Price

Pricing

Chapter 16

Price defined

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

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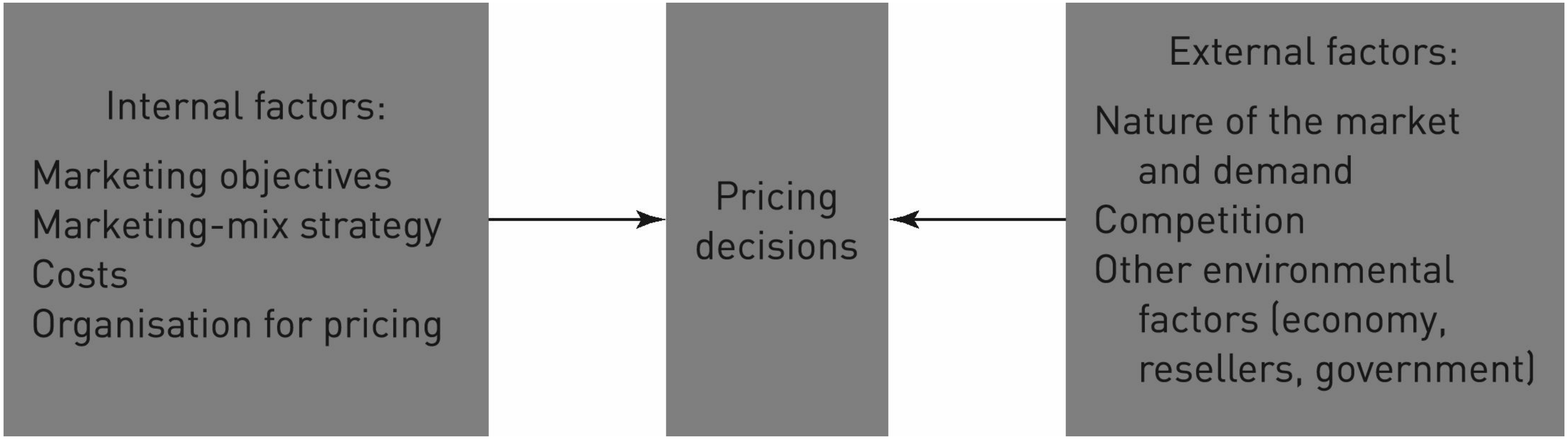

Figure 16.1 Factors affecting price decisions

Internal factors affecting price

- Company's marketing objectives
- Marketing mix strategy
- Costs
- Organisation structure

Marketing objectives

- Pricing should augment the marketing mix strategy
- Marketing objectives are reflected in the pricing decisions and include
  - Survival
  - Current profit maximisation
  - Market share maximisation
  - Product-quality leadership

Marketing mix strategy

- Price decisions are coordinated with product design, distribution and promotional decisions to form an effective integrated marketing programme.
- Various strategies can be used depending upon the type of product and the environment in which it is involved.
- Frequently pricing decisions are made first and the marketing mix evolves around that.
- De-emphasis of price by using the other marketing mix tools to create non-price positions based upon differentiation and value.

