DEVELOPING PRICING STRATEGIES AND PROGRAMS

MARKMA

Rhea G. Jardin

May 11, 2012

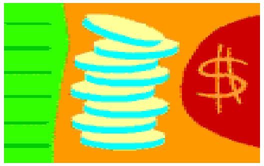
Outline

1. 6 Steps in Setting the Price
2. 4 Price-adaptation Strategies

What is Price?

Price is :

- the one element of the marketing mix that produces revenue



- the amount paid for some goods or services

CONCEPT 1:

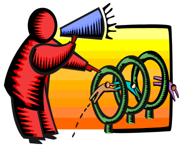
6 Steps in Setting the Price

Selecting the pricing objective

Price objective

Determining demand

Demand



Estimating costs

Costs

Analyze competitors' costs, prices, and offers

Competitors

Selecting pricing method

Pricing method

Selecting the final price

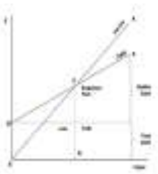
Final price

CONCEPT 1:

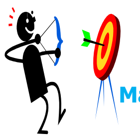
1. Selecting the pricing objective

Selecting the pricing objective

Price objective



Survival (B/E)



Maximize profit

Product leadership

Maximize market skimming

Maximize market share

CONCEPT 1:

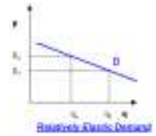
2. Determining Demand

Selecting the pricing objective

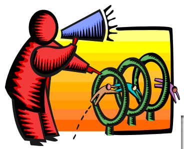
Price objective

Determining demand

Demand



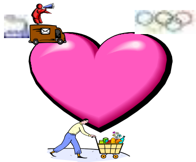
Demand elasticity



Surveys

Statistical analysis

Price experiments

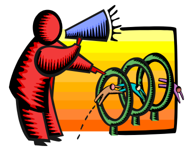


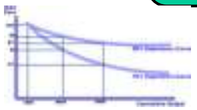
CONCEPT 1:

3. Estimating costs

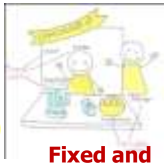
Selecting the pricing objective → Determining demand → Estimating costs

Selecting the pricing objective	Determining demand	Estimating costs
Price objective	*Demand*	*Costs*





Learning curve



Fixed and Variable

Cost per unit of production

CONCEPT 1:

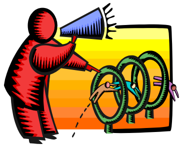
4. Analyze competitors' costs, prices and offers

Selecting the pricing objective

Price objective

Determining demand

Demand



Estimating costs

Costs

Analyze competitors' costs, prices, and offers

Competitors

Evaluate the competitors' price and product value

CONCEPT I:

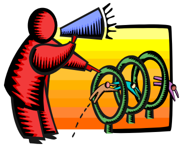
5. Selecting price method

Selecting the pricing objective

Price objective

Determining demand

Demand



Estimating costs

Costs

Analyze competitors' costs, prices, and offers

Competitors

Selecting pricing method

Pricing method

CONCEPT 1:

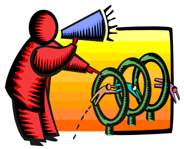
6. Selecting final price

Selecting the pricing objective

Price objective

Determining demand

Demand



Estimating costs

Costs

Analyze competitors' costs, prices, and offers

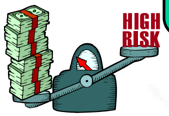
Competitors

Selecting pricing method

Pricing method

Selecting the final price

Final price



Gain & risk sharing

High advertising

Price fixing

Pricing policies

CONCEPT 1:

6 Steps in Setting the Price

Selecting the pricing objective

Price objective

- Survival (B/E)
- Maximize profit
- Product leadership
- Maximize market share
- Maximize market skimming

Determining demand

Demand

- Demand elasticity
- Surveys
- Statistical analysis
- Price experiments

Estimating costs

Costs

- Learning curve
- Fixed and Variable
- Cost per unit of production

Analyze competitors' costs, prices, and offers

Competitors

- Evaluate the competitors' price and product value

Selecting pricing method

Pricing method

- Price markup
- Perceived value
- Value pricing
- Target ROI
- Going-rate pricing
- Auction-type pricing
- Break-even point

Selecting the final price

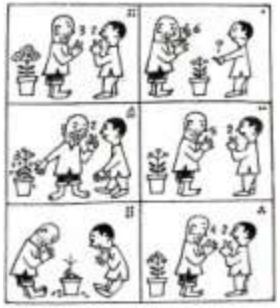
Final price

- Gain & risk sharing
- High advertising
- Price fixing
- Pricing policies

CONCEPT 2:

