Learning Objectives

1. How do consumers process and evaluate prices?
2. How should a company set prices initially for products or services?
3. How should a company adapt prices to meet varying circumstances and opportunities?
4. When and how should a company initiate a price change?
5. How should a company respond to a competitor's price change?
Understanding Pricing

• Pricing in a digital world

✓ Get instant vendor price comparisons
✓ Check prices at the point of purchase
✓ Name your price and have it met
✓ Get products free
✓ Monitor customer behavior & tailor offers
✓ Give customers access to special prices
✓ Negotiate prices online or even in person

Understanding Pricing

• A changing pricing environment

– Sharing economy
– Bartering
– Renting
Understanding Pricing

• How companies price
  – Small companies: boss
  – Large companies: division/product line managers

• How companies *should* price
  – Understanding of consumer pricing psychology
  – a systematic approach to setting, adapting, and changing prices

Consumer Psychology and Pricing

- Reference prices
- Price-quality inferences
- Price endings
Reference Prices

TABLE 16.1 Possible Consumer Reference Prices

- “Fair Price” (what consumers feel the product should cost)
- Typical Price
- Last Price Paid
- Upper-Bound Price (reservation price or the maximum most consumers would pay)
- Lower-Bound Price (lower threshold price or the minimum most consumers would pay)
- Historical Competitor Prices
- Expected Future Price
- Usual Discounted Price

Setting the Price

TABLE 16.2 Steps in Setting a Pricing Policy

1. Selecting the Pricing Objective
2. Determining Demand
3. Estimating Costs
4. Analyzing Competitors’ Costs, Prices, and Offers
5. Selecting a Pricing Method
6. Selecting the Final Price
Step 1: Selecting the Pricing Objective

- Survival
- Maximum current profit
- Maximum market share
- Maximum market skimming
- Product-quality leadership
- Other objectives

Step 2: Determining Demand

- Price sensitivity
- Estimating demand curves
  - Surveys, price experiments, & statistical analysis
- Price elasticity of demand
Figure 16.1
Inelastic And Elastic Demand

Price Sensitivity

TABLE 16.3 Factors That Reduce Price Sensitivity

- The product is more distinctive.
- Buyers are less aware of substitutes.
- Buyers cannot easily compare the quality of substitutes.
- The expenditure is a smaller part of the buyer’s total income.
- The expenditure is small compared to the total cost of the end product.
- Part of the cost is borne by another party.
- The product is used in conjunction with assets previously bought.
- The product is assumed to have more quality, prestige, or exclusiveness.
- Buyers cannot store the product.
Step 3: Estimating Costs

- Types of costs and levels of production
  - Fixed vs. variable costs
  - Total costs
  - Average cost

Step 3: Estimating Costs

- Accumulated production
  - Experience/learning curve
Step 3: Estimating Costs

• Target costing
  – Price less desired profit margin

Step 4: Analyzing Competitors’ Prices

• Firm must take competitors’ costs, prices, & reactions into account
  – Value-priced competitors
Step 5: Selecting a Pricing Method

• Figure 16.4: three major considerations in price
  – Costs = price floor
  – Competitors’ prices = orienting point
  – Customers’ assessment of unique features = price ceiling

Step 5: Selecting a Pricing Method

• Markup pricing
  – Add a standard markup to the product’s cost

\[
\text{Markup price} = \frac{\text{unit cost}}{(1 - \text{desired return on sales})}
\]
Step 5: Selecting a Pricing Method

• Target-return pricing
  • Price that yields its target rate of return on investment

\[
\text{Target-return price} = \text{unit cost} + \frac{\text{desired return} \times \text{invested capital}}{\text{unit sales}}
\]

Figure 16.5
Break-Even for Target-Return Price
Step 5: Selecting a Pricing Method

• Perceived-value pricing
  – Based on buyer’s image of product, channel deliverables, warranty quality, customer support, and softer attributes (e.g., reputation)

Step 5: Selecting a Pricing Method

• Value pricing
• EDLP
  – High-low pricing
• Going-rate pricing
Step 5: Selecting a Pricing Method

- Auction-type pricing

  - English (ascending)
  - Dutch (descending)
  - Sealed-bid

Step 6: Selecting the Final Price

- Additional factors to select final price:
  - Impact of other marketing activities
  - Company pricing policies
  - Gain-and-risk-sharing pricing
  - Impact of price on other parties
Adapting the Price

- Geographical pricing
  - Barter
  - Compensation deal
  - Buyback arrangement
  - Offset

Adapting the Price

- Price discounts and allowances

<table>
<thead>
<tr>
<th>TABLE 16.4 Price Discounts and Allowances</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Discount:</strong></td>
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<tr>
<td><strong>Quantity Discount:</strong></td>
</tr>
<tr>
<td><strong>Functional Discount:</strong></td>
</tr>
<tr>
<td><strong>Seasonal Discount:</strong></td>
</tr>
<tr>
<td><strong>Allowance:</strong></td>
</tr>
</tbody>
</table>
Adapting the Price

- Promotional pricing:
  - Loss-leader pricing
  - Special event pricing
  - Special customer pricing
  - Cash rebates
  - Low-interest financing
  - Longer payment terms
  - Warranties/service contracts
  - Psychological discounting

Adapting the Price

- Price discrimination

- Customer-segment pricing
- Product-form pricing
- Time pricing
- Image pricing
- Location pricing
- Channel pricing
Adapting the Price

- Price discrimination
  - Yield pricing

Initiating and Responding to Price Changes

- Initiating price cuts
  - Excess plant capacity
  - Domination of market

- Price-cutting traps
  - Price concessions
  - Low-quality
  - Fragile market share
  - Shallow pockets
  - Price war
Initiating and Responding to Price Changes

- Initiating price increases

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

Initiating Price Increases

<table>
<thead>
<tr>
<th>TABLE 16.5</th>
<th>Profits before and after a Price Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Before</td>
</tr>
<tr>
<td>Price</td>
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<tr>
<td>Units sold</td>
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<tr>
<td>Revenue</td>
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<tr>
<td>Costs</td>
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<tr>
<td>Profit</td>
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</tbody>
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Initiating and Responding to Price Changes

• Anticipating competitive responses
• Responding to competitors’ price changes