Pricing Concepts

CHAPTER
19

Essentials of Marketing 6

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THE IMPORTANCE OF PRICE

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

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

- Tuition
- Premium
- Fine
- Fee
- Fare
- Toll
- Rent
- Commission
- Dues
- Deposit
- Tips
- Interest
- Taxes

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

PRICING OBJECTIVES

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 Maximization

(Profit = *Revenue* – Expenses)

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

PROFIT MAXIMIZATION

- If the competitive market is <u>not</u> <u>intense</u> 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

PROFIT MAXIMIZATION

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

Return on Investment

Net profit after taxes divided by total assets.

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

MORNINGSTAR BAKERY

- Assume Morningstar has assets of $1.2 million and net profits of $100,000 and a target ROI of 5%.

- ROI = $\frac{\$100{,}000}{\$1{,}200{,}000}$

  = 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

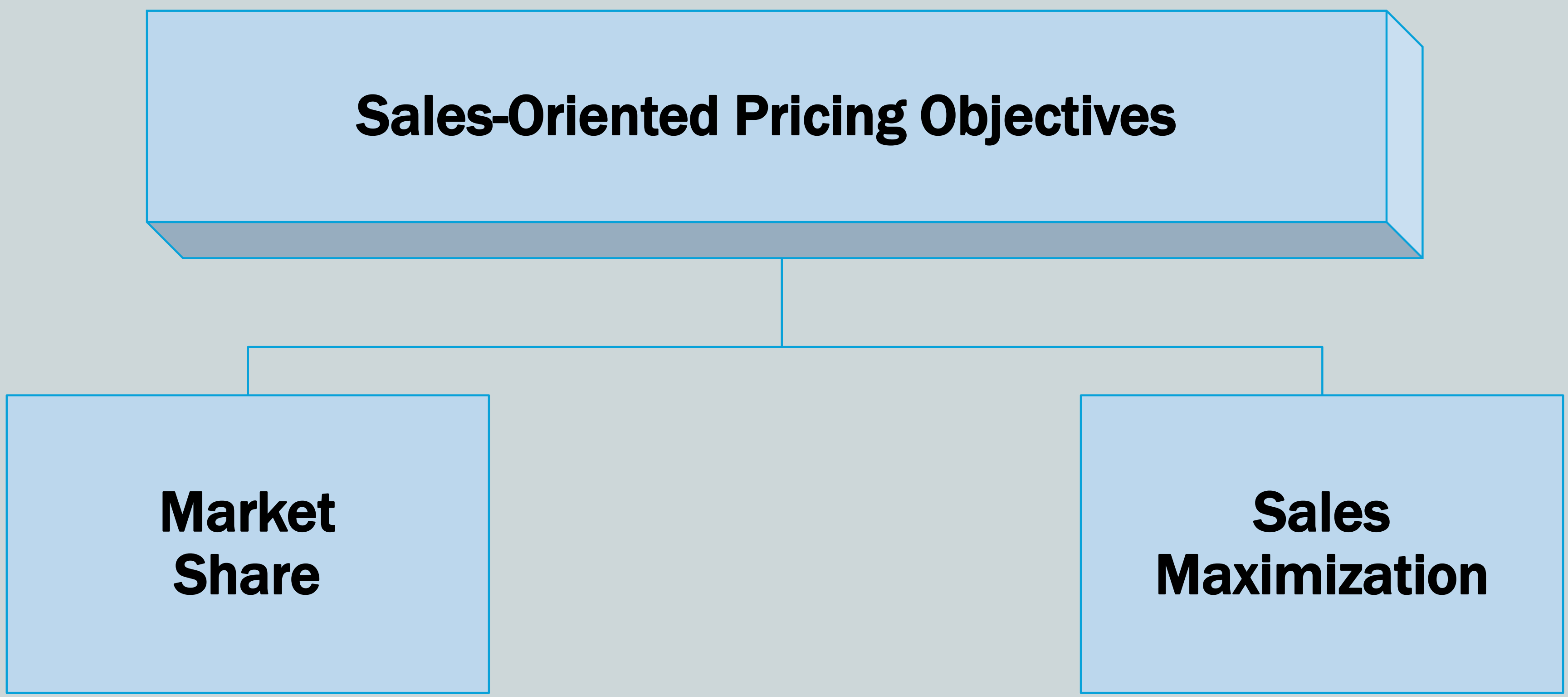
- **Profit-Oriented**
- **Sales-Oriented**
- **Status Quo**