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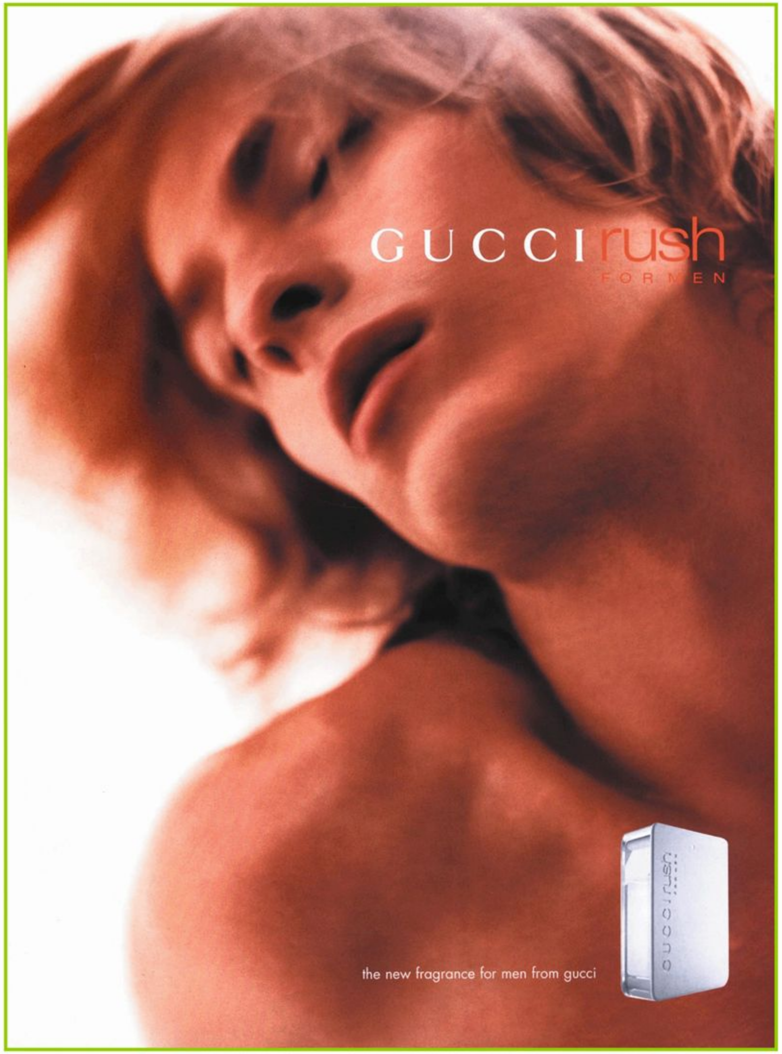

Gucci's very strong image and reputation as a prestigious brand mean that customers are willing to pay for the fashion house's expensive fragrances.
Source: Advertising Archives. Reproduced with permission.

Costs

- ***Types of cost***
  - Fixed costs that do not vary with production or sales level.
  - Variable costs vary with level of production.
  - Total costs, sum of variable and fixed costs.

