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Factors Influencing the Willingness to Pay User Fees

Extension Economics Notes # 2012-5

In this *Note* I explore the factors which influence the demand side of program participation, or the willingness to pay (WTP). The WTP estimates can help you determine how many people will participate in an event at each fee level.

Generally, as the price of a service increases, the number of people purchasing it falls. So some educators worry that participation in their programs will fall if they charge user fees. This is not always the case. In rare cases, higher fees signal higher quality programs and increase the audience's willingness to pay and participation. The WTP estimates allows you to see how changes in your fees, event characteristics and/or your target audience change an audience's WTP and participation.

"Needs, Wants, Effective Demand and WTP"

If fees are used to recover some costs, it is important to understand the difference between needs, *wants*, and *effective demand*. ***Needs*** are those essentials required for life (shelter, water, food, social interaction, etc.*)*. ***Wants*** are the specific forms of these needs which an individual would like to have if they had no monetary limits. ***Effective demand*** is the quantity for each item that a person is willing and able to buy of the items he wants. ***Willingness to Pay (WTP)*** estimates show the number of people who are willing to participate in a program at each fee level. This makes it important to examine the factors influencing the willingness to pay.

Factors Influencing the Willingness to Pay

The following seven factors influence the participation as fees increase:

1) close substitutes,
2) percentage of total cost in user fees,
3) professional requirement vs. optional participation,
4) income levels of participants,
5) the total number of people in the target audience,
6) the background of the target audience, and
7) the past history of fees charged for this program

Extension Economics Notes is *a faculty project and may not reflect the views of the University of Minnesota or its units. I appreciate the feedback from several colleagues but any errors or omissions are my responsibility. From 1974 to 2002 I was a faculty member and Extension Economist at South Dakota State University, Ohio State University, and University of Minnesota. From 2002 to 2007 I served as the Associate Dean and Director for the University of Minnesota Extension.*

1) Why can you charge higher fees for programs <u>without close substitutes</u> without hurting participation?

When there are a lot of close substitutes, a higher fee will lead people to jump to the substitute. But if there are few substitutes, you can increase prices without as much drop in participation. If your audiences perceive a lot of other groups as providing about the same program as you do, you will need to charge what other programs charge. For more on this, re-read *Extension Economics Notes # 2012-4.*

2) **Why can you set higher fees when fees are a <u>small "percentage of the total cost</u>?"**

The fee that you charge for an event is only a part of the total cost to the participants. If your program event requires people to travel, their travel cost adds to their cost. If you program requires them to stay overnight, then the hotel and meals costs adds to their cost. If they have to take time away from work and lose pay, or their work piles up, then this adds to their cost of being away from work, a cost often called "opportunity cost."

If you add together the travel costs, hotel, meals, opportunity costs and fees, then you get the total cost of your program event to the participant. Often these other costs are a much larger percentage of their total costs than are the fees. If this case, you can increase the fees some without problems.

3) If a program event is a <u>professional requirement</u> rather than an optional one, how does this change the audience's WTP?

Program events required as part of a professional certification are a necessity. As a result, participants are willing to pay more than if the educational activity is optional or a leisure activity. Professionals might prefer to pay less but few of them avoid required certification programs due to higher fees. Hence, it is possible to charge more for these required events than for optional ones.

4) How does the <u>participants' income</u> affect the price you can charge?

Generally, the higher the income of the target audience the higher the fee can be for the program. For example, a university that offers an online MBA course for physicians has a relatively high financial cost in addition to tuition. Often in the hour long interview prior to accepting a physician to the program, the applicant has to be asked if she wants to know the estimated cost of all of this. To the doctors, the time cost is much more important than the cash. This is far from the typical Cooperative Extension Service audience, but the principal applies. Sometimes you can offer a second more comprehensive program for high income audiences at a higher fee.

5) How does the <u>number of people in the target audience</u> impact the fee you can charge?

The larger the number of people in your audience the higher the fee you can charge. This is because every group has a small percentage of people that will pay a rather high fee even though many more only will participate at lower fees.

The implication of this is that if you offer a program on a statewide basis, even though delivered in a number of local venues, you will have a larger audience and can charge a larger fee than if the

audience is limited to a small geographic area and small total audience.

