Unit 8

Price and Value

Road Map: Previewing the Concepts

- Identify and explain the external and internal factors affecting a firm's pricing decisions.
- Contrast the three general approaches to setting prices.
- Describe the major strategies for pricing imitative and new products.
- Explain how companies find a set of prices that maximizes the profits from the total product mix.
- Discuss how companies adjust their prices to take into account different types of customers and situations.
- Discuss the key issues related to initiating and responding to price changes.

We will begin learning about pricing strategy by discussing beer!

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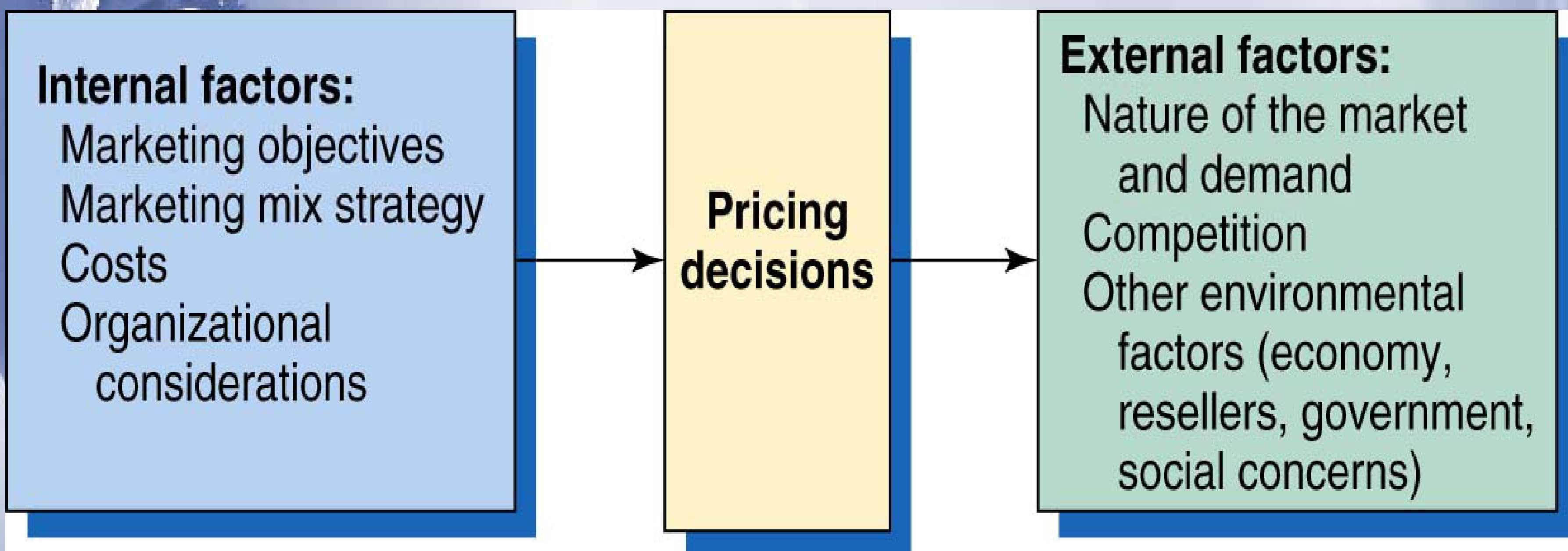
Factors Affecting Price Decisions



