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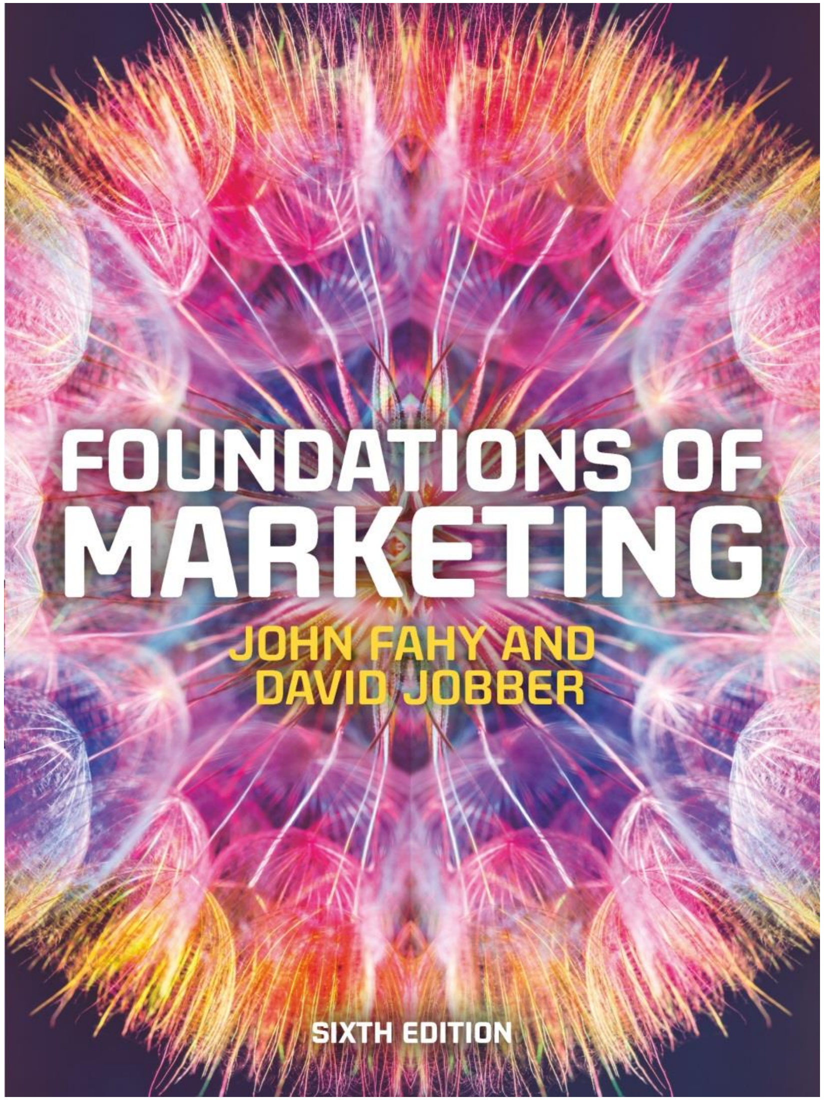
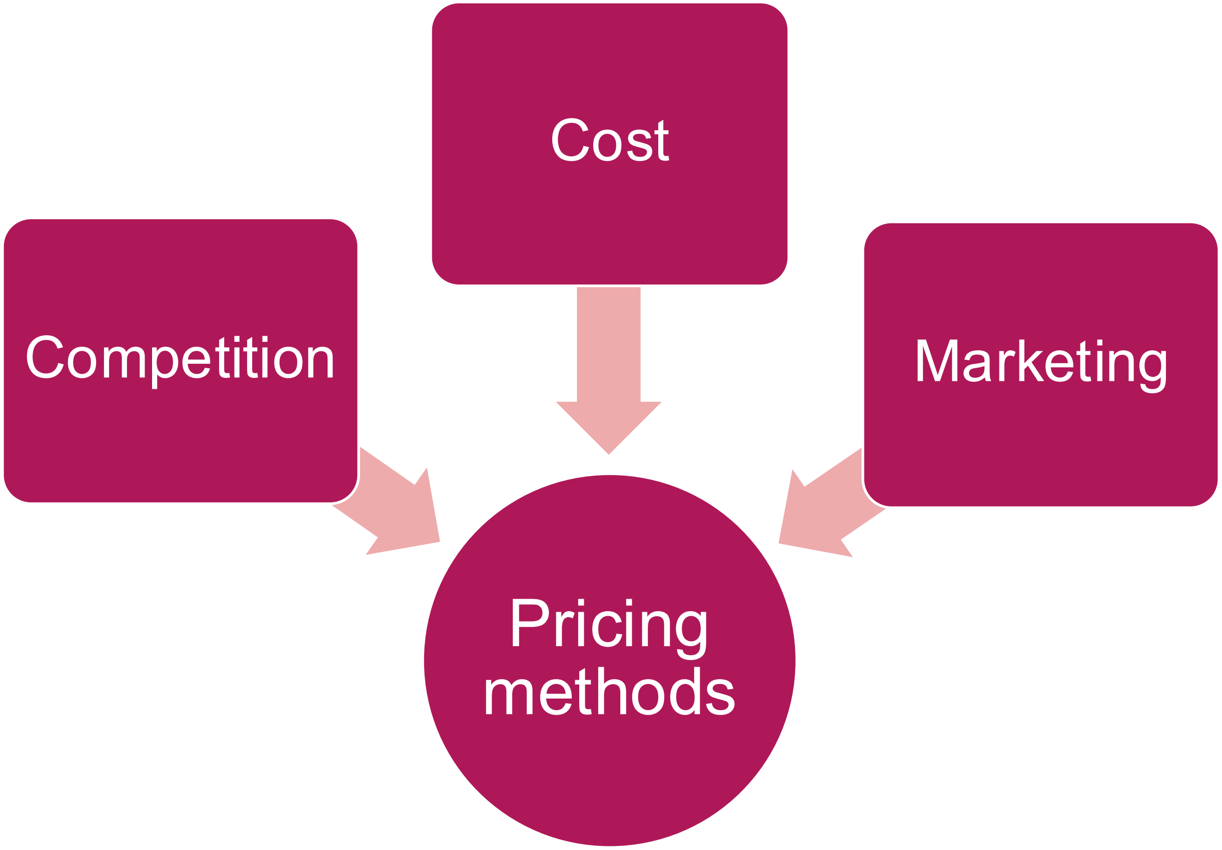
Chapter 8

