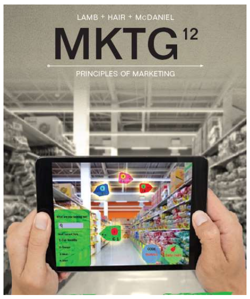
MKTG
Principles Of Marketing
Twelfth Edition



Chapter 19
Pricing Concepts

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Learning Outcomes (1 of 2)

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
19-4 Understand the concepts of dynamic pricing
19-5 Describe cost-oriented pricing strategies

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Learning Outcomes (2 of 2)

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
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

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Learning Objective 1: The Importance of Price

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Price

- **Price** is that which is given up in an exchange to acquire a good or service
- Opposing effects
  - The sacrifice effect of price
  - The information effect of price
- Value is based upon perceived satisfaction
  - "Reasonable price" means "perceived reasonable value" at the time of the transaction

Importance of Price to Marketing Managers

- Managers strive to charge a price that will earn a fair profit
  - **Revenue**: Price charged to customers multiplied by the number of units sold
    - Price × Units = Revenue
  - **Profit**: Revenue minus expenses

Learning Objective 2: Pricing Objectives

Pricing Objectives

- Need to be specific, attainable, and measurable
- Categories
  - Profit oriented
  - Sales oriented
  - Status quo

Profit-Oriented Pricing Objectives

- Profit maximization
- Satisfactory profits
- Most common profit objective is a target return on investment (ROI)

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

- The marketing manager can use the standard, such as ten percent ROI, to determine whether a particular price and marketing mix are feasible.

Sales-Oriented Pricing Objectives (1 of 2)

- Maintaining or increasing **market share**
- Maximizing sales

Sales-Oriented Pricing Objectives (2 of 2)

EXHIBIT 19.1 TWO WAYS TO MEASURE MARKET SHARE (UNITS AND REVENUE)

Company	Units Sold	Unit Price	Total Revenue	Unit Market Share	Revenue Market Share
A	1,000	$1.00	$1,000	50	25
B	200	4.00	800	10	20
C	500	2.00	1,000	25	25
D	300	4.00	1,200	15	30
Total	2,000		$4,000		

Status Quo Pricing Objectives

- **Status quo pricing**: Maintains existing prices or meets the competition's prices
  - Leads to suboptimal pricing as it ignores:
    - Customers' perceived value of the firm's goods or services
    - Goods or services offered by the competitors
- This category requires little planning and is essentially a passive policy.

Learning Objective 3: The Demand Determinant of Price

Nature of Demand

- **Demand** is the quantity of a product that will be sold in the market at various prices for a specified period.
- Lower the price, higher the **demand** for a product or service and vice versa.
- **Supply** is the quantity of a product that will be offered to the market by a supplier or suppliers at various prices for a specified period.
- At higher prices, **supply** increases as manufacturers earn more capital and vice versa.

Elasticity of Demand

- Consumers' responsiveness or sensitivity to changes in price
- **Elastic demand**
  - Situation in which consumer demand is sensitive to changes in price
- **Inelastic demand**
  - Situation in which an increase or a decrease in price will not significantly affect the demand for a product

Factors That Affect Elasticity of Demand

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

Learning Objective 4: Power of Dynamic Pricing

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Dynamic Pricing

- More and more companies are turning to dynamic pricing to help adjust prices.
- **Dynamic pricing**: Ability to change prices very quickly in real time
  - Aids brick-and-mortar retailers to compete more efficiently with online alternatives

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Learning Objective 5: The Cost Determinant of Price

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Types of Cost

- **Variable cost**
  - Cost that varies with changes in the level of output
- **Fixed cost**
  - Cost that does not change as output is increased or decreased

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Markup Pricing (1 of 2)

- Cost of buying the product from the producer, plus amounts for profit and for expenses not otherwise accounted for
- To use markup based on cost or selling price effectively, the marketing manager must calculate an adequate gross margin
  - Margin must provide adequate funds to cover selling expenses and profit

Markup Pricing (2 of 2)

Markups are influenced by:

- Experience
- Merchandise's appeal to customers
- Past response to the markup
- Item's promotional value
- Seasonality of the good
- Fashion appeal
- Product's traditional selling price
- Competition