4 Price-adaptation strategies

1. Geographical pricing
2. Price discounts and allowances
3. Promotional pricing
4. Differentiated pricing

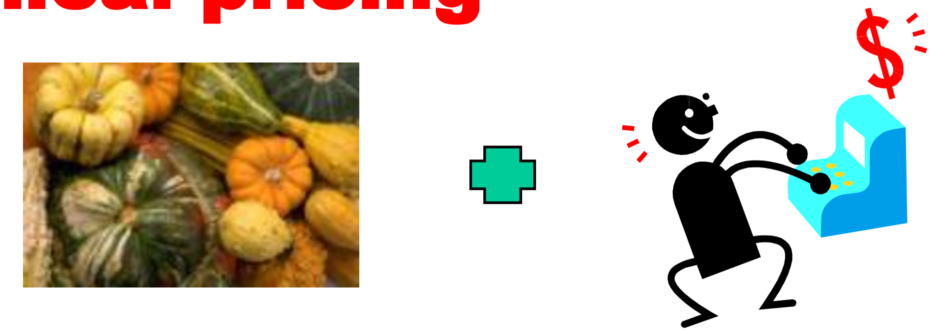


CONCEPT 2:

1. Geographical pricing

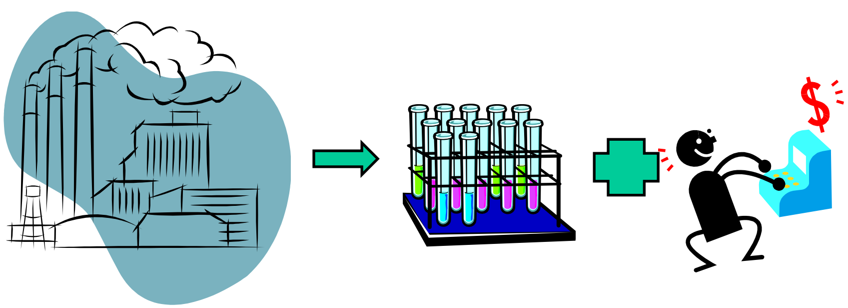
Barter

Direct exchange of goods



Compensation deal

Payment in products and cash



Buyback arrangement

Payment in form of products manufactured by the supplied equipment and cash

Offset

Receives payment in cash but agrees to spend some of the money in the products of that country

CONCEPT 2:

2. Price discounts and allowances

Cash discount

Discounts given to cash, early or prompt payments

Quantity discount

Discounts given to those who buy large volumes

Seasonal discount

Discounts given to products or services that are out of season

Trade discount

Discounts given by manufacturers to resellers

Allowances

Discounts given to gain reseller participation in special programs

CONCEPT 2:

3. Promotional pricing

Special-event pricing

Low-interest financing

Longer payment terms

Cash rebates

Warranties and service contracts

CONCEPT 2:

4. Differentiated pricing

Price discrimination

- selling a product at two or more prices

Customer-segment pricing

- different customer groups pay different prices for the same product or service

Product-form pricing

- different versions of the product are priced differently, but not proportionately to their costs

Image pricing

- the same product are priced at two different levels based on image differences

Concept 2:

4. Differentiated pricing

Channel pricing

- a product is priced depending on where it was purchase (fine restaurant, fast-food chain, or vending machine)

Location pricing

- same product is priced differently at different locations even though the cost is the same

Time pricing

- prices are varied by season, day, or hour (weekend vs weekdays, “early bird” customers)

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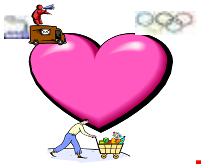

DEVELOPING PRICING STRATEGIES AND PROGRAMS

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MBA Standard
May 11, 2012

Outline: Developing Pricing Strategies and Programs

I. Consumer Psychology and Pricing
II. Steps in Setting Price
III. Learning what Price Adaptation is all about.
IV. Promotional Pricing Tactics
V. Differentiated Pricing
VI. Increasing Prices
VII. Brand Leader Responses To Competitive Price Cuts

How do consumers process & evaluate prices?

process

evaluate

prices

CONSUMER PSYCHOLOGY and PRICING

- REFERENCE PRICES
- PRICE-QUALITY INFERENCES
- PRICE ENDINGS
- PRICE CUES

Definition of Terms:

- **CONSUMER PSYCHOLOGY:** provides opportunities to examine issues such as what factors are most important…
  - when people decide to purchase a particular item
  - how customers determine the value of a service
  - and whether or not television & magazine advertisements can convince a reluctant consumer to try a new product for the 1st time.

PRICING: is the process of determining what a company will receive in exchange for its products

REFERENCE PRICES…

- is a strategy in which a product is sold at a price just below its main competing brand.

- is one component of psychological pricing – sellers consider the psychology of prices & not simply the economics.

- are prices that buyers carry in their minds and refer to when looking at a given product.

PRICE CUES

When to use…

- Customers purchase item infrequently
- Customers are new
- Product designs vary over time
- Prices vary seasonally
- Quality or sizes vary across stores

How should a company set prices for products or services?