Value through Pricing

Foundations of Marketing, Sixth Edition



Pricing Methods

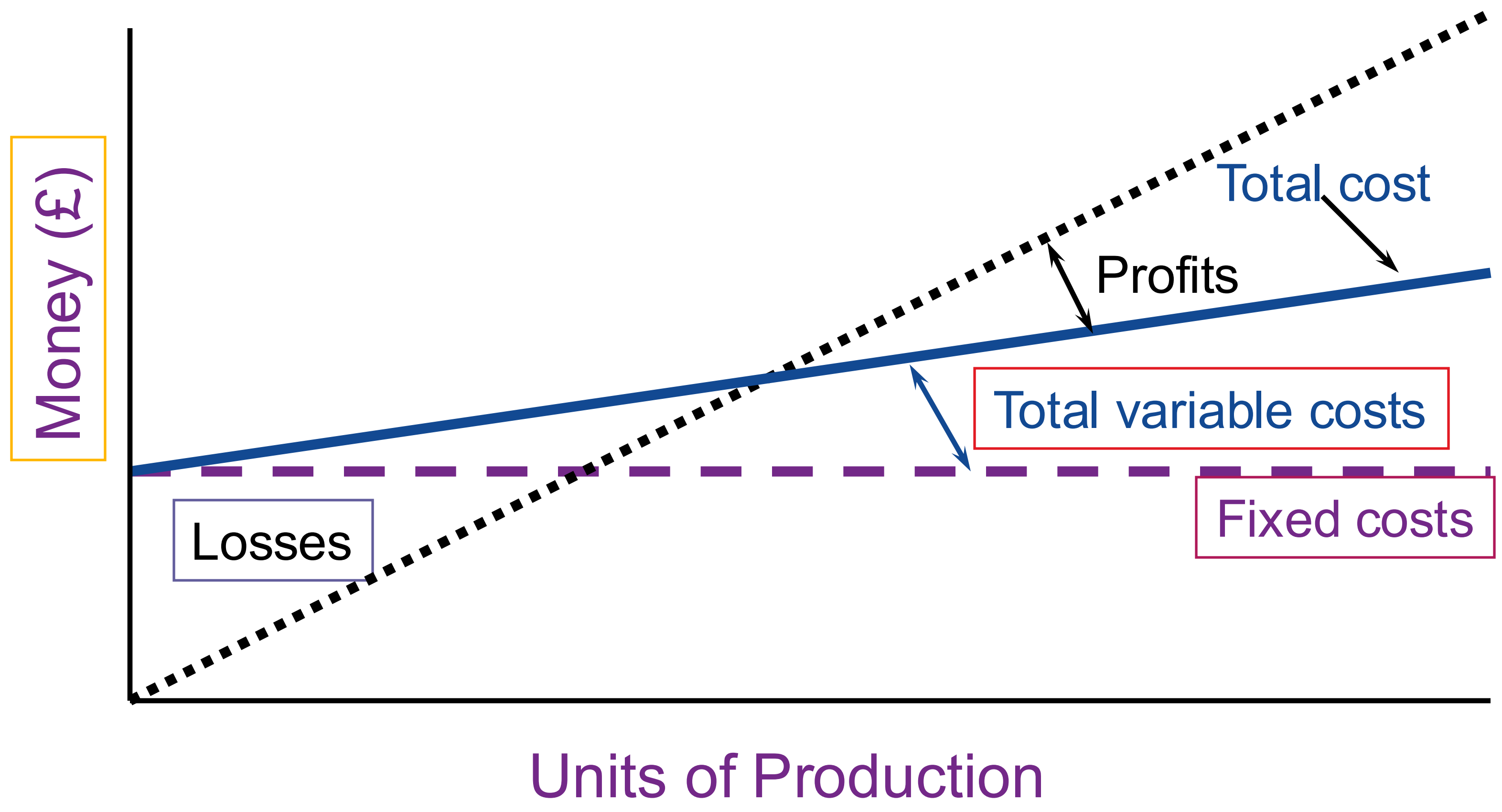


Cost-based Pricing

Year 1	
Direct costs (per unit)	= €2
Fixed costs	= €200,000
Expected sales	= 100,000
Cost per unit	
Direct costs	= €2
Fixed costs (200,000 ÷ 100,000)	= €2
Full costs	= €4
Mark-up (10 per cent)	= €0.40
Price (cost plus mark-up)	= €4.40

Year 2	
Expected sales	= 50,000
Cost per unit	
Direct costs	= €2
Fixed costs (200,000 ÷ 50,000)	= €4
Full costs	= €6
Mark-up (10 per cent)	= €0.60
Price (cost plus mark-up)	= €6.60

Determining the Break-Even Point



Competitor-Oriented Pricing

This type of pricing may take one of 3 forms:

1. Where firms follow the prices charged by leading competitors
2. Where producers take the going-rate price
3. Where contracts are awarded through a competitive bidding process

Competitor-Oriented Pricing

Exhibit 8.2 The launch price of the PlayStation 4 much more closely matched that of competitors than did its predecessor the PlayStation 3, which was priced significantly above the competition and did not reach sales targets as a result.