Sales-Oriented Pricing Objectives

Sales Oriented

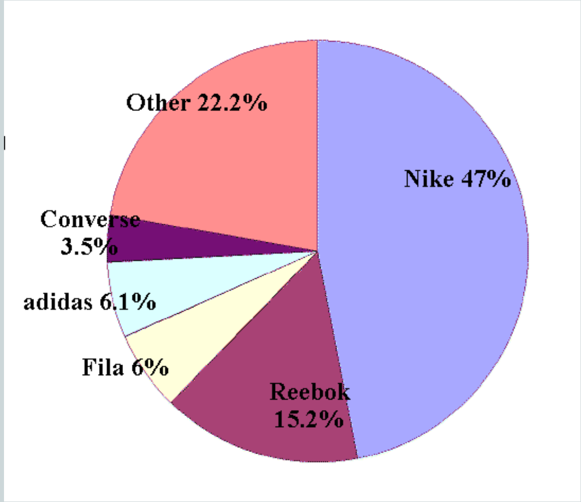
A company objective based on the belief that increasing sales will help the firm more than will increasing profits

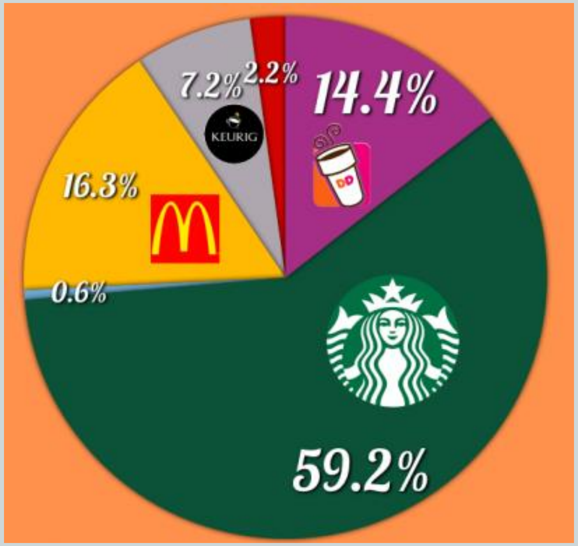
2. SALES-ORIENTED PRICING OBJECTIVES



MARKET SHARE

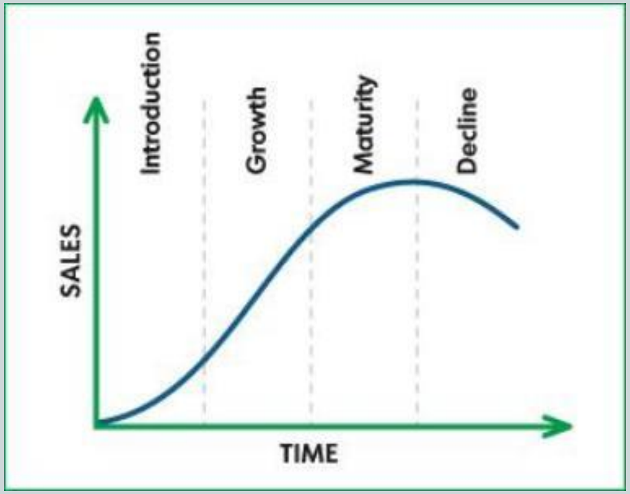
- The percentage of an industry or market's total sales that is earned by a particular company over a specified time period.
  - Market share is calculated by taking the company's <u>sales </u>over the period and <u>dividing</u> it by the <u>total sales </u>of the industry over the same period.





