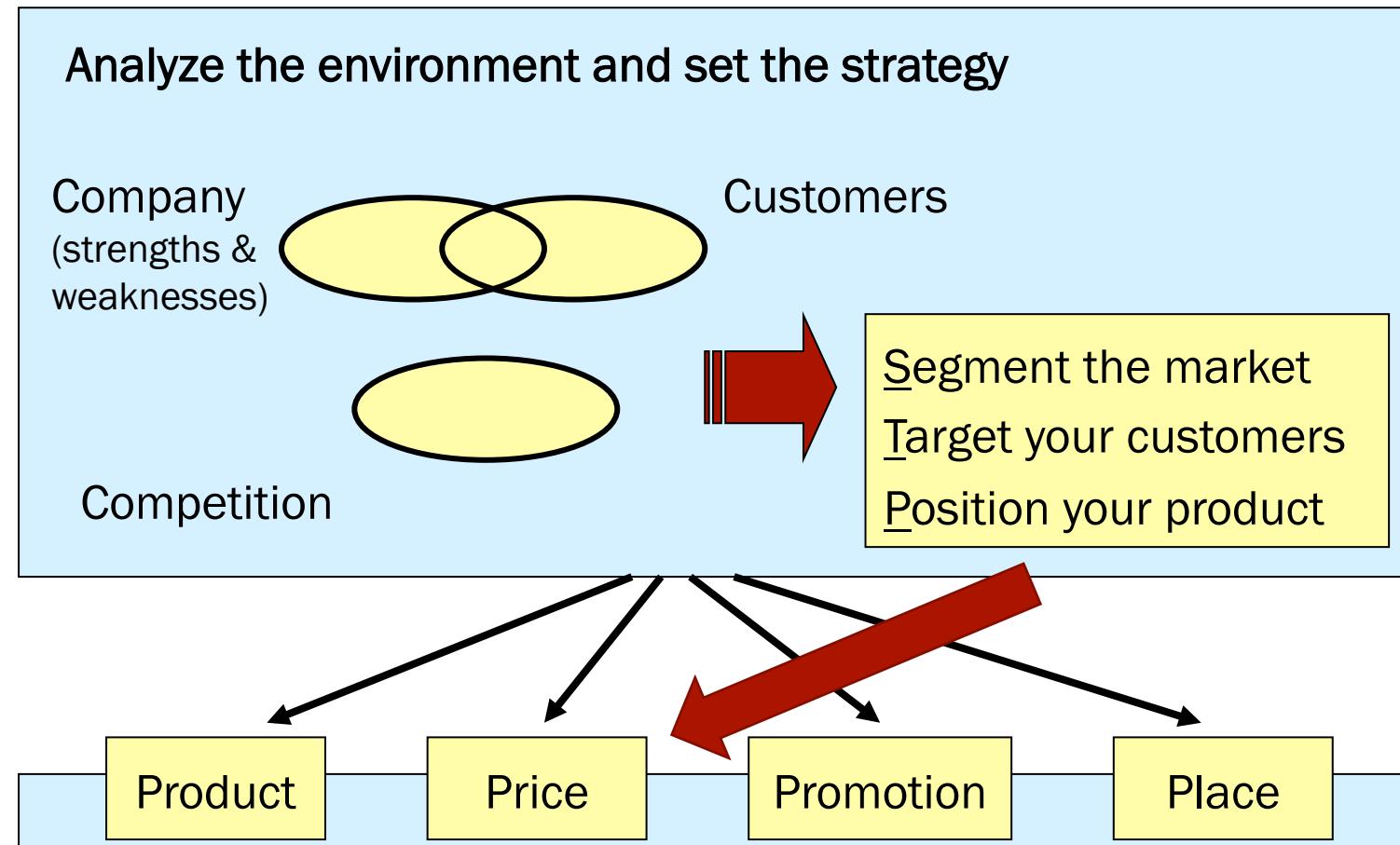


# Chapter 14: Pricing

# Marketing Strategy Overview

## – Basic Structure



Leveraging real tools to implement strategic objectives

# How much are you willing to pay?

Imagine you are introducing Mochi Ice Cream

- Bites of premium ice cream wrapped in a paper-thin sheet of chewy mochi rice cake



- How much do you think grocery stores charge? How much would you pay (assuming you find the product appealing)?

