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Principles of Marketing

Pricing Products:
Understanding and Capturing Customer Value

What Is Price?

Price is the amount of money charged for a product or service. It is the sum of all the values that consumers give up in order to gain the benefits of having or using a product or service.

Price is the only element in the marketing mix that produces revenue; all other elements represent costs

Factors to Consider When Setting Prices

Customer Perception of Value

Effective customer-oriented pricing involves understanding how much value consumers place on the benefits they receive from the product and setting a price that captures that value

Factors to Consider When Setting Prices

Customer Perception of Value

Value-based pricing uses the buyers' perceptions of value, not the seller's 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

Factors to Consider When Setting Prices

Customer Perception of Value

Value-based pricing

- Good-value pricing
- Value-added pricing

Factors to Consider When Setting Prices

Customer Perception of Value

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

Factors to Consider When Setting Prices

Customer Perception of Value

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 promotion to lower prices temporarily on selected items

Factors to Consider When Setting Prices

Customer Perception of Value

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

Factors to Consider When Setting Prices

Company and Product Costs

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

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

Factors to Consider When Setting Prices

Company and Product Costs

Average cost is the cost associated with a given level of output

Factors to Consider When Setting Prices

Company and Product Costs

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

Factors to Consider When Setting Prices

Company and Product Costs

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

$$\text{markup price} = \frac{\text{unit cost}}{(1\text{-desired rate of return})}$$

Factors to Consider When Setting Prices

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

Factors to Consider When Setting Prices

Break-Even Analysis and Target Profit Pricing

$$\text{break-even volume} = \frac{\text{fixed cost}}{(\text{price} - \text{variable cost})}$$

Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

Customer perceptions of value set the upper limit for prices, and costs set the lower limit

Companies must consider internal and external factors when setting prices

Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

Internal factors

- Marketing strategies
- Objectives
- Marketing mix

External factors

- Market demand
- Competitor's strategies and prices

Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

Pricing objectives include:

- Survival
- Profit maximization
- Market share leadership
- Customer retention and relationship building
- Attracting new customers
- Opposing competitive threats
- Increasing product excitement

Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

Target costing starts with an ideal selling price based on consumer value considerations and then targets costs that will ensure that the price is met

Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

Non-price strategies differentiate the marketing offer to make it worth a higher price

Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

Organizational considerations include:

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

Factors to Consider When Setting 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

Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

Types of markets

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

Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

Pure competition is a market with few many buyers and sellers trading uniform commodities where no single buyer or seller has much effect on market price

Monopolistic competition is a market with many buyers and sellers who trade over a range of prices rather than a single market price with differentiated offers.

Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

Oligopolistic competition is a market with few sellers because it is difficult for sellers to enter who are highly sensitive to each other's pricing and marketing strategies

Pure monopoly is a market with only one seller. In a regulated monopoly, the government permits a price that will yield a fair return. In a non-regulated monopoly, companies are free to set a market price.

Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

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

Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

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

$$\text{price elasticity of demand} = \frac{\%\ \text{change in quantity demand}}{\%\ \text{change in price}}$$

Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

Factors affecting price elasticity of demand

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

Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

Competition strategies and prices

Factors to consider

- Comparison of offering in terms of customer value
- Strength of competitors
- Competition pricing strategies
- Customer price sensitivity

Chapter Eleven

Pricing Strategies

New-Product Pricing Strategies

Pricing Strategies

- Market-skimming pricing
- Market-penetration pricing

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

New-Product Pricing Strategies

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

Pricing Strategies

Product line pricing

Optional-product pricing

Captive-product pricing

By-product pricing

Product bundle pricing

Product Mix Pricing Strategies

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

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

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

Pricing Strategies

Product bundle pricing combines several products at a reduced price

Price-Adjustment Strategies

Discount and allowance pricing

Segmented pricing

Psychological

Promotional pricing

Geographic pricing

Dynamic pricing

Internationa
l pricing

Price-Adjustment Strategies

Pricing Strategies

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

- Discounts
- Allowances

Price-Adjustment Strategies

Pricing 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

Price-Adjustment Strategies

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
Pricing 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
Pricing 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

Pricing 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-Adjustment Strategies

Pricing Strategies

Geographical pricing is used for customers in different parts of the country or the world

- FOB pricing
- Uniformed-delivery pricing
- Zone pricing
- Basing-point pricing
- Freight-absorption pricing

Price-Adjustment Strategies

Pricing Strategies

- **FOB (free on board) pricing** means that the goods are delivered to the carrier and the title and responsibility passes to the customer

- **Uniformed delivery pricing** means the company charges the same price plus freight to all customers, regardless of location

Price-Adjustment Strategies
Pricing Strategies

- **Zone pricing** means that the company sets up two or more zones where customers within a given zone pay a single total price

- **Basing point pricing** means that a seller selects a given city as a “basing point” and charges all customers the freight cost associated from that city to the customer location, regardless of the city from which the goods are actually shipped

Price-Adjustment Strategies

Pricing Strategies

- **Freight absorption pricing** means the seller absorbs all or part of the actual freight charge as an incentive to attract business in competitive markets

Price-Adjustment Strategies

Pricing Strategies

Dynamic pricing is when prices are adjusted continually to meet the characteristics and needs of the individual customer and situations

Price-Adjustment Strategies

Pricing Strategies

International pricing is when prices are set in a specific country based on country-specific factors

- Economic conditions
- Competitive conditions
- Laws and regulations
- Infrastructure
- Company marketing objective

Price Changes

Initiating Pricing Changes

- Price cuts
- Price increases

Price Changes

Initiating Pricing Changes

Price cuts occur due to:

- Excess capacity
- Increased market share

Price increase from:

- Cost inflation
- Increased demand
- Lack of supply

Price Changes

Buyer Reactions to Pricing Changes

Price increases	Price cuts
• Product is “hot” • Company greed	• New models will be available • Models are not selling well • Quality issues

Price Changes

Responding to 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

Responding to 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