SALES MAXIMIZATION

- 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

STATUS QUO

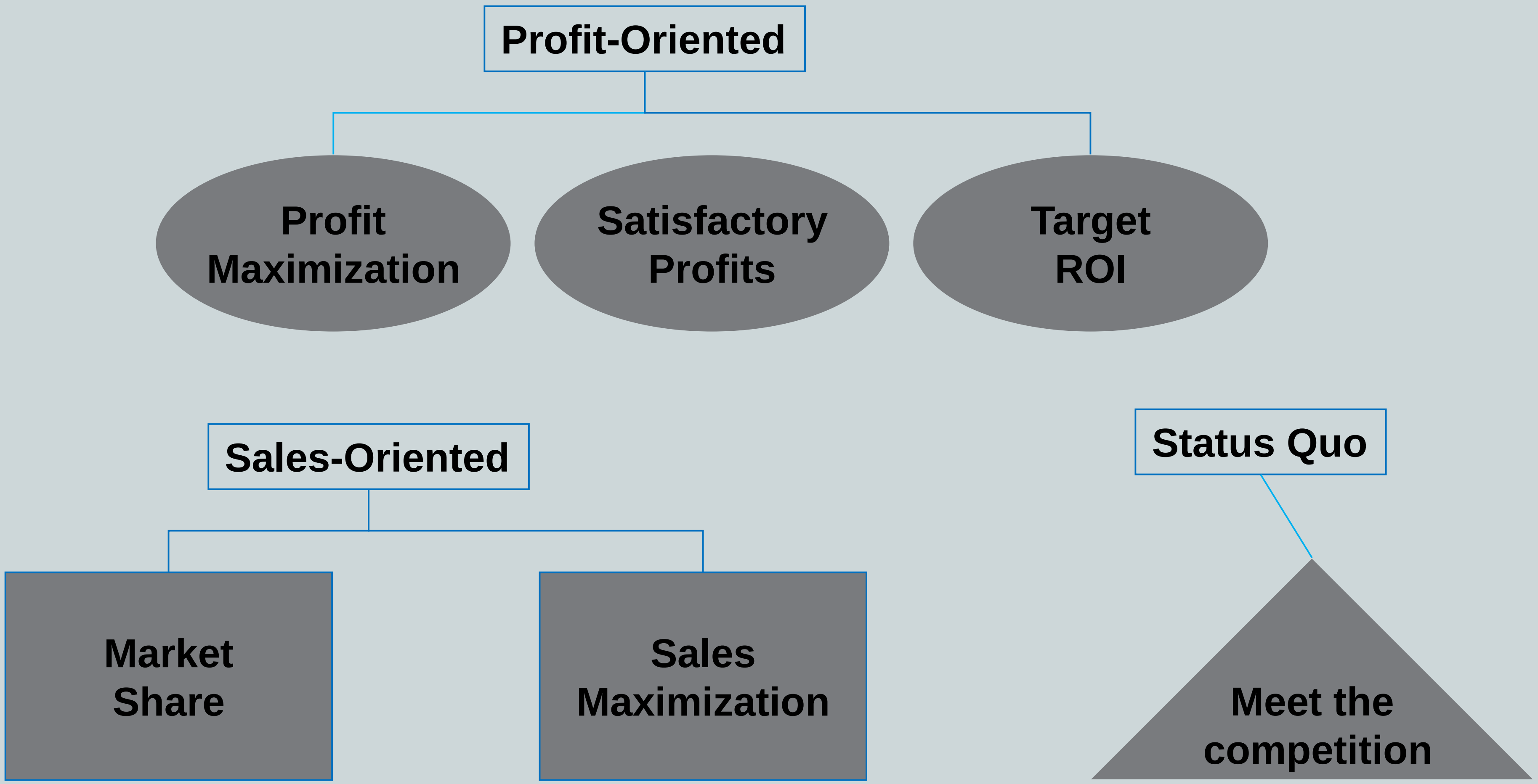
- Michelangelo decides to open a pizza restaurant called Michelangelo's Pizza Palace.
- His current pizza is pretty good, but it is not much different from his direct competitor down the street--- Leonardo's Pizza Pie.
- Leonardo charges $10 for a medium cheese pizza, so Michelangelo decides to also 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