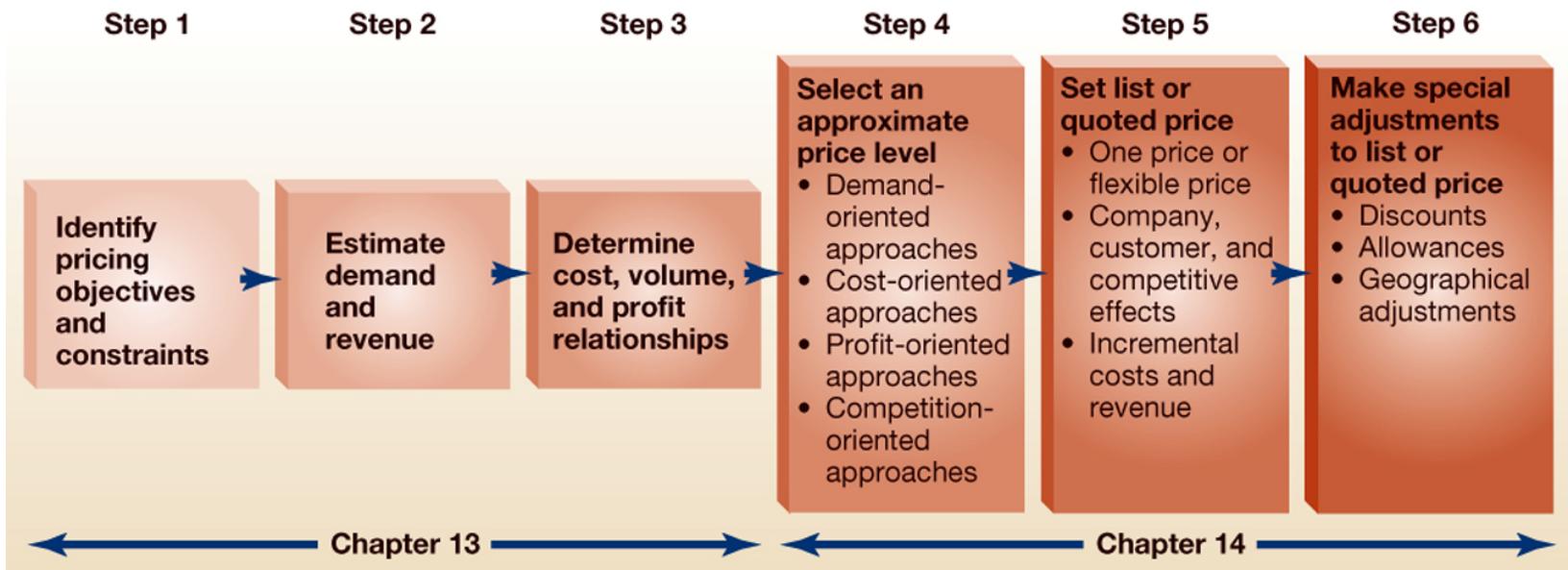
# Different Prices for Same Product

- Trader Joe's vs. Central Market
  - Both sell high-end goods
  - Bubbies Mochi Ice Cream:
    - TJ's sells the box of 9 pieces for \$2.99;
    - Central Market sells the same for \$7.99

# Preview

- Steps to setting a price
- Pricing approaches

# 6 Steps of Setting Price



# Setting the Price of Products

- Based on the product costs and marketplace factors, a manager sets the final price using...

4 Approaches to setting price level

Demand-Oriented  
Pricing

Cost-Oriented  
Pricing

Profit-Oriented  
Pricing

Competition-  
Oriented Pricing

# Setting the Price of Products

## 4 Approaches to setting price level

Demand-Oriented  
Pricing



Weighs factors underlying expected customer tastes and preferences more heavily than such factors as cost, profit and competition

# Setting the Price of Products

## 4 Approaches to setting price level

Cost-Oriented  
Pricing



Price setter stresses the cost side of the pricing problem (not the demand side)

# Setting the Price of Products

4 Approaches to setting price level



Profit-Oriented  
Pricing

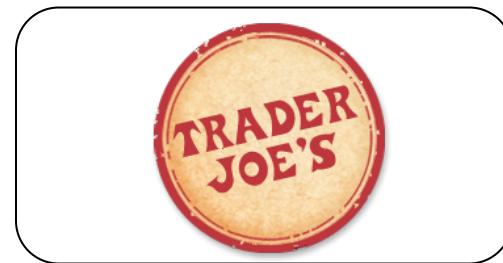
Balances revenues and costs to set price at profit maximizing point

# Setting the Price of Products

4 Approaches to setting price level



Vs.



