

Pricing objectives and pricing methods in the services sector

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Abstract

Purpose – The purpose of this research paper is to explore the pricing objectives that service companies pursue along with the pricing methods that they adopt in order to set their prices.

Design/methodology/approach – An extensive review of the literature revealed the complete lack of any previous work aiming to investigate the potential association between these two important elements of a company's pricing strategy. Thus, the value of the paper lies in the fact that it presents the first attempt to examine this issue empirically. In order to achieve the research objectives, data were collected from 170 companies operating in six different services sectors in Greece through personal interviews.

Findings – The findings of the study reveal that the objectives, which are pursued, are fundamentally qualitative rather than quantitative in their nature with a particular emphasis given on the companies' customers. However, the pricing methods, which are adopted by the majority of the companies, refer to the traditional cost-plus method and the pricing according to the market's average prices. The study also revealed that the pricing objectives are, as should be expected, associated with the pricing methods.

Practical implications – The practical implications of the findings refer to the fact that managers might gain a lot by placing their emphasis on an integrated pricing approach and implement pricing methods that are in line with the pricing objectives that have been initially set. However, the context of the study (Greece) is an obvious limitation to the ability to generalize these findings, suggesting the need for future research that replicates the current study in other countries.

Originality/value – Managers might gain a lot by placing their emphasis on an integrated pricing approach and implement pricing methods that are in line with the pricing objectives that have been initially set.

Keywords Service industries, Pricing policy, Greece

Paper type Research paper

An executive summary for managers and executive readers can be found at the end of this article.

Introduction

A number of different authors have underlined the importance of pricing decisions for every company's profitability and long-term survival. For instance, Nagle and Holden (1995, p. 1) point out:

[...] if effective product development, promotion and distribution sow the seeds of business success, effective pricing is the harvest. Although effective pricing can never compensate for poor execution of the first three elements, ineffective pricing can surely prevent those efforts from resulting in financial success.

Moreover, Marn and Rosiello (1992), Simon (1992), Lovelock (1996), and Shipley and Jobber (2001) have suggested that pricing is the only element of the marketing mix that produces revenues for the firm, while all the others are related to expenses. Diamantopoulos (1991) has also

argued that price is the most flexible element of marketing strategy in that pricing decisions can be implemented relatively quickly in comparison with the other elements of marketing strategy.

Despite this significance of pricing as an element of the company's marketing strategy, there seems to be a lack of interest among marketing academics on this issue, which has brought Nagle and Holden (1995) to suggest that pricing is the most neglected element of the marketing mix. Within this context, the empirical research that has been conducted on the field of pricing is very limited, while this is even more evident in the case of services. However, the distinctive characteristics of services (intangibility, heterogeneity, perishability and inseparability) necessitate a closer look at the way at which services are priced (Schlissel and Chasin, 1991; Zeithaml and Bitner, 1996; Kurtz and Clow, 1998; Langeard, 2000; Hoffman *et al.*, 2002).

Given this lack of empirical research, this paper tries to contribute to this neglected topic by investigating the pricing objectives that service organizations pursue along with the pricing methods that they adopt in order to set their prices. In addition to this, an effort is being made to examine the extent to which the pricing objectives are associated with the pricing methods adopted. A review of the existing literature reveals that these two issues have been examined in isolation (Schlissel, 1977; Zeithaml *et al.*, 1985; Morris and Fuller, 1989; Meidan and Chin, 1995), while, to the best of our knowledge, no previous research has investigated the extent to which the pricing objectives pursued are associated with the pricing methods.

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Thus, the objectives of the present study are twofold:

- (1) To examine the pricing objectives pursued along with the pricing methods adopted by service organizations.
- (2) To investigate whether the pricing objectives pursued are associated with the pricing methods adopted.

The paper is organized as follows: a comprehensive review of the existing literature on pricing objectives and pricing methods is presented along with the research methodology used. Moreover, the data analysis and the discussion of results are reported, while at the end of the paper the conclusions and the implications of the main findings of the study are presented.

Literature review

Pricing objectives

According to Oxenfeldt (1983), pricing objectives provide directions for action. "To have them is to know what is expected and how the efficiency of the operations is to be measured" (Tzokas *et al.*, 2000a, p. 193). Table I summarizes the fundamental pricing objectives that have been derived from the services pricing literature (Channon, 1986; Cannon and Morgan, 1990; Bonnici, 1991; Payne, 1993; Palmer, 1994; Bateson, 1995; Drake and Llewellyn, 1995; Woodruff, 1995; Ansari *et al.*, 1996; Lovelock, 1996; Meidan, 1996; Zeithaml and Bitner, 1996; Hoffman and Bateson, 1997; Langeard, 2000).