Status Quo Pricing Objectives

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

PRICING OBJECTIVES



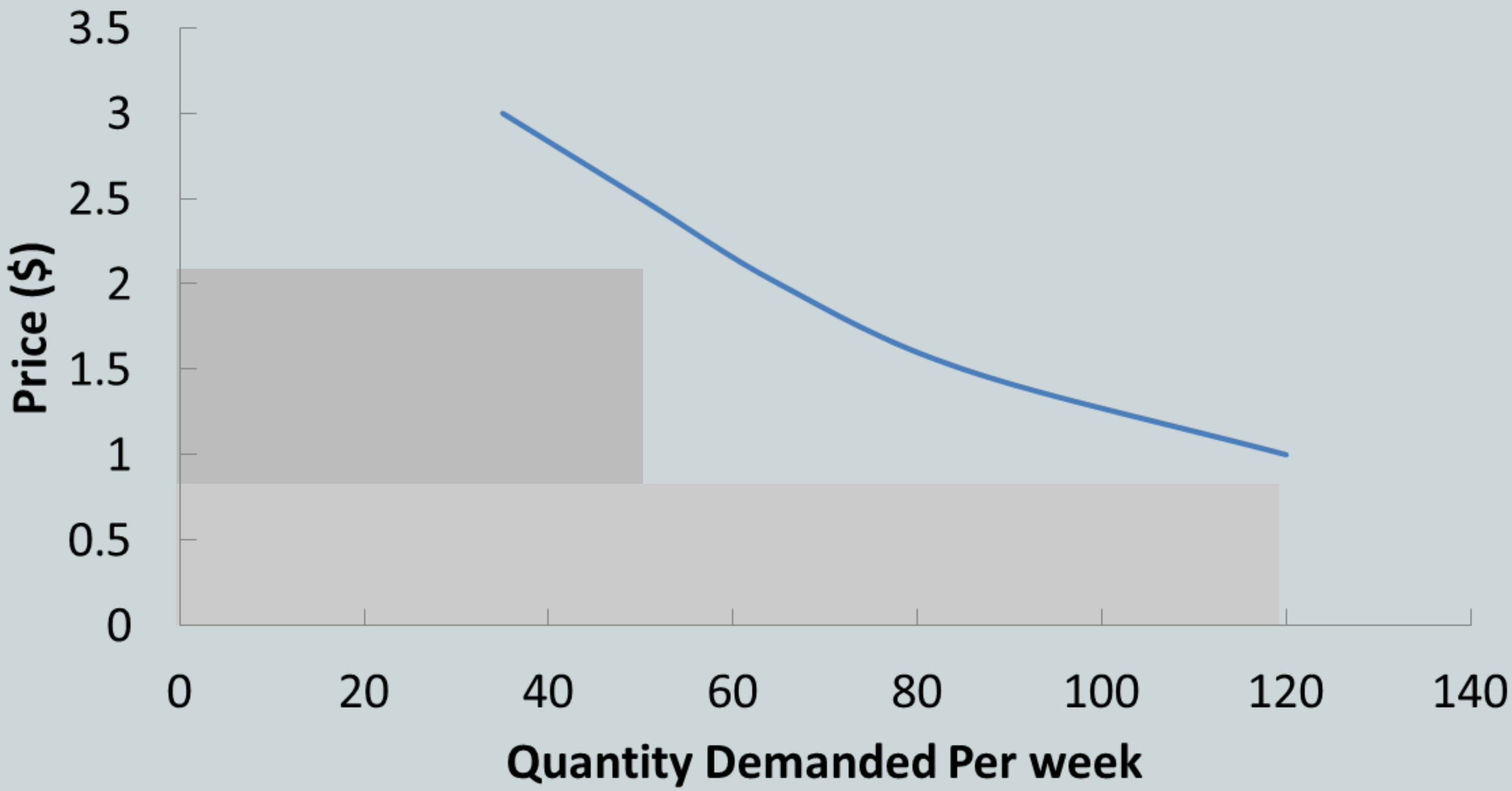
THE DEMAND DETERMINANT OF PRICE

Explain the role of demand in price determination

THE DEMAND DETERMINANT OF PRICE

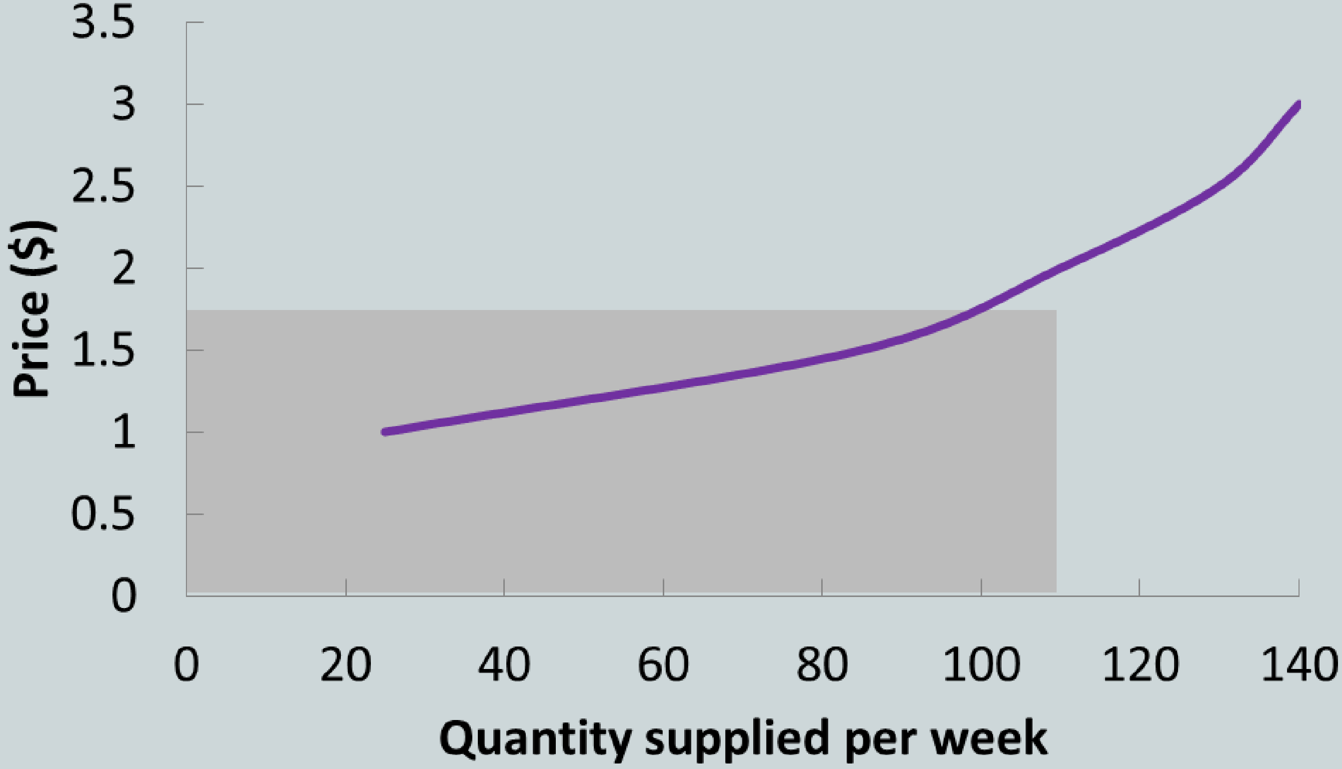
Demand	**Describes a consumer's desire and willingness to pay a price for a specific good or service.**
