Pricing Concepts

MKTG 8

Chapter 19

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Learning Outcomes

- LO1 Discuss the importance of pricing decisions to the economy and to the individual firm
- LO2 List and explain a variety of pricing objectives
- LO3 Explain the role of demand in price determination

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Learning Outcomes

- LO4 Understand the concept of yield management systems
- LO5 Describe cost-oriented pricing strategies
- LO6 Demonstrate how the product life cycle, competition, distribution and promotion strategies, customer demands, the Internet and extranets, and perceptions of quality can affect price

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The Importance of Price

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

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LO1

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

LO1

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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."

LO1

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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.**

LO1

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Trends Influencing Price

Flood of new products

Increased availability of bargain-priced private and generic brands

Price cutting as a strategy to maintain or regain market share

Internet used for comparison shopping

U.S. recession from late 2007 to 2009.

LO1

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Pricing Objectives

List and explain a variety of pricing objectives

LO2

Pricing Objectives

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

LO2

Profit-Oriented Pricing Objectives

Profit-Oriented Pricing Objectives

- Profit Maximization
- Satisfactory Profits
- Target Return on Investment

LO2

Profit Maximization

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

LO2

Return on Investment (ROI)

Net profit after taxes divided by total assets.

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

LO2

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Sales-Oriented Pricing Objectives

Sales-Oriented Pricing Objectives

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

LO2

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Market Share

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

LO2

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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

LO2

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Status Quo Pricing Objectives

Status Quo Pricing Objectives

- **Maintain existing prices**
- **Meet competition's prices**

LO2

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The Demand Determinant of Price

Explain the role of demand in price determination

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LO3

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.

LO3

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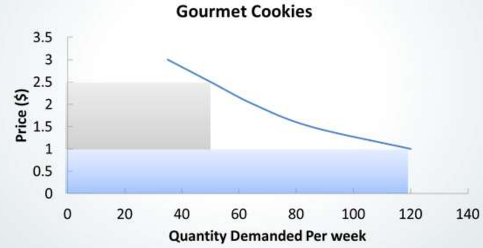
Exhibit 19.2

Demand Curve and Demand Schedule for Gourmet Cookies



Price per package of gourmet cookies ($)	Packages of gourmet cookies demanded per week	Price per package of gourmet cookies ($)	Packages of gourmet cookies demanded per week
3.00	35	1.50	85
2.50	50	1.00	120
2.00	65		

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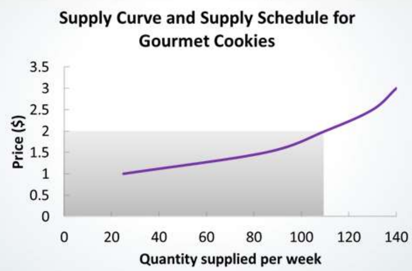
Exhibit 19.3



Price per package of gourmet cookies ($)	Packages of gourmet cookies supplied per week	Price per package of gourmet cookies ($)	Packages of gourmet cookies supplied per week
3.00	140	1.50	85
2.50	130	1.00	25
2.00	110		

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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.

LO3

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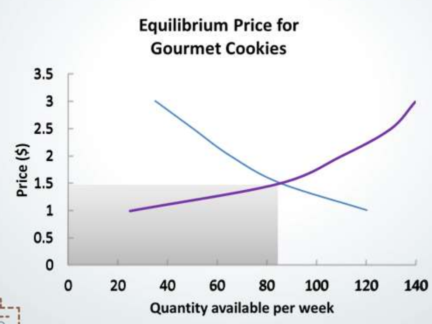
Exhibit 19.4



LO3

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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.
Unitary Elasticity	An increase in sales exactly offsets a decrease in prices, so total revenue remains the same.

LO3

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Elasticity of Demand

$$\text{Elasticity } (E) = \frac{\text{Percentage change in quantity demanded of good A}}{\text{Percentage change in price of good A}}$$

If $E > 1$, demand is elastic.
If $E < 1$, demand is inelastic.
If $E = 1$, demand is unitary.

