered fair if the company completely compensates its cost increase. It is also consistent with fairness norms not to pass cost decreases to the customer, since, in this case the seller's profit increases without violating the buyer's reference price entitlement.

7.3 Research objectives

The objective of the study is to establish how consumers perceive the fairness of a price increase in State Sponsored Firms (SSF's). When a State Sponsored Firm faces a decrease in subsidy from government, cost increase or externally influenced factor, how do clients perceive an increase in price that may result? In achieving this objective the study would like to ask the following questions:

- Is Dual Entitlement (DE) principle the dominant norm of price fairness?
- To what extent is the fairness of a price increase inferred from a firm's motive and inferred relative profit?
- Can attribution of responsibility for a price increase be used to justify fairness of a price increase?
- Does a consumer judge the fairness of a price increase in terms of the social acceptability of the price in relation to community standards?

The second objective is to recommend from the findings, various strategies that practising managers and policy makers may use to justify a price increase in a manner that is acceptable to clients.

7.4 Conceptual framework and propositions

Meaning of fairness in an exchange relationship: The concepts of distributive and procedural justice, equity theory, attribution theory and dual entitlement provide guidance in defining fairness. The concept of distributive justice suggest that fairness occurs when all parties involved in an exchange relationship, directly (i.e. buyer and seller) and indirectly (i.e. two buyers purchasing from the same seller), share the same ratio of profits to investment (Cox, 2001). A discrepancy in any one of these comparisons or unequal ratios of contributions to rewards result in perceived injustice by both parties. Additional research expanded on the idea of distributive justice and concluded that both buyers and sellers compare price to:

- The prices paid by other customers for the same products or services (Martins & Monroe,1994); and
- The individual economic outcome and social utility derived from what each party invests and receives (Maxwell, 1999a).

Fairness as determined by society norms and behaviours: The research by Dickson & Kalapurakal, (1994) reveals that the process by which a firm determines its pricing structure determines how consumers perceive the

fairness of the firm's prices. A price increase resulting from a process that does not meet society norms and expectations will lead to complaints and possible punishment by consumers such as switching to a competing service or product. In one study Maxwell (1995) examined perceived fairness when the posted tag price for the item (a socially acceptable pricing practice) was higher than the scanner price (an economically acceptable price). Despite the higher posted price being against their economic self-interest, 75% of the respondents judged it fair to be charged the higher price since that was what had been posted on the shelf.

Fairness is therefore a judgement of whether an outcome and/or the process to reach an outcome are reasonable, acceptable or just (Bolton, Warlop & Alba, 2003). The cognitive aspect of this definition indicates that price fairness judgements involve a comparison of a price or procedure with a standard, reference or norm. Maxwell (2002) has designed a rule based model, which depicts a causal-chain reaction as shown in (figure 1). In the model, consumers infer that price setting process has been done fairly and no rule has been violated when the actual price is the same as the reference price. As Kahneman et al., (1986a) point out; "people have high expectations of conformity to rules of exchange".

Insert Figure 1 HERE

Equity theory and fairness: Equity theory explains that individuals (who are similar to one another) gauge the fairness (or equity) of an exchange by comparing the ratios of their contributions to a particular exchange versus the resulting outcome. Perceived fairness or equity occurs if all parties in the exchange receive the same outcome or ratio, whereas disparate ratios result in social tensions that leave the "short-charged" individuals angry and benefiting party feeling guilty (Cox, 2001:266).

Once inequality within an exchange is noted the parties engage in activities that reduce the tension and move the relationship back toward an equitable position. Martins (1995) outline the following four key methods by which to reduce inequality:

- Change the quantities of inputs and outcomes for one or both parties;
- Alter the perceived importance or weighting of either party's input and/or outputs;
- Leave or end the exchange relationship and;
- Change the reference other.

Fairness as a dual entitlement: The principle of dual entitlement builds on equity theory and suggests that fairness perceptions depend on the reference transaction, the outcomes of the exchange parties, and the exchange context. Buyers and sellers believe that they are entitled to a reference price and reference profit respectively (Kahneman, Knetsch & Thaler, 1986a). If either party does not receive its entitlement, the relationship will be perceived as unfair.

Attribution theory: Attribution theory is used to explain how consumers interpret price increases. The theory conceives of human beings following some sort of internal logic or personally rational model, sometimes called "common sense".

- **Fundamental attributional bias**
  Maxwell, (1999a) believes that the process of attribution is affected by various biases and distortions of judgement which can result in misinterpretation of the situation. So, rather than to blame abstract market forces, consumers would tend to attribute the cause of a perceived price increase to a human agent.
- **Price increase resulting in less positive attitude**
  Given unfavourable nature of a price increase, it is anticipated that buyers will attribute the cause to the actions of the company. They will infer that companies have not complied with social norms of the company's role and are expected to have a less positive attitude toward the company (figure 2).

Insert Figure 2 HERE

Inferred motive and perceptions of price fairness: Campbell (1999a) demonstrated that when it was inferred a firm had a negative motive for price increase, the increase was perceived less fair. In addition, Campbell showed that a firm's reputation can influence the inferred motive. Firm's with good reputation get customers' benefit of doubt when inferring motive. Two factors are identified that directly affect the perceived fairness of a price change: (1) inferred relative profit and; (2) consumers' inferences about the firm's motive for price change. Reputation indirectly affects perceptions of price fairness by influencing the inferred motive. Likewise, if the price is attributed to a positive or benevolent motive, such as to aid a good cause or equitably distribute a scarce good, it will be perceived as fair (Campbell, 1999a:189) (figure 3).