Supply	**The quantity of a commodity that is in the market and available for purchase at a particular price.**

Demand Curve and Demand Schedule for Gourmet Cookies



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		

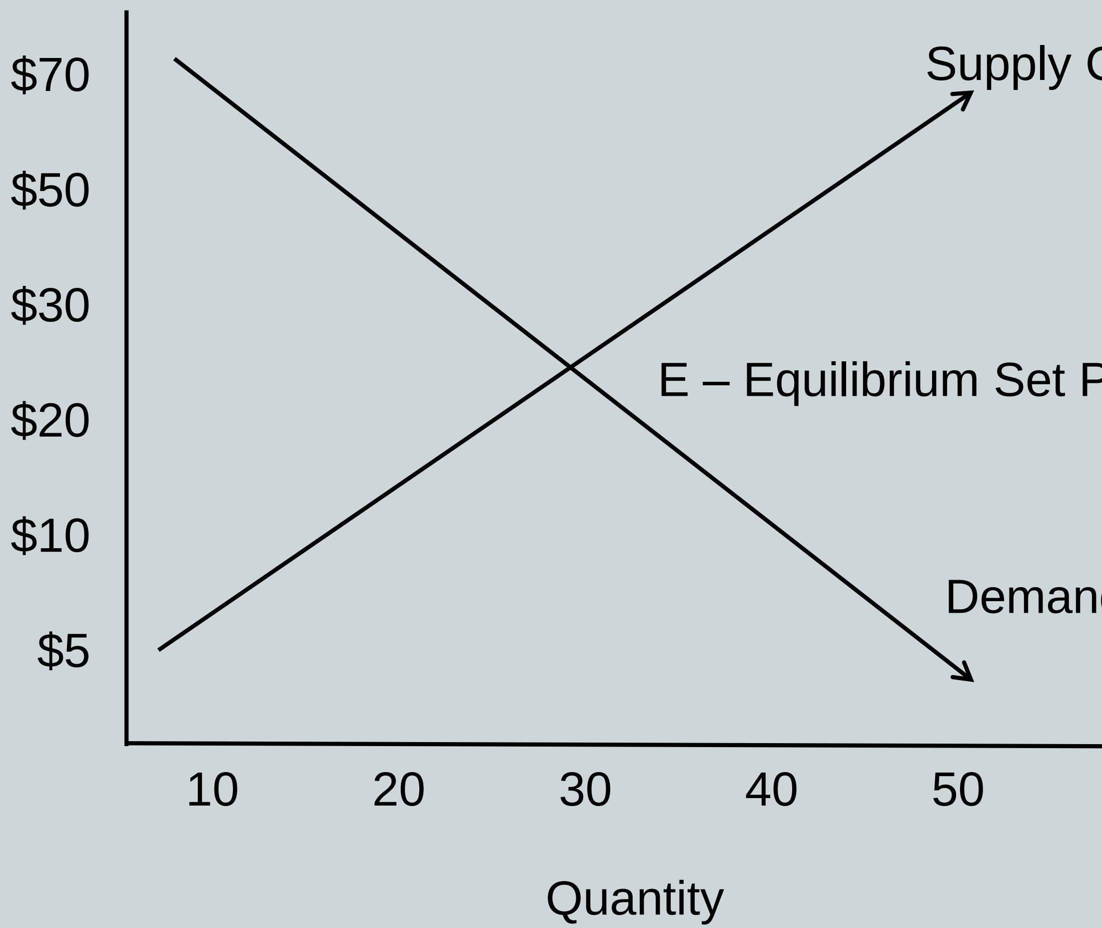
Supply Curve and Supply Schedule for Gourmet Cookies