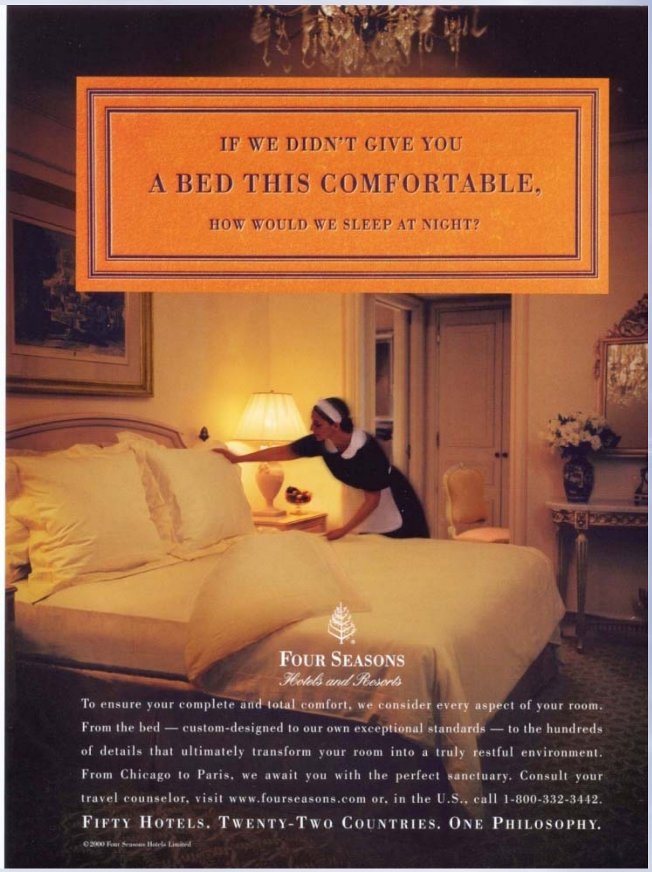
Internal Factors Affecting Pricing Decisions: Marketing Objectives

Marketing Objectives

- **Survival**
  Low Prices Hoping to Increase Demand.
- **Current Profit Maximization**
  Choose the Price that Produces the Maximum Current Profit, Etc.
- **Market Share Leadership**
  Low as Possible Prices to Become the Market Share Leader.
- **Product Quality Leadership**
  High Prices to Cover Higher Performance Quality and R&D.

