

PRINCIPLES OF
Marketing

Chapter Ten

Pricing: Understanding and Capturing Customer Value



Pricing Concepts Understanding and Capturing Customer Value

Topic Outline

- What Is a Price?
- Customer Perceptions of Value
- Company and Product Costs
- Other Internal and External Considerations Affecting Price Decisions



What Is a Price?

Price is the amount of money charged for a product or service. It is the sum of all the values that consumers give up in order 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



Factors to Consider When Setting Prices

Customer Perceptions of Value

- Understanding how much value consumers place on the benefits they receive from the product and setting a price that captures that value



Factors to Consider When Setting Prices

Customer Perceptions of Value

Value-based pricing uses the buyers' perceptions of value, not the sellers cost, as the key to pricing. Price is considered before the marketing program is set.

- Value-based pricing is customer driven
- Cost-based pricing is product driven



Factors to Consider When Setting Prices

Customer Perceptions of Value

Value-based pricing

Good-value pricing

Value-added pricing



Factors to Consider When Setting Prices

Customer Perceptions of Value

Good-value pricing offers the right combination of quality and good service to fair price

Existing brands are being redesigned to offer more quality for a given price or the same quality for less price



Factors to Consider When Setting Prices

Customer Perceptions of Value

Everyday low pricing (EDLP) involves charging a constant everyday low price with few or no temporary price discounts

High-low pricing involves charging higher prices on an everyday basis but running frequent promotions to lower prices temporarily on selected items



Factors to Consider When Setting Prices

Customer Perceptions of Value

Value-added pricing attaches value-added features and services to differentiate offers, support higher prices, and build pricing power

Pricing power is the ability to escape price competition and to justify higher prices and margins without losing market share



Factors to Consider When Setting Prices

Company and Product Costs

Cost-based pricing involves setting prices based on the costs for producing, distributing, and selling the product plus a fair rate of return for its effort and risk



Factors to Consider When Setting Prices

Company and Product Costs

Cost-based pricing adds a standard markup to the cost of the product



Factors to Consider When Setting Prices

Company and Product Costs

Types of costs

Fixed
costs

Variable
costs

Total
costs



Factors to Consider When Setting Prices

Company and Product Costs

Fixed costs are the costs that do not vary with production or sales level

- Rent
- Heat
- Interest
- Executive salaries



Factors to Consider When Setting Prices

Company and Product Costs

Variable costs are the costs that vary with the level of production

- Packaging
- Raw materials



Factors to Consider When Setting Prices

Company and Product Costs

Total costs are the sum of the fixed and variable costs for any given level of production

Average cost is the cost associated with a given level of output



Factors to Consider When Setting Prices

Costs as a Function of Production Experience

- Experience or learning curve is when average cost falls as production increases because fixed costs are spread over more units



Factors to Consider When Setting Prices

Cost-Plus Pricing

- Cost-plus pricing adds a standard markup to the cost of the product
- Benefits
 - Sellers are certain about costs
 - Prices are similar in industry and price competition is minimized
 - Consumers feel it is fair
- Disadvantages
 - Ignores demand and competitor prices



Factors to Consider When Setting Prices

Break-Even Analysis and Target Profit Pricing

Break-even pricing is the price at which total costs are equal to total revenue and there is no profit

Target profit pricing is the price at which the firm will break even or make the profit it's seeking



Factors to Consider When Setting Prices

Other Internal and External Considerations

- Customer perceptions of value set the upper limit for prices, and costs set the lower limit
- Companies must consider internal and external factors when setting prices



Factors to Consider When Setting Prices

Other Internal and External Considerations

Target costing starts with an ideal selling price based on consumer value considerations and then targets costs that will ensure that the price is met



Factors to Consider When Setting Prices

Other Internal and External Considerations

Organizational considerations include:

- Who should set the price
- Who can influence the prices



Factors to Consider When Setting Prices

Other Internal and External Considerations

The Market and Demand

- Before setting prices, the marketer must understand the relationship between price and demand for its products



Factors to Consider When Setting Prices

Other Internal and External
Consideration
The Market and Demand

Pure competition

Monopolistic competition

Oligopolistic competition

Pure monopoly



Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

Pure competition is a market with many buyers and sellers trading uniform commodities where no single buyer or seller has much effect on market price

Monopolistic competition is a market with many buyers and sellers who trade over a range of prices rather than a single market price with differentiated offers.



Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

Oligopolistic competition is a market with few sellers because it is difficult for sellers to enter a market who are highly sensitive to each other's pricing and marketing strategies

Pure monopoly is a market with only one seller. In a regulated monopoly, the government permits a price that will yield a fair return. In a non-regulated monopoly, companies are free to set a market price.



TABLE 23.1**Characteristics of the Four Basic Market Models**

Characteristic	Market Model			
	Pure Competition	Monopolistic Competition	Oligopoly	Pure Monopoly
Number of firms	A very large number	Many	Few	One
Type of product	Standardized	Differentiated	Standardized or differentiated	Unique; no close substitutes
Control over price	None	Some, but within rather narrow limits	Limited by mutual interdependence; considerable with collusion	Considerable
Conditions of entry	Very easy, no obstacles	Relatively easy	Significant obstacles	Blocked
Nonprice competition	None	Considerable emphasis on advertising, brand names, trademarks	Typically a great deal, particularly with product differentiation	Mostly public relations advertising
Examples	Agriculture	Retail trade, dresses, shoes	Steel, automobiles, farm implements, many household appliances	Local utilities



Factors to Consider When Setting Prices

Other Internal and External Considerations

The demand curve shows the number of units the market will buy in a given period at different prices

- Normally, demand and price are inversely related
- Higher price = lower demand
- For prestige (luxury) goods, higher price can equal higher demand when consumers perceive higher prices as higher quality



Factors to Consider When Setting Prices

Other Internal and External Considerations

Price elasticity of demand illustrates the response of demand to a change in price

Inelastic demand occurs when demand hardly changes when there is a small change in price

Elastic demand occurs when demand changes greatly for a small change in price

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



Factors to Consider When Setting Prices

Other Internal and External Considerations Competitor's Strategies

- Comparison of offering in terms of customer value
- Strength of competitors
- Competition pricing strategies
- Customer price sensitivity



Factors to Consider When Setting Prices

Other Internal and External Consideration

Economic conditions

Reseller's response to price

Government

Social concerns