Insert Figure 3 HERE

A Conceptual framework for perceived price fairness: Xia, Monroe & Cox (2004:3) define price fairness as "consumer's assessment and associated emotions of whether the difference (or lack of difference) between a seller's price and the price of a comparative other party is reasonable, acceptable, or justifiable" They present a conceptual framework for price fairness that integrates the conceptualisations and organizes existing price fairness research (figure 4).

Insert Figure 4 HERE

PROPOSITIONS: Given the varied views on the meaning of price fairness, measurement of perception and clients' response to price increase, this research used the following propositions to guide the empirical study:

- **Proposition 1**: *Consumers use altruistic motivation assumed in Dual Entitlement (DE) principle as a norm (motive) in perceptions of price fairness for state sponsored firms.*

Kahneman et al., (1986a, 1986b) in two influential papers proposed **"dual entitlement"** as the dominant norm of price fairness. The DE principle concludes that cost-justified price increases are perceived to

be fair. This principle has received some empirical support in the literature (Urbany et al., 1989). Others have provided theoretical grounding for DE principle using attribution theory (Vaidyanathan & Aggarwal, 2003). They used attribution theory to understand consumers' perceptions of fairness of price increases. Using the DE principle, researchers have concluded that price increases will be perceived as fairer if they are cost-justified. Vaidyanathan & Aggarwal (2003) empirically demonstrated that this is not universally true.

- **Proposition 2:** *It is fair for a state sponsored firm to increase price to protect its reference profit especially when a government subsidy is eliminated.*

- **Proposition 3:** *A price increase that is cost-justified is perceived to be fair as long as the firm has been fair and consistent in the treatment of cost changes.*

- **Proposition 4:** *Attribution of responsibility for price increase influences perception of price fairness.*

Vaidyanathan & Aggarwal (2003) have made very interesting findings that even cost-justified price increases can be perceived as less fair when the locus of causality is internal to the seller and/or when the price increase is within the volitional control of the seller. For example, they concluded "when competitors' prices stay the same or when the cost increase is directly attributable to the seller's actions, even cost-justified price increases are seen as less fair"

7.5 Research methodology

Unit of analysis: The research is based on information obtained from students and employees of four main educational institutions in Seychelles (Seychelles Institute of Management, Adult Learning and Distance Education

Centre, Seychelles Polytechnic and National Institute of Education). This information includes their perceptions regarding the price increase under stated scenarios in a questionnaire.

Sample selection: Convenience sampling is used because the sampled population will depend on their availability for the study. A random sample is used to determine the participant in the study and a table of random numbers was used to pick the participants from a list provided by the institutions to eliminate the bias often associated with this method. Non-probability sampling is arbitrary and subjective, but has been used in research for the following reasons:

(1). It has been chosen because of cost and time constraints;

(2).Non-probability sampling is a feasible alternative with modifications (Cooper & Schindler, 2003:200).

Data collection procedures: A questionnaire was hand delivered to 200 participants through their lecturers. The participants were asked to participate in a short survey related to pricing policies of state sponsored firms. The questionnaire was issued at the start of a regular class lecture and collected at the next lecture session. This meant all questionnaires were received. This strategy worked well since a total of 152 questionnaires were received back representing a response rate of 76%.

The subjects are asked to carefully read a paragraph containing the experimental manipulations (a scenario) describing a pricing action, and to answer the question about the new fair price the company should set or choose from the ratings given. No other measures were taken. The study utilises scenarios in which hypothetical firms are chosen and shown to make a pricing decision that affect the customer. The scenario is written down and presented to the participant, who then evaluates the fairness of the action.

Variable and measures

- **Proposition 1: Testing dual entitlement principle.**

Perception of fairness due to cost increases. Scenario (1a) which indicates a cost increase is presented to respondents and measures their response by asking them to suggest a new fair price if a subsidised firm is faced by cost increase from internal factors like salaries, maintenance and overhead costs.

The respondents suggest a fair price SR(x)[6] if the cost increases by SR30. It is assumed that SR470 (i.e. the price without the subsidy) is used by respondents as the reference price and the responses (x) are then compared to the reference price. Past studies have used a similar indicator to measure the responses (Warlop & Novoseltsev, 2000). The total value and mean of responses (SRx – SR470, where x is the new price suggested) is calculated as SR5,074.6 and SR34.75 respectively.

Perception of fairness due to cost decreases. Scenario (1b) presents an opposite case where costs decrease and ask for a new fair price. In both Scenarios SR470 (Seychelles Rupees) is assumed to be the reference price upon which respondents use to make a judgement. This is measured by asking respondents to suggest a new fair price if the cost decreases by SR30. It is also assumed that SR470 (i.e. the price without subsidy) is used by respondents as the reference price and the responses are then compared with the reference price. This procedure is similar to one used in price increase above. The total value and mean responses is calculated as SR2,146.2 and SR14.7 respectively.

Interpretation. The combination of both cost increase and decrease results in an overall set of price fairness principles which people may use when company's costs change. Warlop & Novoseltsev (2000) presented a framework (figure 5) which summarizes the principles consumers may use when determining the fairness of price changes.

Insert Figure 5 HERE

[6] SR (x) is the new fair price suggested by respondents in Seychelles Rupees after reading scenario (1a) and 1(b).

When costs change, the consumers will infer the new fair price on the basis of their perceptions about profit the company is entitled to make. In other words, consumers make normative judgments about the company's absorption rate – the share of cost change the company should (or is allowed to) keep. Absorption rates for cost increase and cost decrease situations are two characteristics which help to distinguish one principle from another. Identical absorption rates describe the symmetrical price fairness judgment pattern. When the absorption rates are different, they imply either a **self-interest principle** or an **altruistic principle** (Warlop & Novoseltsev, 2000).

- **Proposition 2: Perception when subsidy is removed and price increases**

  Subsidy eliminated. The proposition is examined by Scenario (2).The actual cost is SR5, but due to subsidy the price charged is only SR4. The scenario is manipulated to show that the subsidy has been removed and the company now charges SR5. Consumers are then asked to rate this behaviour.