Competition-Oriented Pricing

Price setter focuses on what competitors or “the market” is doing

# Demand-Oriented Approaches

- **Skimming Pricing**

A firm introduces a new or innovative product at a high initial price that only customers who REALLY desire the product would pay

- Penetration Pricing
- Prestige Pricing
- Price Lining



September 26, 1996 -  
Toshiba announces first  
home DVD player  
SD-3000 (\$674).

# Demand-Oriented Approaches

- Skimming Pricing
- Penetration Pricing

Setting a low initial prices on a new product to appeal immediately to mass market

- Prestige Pricing
- Price Lining

Snickers Charged  
boasts 60 milligrams  
of caffeine, taurine  
and other B vitamins  
(about 10% of your  
RDA).



Introductory price: \$.75

# Demand-Oriented Approaches

- Skimming Pricing
- Penetration Pricing
- Prestige Pricing

Setting price so high that quality or status-seeking customers will be attracted to the product and buy it.

- Price Lining



# Most Expensive Perfume in the World

- Imperial Majesty, which costs \$215,000 a bottle, is the most expensive perfume in the world.
- Would it smell as sweet at any other price?



# Demand-Oriented Approaches

- Skimming Pricing
- Penetration Pricing
- Prestige Pricing
- Price Lining

If a firm is selling a line of products, they set the prices of products that are alike in size, ingredients etc. at the same level

How can P&G Line Price these products?



# Demand-Oriented Approaches

- **Odd-Even Pricing**

Setting the price a few dollars/cents below an even number to signal a discount or lower price

- **Target Pricing**

- **Bundle Pricing**

- **Yield Management Pricing**

Q: Is ODD or EVEN  
pricing more likely to be  
a sale price?

Is \$19 or \$19.99 a  
sale price?

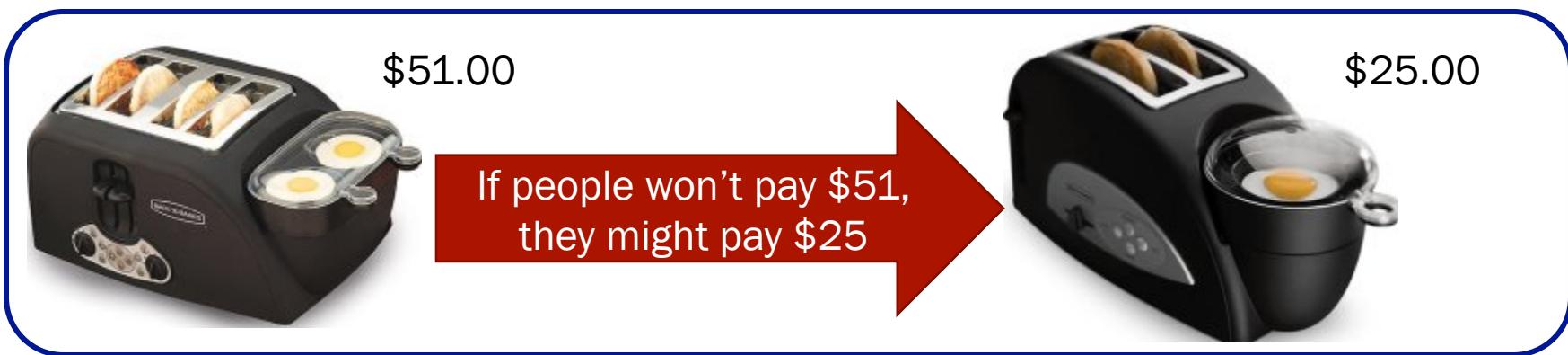
# Odd-Even Pricing

- Article: Why There Are More .300 Hitters Than .299 Hitters, And Why It Matters...

# Demand-Oriented Approaches

- Odd-Even Pricing
- **Target Pricing**

Estimating what the customer is willing to pay and working backwards to create a product that matches this price



- Bundle Pricing
- Yield Management Pricing

# Demand-Oriented Approaches

- Odd-Even Pricing
- Target Pricing
- **Bundle Pricing**

The marketing of two or more products in a single package price



Segregate gains and integrate losses  
- Richard Thaler

**iPadBundles**

APPLE IPAD BUNDLES	16GB	32GB	64GB
<input checked="" type="checkbox"/> WiFi - Keyboard Doc - Case - iDoc Available APR 3	\$72 monthly <b>Apply Now</b>	\$80 monthly <b>Apply Now</b>	\$99 monthly <b>Apply Now</b>
<input checked="" type="checkbox"/> WiFi + 3G - Keyboard Doc - Case - iDoc Available Late APR	\$85 monthly <b>Apply Now</b>	\$95 monthly <b>Apply Now</b>	\$109 monthly <b>Apply Now</b>