Costs as a function of production experience

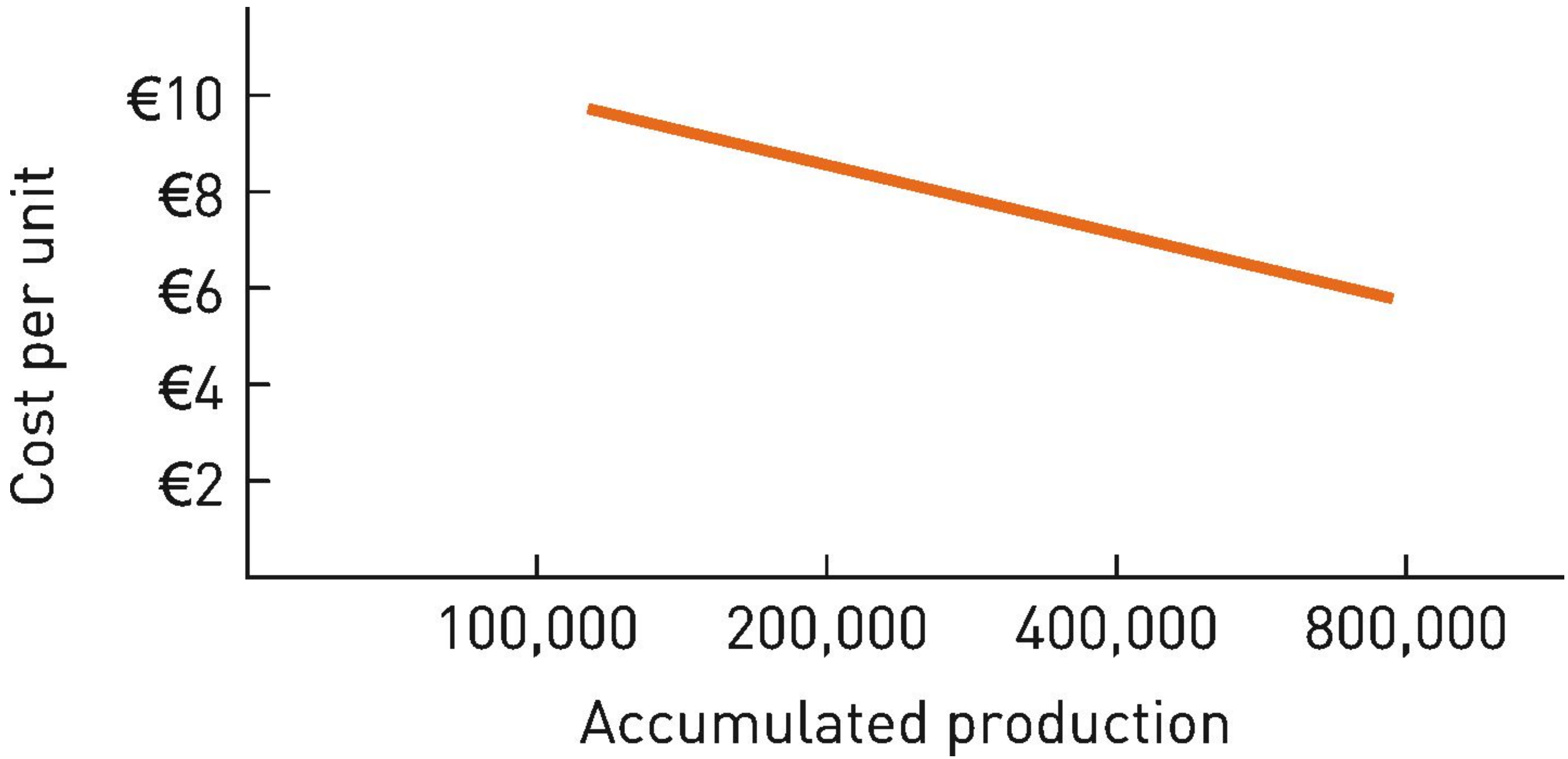

Figure 16.3 Cost per unit as a function of accumulated production: the experience curve

External factors affecting pricing decisions

External factors include the nature of the market and demand, competition and other environmental elements.

- ***The market and demand***
- Costs set the lower limit and demand sets the upper limit of price. This price-demand relationship is of fundamental importance to marketers.