  Measures: The responses are rated as done in other previous studies on price perceptions by Kahneman et al., (1986:729): (1) Completely fair (2) Acceptable (3) Unfair and (4) Very unfair. The two favourable and the two unfavourable categories are grouped to indicate the propositions of respondents who judge the action acceptable or unfair. As Kahneman et al. (1986: 729) did in their study, this study also uses the perceived fairness or otherwise as simply an abbreviation for "substantial majority of the population studied think it is fair.

- **Proposition 3: Examining the consistency of firm behaviour with both increase and decrease.**

  Firm's behaviour: The firm gives a justification for a price increase as a change in foreign exchange rates that makes it imports more expensive. Later on the foreign exchange rates work in the favour of the company, but it does not reduce the price.

Measures: The responses are rated in the same way as in proposition 3 above.

- **Proposition 4: Attribution of responsibility and price increase**
  Who is responsible: two scenarios are used to tests this proposition. Scenario (4a) is manipulated to show that the firm's mistake leads to price increase. Scenario (4b), he situation is manipulated to show that the cause of the increase is external and outside the control of the firm.
  Measures: The rating scale is similar to ones used in both proposition 2 and 3.

7.6 Research findings

Empirical results: Scenario 1

The mean[7] of the difference for cost increase is SR34.75. This is plotted as point (b) (figure 6). The mean of the difference for price decrease is SR14.7 and is also plotted as the lowest point (a) (figure 6). When the two points are joined together, it gives the absorption rate that reflects what consumers think about the pricing behaviour in scenario one.

The consumer response is designed to measure the absorption rate. In other words, consumers make normative judgments about the firm's absorption rate – the share of cost change the company should (or is allowed to) keep. For instance, when unit costs increase by SR30 (Seychelles Rupees), there are several options; the firm is allowed to increase the price to SR34.75, which is SR4.75 more than the actual increase. When the price decrease by SR30, the firm is allowed to decrease the price up to SR14.70, where the consumer gains SR 15.30 and the firm retains SR14.70. The expected price decrease is not the full amount of SR30 decrease.

Insert Figure 6 HERE

Interpretation of results from Scenario 1

How is consumers' response (figure 6) interpreted? The absorption rate above is categorized as asymmetric (line a-b). The consumers have responded according to the second asymmetric principle which suggests that

[7] The mean of the difference is calculated as (SR x – SR 470)/146. 146 is the total number of accepted responses from the questionnaires received back.

a subsidized firm is not only allowed to increase price whenever it is justified by a cost increase but is also allowed to keep a share of benefits when its costs decrease.

The consumers surveyed have responded with altruistic motivation (line (c) figure 5), assumed in DE principle. Instead of sharing benefits and burdens, consumers allow companies to benefit out of both situations of cost increase and decrease. The findings confirms the study's proposition 1 which postulated that consumers use altruistic motivation assumed in Dual Entitlement principle as a norm (motive) in perceptions of price fairness for state sponsored firms.

Empirical results Scenario 2

This scenario was designed specifically to experiment proposition 2 which stated that: "it is fair for a state sponsored firm to increase price to protect its reference profit especially when a government subsidy is eliminated". The results are that, 92.6%[8] of respondents (N=148) considered it fair for the firm to increase the price to cover up the eliminated government subsidy. As indicated earlier, completely fair and acceptable ratings are together considered as fair response and the other two ratings are unfair. With this analysis, only 7.4% rated this behaviour as unfair.

Explanation of findings from scenario 3

The finding indicates that it is acceptable for firms to protect themselves from losses resulting from an elimination of government subsidy even if the consumer has to bear the resulting price increase. In this case the firm is not increasing the price to earn more profit, but only to cover for the subsidy that has been removed. The near unanimity of responses to this question indicates that actions that help a firm to continue in operation when subsidy is eliminated are highly welcomed.

Empirical results Scenario 3

Proposition 3 which stated that *"a price increase that is cost-justified is perceived to be fair as long as the firm has been fair and consistent in the*

[8] Completely fair and acceptable are treated as fair i.e. (44+93)/148 = 92.6%. Unfair and very unfair are both treated as unfair i.e. (9+2)/148 = 7.4%.

treatment of cost changes" is tested. It presented a full set of scenario that looked at past behaviour to test the DE principle as confirmed in scenario one. The scenario is intended to test the robustness of DE principle. Is DE principle indeed a principle (basic truth, law or doctrine that embodies community norms of fairness?). In the scenario, fluctuating foreign exchange rates is cited as the reason for both an initial increase in cost and a subsequent decrease in cost of toys. The results indicates that 87.9%[9] of the respondents (N=149) considered it unfair while only 12.1% thought the firm's behaviour was fair.

Interpretation of findings from scenario 3

This result provides support to the research claim that judgments of fairness are based on historical perspective rather than on the present situation alone. The consistent application of cost increase and cost decrease is considered much fairer than a rule which only applies to cost increases and so favour the firm. The DE principle is affected depending on how the information is presented to consumers. When in scenario 1 only half the information about the behaviour of the firm is presented to consumers, DE principle was supported. In an alternative case (scenario 3), when the full information is available about the firms past behaviour, then DE principle is not supported.

Previous research by Kahneman and Tversky (as quoted by Kalapurakal, Dickson & Urbany, 1991), with their famous prospect theory concluded that the context in which decision problems are presented can give rise to different preferences. This illustrates that judged fairness of pricing rules are indeed subject to contextual effects. By comparing how responses to scenario 1 and 3 give different results about DE principle, then one explanation can be this factor of framing effect.