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		

VIDEO GAMES

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



Supply Curve – Supplier controls

Surplus – Supply > Demand
Shortage – Demand > Supply

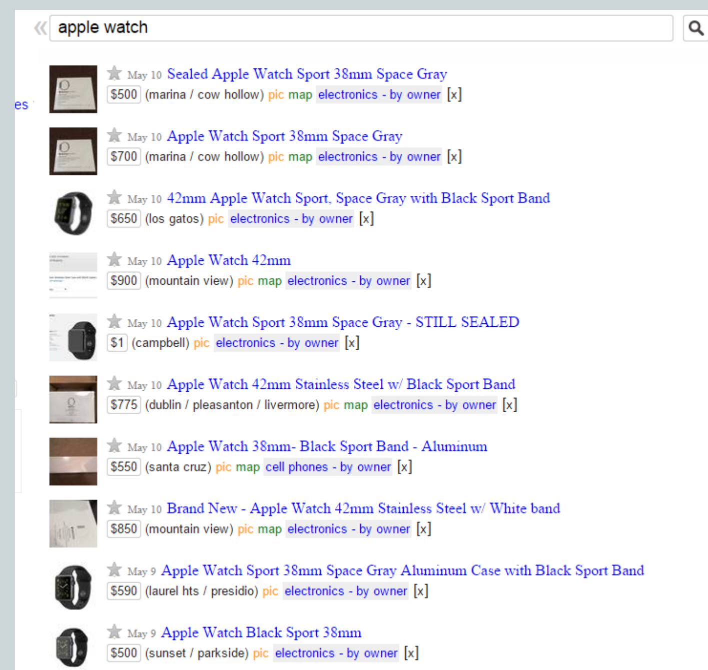
E – Equilibrium Set Price – Demand & Supply Equal

