# Introduction to Marketing

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# Pricing: Understanding and Capturing Customer Value (Chapter 10 & 11)

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# Learning Objectives

- What Is a Price?
- Customer Perceptions of Value
- Company and Product Costs
- Other Internal and External Considerations Affecting Price Decisions

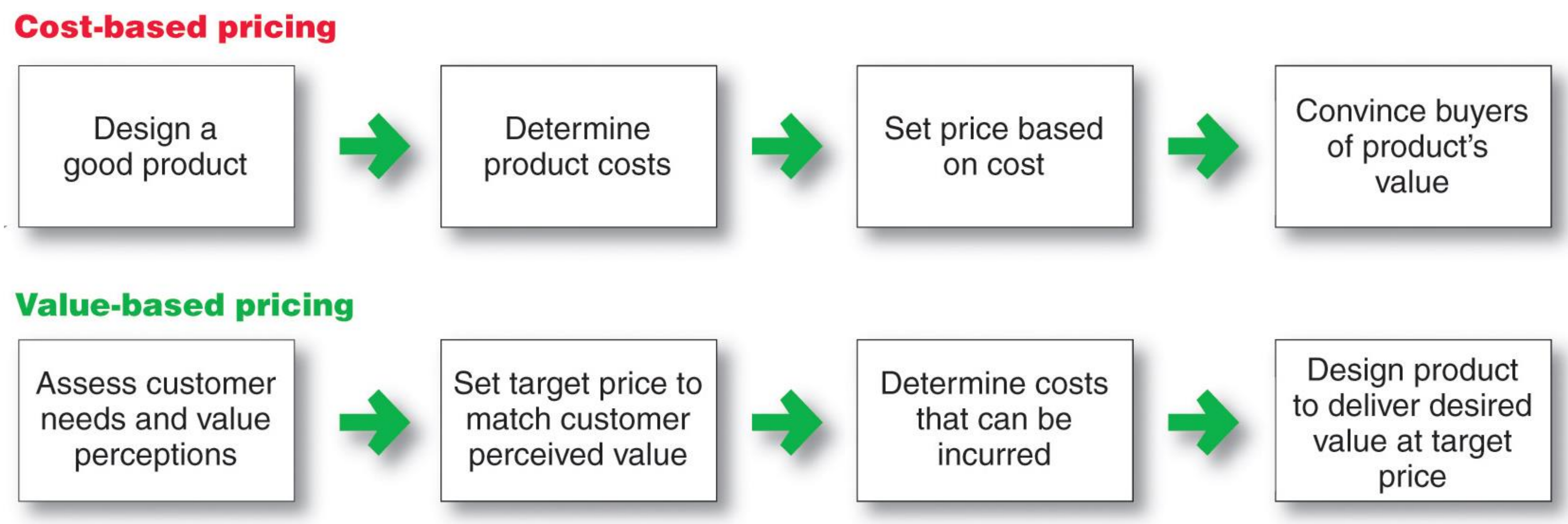
# Pricing Strategy

# Major Pricing Strategies

**Value-based pricing** uses the buyers' perceptions of value, not the sellers cost, as the key to pricing. Price is considered before the marketing program is set.

- Value-based pricing is customer driven
- Cost-based pricing is product driven

# Major Pricing Strategies



# Major Pricing Strategies

**Good-value pricing** offers the right combination of quality and good service to fair price

- Existing brands are being redesigned to offer more quality for a given price or the same quality for less price

# Major Pricing Strategies

## Good Value Pricing

**Everyday low pricing** (EDLP) involves charging a constant everyday low price with few or no temporary price discounts

**High-low pricing** involves charging higher prices on an everyday basis but running frequent promotions to lower prices temporarily on selected items

# Major Pricing Strategies

**Value-added pricing** attaches value-added features and services to differentiate offers, support higher prices, and build **pricing power**

- ***Pricing power*** is the ability to escape price competition and to justify higher prices and margins without losing market share

# Major Pricing Strategies

**Cost-based pricing** involves setting prices based on the costs for producing, distributing, and selling the product plus a fair rate of return for its effort and risk

# Major Pricing Strategies

**Cost-plus pricing** adds a standard markup to the cost of the product

- Benefits
  - Sellers are certain about costs
  - Prices are similar in industry and price competition is minimized
  - Consumers feel it is fair
- Disadvantages
  - Ignores demand and competitor prices

# Company and Product Costs

**Cost-based pricing** adds a standard markup to the cost of the product

markup price= unit cost /(1-desired rate of return)