Empirical results Scenario 4

The objective of this study is to examine if consumers perceive a price increase caused by the firm (internal locus of causality) to be more (or less) fair than a price increase driven by external locus of causality. The proposition 4 which stated that *"attribution of responsibility for price increase influences*

[9] Fair is calculated as (66+65)/149 = 87.9% and unfair (17+1)/149 = 12.1%.

perception of price fairness," is investigated here. The study conducted two experiments to examine the fairness perception on two attributional dimensions, i.e. locus of cause and locus of controllability. Locus refers to whether the cause of an action is internal to the actor or external. Locus is determined based on who is responsible for a given action. Controllability is based on whether an action was in volitional control of an actor or not. While scenario 4(a) test locus of cause, scenario 4(b) examines locus of controllability.

Results from scenario 4(a) suggest that even cost-justified price increases can be perceived as less fair when the locus of causality is internal to the firm. A large proportion of respondents (86.7%, N=150) find it unfair for the firm to increase price as a result of an action within its control – poor record keeping. The fact that the firm has to incur a large tax penalty cost is irrelevant since, it was within the firm's control to manage good record keeping, so avoiding the tax penalty. This result illustrate that there are conditions where DE principle cannot hold true, especially when attribution of responsibility is within the firm's control.

Scenario 4(b) illustrates that a price increase is perceived to be uncontrollable if the product in question is imported and there is a shortage from the country of importation. The responses indicated that 87.2%[10] (N=149) felt that it was fair to increase price in such a situation while 13.3% felt otherwise. Thus, consumers' perception of controllability is determined largely by examining if the actor could have done otherwise.

Summary of findings

The analysis of the findings above show some mixed results. The reaction to scenario 1 is that price increases justified by cost increase is acceptable especially for subsidized organizations. This has confirmed the DE principle. This contrasts sharply with the findings in scenario 3, which gives a conflicting indicator to the assumption in DE principle. It leads to a conclusion that even cost justified price increase can be considered unfair if the historical behaviour

[10] Fair is calculated as (3+17)/150 and unfair (53+77)/150

the firm is taken into consideration by the consumer. When scenario 3 mentioned how the firm had behaved previously when trying to justify a price increase, then consumers become aware and formation of fair price judgments is influenced by the consistent behaviour of the firm. It emphasizes that consumers are concerned about the consistent behaviour of firms with regard to price increase and decrease.

Any justification for price increases to protect a firm's reference profit has been confirmed especially where the reason given is removal of a government subsidy. The consumers seemed more sympathetic to state sponsored firms survival in the face of government cut back on support in terms of subsidy. The scenario 2 presented a clear case of a firm just increasing price to recover the subsidy and there is unanimous positive response to that pricing behaviour.

The summary of data from empirical study is:

- If consumers infer that a firm had a negative motive for a price increase, the price is perceived to be unfair relative to when the consumers do not infer that the firm had a negative motive.
- Consumers use altruistic motivation assumed in DE when making fairness judgments for subsidized firms.
- A cost-justified price increase is perceived to be fair as long as the firm has been consistent it its treatment of cost increase and decrease in the past. If consumers know how the firm had acted previously, then they tend not to follow the DE principle where they notice the firm was not consistent with its treatment of cost decreases.
- Consumers allowed state sponsored firms to protect their reference profit in the face of declining government subsidy. Firms that increased their cost to cover the eliminated subsidy were considered to have acted fairly.
- Attribution of price increase also influences perception of fairness. Consumers look at the cause of the increase and view unfavourable

causes within the firm and controllable that are used to justify price increases.

7.7 Recommendations

Consequences of price increase: The negative consequences of a price increase are inevitable since the customers will be hurt financially. From purely an economic point of view, any price increase will be unacceptable. Managers cannot change that, but they can influence whether an increase is considered acceptable (Maxwell, 1995). The early price fairness research was motivated by the belief that perceived price unfairness constraints firm's attempts to maximize profitability (Kahneman et al., 1986a). The belief was that buyers react in ways that produce negative consequences for firms. The consequences may range from lower purchase intentions, complaints, and negative word of mouth (Campbell, 1999; Huppertz, Arenson, and Evans, 1978).

Therefore, it may be assumed that buyers will try to protect themselves from price increase and try to cope with the negative emotions that may have occurred. In developing pricing strategies, firms have to consider how their consumers will process information on prices. Empirical studies from this research have demonstrated that customers demonstrate biased attributions towards price increases.

Cost - based justification: The study results have shown that even for cost–based price increases, consumers who view the locus of the cost increase as being internal to the firm were not accepting cost-justified increases. The implication of this for policy makers is that a firm can increase the acceptability of a price increase if they justify it not only in terms of cost increase but also in terms of an externally caused cost increase. A cost justified increase that is perceived as being caused by factors internal to the firm will be perceived as being less fair than one caused by factors external to the firm.

Influence of attribution factors: When it is not easy for consumers to acquire information about the firm's actual costs and profits, they have no alternative but to make attributions as to who is responsible for price increase. Attribution theory provides insight to the inferences that people make when they wonder why an event has occurred. An unexpected price increase is both surprising and negative and may lead to consumer consideration of why a firm raised price (Campbell1999a). Drawing on attribution theory, this report analyzed both internal and external factors influences on perception of price increase. It has emerged from the study that causal attributions influence people's reaction to price increase (scenario 4). Respondents did not see scenario 4(a) as fair. This demonstrates that the price increase seen as most fair is one whose cause is located external to the firm (Scenario 4b). When complete information on past behaviour of a firm is presented to consumers, the reaction is then based on this additional information (scenario 3). They then did not judge cost justified price increase to be fair based on the firm's past behaviour.

