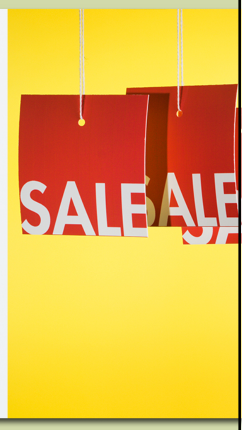
Chapter 19
Pricing Concepts



MKTG10
Lamb, Hair, and McDaniel

LEARNING OUTCOMES

19-1 Discuss the importance of pricing decisions to the economy and to the individual firm

19-2 List and explain a variety of pricing objectives

19-3 Explain the role of demand in price determination

LEARNING OUTCOMES

19-4 Understand the concepts of dynamic pricing and yield management systems

19-5 Describe cost-oriented pricing strategies

19-6 Demonstrate how the product life cycle, competition, distribution and promotion strategies, customer demands, the Internet and extranets, and perceptions of quality can affect price

LEARNING OUTCOMES

19-7 Describe the procedure for setting the right price

19-8 Identify the legal constraints on pricing decisions

19-9 Explain how discounts, geographic pricing, and other pricing tactics can be used to fine-tune a base price

19-1 The Importance of Price

Discuss the importance of pricing decisions to the economy and to the individual firm

The Importance of Price

To the seller...
Price is revenue

To the consumer...
Price is the cost of something

Price allocates resources in a free-market economy

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What is Price?

- The Sacrifice Effect of Price
  - Price is that which is sacrificed to get a good or service.
- The Information Effect of Price
  - People infer quality information based on price.
- Value Is Based upon Perceived Satisfaction
  - "Reasonable price" means "perceived reasonable value."

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The Importance of Price to Marketing Managers

Revenue	**The price charged to customers multiplied by the number of units sold.**
Profit	**Revenue minus expenses.**

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19-2 Pricing Objectives

List and explain a variety of pricing objectives

Pricing Objectives

- **Profit-Oriented**
- **Sales-Oriented**
- **Status Quo**

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Profit-Oriented Pricing Objectives

Profit-Oriented Pricing Objectives

- Profit Maximization
- Satisfactory Profits
- Target Return on Investment

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Profit Maximization

Setting prices so that total revenue is as large as possible relative to total costs.

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Return on Investment (ROI)

Net profit after taxes divided by total assets.

$$\text{ROI} = \frac{\textbf{Net profit after taxes}}{\textbf{Total assets}}$$

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Sales-Oriented Pricing Objectives

Sales-Oriented Pricing Objectives

- **Market Share**
- **Sales Maximization**

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Market Share

A company's product sales as a percentage of total sales for that industry.

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Sales Maximization

Rather than strive for market share, sometimes companies try to maximize sales.

- Uses a short-term objective to maximize sales
- Ignores profits, competition, and the marketing environment
- May be used to sell off excess inventory

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Status Quo Pricing Objectives

Status Quo Pricing Objectives

- Maintain existing prices
- Meet competition's prices

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19-3 The Demand Determinant of Price

Explain the role of demand in price determination

The Demand Determinant of Price

Demand	The quantity of a product that will be sold in the market at various prices for a specified period.
Supply	The quantity of a product that will be offered to the market by a supplier at various prices for a specific period.

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How Demand and Supply Establish Price

Price Equilibrium	The price at which demand and supply are equal.
Elasticity of Demand	Consumers' responsiveness or sensitivity to changes in price.

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Elasticity of Demand

Elastic Demand	Consumers buy more or less of a product when the price changes.
Inelastic Demand	An increase or a decrease in price will not significantly affect demand.

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Factors that Affect Elasticity of Demand

- **Availability of substitutes**
- **Price relative to purchasing power**
- **Product durability**
- **A product's other uses**

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19-4 The Power of Dynamic Pricing and Yield Management Systems

Understand the concepts of dynamic pricing and yield management systems

Dynamic Pricing

A strategy whereby prices are adjusted over time to maximize a company's revenues

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Yield Management Systems

- Discounting early purchases
- Limiting early sales at discounted prices
- Overbooking capacity

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Yield Management Systems

Yield Management Systems (YMS) make it possible for a company to:

1. **Stimulate demand when demand is low**
2. **Maximize profits when demand is high**

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19-5 The Cost Determinant of Price

Describe cost-oriented pricing strategies

The Cost Determinant of Price

Types of Costs

- **Variable Cost** — Varies with changes in level of output
- **Fixed Cost** — Does not change as level of output changes

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Setting Prices

Methods Used to Set Prices

- Markup pricing
- Keystoning
- Break-Even Pricing

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Markup Pricing

Markup Pricing	The cost of buying the product from the producer plus amounts for profit and for expenses not otherwise accounted for.
Keystoning	The practice of marking up prices by 100 percent, or doubling the cost.

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19-6 Other Determinants of Price

Demonstrate how the product life cycle, competition, distribution and promotion strategies, customer demands, the Internet and extranets, and perceptions of quality can affect price

Other Determinants of Price

- **Stages of the PLC**
- **Competition**
- **Distribution Strategy**
- **The Internet and Extranets**
- **Promotion Strategy**
- **Demands of Large Customers**
- **Price versus Quality**

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Stages in the Product Life Cycle

- Introductory stage: Price is high
- Growth stage: Price stabilizes
- Maturity stage: Price decreases
- Decline stage: Price decreases

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The Competition

- High prices may induce firms to enter the market.
- Competition can lead to price wars.