Market-led Pricing

A key marketing consideration when pricing is estimating value to the customer. Three useful techniques for determining customers' perception of value are:

- Trade-off analysis
- Experimentation
- Economic value to the customer analysis (EVC)

Market-led Pricing

Exhibit 8.3 The Hermės Matte Crocodile Birkin bag is priced at roughly US$120,000.

Economic Value to the Customer (EVC)

Estimating a product's value to the customer:

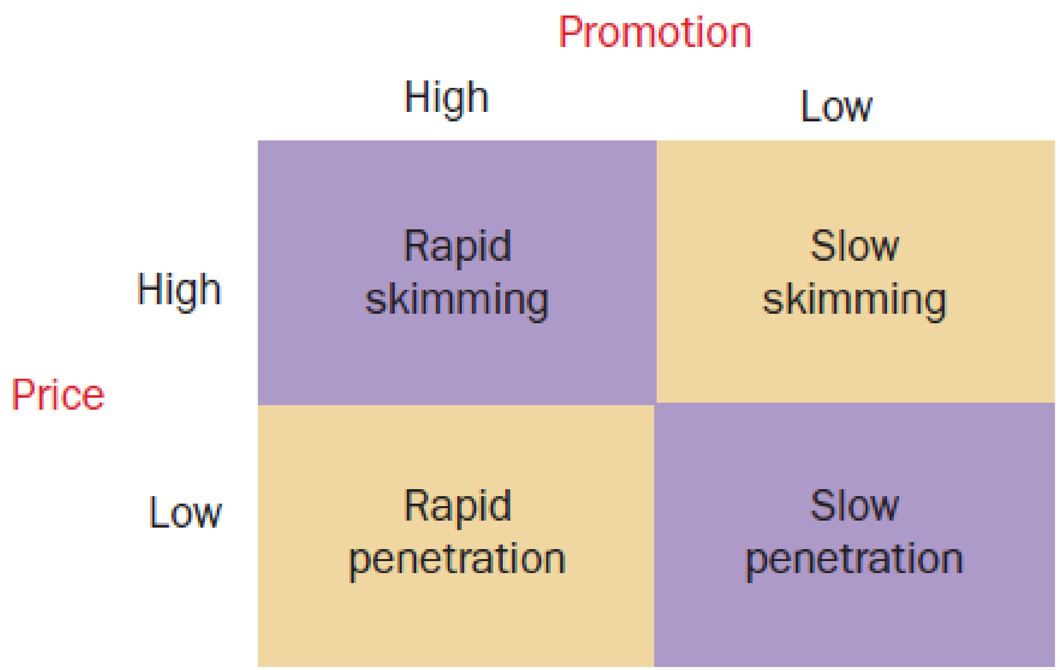
the more value
a product gives compared to the competition,
the higher the price
that can be charged

Exhibit 8.3 Products like those from luxury brand company Prada command premium prices due to their association with high value

Other factors influencing price-setting decisions

New Product Launch Strategy

Figure 8.2 New product launch strategies



Rapid Skimming Strategy

Exhibit 8.5 The original Apple iPhone was launched using a rapid skimming strategy.