# Factors to Consider When Setting Prices

Company and Product Costs

Types of costs

- Fixed costs
- Variable costs
- Total costs

# Factors to Consider When Setting Prices

Company and Product Costs

Fixed costs are the costs that do not vary with production or sales level

- Rent
- Heat
- Interest
- Executive salaries

# Factors to Consider When Setting Prices

Company and Product Costs

Variable costs are the costs that vary with the level of production

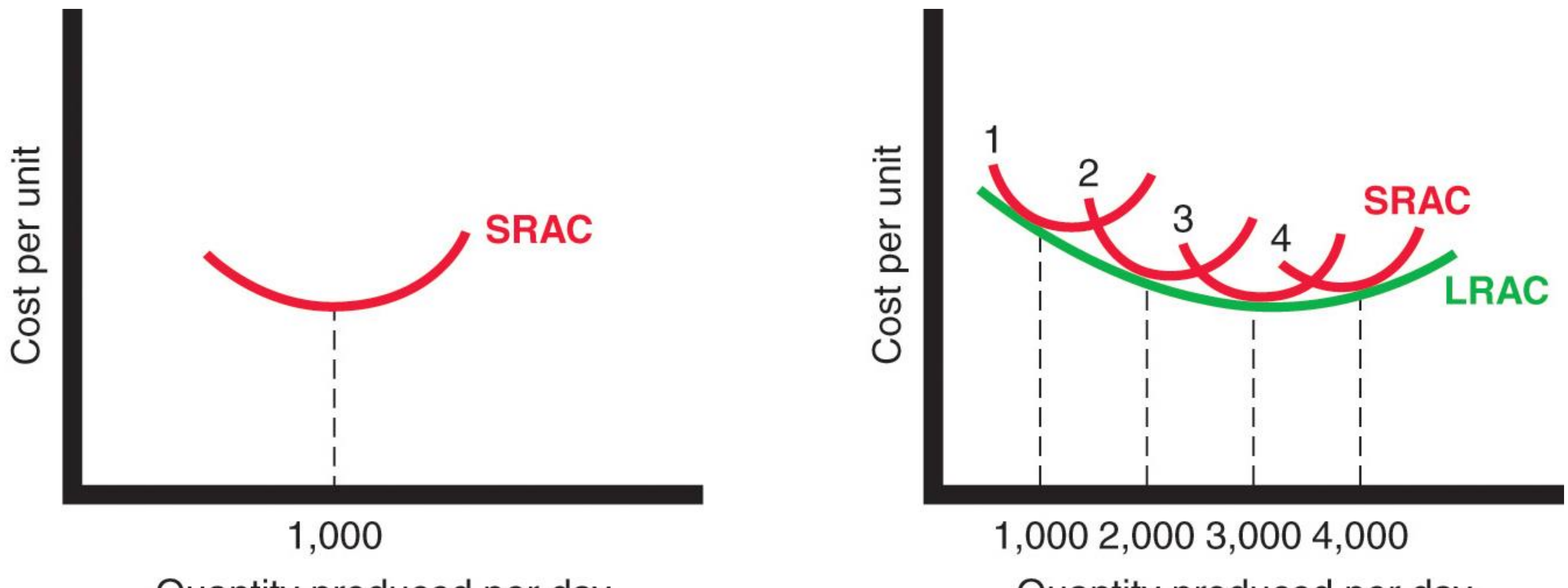
- Packaging
- Raw materials

# Factors to Consider When Setting Prices

Company and Product Costs

- Total costs are the sum of the fixed and variable costs for any given level of production
- Average cost is the cost associated with a given level of output

# Costs at Different Levels of Production




**A. Cost behavior in a fixed-size plant** **B. Cost behavior over different-size plants**

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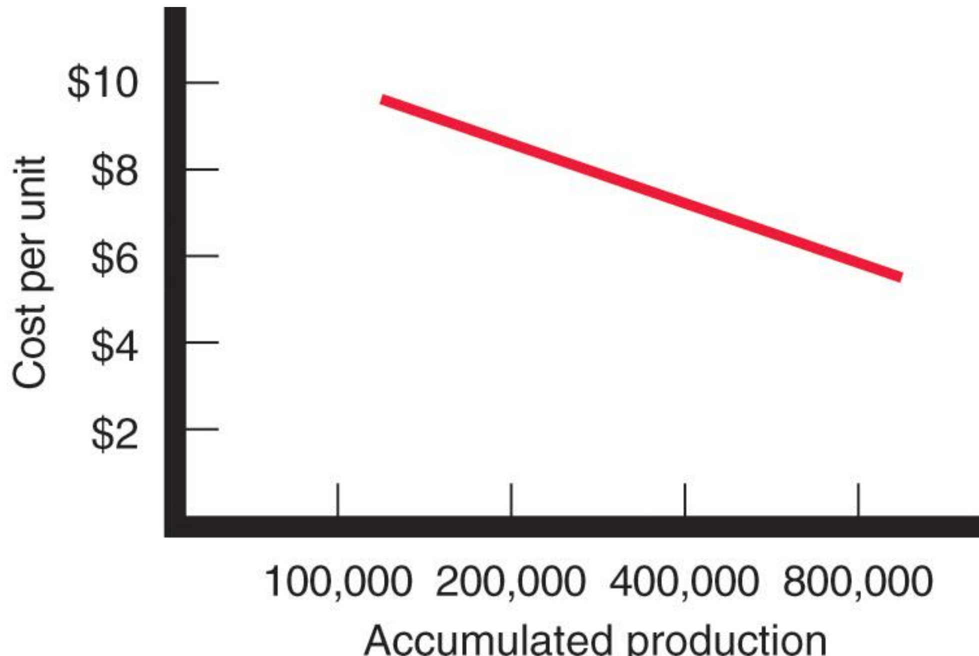
# Costs as a Function of Production Experience