Break-Even Pricing

- Break-even analysis determines what sales volume must be reached before total revenue equals total costs
- Provides a quick estimate of:
  - How much the firm must sell to break even
  - How much profit can be earned if a higher sales volume is obtained
- Limitations
  - Hard to determine if a cost is fixed or variable
  - Ignores demand

Learning Objective 6: Other Determinants of Price

Other Determinants of Price

- Stages in the product life cycle
- Competition, price matching, and customer loyalty
- Distribution strategy
- Impact of the Internet and extranets
- Promotion strategy
- Demands of large customers
- Relationship of price to quality

Stages in the Product Life Cycle (1 of 3)

- Introductory stage
- Growth stage
- Maturity stage
- Decline stage

Stages in the Product Life Cycle (2 of 3)

- Introductory stage—Management usually sets prices high during the introductory stage. One reason is that it hopes to recover its development costs quickly
- Growth stage—As the product enters the growth stage, prices generally begin to stabilize for several reasons. First, competitors have entered the market, increasing the available supply. Second, the product has begun to appeal to a broader market. Finally, economies of scale are lowering costs, and the savings can be passed on to the consumer in the form of lower prices.

Stages in the Product Life Cycle (3 of 3)

- Maturity stage—Maturity usually brings further price decreases as competition increases and inefficient, high-cost firms are eliminated
- Decline stage—The final stage of the life cycle may see further price decreases as the few remaining competitors try to salvage the last vestiges of demand. Prices may eventually rise dramatically if the product survives and moves into the specialty goods category, as horse-drawn carriages and vinyl records have.

Competition, Price Matching, and Customer Loyalty

- Competition varies during the product life cycle, of course, and so at times it may strongly affect pricing decisions.
- Although a firm may not have any competition at first, the high prices it charges may eventually induce another firm to enter the market.
- Companies attempt to build customer loyalty in many ways. One approach is to offer discounts to regular patrons.
- Discounts can be an excellent tool to build customer loyalty, but care must be taken not to compromise profit goals.

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Distribution Strategies

- Adequate distribution for a new product can be attained by:
  - Offering a larger-than-usual profit margin to distributors
  - Giving distributors a large trade allowance to help:
    - Offset the costs of promotion
    - Stimulate demand at the retail level

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Impact of the Internet and Extranets

- Using shopping bots
  - Shopping bots—Searches the web for the best prices for a particular item that one wishes to purchase
    - Give pricing power to the consumer
- Internet auctions
  - Business-to-business auctions may be the dominant form in the future

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Promotion Strategy

- Price is often used as a promotional tool to increase consumer interest.
- Price promotion alone does not always create a low price image.
- Upscale ambiance, expensive specialty offerings, premier locations, a high level of service, and a lack of price matching contribute to a high price image as well.

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Demands of Large Customers

- Manufacturers find that their large customers such as department stores often make specific pricing demands that the suppliers must agree to
- The company recently instituted a policy requiring suppliers to evaluate and disclose the full environmental costs of their products

Relationship of Price to Quality

- Consumers tend to rely on high price as a predictor of good quality when a purchase decision involves uncertainty.
- Higher prices increase expectation and set a reference point against which people can evaluate their consumption experiences.

Learning Objective 7: How to Set a Price on a Product

Establish Pricing Goals

- The first step in setting the right price is to establish pricing goals.
- A good understanding of the marketplace and of the consumer can sometimes tell a manager very quickly whether a goal is realistic.
- A profit maximization objective may require a bigger initial investment than the firm can commit to or wants to commit to.

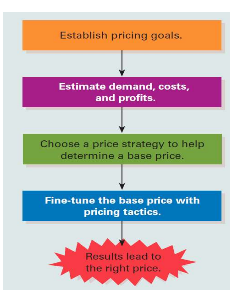
Estimate Demand, Costs, and Profits

- Elasticity is a function of the perceived value to the buyer relative to the price.
- The types of questions managers consider when conducting marketing research on demand and elasticity are key.
- After establishing pricing goals, managers should estimate total revenue at a variety of prices.

