Pricing strategy

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Pricing Strategy

- how does a company decide what price to charge for its products and services?
- what is “the price” anyway? doesn’t price vary across situations and over time?
- some firms have to decide what to charge different customers and in different situations
- they must decide whether discounts are to be offered, to whom, when, and for what reason

The Meaning of Price

we generally think of price in monetary terms

may be more useful to think of what it ***costs*** us to acquire something of value

- *the costs may be monetary or non-monetary*
- we need to think in terms of time and effort, as well as the monetary costs

The Customer Wants Value

- price is not always an important factor in influencing a sale; the customer wants more than a low price, may be willing to pay more
- the customer considers what he or she gets for the price paid; the seller must offer ***value***
- price of a product or service communicates a message to the consumer about quality
- *what causes them to conclude that they "paid too much" or "got a great deal"?*

The Consumer's View of Price

- some consumers are very interested in getting a low price and pay close attention to price; they are ***price sensitive***. But, this is *variable and personal*
- many are interested in other elements of the purchase, including brand, quality, etc.
- there is a tendency to link quality with price
- *consumers are often prepared to pay more if they expect to get added value*
- adding value doesn't mean dropping price

Pricing Objectives

- a firm may have several pricing objectives
  - to achieve a certain return on sales
  - to maximize short-term or long-term profits
  - to increase sales to a certain level
  - to achieve a target share of the market
  - to maintain price stability in the market
  - to meet competitors' prices
- the latter two may involve nonprice competition

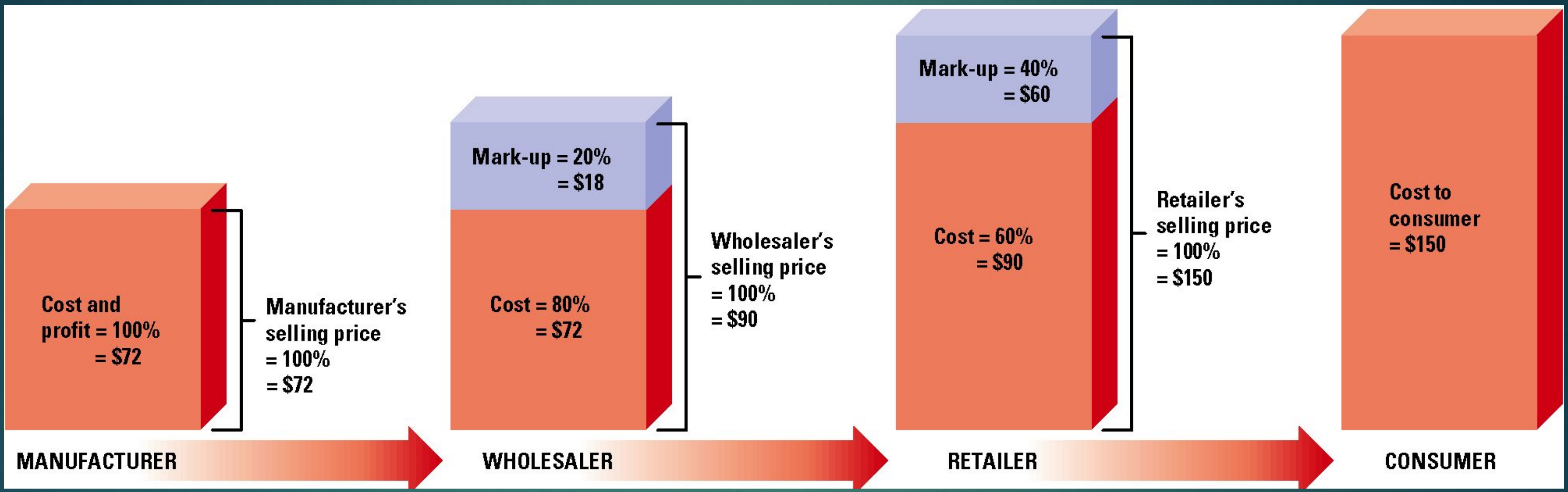
Factors Affecting Price

- pricing must take the customer into account
- how ***price elastic*** is demand?
- do customers have an ***expected price*** in mind?
- for some products, demand is ***inverse***; if price is increased, sales will actually increase
- how is the competition likely to respond?
- price must be consistent with and support other elements of the marketing mix

Cost as a Determinant of Price

- the cost of producing or offering the product or service must be considered in setting price
- while easy to calculate, cost-plus pricing is not usually practical and is not often used
- occasionally, a firm will sell below cost
- occasionally also, a firm will price so as to recover marginal (variable) costs only
- when would such approaches be used?