- Experience or learning curve is when average cost falls as production increases because fixed costs are spread over more units

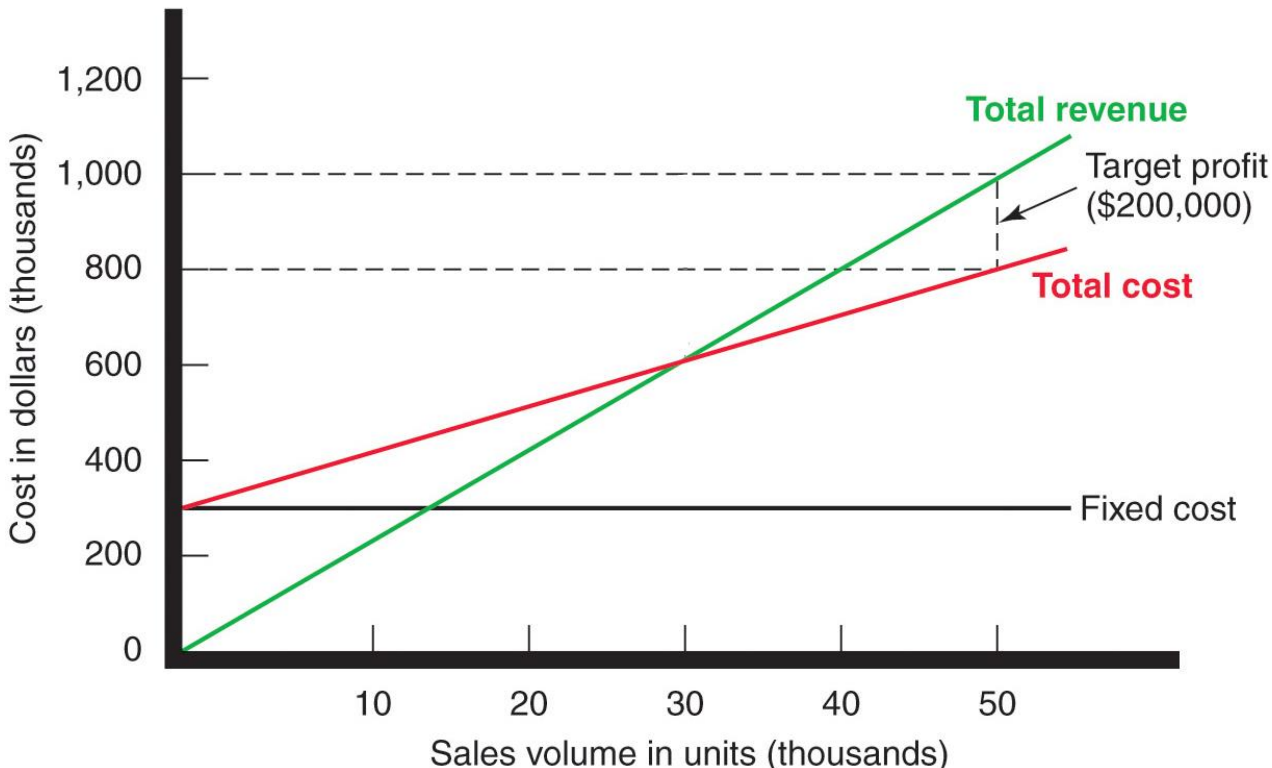


# Break-Even Analysis and Target Profit Pricing

**Break-even pricing** is the price at which total costs are equal to total revenue and there is no profit

**Target profit pricing** is the price at which the firm will break even or make the profit it's seeking

# Break-Even Analysis and Target Profit Pricing



# Other Internal and External Considerations Affecting Price Decisions

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# Other Internal and External Considerations Affecting Price Decisions

## Overall Marketing Strategy, Objectives and Mix

- Price must be considered in relation to the broader marketing strategy

# Other Internal and External Considerations Affecting Price Decisions

**Organizational considerations** include:

- Who should set the price
- Who can influence the prices

# Other Internal and External Considerations Affecting Price Decisions

The **Market and Demand**

- Before setting prices, the marketer must understand the relationship between price and demand for its products

# Other Internal and External Consideration Affecting Price Decisions

The **Market and Demand**

Types of markets

- Pure competition
- Monopolistic competition
- Oligopolistic competition
- Pure monopoly

