Pricing

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Pricing

- What is price?;
- Pricing approaches and considerations;
- Pricing strategies;

What is price?

- Everything given in exchange for something else. 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.
- Forms of price – price, rent, tuition fee, service fee, rate, toll, wage, salary, commission, fare, tax, etc.

Most common mistakes in pricing

- pricing that is too cost-oriented;
- prices that are not revised often enough to reflect market changes;
- pricing that does not take the rest of the marketing mix into account;
- prices that are not varied enough for different products, market segments and purchase occasions;

Pricing approaches and considerations
Factors influencing pricing

- Internal factors – marketing objectives, marketing mix strategy, costs, organisational issues (transfer pricing), product quality;
- External factors – demand, price elasticity, competitors' prices, legislation, economic conditions, etc.;

Internal Factors Affecting Pricing Decisions

- **Marketing Objectives:** examples of common objectives are survival, current profit maximization, market-share maximization and product-quality leadership.
- **Marketing-Mix Strategy:** Price decisions must be co-ordinated with product design, distribution and promotion decisions to form a consistent and effective marketing programme.

Internal Factors Affecting Pricing Decisions

Costs:

- fixed costs - costs that do not vary with production or sales level
- variable costs - costs that vary directly with the level of production
- total costs -the sum of the fixed and variable costs for any given level of production
- average cost is equal to total cost divided by the number of goods produced.
- marginal cost is the change in total cost that arises when the quantity produced changes by one unit.

External Factors Affecting Pricing Decisions: The Market and Demand

Pricing in different types of market

- **Pure competition**: the market consists of many buyers and sellers trading in a uniform commodity such as wheat, copper or financial securities. No single buyer or seller has much effect on the going market price.
- **Monopolistic competition**: the market consists of many buyers and sellers that trade over a range of prices rather than a single market price. A range of prices occurs because sellers can differentiate their offers to buyers.

External Factors Affecting Pricing Decisions: The Market and Demand

- **oligopolistic competition:** the market consists of a few sellers that are highly sensitive to each other's pricing and marketing strategies. Each seller is alert to competitors' strategies and moves.
- **pure monopoly:** the market consists of one seller. The monopolist is able to charge whatever price they wish due to the absence of competition, but their overall revenue will be limited by the ability or willingness of customers to pay their price.

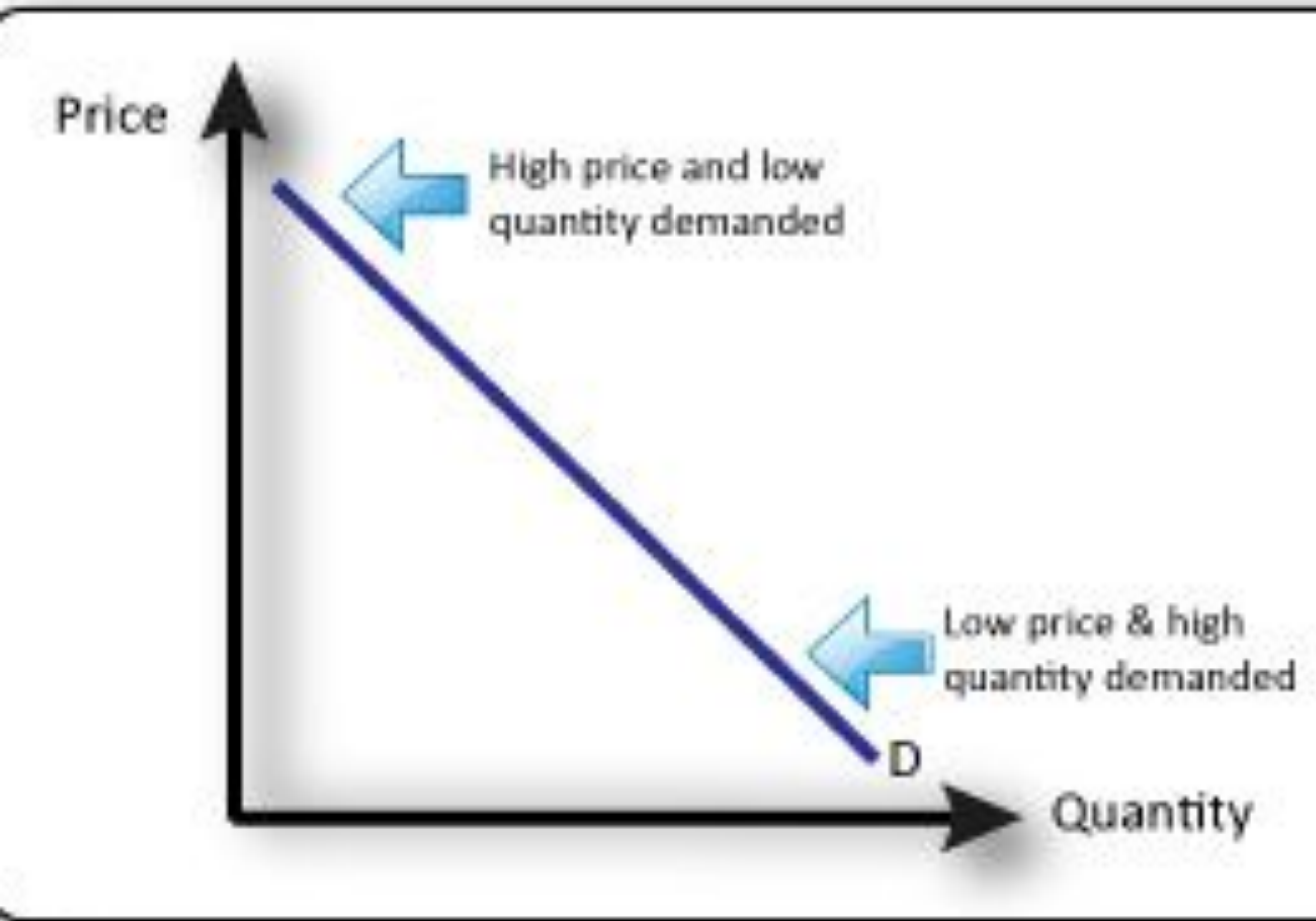
External Factors Affecting Pricing Decisions: The Market and Demand