**iPad All-in-One Packages Exclusively @ 800HighTech.com**

**Each Bundle Includes:**

Keyboard      Case      Dock

An advertisement for iPad bundles. It features a table comparing four bundle options: WiFi (16GB \$72 monthly), WiFi + 3G (16GB \$85 monthly), WiFi (32GB \$80 monthly), and WiFi + 3G (32GB \$95 monthly). WiFi (64GB) and WiFi + 3G (64GB) are listed but not fully visible. Each row includes an 'Apply Now' button. Below the table, it says 'iPad All-in-One Packages Exclusively @ 800HighTech.com'. It also lists 'Each Bundle Includes: Keyboard, Case, Dock' with corresponding icons.

- Yield Management Pricing

# Demand-Oriented Approaches

- Odd-Even Pricing
- Target Pricing
- Bundle Pricing
- Yield Management Pricing



Charging different prices to maximize revenue for a set amount of capacity occupied at any given time.

McDonalds has 6 – 8 pricing strategies within O'Hare airport – that means that a burger can range in price from \$1. 50 - \$2.50+

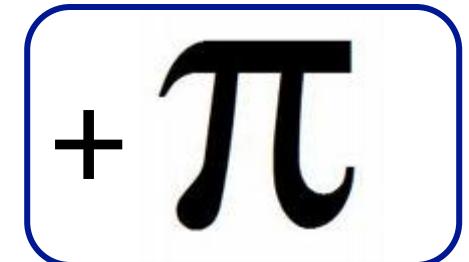
# Cost-Oriented Approaches

- **Standard Markup Pricing**

Variable and fixed costs per unit are estimated, and a standard markup is added.

- **Cost-Plus Pricing**

- **Experience Curve Pricing**



# Cost-Oriented Approaches

- Standard Markup Pricing
- Cost-Plus Pricing

Variation of standard mark-up pricing. Summing the total unit cost of providing a product or service and adding a specific **additional amount** (relating to the \$\$ for the customized aspect of the product) to arrive at a price. Used for one-of-a-kind items

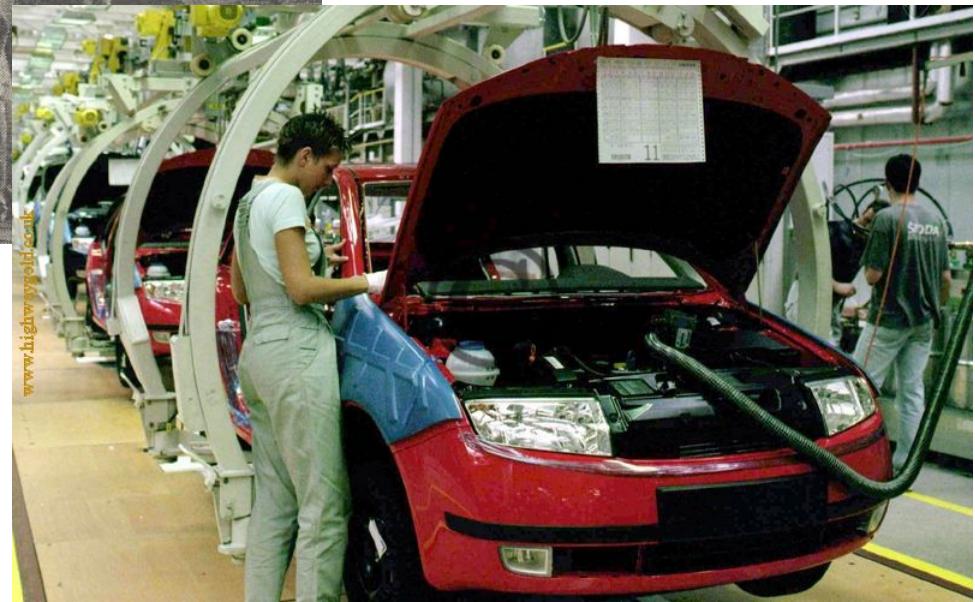
- Experience Curve Pricing

# Cost-Oriented Approaches

- Standard Markup Pricing
- Cost-Plus Pricing
- **Experience Curve Pricing**

Prices declines because the unit cost of product or service declines as the firm's experience at producing or selling it doubles