Making the firm's costs salient may reduce people's estimate of a firm's profit margin, thereby decreasing their perceptions of price unfairness (Bolton, Warlop & Alba, 2003). However, not all costs are equally legitimate. Price increases that result from managerially influenced cost increases are perceived less fair than externally caused cost increases (Vaidyanathan & Aggarwal, 2003).

Studies by other researchers (Vaidyanathan & Aggarwal 2003) also concluded that if sellers want to positively influence consumer perceptions of the fairness of a price increase, they need to highlight the causes behind the increase (i.e. if the causes are external or internal). They have recommended, especially for public policy to watch out on unscrupulous sellers who could mislead consumers into accepting unnecessary price increases by giving phony reasons. Buyers and policy makers need to beware of sellers who may use external, uncontrollable causes to engage in unnecessary price increases.

Role of inferred motive: Campbell (1999a) had recognized the role inferred motive play in determining unfairness perception. She demonstrated that when it was inferred a firm had a negative motive for price increase, the increase was perceived less fair. For state sponsored firms with the motive of protecting the reference profit has been overwhelmingly accepted in scenario 2, where 92.6% felt it was fair to protect reference profit in the face of declining subsidy.

Identifying the antecedents of price unfairness (figure 3) will help managers in developing pricing strategy that will be perceived in a favourable manner by consumers. One factor that is important includes the motive for the pricing behaviour. Similarly Kahneman et al., (1986a, 1986b) suggest that consumers respond to the perceived reasons for the price and that one "justifiable" reason for price increase is to protect reference profit. This probably explains why there is a positive response to scenario 2 and 4(b).

Providing information to consumers: The difference on how respondents reacted to scenario 1 and 3 indicates that consumer's perception is radically changed based on how much information they have in regard to the pricing policy of firms. Differences in information availed to consumers might influence motive consumers infer, resulting in differences in perception of fairness.

From the literature review, it was discussed that procedural justice theory, equity theory and principle of DE all agree that information that provides reasons why a certain price is set my influence perceptions of price fairness. Such information may include procedures or processes that lead to observed prices (Xia, Monroe & Cox, 2004: 3). They conceptualized (figure 4) among other factors that: first, a price increase may be caused by an increase in costs. Secondly, the type of cost and whether sellers have control over the costs may influence the degree of fairness. Third, consumers may consider more than a particular transaction and make inferences based on their previous experiences. An example would be a consumer who has had a good experience with the firm during repeated transactions may assume that a price increase occurs for legitimate reasons when the reason for the price

increase is actually unknown. Fourth, consumers may also rely on their general knowledge or beliefs about the firm's practices to adjust their judgment of price fairness.

What this suggest is, when there is a good reason for a price, tell everyone about it. Marketing communication should also be used to provide explanations for the prices. These explanations can guide the inferences consumers make for the motive behind the price. Campbell (1999b) concludes that telling consumers the reason for a price can lead to greater perceptions of fairness.

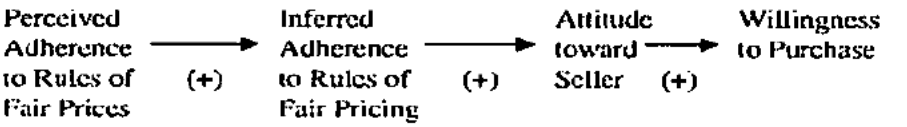
Who is responsible? : The discussion so far indicates that it is helpful for consumers to sort out whether the firm is responsible for the price increase or some external factor. It may be useful in a firm pricing strategy and tactics to proactively provide relevant information to influence buyers' attributions for the price increase.

Marketing communications: The study has illustrated how what consumers learn about the firm and what the firms say about their motives influence perceptions. Marketing information can be used to manage consumers' inferences during advertisements, to provide justification for price increase. Recent research work suggests that a consumer's response to marketing can be influenced by inferences about the firm's motive for taking a particular action (Campbell, 1995). Their research confirmed the notion that people look behind the price to the firm's motive. Therefore, pricing decisions should be made with consideration given to the need to communicate the price and the reasons behind it. Campbell (1999a) has pointed out the wisdom of integrating pricing and communication decisions.

In a separate study, Campbell (1999b:150) concluded that one use of marketing communications should be to provide explanations for prices. These explanations can guide the inferences that consumers make for the motive behind the price. All what is implied is that telling consumers the reason for the price can lead to greater perceptions of fairness.

Article list of figures

1.1 **Figure 1: Direction of relationships in a rule based fair price model**



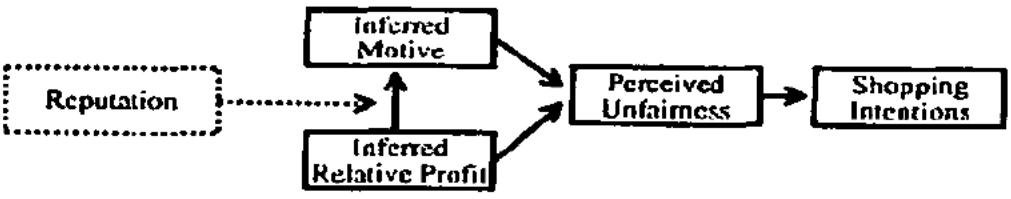
Source: Maxwell, Journal of economic psychology 23(2002:191-212)

1.2 **Figure 2: Model of attribution of a price increase**

price (same/increased)	→ (−)	attributed seller actions: inferred compliance to socially approved pricing practices	→ (+)	attitude toward seller

