



Principles of Marketing by Philip Kotler and Gary Armstrong

Chapter 10



Pricing

Understanding and Capturing Customer
Value

Objective Outline

1

What Is a Price?
Answer question “What is a price?” and discuss the importance of pricing in today’s fast-changing environment.

2

Major Pricing Strategies
Identify the three major pricing strategies and discuss the importance of understanding customer-value perceptions, company costs, and competitor strategies when setting prices.

Objective Outline

3 →

Other Internal and External Considerations Affecting Price Decisions

Identify and define the other important external and internal factors affecting a firm's pricing decisions

What is a Price?

- In the narrowest sense, **price** is the amount of money charged for a product or a service.
- More broadly, price is the sum of all the values that customers give up to gain the benefits of having or using a product or service.
- Price is the only element in the marketing mix that produces revenue; all other elements represent costs.

Major Pricing Strategies

- The price the company charges will fall somewhere between one that is too low to produce a profit and one that is too high to produce any demand.

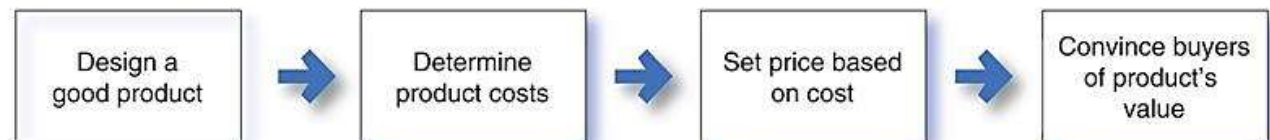
If customers perceive that a product's price is greater than its value, they won't buy it. If the company prices the product below its costs, profits will suffer. Between the two extremes, the "right" pricing strategy is one that delivers both value to the customer and profits to the company.



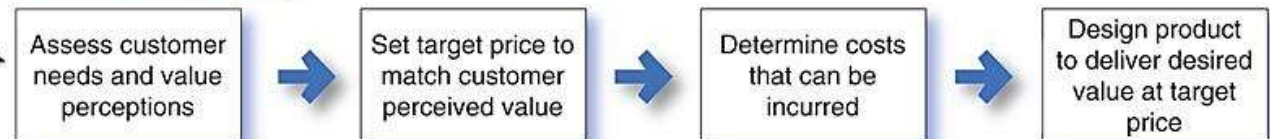
Customer Value-Based Pricing

- **Customer value-based pricing** uses buyers' perceptions of value as the key to pricing.
- The company first assesses customer needs and value perceptions.
- It then sets its target price based on customer perceptions of value.
- The targeted value and price drive decisions about what costs can be incurred and the resulting product design.

Cost-based pricing



Value-based pricing



Costs play an important role in setting prices. But, like everything else in marketing, good pricing starts with the customer.

Good-Value Pricing

- In response, many companies have changed their pricing approaches to bring them in line with changing economic conditions and consumer price perceptions.
- More and more, marketers have adopted **good-value pricing** strategies — offering the right combination of quality and good service at a fair price.

➤ **Everyday low pricing (EDLP)**

- EDLP involves charging a constant, everyday low price with few or no temporary price discounts.

➤ **High-Low Pricing**

- It involves charging higher prices on an everyday basis but running frequent promotions to lower price temporarily on selected items.

