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MIEIC –MARKETING

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What is Price?

- **Price** is the amount of money charged for a product or service, or the sum of all the values that customers exchange for the benefits of having or using the product or service.

Price

- Price is a crucial factor influencing the purchase decision, with a strong impact on company's profits.
  - Price is a crucial factor for segments with lower purchase capacity.
  - Price is an important element of the marketing mix.
  - Price is also the easiest element of the marketing mix to adjust, and communicates the intended value of the offering.

Consumer Psychology and Pricing

Price-Quality Inferences

Reference Prices

$1.^99

Price perceptions

A Black T-Shirt

Armani - $275

Gap - $14.90

H&M - $7.90

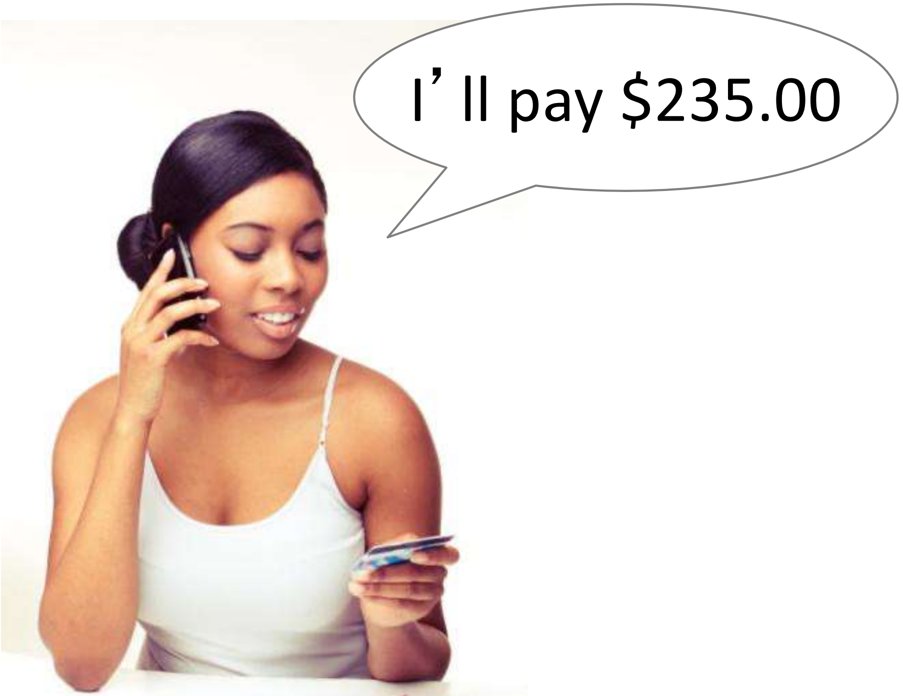
Possible Consumer Reference Prices

- Customers may not know exactly the prices of competing services, but have in mind a reference price for the service category.
- The company should pay attention to the prices of related products.

- "Fair price"
- Typical price
- Last price paid
- Upper-bound price
- Lower-bound price
- Competitor prices
- Expected future price
- Usual discounted price

Changing Price Environment

Buyers



Name Your Own Price

Instant Price Comparisons

Get Products/services Free

Price as an Indicator of Quality

- Customers use price as a quality indicator, especially when there is lack of other information available.
- Price can reinforce the image of exclusiveness of certain products.

PRADA MILANO
LOUIS VUITTON
GUCCI

Can price attract some customers?

Customer Often Lack of Knowledge of Service Prices

- Customers often lack reference prices for services
  - Service variability limits knowledge
  - Providers are unwilling to estimate prices
  - Individual customer needs vary
  - Collection of price information by customers is difficult
  - Prices are not visible

Pricing and revenue management

- A key goal of an effective service pricing is to manage revenues in ways that improve profitability
  - Different prices according to the reservation moment
    - Ex: flight tickets
  - Different prices according to the moment of service usage
    - Ex: hotel rooms
  - Different prices according to the service usage type
    - Ex: mobile phone operators

Pricing Issues

- How much to charge?
- What basis for pricing?
- Who should collect payment?
- Where should payment be made?
- When should payment be made?
- How should payment be made?
- How to communicate prices?