Mark-Up Pricing by Retailers and Wholesalers



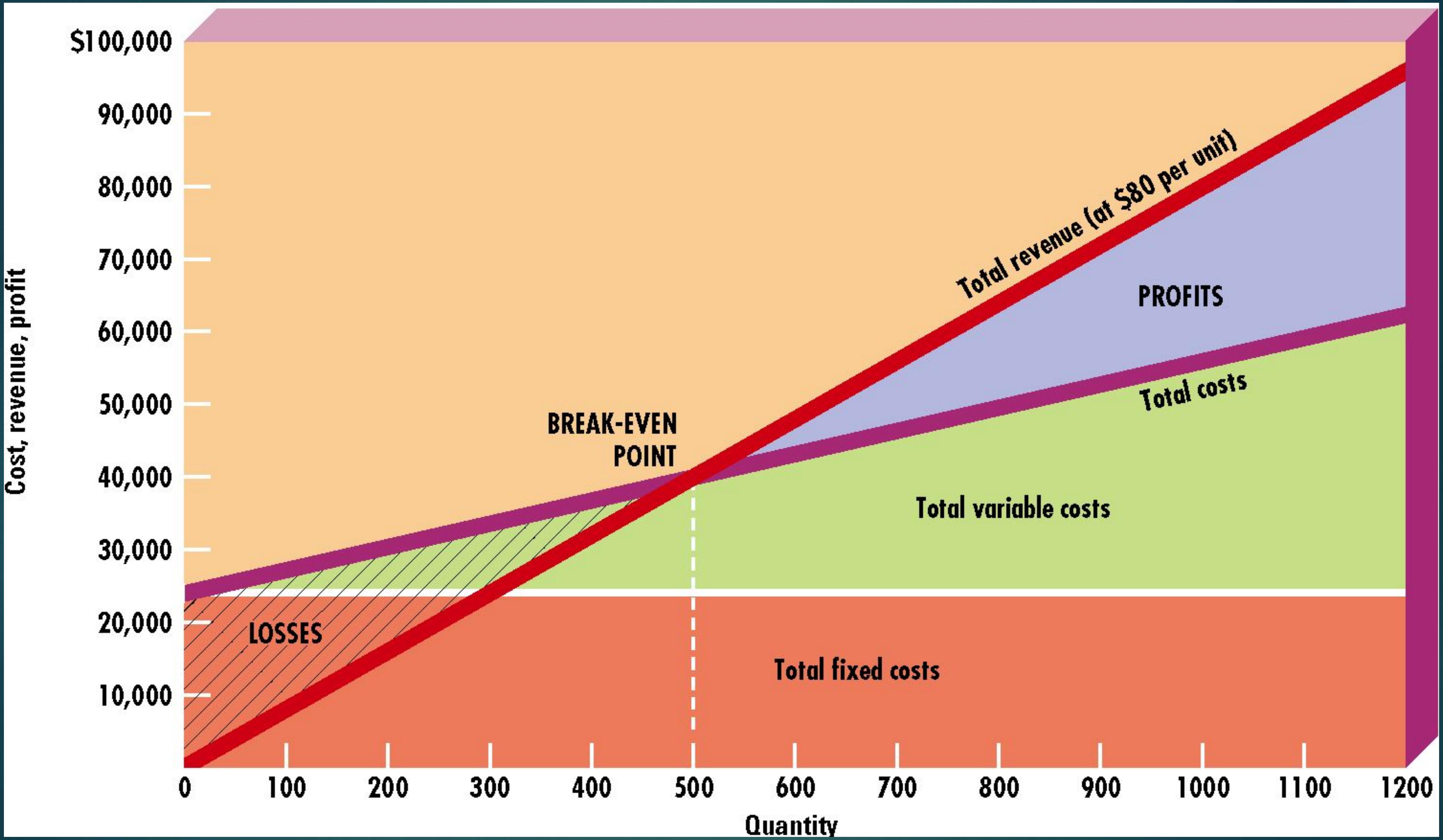
Costs and Break-Even Analysis

- cost is viewed as a ***floor*** under a firm's price
- many firms do not have particularly good cost data and may not know what it costs to produce a product or service
- the ***break-even point*** is where total revenue equals total costs; will be different for each price -- lets a firm see what it will need to sell
- break-even analysis is not a pricing strategy, but can offer useful information

