# Chapter 4

# Measuring Willingness-to-Pay

In many companies pricing decisions are made without profound understanding of the likely response of the buyers and competitors. These companies do not conduct pricing research and as a result do not have a serious pricing strategy in a marketing sense. They rather have something that could be called an intuitive pricing strategy. Several studies indicate that only 8% to 15% of the companies conduct serious pricing research to develop effective pricing strategies (Monroe and Cox, 2001). Other studies have shown that 49.9% of the surveyed companies adjust prices once or less in a typical year. Further, only 13% of the prices that were changed were a result of a scheduled review of the current pricing policy (Monroe, 2003, p. 19).

In contrast to what seems to be common practice, managers consider the knowledge of customers' response behavior to different prices to be the cornerstone of most marketing strategies, particularly in the areas of product development, value audits, and competitive strategy (Anderson et al., 1993).

On the importance of valid estimates of willingness-to-pay (WTP) researchers agree with managers. Balderjahn (2003, p. 387) considers valid estimates of willingness-to-pay to be essential for developing an optimal pricing strategy in marketing. Such estimates can be used to forecast market response to price changes and for modeling demand functions.

In this chapter different methods that are applied for measuring willingness-to-pay are introduced. We classify these methods and give references to substantial theoretical and empirical work. The advantages and drawbacks of the methods are discussed. The discussion of the different methods clearly indicates that *the best* method that should be used does not exist. Rather it depends on the objective of the marketer. If costly methods can be applied and quick results are not of main interest, different pricing strategies can be tested with field experiments in real market settings. If estimations of willingness-to-pay are needed frequently, it can be more efficient to apply less time consuming and less costly surveying techniques.

At the end of the chapter it will be demonstrated that within indirect surveying there is a method missing which has both the ability to estimate willingness-to-pay at the individual level based on each respondents information and explicitly elicits choice behavior during the interview.

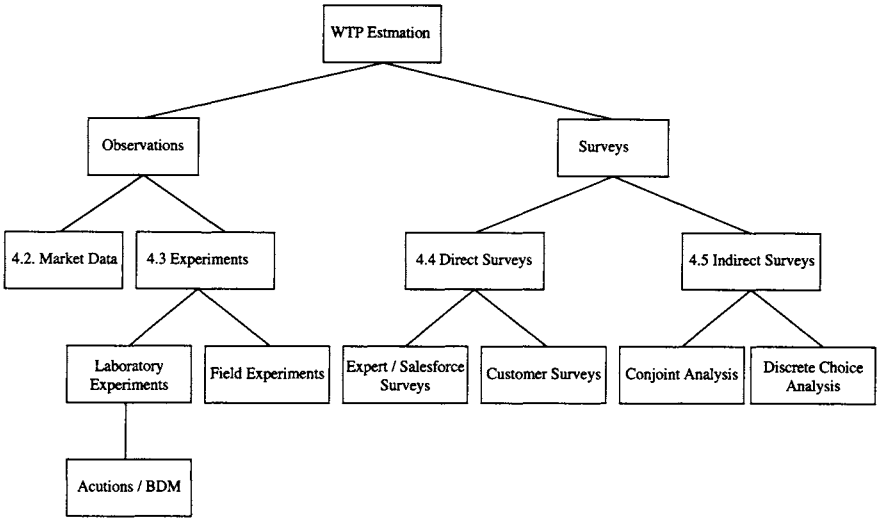


Figure 4.1: Classification of methods for estimation of willingness-to-pay.

## 4.1 Classification of Methods

A classification of methods to estimate willingness-to-pay is presented in Figure 4.1. On the highest level the methods can be distinguished whether they are surveys or based on data from observations. Taking a closer look at observations, real data can be used, such as market data, or experiments can be performed. Experiments can further be divided in field experiments and laboratory experiments. Within field experiments one can further distinguish, whether the probands are aware they are participating in an experiment or not. Observations are also referred to as *revealed preference.*

Looking at surveys for estimation of willingness-to-pay there exist direct surveys and indirect surveys. Preference data derived from surveys is also referred to as *stated preference.* In direct surveys probands are asked to state how much they would be willing to pay for some product. In indirect surveys some sort of rating or ranking procedure for different products is applied. Conjoint analysis is an indirect surveying method.

A different classification can be found in Marbeau (1987). The author distinguishes the measurement methods on the highest level, whether they are monadic tests or competitive tests. In the former price information is elicited without considering a competitive context. In the latter a competitive context is present.

Balderjahn (2003) distinguishes estimation methods on the highest level, whether they elicit price information at the individual level or at aggregate level.

Nagle and Holden (2002) classify techniques for measuring price sensitivity at the high-