CHAPTER 19

Pricing Concepts

Essentials of Marketing
Lamb, Hair, McDaniel

Designed by Eric Brengle
B-books, Ltd.

Prepared by Deborah Baker
Texas Christian University
Discuss the importance of pricing decisions to the economy and to the individual firm.
THE IMPORTANCE OF PRICE

To the seller...
Price is revenue

To the consumer...
Price is the cost of something

Setting Price is one of the hardest tasks for a marketing manager
WHAT IS PRICE?

Price is that which is given up in an exchange to acquire a good or service.

The overall sacrifice a customer is willing to make – money, time, energy – to acquire a specific product or service.
## TERMS USED TO DESCRIBE PRICE

<table>
<thead>
<tr>
<th>Tuition</th>
<th>Commission</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium</td>
<td>Dues</td>
</tr>
<tr>
<td>Fine</td>
<td>Deposit</td>
</tr>
<tr>
<td>Fee</td>
<td>Tips</td>
</tr>
<tr>
<td>Fare</td>
<td>Interest</td>
</tr>
<tr>
<td>Toll</td>
<td>Taxes</td>
</tr>
<tr>
<td>Rent</td>
<td></td>
</tr>
</tbody>
</table>
THE IMPORTANCE OF PRICE TO MARKETING MANAGERS

Revenue

The price charged to customers multiplied by the number of units sold.

Profit

Revenue minus expenses

(Profits drive growth, salaries, and corporate investments).

Revenue - $100 x 25 candles = $2,500
Profit = $2,500 – 500 candle supplies = $2,000
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
List and explain a variety of pricing objectives
PRICING OBJECTIVES

Profit-Oriented

Sales-Oriented

Status Quo
1. PROFIT-ORIENTED PRICING OBJECTIVES

Profit-Oriented Pricing Objectives

- Profit Maximization
- Satisfactory Profits
- Target Return on Investment
Profit Maximization

(Profit = Revenue – Expenses)

Setting prices so that total revenue is as large as possible relative to total costs.
If the competitive market is not intense a firm may charge the highest price that consumers are willing to pay.

Sometimes you may have an advantage for reasons based on:

- geographic advantage
- special features not available on other competitors' products (tablets launched with flash)
- Very, very famous brand.
THE RODDLER - $2,500
Increase Customer Service

Reduce Operating Costs (expensed)
2. SATISFACTORY PROFITS

Satisfactory Profits

Setting prices so that profits are reasonable or satisfactory to stockholders and management.
1. PROFIT-ORIENTED PRICING OBJECTIVES

Profit-Oriented Pricing Objectives

- Profit Maximization
- Satisfactory Profits
- Target Return on Investment
RETURN ON INVESTMENT

ROI = \frac{\text{Net Profit after taxes}}{\text{Total assets}}
Assume Morningstar has assets of $1.2 million and net profits of $100,000 and a target ROI of 5%.

ROI = $100,000
$1,200,000
= 8.3%
TARGET RETURN ON INVESTMENT (ROI)

- Most common profit objective
- The higher the firms ROI, the better off the firm is
- Puts the firms profits into perspective by showing profits relative to investment
- Just because a firm has a large market share, does not necessarily mean high profits

\[
\text{ROI} = \frac{\text{Net Profit after taxes}}{\text{Total assets}}
\]
PRICING OBJECTIVES

- Profit-Oriented
- Sales-Oriented
- Status Quo
Sales-Oriented Pricing Objectives

A company objective based on the belief that increasing sales will help the firm more than will increasing profits.
2. SALES-ORIENTED PRICING OBJECTIVES

Sales-Oriented Pricing Objectives

- Market Share
- Sales Maximization
The percentage of an industry or market's total sales that is earned by a particular company over a specified time period.

Market share is calculated by taking the company's sales over the period and dividing it by the total sales of the industry over the same period.
Short-term objective to maximize sales

Ignores profits, competition, and the marketing environment

May be used to sell off excess inventory

Used to maximize year end sales to meet sales objectives
PRICING OBJECTIVES

- Profit-Oriented
- Sales-Oriented
- Status Quo
STATUS QUO PRICING

Status Quo

A competitor oriented strategy in which a firm changes prices only to meet those of the competition.
Michelangelo decides to open a pizza restaurant called Michelangelo's Pizza Palace.