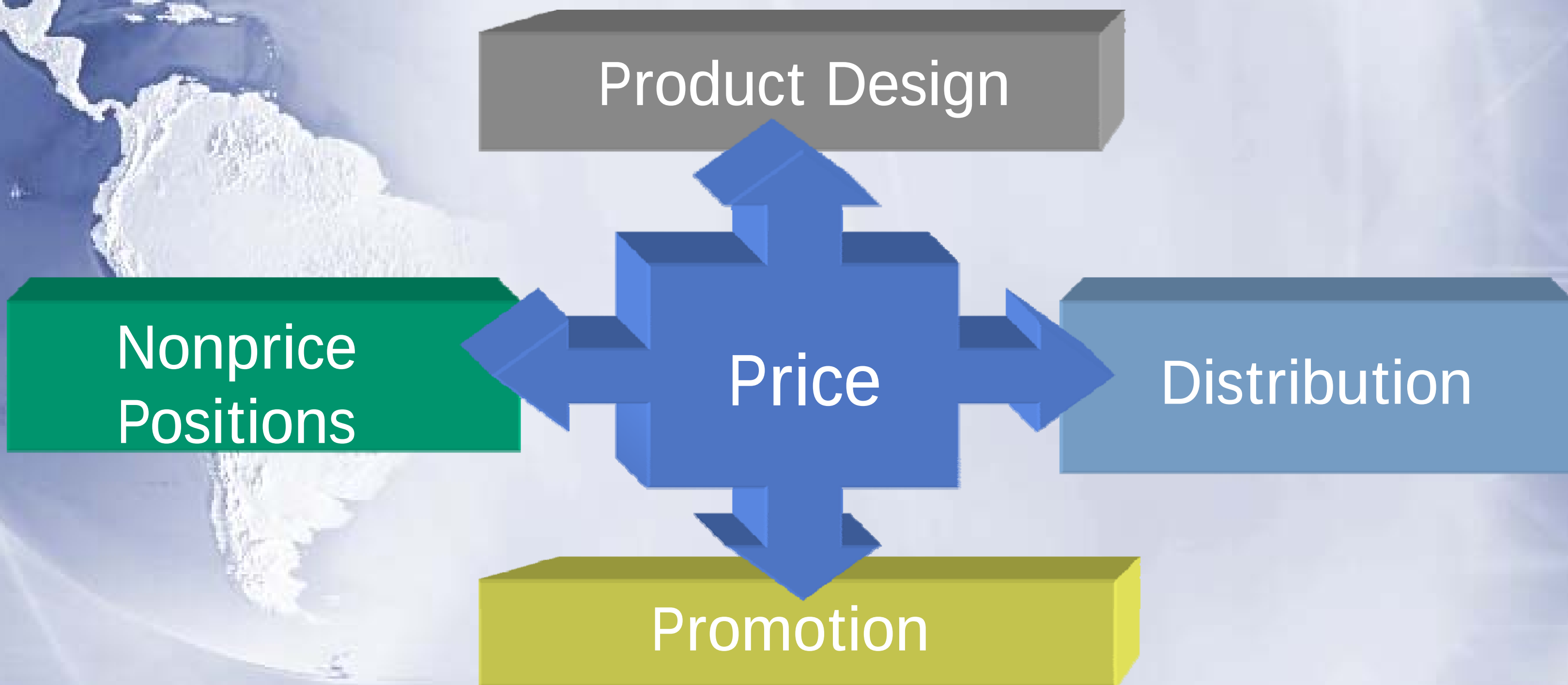
Four Seasons Hotel

- Four Seasons uses the *product quality leadership* strategy.
- It starts with very high quality service, then charges a price to match.
- http://www.fourseasons.com



Internal Factors Affecting Pricing Decisions: Marketing Mix Strategy

Customers Seek Products that Give Them the Best Value in Terms of Benefits Received for the Price Paid.



Types of Cost Factors that Affect Pricing Decisions

Fixed Costs
(Overhead)
Costs that don't
vary with sales or
production levels
Executive Salaries, Rent

Variable Costs

Costs that do vary
directly with the
level of production
Raw materials

Total Costs
Sum of the Fixed and Variable Costs for Any Given
Level of Production

External Factors Affecting Pricing Decisions

Market and Demand

Competitors' Costs, Prices, and Offers

Other External Factors
Economic Conditions
Reseller Reactions
Government Actions
Social Concerns

Market and Demand Factors Affecting Pricing Decisions

Pricing in Different Types of Markets

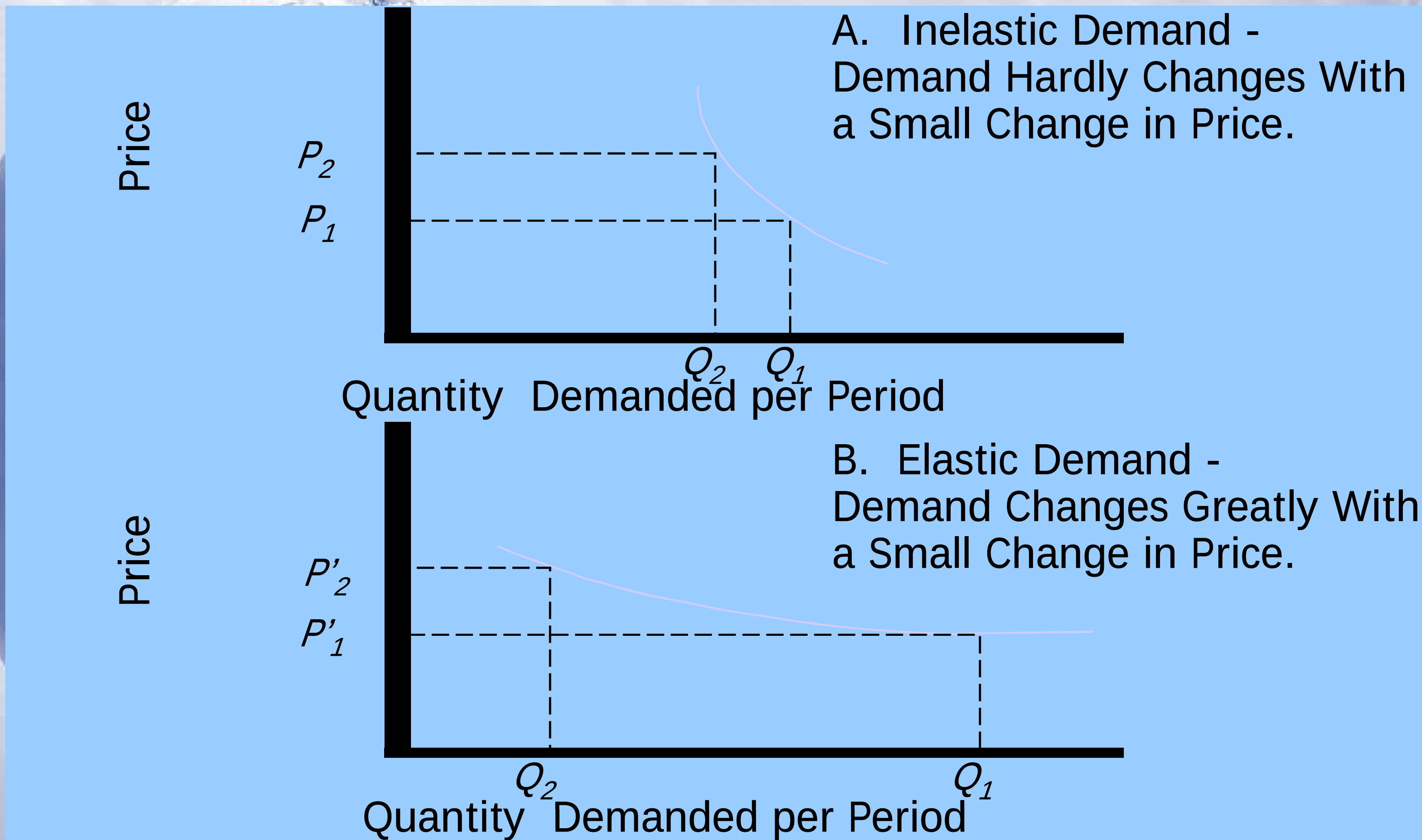
Pure Competition
Many Buyers and Sellers Who Have Little Effect on the Price