Pricing strategy

1. Selecting the Pricing Objective
2. Determining Demand
3. Estimating Costs
4. Analyzing Competitors’ Costs, Prices, and Offers
5. Selecting a Pricing Method
6. Selecting the Final Price

1. Selecting the Pricing Objective

Survival
Maximum Current Profit
Maximum Market Share
Maximum Market Skimming
Product-Quality Leadership
Other Objectives

Survival

- Survival is a short-run objective for firms to deal with overcapacity, intense competition, or changing consumer wants.
- To survive, the company reduces its price, if it covers variable costs, as it will have to support the fixed costs if it closes production.

Maximization of current profit

- *Maximize current profits* emphasis current performance
- Based on demand and costs estimates, the firm tries to maximize current profit.
  - This strategy requires a good knowledge of demand and cost structure.
  - An excessive focus on short term profits may sacrifice long-run performance.

Maximization of market share

- Maximum market share utilizes a market-penetration price
  - Setting a ***low price*** for a new product in order to attract a large number of buyers and a large market share.
- Belief that a higher sales volume will lead to lower unit costs and higher long-run profit.
- This strategy works when:
  - Customers are price sensitive (elastic demand);
  - Production and distribution costs fall with accumulated production experience;
  - Lower prices discourages actual and potential competition.

Maximum market skimming

- Maximum market skimming utilizes a market-skimming price
- Prices start ***high and slowly drip*** over time.
  - Ex: Sony 1st HDTV cost $43.000 in 1990, in 1993 $6.000, in 2010 $600.
- This strategy can be fatal if competitors price low.
- This strategy works when:
  - Sufficient number of buyers have a high current demand;
  - Production costs are high when the production volume is low;
  - High initial price does not attract more competitors;
  - The high price communicates the image of a superior product.

Product – Quality leadership

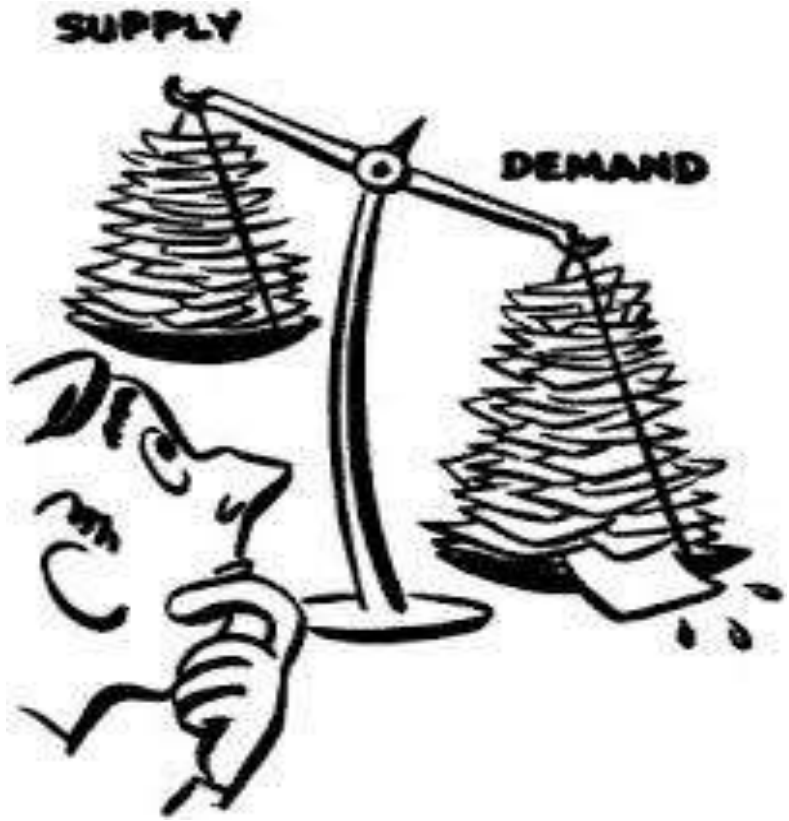
- A firm striving to be a product-quality leader offers brands that are "affordable luxuries"
- Products or services characterized by high levels of perceived quality, taste, and status with a ***price just high enough not to be out of consumers' reach.***