Choose a Price Strategy

- **Price strategy** defines the initial price and gives direction for price movements over the product life cycle.
- The price strategy sets a competitive price in a specific market segment based on a well-defined positioning strategy.
- Changing a price level from premium to super premium may require a change in the product itself, the target customers served, the promotional strategy, or the distribution channels

Exhibit 19.3 Steps In Setting The Right Price On A Product



Price Strategy - Approaches

- Price skimming
- Penetration pricing
- Status quo pricing

Price Skimming

- Firm charges a high introductory price, coupled with heavy promotion.
- Situations when skimming is successful .
  - There is strong demand for a good or service.
  - Product is legally well protected, represents a technological breakthrough, or has blocked the entry to competitors.

Penetration Pricing

- Firm charges a relatively low price for a product when it is first rolled out as a way to reach the mass market
- Requires a higher volume of sales to reach break-even point
- Low prices can attract additional buyers to the market
  - Increased sale can justify production expansion or the adoption of new technologies

Status Quo Pricing

- Charging a price identical to or very close to the competition's price
- Advantage—Simplicity
- Disadvantage—Strategy ignores demand or cost or both

Learning Objective 8: The Legality of Price Strategy

Illegal Pricing Strategies

- Unfair trade practices
- Price fixing
- Price discrimination
- Predatory pricing

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Unfair Trade Practices, Price Fixing, and Predatory Pricing

- **Unfair trade practice acts**
  - Laws that prohibit wholesalers and retailers from selling below cost
- **Price fixing**
  - Agreement between two or more firms on the price they will charge for a product
- **Predatory pricing**
  - Practice of charging a very low price for a product with an intent to drive competitors out of business or out of a market

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Robinson-Patman Act of 1936 (1 of 2)

Prohibits:

- Firms from selling similar commodities at different prices to two or more different buyers within a short time
- Sellers from offering two buyers different supplementary services
- Buyers from using their purchasing power to force sellers into granting discriminatory prices or services

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Robinson-Patman Act of 1936 (2 of 2)

Defenses provided for a seller charged with price discrimination

- Cost
- Market conditions
- Competition

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Predatory pricing

- Practice of charging a very low price for a product with the intent of driving competitors out of business or out of a market.
- Once competitors have been driven out, the firm raises its prices.
- This practice is illegal under the Sherman Act and the Federal Trade Commission Act.

Learning Objective 9: Tactics for Fine-Tuning the Base Price

Tactics for Fine-Tuning the Base Price

- Discounts, allowances, and rebates
- Value-based pricing
- Geographic pricing
- Other pricing strategies

Discounts, Allowances, Rebates, and Value-Based Pricing Tactics (1 of 4)

- A base price can be lowered through the use of discounts and the related tactics of allowances, rebates, low or zero percent financing, and value-based pricing. Discounts are used to encourage customers to do what they would not ordinarily do, such as pay cash, take delivery out of season, or performing certain functions within a distribution channel.
- **Quantity discounts** are offered when a customer buys multiple units or above a specified dollar amount. A **cumulative quantity discount** is applied to a buyer's total purchases made during a specific period, whereas a **noncumulative quantity discount** is applied to a single order placed during a certain period.

Discounts, Allowances, Rebates, and Value-Based Pricing Tactics (2 of 4)

- **Cash discounts** are offered in return for prompt payment of a bill.
- **Functional discounts** (**trade discounts**) are offered when channel intermediaries perform a service for the manufacturer.
- **Seasonal discounts** apply when certain merchandise is bought out of season.
- A gambled price discount is based upon the outcome of a probabilistic gamble.
- **Promotional allowances** (or **trade allowance**) are payments to dealers for promoting the manufacturer's products.

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Discounts, Allowances, Rebates, and Value-Based Pricing Tactics (3 of 4)

- **Rebates** are cash refunds given for purchasing a product within a specified period.
- Coupons are discounts offered via paper, a printable web page, or an electronic code.
- Zero percent financing offers no interest charge in order to increase sales. However, it does cost the manufacturers.
- Some websites offer free shipping when a customer shops for a certain amount.

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Discounts, Allowances, Rebates, and Value-Based Pricing Tactics (4 of 4)

- **Value-based pricing** sets the price at a level that seems to the customer to be a good price compared to other prices.
  - The basic assumption with value-based pricing is that the firm is customer driven, seeking to understand the attributes customers want in the goods and services they buy and the value of that bundle of attributes to customers.