# Increasing Efficiency



# Profit-Oriented Approaches

## ■ Target Profit Pricing

Firm sets an annual target of a specific \$ volume of profit

$$\text{Profit} = \text{Total Revenue} - \text{Total Cost}$$

$$\text{Profit} = (P \times Q) - [FC + (UVC \times Q)]$$

Unit Variable cost is a constant \$11 per unit

Fixed cost is a constant \$45,000

Demand is insensitive to price up to \$100 per unit

A target profit is sought of \$9000 at an annual volume of 2,000 products

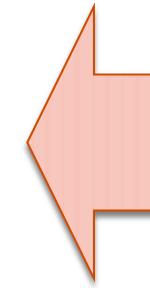
$$9,000 = (P \times 2,000) - [45,000 + (11 \times 2000)]$$

$$67,000 + 9,000 = 2,000P - [45,000 + 22000] + 67,000$$

$$76,000 / 2,000 = 2,000P / 2,000$$

$$\$38 = \text{Price}$$

Fill in your costs and quantity and solve for Price



# Profit-Oriented Pricing Approaches

One drawback of *Target Profit Pricing* is there is no benchmark of sales or investment used to show how much of the firm's effort is needed to achieve the target

- Target Profit Pricing
- **Target Return-On-Sales Pricing**

Set prices that will give them a profit that is a specified percentage of sales volume  
- this is a measure of how much effort/sales is needed to achieve this target

- **Target Return on Sales = Target Profit / Total Revenue**

Unit Variable cost is a constant \$11 per unit

Fixed cost is a constant \$45,000

Target sets a 20% return on sales at annual volume of 3000 units

$$20\% = (\text{TR} - \text{TC}) / \text{TR}$$

$$.20 = (P \times Q) - [\text{FC} + (\text{UVC} \times Q)] / \text{TR}$$

$$.20 = (P \times 3,000) - [45,000 + (11 \times 3000)] / P \times 3000$$

$$(3000P) * .20 = \underline{3000P - [78,000]} * (3000P)$$
$$\qquad\qquad\qquad 3000P$$

$$.2 * 3000P = 3000P - 78000$$

$$600P - \underline{3000P} = 3000P - 78000 - 3000P$$

$$-2400P \quad (1/2400) = -78000 \quad (1/2400)$$

$$P = \$32.5$$

Fill in your costs and quantity and solve for Price

# Competition-Oriented Approaches

## ■ Customary Pricing

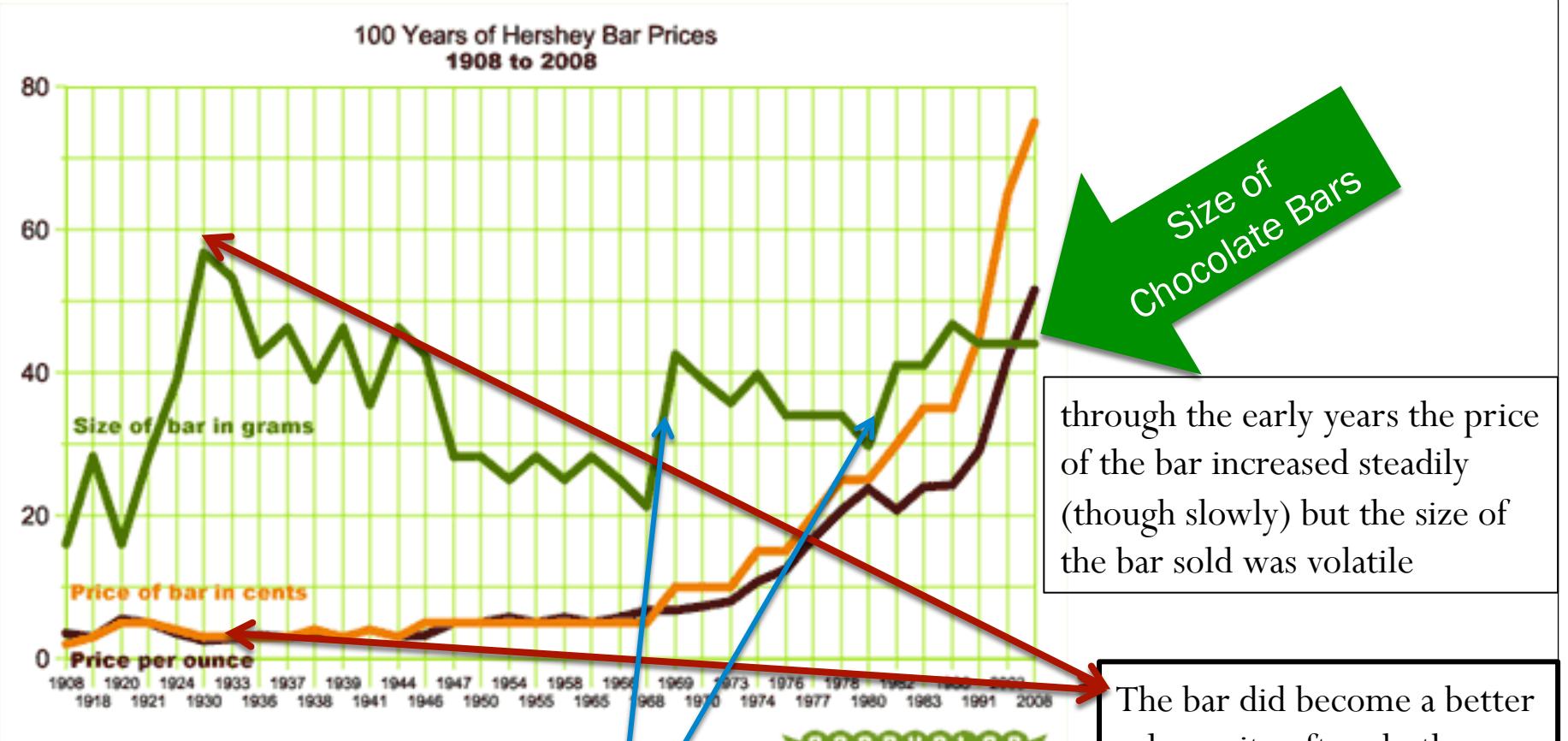
Some products, where tradition, a standardized channel of distribution or other competitive factors dictate price, this type of pricing is used.