STEPS:

1) Select the *PRICE OBJECTIVE*

2) Determine *DEMAND*

3) Estimate *COSTS*

4) Analyze competitor *PRICE MIX*

5) Select *PRICING METHOD*

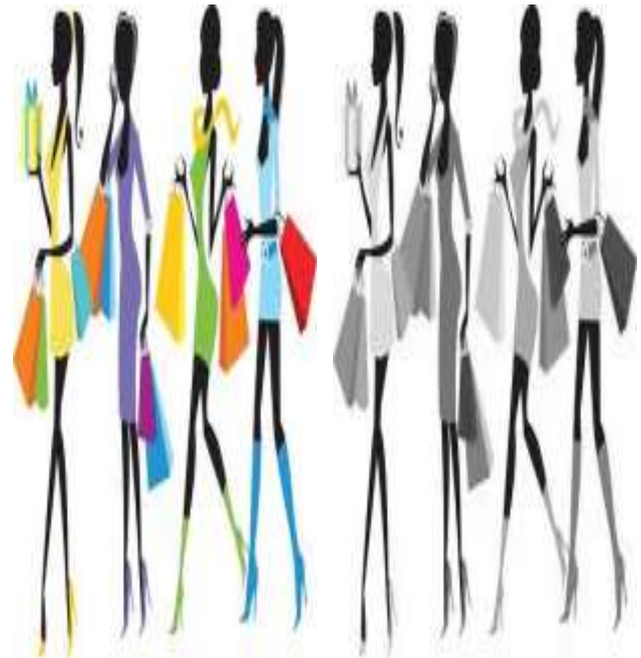
6) Select *FINAL PRICE*

I. SELECT THE PRICE OBJECTIVE

- Survival
- Maximum current profit
- Maximum market share
- Maximum market skimming
- Product – quality leadership

II. DETERMINE DEMAND

- Price sensitivity
- Estimating demand curves
- Price elasticity of demand



III. ESTIMATE COSTS

- Types of Costs
- Accumulated Production
- Activity – based Cost Accounting
- Target Costing

IV. ANALYZE COMPETITOR PRICE MIX

- Identify nearest price competitors
- Take competitor's features and prices into account
- Make decision to charge more, the same or less than competitors
- Monitor competitors' reaction to your pricing strategy

V. SELECT PRICING METHOD

- Mark up Pricing
- Target-return pricing
- Perceived-value pricing
- Value pricing
- Going-rate pricing
- Auction-type pricing

VI. SELECT THE FINAL PRICE

- Impact of other marketing activities
- Company pricing policies
- Gain-and-risk sharing pricing
- Impact of price on other parties

PRICE-ADAPTATION STRATEGIES

GEOGRAPHICAL PRICING

DISCOUNTS / ALLOWANCES

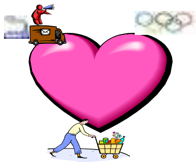
PROMOTIONAL PRICING

DIFFERENTIATED PRICING

PRICE-ADAPTATION STRATEGIES

COUNTERTRADE

- Barter
- Compensation deal
- Buyback arrangement
- Offset



PRICE-ADAPTATION STRATEGIES

DISCOUNTS / ALLOWANCES

- Cash Discount
- Quantity Discount
- Functional Discount
- Seasonal Discount
- Allowance

PROMOTIONAL PRICING TACTICS

- Loss-leader pricing
- Special-event pricing
- Low-interest financing
- Longer payment terms
- Warranties & service contracts
- Cash Rebates
- Psychological discounting

DIFFERENTIATED PRICING & PRICE DISCRIMINATION

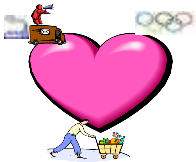
- Customer-segment pricing
- Product-form pricing
- Image pricing
- Channel pricing
- Location pricing
- Time pricing
- Yield pricing

INCREASING PRICES

- Delayed quotation pricing
- Escalator clauses
- Unbundling
- Reduction of discounts

BRAND LEADER RESPONSES TO COMPETITIVE PRICE CUTS

- Maintain price
- Maintain price & add value
- Reduce price
- Increase price & improve quality
- Launch a low-price fighter line



DEVELOPING PRICING STRATEGIES AND PROGRAMS

Shelle Caiga
MBA Standard
May 11, 2012

Chapter 14 Developing Pricing Strategies and Programs

Donna Sia

May 11, 2012

OUTLINE:

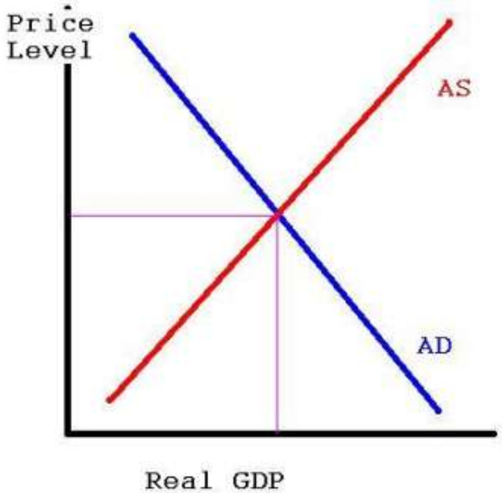
When setting effective pricing policy a company

1. Follows six pricing procedures
2. Selects a pricing structure that reflects various situations
3. Chooses what price adaptation strategy to use
4. Examine the effect of price changes
5. Responds to competitors price challenge

Price is the only element in the marketing mix that produces revenue;

the others produce cost.