His current pizza is pretty good, but it is not much different from his direct competitor down the street--- Leonardo's Pizza Pie.

Leonardo charges $10 for a medium cheese pizza, so Michelangelo decides to also charge $10 for his medium cheese pizza.

Status quo pricing strategy copies the price levels of its competitors or maintains the current price levels of similar products or services in the market.
3. STATUS QUO PRICING OBJECTIVES

- Maintain existing prices
- Meet competition’s prices
PRICING OBJECTIVES

Profit-Oriented

- Profit Maximization
- Satisfactory Profits
- Target ROI

Sales-Oriented

- Market Share
- Sales Maximization

Status Quo

Meet the competition
Explain the role of demand in price determination
THE DEMAND DETERMINANT OF PRICE

Demand
Describes a consumer’s desire and willingness to pay a price for a specific good or service.

Supply
The quantity of a commodity that is in the market and available for purchase at a particular price.
### Demand Curve and Demand Schedule for Gourmet Cookies

<table>
<thead>
<tr>
<th>Price per package of gourmet cookies ($)</th>
<th>Packages of gourmet cookies demanded per week</th>
<th>Price per package of gourmet cookies ($)</th>
<th>Packages of gourmet cookies demanded per week</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.00</td>
<td>35</td>
<td>1.50</td>
<td>85</td>
</tr>
<tr>
<td>2.50</td>
<td>50</td>
<td>1.00</td>
<td>120</td>
</tr>
<tr>
<td>2.00</td>
<td>65</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Supply Curve and Supply Schedule for Gourmet Cookies

<table>
<thead>
<tr>
<th>Price per package of gourmet cookies ($)</th>
<th>Packages of gourmet cookies supplied per week</th>
<th>Price per package of gourmet cookies ($)</th>
<th>Packages of gourmet cookies supplied per week</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.00</td>
<td>140</td>
<td>1.50</td>
<td>85</td>
</tr>
<tr>
<td>2.50</td>
<td>130</td>
<td>1.00</td>
<td>25</td>
</tr>
<tr>
<td>2.00</td>
<td>110</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
**VIDEO GAMES**

**Supplier - Manufacturer**
Higher $, higher supply
Lower $, lower supply

**Demand Curve** – Consumer Controls

**Supply Curve** – Supplier controls

**E** – Equilibrium Set Price – Demand & Supply Equal

**Surplus** – Supply > Demand
**Shortage** – Demand > Supply

**Consumers**
Higher $, lower demand
Lower $, higher demand
Apple launched knowing that consumer demand for Apple Watch would “exceed our supply at launch”

- Shoppers interested in the Apple Watch will at first only be able to place orders for the device online.

![Demand Curve - Consumer Controls](image1)

![Supply Curve - Supplier controls](image2)

E = Equilibrium Set Price

$\begin{align*}
\text{Quantity} & \quad 10 \quad 20 \quad 30 \quad 40 \quad 50 \\
\text{Supply Curve - Supplier controls} & \quad \|
\end{align*}$

$\begin{align*}
\text{Demand Curve - Consumer Controls} & \quad \|
\end{align*}$
A demand curve shows how many units of a product or service consumers will demand during a specific period of time at different prices.

- Typically, there is an inverse relationship between the price of a product and the quantity demanded.

- The point at which it intersects the supply curve for the same commodity supposedly establishes the price of the commodity in a free market.
How demand and supply establish price

Elasticity of Demand

Consumers’ responsiveness or sensitivity to changes in price.

How does a change in price impact quantity demanded?