Monopolistic Competition
Many Buyers and Sellers Who Trade Over a Range of Prices

Oligopolistic Competition
Few Sellers Who Are Sensitive to Each Other's Pricing/ Marketing Strategies

Pure Monopoly
Single Seller

Price Elasticity of Demand



Major Considerations in Setting Price

LOW PRICE				HIGH PRICE
No possible profit at this price	Product costs	Competitors' prices and other external and internal factors	Consumer perceptions of value	**No possible demand at this price**

Cost-Based Pricing

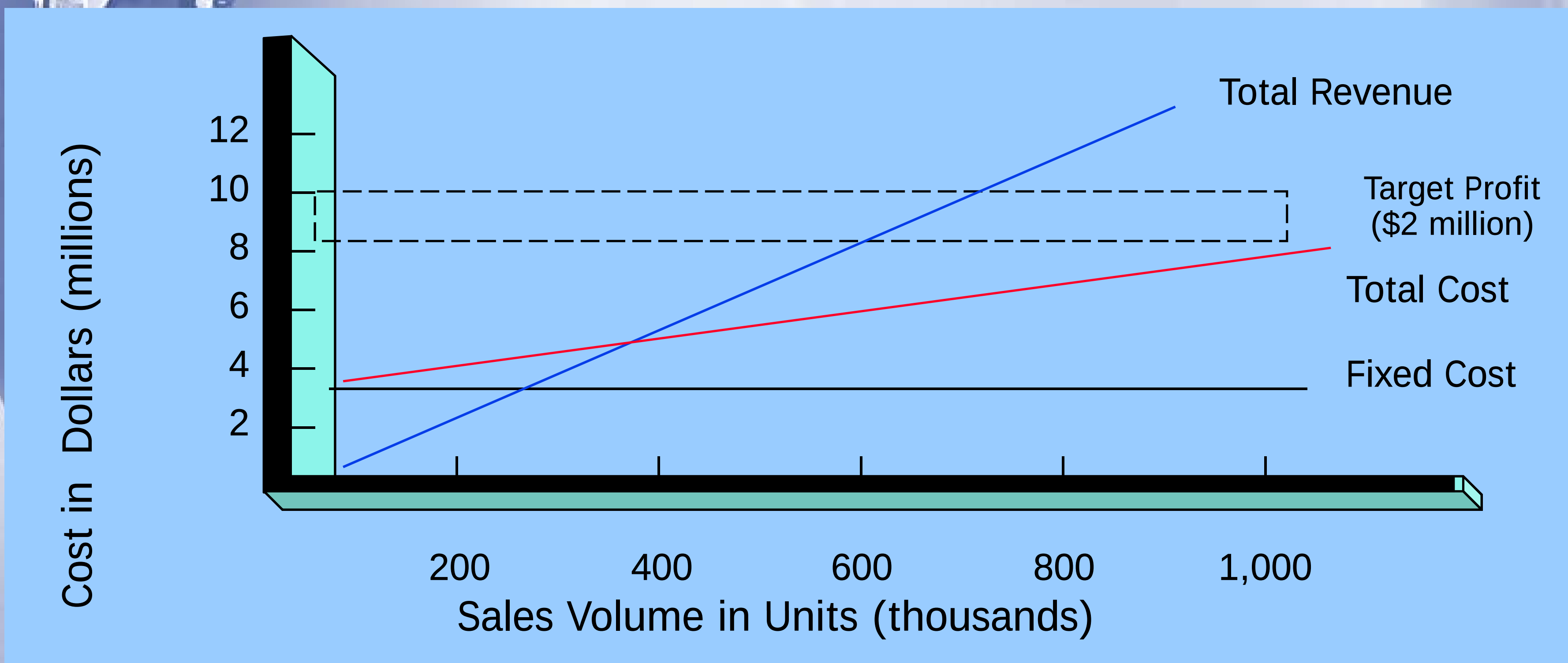
- Certainty About Costs
- Pricing is Simplified
- Price Competition Is Minimised
- Fairer to Buyers & Sellers