How do they raise prices???

## ■ Above-, At-, or Below-Market Pricing

## ■ Loss-Leader Pricing





Often when the price went up, so did the size of the bar as a way to offset the perception of poor value.

However, the trend in the past 20 years has been to keep the bar the same size but simply raise the prices as needed.

# Competition-Oriented Approaches

- Customary Pricing
- Above-, At-, or Below-Market Pricing

Sometimes it's difficult to identify a specific market price for competing products. Marketing managers will have a **subjective feel** for these prices and set their products' at or above or below these prices



- Loss-Leader Pricing

# Competition-Oriented Approaches

- Customary Pricing
- Above-, At-, or Below-Market Pricing
- **Loss-Leader Pricing**

Special promotion that a retailer might run to deliberately sell one product below its customary price to attract attention and attract attention, hopefully generating other sales.



# Step 5: Set the List or Quoted Price

- **One-Price Policy (Fixed Pricing)**

One price for all buyers

- **Flexible-Price Policy (Dynamic Pricing)**

# Step 5: Set the List or Quoted Price

- One-Price Policy (Fixed Pricing)
- **Flexible-Price Policy (Dynamic Pricing)**

Setting different prices for products and services depending on individual buyers and purchase situations

<http://online.wsj.com/article/SB117522181197454106.html>

One patron spent \$500 a night for an ocean-view room at the El Dorado Royale on the Riviera Maya in Mexico last month, was constantly reminded of her lesser standing during her two-night stay. Guests in the resort's Casita suites, which cost about 50% more, have private pools, exclusive use of certain beds on the beach and restaurant reservation priority. For identification, Casita guests get beige-striped towels, while regular guests have green-striped towels.



# Company, Customer and Competitive Effects on Pricing

- **Company Effects**

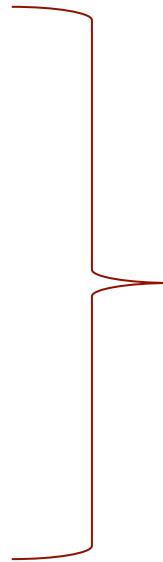
How does price affect other items, costs, profits?

- **Customer Effects**

How does price affect customer perceptions?