# Pure Competition

# Monopolistic/Oligopolistic Competition

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# Pure Monopoly

# Other Internal and External Considerations Affecting Price Decisions

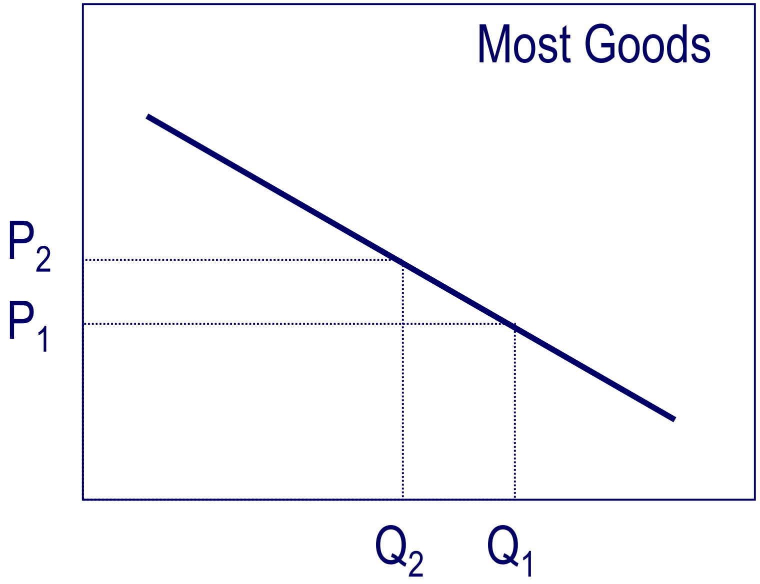
## The Market and Demand

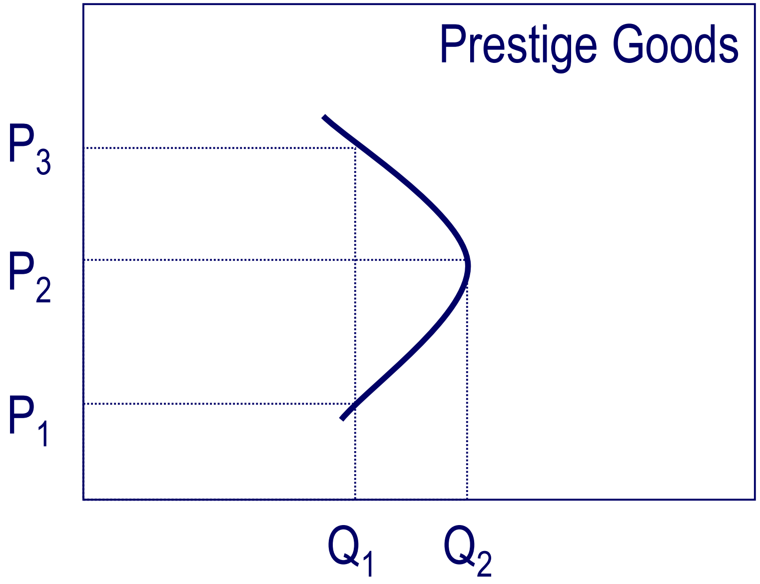
### *Analyzing the Price Demand Relationship*

**The demand curve** shows the number of units the market will buy in a given period at different prices

- Normally, demand and price are inversely related
- Higher price = lower demand
- For prestige (luxury) goods, higher price can equal higher demand when consumers perceive higher prices as higher quality

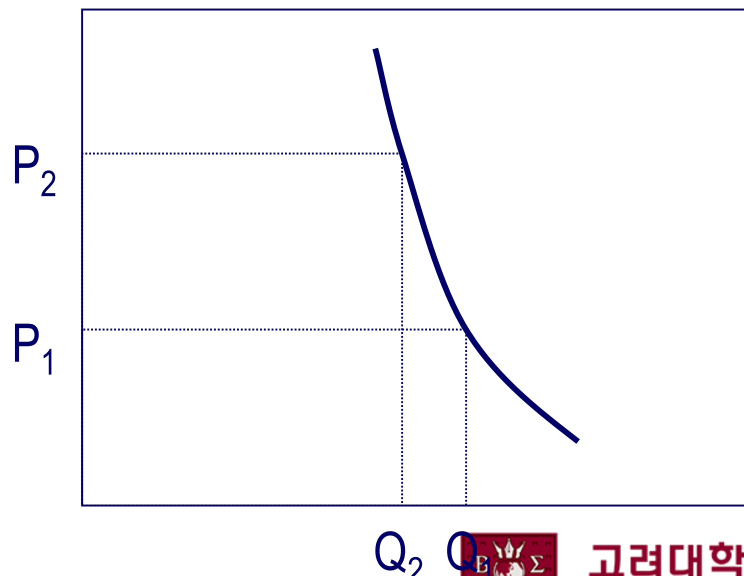
# Consumer Demand vs Price



# Price Elasticity of Demand

- How responsive demand will be to a change in price
  - If demand hardly changes with a small change in price – then demand is *inelastic*