Cost-Plus Pricing is an Approach That Adds a Standard Markup to the Cost of the Product

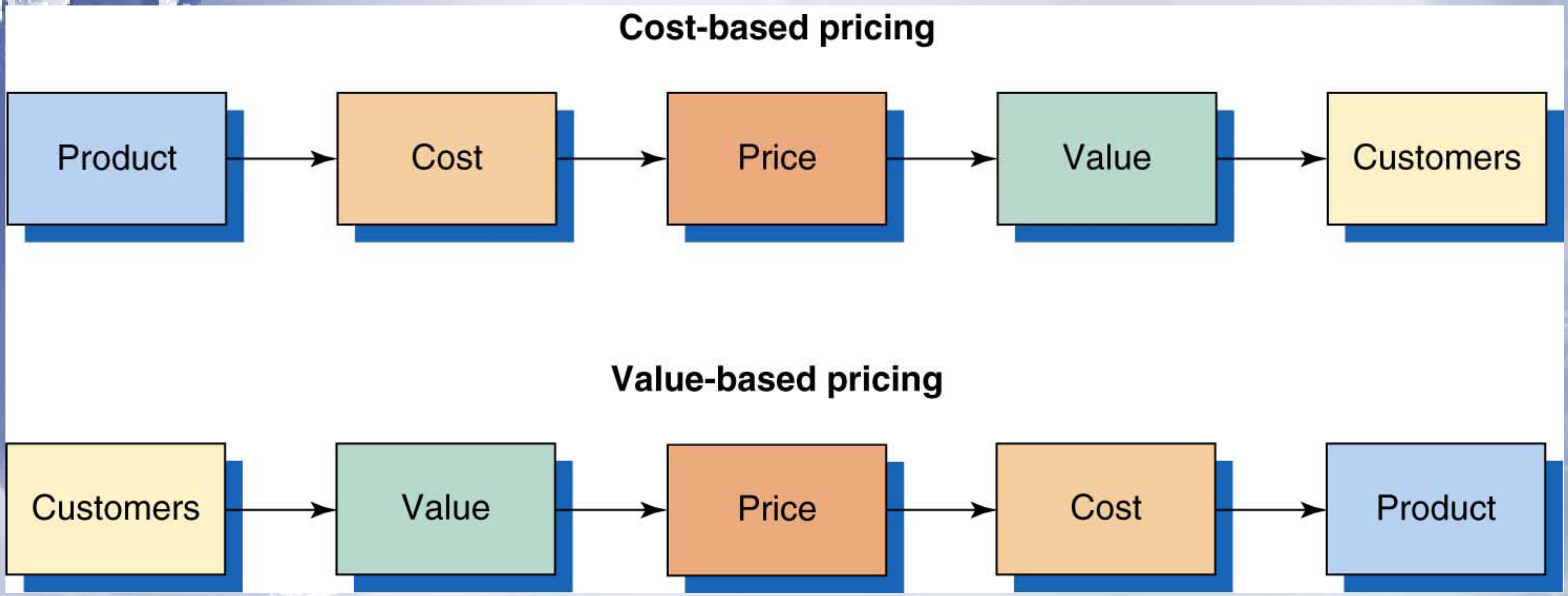
- Simplest Pricing Method
- Ignores Current Demand & Competition