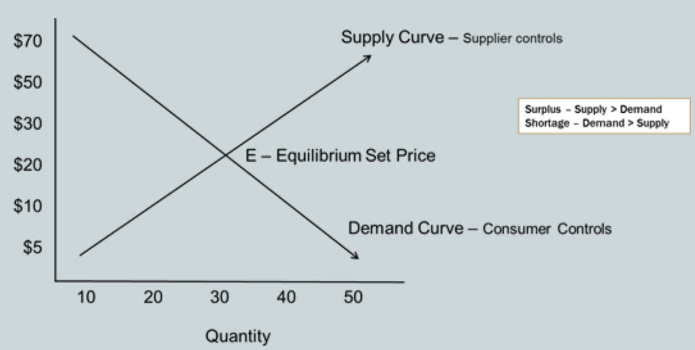
Demand Curve – Consumer Controls

Consumers
Higher \$, lower demand
Lower \$, higher demand

APPLE WATCH

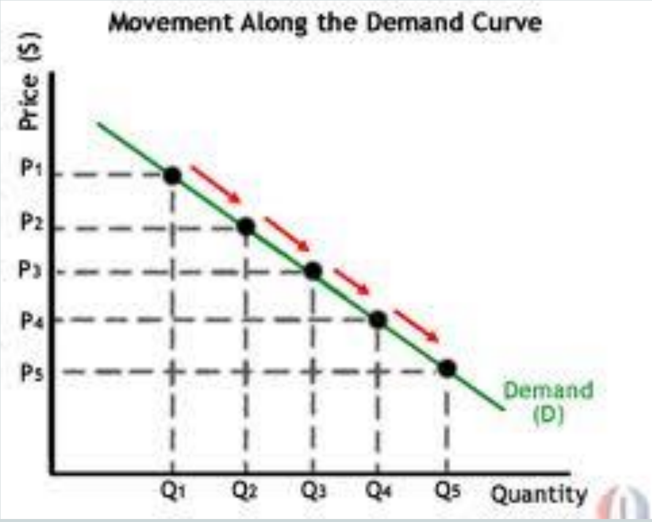
- Apple launched knowing that consumer demand for Apple Watch would “exceed our supply at launch”
  - Shoppers interested in the Apple Watch will at first only be able to place orders for the device online.

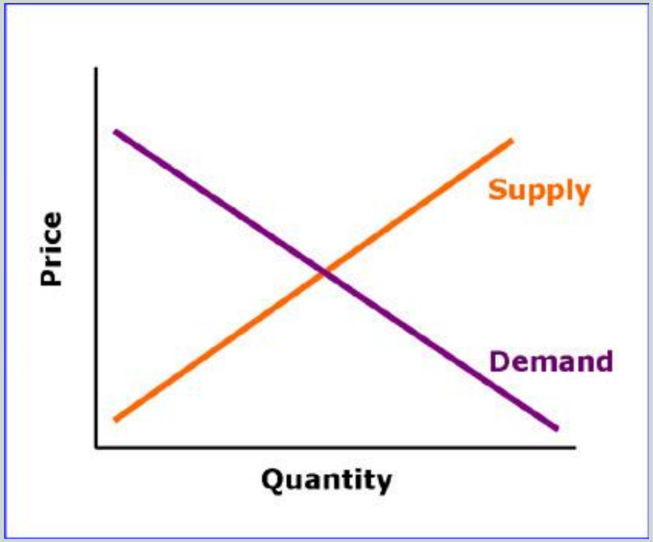




DEMAND CURVES AND PRICING

- 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: $\dfrac{\text{\% change in quantity}}{\text{\% change in price}}$

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

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

ELASTICITY OF DEMAND

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

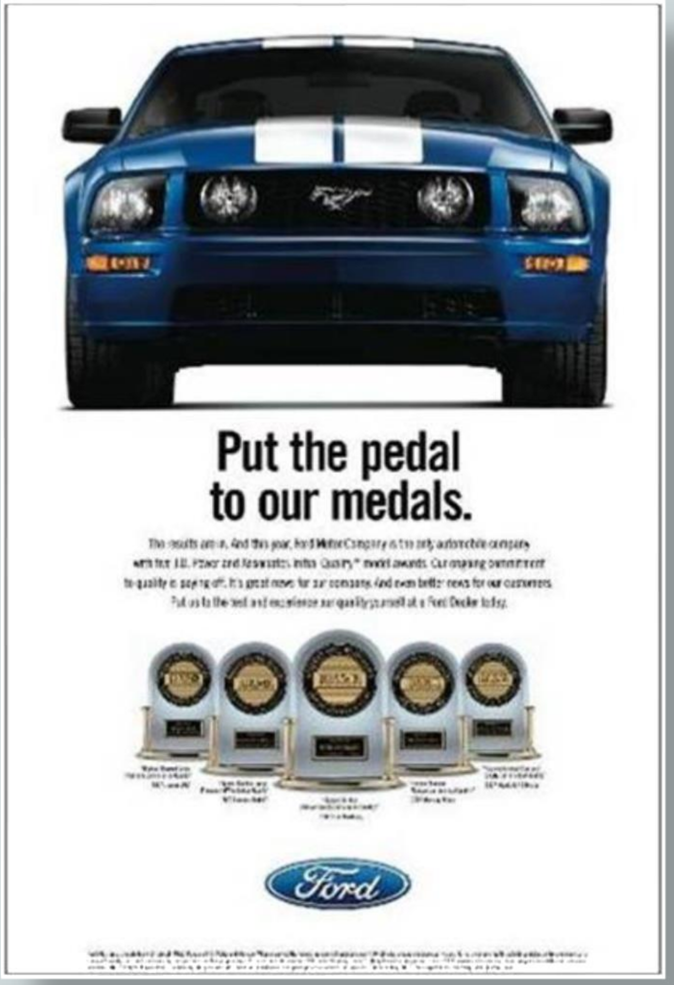
If *E* > 1, demand is elastic.
If *E* < 1, demand is inelastic.
If *E* = 1, demand is unitary.