Diamantopoulos (1991, p. 139) suggests that pricing objectives can "fall under three main headings relating to their content (i.e. nature), the desired level of attainment and the associated time horizon". As far as their content is concerned, both quantitative and qualitative objectives can enter the objective functions of firms. The quantitative objectives can be measured easily and include those objectives that are related to the firm's profits, sales, market share and cost coverage. On the other hand, the qualitative ones are associated with less quantifiable goals such as the relationship

Table I Pricing objectives of service firms

| | |
|---|--|
| Profit maximization | Achievement of satisfactory profits |
| Sales maximization | Achievement of satisfactory sales |
| Market share maximization | Achievement of a satisfactory market share |
| Market share increase | Cost coverage |
| Return on investment (ROI) | Return on assets (ROA) |
| Coverage of the existing capacity | Liquidity maintenance and achievement |
| Price differentiation | Service quality leadership |
| Distributors' needs satisfaction | Creation of prestige image for the company |
| Price stability in the market | Price wars avoidance |
| Sales stability in the market | Market development |
| Discouragement of new competitors' entering into the market | Price similarity with competitors |
| Maintenance of the existing customers | Customers' needs satisfaction |
| Determination of "fair" prices for customers | Attraction of new customers |
| Long-term survival | Achievement of social goals |

with customers, competitors, distributors, the long-term survival of the firm and the achievement of social goals.

Regarding the desired level of attainment, pricing objectives may be divided into these objectives that endeavor to achieve maximum results (i.e. in terms of profits or sales) *vis-à-vis* those that pursue satisfactory results. However, it is interesting to mention in this point that the objective of "maximization" has been criticized by a number of different authors in the existing literature as being rather unrealistic to achieve. This may attributed to the limited information that pricing managers might possess, the lack of communication inside the company or even the avoidance of government intervention that an excessive profitability could cause (Boone and Kurtz, 1980; Bagozzi *et al.*, 1998; Keil *et al.*, 2001).

With reference to the time horizon of attainment, pricing objectives may be distinguished between short-term and long term ones. The short-term objectives endeavor to satisfy specific goals in a short time period (i.e. six months or one year), whereas the impact of the long-term objectives may only be realized after a long period of time. Moreover, the aforementioned authors have suggested that an excessive emphasis on short-term objectives may risk the long-term position of a firm in the market.

The above classification of pricing objectives notwithstanding, the complexity of pricing decisions imposes the need to pursue more than one objective at a time (Oxenfeldt, 1983; Diamantopoulos, 1991; Smith, 1995). Moreover, not all of them are compatible with each other since the objective of sales maximization for example could lead to lower profits (Keil *et al.*, 2001), while an excessive emphasis on profits could be in contrast with the achievement of social goals.

The few empirical studies that have been conducted on the issue of pricing objectives in the services sector show that quantitative objectives tend to be regarded as more important than qualitative ones with a particular emphasis placed on profit considerations. Specifically, by studying 43 pest control companies in the USA, Schlissel (1977) found that the most popular objective was profit maximization followed by the achievement of a satisfactory profit. Also, Morris and Fuller (1989) investigated the pricing behavior of 71 US accounting companies and found that the achievement of a satisfactory short-term profit was the most popular objective among the companies in their sample. Moreover, Meidan and Chin (1995) investigated the pricing practices of 45 building societies operating in the UK and concluded that more than 80percent of the companies in their sample considered the objectives associated with cost as being the most important ones.

Pricing methods

While the pricing objectives provide general directions for action, Oxenfeldt (1983) defines pricing methods as the explicit steps or procedures by which firms arrive at pricing decisions. A comprehensive review of the literature of pricing of services identified twelve pricing methods falling into three large categories namely cost based, competition based and demand based. These methods are:

(1) Cost-based methods:

- Cost-plus method – a profit margin is added on the service's average cost (Schlissel, 1977; Goetz, 1985; Zeithaml *et al.*, 1985; Ward, 1989; Palmer, 1994;

Payne, 1993; Bateson, 1995; Zeithaml and Bitner, 1996).

- Target return pricing – the price is determined at the point that yields the firm's target rate of return on investment (McIver and Naylor, 1986; Meidan, 1996).
- Break-even analysis – the price is determined at the point where total revenues are equal to total costs (Channon, 1986; Lovelock, 1996).
- Contribution analysis – a deviation from the break-even analysis, where only the direct costs of a product or service are taken into consideration (Schlissel and Chasin, 1991; Bateson, 1995).
- Marginal pricing – the price is set below total and variable costs so as to cover only marginal costs (Palmer, 1994).

(2) *Competition-based methods:*

- Pricing similar to competitors or according to the market's average prices (Channon, 1986; Payne, 1993; Palmer, 1994; Woodruff, 1995; Zeithaml and Bitner, 1996).
- Pricing above competitors (Bonnici, 1991; Meidan, 1996; Zeithaml and Bitner, 1996; Mitra and Capella, 1997; Langeard, 2000).
- Pricing below competitors (Payne, 1993; Palmer, 1994; Zeithaml and Bitner, 1996).
- Pricing according to the dominant price in the market – the leader's price that is adopted by the rest of the companies in the market (Kurtz and Clow, 1998).

(3) *Demand-based pricing:*

- Perceived-value pricing – the price is based on the customers' perceptions of value (Channon, 1986; Lovelock, 1996; Zeithaml and Bitner, 1996; Hoffman and Bateson, 1997).
- Value pricing – a fairly low price is set for a high quality service (Cahill, 1994).
- Pricing according to the customers' needs – the price is set so as to satisfy customers' needs (Bonnici, 1991; Ratza, 1993).