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Distribution Strategy

Manufacturers

- Offer a larger profit margin or trade allowance
- Use exclusive distribution
- Franchising
- Avoid business with price-cutting discounters
- Develop brand loyalty

Wholesalers/Retailers

- Sell against the brand
- Buy gray-market goods

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The Impact of the Internet and Extranets

Shopping Bots	A program that searches the Web for the best price for a particular item.
Internet Auctions	Business-to-business auctions are likely to be the dominant form of online auctions in the future.

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Promotion Strategy

Price is often used as a promotional tool to increase consumer interest.

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Demands of Large Customers

Require suppliers to pay cash rebates if stores' profit margins aren't met.

Fines for violations of ticketing, packing, and shipping rules.

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The Relationship of Price to Quality

When a purchase decision involves uncertainty, consumers tend to rely on a high price as a predictor of good quality.

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Dimensions of Quality

1. Ease of use
2. Versatility
3. Durability
4. Serviceability
5. Performance
6. Prestige

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19-7

How to Set a Price on a Product

Describe the procedure for setting the right price

Setting the Right Price

- Establish pricing goals
- Estimate demand, costs, and profits
- Choose a price strategy
- Fine-tune with pricing tactics
- Results lead to the right price

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Choose a Price Strategy

Price Skimming	A firm charges a high introductory price, often coupled with heavy promotion.
Penetration Pricing	A firm charges a relatively low price for a product initially as a way to reach the mass market.
Status Quo Pricing	Charging a price identical to or very close to the competition's price.

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Price Skimming

Situations When Price Skimming Is Successful

- Strong Demand
- Unique/Superior Advantages
- Legal Protection of Product
- Technological Breakthrough
- Blocked Entry to Competitors

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Penetration Pricing

Advantages	Disadvantages
▪ Can lead to lower cost per unit as production expands	▪ Requires gear up for mass production
▪ Discourages or blocks competition from market entry	▪ Selling large volumes at low prices
▪ Boosts sales and provides large profit increases	▪ Strategy to gain market share may fail

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Status Quo Pricing

Advantages	Disadvantages
▪ Simplicity	▪ Strategy may ignore demand and/or cost
▪ Safest route to long-term survival for small firms	

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19-8

The Legality of Price Strategy

Identify the legal constraints on pricing decisions

The Legality of Price Strategy

- Unfair Trade Practices
- Price Fixing
- Price Discrimination
- Predatory Pricing

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Unfair Trade Practices and Price Fixing

Unfair Trade Practices Acts	Laws that prohibit wholesalers and retailers from selling below cost.
Price Fixing	An agreement between two or more firms on the price they will charge for a product.

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Price Discrimination

The Robinson-Patman Act of 1936:

1. There must be price discrimination.
2. Transaction must occur in interstate commerce.
3. Seller must discriminate by price among two or more purchasers.
4. Products sold must be commodities or tangible goods.
5. Products sold must be of like grade and quality.
6. There must be significant competitive injury.

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Price Discrimination

The Robinson-Patman Act of 1936:

Seller Defenses

- Cost
- Market Conditions
- Competition

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Predatory Pricing

The practice of charging a very low price for a product with the intent of driving competitors out of business or out of a market.

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19-9

Tactics for Fine-Tuning the Base Price

Explain how discounts, geographic pricing, and other pricing tactics can be used to fine-tune the base price

Tactics for Fine-Tuning the Base Price

- Discounts
- Geographic pricing
- Other pricing tactics

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Discounts, Allowances, Rebates, and Value-Based Pricing

- Quantity Discounts
- Promotional Allowances
- Cash Discounts
- Rebates
- Functional Discounts
- Zero Percent Financing
- Seasonal Discounts
- Value-Based Pricing

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Geographic Pricing

FOB Origin Pricing	The buyer absorbs the freight costs from the shipping point ("free on board").
Uniform Delivered Pricing	The seller pays the freight charges and bills the purchaser an identical, flat freight charge.
Zone Pricing	The U.S. is divided into zones, and a flat freight rate is charged to customers in a given zone.
Freight Absorption Pricing	The seller pays for all or part of the freight charges and does not pass them on to the buyer.
Basing-Point Pricing	The seller charges freight from a basing point, regardless of the city from which the goods are shipped.

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Other Pricing Tactics

Single-Price Tactic	All goods offered at the same price
Flexible Pricing	Different customers pay different prices
Trade-Ins	Exchanging one item for a credit towards another. Used often at car dealerships
Professional Services Pricing	Used by professionals with experience, training or certification
Price Lining	Several line items at specific price points
Leader Pricing	Sell product at near or below cost
Bait Pricing	Lure customers through false or misleading price advertising
Odd-Even Pricing	Odd-number prices imply bargain Even-number prices imply quality
Price Bundling	Combining two or more products in a single package
Two-Part Pricing	Two separate charges to consume a single good
Pay What You Want	Product price chosen by customers

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Consumer Penalties

Businesses impose consumer penalties if...

- An irrevocable loss of revenue is suffered
- Additional transaction costs are incurred

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Chapter 19 Video

Ski Butternut

Ski Butternut is a ski mountain in the Berkshires dedicated to offering a great family ski value. In this video, Matt Sawyer discusses the various ways that Ski Butternut uses pricing to drive new business and local business to the mountain. He also discusses how correct pricing can help the next year's business model through season pass sales.

CLICK TO PLAY VIDEO

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Part 6 Video

Scripps Networks Interactive

Pricing Decisions

Scripps Networks Interactive is a group of television networks including such popular channels as Food Network, HGTV, and The Cooking Channel. In this clip, executives from Scripps discuss how they decide what pricing decisions to make based on their major audience, and how those decisions can also affect distribution and the content itself.

CLICK TO PLAY VIDEO

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