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Methods of Geographic Pricing (1 of 3)

- FOB origin pricing
- Uniform delivered pricing
- Zone pricing
- Freight absorption pricing
- Basing-point pricing

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Methods of Geographic Pricing (2 of 3)

- In **FOB origin pricing**, the buyer is required to absorb the freight costs from the shipping point.
- In **uniform delivered pricing**, the seller pays the actual freight charges and bills every purchaser an identical, flat freight charge.
- **Zone pricing** is a modification of uniform delivered pricing. It divides the United States into segments or zones and charges a flat freight rate to all customers in a given zone.

Methods of Geographic Pricing (3 of 3)

- In **freight absorption pricing**, the seller pays all or part of the actual freight charges and does not pass them on to the buyer.
- **Basing-point pricing** involves charging freight from a given point, regardless of the city from which the goods are shipped.

Other Pricing Tactics (1 of 5)

- Single-price tactic
- Flexible pricing (variable pricing)
- Professional services pricing
- Price lining
- Leader pricing (loss-leader pricing)
- Bait pricing
- Odd–even pricing (psychological pricing)
- Price bundling
- Two-part pricing
- Pay what you want
- Package content reduction

Other Pricing Tactics (2 of 5)

- Other pricing tactics are unique and defy neat categorization. Managers use these tactics to stimulate demand for specific products, to increase store patronage, and to offer a wider variety of merchandise at a specific price point.
  - A merchant using **single-price tactic** offers all goods and services at the same price.
  - With **flexible pricing (variable pricing)**, different customers pay different prices for essentially the same merchandise bought in equal quantities.

Other Pricing Tactics (3 of 5)

- Professional services pricing is used by people with lengthy experience, training, and often certification by a licensing board.
- **Price lining** is the practice of offering a product line with several items at specific price points.
- In **leader pricing (loss-leader pricing)**, a product is sold near or even below cost in the hope that shoppers will buy other items once they are in the store.

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Other Pricing Tactics (4 of 5)

- **Bait pricing** tries to get consumers into a store through false or misleading price advertising and uses high-pressure selling to persuade consumers to buy more expensive merchandise.
- The **odd–even pricing** tactic uses odd-numbered prices to connote bargains and even numbered prices to imply quality.
- **Price bundling** involves marketing two or more products in a single package for a special price.
- The **two-part pricing** strategy charges two separate amounts to consume a single good or service.

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Other Pricing Tactics (5 of 5)

- Pay what you want is a risky tactic that people use to pay for something what they think it is worth.
- Manufacturers keep the price and package size the same while reducing the amount of content.

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Consumer Penalties

- Extra fee paid by the consumer for violating the terms of the purchase agreement
- Businesses impose penalties when:
  - They suffer an irrevocable revenue loss.
  - They incur significant additional transaction costs if customers are unable or unwilling to complete their purchase obligations.

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Key Terms (1 of 6)

- Price
- Revenue
- Profit
- Return on investment (ROI)
- Market share
- Status quo pricing
- Demand
- Supply
- Elasticity of demand
- Elastic demand

Key Terms (2 of 6)

- Inelastic demand
- Dynamic pricing
- Variable cost
- Fixed cost
- Markup pricing
- Keystoning
- Break-even analysis
- Extranet
- Price strategy

Key Terms (3 of 6)

- Price skimming
- Penetration pricing
- Unfair trade practice acts
- Price fixing
- Predatory pricing
- Base price
- Quantity discount
- Cumulative quantity discount

Key Terms (4 of 6)

- Noncumulative quantity discount
- Cash discount
- Functional discount (trade discount)
- Seasonal discount
- Promotional allowance (trade allowance)
- Rebate
- Value-based pricing
- FOB origin pricing

Key Terms (5 of 6)

- Uniform delivered pricing
- Zone pricing
- Freight absorption pricing
- Basing-point pricing
- Single-price tactic
- Flexible pricing (variable pricing)
- Price lining

Key Terms (6 of 6)

- Leader pricing (loss-leader pricing)
- Bait pricing
- Odd–even pricing (psychological pricing)
- Price bundling
- Two-part pricing
- Consumer penalty