6) How can the <u>background of the target audience</u> influence the fee charged?

In rural communities it is not possible to charge very much for some types of research analysis. The reason is not entirely due to the lower incomes in these areas, although that is a factor. Often a more important reason for this low WTP is that the target audience is unfamiliar with the types of analysis required. For example, economic impact analysis uses input-output models. In larger urban areas, the professionals in development agencies often have been exposed to input-output in college and understand its pros and cons. On the other hand, professional developers in smaller towns often have not been exposed to these tools and are uncertain whether they are worth the fees required. Hence, the same types of research will sell better in metro areas compared to rural areas.

After a particular approach has been demonstrated in a number of rural communities, other rural communities are more likely to be willing to pay higher fees. In this sense, Extension's offering of these programs at lower fees initially often helps build the market for the private sector.

7) How does the <u>past history of fees</u> influence what you can charge?

If an audience has had a history of not paying for a program, it is harder to charge for the program. For example, some of Extension community development (CD) programs charge relatively high fees (although few cover all costs) because CD audiences are not accustomed to getting the programs free or nearly so as with some agricultural groups.

Can you do anything about this? Yes, you can point out the following:

- benefits which previous participants reported from doing program.
- WTP survey results from previous participants.
- cutbacks in public funding that make user fees necessary.
- the cost of the program and the other sources of support for the program
- the percentage of the costs being covered by fees (often quite low).
- the percentage of college tuition being paid at your university and how it has changed over the past 30 years.
- the risk of discontinuing the program without some fees.

In established programs, it is very important to work with the leadership of the target audience to help them understand the trade-offs involved in setting fees. Consider the negative reactions toward banks when they suddenly announced much higher fees for using debit cards. Ultimately, they had to withdraw their higher fees.

Four Principles for Raising Fees

Principle 1: Don't raise fees if other cost recovery is possible.

First, explore alternative funding options for your program's events (*Extension Economics Notes # 2012-1*). Second, discuss whether the characteristics of your program are a good match for charging user fees *(Extension Economics Notes # 2012-2)* Third, find ways to decreases the costs per person *(Extension Economics Notes # 2012-3).* Attention to these details reduces the potential negative impacts of increasing fees.

Principle 2: Know what the willingness to pay (WTP) is for your program.

Often, very low fees are below what people are willing and able to pay for the program. When this is true, then the increased fees do not result in decreases in participation. In some cases, the higher fees might even signal that the program quality is superior and you will attract more participants. Consider the factors which influence peoples' willingness to pay and then estimate the WTP at different fee levels. (For a simple way to estimate the WTP for your program see *Extension Economics Notes # 2012-4* – under Task 3).

Principle 3: Increase fees if this would help you reach more people.

If you keep your fees very low, and you lack sufficient other funding, you might be able to only offer events in a few places and a few times. When more people want to participant than you can handle at the current fees, try raising the fees a little. The additional fees can help you serve more people. If you raise the fees slowly, you can find the point at which you no longer increase your total revenue because you lose too many people.

Principle 4: Work closely with target audiences before raising fees.

This does not mean simply asking the audiences if you should raise fees. The answer to that is always "NO." After all, when was the last time you volunteered to pay more for a service? Rather share with them the costs of doing the program, the ways you have worked to cut costs, and the alternative sources of funding. Collect good evaluation data on the program and start sharing it once the program is beyond the early pilot programs. Once cost estimates are reasonably accurate (see *Notes # 2012-3)*, it is wise to share them with a short statement such as the following:

> *This educational event was developed and delivered to you by the __ (Name of State) __University Extension at a cost of $__ per person. It is funded by a combination of public funds, sponsorship support from ___ (Name of Firm or Agency) __ and user fees. Scholarships are available by calling __ (phone) ___.*

Discussion Questions for Program Team

1) Which of the seven factors influencing willingness to pay are relevant to our program and what are the implications for our fees?
2) Which of the four principles on fees should we adopt? Specifically how would we do it?
3) Are there tasks we will need to do after this discussion? If so, who from our team will do them and by when?