Analysing the price-demand relationship

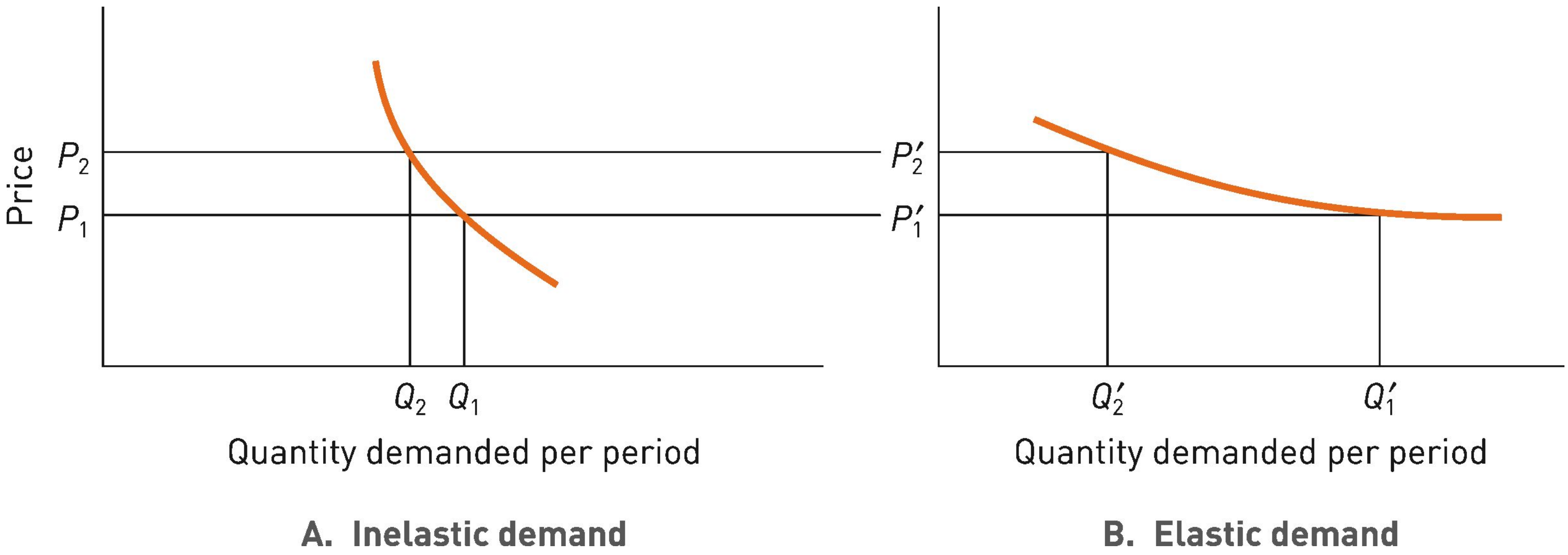

Figure 16.4 Inelastic and elastic demand

Price influence on profits

- Profit is the balance of income generated minus the costs incurred to sell the product
- Many financial management ratios
  - Return on investment (ROI)
  - Return on sales
  - (EVA) Economic Value Added

Competitors and other external factors impacting price

- **Competitors' costs, prices and offers**
  - Competitor price benchmarking gives a good indication of market price acceptance levels.
- Economic conditions such as recession.
- Resellers and intermediaries.
- Governmental influences such as tariffs on imports.
- Social concerns

Pricing objectives

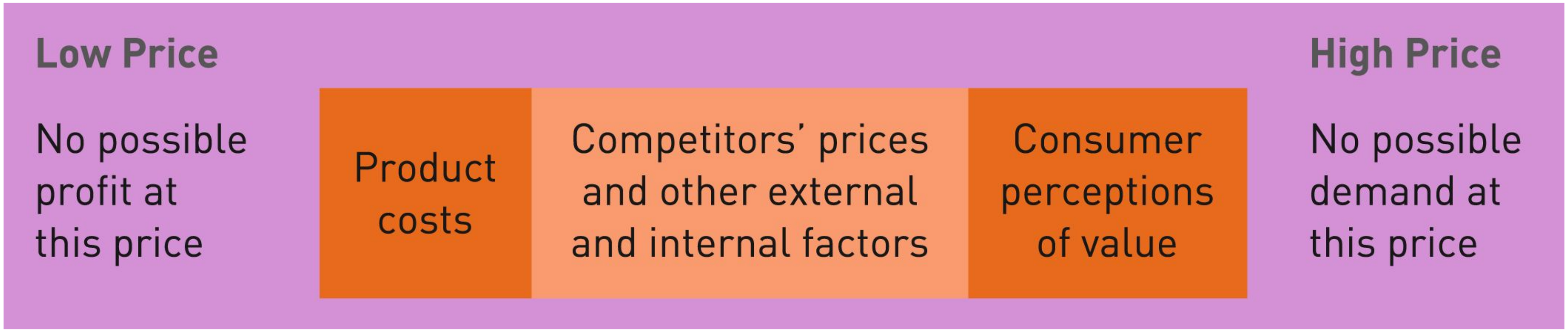

Figure 16.5 Primary considerations in price settings

1. Cost based pricing

- ***Cost-plus pricing***
  - Adding a standard mark-up to the cost of the product.
    - *Mark-up/down*
      - *The difference between selling price and cost as a percentage of selling price or cost*
- ***Break-even analysis and target profit pricing***
  - Setting price to break even on the costs of making and marketing a product.

