Pricing Products:

Pricing Considerations and Approaches

Chapter 10

Learning Goals

1. **Identify and define the internal factors affecting a firm's pricing decisions**
2. **Identify and define the external factors affecting pricing decisions, including the impact of consumer perceptions of price and value**
3. **Contrast the three general approaches to setting prices**

Case Study
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

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?

Price Has Many Names

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

What is Price?

- **Dynamic Pricing on the Web allows SELLERS to:**
  - **Monitor customer behavior and tailor offers.**
  - **Change prices on the fly to adjust for changes in demand or costs.**
  - **Aid consumers with price comparisons.**
  - **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**
- **Common Pricing Mistakes**
  - **Reducing prices too quickly to get sales**
  - **Pricing based on costs, not customer value**

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**

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 affects 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 where pricing departments may be created**

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**
- **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 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.**
  - **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**