Breakeven Analysis or Target Profit Pricing

Tries to Determine the Price at Which a Firm Will Break Even or Make a Certain Target Profit.



Cost-Based Versus Value-Based Pricing



Interactive Student Assignment

- After examining the previous slide, compare and contrast cost-based pricing and value-based pricing.
- What are situations that favor each pricing method?

Competition-Based Pricing

Methods for Setting Prices

Going-Rate
Company Sets Prices Based on What Competitors Are Charging

Sealed-Bid
Company Sets Prices Based on What They Think Competitors Will Charge

? ?

New-Product Pricing Strategies

Market-Skimming

- Setting a High Price for a New Product to “Skim” Maximum Revenues from the Target Market.
- Results in Fewer, But More Profitable Sales.
- I.e. Intel, Sony Playstation, New Televisions

- Use Under These Conditions:
  - Product’s Quality and Image Must Support Its Higher Price.
  - Costs Can’t be so High that They Cancel the Advantage of Charging More.
  - Competitors Shouldn’t be Able to Enter Market Easily and Undercut the High Price.

New-Product Pricing Strategies

- Use Under These Conditions:
  - Market Must be Highly Price-Sensitive so a Low Price Produces More Market Growth.
  - Production/Distribution Costs Must Fall as Sales Volume Increases.
  - Must Keep Out Competition & Maintain Its Low Price Position or Benefits May Only be Temporary.

Market Penetration

- Setting a Low Price for a New Product in Order to "Penetrate" the Market Quickly and Deeply.
- Attract a Large Number of Buyers and Win a Larger Market Share.
- I.e. Dell

Interactive Student Assignment

- Which pricing strategy – (Market Skimming or Market Penetration) does each of the following companies/products use?
  - **McDonald's,**
  - **Sony (television and other home electronics),**
  - **Bic Corporation (pens, lighters, shavers, and related products), and**
  - **IBM (personal computers).**
  - **Salt**

Product Mix-Pricing Strategies: Product Line Pricing

- Involves setting price steps between various products in a product line based on:
  - Cost differences between products,
  - Customer evaluations of different features, and
  - Competitors' prices.

Product Mix-Pricing Strategies

- Optional-Product
  - Pricing optional or accessory products sold with the main product. i.e camera bag.
- Captive-Product
  - Pricing products that must be used with the main product. i.e. film.

Adjusting Basic Price to Reward Customers for Certain Responses

- Cash Discount
- Quantity Discount
- Functional Discount
- Seasonal Discount
- Trade-in Allowance
- Promotional Alowance

Segmented Pricing

- Selling Products at two or more prices even through there is no difference in cost.
  - Customer Segment
  - Product - Form
  - Location Pricing
  - Time Pricing

How much does a bottle of perfume cost?

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Psychological Pricing

- Considers the psychology of prices and not simply the economics.
- Customers use price <u>less</u> when they can judge quality of a product.
- Price becomes an important quality signal when customers can't judge quality; price is used to say something about a product.