Product Line Strategy

Marketing-orientated companies need to take account of where the price of a new product fits into its existing product line.

Where multiple segments appear attractive, modified versions of the product should be designed, and priced differently, not according to differences in costs, but in line with the respective values that each target market places on a product.

Some companies prefer to extend their product lines rather than reduce the price of existing brands in the face of price competition (see Exhibit 8.6)

Competitive Marketing Strategy

Strategic objectives	Price implication
Build objective	Price lower than competition
Hold objective	Maintain or match price relative to competitors
Harvest objective	Set premium prices
Reposition objective	Price change

Channel Management Strategy

When products are sold through intermediaries such as distributors or retailers, the list price to the customer must reflect the margins required by the distributors.

The implication is that pricing strategy is dependent on understanding not only the ultimate customer but also the needs of distributors and retailers who form the link between them and the manufacturer.

International Marketing Strategy

The first challenge that managers will have to deal with when exporting is **price escalation**.

Price escalation means a number of factors may combine to put pressure on the firm to increase the prices it charges in other countries. These may include inflation rates, exchange rates and custom duties.

In such instances it is important for firms to guard against **parallel importing** – this is when products destined for an international market are re-imported back into the home market and sold through unauthorized channels at levels lower than the company wishes to charge.

Managing Price Changes

There are 3 key issues associated with initiating price changes:

1. Circumstances which might lead a company to raise or lower prices
2. Tactics
3. Estimating the competitor's reaction

Initiating Price Changes

Table 8.2 Initiating price changes

	Increases	Cuts
Circumstances	Value greater than price Rising costs Excess demand Harvest objective	Value less than price Excess supply Build objective Price war unlikely Preempt competitive entry
Tactics	Price jump Staged price increases Escalator clauses Price unbundling Lower discounts	Price fall Staged price reductions Fighter brands Price bundling Higher discounts
Estimating competitor reaction	Strategic objectives Self-interest Competitive situation Past experience	

Reacting to Competitors' Price Changes

Table 8.3 Reacting to competitors' price changes

	Increases	Cuts
When to follow	Rising costs Excess demand Price-insensitive customers Price rise compatible with brand image Harvest or hold objective	Falling costs Excess supply Price-sensitive customers Price fall compatible with brand image Build or hold objective
When to ignore	Stable or falling costs Excess supply Price-sensitive customers Price rise incompatible with brand image Build objective	Rising costs Excess demand Price-insensitive customers Price fall incompatible with brand image Harvest objective
Tactics		
Quick response	Margin improvement urgent	Offset competitive threat
Slow response	Gains to be made by being customers' friend	High customer loyalty

Reacting to Competitors' Price Changes

Exhibit 8.8 Market leader P&O Cruises decided to move away from the price competition that was rampant in its business and focus instead on the value of a cruise holiday through its 'This is the life' campaign.

Customer Value Through Pricing

Cost management

- Cost control is critical for firms that attempt to lead on price as their success in controlling costs has a direct impact on profit margins.

Yield management

- Very popular in services businesses like travel and hotel is the monitoring of demand or potential demand patterns.

Dynamic pricing

- This means that prices are adjusted continually, based on demand and potential demand.

Chapter Summary

1. There are three bases upon which prices are set, namely cost, competition and market value.
2. Pricing levels set may be influenced by a number of other marketing strategy variables, namely, positioning strategy, new-product launch strategy, product-line strategy, competitive strategy, channel management strategy and international marketing strategy.
3. Price may be the core value proposition offered by some organizations that employ a combination of cost management, yield management and dynamic pricing to generate high profitability levels.
4. That marketers need to make decisions relating to initiating price changes or responding to the price changes made by competitors. Whether prices are rising or falling, various factors need to be taken into account; these are important decisions as they affect the overall profitability of the firm.
5. That there are key issues surrounding the ethics of price setting such as price fixing, deceptive pricing and product dumping are frequently targeted by regulators. Greater levels of price transparency are assisting consumers to avoid being exploited by unscrupulous companies.
6. Price may be the core value proposition offered by some businesses. In these cases, organizations employ a combination of cost management, yield management and dynamic pricing to generate high profitability levels.