- Consumer perceptions of price and value:

If customers perceive that the price is greater than the product's value, they will not buy the product. If consumers perceive that the price is below the product's value, they will buy it, but the seller loses profit opportunities.

External Factors Affecting Pricing Decisions: Relationship Between Level of Prices and Demand

- Each price the company might charge will lead to a different level of demand. The demand curve shows the number of units that the market will buy in a given time period at different prices that might be charged.


Price
High price and low
quantity demanded
Low price & high
quantity demanded
D
Quantity

Price elasticity

- Price elasticity: A measure of the sensitivity of demand to changes in price.
- If demand hardly changes with a small change in price, it is inelastic. If demand changes greatly, the demand is elastic.
- If demand is elastic rather than inelastic, sellers will consider lowering their price.

Price influence on profit

- Gross profit is the difference between net proceeds from sales and the cost of goods sold.
- Net profit is the difference bettween income from goods sold and all expenses incurred.

External Factors Affecting Pricing Decisions: Competitors' Costs, Prices and Offers

By knowing what the competition charges for a comparable part, you can better price your product.

Pricing approaches and considerations
Pricing approaches

- Cost based pricing
- Break-even analysis
- Value based pricing
- Competition based pricing

Pricing approaches

- cost-plus pricing - adding a standard mark-up to the cost of the product

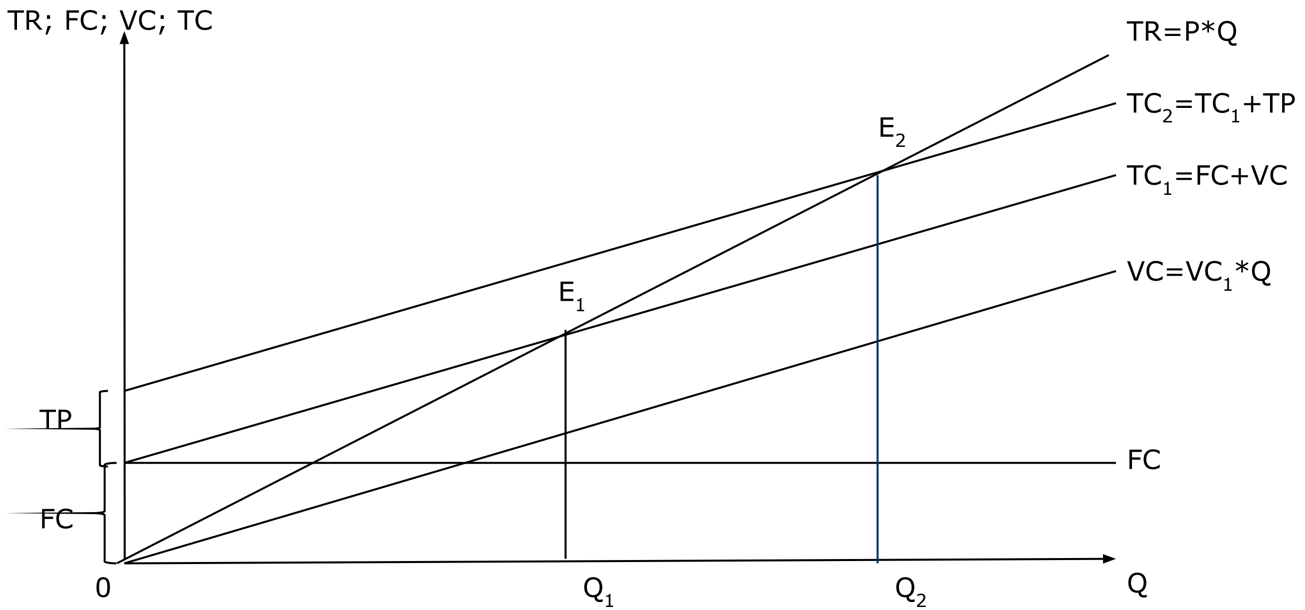
Markup Pricing

Markup is the amount added to the **cost** of the product to determine the **selling price**.

Example:

Percentage	×	Cost	=	**Markup**
40%	×	$50.00	=	$20.00
Cost	+	Markup	=	**Selling Price**
$50.00	+	$20.00	=	$70.00

Pricing approaches and considerations
Pricing approaches – Break-even analysis



Break-even analysis

Abbreviations:
FC – fixed costs; *VC* – variable costs; *TC* – total costs;
VC_1 – variable costs per unit; *P* – price per unit; *Q* – quantity;
TR – total revenues; *TP* – target profit

Value-Based Pricing

- Value based pricing is the practice of setting the price of a product or service at its perceived value to the customer.

Cost-Based Versus Value-Based Pricing

Cost-Based Pricing	Value-Based Pricing
Product	Customer
Cost	Value
Price	Price
Value	Cost
Customers	Product

Advantages of Value Based Pricing

- Increases profits. This method results in the highest possible price that you can charge, and so maximizes profits.
- Customer loyalty. Despite the high prices charged, you can achieve extremely high customer loyalty for repeat business and referrals, but only if the service or product provided justifies the high price.

Disadvantages of Value Based Pricing

- The very high prices to be expected under this method will only be acceptable to a small number of customers.
- This method tends to work best for smaller organizations that are highly specialized.
- Leaving a great deal of room for competitors to offer lower prices and take away your market share