As in the case of the pricing objectives of services, the empirical research, which has been conducted on the pricing methods of services, is extremely limited. A common finding of the few studies conducted is the dominance of the cost-plus methods mainly due to its simplicity and easiness to use. More specifically, Schlissel (1977) found that 24 out of 43 pest control companies (56 percent) in the USA followed the cost-plus method. Similarly, Goetz (1985) investigating the pricing methods of 56 dry-cleaning services in the USA reached the conclusion that 36 companies in his sample (65 percent) adopted this method. Also, Zeithaml *et al.* (1985), in their study of the pricing behavior of 323 service companies in 13 different sectors in the USA, found that the 63 percent of these companies had adopted the cost-plus method. Finally, the work by Morris and Fuller (1989) in 71 accounting companies of the USA has shown that 75 percent of these companies were relying on cost-based methods.

Research methodology

Sample and data collection

The present study is part of a wider research on the pricing practices of service organizations operating in Greece. Given the fact that the services sector includes a vast number of sub-

sectors, it is almost impossible to investigate all the existing sectors. Within this context, it was felt appropriate to focus the current research on those sectors that may be considered as being significant for every national economy given their contribution to the country's gross domestic product and the number of employees that they employ. Consequently, the following sectors were investigated:

- banks;
- insurance companies;
- transportation and shipping companies;
- airline companies;
- information technology companies; and
- medical services.

These sections also represent a cross-section of both business-to-business (transportation and shipping companies and information technology companies) and business-to-consumer services (banks, insurance companies, airline companies and medical services).

According to ICAP's (2000) Directory (Gallup's subsidiary in Greece), which was used as the sampling frame of the research, the number of companies in the sectors in question was 1,495. At this point, it was decided that the research should focus only on those companies that had a total turnover of more than 1.5 million Euros in 1999, given the fact that pricing within small companies is treated in a less systematic way in comparison with large companies (Cunningham and Hornby, 1994; Carson *et al.*, 1998). In this way, the sample was reduced to 558 companies and, due to changes in addresses and/or the closedown of some of these companies, the original sample was eventually reduced to 464 companies.

Next, a personalized pre-notification letter was mailed to each of these companies explaining the objectives of the study and soliciting cooperation, while a week after, a telephone call was made to each company in order to examine the possibility of participating in the study. This approach has been found to increase response rates considerably (Yu and Cooper, 1983).

A total of 170 companies agreed to participate in the study representing a response rate of 36.7 percent, which is similar to other studies that have been conducted in the field of pricing (Shiple, 1981; Hornby and MacLeod, 1996; Tzokas *et al.*, 2000a, b). Table II summarizes the breakdown of the responses across the different sectors. The X^2 statistic was calculated for variations among the number of companies in the initial sample and the number of companies that finally responded. This statistic ($X^2 = 30.000$, $p = 0.224$) indicated that there was not overall response bias.

An appointment was made with these 170 companies and personal interviews were conducted. Our decision to use this method was based on its advantages comparing to phone or mail interviews. These advantages are related to the higher response rates associated with this method, the completion of every particular question and in the right order, the ability of the interviewer to explain unambiguous questions to the respondents along with the ability to ensuring the respondents' eligibility to the survey (Churchill, 1995; Chisnall, 1997).

Research instrument

The data were secured by means of a ten-page questionnaire. Following the suggestions of many marketing research academics an effort was made to avoid leading and

Table II Total population, sample, number of companies that responded and response rate across each sector

| | Population | Sample | Number of companies that responded | Response rate (%) |
|-----------------------------------|------------|--------|------------------------------------|-------------------|
| Transportation-shipping companies | 585 | 136 | 56 | 41.2 |
| Insurance companies | 202 | 76 | 29 | 38.2 |
| Medical services | 257 | 64 | 28 | 43.7 |
| Information technology companies | 256 | 72 | 21 | 29.2 |
| Airlines | 134 | 62 | 19 | 30.6 |
| Banks | 61 | 54 | 17 | 31.5 |
| Total | 1,495 | 464 | 170 | 36.7 |

unambiguous questions, paying particular attention to the wording and the sequence of questions and ensuring a professional style and format (Herzog and Bachman, 1981; Mayer and Piper, 1982; Gold, 1996; Nicholls, 1996). Information was collected by adopting various kinds of scales such as binary, ordinal and Likert type. Furthermore, before using the questionnaire for data collection, a detailed pretest based on personal interviews among two academics and ten practitioners was undertaken in order to increase its validity. Moreover, the questionnaire was designed in such a way so that data for specific services (one in each company), which had been priced recently, could be collected.

Measures

Pricing objectives

The respondents were provided with a list of 28 pricing objectives (presented in Table I) and they were asked to indicate, using a 1–5 scale (1 = Not important at all to 5 = Very important) how important they considered each one of them in pricing the service that they had chosen for discussion (e.g. a loan in the case of a bank or a life insurance in the case of an insurance company).