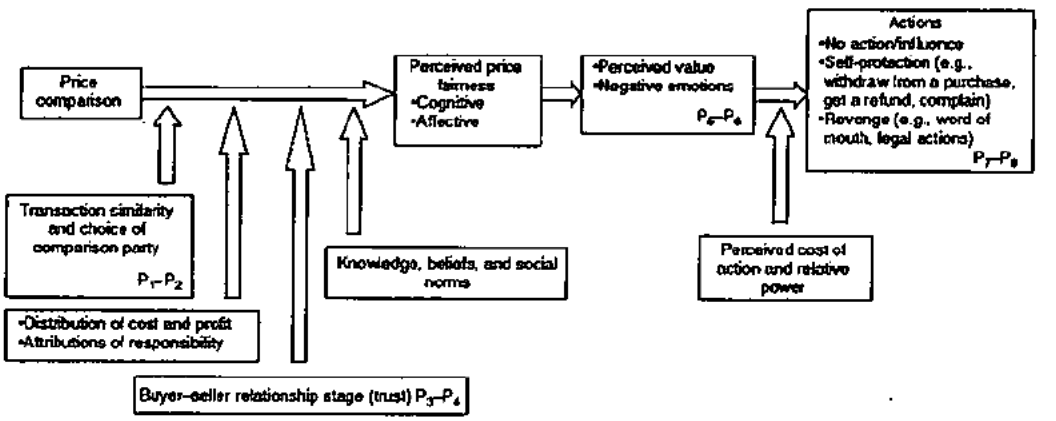
Source: Maxwell, Journal of consumer marketing 16(1999a:9-23)

1.3 **Figure 3: Relations among antecedents and consequences of perceived unfairness**



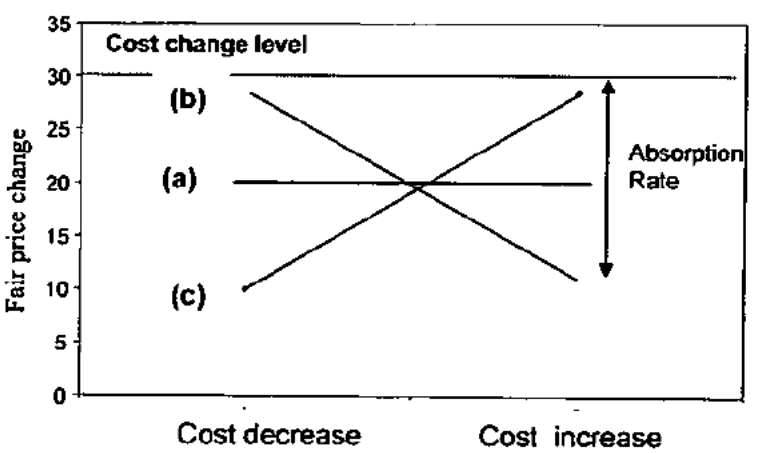
Source: Campbell, Journal of marketing research Vol.35, May (1999a: 187-199).

1.4 Figure 4: A conceptual framework of price fairness



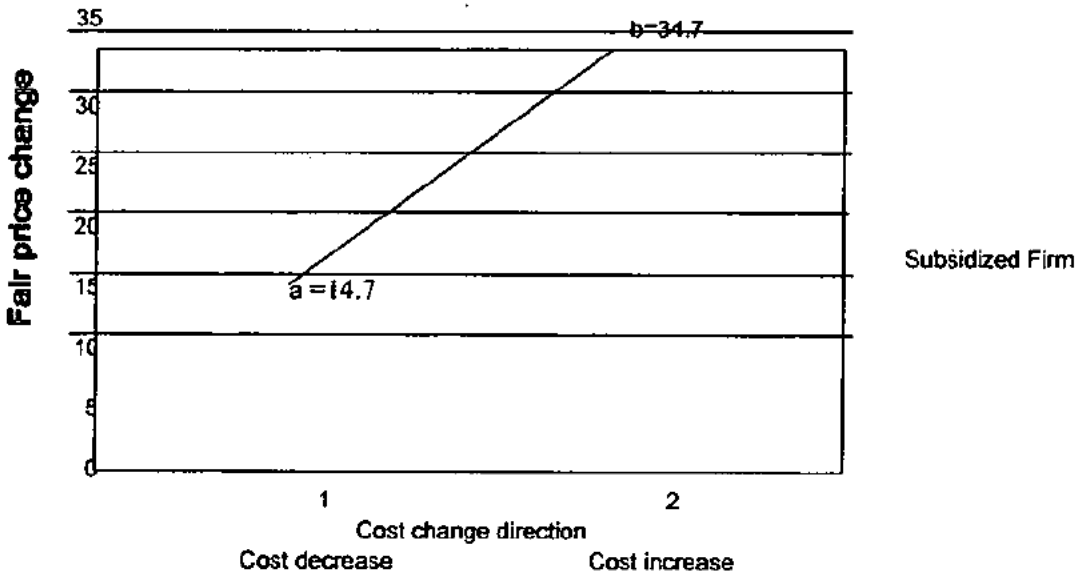
Source: Xia, Monroe & Cox, Journal of marketing 68(2004:1-15)

1.5 Figure 5: Theoretical patterns of price fairness judgments principles



Source: Warlop & Novoseltsev, Fordham University Pricing Conference Proceedings, May (2000: 1-36).

1.6 Figure 6: Absolute fair price change as a function of cost change direction (Plot of means)



7.8 Article list of tables

2.1 SCENARIO 1

Scenario (1a) Cost Increase

An Institution X offers education and training services in Mahe, Praslin and La Digue. The business of the Institution is partly subsidized by the government. The average cost of training per student is **SR 500**. These costs include salaries, maintenance costs, overheads, and so on. Due to the subsidies from the government the price for the training charged by Institution X is only SR **470**.

It happened that costs of the company operations have increased. As a result, the costs for the training have risen from **SR 500 to SR 530 (SR 30 increase)**.

According to your opinion, what should be a new fair price for the training per student?

The new fair price for the training should be SR .....

