Price - MKTG 300

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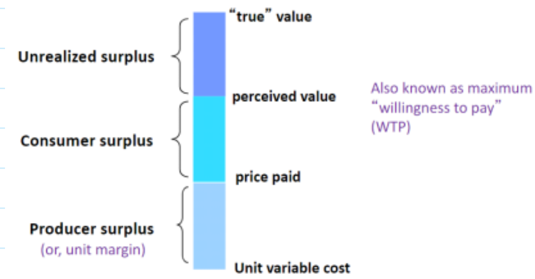
Common Pricing Objectives

- Survival, maximize profit, or maximize market share
- Become product-quality leader or Maximize market skimming

Surplus

- Unit variable cost is $5
- Price is $6
- Maximum WTP is $8
- True value is $11

Surplus	Amount
Producer (Price – UVC)	$1
Consumer (WTP – Price)	$2
Unrealized (True – WTP)	$3



Price - UVC = Producer Surplus
WTP - Price = Consumer Surplus
True - WTP = Unrealized Surplus
Perceived value AKA maximum WTP

How can we maximize producer surplus?

- Decrease Variable Cost
    - can try to make manufacturing process more efficient
- Increase the price (cutting into consumer surplus)
    - Individuals differ in their price sensitivity
    - Increasing price to attract price-insensitive customers, without increasing quality
- Increase WTP (and then price)

Price Discrimination

- Selling a product/service at two or more prices that do not completely reflect a difference in costs
    - 1st degree: Seller charges a separate price to each customer depending on the intensity of his/her demand (maximum WTP)
    - 2nd degree: Seller charges less to buyers who buy in bulk (i.e., quantity discount)
    - 3rd degree: Seller charges different amounts to different classes of buyers (often based on ability to pay/average WTP

Periodic vs. Random Discounting

- Periodic = Predictable
    - Ex: Memorial Day Weekend Sales, Black Friday
- Random = Unpredictable
    - Discourages people with high willingness to pay from waiting for sales
    - People with lower WTP can still get low prices, they just have to wait and watch

Product Line Pricing

Establish a line of related products that vary in quality and price

- Extract greater surplus from less price-sensitive customers
- Young, price-sensitive customers can get in at the ground floor, and trade up when income increases

Premium Pricing
- Offering high-end items for price-insensitive customers—e.g., first class seat

Some Factors Leading to Less Price Sensitivity
- When consumers are less aware of substitutes
  - Or consumers cannot easily compare quality of substitutes
- The purchase is small compared to buyer's income/budget
- Prestige products
- Individual differences (tightwads and spendthrifts)
- New payment methods
  - Reduce the pain of paying
  - Ex: autopay bills, credit cards, mobile payments

Option 3: Value Pricing
(Increase Perceived Value and, thus, Willingness to Pay)
- Trying to reduce gap between perceived value and true value—And thus increase willingness to pay
- Common for stimulate demand
- The focus here is on articulating benefits
  - Ex: if making a faster version of an existing product, emphasize time saved rather than enhanced speed

Value Pricing can be contrasted with Competitive Pricing
- Competitive Pricing
  - Competitor-driven pricing
  - Common for earn share strategy
  - Typically intended to capture market share
- Competitive pricing is risky
  - Partly allowing competition to drive our pricing strategy
  - Easy to get into price wars; ex Fast Food category

Other Pricing Tactics
Beyond price discrimination, there are some other pricing tactics we should know
- These are harder to categorize from the perspective of economic surpluses
  - Price bundling
  - Loss leader pricing and complementary pricing
  - Markup pricing

Price Bundling
- The sale of two or more separate products in one package at a discount
- Pure Bundling
  - Component goods only offered together; ex: a fixed price menu
- Mixed Bundling
  - Component goods offered as a package, or separately; ex: season tickets
- What is considered bundling? (Loose vs. strict definition)

Loss Leader Pricing
- Offer good at or below cost to entice customers to come in and buy other, higher-margin goods
  - Gallon of milk a common loss leader
  - Often perishable
  - Often far from store entrance
- Complementary pricing: Loss leader can be used in tandem with another item
  - Ex: keurig, have to buy k cups; razor, have to buy more replacement blades

Perhaps the simplest pricing method: Markup Pricing

- Adding a markup to the product's cost
- Ignores current demand, perceived value, competition
- Cost easier to determine than demand
- Despite non-optimality, remains popular

Two Important Pricing Tactics

- Trial
    - large discount on initial purchase
    - target non-users
    - We do this if we expect sampling (experiencing) our good to be the best way to sway non-users
- Continuity
    - moderate/light discount on multiple purchases
    - target current users
    - fails if current users stock up but don't increase their rate of consumption