Estimating Costs:

- **Fixed costs -** are those costs that do not vary with production or sales revenue.
- **Variable costs -** are those costs that vary directly with production.
- **Total costs =** Fixed Cost + Variable Cost
- (for a given level of production.)

Break-Even Chart for Futon Factory



Practical Aspects of Pricing

- price can not be set solely on cost; customer, market, and competition must be considered
- costs are important in that they affect margin
- price is often affected by positioning strategy
- may have no choice but to match competition
- positive image may allow price to be set higher
- price is linked to ability to compete on ***nonprice*** factors, such as excellent service

Market-Based Pricing

- some firms are forced to price to ***meet competition***, especially where larger firms are price leaders and products undifferentiated
- others will price ***below competition*** in a discount situation to gain a competitive advantage; have to keep costs down to do this
- occasionally firms price ***above competition*** where their products are distinctive or where they have been able to add value for customers

Price Competition

- some firms choose to compete primarily on price; this assumes that consumers are mainly interested in getting the lowest prices
- competing on price implies
  - offering low prices and minimal service levels
  - relying on price to change the consumer's perception of value, without changing other factors
  - reacting to competitive price changes with changes of one's own

Nonprice Competition

- some firms feel price is the main competitive tool, that customers always want low prices
- other firms are looking for ways to ***add value***, thereby being able to avoid low prices
- sometimes prices have to be changed in response to competitive actions
- many firms would prefer to engage in ***nonprice competition*** by building brand equity and relationships with customers

Moving Off Price Competition

- in recent years some firms have moved away from competing mainly on price
- ***value pricing*** implies that the firm tries to offer the best price possible, but also adds other benefits to increase perceived value, while keeping its costs as low as possible
- ***relationship pricing*** simply means giving the best prices to the firm's better customers as an incentive for them to remain loyal