2. Determining Demand

Price sensitivity

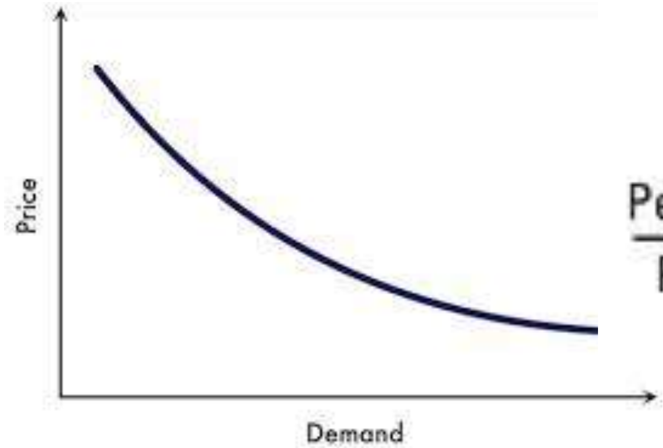
Estimating demand curves

Price Elasticity of Demand



Price negatively influences demand in the great majority of cases.

Price elasticity of demand

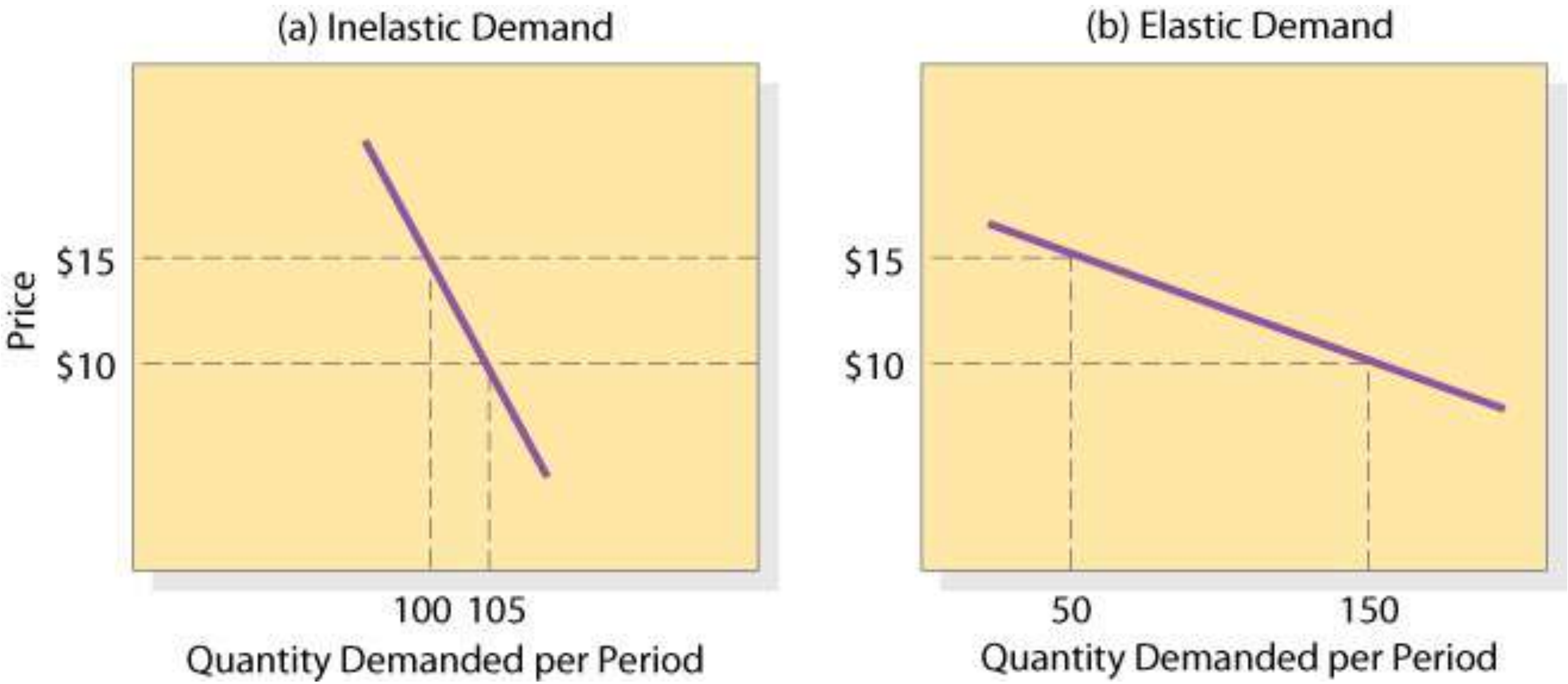


$$\text{Price Elasticity} = \frac{\text{Percentage change in demand}}{\text{Percentage change in price}}$$

- $Epd = \dfrac{(\Delta Qd / Qd)}{(\Delta p / p)}$

- The demand price elasticity provides a measure of how sensitive the demand is to price variations.