Scenario (1b) Cost decrease

An Institution X offers education and training services in Mahe, Praslin and La Digue. The business of the Institution is partly subsidized by the government. The average cost of training per student is **SR 500**. These costs include salaries, maintenance costs, overheads, and so on. Due to the subsidies from the government the price for the training charged by Institution X is only SR**470**.

It happened that costs of the company operations have decreased. As a result, the costs for the training have fallen from **SR 500 to SR 470 (SR 30 decrease)**.

According to your opinion, what should be a new fair price for the training per student?

The new fair price for the training should be SR .....

2.2 SCENARIO 2

Scenario 2 Subsidy eliminated

Firm X offers public transport and taxi services in Mahe, Praslin and La Digue. The business of the firm is subsidized by the government. The average cost of a ticket per trip is **SR 5**. These costs include salaries, maintenance costs, overheads, and so on. Due to the subsidies from the government the actual price of a ticket per trip charged by firm X is only **SR 4**.

It happened that the government subsidy has been removed as the firm has been given autonomy to operate, sustain itself and generate revenue from its services. The firm now charges **SR 5** per ticket.

According to your opinion, rate this pricing behaviour:

1 - Completely fair
2 - Acceptable
3 - Unfair
4 - Very unfair

2.3 SCENARIO 3

Scenario 3 Complete test of Dual entitlement principle

A state owned supermarket in Mahe has been buying a toy for SR 100. The standard pricing practice used by the supermarket is to price toys at double their cost so the selling price of the toy is SR 200. This covers all the selling costs, overheads and includes a profit. The supermarket can sell all the toys it can buy.

Suppose because of changes in foreign exchange rate the cost of the toy rises from SR 100 to SR 120 and the selling price is increased to SR 220.

As a result of another change in currency exchange rates, the cost of the toy falls by SR 20 back to SR 100. The supermarket continues to sell the toy at SR 220.

According to your opinion, rate this pricing behaviour:

1 - Completely fair
2 - Acceptable
3 - Unfair
4 - Very unfair

2.4 SCENARIO 4

Scenario 4(a)

4(a) a large supermarket in Mahe discovers that it is required to make a large tax payment penalty to the government as a result of poor record keeping of invoices that resulted in accounting oversight.

As a result of this increased cost, the supermarket decides to increase the selling price.

According to your opinion, rate this pricing behaviour:

1 - Completely fair
2 - Acceptable
3 - Unfair
4 - Very unfair

Scenario 4(b)

4(b) The supermarket in 4(a) above imports its fresh fruits from South Africa, where currently there is a shortage. The supplier abroad has increased its price.

As a result of this higher import price, the supermarket decides to increase the selling price.

According to your opinion, rate this pricing behaviour:

1 - Completely fair
2 - Acceptable
3 - Unfair
4 - Very unfair

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APPENDICES

APPENDIX 1

1.7 Definition of key terms

1.7.1 State sponsored firms:

Firms formed under an Act of Parliament and given initial funding by the government, but now have autonomy to operate as profitable businesses, and may occasionally get direct funding from the government.

1.7.2 Perception:

It is a process by which individuals organise and interpret their sensory impressions in order to give meaning to their environment.

1.7.3 Price perception:

It is a process by which consumers translate prices into meaningful cognitions (Liechtenstein, Bloch & Black, 1988).

1.7.4 Price fairness:

Is defined as a buyer's assessment and associated emotions whether the difference (or lack of the difference) between a seller's price and the price of a comparative other party is reasonable, acceptable or justifiable (Xia, Monroe, & Cox, 2004).

1.7.5 Cheapness:

The perceived economic convenience of the transaction carried out by a customer to purchase a product or service (Padula & Busacca, 2005)

1.7.6 Internal reference price:

The internal reference price is defined as the "standard against which observed prices are compared" (Winer, 1988). It is a price that a buyer expects. It is based on both prior experience and external reference prices provided by advertising and sales promotion

1.7.7 Transaction utility:

Kachelmeier, Limberg & Schadewald, (1991:449) define transaction utility as the "incremental willingness or hesitance to buy at a certain price that is attributable to the consumer's assessment of whether the proposed price is justified by the societal standards of fairness".

1.7.8 Procedural Justice:

Concerns the process through which outcomes are obtained, whether the actions of a person responsible for an outcome are considered fair. As applied to prices, Procedural Justice concerns whether the seller has "played fair" by adhering to the rules of process when setting the price

1.7.9 Reference transaction:

It is typically the most recent or an average transaction.

APPENDIX 2

2.2 Questionnaire

QUESTIONNAIRE: Perception of Consumer of public goods and services to fairness of a price increase.

Dear respondent,

I am Master student following a course in Business Leadership. For my research project, I am investigating the perception of consumers to various pricing decisions under certain circumstances in state sponsored institutions in Seychelles.

Therefore, I would appreciate if you take a few minutes to complete this questionnaire. The questionnaire is a means of collecting information to enable the researcher come up with meaningful recommendations on the foregoing subject.

Imagine yourself as a consumer of a service or product provided by a state sponsored organization in Seychelles. Please respond to the questions as if you are buying the product or service.

Please note that the scenario presented is purely hypothetical and does not refer to any particular organization in Seychelles.

Your name is not required and information will be treated with complete confidentiality.

Thank you for your time and help.

2.3 PART 1. PERSONAL DATA

Please tick one of the choices

A. Personal Characteristics

1. **Age**
   18 – 29 yrs. old ( )
   30 – 39 yrs. old ( )
   40 – 49 yrs. old ( )
   50 and above ( )

2. **Gender**
   Male ( ) Female ( )

3. **Employment status (Tick one)**
   Employed & (not a student) ( )
   Student & (currently employed) ( )
   Student & (Never been employed) ( )
   Student & (currently unemployed) ( )

2.4 PART 2. SCENARIO 1

Below you will find a short description of two situations faced by a firm. The situation is related to the firm's pricing policy.