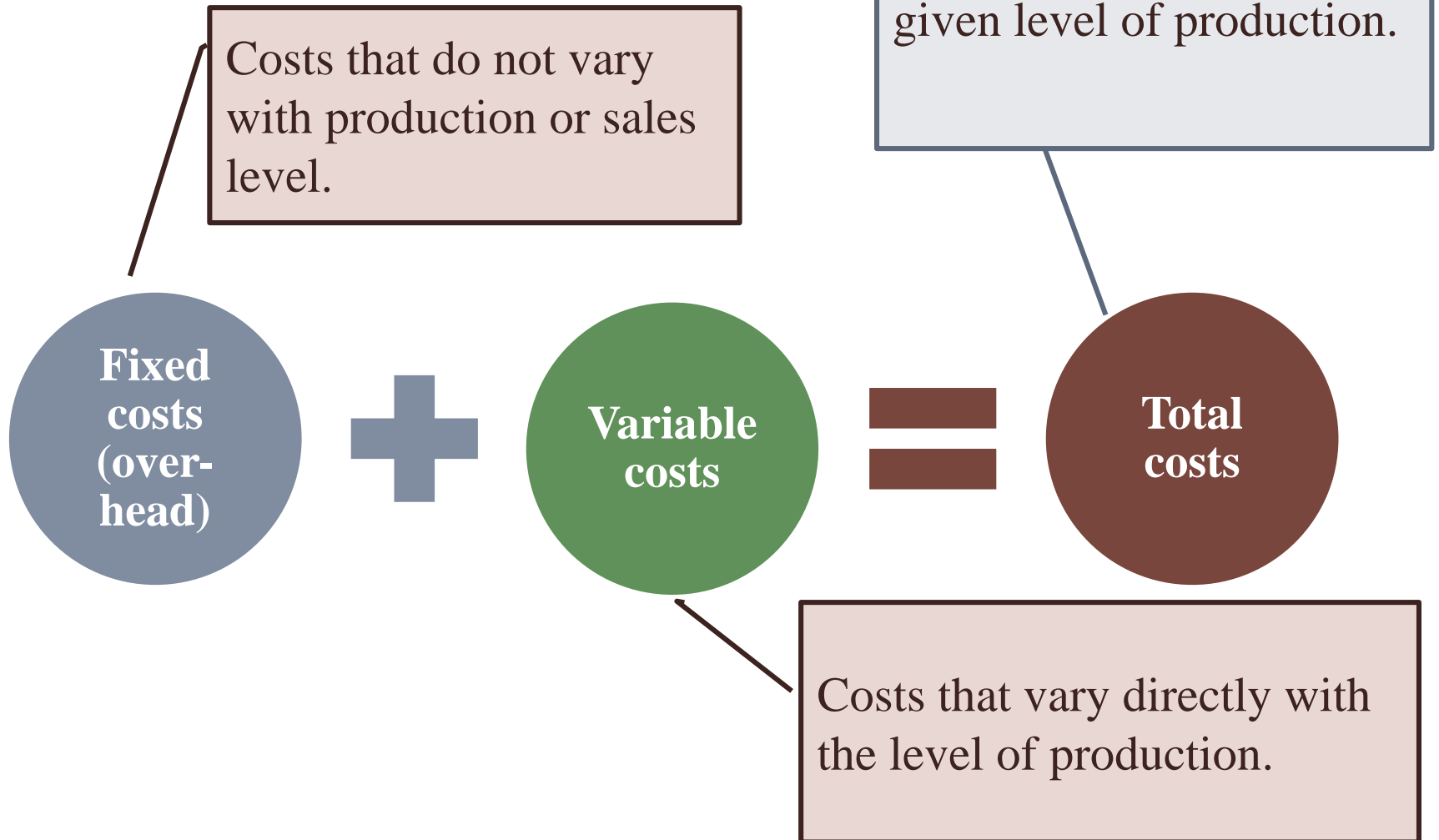
Value-Added Pricing

- Many companies adopt **value-added pricing** strategies.
- Rather than cutting prices to match competitors, they attach value-added features and services to differentiate their offers and thus support their higher prices.

Cost-Based Pricing

- **Cost-Based pricing** involves setting prices based on the costs of producing, distributing, and selling the product plus a fair rate of return for its effort and risk.
- A company's costs may be an important element in its pricing strategy.

Types of Costs



Costs at Different Levels of Production

- To price wisely, management needs to know how its costs vary with different levels of production.

Costs as a Function of Production Experience

- This drop in the average cost with accumulated production experience is called the **experience curve**
- If a downward-sloping experience curve exists, this is highly significant for the company.
- Not only will the company's unit production cost fall, but it will fall faster if the company makes and sells more during a given time period.
- But the market has to stand ready to buy the higher output.
- Experience-curve pricing carries some major risks.
- The aggressive pricing might give the product a cheap image.
- The strategy also assumes that competitors are weak and not willing to fight it out by meeting the company's price cuts.

Cost-Plus Pricing

- The simplest pricing method is **cost-plus pricing** (or **markup pricing**) — adding a standard markup to the cost of the product.

Markup pricing remains popular for many reasons.

Sellers are more certain about costs than about demand.

Many people feel that cost-plus pricing is fairer to both buyers and sellers.

When all firms in the industry use this pricing method, prices tend to be similar, so price competition is minimized.

Break-Even Analysis and Target Profit Pricing

- **Break-even pricing (target return)** sets price to break even on the costs of making and marketing a product, or setting price to make a target return.
- Target return pricing uses the concept of a *break-even chart*, which shows the total cost and total revenue expected at different sales volume levels.

Competition-Based Pricing

- **Competition-based pricing** involves setting prices based on competitors' strategies, costs, prices, and market offerings.
- Consumers will base their judgments of a product's value on the prices that competitors charge for similar products.

Other Internal and External Considerations Affecting Price Decisions

- Internal factors affecting pricing include the company's overall marketing strategy, objectives, and marketing mix, as well as other organizational considerations.
- External factors include the nature of the market and demand and other environmental factors.

Overall Marketing Strategy, Objectives, and Mix

- Price is only one element of the company's broader marketing strategy.
- So, before setting price, the company must decide on its overall marketing strategy for the product or service.
- Pricing may play an important role in helping to accomplish company objectives at many levels.
- **Target costing** is the pricing that starts with an ideal selling price, then targets costs that will ensure that the price is met.