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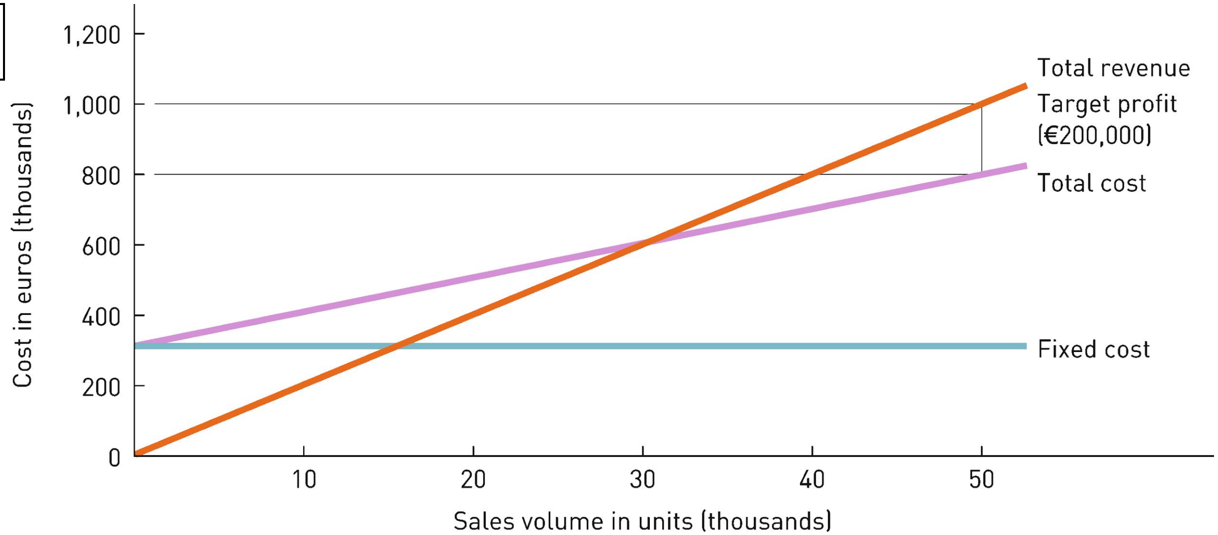

Figure 16.6 Break-even chart for determining target price

(1) Price (€)	(2) Unit demand needed to break even (000)	(3) Expected unit demand at given price (000)	(4) Total revenues = (1) × (3) (€000)	(5) Total cost* (€000)	(6) Profit = (4) – (5) (€000)
14	75	71	994	1,010	–16
16	50	67	1,072	970	102
18	37.5	60	1,080	900	180
20	30	42	840	720	120
22	25	23	506	530	–24

*Assumes a fixed cost of €300,000 and a constant unit variable cost of €10.

Table 16.2 Break-even volume and profits at different prices

2. Value based pricing

- Setting price based on the buyers' perceptions of product values rather than on the cost.
- Underlying principle is to offer the right combination of quality and good service at a fair price.
- *Everyday low pricing* is an important aspect of value pricing at the retail level.