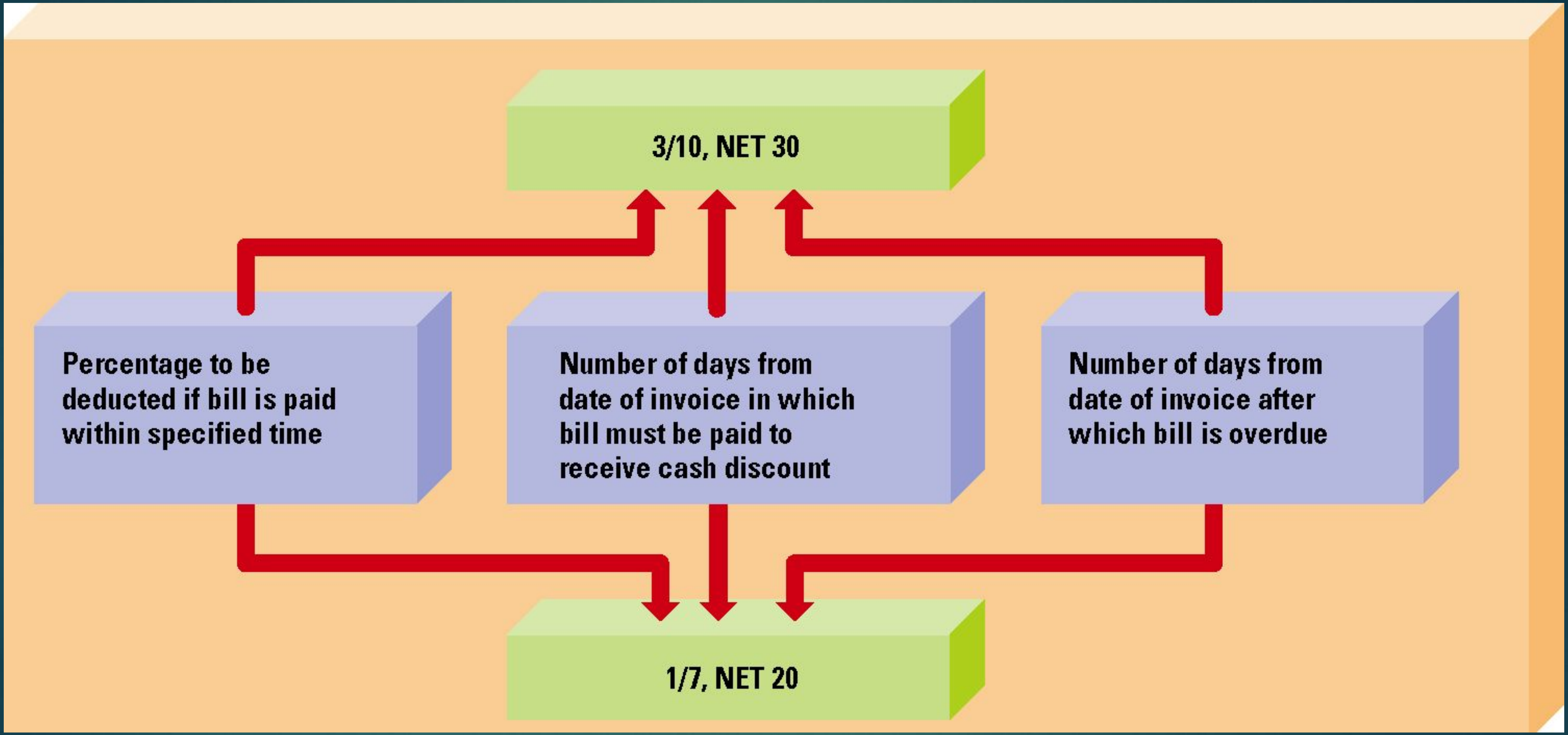
Market-Entry Pricing Strategies

- could set the initial price high to ***"skim the cream"*** before competition arrives; allows the firm to recover R&D costs, used when product is distinctive and demand inelastic
- with ***"market-penetration"*** pricing, price is set low at the start to deter competition; demand is elastic and competition is expected
- in practice, firms tend to use a combination of these strategies; different for each segment

Discounts and Allowances

- ***quantity or volume discounts*** reward large purchases and encourage repeat buying
- ***trade discounts*** granted as compensation for services performed usually by intermediaries
- ***cash discounts*** encourage speedy payment and enhance the seller’s cash flow
- other discounts are awarded to encourage purchases at certain times of year or to compensate resellers for promotional efforts

Parts of a Cash Discount



Pricing and the Law

- certain pricing policies may be considered illegal For Example in Canada:

  predatory pricing is intended to drive competitors out of the market

  - ***price discrimination*** must be a practice to be considered illegal
  - ***promotional allowances*** must be granted proportionally to all purchasers

Questionable Pricing Practices

- ***resale price maintenance*** involves a supplier requiring that intermediaries sell a product at a certain price: illegal in Canada, firms are allowed to specify a "suggested" retail price
- some firms reduce prices, possibly even below cost, to attract customers; this form of ***"loss-leader"*** pricing is not illegal unless it persists for a long time with the goal of eliminating competition (predatory pricing)

Geographic Pricing Strategies

- shipping costs will often require that different prices be charged in different regions
- if price is ***f.o.b. plant***, buyer pays the freight
- ***uniform delivered*** pricing means that all buyers pay the same, regardless of location
- ***zone-delivered*** pricing sets different prices for different regions, depending on shipping costs
- under ***freight-absorption*** pricing, seller will pay some of the shipping costs for the buyer

Special Pricing Strategies

- firms may adopt a ***one-price strategy*** or charge different prices to different customers
- ***price lining*** involves setting prices at a small number of fixed levels within a company
- the ***psychology*** of pricing suggests that price will convey a message about the product or service being sold; ***odd pricing*** is often used to suggest a bargain, while ***even pricing*** is used more in prestigious, fashion stores

Thanks for your attention