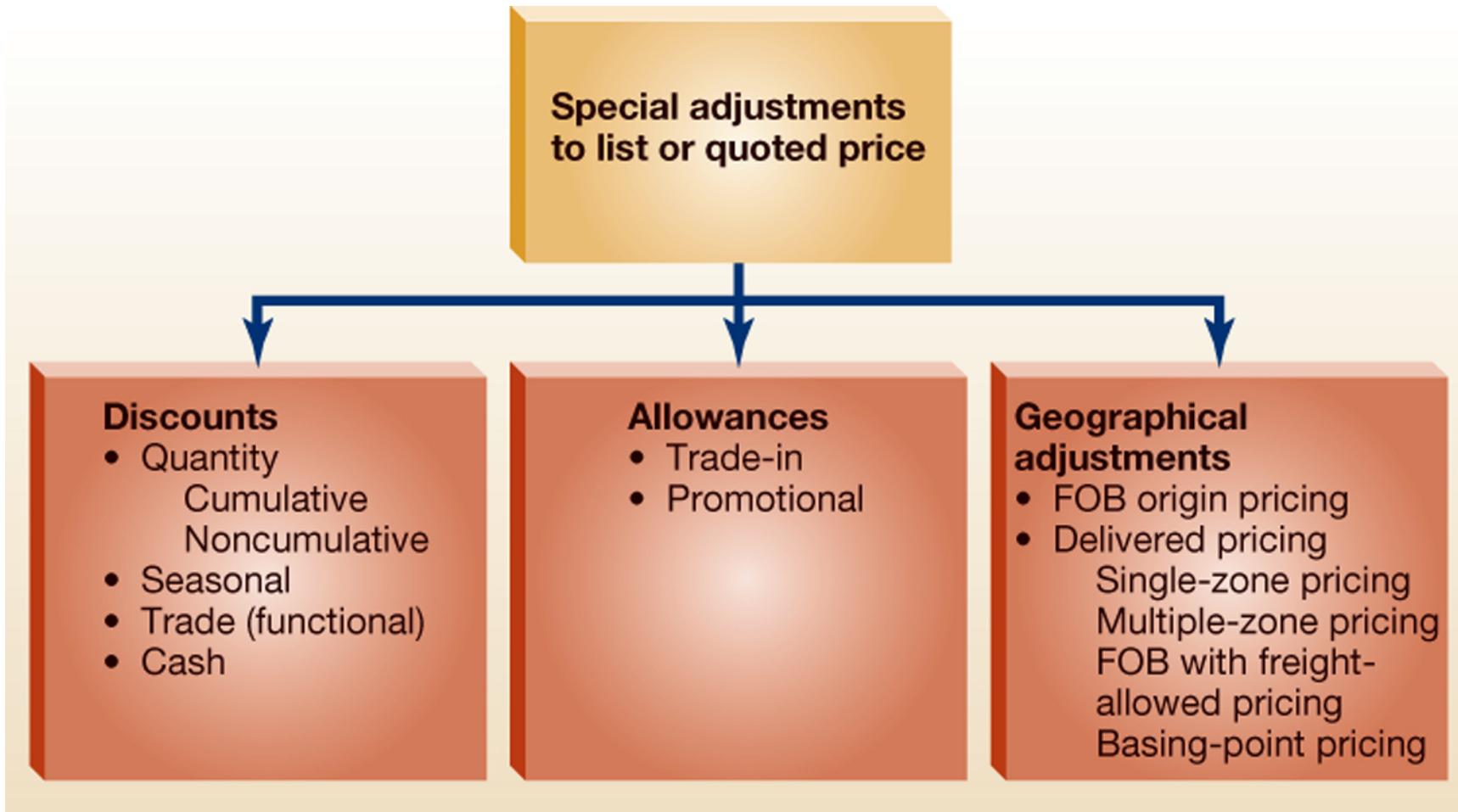
- **Competitive Effects**

How will competition react?



As the final price is quoted, each of these has to be assessed

# Step 6: Make Special Adjustments to List or Quoted Prices



# Legal Issues: Regulatory Aspects of Pricing

- Price Fixing
  - Conspiracy across firms to set pricing across market
- Price as a discriminatory tool
  - Different prices charged to different customers
    - May be justified if justified based on (1) **different costs for different customers**, (2) seasonal or changing market conditions and are not used to injure competition



3.5 X more

Between  
\$200 - \$2000+

1/3 more

# Legal Issues: Regulatory Aspects of Pricing

- Price Fixing
  - Conspiracy across firms to set pricing across market
- Price as a discriminatory tool
  - Different prices charged to different customers
    - May be justified if justified based on (1) **different costs for different customers**, (2) seasonal or changing market conditions **and are not used to injure competition**
- Deceptive pricing
  - Misleading customers
- Geographical Pricing
  - Could be legal if no conspiracy exists
    - in 1996, consumers sued VSC based on allegations that Victoria's Secret distributed different versions of its catalog that offered different prices to different customer groups for the same items.
- Predatory Pricing
  - Setting low prices to drive out competition

