

Pricing Considerations and Approaches

Chapter 11

Objectives

- Understand the internal factors affecting a firm's pricing decisions.
- Understand the external factors affecting pricing decisions, including the impact of consumer perceptions of price and value.
- Be able to contrast the three general approaches to setting prices.

Priceline.com

- "Buyer-driven commerce" concept offers lower prices to consumers and the ability to sell excess inventory to sellers
- 13.5 million user customer base
- Tremendous growth
- Most deals relate to travel or time sensitive / perishable services
- Not all ventures have been profitable
- Some customers find it difficult to commit to purchase prior to learning details

Price Has Many Names

- Rent
- Fee
- Rate
- Commission
- Assessment
- Tuition
- Fare
- Toll
- Premium
- Retainer
- Bribe
- Salary
- Wage
- Interest
- Tax

Definition

- Price
 - 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.

What is Price?

- Dynamic Pricing on the Web allows SELLERS to:
 - Charge lower prices, reap higher margins.
 - Monitor customer behavior and tailor offers.
 - Change prices on the fly to adjust for changes in demand or costs.
 - Negotiate prices in online auctions and exchanges.

What is Price?

- Dynamic Pricing on the Web allows BUYERS to:
 - Get instant price comparisons from thousands of vendors.
 - Find and negotiate lower prices.
 - Negotiate prices in online auctions and exchanges.

What is Price?

- Price and the Marketing Mix:
 - Only element to produce revenues
 - Most flexible element
 - Can be changed quickly
- Price Competition
- Common Pricing Mistakes

Factors to Consider When Setting Price

Internal Factors

- *Marketing objectives*
- *Marketing mix strategies*
- *Costs*
- *Organizational considerations*

- Market positioning influences pricing strategy
- Other pricing objectives:
 - Survival
 - Current profit maximization
 - Market share leadership
 - Product quality leadership
- Not-for-profit objectives:
 - Partial or full cost recovery
 - Social pricing

Factors to Consider When Setting Price

Internal Factors

- *Marketing objectives*
- *Marketing mix strategies*
- *Costs*
- *Organizational considerations*

- Pricing must be carefully coordinated with the other marketing mix elements
- Target costing is often used to support product positioning strategies based on price
- Nonprice positioning can also be used

Factors to Consider When Setting Price

Internal Factors

- *Marketing objectives*
- *Marketing mix strategies*
- *Costs*
- *Organizational considerations*

- Types of costs:
 - Variable
 - Fixed
 - Total costs
- How costs vary at different production levels will influence price setting
- Experience (learning) curve effects on price

Factors to Consider When Setting Price

Internal Factors

- *Marketing objectives*
- *Marketing mix strategies*
- *Costs*
- *Organizational considerations*

- Who sets the price?
 - Small companies: CEO or top management
 - Large companies: Divisional or product line managers
- Price negotiation is common in industrial settings
- Some industries have pricing departments

Factors to Consider When Setting Price

External Factors

- *Nature of market and demand*
- *Competitors' costs, prices, and offers*
- *Other environmental elements*

- Types of markets
 - Pure competition
 - Monopolistic competition
 - Oligopolistic competition
 - Pure monopoly
- Consumer perceptions of price and value
- Price-demand relationship
 - Demand curve
 - Price elasticity of demand

Factors to Consider When Setting Price

External Factors

- *Nature of market and demand*
- *Competitors' costs, prices, and offers*
- *Other environmental elements*

- Consider competitors' costs, prices, and possible reactions when developing a pricing strategy
- Pricing strategy influences the nature of competition
 - Low-price low-margin strategies inhibit competition
 - High-price high-margin strategies attract competition
- Benchmarking costs against the competition is recommended

Factors to Consider When Setting Price

External Factors

- *Nature of market and demand*
- *Competitors' costs, prices, and offers*
- *Other environmental elements*

- Economic conditions
 - Affect production costs
 - Affect buyer perceptions of price and value
- Reseller reactions to prices must be considered
- Government may restrict or limit pricing options
- Social considerations may be taken into account

General Pricing Approaches

- **Cost-Based Pricing: *Cost-Plus Pricing***
 - Adding a standard markup to cost
 - Ignores demand and competition
 - Popular pricing technique because:
 - ❖ It simplifies the pricing process
 - ❖ Price competition may be minimized
 - ❖ It is perceived as more fair to both buyers and sellers

General Pricing Approaches

Cost-Based Pricing Example

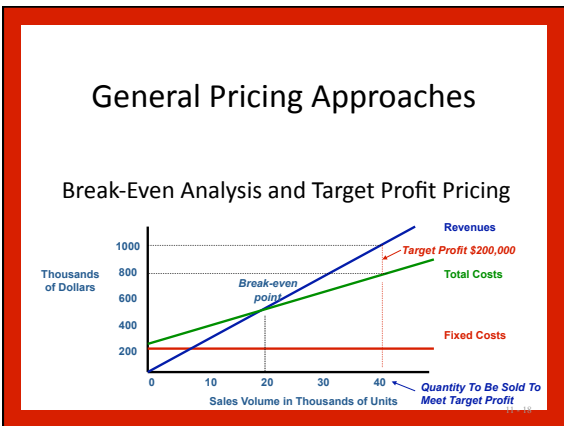
Variable costs: \$20 Fixed costs: \$ 500,000
 Expected sales: 100,000 units Desired Sales Markup: 20%

Variable Cost + Fixed Costs/Unit Sales = Unit Cost
 $\$20 + \$500,000/100,000 = \$25 \text{ per unit}$

Unit Cost/(1 - Desired Return on Sales) = Markup Price
 $\$25 / (1 - .20) = \31.25

General Pricing Approaches

- **Cost-Based Pricing: *Break-Even Analysis and Target Profit Pricing***
 - Break-even charts show total cost and total revenues at different levels of unit volume.
 - The intersection of the total revenue and total cost curves is the break-even point.
 - Companies wishing to make a profit must exceed the break-even unit volume.



- ### General Pricing Approaches
- Value-Based Pricing:
 - Uses buyers' perceptions of value rather than seller's costs to set price.
 - Measuring perceived value can be difficult.
 - Consumer attitudes toward price and quality have shifted during the last decade.
 - ❖ Introduction of less expensive versions of established brands has become common.

- ### General Pricing Approaches
- Value-Based Pricing:
 - Business-to-business firms seek to retain pricing power
 - ❖ Value-added strategies can help
 - Value pricing at the retail level
 - ❖ Everyday low pricing (EDLP) vs. high-low pricing

- ### General Pricing Approaches
- Competition-Based Pricing:
 - Also called going-rate pricing
 - May price at the same level, above, or below the competition
 - Bidding for jobs is another variation of competition-based pricing
 - ❖ Sealed bid pricing

- ### Keywords
- Price
 - Pricing objectives
 - Profit maximization
 - Market share leadership
 - Variable costs
 - Fixed costs
 - Total costs
 - Learning curve
 - Price negotiation
 - Pure competition
 - Pure Monopoly
 - Oligopoly
 - Demand curve
 - Price elasticity
 - Cost-based pricing
 - Break-even
 - Value based pricing
 - Everyday Low Pricing
 - Competition Based Pricing