  - Demand is **price elastic** = Small changes in price lead to big changes in demand
  - Demand for service is **price inelastic** = Big changes have little impact on demand

Inelastic and Elastic Demand



The effect of elasticity on revenue

- Total Revenue (TR) = p*Qd

- Epd > 1: Δ^{-} p => Δ^{+} TR price elastic
  - 15*50=750 ; 10*150=1500

- Epd = 1: Δ^{-} p => Δ TR=0

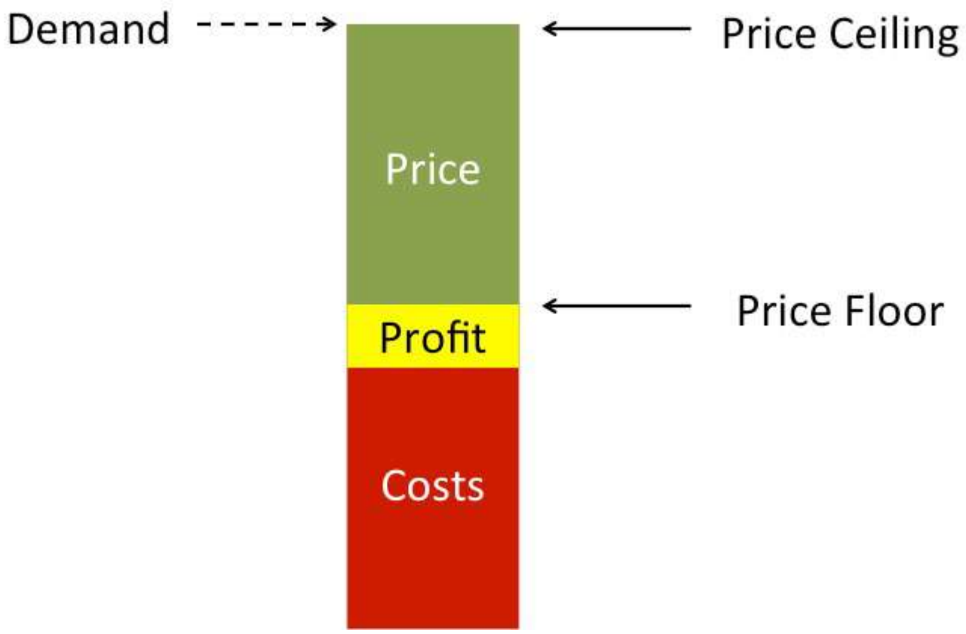
- Epd <1: Δ^{-} p => Δ^{-} TR price inelastic
  - 15*100=1500; 10*105=1050