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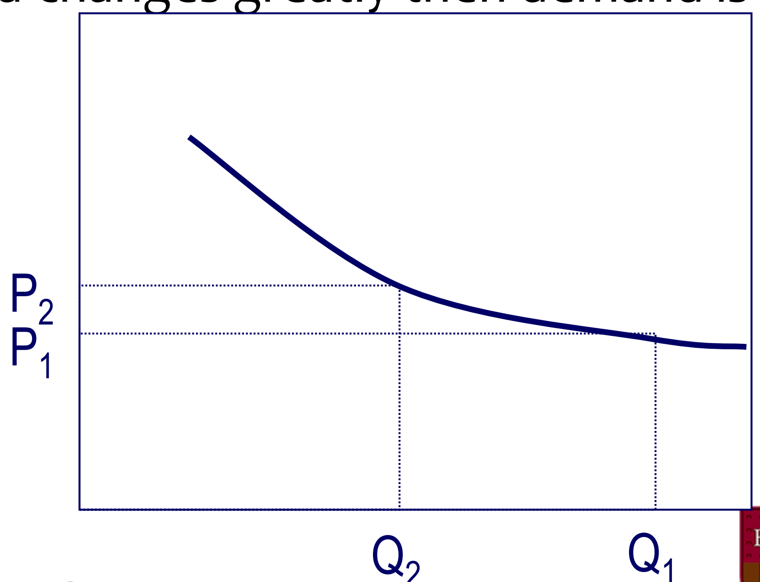
# Price Elasticity of Demand

- How responsive demand will be to a change in price
  - If demand hardly changes with a small change in price – then demand is *inelastic*
  - If demand changes greatly then demand is *elastic*





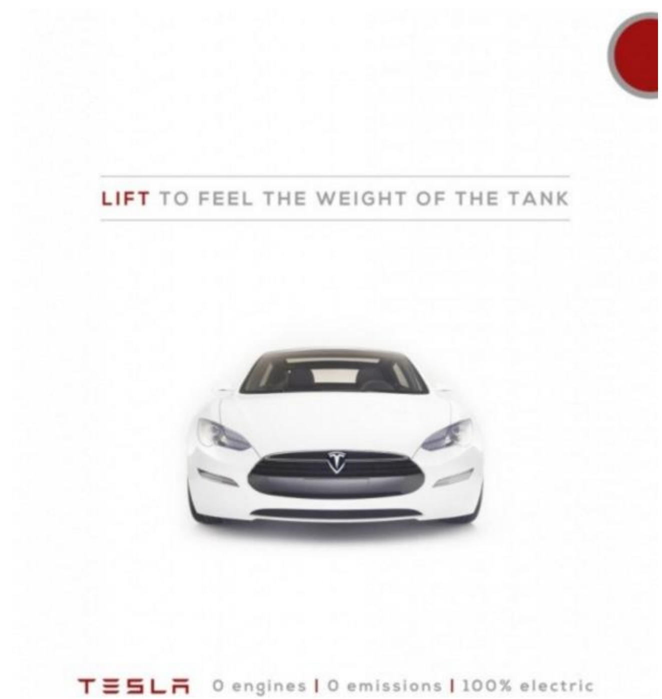
# Other Internal and External Consideration Affecting Price Decision

- Price elasticity of demand illustrates the response of demand to a change in price
  - Inelastic demand occurs when demand hardly changes when there is a small change in price
  - Elastic demand occurs when demand changes greatly for a small change in price
- Price elasticity of demand= $\frac{\text{\% change in quantity demand}}{\text{\% change in price}}$

# Other Internal and External Consideration Affecting Price Decisions

Factors affecting price elasticity of demand

- Unique product
- Quality
- Prestige
- Substitute products
- Cost relative to income

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# Factors to Consider When Setting Prices

- Other Internal and External Consideration Affecting Price Decisions
- Other external factors
  - Economic conditions
  - Reseller’s response to price
  - Government
  - Social concerns