Promotional Pricing

Temporarily Pricing Products Below List Price Through:

- Loss Leaders
- Special-Event Pricing
- Cash Rebates
- Low-Interest Financing
- Longer Warranties
- Free Maintenance
- Discounts

Other Price Adjustment Strategies

Geographical Pricing

- Pricing products for customers located in different parts of the country or world.
- i.e. FOB-Origin, Uniform-Delivered, Zone, Basing-Point, & Freight-Absorption.

International Pricing

- Adjusting prices for customers in different counties.
- Price Depends on Costs, Consumers, Economic Conditions, Competitive Situations, & Other Factors.

Initiating Price Changes

Price Cuts

Why?

Excess Capacity

Falling Market Share

Dominate Market Through Lower Costs

Price Increases

Why?

Cost Inflation

Overdemand: Company Can’t Supply All Customers’ Needs

Reactions to Price Changes

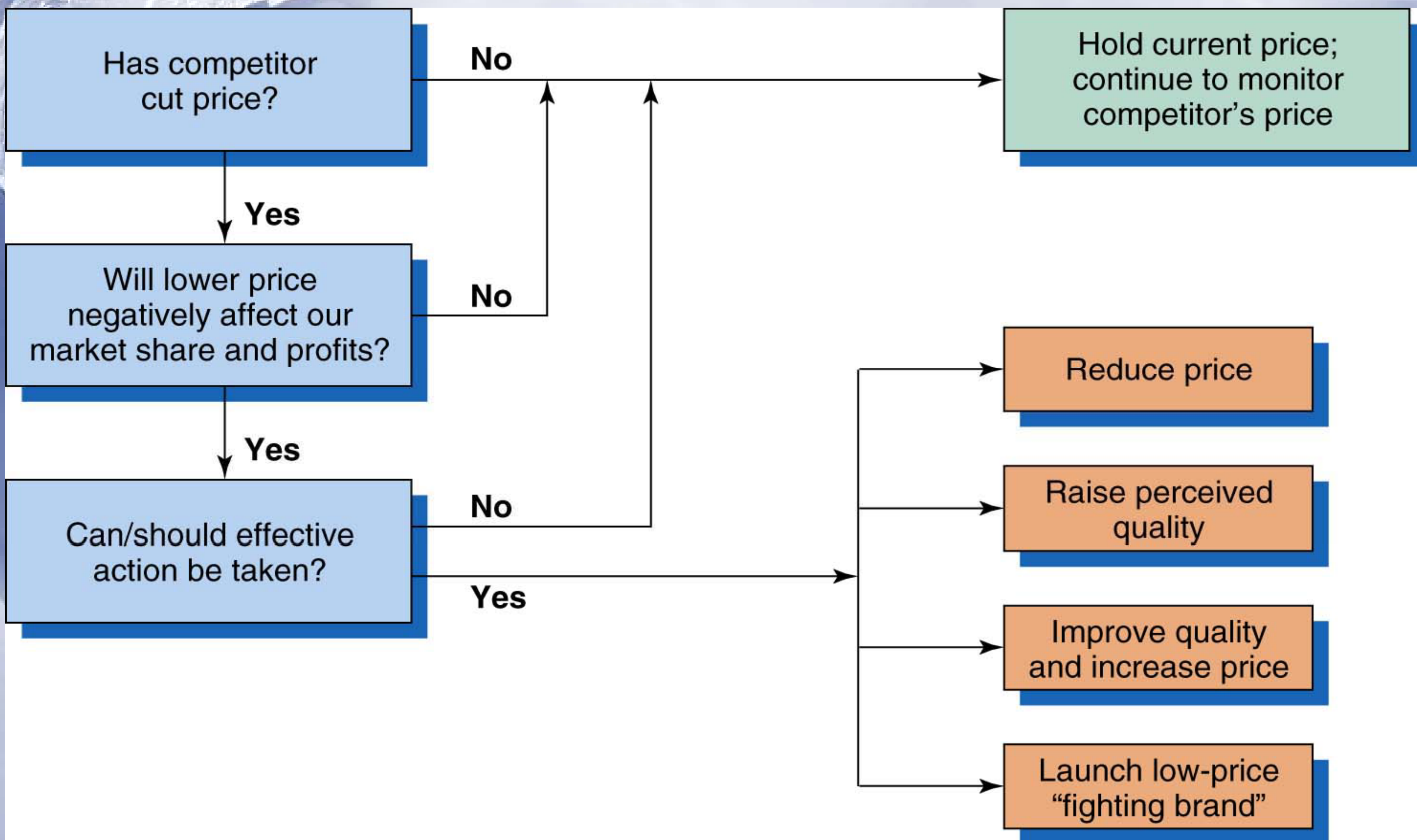
Price Cuts Are Seen by Buyers As:

- Being Replaced by Newer Models
- Current Models Are Not Selling Well
- Company is in Financial Trouble
- Quality Has Been Reduced
- Price May Come Down Further

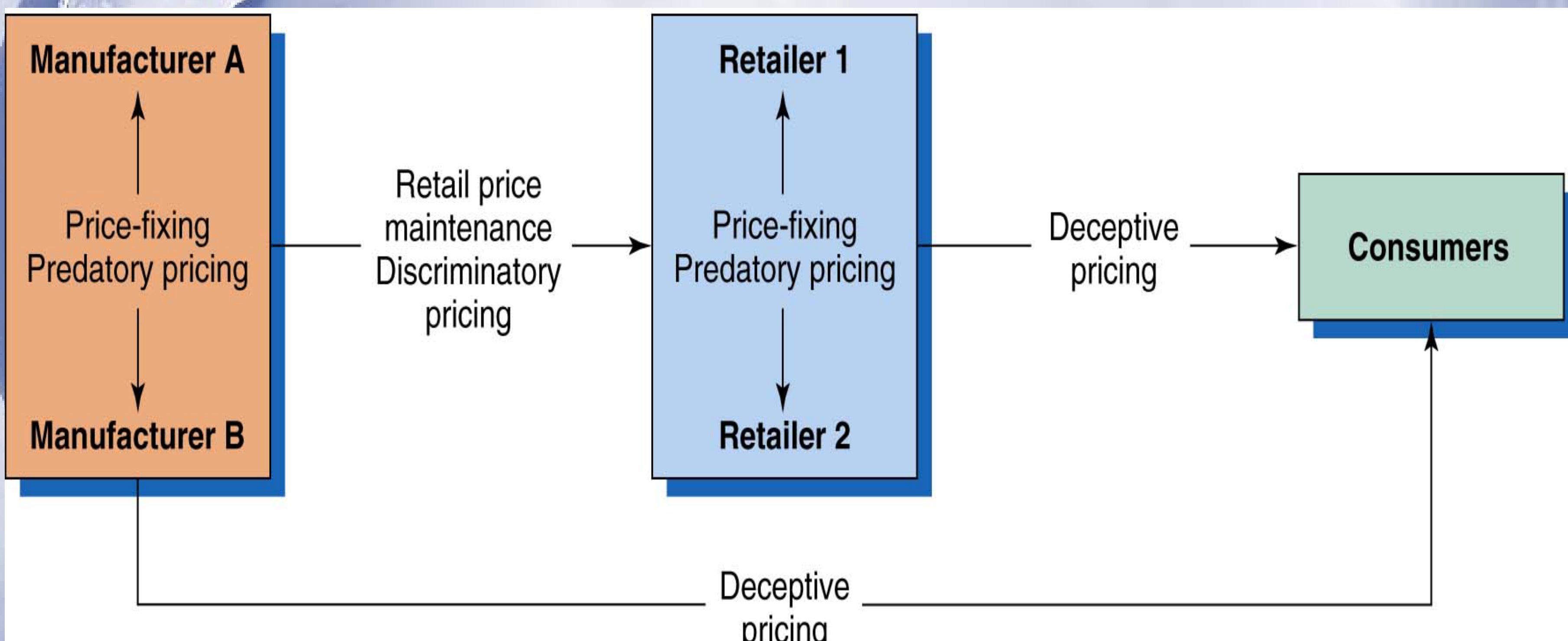
Competitors Mostly React When:

- Number of Firms is Small
- Product is Uniform
- Buyers are Well Informed

Assessing/Responding to Competitor's Price Changes



Public Policy Issues in Pricing



Rest Stop: Reviewing the Concepts

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