Consumers use common price references.



Fair price

Typical Price

Lower-bound

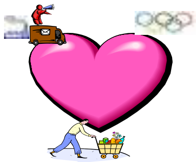
Last Price Paid

They may also refer to:

Competitor's Price

Usual Discounted Price

Expected Future Price



Companies follow 6 steps when setting prices.

1 Select the price objective

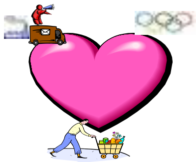
2 Determine demand

3 Estimate costs

4 Analyze competitor price mix

5 Select pricing method

6 Select final price



In selecting price objectives, companies must look at

Survival

Maximum current profit

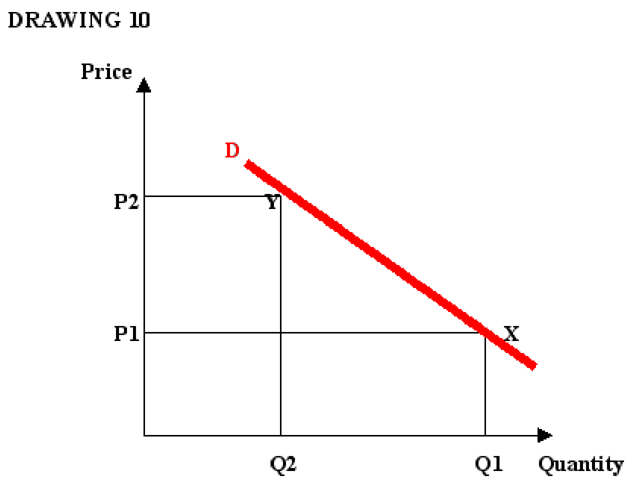
Maximum market share

Maximum market skimming

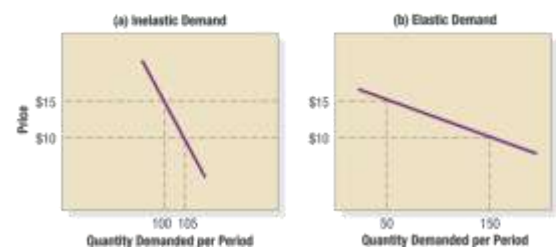
Product-quality leadership

Demand can be determined by examining:

Price Sensitivity

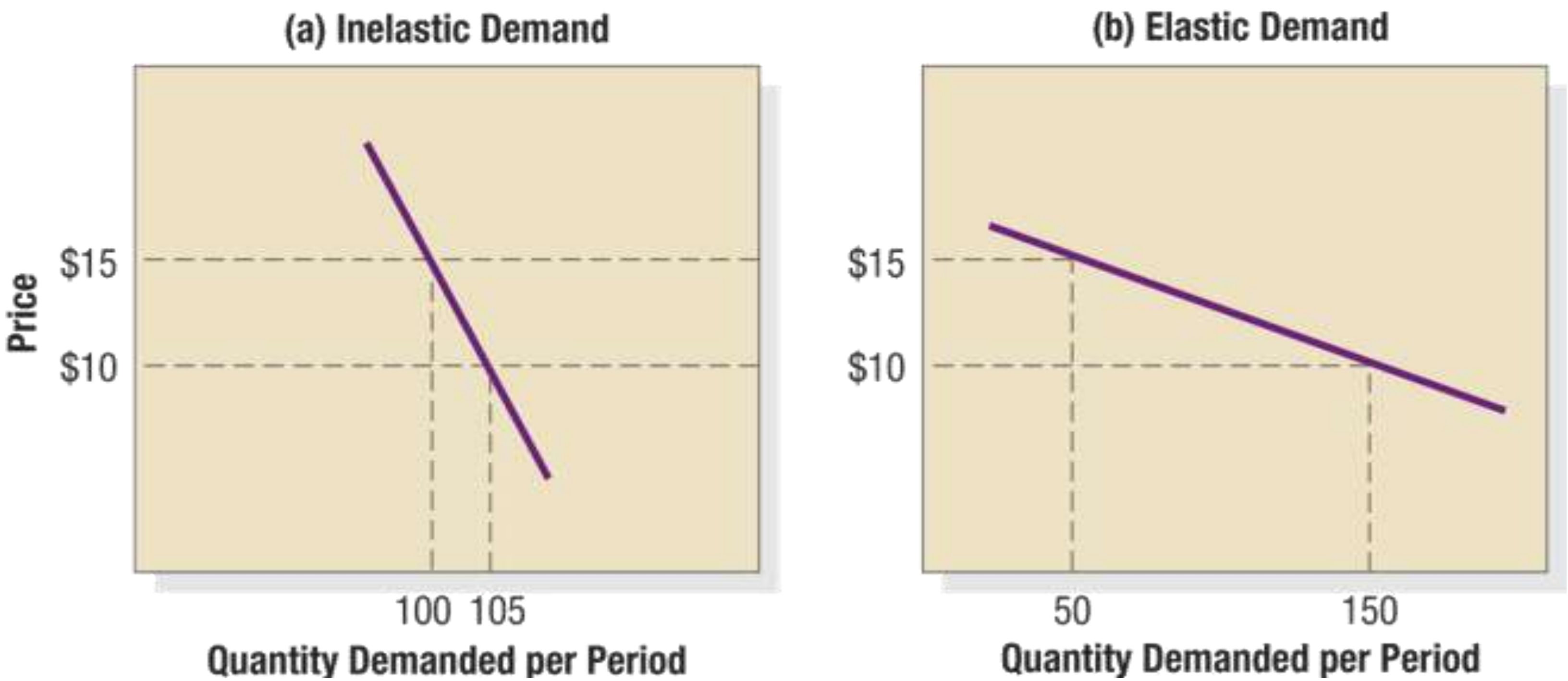


Estimating Demand Curves



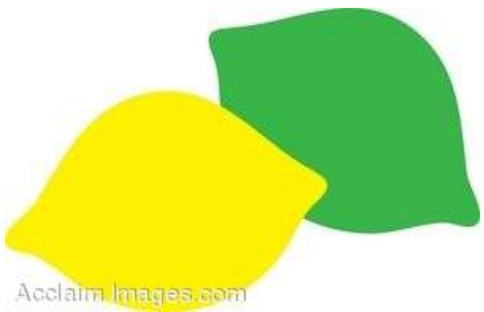
Price Elasticity of Demand

Changes in price affect consumer demand:



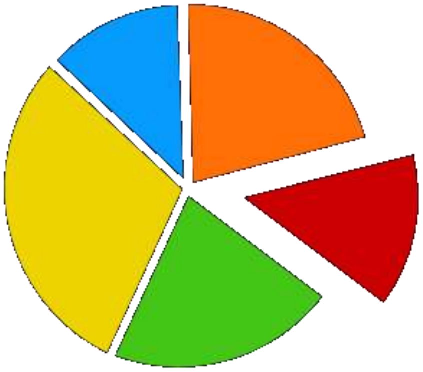
Source: Marketing Management, Kotler and Keller, 13th ed.

Customers are likely to be less sensitive to price changes when:



product is more distinctive

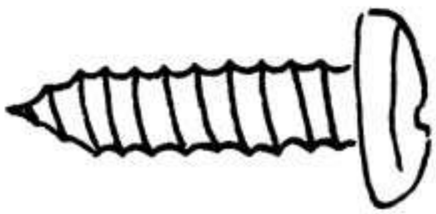
less aware of substitutes



cannot easily compare the quality of substitutes

expenditure is a smaller part of buyer's total income

Customers are likely to be less sensitive to price changes when:



small compared to the total cost of the end product

Part of the cost is paid by another party

used with previously purchased assets

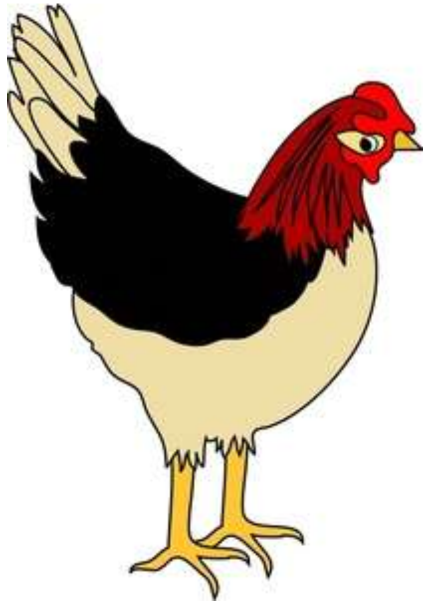
Customers are likely to be less sensitive to price changes when:

assumed to have high quality and prestige

cannot store the product

Costs can either be fixed or variable

Fixed Cost

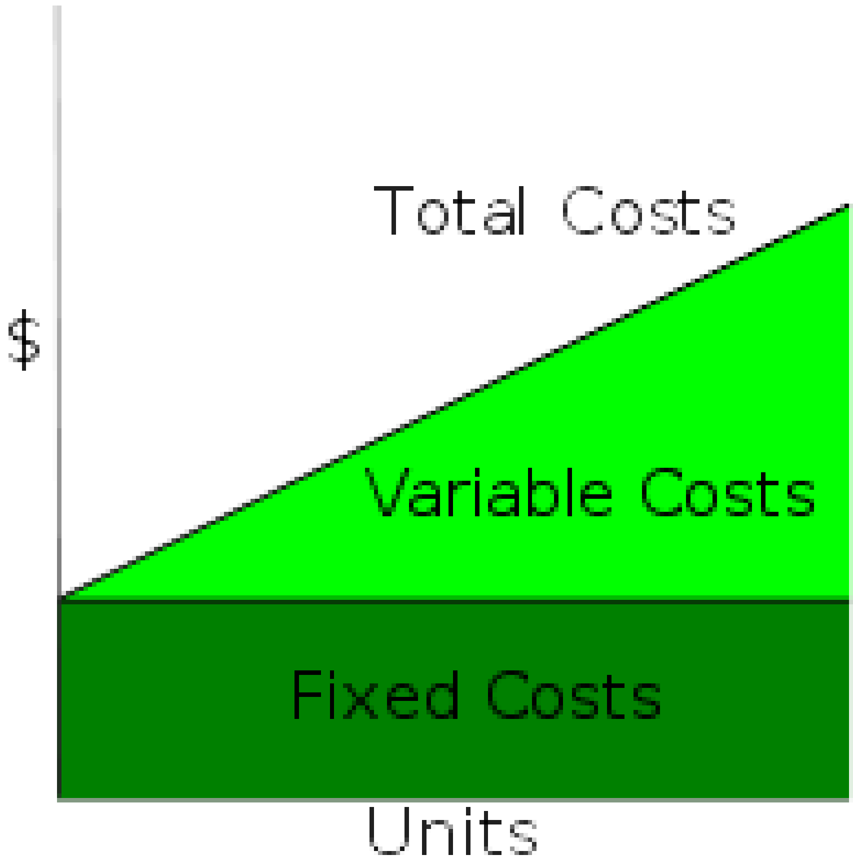


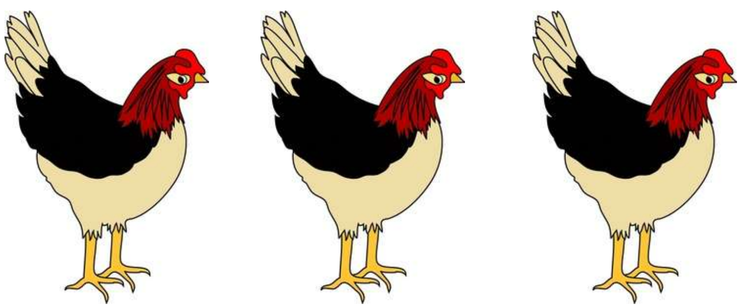
Variable Cost

process

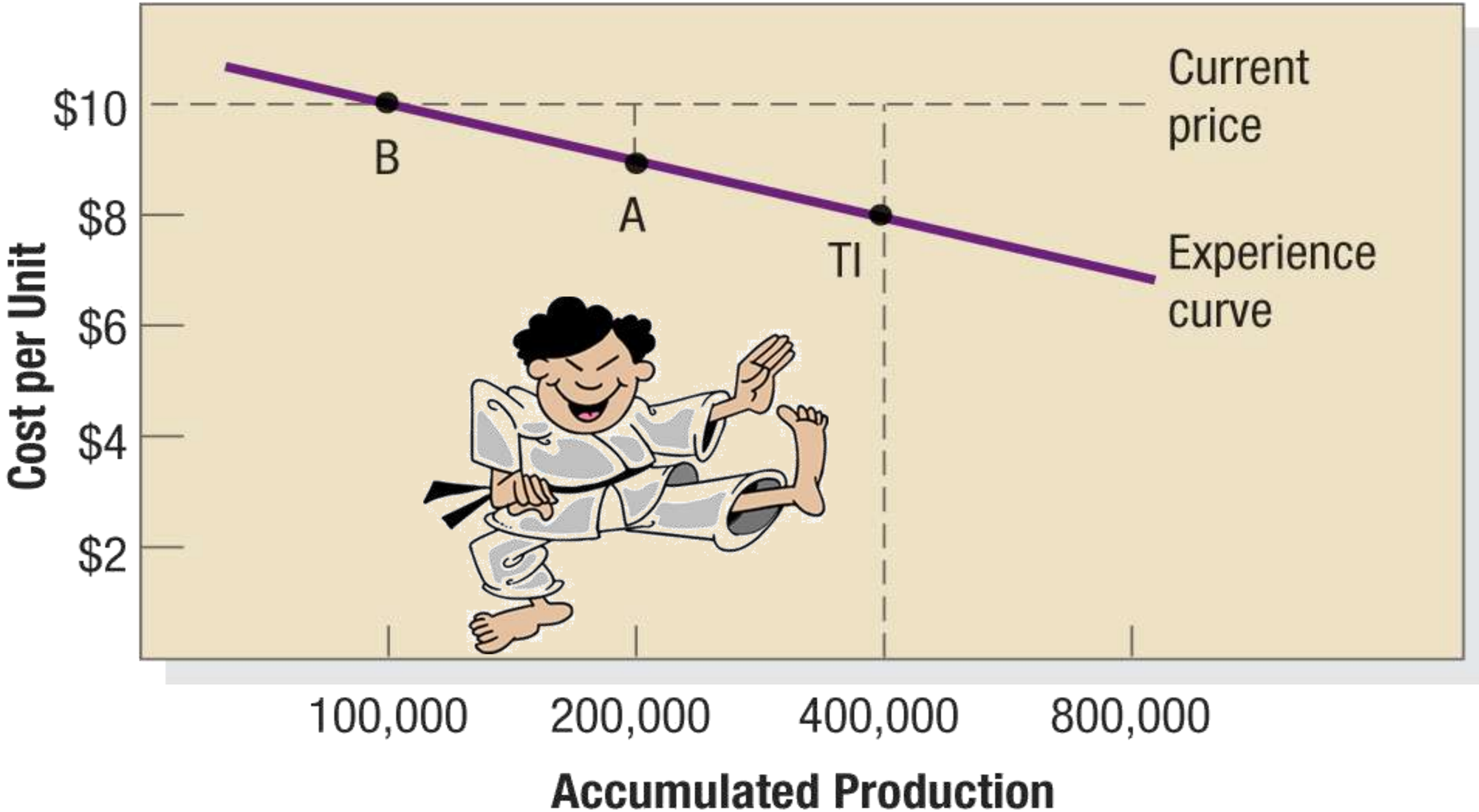
output

The sum of variable and fixed cost for any given level of production is the total cost





As production accumulates average cost decreases



Source: Marketing Management, Kotler and Keller, 13th ed.

To arrive at target cost, first

determine target price and desired function

given product's appeal and competitor's price

Then: *Target Selling Price = $ 9.90*

Less Profit Margin = $ 3.40

Target Cost = $ P 6.50

Different pricing methods can be used in varying situations

Markup pricing

Target-return pricing

Perceived-value pricing

Value pricing

Going-rate pricing

Auction-type pricing

Markup Pricing is just adding a standard mark-up to the product's cost.

Variable cost per unit	$10.00
Fixed Cost	$ 300,000.00
Expected Unit Sales	50,000 units

$$\text{Unit cost} = \text{variable cost} + \frac{\text{fixed cost}}{\text{unit sales}}$$

$$= \$10.00 + \frac{\$\,300{,}000.00}{50{,}000}$$

$$= \$16.00$$

Desired Mark Up= 20%

$$\text{Selling Price} = \frac{\text{Unit Cost}}{(1-\text{desired return})} = \frac{\$16.00}{(1-0.20)} = \$20$$

Target-return pricing is used by companies who need to make a fair return on investment