Pricing methods

The respondents were provided with a list of 12 pricing methods (as listed previously) and were asked to indicate, using a binary scale (0 = No, 1 = Yes) which one of them had adopted to price the service in question.

Data analysis and discussion of research results

Pricing objectives

The mean scores of each pricing objective are presented in Table III, where it can be seen that the three most important objectives are those that are related to customers. More specifically, the most important objective is the maintenance of the existing customers (4.31) followed by the attraction of new customers (4.28) and the satisfaction of customers' needs (4.18).

These findings indicate that the companies in our sample have understood the significance of taking into consideration those factors associated with their customers for making effective pricing decisions (Smith and Nagle, 1994; Zeithaml and Bitner, 1996). Other important objectives are the cost coverage (4.08), the creation of a prestige image for the company (4.07), its long-term survival (4.06) and the service quality leadership (4.03). This emphasis on the service quality and a prestige image is in line with the suggestions made by a number of authors regarding their importance in the case of

services (Bonnici, 1991; Woodruff, 1995; Langeard, 2000; Tse, 2001).

On the other hand, it is noteworthy that the objectives related to profit, sales and market share are less important, while at the same time more emphasis is given on the achievement of satisfactory rather than the maximum results *vis-à-vis* these indicators. This can be attributed to the difficulties associated with maximizing profits or sales in reality. Moreover, the least important objective is the discouragement of new competitors' entering into the market (2.56) mainly due to the high barriers to entry that exist in some of the sectors examined in our study (i.e. banks, airlines, transportation-shipping companies).

The above findings indicate that the companies in our sample tend to regard the qualitative objectives as being more significant than the quantitative ones. This finding may be attributed to the importance that they attach in ensuring the long-term position of the firm, since an excessive emphasis on quantitative objectives may risk this position (Cannon and Morgan, 1990; Diamantopoulos, 1991; Bagozzi *et al.*, 1998). Furthermore, the mean values of the pricing objectives indicate that they seem to pursue more than one objective perhaps due to the complexity that characterizes pricing decisions (Oxenfeldt, 1983; Diamantopoulos, 1991; Smith, 1995).

It is also interesting to mention that these findings are in contrast with those put forward by Meidan and Chin (1995), Morris and Fuller (1989) and Schlissel (1977), which indicate that the profit-related objectives are considered as being the most important ones. These differences may be partially attributed to the fact that some of the qualitative objectives measured in our study had not been incorporated in the aforementioned studies.

An examination of the correlation matrix of the 28 pricing objectives revealed that many of these objectives were interrelated. This led us to the conclusion that these initial objectives could be reduced in a subset of major underlying dimensions-factors. Thus, a factor analysis (principal components analysis, Varimax rotation) was performed that is presented again in Table III. On the basis of eigenvalue > 1.0 and factor loadings > 0.4 eight factors were identified namely stability in the market, customer related objectives, service quality related objectives, financial objectives, achievement of satisfactory profits and sales, market share and capacity related objectives, competition-related objectives and maximization of profits and sales. These factors represent different objectives and explain the 64.491 percent of the total variance, while the reliability for each factor measured by Cronbach's Alpha ranges from 0.630 to 0.796, which can be

Table III Mean scores and factor analysis of the pricing objectives pursued by service companies

| | Factor 1 | Factor 2 | Factor 3 | Factor 4 | Factor 5 | Factor 6 | Factor 7 | Factor 8 |
|--|-------------------------|-----------------------------|------------------------------------|----------------------|---|--|--------------------------------|-----------------------------------|
| | Stability in the market | Customer-related objectives | Service quality-related objectives | Financial objectives | Achievement of satisfactory profits and sales | Market share and capacity-related objectives | Competition-related objectives | Maximization of profits and sales |
| | Loading | Loading | Loading | Loading | Loading | Loading | Loading | Loading |
| Mean | | | | | | | | |
| Price stability in the market | 3.24 | | | | | | | |
| Sales stability in the market | 3.39 | | | | | | | |
| Market development | 3.64 | | | | | | | |
| Distributors' needs satisfaction | 2.61 | | | | | | | |
| Determination of fair prices for customers | 3.50 | | | | | | | |
| Maintenance of the existing customers | 4.31 | 0.793 | | | | | | |
| Long-term survival | 4.06 | 0.694 | | | | | | |
| Attraction of new customers | 4.28 | 0.673 | | | | | | |
| Achievement of social goals | 3.34 | 0.562 | | | | | | |
| Customers' needs satisfaction | 4.18 | 0.539 | | | | | | |
| Service quality leadership | 4.03 | | 0.786 | | | | | |
| Creation of a prestige image for the company | 4.07 | | 0.742 | | | | | |
| Price differentiation | 3.24 | | 0.674 | | | | | |
| ROA | 2.67 | | | 0.883 | | | | |
| ROI | 2.93 | | | 0.845 | | | | |
| Liquidity achievement and maintenance | 3.19 | | | 0.475 | | | | |
| Achievement of satisfactory profits | 3.84 | | | | 0.762 | | | |
| Achievement of satisfactory sales | 3.85 | | | | 0.760 | | | |
| Cost coverage | 4.08 | | | | 0.630 | | | |
| Market share increase | 2.84 | | | | | 0.716 | | |
| Market share leadership | 3.15 | | | | | 0.682 | | |
| Achievement of a satisfactory market share | 3.53 | | | | | 0.521 | | |
| Coverage of the existing capacity | 3.04 | | | | | 0.429 | | |
| Price similarity with competitors | 3.15 | | | | | | 0.752 | |
| Price wars avoidance | 2.96 | | | | | | 0.722 | |
| Discouragement of new competitors entering into the market | 2.56 | | | | | | 0.468 | |
| Profit maximization | 3.49 | | | | | | | 0.684 |
| Sales maximization | 3.78 | | | | | | | 0.661 |
| Eigenvalue | | 1.992 | 1.898 | 1.518 | 1.339 | 1.191 | 1.102 | 1.001 |
| Cronbach's alpha | | 0.796 | 0.783 | 0.785 | 0.702 | 0.702 | 0.630 | 0.692 |
| Variance (%) explained | | 10.984 | 10.323 | 8.578 | 7.668 | 6.935 | 5.797 | 5.631 |
| Cumulative variance (%) explained | | 10.984 | 21.307 | 29.885 | 46.128 | 53.063 | 58.860 | 64.491 |

