

## Chapter 20 Pricing Concepts

MKTG9  
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## LEARNING OUTCOMES

- 20-1 Discuss the importance of pricing decisions to the economy and to the individual firm
- 20-2 List and explain a variety of pricing objectives
- 20-3 Explain the role of demand in price determination

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## LEARNING OUTCOMES

- 20-4 Understand the concepts of dynamic pricing and yield management systems
- 20-5 Describe cost-oriented pricing strategies
- 20-6 Demonstrate how the product life cycle, competition, distribution and promotion strategies, customer demands, the Internet and extranets, and perceptions of quality can affect price

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20-1

## The Importance of Price

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

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## 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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## 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**

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20-2

## Pricing Objectives

List and explain a variety of pricing objectives

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## 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)

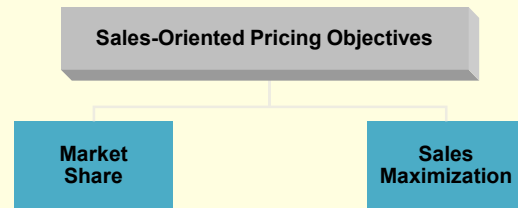
Net profit after taxes divided by total assets.

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

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## Sales-Oriented Pricing Objectives



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## Market Share

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

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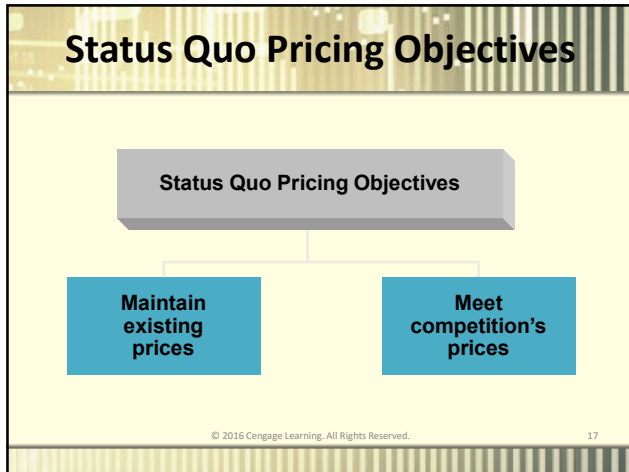
## Sales Maximization

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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20-3

## The Demand Determinant of Price

**Explain the role of demand in price determination**

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## The Demand Determinant of Price

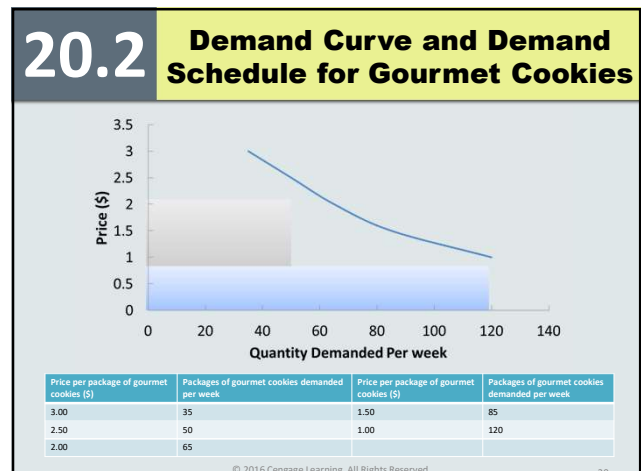
Demand

The quantity of a product that will be sold in the market at various prices for a specified period.

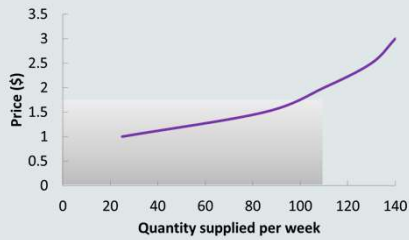
Supply

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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## 20.3 Supply Curve and Supply Schedule for Gourmet Cookies



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.

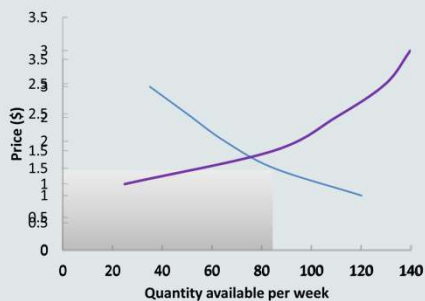
### Elasticity of Demand

Consumers' responsiveness or sensitivity to changes in price.

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## 20.4 Equilibrium Price for Gourmet Cookies



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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.

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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.

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## 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

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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

Rate of inflation

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20-4

## The Power of Dynamic Pricing and Yield Management Systems

Understand the concepts of dynamic pricing and yield management systems

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## 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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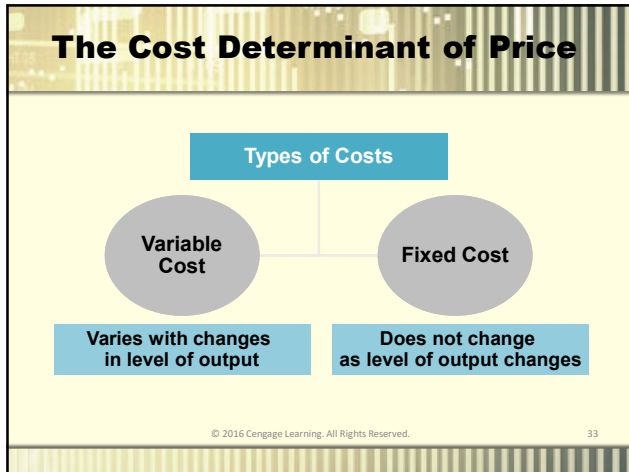
20-5

## The Cost Determinant of Price

**Describe cost-oriented pricing strategies**

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### The Cost Determinant of Price

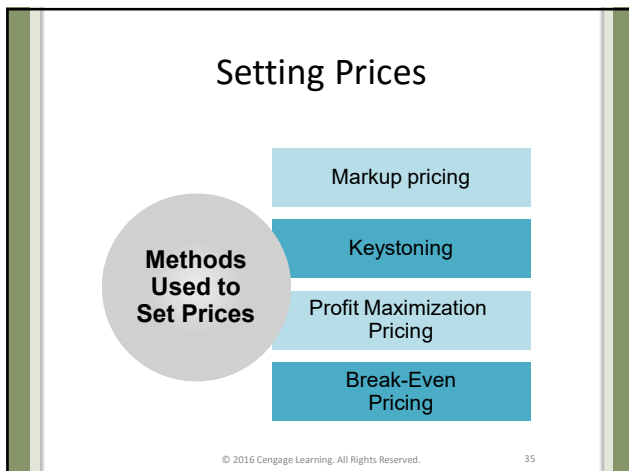
**Average Variable Cost (AVC):** Total variable cost divided by quantity of output.

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

**Average Fixed Cost (AFC):** Total fixed costs divided by quantity of output.

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

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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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## 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.

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## Break-Even Pricing

$$\text{Break-Even Quantity} = \frac{\text{Total fixed costs}}{\text{Fixed cost contribution}}$$

$$\text{Fixed cost Contribution} = \text{Price} - \text{AVC}$$

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20-6

## 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

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## 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.

### **Prestige Pricing**

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

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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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## *Chapter 20 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](#)