Measured as: \( \frac{\% \text{ change in quantity}}{\% \text{ change in price}} \)
ELASTICITY OF DEMAND

Elastic Demand
Consumers buy more or less of a product when the price changes. - Concert tickets, food, clothing

Inelastic Demand
An increase or a decrease in price will not significantly affect demand. - Insulin, gas, cigarettes, medication

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

<table>
<thead>
<tr>
<th>Price Goes...</th>
<th>Revenue Goes...</th>
<th>Demand is...</th>
</tr>
</thead>
<tbody>
<tr>
<td>Down</td>
<td>Up</td>
<td>Elastic</td>
</tr>
<tr>
<td>Down</td>
<td>Down</td>
<td>Inelastic</td>
</tr>
<tr>
<td>Up</td>
<td>Up</td>
<td>Inelastic</td>
</tr>
<tr>
<td>Up</td>
<td>Down</td>
<td>Elastic</td>
</tr>
<tr>
<td>Up or Down</td>
<td>Stays the Same</td>
<td>Unitary Elasticity</td>
</tr>
</tbody>
</table>
ELASTICITY OF DEMAND

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.
FACTORS THAT AFFECT ELASTICITY OF DEMAND

- Availability of substitutes
- Price relative to purchasing power
- Product durability
- A product’s other uses
- Rate of inflation
Reference prices are prices that buyers carry in their minds and refer to when looking at a given product.

Reference price is one component of psychological pricing, in which the sellers consider the psychology of prices and not simply the economics.
Odd prices may be so traditional that sellers are afraid to round them off.
They may suggest a good deal.
They may also suggest low quality.
Most inexperienced consumers use price as an indicator of quality.

Price becomes crucial when consumers have little knowledge about certain products/brands.

Wine ranges in price from under $5 a bottle to over $100K a bottle. How do you know which to choose?
EVERYDAY LOW PRICING VS. HIGH/LOW PRICING

Create value in different ways

EDLP saves search costs of finding lowest overall prices

High/low provides the thrill of the chase for the lowest price

Everyday low pricing (EDLP) vs. High/low pricing
Other Determinants of Price

- Stages of the Product Life Cycle
- Competition
- Distribution Strategy
- Promotion Strategy
- Perceived Quality
1. STAGES IN THE PRODUCT LIFE CYCLE

- **Introductory Stage**
  - $\text{High}$

- **Growth Stage**
  - $\text{Stable}$

- **Maturity Stage**
  - $\text{Decrease}$

- **Decline Stage**
  - $\text{Decrease}$
  - $\text{Stable}$
  - $\text{High}$
Stages in the Product Life Cycle

- Introductory stage – prices high
- Growth stage – prices stabilize
- Maturity stage – price decreases
- Decline stage – price decreases
High prices may induce firms to enter the market

Competition can lead to price wars

Global competition may force firms to lower prices
PROMOTIONAL STRATEGY

- Price used at a sales promotion to incent immediate sales
  - Coupons
  - Cents off
  - Manufacturer’s rebate
  - BOGO
THE RELATIONSHIP OF PRICE TO QUALITY

Prestige Pricing

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

Used when a customer is unsure.
Prices set low with the intent to drive competitor out of business

Illegal

Difficult to prove
PRICE DISCRIMINATION

when a firm charges a different price to different groups of consumers for an identical good or service

the firm separates the whole market into each individual consumer and charges them the price they are willing and able to pay

hotel and airline industries where spare rooms and seats are sold on a last minute standby basis
FACTORS AFFECTING PRICE

**Price**
- Convenience
- Selling against the brand
- Exclusive distribution

**Intranet and extranets**
- Consumers use shopping for bargains
- Increased competition
- Internet auctions

**PLC**
- Introduction
- Growth
- Maturity
- Decline
- Other firms enter market
- Price wars
- Convenience
- Selling against the brand
- Exclusive distribution

**Competition**

**Distribution**

**Promotion strategy**
- Large customers pressure suppliers for price reductions and guaranteed margins
- Price used as a promotional tool

**Demands of large customers**
- Uncertain consumers tend to rely on price to indicate quality (“You get what you pay for.”)

**Price/quality relationship**

**Price used as a promotional tool**

**Large customers pressure suppliers for price reductions and guaranteed margins**

**Uncertain consumers tend to rely on price to indicate quality (“You get what you pay for.”)**

**Competition**

**Distribution**

**Promotion strategy**

**Demands of large customers**

**Price/quality relationship**