Notes: KMO test = 0.845; Bartlett test of sphericity = 2149.478, Significance = 0.000

considered as satisfactory (Nunnally, 1978). Furthermore, they are consistent with the classification schemes that have been developed by other authors in the services marketing literature (Payne, 1993; Palmer, 1994; Woodruff, 1995; Lovelock, 1996; Zeithaml and Bitner, 1996; Kurtz and Clow, 1998).

The reliability of this eight-factor model was tested by splitting the sample randomly into halves and again conducting a factor analysis in each half. Both the eight-factor solution and the loadings remained unchanged suggesting that the results reported here are not due to chance.

Pricing methods

The frequency distribution for each pricing method is presented in Table IV, where it can be seen that the two most popular methods, are the cost-plus method and the pricing according to the market's average prices respectively. This may be attributed to the fact that these methods are easy to implement. It is also interesting to note that these methods are the only ones adopted by the majority of the companies in our sample (58.2 percent and 55.3 percent respectively), while all the others are used by a smaller number of companies (less than 30 percent).

The limited emphasis given to the customer-based methods (i.e. pricing according to customers' needs, perceived-value pricing and value pricing) is a bit surprising given that the customer-based objectives were found to be the most popular among the companies in our sample. However, these findings may be attributed to the difficulty in determining customers' demand and needs and the fact that the companies in our sample may believe that by adopting the cost-plus method they can cover their costs and levy competitive prices and thus can satisfy the existing customers' needs and attract new customers.

The association of pricing objectives and pricing methods

In order to examine whether an association between the pricing objectives and the pricing methods exist, a logistic regression analysis with the Maximum Likelihood Ratio method was carried out. This analysis "is multiple regression but with an outcome variable that is a categorical dichotomy

Table IV Pricing methods adopted by service organizations

| | <i>n</i> | % |
|---|----------|------|
| Cost-plus method | 99 | 58.2 |
| Pricing according to the market's average prices | 94 | 55.3 |
| Target return pricing | 48 | 28.2 |
| Pricing according to the dominant price in the market | 47 | 27.6 |
| Pricing according to the customers' needs | 46 | 27.1 |
| Break-even analysis | 41 | 24.1 |
| Perceived-value pricing | 40 | 23.5 |
| Value pricing | 39 | 22.9 |
| Pricing below competitors | 24 | 14.1 |
| Pricing above competitors | 16 | 9.4 |
| Contribution analysis | 13 | 7.6 |
| Marginal pricing | 3 | 1.8 |

Note: The sum of percentages is larger than 100, since respondents could give multiple responses, as they use more than one method

and predictor variables that are continuous or categorical... Using logistic regression... we predict the probability of a dependent variable *Y* occurring given known values from a predictor variable *X* or a set of predictor variables" (Field, 2000, pp. 163-4). Moreover, "the logistic probability model has the form $\Pr(y_i = 1) = [\exp(\beta^T x)]/[1 + \exp(\beta^T x)]$, where \Pr is the probability of variable *Y* occurring, *x* are the independent variables and the *b* the respective coefficients" (Baltas, 1997, p. 318).

This logistic regression analysis was used in order to examine the impact of pricing objectives set on the pricing methods adopted given the fact that the pricing methods in our study are categorical variables while the pricing objectives are continuous variables. More specifically, the nine pricing methods that had been used by more than 20 companies were considered as the dependent variables while the pricing objectives as the independent variables. In other words, we examine the adoption of a particular pricing method as a function of the pricing objectives set. In order to avoid the possibility of multicollinearity, the eight factors-dimensions of pricing objectives, which were derived from the factor analysis previously mentioned, were used as the independent variables.