# Pricing Strategies

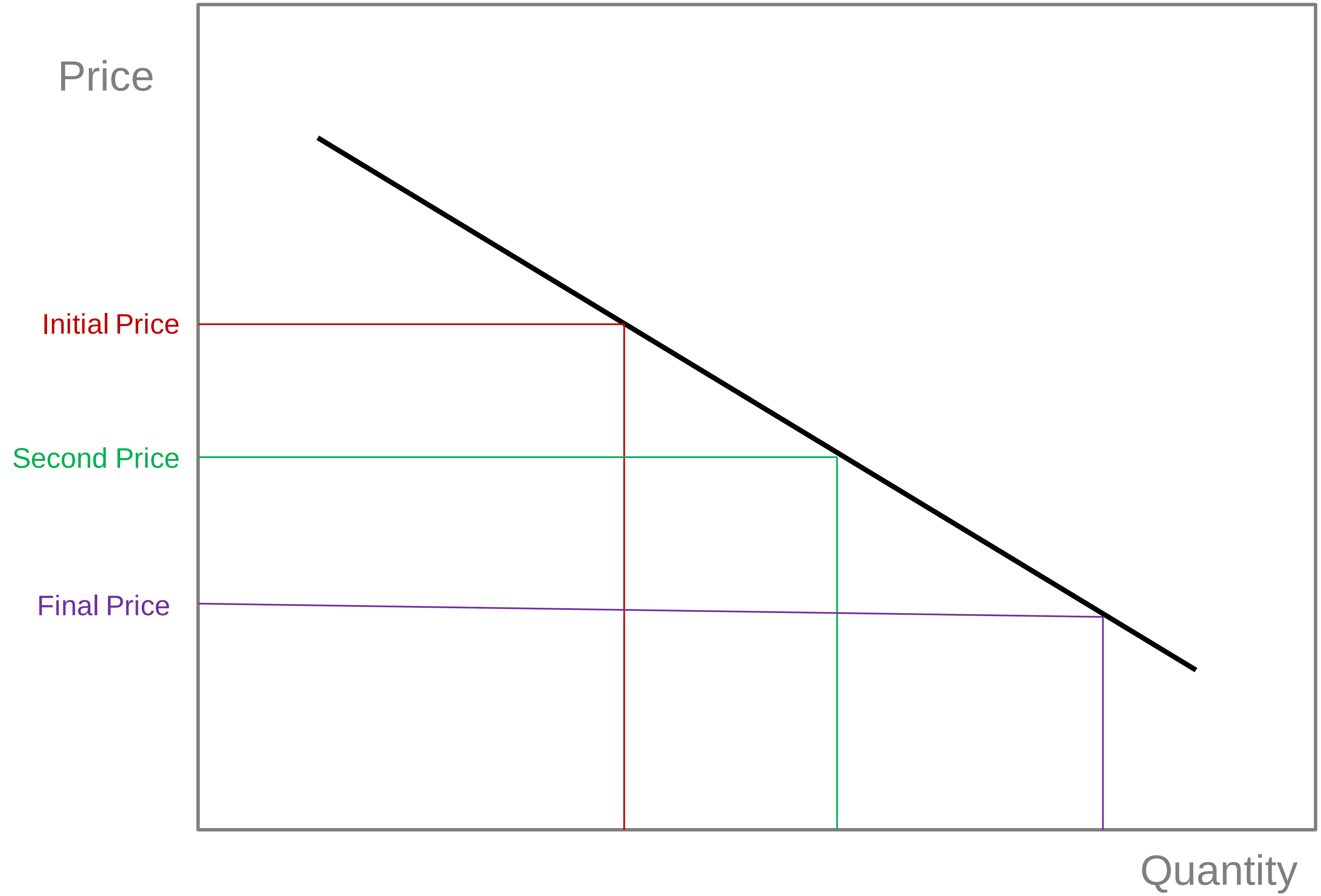
# Learning Objectives

- New-Product Pricing Strategies
- Product Mix Pricing Strategies
- Price Adjustment Strategies
- Price Changes