Cost-based vs. value-based pricing

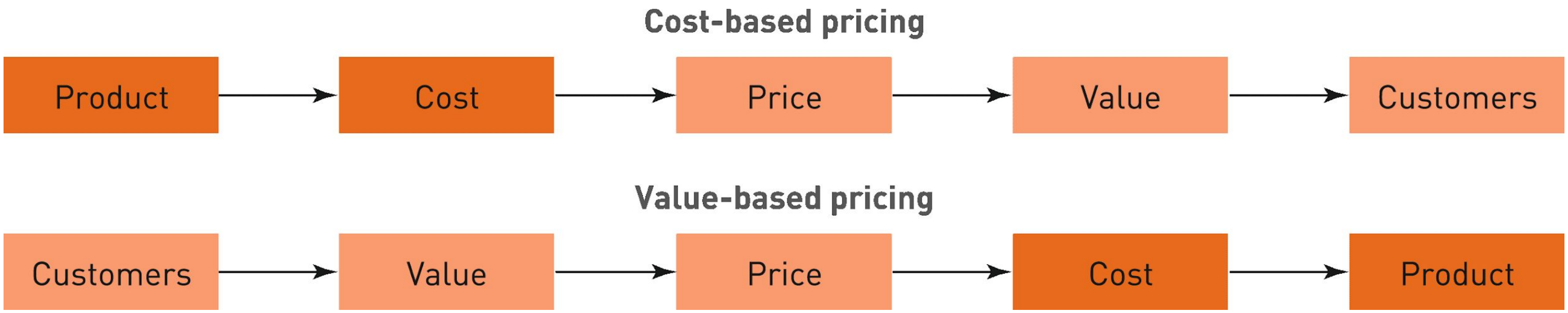

Figure 16.7 Cost-based versus value-based pricing
Source: *The Strategy and Tactics of Pricing*, 3rd edn by Thomas T. Nagle and Reed K. Holden (2002), p. 4. Reprinted by permission of Pearson Education, Inc., Upper Saddle River, NJ 07458.

3. Competition based pricing

- ***Going-rate pricing***
  - Setting price based largely on following competitors' prices rather than on company costs or demand.
- ***Sealed-bid pricing***
  - Potential buyers submit *sealed bids*, and the item is awarded to the buyer who offers the best price.
    - *English auction* is where the price is raised until only one bidder remains.
    - *Dutch auction* is where prices start high and are lowered successively until someone buys.
    - *Collective buying* is where an increasing number of customers agree to buy as prices are lowered to the final bargain price.
    - *Reverse auction* is where the customers name the price that they are willing to pay for an item and seek a company willing to sell.

		Price	
		High	**Low**
Quality	**High**	Premium strategy	Good-value strategy
	Low	Overcharging strategy	Economy strategy

Figure 16.8 Four price-positioning strategies

Pricing for new products with innovative features and benefits:

- ***Market skimming pricing***
  - Pricing strategy used for new products that have unique features and benefits over the competition.
  - A high price is set for the new product to skim the maximum price and generate the most profit.
- ***Market penetration pricing***
  - Initial low price to penetrate the market and convert as many buyers onto the new product and grab a large market share.
  - This is a short-term strategy that is dangerous and needs to be supported by a robust range of products to leverage against.

Product-mix pricing strategies (1)

- **Product line pricing**
  - Setting the price steps between various products in a product line, based on cost differences between the products, customer evaluations of the different features and the competitors' pricing.
- **Optional-product pricing**
  - The pricing of optional or accessory products along with a main product.
- **Captive-product pricing**
  - Setting a price for products that must be used in conjunction with a main product, such as blades for a razor and film for a camera.

Product-mix pricing strategies (2)

- **By-product pricing**
  - Using the by-product pricing method, the manufacturer seeks markets for the by-products of the main product production and recoups costs of waste from the production process.
  - This may include the metal shavings from steel cutting, being gathered and processed as scrap metal.
- **Product bundle pricing**
  - Strategy used to combine several products and offering the bundle of products at a reduced rate, thus leveraging the entire range of products.

Product-mix pricing strategies (3)

Product line pricing	Optional-product pricing	Captive-product pricing	By-product pricing	Product-bundle pricing
Setting price steps between product line items	Pricing optional or accessory products sold with the main product	Pricing products that must be used with the main product	Pricing low-value by-products to get rid of them	Pricing bundles of products sold together

Table 16.4 Product-mix pricing strategies

Price adjustment strategies

Discount and allowance pricing	Segmented pricing	Psychological pricing	Value pricing	Promotional pricing	Geographical pricing	International pricing
Reducing prices to reward customer responses such as paying early or promoting the product	Adjusting prices to allow for differences in customers, products and locations	Adjusting prices for psychological effect	Adjusting prices to offer the right combination of quality and service at a fair price	Temporarily reducing prices to increase short-run sales	Adjusting prices to account for the geographical location of customers	Adjusting prices in international markets

Table 16.5 Price adjustment strategies

Geographical pricing (1)

- Pricing based on where the customers are located.

- ***Free on board FOB-origin pricing***
  - Goods are placed free on board a carrier; the customer then pays the freight from the factory to the destination.

- ***Uniform delivered pricing***
  - Company charges the same price plus freight to all customers, regardless of their location.