After performing nine logistic regression analyses, one for each pricing method, four were found to be statistically significant. One of them, target return pricing, refers to cost based methods, while the other three, pricing according to the market's average prices, pricing according to the dominant price in the market and pricing below competitors to competition based methods.

Target return pricing

The analysis pertaining the target return pricing method (Table V), revealed that four objectives are associated with this method, namely:

- (1) the achievement of satisfactory profits and sales (0.505);
- (2) the service quality related objectives (0.367);
- (3) the financial objectives (0.350); and
- (4) the stability in the market (-0.321).

With respect to the "achievement of satisfactory profits and sales" and the "financial objectives", we should expect these objectives to be associated with the target return pricing method since, as McIver and Naylor (1986) have suggested, the fundamental aim of the target return pricing method is to

Table V Target return pricing and pricing objectives

| Variables | Coefficients β |
|---|----------------------|
| Stability in the market | -0.321*** |
| Customer-related objectives | 0.093 |
| Service quality-related objectives | 0.367*** |
| Financial objectives | 0.350*** |
| Achievement of satisfactory profits and sales | 0.505* |
| Market share and capacity-related objectives | -0.008 |
| Competition-related objectives | 0.023 |
| Maximization of profits and sales | 0.265 |
| Percent of total correct predictions | 70 |
| Log likelihood (max) | -92.446 |
| X ² improvement | 17.463*** |

Notes: ^a df: 8; * $p < 0.025$; ** $p < 0.05$; *** $p < 0.1$

yield the target return on the firm's potential investment (financial objectives) and achieve satisfactory profits and sales. Similarly, the association of the "service quality related objectives" with the method in question might indicate that the provision of a high-quality service necessitates some investments (e.g. in terms of facilities or after sales services) a satisfactory return of which may be the aim of the company.

On the other hand, the negative impact of the objective of "stability in the market" on this method is interesting and can be partially explained by the fact that the cost-based methods in general and the target return pricing in particular tend to disregard the market conditions (i.e. customers' demand and competitive prices). Thus, this method may lead to prices different from the average market ones (either below or above them), which in the long run might destabilize the market.

Average market prices

With reference to the method of pricing according to the market's average prices (Table VI), the possibility of adopting it increases when the objectives that are pursued are associated with the competitors (0.569) and the customers (0.384). This finding is expected since this method may lead to the establishment of harmonic climate in the market, which can profit both customers and society in general (Diamantopoulos, 1991).

However, the attempt to achieve "service quality related objectives" (-0.571) and the "maximization of profits and sales" (-0.410) tends to reduce the probability of pricing according to market prices. These findings are expected, since a high-quality service may justify a price above those charged by the competitors (Mitra and Capella, 1997; Tse, 2001), whereas the effort to maximize profits, sales or market share may necessitate levying prices different from the average market prices (Bagozzi *et al.*, 1998).

Dominant market price

We can see from Table VII that this method is associated, as we should expect, only with "competition related objectives" (0.425).

Table VI Pricing according to the market's average prices and pricing objectives

| Variables | Coefficients β |
|---|----------------------|
| Stability in the market | 0.211 |
| Customer-related objectives | 0.384*** |
| Service quality-related objectives | -0.571** |
| Financial objectives | -0.188 |
| Achievement of satisfactory profits and sales | 0.179 |
| Market share and capacity-related objectives | 0.126 |
| Competition-related objectives | 0.569** |
| Maximization of profits and sales | -0.410**** |
| Percent of total correct predictions | 67.6 ^a |
| Log likelihood (max) | -100.935 |
| X ² improvement | 31.991 ^{ab} |

Notes: ^a Although this percentage is not very high, it is similar to those of other studies that have been using logistic regression analyses (Iguzquiza, 1996; Pitt *et al.*, 2000); ^b df: 8; * $p = 0.000$; ** $p < 0.005$; *** $p < 0.05$; **** $p < 0.025$

Table VII Pricing according to the dominant price in the market and pricing objectives

| Variables | Coefficients β |
|---|----------------------|
| Stability in the market | 0.155 |
| Customer-related objectives | -0.138 |
| Service quality-related objectives | -0.211 |
| Financial objectives | 0.154 |
| Achievement of satisfactory profits and sales | -0.100 |
| Market share and capacity-related objectives | 0.146 |
| Competition-related objectives | 0.425* |
| Maximization of profits and sales | 0.279 |
| Percent of total correct predictions | 72.4 |
| Log likelihood (max) | -94.751 |
| X ² improvement | 10.960 ^a |

Notes: ^a df: 8; * $p < 0.05$

Pricing below competitors

As we can see from Table VIII, the adoption of this method was found to be associated with pricing objectives pertaining to competition and market share and capacity utilization.

These findings underline the fact that efforts to increase market share and utilize the existing capacity might necessitate charging lower prices than those charged by the competitors.

Based on the above logistic regression analyses, Table IX presents the association of pricing objectives and pricing methods identified in our study.