You will be asked about a new price the firm should set for its product. Notice that there is no exact answer for these two questions.

Please fill in the new price which you feel will be fair in the presented situation.

Scenario (1a) Cost Increase

An Institution X offers education and training services in Mahe, Praslin and La Digue. The business of the Institution is partly subsidized by the government. The average cost of training per student is **SR 500**. These costs include salaries, maintenance costs, overheads, and so on. Due to the subsidies from the government the price for the training charged by Institution X is only SR **470**.

It happened that costs of the company operations have increased. As a result, the costs for the training have risen from **SR 500 to SR 530 (SR 30 increase)**.

According to your opinion, what should be a new fair price for the training per student?

The new fair price for the training should be SR .....

Scenario (1b) Cost decrease

An Institution X offers education and training services in Mahe, Praslin and La Digue. The business of the Institution is partly subsidized by the government. The average cost of training per student is **SR 500**. These costs include salaries, maintenance costs, overheads, and so on. Due to the subsidies from the government the price for the training charged by Institution X is only SR**470**.

It happened that costs of the company operations have decreased. As a result, the costs for the training have fallen from **SR 500 to SR 470 (SR 30 decrease)**.

According to your opinion, what should be a new fair price for the training per student?

The new fair price for the training should be SR .....

2.5 PART 3. SCENARIO 2

Below you will find a short description of a situation faced by a firm. The situation is related to the firm's pricing policy.

Please indicate the extent of your agreement to the following statements. The degree of answers is as follows:

1. Completely fair
2. Acceptable
3. Unfair
4. Very unfair

Please encircle your answers after reading the scenario below:

Scenario 2 Subsidy eliminated

Firm X offers public transport and taxi services in Mahe, Praslin and La Digue. The business of the firm is subsidized by the government. The average cost of a ticket per trip is **SR 5**. These costs include salaries, maintenance costs, overheads, and so on. Due to the subsidies from the government the actual price of a ticket per trip charged by firm X is only **SR 4**.

It happened that the government subsidy has been removed as the firm has been given autonomy to operate, sustain itself and generate revenue from its services. The firm now charges **SR 5** per ticket.

According to your opinion, rate this pricing behaviour:

1 - Completely fair
2 - Acceptable
3 - Unfair
4 - Very unfair

2.6 PART 4. SCENARIO 3

Below you will find a short description of a situation faced by a firm. The situation is related to the firm's pricing policy.

Please encircle your answers after reading carefully the scenario below:

Scenario 3 Complete test of Dual entitlement principle

A state owned supermarket in Mahe has been buying a toy for SR 100. The standard pricing practice used by the supermarket is to price toys at double their cost so the selling price of the toy is SR 200. This covers all the selling costs, overheads and includes a profit. The supermarket can sell all the toys it can buy.

Suppose because of changes in foreign exchange rate the cost of the toy rises from SR 100 to SR 120 and the selling price is increased to SR 220.

As a result of another change in currency exchange rates, the cost of the toy falls by SR 20 back to SR 100. The supermarket continues to sell the toy at SR 220.

According to your opinion, rate this pricing behaviour:

1 - Completely fair
2 - Acceptable
3 - Unfair
4 - Very unfair

2.7 PART 5. SCENARIO 4

Below you will find a short description of a situation faced by a firm. The situation is related to the firm's pricing policy.

Please encircle your answers after reading carefully the scenario below:

Scenario 4(a)

4(a) a large supermarket in Mahe discovers that it is required to make a large tax payment penalty to the government as a result of poor record keeping of invoices that resulted in accounting oversight.

As a result of this increased cost, the supermarket decides to increase the selling price.

According to your opinion, rate this pricing behaviour:

1 - Completely fair
2 - Acceptable
3 - Unfair
4 - Very unfair

Scenario 4(b)

4(b) The supermarket in 4(a) above imports its fresh fruits from South Africa, where currently there is a shortage. The supplier abroad has increased its price.

As a result of this higher import price, the supermarket decides to increase the selling price.

According to your opinion, rate this pricing behaviour:

1 - Completely fair
2 - Acceptable
3 - Unfair
4 - Very unfair

APPENDIX 3

3.1 Covering letter 1

Ref: Mrs Elsabe Broodryk
Tel: + 27 11 6520352
E-mail: broodje@unisa.ac.za
Web: www.sblunisa.ac.za

2005-05-17

TO WHOM IT MAY CONCERN

NON-DISCLOSURE LETTER

This confirms that **Mr SO Omollo (student number 34406298)** a registered final year student is at the Graduate School of Business Leadership. He is doing the Research Report as part of the requirements of obtaining the MBL postgraduate degree. **His topic:** *Perception of price fairness in state sponsored firms in Seychelles.*

Please be of assistance with the collecting of research material and feedback on questionnaires to complete the report.

On behalf of the Business School and Mr Omollo we thank you for your cooperation.

Yours sincerely

MS C STRASHEIM
MANAGER: MBL 3
CStrasheim@sbleds.ac.za
Office: +27 11 652 0238
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3.2 Covering letter 2

Samuel Ochieng Omollo
Seychelles Institute of Management
P. O. Box 678
Victoria
Seychelles

27th May 2005

The Director
National Institute
Of Education
Seychelles.

Dear Sir/Madam

Research Data collection permission

I wish to request for approval to collect data through a questionnaire for research purposes. I am currently doing a research on "perception of price fairness in state sponsored firms in Seychelles" in part fulfilment of a Master in Business Leadership degree.

I intend to use students at the institute as my sample frame. A questionnaire will be provided and students will give their response.

The university has counter accepted that there is a non-disclosure agreement as per the attached letter. All information is for the research purposes only.

Yours faithfully

SAMUEL O. OMOLLO (MR.)