International pricing

- Globalisation and the development of international pricing strategies offer many challenges and complexities to companies.
- Prices will be influenced by:
  - economic conditions
  - competitive situations
  - laws
  - regulations
  - sophistication of the retailing and wholesaler environments.

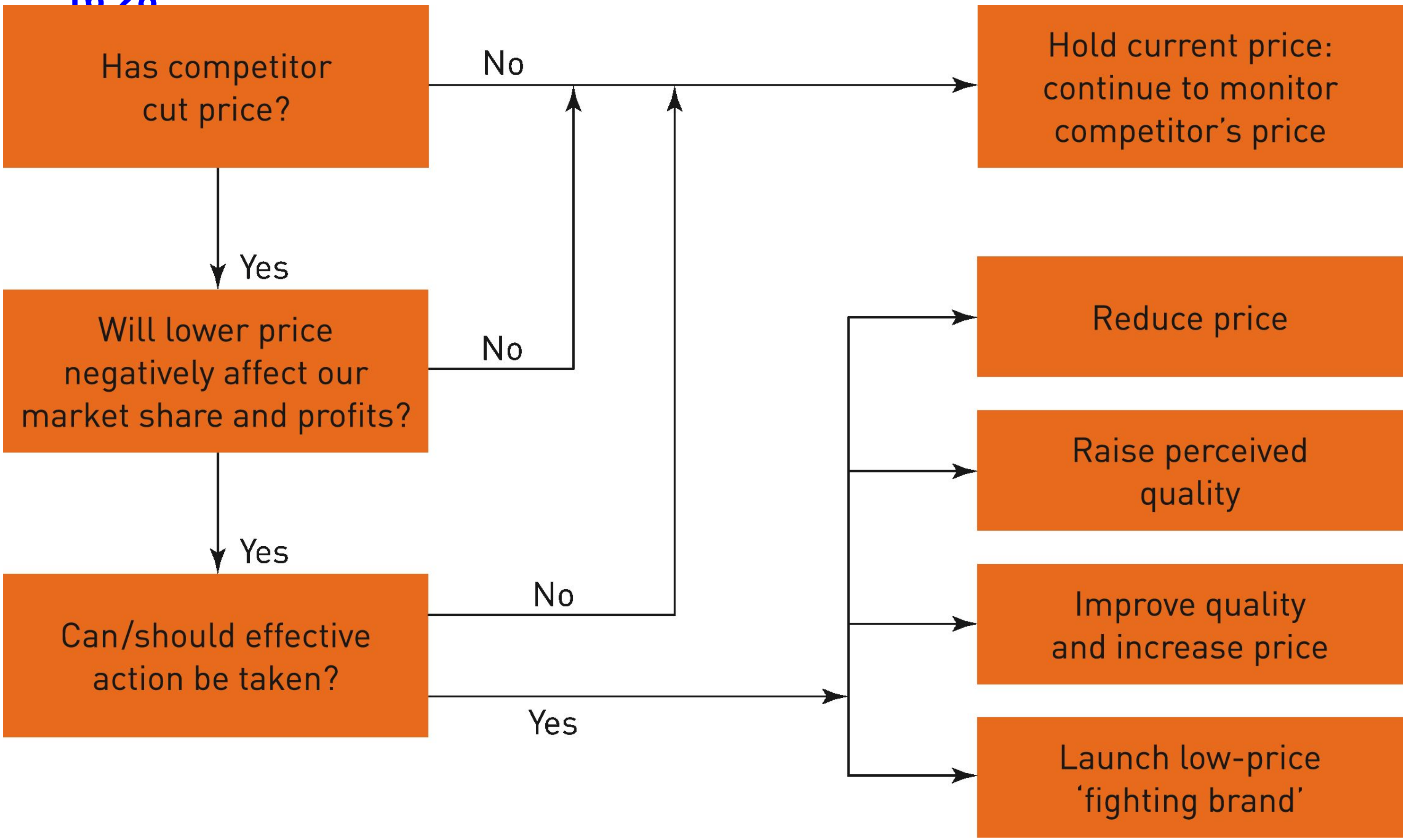

Figure 16.9 Assessing and responding to a competitor's price cut