Conclusion

The objectives of this research were to investigate the pricing objectives that service organizations pursue along with the pricing methods that they adopt and the extent to which these objectives and methods are associated. Collecting data from 170 service organizations through personal interviews, it was found that the companies in our sample are fundamentally pursuing qualitative rather than quantitative objectives with a particular emphasis being placed on attracting new customers, maintaining the existing ones and satisfying their needs. Other important objectives were found to be the service quality leadership, the creation of a prestige image of the company and the long-term survival.

Table VIII Pricing below competitors and pricing objectives

| Variables | Coefficients β |
|---|----------------------|
| Stability in the market | -0.235 |
| Customer-related objectives | 0.438 |
| Service quality-related objectives | -0.221 |
| Financial objectives | 0.023 |
| Achievement of satisfactory profits and sales | 0.322 |
| Market share and capacity-related objectives | 0.546* |
| Competition-related objectives | 0.478** |
| Maximization of profits and sales | -0.148 |
| Percent of total correct predictions | 85.9 |
| Log likelihood (max) | -61.778 |
| X ² improvement | 14.857*** |

Notes: ^a df: 8; * $p < 0.05$; ** $p < 0.1$

Table IX The association of pricing objectives and pricing methods

| | Stability in the market | Customer- related objectives | Service quality- related objectives | Financial objectives | Achievement of satisfactory profits and sales | Market share and capacity-related objectives | Competition- related objectives | Maximization of profits and sales |
|---|-------------------------------|------------------------------------|--|-------------------------|---|--|---------------------------------------|---|
| Pricing according to the market's average prices | NS | (+) | (-) | NS | NS | NS | (+) | (-) |
| Target return pricing | (-) | NS | NS | (+) | (+) | NS | NS | NS |
| Pricing according to the dominant price in the market | NS | NS | NS | NS | NS | NS | (+) | NS |
| Pricing below competitors | NS | NS | NS | NS | NS | (+) | (+) | NS |

However, the service organizations in our sample seem to pay very little attention in adopting customer oriented methods perhaps due to the difficulty in determining their customers' demand and needs. They tend to use the traditional cost-plus methods perhaps due to the simplicity associated with these methods. Moreover, the intensive competitive environment that they face tends to force them to price according to the market's average prices.

It is also interesting to note the association of pricing objectives and pricing methods as it was identified in our study. In particular, the customer-related objectives along with the competition-related objectives were found to be associated positively with the method of pricing according to the market's average prices, while the service quality-related objectives and the maximization of profits and sales objective were found to be associated negatively with this specific method. Moreover, the financial objectives along with the achievement of satisfactory profits and sales objective were associated positively with the method of target return pricing, while the stability in the market objective was associated negatively with this method. Furthermore, the competition-related objectives were associated positively with the method of pricing according to the dominant price in the market and the method of pricing below competitors, while the market share and capacity-related objectives were also associated positively with the method of pricing below competitors.

It is clear from the above that the competition-related objectives are bound to have a bearing on competition-based methods (i.e. pricing according to the dominant price in the market and pricing below competitors), whereas the financial objectives have a bearing on cost-based methods (i.e. target return pricing), as we should expect.

Managerial implications

This study indicates that the suggestions made by marketing academics regarding the need to incorporate customers' needs and demands into the company's pricing behavior is embedded in the pricing objectives of the companies in our sample. However, regarding their pricing methods they seem to rely on the traditional cost-plus method. This is not surprising given the easiness associated with its implementation along with the difficulty in following customer-based methods. As Cram (1996, p. 38) has suggested "pricing will always be a challenging area ... Perhaps future answers will come less from thinking of the price as the point of a single transaction and more from seeing

pricing as a means of securing customer loyalty". Certainly, this is not an easy task and necessitates a different mentality towards pricing that will favor formal market research in order to understand customers' attitudes and needs. However, as Nagle and Holden (1995) have suggested, such an approach may improve the quality of pricing decisions. This is intensified by the heavy criticisms surrounding the cost-plus method as placing its emphasis merely on the production cost and disregarding the market conditions. Thus, a clear implication for managers responsible for pricing decisions within their firms is to move away from these simplistic cost-plus formulas and treat pricing from a customer's point of view in all the steps of their pricing process. Within this context, they should always have their customers in mind and to go a step further and endeavor to adapt the cost to their customers' needs.

However, such a customer orientation should be integrated within a more general market orientation approach where the pricing practices of competitors are also taken into consideration. This will help the company to reflect more accurately the pricing requirements of its market characteristics and conditions. The fact that the pricing method of pricing according to the market's average price was the second most popular method among the companies in our sample is indicative on this issue. Thus, managers need to continuously pay attention to competitors' pricing behavior as the only "sure-fire" way to ensure that they stay in the market. Any attempt to price the offered services above or below the market's average prices should be justified only when a higher quality service is offered to the market.

Moreover, the fact that different pricing objectives were found to lead to different pricing methods reflects the need to have a coherent pricing strategy if effective pricing decisions are to be made. Thus, it seems that the selection of a particular pricing method should be guided by the pricing objectives and goals that the company has set a priori and endeavored to achieve these objectives. As Garda (1991) has suggested:

... a common mistake for many companies is to treat pricing in a non-systematic way and regard its various components as independent to each other.