Factors that reduce elasticity

- The product is more distinctive
- Buyers are less aware of substitutes
- Buyers not readily notice the higher price
- Buyers are slow in changing buying habits
- Buyers think the higher prices are justified
- The expenditure are a small part of buyer's total income
- Price is only a small part of the total cost of obtaining, operating, and servicing the product over its lifetime.

3. Estimating Costs

- Demand sets the price ceiling while costs set the floor.
- Several factors affect product costs:
  - Fixed and variable costs
  - Economies of scale
  - Economies of experience



Some factors affecting costs

- Total costs = fixed costs + variable costs
- Economies of scale
  - In long-run, as production increase, costs decrease.
    - Ex: development of a central distribution center for a retail chain.
- Economies of experience
  - As companies accumulates production experience the average cost declines.

4. Analyzing Competitors' Offers

- Competitors' offerings
- Competitors' costs
- Competitors' prices
- Possibility of retaliation and price changes.

Worth to Customer

5. Selecting a Pricing Method

5. Selecting a Pricing Method

Pricing Methods

- Cost-based pricing
  - Markup pricing (cost-plus pricing)
  - Target-return pricing (price that yields its target rate of return on investment, ex: utilities companies)
- Value-based pricing
  - Perceived-Value pricing (buyer’s image/reputation of the product/service)
  - Value pricing (fairly low price for a high-quality offering)
- Competition-based pricing
  - Going-rate pricing (based on competitors’ prices. Ex: steel)
  - Auction-type pricing (have one seller and many buyers. Ex:. eBay)