# Five most common deceptive pricing practices

DECEPTIVE PRACTICE	DESCRIPTION
Bait and switch	A deceptive practice exists when a firm offers a very low price on a product (the bait) to attract customers to a store. Once in the store, the customer is persuaded to purchase a higher-priced item (the switch) using a variety of tricks, including (1) downgrading the promoted item, (2) not having the item in stock, or (3) refusing to take orders for the item.
Bargains conditional on other purchases	This practice may exist when a buyer is offered “1-Cent Sales,” “Buy 1, Get 1 Free,” and “Get 2 for the Price of 1.” Such pricing is legal only if the first items are sold at the regular price, not a price inflated for the offer. Substituting lower-quality items on either the first or second purchase is also considered deceptive.
Comparable value comparisons	Advertising such as “Retail Value \$100.00, Our Price \$85.00” is deceptive if a verified and substantial number of stores in the market area did not price the item at \$100.
Comparisons with suggested prices	A claim that a price is below a manufacturer’s suggested or list price may be deceptive if few or no sales occur at that price in a retailer’s market area.
Former price comparisons	When a seller represents a price as reduced, the item must have been offered in good faith at a higher price for a substantial previous period. Setting a high price for the purpose of establishing a reference for a price reduction is deceptive.

# Legal Issues: Deceptive pricing

- Bait and switch
  - You see an ad in the paper for your favorite SUV showing a monthly payment of \$299 a month. It looks like a great deal, since, either according to simple math or someone you know who recently got this vehicle, the payment should be more like \$500 a month. Keep in mind, people never read the fine print. You are very excited to get your new SUV for this low, low payment and show up on the lot. You mention the ad you saw in the paper. Lo and behold, the salesman regretfully informs you that the particular car has already been sold...
- Conditional bargains
  - “Buy 1 get one 50%” – elevating the price of the first product

# Bait And Switch

Excludes all of the fashion brands (e.g. Oakley, Maui Jim) but no mention of this in advertisement.

## Eyewear Discounts from LensCrafters<sup>®</sup> for our business neighbors.



LENS CRAFTERS<sup>®</sup>

\$80  
Savings Card

Retain this card for valuable savings for you and your family until September 2009

This is not insurance.

### Eyewear Discounts

- \$80 off each complete pair of eyeglasses or prescription sunglasses
- Card can be shared with all members of your household and may be used multiple times
- Double the standard LensCrafters<sup>®</sup> 30-day unconditional guarantee - Now 60 days

**This card entitles you to exclusive discounts. Offers valid only with card.**

Bring this valuable discount card to any LensCrafters<sup>®</sup> location and save on this season's new designer eyewear. You'll also get:

**• 30-Day 60-Day Money-Back Guarantee**

If you are not happy with the way you look or see, we will exchange your eyeglasses or refund your money.

**• 30-Day 60-Day Price Match**

If you find a lower price on an identical pair (same frame and lenses) in stock at any competitor, we will refund the difference.

**• Convenient Locations**

Open evenings and weekends with one-hour service available on most eyeglasses.

**• Lifetime Maintenance**

Free cleaning and adjustments for the lifetime of your glasses.

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\$80 OFF ALL Eyeglasses and Prescription Sunglasses. ANY FRAME, ANY LENS, ANY PRESCRIPTION. Valid on multiple pairs. Both frame and lenses purchase required. Cannot be combined with any other offer, previous purchases, vision and insurance plans, readers or non-prescription sunglasses. Savings applied to lenses. Offer valid with coupon only. Valid prescription required. Discounts are off regular price. Void where prohibited. See store for details. Reproduction, Internet distribution or resale is strictly prohibited.

Offer expires 9/30/09

Savings Code 1974585

Call 1-800-522-LENS (5367) or visit  
[lenscrafters.com](http://lenscrafters.com) for a store location near you.

**This is not insurance.**

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# Legal Issues: Deceptive pricing...

- Comparable value comparisons
  - Retailer Doe advertises Brand X pens as having a Retail Value \$15.00, My Price \$7.50,"
- Comparisons with suggested prices
  - "Manufacturer's suggested retail price is \$10, our price \$7.50"
- Former price comparisons
  - Price based on mark up should be \$7.50. The retailer sells it at \$10 for a couple of weeks and then marks it down to \$7.50 and advertises the "deal"

# Legal issues: Predatory pricing

- Setting very low prices to reduce competition
- Example



American Airlines vs. small airlines (Vanguard, Sun Jet and Western Pacific)

Average price Dallas – Kansas City before competition = \$108

Dropped to \$80 with competition plus doubled number of flights

After competition gave up, fares went up to \$147 and number of flights were scaled back

# Review

- What are the six steps of pricing?
- What are the four approaches of setting a price?
- What are the demand-oriented approaches?
- What is an example of deceptive pricing?