# New-Product Pricing Strategies

**Market-skimming pricing** is a strategy with high initial prices to "skim" revenue layers from the market

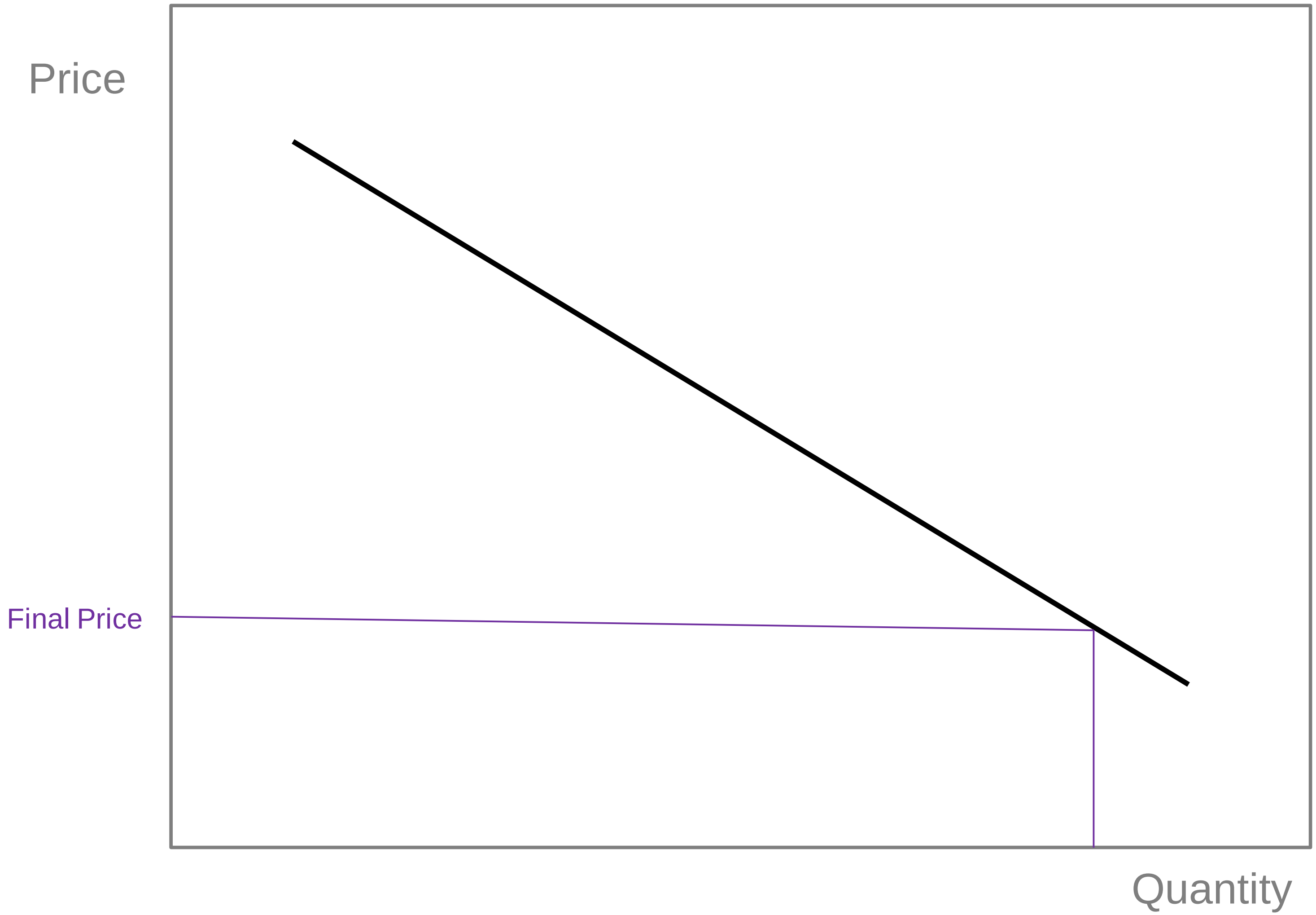
- Product quality and image must support the price
- Buyers must want the product at the price
- Costs of producing the product in small volume should not cancel the advantage of higher prices
- Competitors should not be able to enter the market easily


Price
Initial Price
Second Price
Final Price
Quantity

# New-Product Pricing Strategies

**Market-penetration pricing** sets a low initial price in order to penetrate the market quickly and deeply to attract a large number of buyers quickly to gain market share

- Price sensitive market
- Inverse relationship of production and distribution cost to sales growth
- Low prices must keep competition out of the market


Price
Final Price
Quantity

# Product Mix Pricing Strategies

**Product line pricing** takes into account the cost differences between products in the line, customer evaluation of their features, and competitors' prices

**Optional-product pricing** takes into account optional or accessory products along with the main product

# Product Mix Pricing Strategies

**Captive-product pricing** involves products that must be used along with the main product

**Two-part pricing** involves breaking the price into:

- Fixed fee
- Variable usage fee

# Price Mix Pricing Strategies

**By-product pricing** refers to products with little or no value produced as a result of the main product. Producers will seek little or no profit other than the cost to cover storage and delivery.

# Price Mix Pricing Strategies

**Product bundle pricing** combines several products at a reduced price

# Price-Adjustment Strategies

**Discount and allowance pricing** reduces prices to reward customer responses such as paying early or promoting the product

- Discounts
- Allowances

# Price-Adjustment Strategies

- **Segmented pricing** is used when a company sells a product at two or more prices even though the difference is not based on cost

# Segmented Pricing

To be effective:

- Market must be segmentable
- Segments must show different degrees of demand
- Watching the market cannot exceed the extra revenue obtained from the price difference
- Must be legal

# Price-Adjustment Strategies

**Psychological pricing** occurs when sellers consider the psychology of prices and not simply the economics

**Reference prices** are prices that buyers carry in their minds and refer to when looking at a given product

- Noting current prices
- Remembering past prices
- Assessing the buying situations

# Price-Adjustment Strategies

**Promotional pricing** is when prices are temporarily priced below list price or cost to increase demand

- Loss leaders
- Special event pricing
- Cash rebates
- Low-interest financing
- Longer warrantees
- Free maintenance

# Price-Adjustment Strategies

Risks of promotional pricing

- Used too frequently, and copies by competitors can create "deal-prone" customers who will wait for promotions and avoid buying at regular price
- Creates price wars