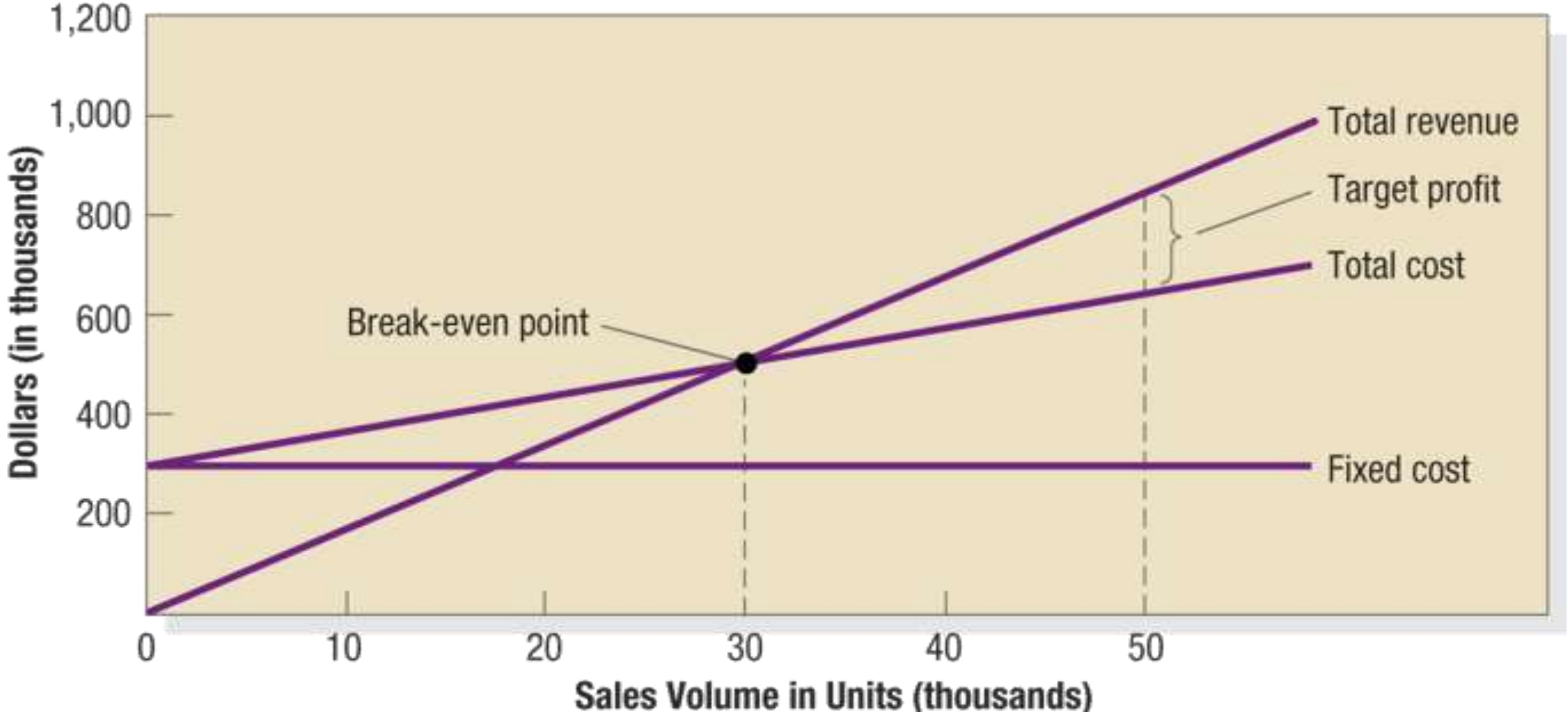
Desired ROI = 20% or € 200,000

Target-return on price

$$= \text{unit cost} + \frac{\text{desired return} \times \text{investment capital}}{\text{unit sales}}$$

$$= \$16.00 + \frac{0.20 \times \$1{,}000{,}000.00}{50{,}000} = \$20.00$$

Break-even analysis is used to determine target return price and break-even volume



Source: Marketing Management, Kotler and Keller, 13th ed.

Perceived Value Pricing

$ 90,000 tractor's price = competitor's price

$ 7,000 superior durability

$ 6,000 superior reliability

$ 5,000 superior service

<u>$ 2,000 longer warranty</u>

CATERPILLAR®

$ 110,000 superior value

<u>- 10,000 discount</u>

$ 100,000 final price

The internet and Auction type pricing:

English auctions

Dutch auctions

Sealed-bid auctions

Source: Marketing Management, Kotler and Keller, 13th ed.

Price Adaptation Strategy

Geographical Pricing

Discounts and Allowances

Prompt payment discount

Volume discount

Seasonal Discount

Promotional Pricing

Loss-leader Pricing

Special-event pricing

Low-interest financing

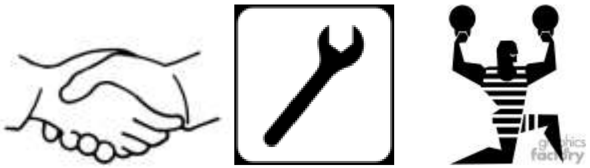
Profits Before and After a Price Increase

	Before	After	
Price	$ 10	$10.10	(a 1 percent price increase)
Units sold	100	100	
Revenue	$1000	$1010	
Costs	–970	–970	
Profit	$ 30	$ 40	(a 33⅓ percent profit increase)

Source: Marketing Management, Kotler and Keller, 13th ed.

Respond to Low-Cost rival by:

1. Maintaining price



2. Maintaining price and adding value

3. Reducing price
4. Increasing price and improving quality

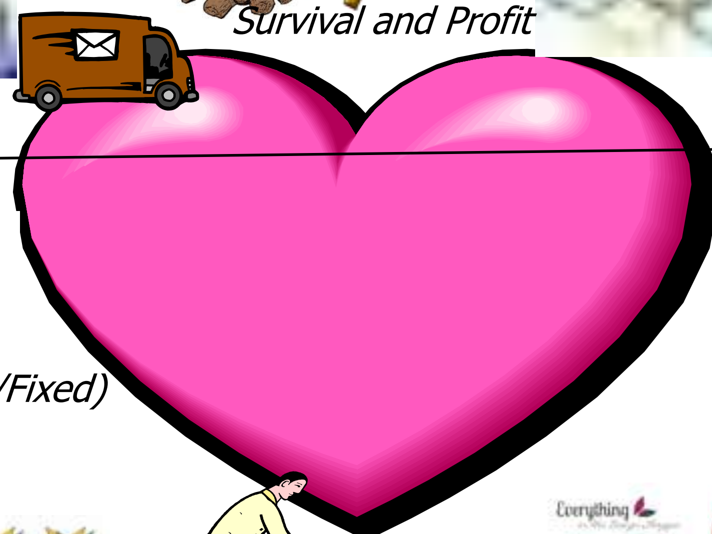
5. Launching a low-price fighter line

In summary:

Price is the only element in the marketing mix that produces revenue

Competitor's can also offer attractive prices

Survival and Profit



Price objectives

Products Cost (Variable/Fixed)

Maximize market share

Deliver value to customers

consumer psychology

Sensitivity to price changes

Durability, reliability, excellent service

Chapter 14
Developing Pricing Strategies and Programs

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