Organizational Considerations

- Top management sets the pricing objectives and policies, and it often approves the prices proposed by lower level management or salespeople.
- In industries in which pricing is a key factor, companies often have pricing departments to set the best prices or help others set them.
- These departments report to the marketing department or top management.
- Others who have an influence on pricing include sales managers, production managers, finance managers, and accountants.

The Market and Demand

- In this section, we take a deeper look at the price-demand relationship and how it carries for different types of markets.
- We then discuss methods for analyzing the price-demand relationship.

Pricing in Different Types of Markets

Oligopolistic Competition

- The market consists of a few large sellers.
- Because there are a few sellers, each seller is aware of and responsive to competitors' pricing strategies and moves.

Pure Monopoly

- The market is dominated by one seller.
- The seller may be a government monopoly, a private regulated monopoly, or a private unregulated monopoly.

THE VAN OF YOUR DREAMS.

Bask in the serene glow of the all-new Honda Odyssey. With its spa-like interior, your cargo lives in peaceful harmony. A third row folds down with a single, effective touch. Bluetooth® centers your focus on the road ahead while a perfectly balanced audio system takes you on a journey of pure van bliss. The van beckons. Like no van before.

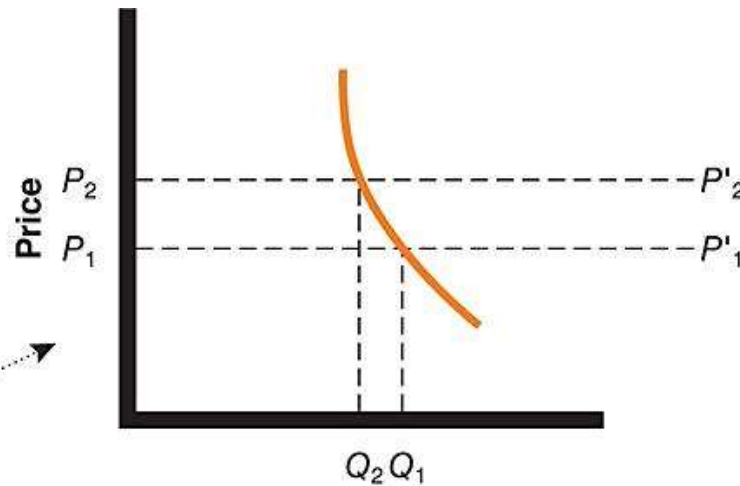
©2010 Honda Motor Co., Ltd. All rights reserved. Honda, the Honda logo, and Odyssey are trademarks of Honda Motor Co., Ltd. in the U.S. and other countries. Bluetooth is a registered trademark of Bluetooth SIG, Inc. All other trademarks are the property of their respective owners.

selling to set their offers apart.

Analyzing the Price-Demand Relationship

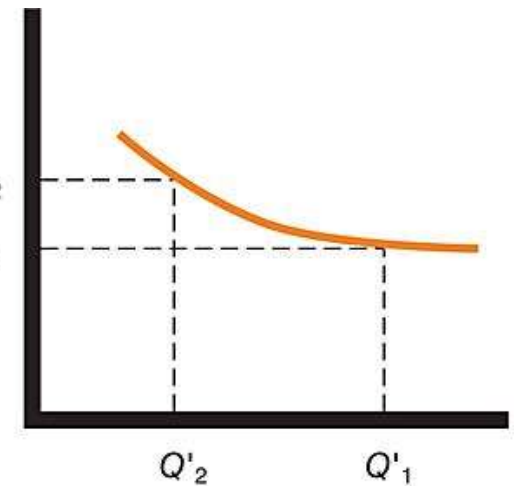
- **Demand curve** is a curve that shows the number of units the market will buy in a given time period, at different prices that might be charged.

Price and demand are related—no big surprise there. Usually, higher prices result in lower demand. But in the case of some prestige goods, the relationship might be reversed. A higher price signals higher quality and status, resulting in more demand, not less.



Quantity demanded per period

A. Inelastic demand



Quantity demanded per period

B. Elastic demand

Price Elasticity of Demand

- **Price Elasticity** is a measure of the sensitivity of demand to changes in price.
- It is given by the following formula:

$$\text{price elasticity of demand} = \frac{\% \text{change in quantity demanded}}{\% \text{change in price}}$$

- If demand is elastic rather than inelastic, sellers will consider lowering their prices.
- A lower price will produce more total revenue.
- Marketers need to work harder than ever to differentiate their offerings when a dozen competitors are selling virtually the same product at a comparable or lower price.

The Economy

- Economic conditions can have a strong impact on the firm's pricing strategies.
- Economic factors such as a boom or recession, inflation, and interest rates affect pricing decisions because they affect consumer spending, consumer perceptions of the product's price and value, and the company's costs of producing and selling a product.

Other External Factors

- Resellers react to various prices
- Government
- Social Concerns

The End