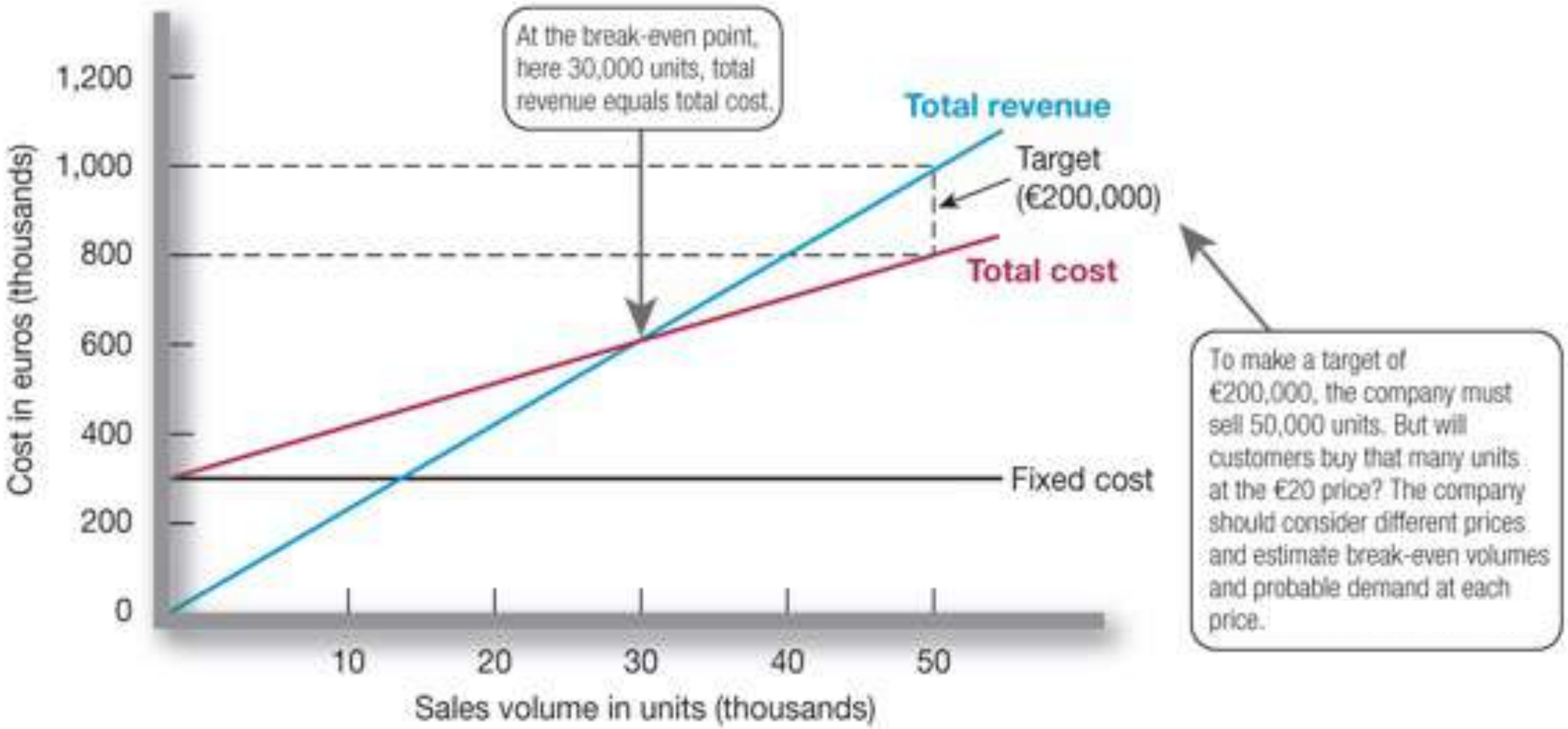
5. Selecting a Pricing Method

- **Markup pricing** (cost-plus pricing): adds a standard markup to the cost of the product:

$$\text{Markup price} = \frac{\text{unit cost}}{(1 - \text{desired return on sales})}$$

Break-Even Chart for Determining Target-Return Price and Break-Even Volume

- **Target return pricing** is the price at which the firm will break even or make the profit it's seeking (ex: utilities companies)



5. Selecting a Pricing Method

- Perceived-Value pricing
  - Based on buyer's image of product, channel deliverables, warranty quality, customer support, and softer attributes (e.g., reputation)
    - The company first assesses customer needs and value perceptions.
    - Then sets its target price based on customer perceptions of value.
  - The key to perceived-value pricing is to deliver more unique value than competitors and to demonstrate this to prospective buyers.

5. Selecting a Pricing Method

- Value pricing
  - Offering the right combination of quality and good service at a fair price.
  - Value pricing is thus not just simply setting lower prices
  - Implies reengineering the company's operations to become a low-cost producer without sacrificing quality to attract a large number of value-conscious customers.
    - Ex: IKEA, Target, Southwest Airlines.

5. Selecting a Pricing Method

- Going-rate pricing
  - The firm bases its price largely on competitors' prices.
    - In oligopolistic industries that sell a commodity such as steel, paper, or fertilizer, all firms normally charge the same price.
    - Smaller firms "follow the leader," changing their prices when the market leader's prices change rather than when their own demand or costs change.

5. Selecting a Pricing Method

- Auction-type
  - One seller and many buyers.
    - Ex:. eBay

6. Selecting the Final Price

Impact on others

Company Pricing Policies

Adapting the Price

Geographic Pricing

Price Discounts

Promotional Pricing

Differentiated Pricing

Dealing with Price Changes

Raising Prices

Cutting Prices

Competitor moves

Pricing in a digital world

- ✓ Get instant vendor price comparisons
- ✓ Check prices at the point of purchase
- ✓ Name your price and have it met
- ✓ Get products free
- ✓ Monitor customer behavior & tailor offers
- ✓ Give customers access to special prices