

Setting the Right Price

MKTG 8

Chapter 20

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2014-2015

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Learning Outcomes

- LO¹ Describe the procedure for setting the right price
- LO² Identify the legal and ethical constraints on pricing decisions
- LO³ Explain how discounts, geographic pricing, and other special pricing tactics can be used to fine-tune the base price
- LO⁴ Discuss product line pricing
- LO⁵ Describe the role of pricing during periods of inflation and recession

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How to Set a Price on a Product

Describe the procedure for setting the right price

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Exhibit 20.1

New-Product Development Process

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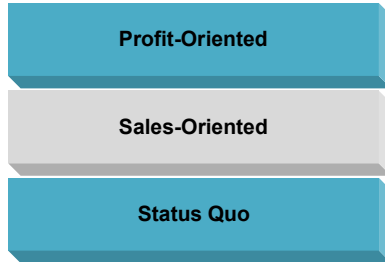
graph TD
    A[Establish pricing goals] --> B[Estimate demand, costs, and profits]
    B --> C[Choose a price strategy]
    C --> D[Fine-tune with pricing tactics]
    D --> E[Results lead to the right price]
    
```

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Establish Pricing Goals

Pricing objectives fall into three categories:



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Choose a Price Strategy

A basic, long-term pricing framework that establishes the initial price for a product and the intended direction for price movements over the product life cycle.

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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. |

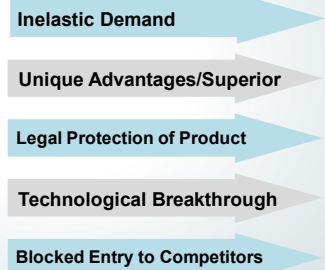
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Price Skimming

Situations When Price Skimming Is Successful



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Penetration Pricing

Advantages

- Can lead to lower cost per unit as production expands
- Discourages or blocks competition from market entry
- Boosts sales and provides large profit increases

Disadvantages

- Requires gear up for mass production
- Selling large volumes at low prices
- Strategy to gain market share may fail

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Status Quo Pricing

Advantages

- Simplicity
- Safest route to long-term survival for small firms

Disadvantages

- Strategy may ignore demand and/or cost

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The Legality of Price Strategy

Identify the legal and ethical constraints on pricing decisions

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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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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

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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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Pricing Products Too Low

Sometimes managers price their products too low, thereby reducing company profits. This seems to happen for two reasons:

1. Managers attempt to buy market share through aggressive pricing.
2. Managers have a natural tendency to want to make decisions that can be justified objectively.

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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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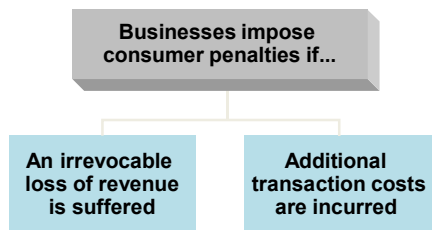
Other Pricing Tactics

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

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Consumer Penalties

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Product Line Pricing

Discuss product line pricing

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Product Line Pricing

Setting prices for an entire line of products.

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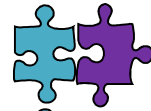
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Relationships among Products

Complementary



Substitutes



Neutral



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Joint Costs

Costs that are shared in the manufacturing and marketing of several products in a product line.

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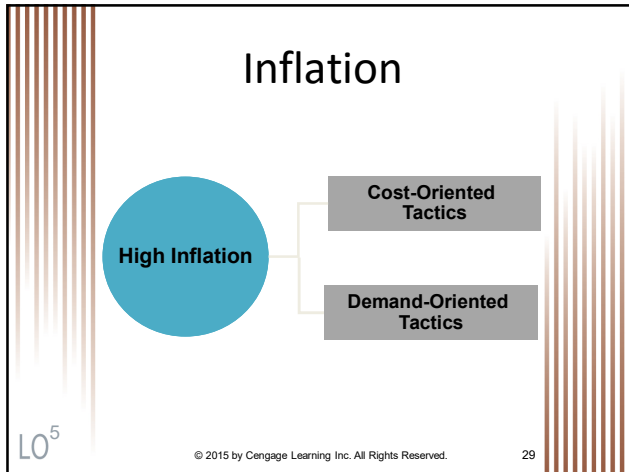
Pricing during Difficult Economic Times

Describe the role of pricing during periods of inflation and recession

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Cost-Oriented Tactics

Problems with Cost-Oriented Tactics

- A high volume of sales on an item with a low profit margin may still make the item highly profitable.
- Eliminating a product may reduce economies of scale.
- Eliminating a product may affect the price-quality image of the entire line.

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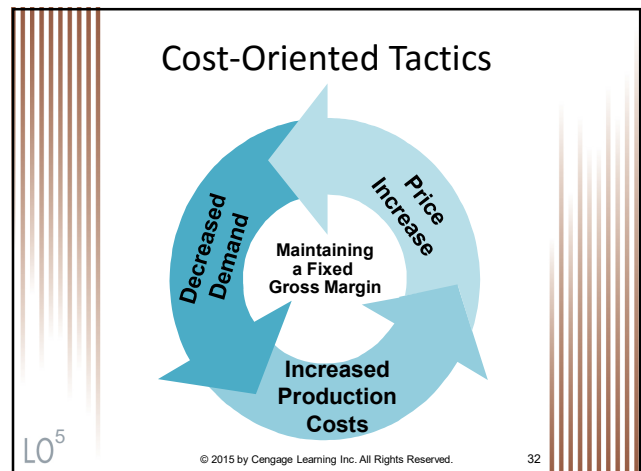
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Cost-Oriented Tactics

- **Delayed-quotation pricing:** Used for industrial installations and many accessory items; firm price is not set until the item is finished or delivered.
- **Escalator pricing:** Final selling price reflects cost increases incurred between the order time and the delivery time.
- Hold prices constant, but add new fees.

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Demand-Oriented Tactics

Price Shading

The use of discounts by salespeople to increase demand for one or more products in a line.

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Demand-Oriented Tactics

Strategies to Make Demand More Inelastic

Cultivate selected demand

Create unique offerings

Change the package design

Heighten buyer dependence

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Recession

Value-Based Pricing

Bundling or Unbundling

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Supplier Strategies during Recession

Renegotiating contracts

Offering help

Keeping the pressure on

Paring down suppliers

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Chapter 20 Video

BoltBus

BoltBus is Greyhound's express bus service that operates off curb-sides in major metropolitan areas. This video clip covers BoltBus pricing decisions and how the company decides what the prices are as well as how it keeps costs down.

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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.

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