# Price Changes

- Initiate price cuts when a firm:
  - Has excess capacity
  - Faces falling market share due to price competition
  - Desires to be a market share leader

- Initiate price increases when a firm
  - can increase profit
  - faces cost inflation
  - faces greater demand than can be supplied

# Buyer Reactions to Pricing Changes

| Price increases | Price cuts |
| --- | --- |
| • Product is "hot"<br>• Company greed | • New models will be available<br>• Models are not selling well<br>• Quality issues |

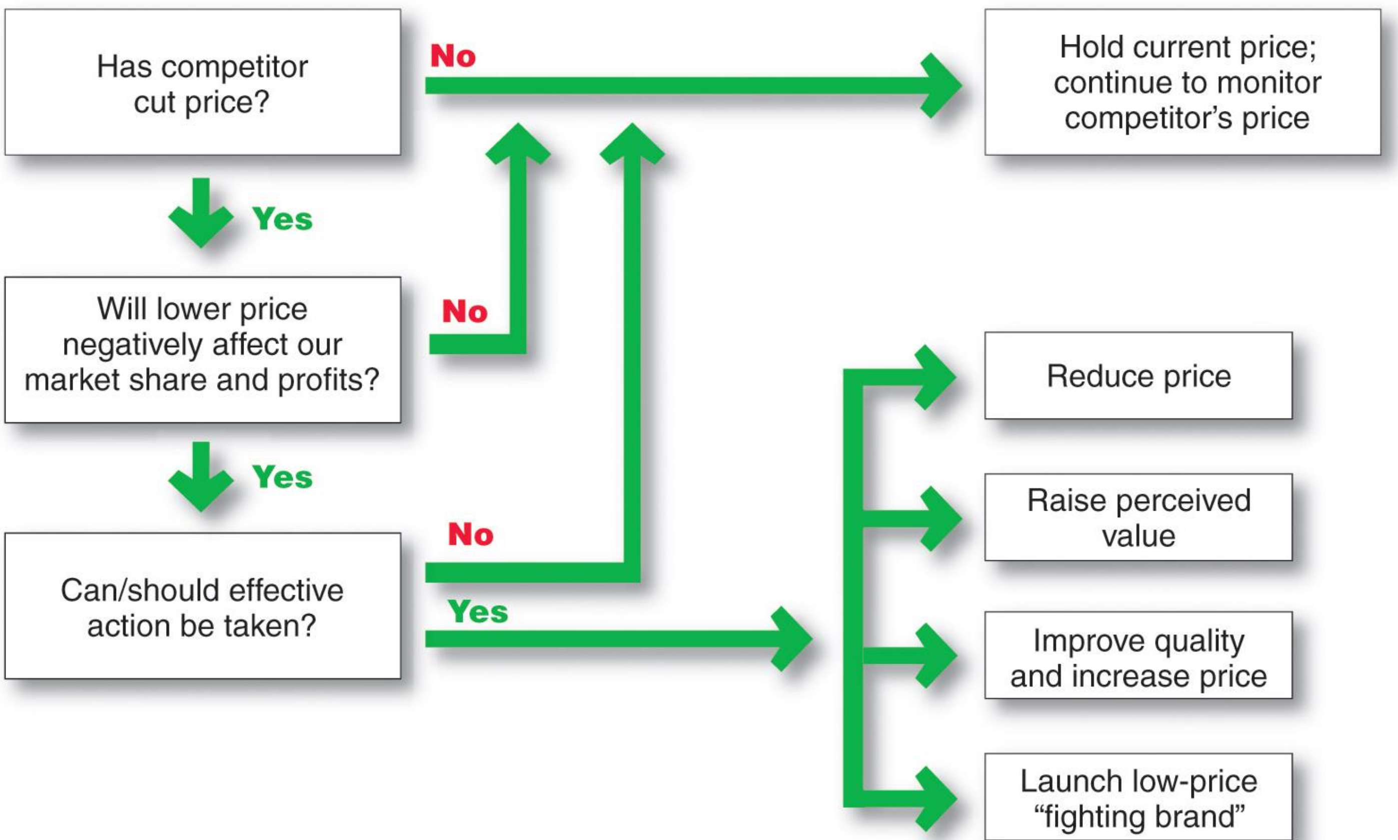
# Price Changes

- Questions
  - Why did the competitor change the price?
  - Is the price cut permanent or temporary?
  - What is the effect on market share and profits?
  - Will competitors respond?

# Price Changes

- Solutions
  - Reduce price to match competition
  - Maintain price but raise the perceived value through communications
  - Improve quality and increase price
  - Launch a lower-price “fighting” brand

# Price Changes



# Public Policy and Pricing

**Price fixing**: Sellers must set prices without talking to competitors

**Predatory pricing**: Selling below cost with the intention of punishing a competitor or gaining higher long-term profits by putting competitors out of business