Managers might have to gain a lot by placing more emphasis on such an integrated pricing approach and implement pricing methods that are in line with the pricing objectives that have been initially set.

Limitations and future research

Although the present study represents a first attempt to examine empirically the relationship between pricing objectives and methods in the services sector, its findings should be treated with caution by the reader. More specifically, the context of the study (Greece) is an obvious limitation since it limits the ability to generalize the results in other countries. Thus, future research that replicates the current study in other countries could further improve our understanding of the concepts presented here.

Moreover, another limitation of the study is related to the increased heterogeneity associated with cross-sectional samples (as in the present study) due to the fact that they induce negative effects on the quality of the findings (Bilkey, 1978; Dubinsky and Ingram, 1982). However, such samples can increase their generalizability and have also been adopted by other studies in the field of pricing (Shipley, 1981; Zeithaml *et al.*, 1985; Tzokas *et al.*, 2000a, b).

Future research may investigate the impact of the context of the organization and the impact of environmental variables such as the sector of operation, the market structure etc. on the pricing objectives pursued and the pricing methods adopted. Given the multidimensionality of pricing decisions identified in our work, different characteristics of the market for instance might necessitate the adoption of different pricing objectives and pricing methods. Similarly, the company's sector of operation or size could also influence the aforementioned objectives and methods. The examination of these issues could lead to a better understanding of the concepts presented in this paper.

Additionally, another avenue for future research may be the investigation of the impact that different pricing objectives and methods have on the achievement of corporate objectives. Within this context, the most effective pricing objectives and methods may be identified as being those that lead to the achievement of corporate goals.

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Further reading

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Executive summary and implications for managers and executives

This summary has been provided to allow managers and executives a rapid appreciation of the content of this article. Those with a particular interest in the topic may then read the article in toto to take advantage of the more comprehensive research undertaken and its results to get the full benefit of the material present.

Pricing objectives and pricing methods

Pricing is the most neglected element of the marketing mix. The pricing objectives of service firms provide directions for action. They range from, for example, maximizing profits, or sales, or market share, to avoiding price wars or achieving social goals. Pricing methods, meanwhile, are explicit steps or procedures by which firms arrive at marketing decisions. They can be cost based (such as adding a profit margin to the average cost of the service), competition based (such as pricing similar to competitors or according to the market's average prices) or demand based (such as setting the price so as to satisfy the customer's needs).

Avlonitis and Indounas examine the pricing objectives pursued, along with the pricing methods adopted, by 170 service organizations operating in Greece. The authors also investigate whether the pricing objectives pursued are associated with the pricing methods adopted. Their research covers banks, insurance companies, transportation and shipping firms, airlines, information technology businesses and medical services.

The most important pricing objectives

The most important pricing objective is revealed to be maintenance of existing customers, followed by the attraction of new customers and the satisfaction of customers' needs. Other important objectives are cost coverage, the creation of a prestige image for the company, its long-term survival, and service quality leadership. Objectives related to profit, sales and market share are less important, perhaps because of the difficulties associated with maximizing profits or sales in reality. The least important objective is discouraging new competitors from entering the market, perhaps because of the high barriers to market entry that exist among some of the sectors examined in the study.

The findings indicate that the companies regard quantitative objectives (those related to, for example, the firm's profits, sales, market share and cost coverage) as less significant than qualitative objectives, which are associated with less quantifiable goals such as the relationship with customers, competitors and distributors, plus the long-term survival of the firm and the achievement of social goals. Moreover, companies seem to pursue more than one objective, perhaps because of the complexity of pricing decisions.

The most popular pricing methods

The two most popular pricing methods used by service companies in the study are cost-plus, where a profit margin is added to the average cost of the service, and pricing according to the market's average prices. This may be because both methods are easy to implement.

The limited emphasis given to customer-based methods – such as pricing according to customers' needs or customers' perceptions of value, or setting a fairly low price for a high-quality service – is surprising given that customer-based objectives are the most popular among the companies

surveyed. One reason may be the difficulty of determining customers' demands and needs. Another may be that the cost-plus method enables firms to cover their costs and levy competitive prices, and thus both satisfy existing customers and attract new ones.

The association of pricing objectives and pricing methods

The study confirms that the pricing objectives are associated with the pricing methods. Competition-related objectives have a bearing on competition-based pricing methods such as pricing according to the dominant price in the market and pricing below competitors. Financial objectives, meanwhile, have a bearing on cost-based pricing methods such as target-return pricing, where the price is determined at the point that yields the firm's target rate of return on investment.

Implications for managers

Managers should strive to move away from simplistic cost-plus pricing, which disregards market conditions, and should treat pricing from a customer's perspective in all the steps of their pricing process. They should always have their customers in mind and should endeavor to adapt the cost to their customers' needs. Competitors' pricing practices should also be taken into consideration. Setting a price above the market average is justified only when a higher quality service is offered.

Moreover, managers have much to gain from adopting an integrated pricing approach, where they implement pricing methods that are in line with the pricing objectives the company has already set.

(A précis of the article "Pricing objectives and pricing methods in the services sector". Supplied by Marketing Consultants for Emerald.)