Customer Satisfaction and Price Tolerance

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Abstract

This study investigates the association between customer satisfaction and willingness-to-pay or price tolerance. The goal is not only to determine whether the association between customer satisfaction and price tolerance is positive or negative but also to gauge the degree of association. The Swedish Customer Satisfaction Barometer provides the data. The empirical analysis indicates a negative association between the level of customer satisfaction provided by the firm and the degree of price tolerance exhibited by its customers. However, a positive association is found between year-to-year changes in the levels of customer satisfaction and price tolerance.

To what extent does improving customer satisfaction increase customer willingness-to-pay or price tolerance and, consequently, decrease price sensitivity? The goal of this study is to investigate whether the association between satisfaction and price tolerance is positive or negative, as well as to gauge the degree of association between these two important constructs. Adding to our understanding of the different ways increasing customer satisfaction can benefit the firm is important to managers considering initiating or continuing such efforts, as well as to researchers interested in developing theory in the area. This is particularly true in the case of price tolerance, as it has not received the degree of attention paid other consequences of satisfaction, such as repurchase intentions (Anderson and Fornell, 1993).

1. Customer satisfaction and price tolerance

Customer satisfaction is a post hoc evaluation of consumption experience (Oliver, 1980). A customer satisfaction evaluation can be quite specific in nature—a specific subset of experience such as a single transaction and/or particular attribute—but may also be cumulative, based on all previous experience with a good or service (Anderson and Fornell, 1993). As the purpose of this study is to investigate buyers' price tolerance—the maximum price increased satisfied customers are willing to pay or tolerate before switching—it seems natural to focus on cumulative customer satisfaction. Cumulative customer satisfaction, as opposed to satisfaction with a specific transaction or product attribute, should provide a more accurate depiction of the net or marginal value customers attach to future consumption of a good or service.
Price tolerance is closely related to the concept of consumer surplus: “the excess of the price which a man would be willing to pay rather than go without having a thing over what he actually does pay is the economic measure of his satisfaction surplus” (Marshall, 1890). Consequently, we might expect customers to have greater price tolerance for products providing greater satisfaction. This would seem to be a fundamental tenet of rational economic behavior.

To illustrate, consider the classical depiction of the relationship between price and demand presented in Figures 1a and 1b. As the level customer satisfaction provided by the firm increases, price tolerance should increase. As the price tolerance of each individual increases, the demand curve depicted in Figure 1a should move upward and outward as shown in Figure 1b.

However, while the hypothesis that an increase customer satisfaction should lead to an increase in price tolerance seems intuitive at first glance, firms providing higher customer satisfaction will not necessarily have customers with greater price tolerance. To see this, consider that although customer satisfaction is found to be higher for firms in more competitive categories (Anderson, 1994), price tolerance may actually be lower as the quality of the “next best” alternative is likely to be more attractive than would be the case in less competitive categories.

2. Methodological approach

To investigate the direction and degree of association between customer satisfaction and price tolerance, we posit the following expression for the relationship:

\[ PT_{it} = \alpha + \beta(CS_{it}) + \eta_i + \varepsilon_{it} \] (1)

where

- \( PT_{it} \) = Price tolerance of firm \( i \)'s customers at time \( t \),
- \( CS_{it} \) = Customer Satisfaction for firm \( i \)’s customers at time \( t \),

![Figure 1a. Consumer demand prior to an increase in customer satisfaction.](image1a)

![Figure 1b. Consumer demand following an increase in customer satisfaction.](image1b)