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 PRICING

- 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

- 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

THE PRICE-QUALITY RELATIONSHIP

- 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

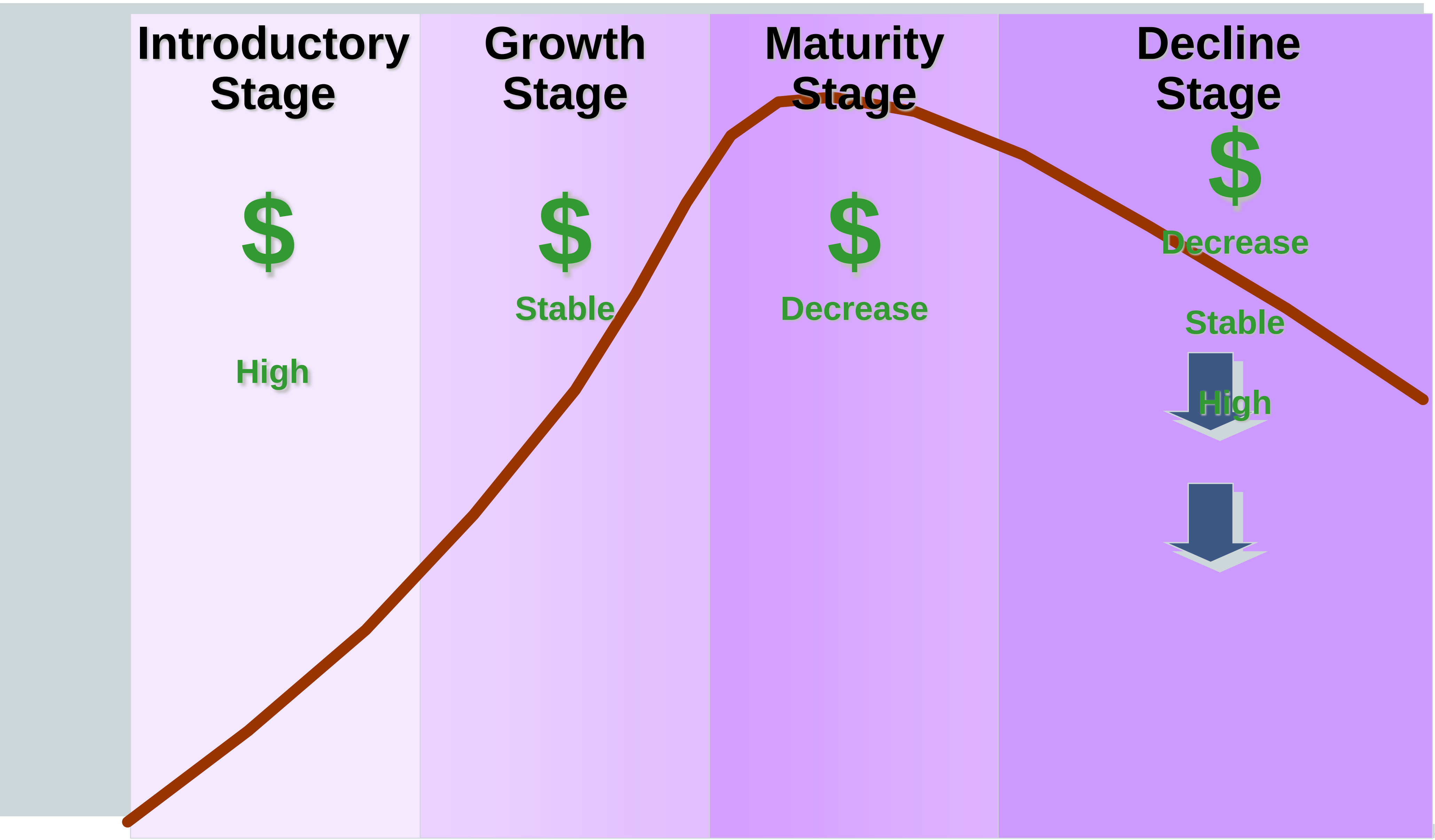
Competition

Distribution Strategy

Promotion Strategy

Perceived Quality

1. STAGES IN THE PRODUCT LIFE CYCLE



Stages in the Product Life Cycle

Introductory stage – prices high

Growth stage – prices stabilize

Maturity stage – price decreases

Decline stage – price decreases

THE COMPETITION

- 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.

PREDATORY PRICING

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