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.

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

What is Price?

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 per unit

Unit Cost/(1 – Desired Return on Sales) = Markup Price

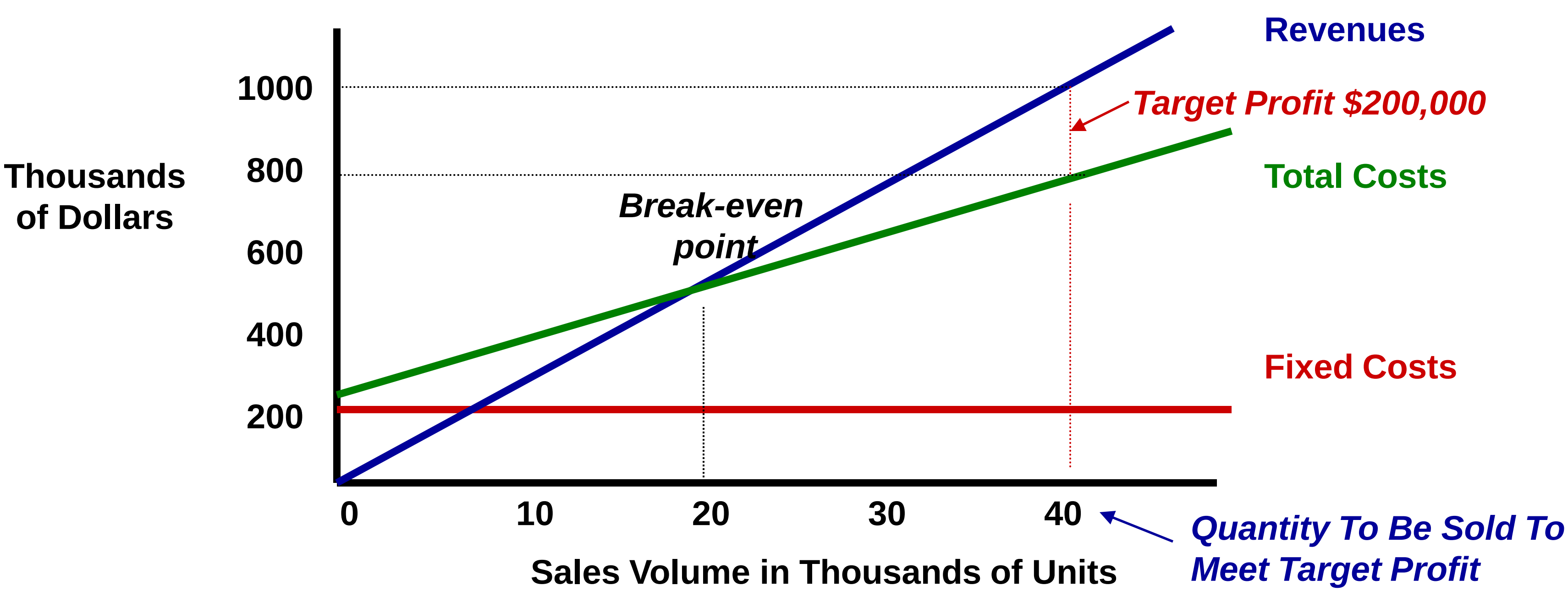
\$25 / (1 - .20) = \$31.25

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

Break-Even Analysis and Target Profit Pricing



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*