Competitor based pricing

Advantages:

- It’s fairly simple;
- It’s low risk;
- It can be accurate;

Disadvantages

- It leads to large missed opportunities;
- It’s done by everyone, which creates pricing group decisions;

Pricing strategies

- New product pricing strategies – market-skimming pricing and market penetration pricing
- Product-mix pricing strategies – product line pricing, optional product pricing, by-product pricing, captive product pricing, product-bundle pricing
- Price adjustment strategies – discounts and allowances, psychological pricing, promotional pricing
- Price discrimination

New product pricing strategies

Penetration pricing: setting a relatively low initial entry price to attract new customers.

- This can achieve high market penetration rates quickly. This can take the competitors by surprise, not giving them time to react.
- It can create goodwill among the early adopters segment. This can create more trade through word of mouth.
- It discourages the entry of competitors. Low prices act as a barrier to entry.

New product pricing strategies

Skimming: Selling a product at a high price and sacrificing high sales to gain a high profit. A skimming strategy would generally be supported by the following conditions:

- Having a premium product.
- Having legal protection via a patent or copyright

Product mix strategies

- **Product line pricing** refers to the practice of reviewing and setting prices for multiple products that a company offers in coordination with one another.
- **Optional pricing**: Pricing optional or accessory products sold with the main product
- **Captive product pricing**: Pricing products that must be used with the main product
- **By Product Pricing:** By product is something which is produced as a result of producing something else
- **Product bundle pricing:** Pricing bundles of products sold together

Price adjustment strategies

Discounts and Allowances: reductions to the selling price of goods or services.

- **Cash Discounts:** encourage buyers to pay earlier
- **Trade Discounts:** encourage trade channel members in the distribution channel to perform some function
- **Quantity Discounts:** to encourage buyers to buy more.
- **Promotional Allowances:** to reward buyers for participating in promoting the seller's products.
- **Trade in Allowances** Turning in an old item when buying a new one

Price adjustment strategies

- **Segmented Pricing**: a company fixes or sets more than one price for a product, irrespective of its production and distribution costs being the same.
- **Psychological Pricing:** . Instead of appealing to the rational side of the consumer, this strategy appeals to their emotional side.

Price adjustment strategies

- **Promotional Pricing:** Temporarily reducing prices to increase short-run sales
- **Value-Based Pricing:** Adjusting prices to offer the right combination of quality and service at a fair price

Price adjustment strategies

- **Geographical Pricing:** Adjusting prices to account for the geographic location of customers
- **International Pricing:** Adjusting prices in international markets

Price Changes

- **Initiating Price Cuts**
- **Initiating Price Increases**