LO3

Elasticity of Demand

Price Goes…	Revenue Goes…	Demand is…
Down	Up	Elastic
Down	Down	Inelastic
Up	Up	Inelastic
Up	Down	Elastic
Up or Down	Stays the Same	Unitary Elasticity

LO3

Factors that Affect Elasticity of Demand

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

LO3

The Power of Dynamic Pricing and Yield Management Systems

Understand the concept of yield management systems

LO4

Yield Management Systems

Discounting early purchases

Limiting early sales at discounted prices

Overbooking capacity

LO4

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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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LO4

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Yield Management Systems

Supply Side of Product or Service

Capital Intensity			
	High	Office block House	Airline seat Utilities Sport event Rental car
	Low	Shirt Pencils	Food Tropical fish
		Low	High
		Perishability	

SOURCE: "Dynamic Pricing Schemes—Established Supplier Led Pricing—Yield Management," online at http://www.managingchange.com/hynamic/yieldmgt.htm, accessed November 7, 2007.

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Yield Management Systems

Demand Side of Product or Service

Variability of Demand			
	High	Utilities Highway use Telephone	Airline seat Sport event Rental car Mobile phone
	Low	Food Music CD Shirt	Office block Laptop House
		Low	High
		Variability of Value	

SOURCE: "Dynamic Pricing Schemes—Established Supplier Led Pricing—Yield Management," online at http://www.managingchange.com/hynamic/yieldmgt.htm, accessed November 7, 2007.

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The Cost Determinant of Price

Describe cost-oriented pricing strategies

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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

LO5 34

The Cost Determinant of Price

Average Variable Cost (AVC): Total variable cost divided by quantity of output.

Average Total Cost (ATC): Total costs divided by quantity of output.

Marginal Cost (MC): The change in total costs associated with a one-unit change in output.

LO5 35

The Cost Determinant of Price

Methods Used to Set Prices

- Markup pricing
- Keystoning
- Profit Maximization Pricing
- Break-Even Pricing

LO5 36

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.

LO5

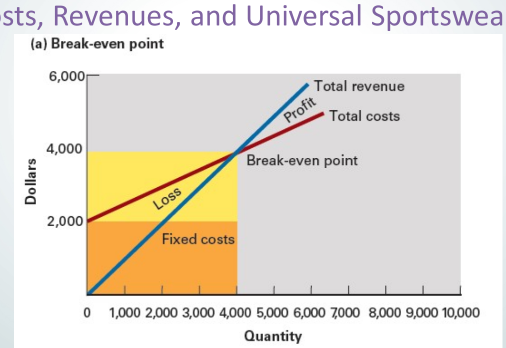
Profit Maximization

Profit Maximization	A method of setting prices that occurs when marginal revenue equals marginal cost.
Marginal Revenue (MR)	The extra revenue associated with selling an extra unit of output, or the change in total revenue with a one-unit change in output.

LO5

Exhibit 19.7

Costs, Revenues, and Universal Sportswear



Break-Even Pricing

Break-Even Quantity = **Total fixed costs / Fixed cost contribution**

Fixed cost Contribution = **Price - Avg. Variable Cost**

LO5

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

LO6

Other Determinants of Price

- Stages of the Product Life Cycle
- Competition
- Distribution Strategy
- Promotion Strategy
- Perceived Quality

LO6

Stages in the Product Life Cycle

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

LO6

The Competition

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

LO6

Distribution Strategy

Manufacturers	Wholesalers/Retailers
• Offer a larger profit margin or trade allowance • Use exclusive distribution • Franchising • Avoid business with price-cutting discounters • Develop brand loyalty	• Sell against the brand • Buy gray-market goods

LO6

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The Impact of the Internet

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.

LO6

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Promotion Strategy

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

LO6

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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.

LO6

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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.

Prestige Pricing

Charging a high price to help promote a high-quality image.

LO6

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Dimensions of Quality

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

LO6

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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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