11. DEVELOPING PRICING STRATEGIES AND PROGRAMS

UNIVERSITAS
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Synonyms for Price

- Rent
- Tuition
- Fee
- Fare
- Rate
- Toll
- Premium
- Honorarium
- Special assessment
- Bribe
- Dues
- Salary
- Commission
- Wage
- Tax

The Internet Changes the Pricing Environment –

By Providing Information

Common Pricing Mistakes

- Determine costs and take traditional industry margins
- Failure to revise price to capitalize on market changes
- Setting price independently of the rest of the marketing mix
- Failure to vary price by product item, market segment, distribution channels, and purchase occasion

Consumer Psychology and Pricing

- Reference prices
- Price-quality inferences
- Price endings
- Price cues

Tiers in Pricing

Most markets have three to five price points or tiers.

- Marriott Vacation Club—Vacation Villas (highest price)
- Marriott Marquis (high price), Marriott (high-medium price)
- Renaissance (medium-high price), Courtyard (medium price)
- TownPlace Suites (medium-low price), and Fairfield Inn (low price)

Steps in Setting Price

- Select the price objective
- Determine demand
- Estimate costs
- Analyze competitor price mix
- Select pricing method
- Select final price

Step 1: Selecting the Pricing Objective

The company first decides where it wants to position its market offering.

Five major objectives:

- **Survival ➔** Prices cover VC and some FC
- **Maximum current profit ➔** estimate the demand and costs associated with alternative prices and choose the price that produces maximum current profit
- **Maximum market share ➔** set lowest price
- **Maximum market skimming ➔** companies with new technology favor setting high prices
- **Product-quality leadership ➔** high quality-high price; low quality-low price

Step 2: Determining Demand

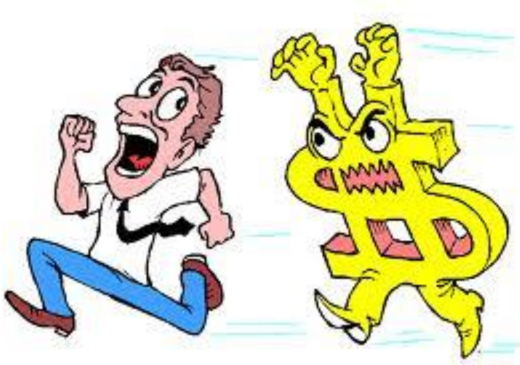
- Price sensitivity

  customers are less price sensitive to low-cost items or items they buy infrequently
- Estimate demand curves
- Price elasticity of demand

Step 3: Estimating Costs

The company wants to charge a price that covers its cost of producing, distributing, and selling the product, including a fair return for its effort and risk.

- Types of costs
- Accumulated production
- Target costing



Step 4: Analyzing Competitor's Costs

- If the **firm's offer contains features not offered by the nearest competitor**, it should evaluate their worth to the customer and **add that value to the competitor's price**.
- If the **competitor's offer contains some features not offered by the firm**, the firm should **subtract their value from its own price.**
- Now the firm can decide whether it can charge more, the same, or less than the competitor

Step 5: Selecting a Pricing Method

- **Markup pricing**

Variable cost per unit	\$10
Fixed costs	\$300,000
Expected unit sales	50,000

$$\text{Unit cost} = \text{variable cost} + \frac{\text{fixed cost}}{\text{unit sales}} = \$10 + \frac{\$300{,}00}{50{,}000} = \$16$$

$$\text{Markup price} = \frac{\text{unit cost}}{(1 - \text{desired return on sales})} = \frac{\$16}{1 - 0.2} = \$20$$

- **Target-return pricing**

  the firm determines the price that yields its target rate of return on investment.

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

$$= \$16 + \frac{.20 \times \$1{,}000{,}000}{50{,}000} = \$20$$

- **Perceived-value pricing**

\$90,000	is the tractor's price if it is only equivalent to the competitor's tractor
\$7,000	is the price premium for Caterpillar's superior durability
\$6,000	is the price premium for Caterpillar's superior reliability
\$5,000	is the price premium for Caterpillar's superior service
\$2,000	is the price premium for Caterpillar's longer warranty on parts
\$110,000	is the normal price to cover Caterpillar's superior value
– \$10,000	discount
\$100,000	final price

- **Value pricing**

  charging a fairly low price for a high-quality offering

- **Going-rate pricing**

  the firm bases its price largely on competitors' prices.

- **Auction-type pricing**

Step 6: Selecting the Final Price

- **Impact of other marketing activities**
  - Brands with average relative quality but high relative advertising budgets could charge **premium prices.**
  - Brands with high relative quality and high relative advertising obtained the **highest prices**
  - For market leaders, the positive relationship between high prices and high advertising held most strongly in the later stages of the product life cycle.
- **Company pricing policies**
- **Gain-and-risk sharing pricing**
- **Impact of price on other parties**

Adapting the Price

- **Geographical Pricing**: Pricing varies by location

Price Discounts and Allowances

- **Discount:** A price reduction to buyers who pay bills promptly
- **Quantity discount**: A price reduction to those who buy large volumes
- **Functional discount:** offered by a manufacturer to trade channel members if they will perform certain functions, such as selling, storing, and record keeping.
- **Seasonal discount**: A price reduction to those who buy merchandise or services out of season.
- **Allowance:** An extra payment designed to gain reseller participation in special programs

- **Promotional Pricing Tactics**
  - **Loss-leader pricing**: drop the price on well-known brands to stimulate additional store traffic
  - **Special-event pricing**: Sellers will establish special prices in certain seasons to draw in more customers. Every August, there are back-to-school sales.
  - **Cash rebates** : cash back
  - **Low-interest financing**
  - **Longer payment terms:** stretch loans over longer periods and thus lower the monthly payments
  - **Warranties and service contracts**
  - **Psychological discounting**: “Was $359, now $299.”

Differentiated Pricing

- **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
- **Image pricing:** price the same product at two different levels based on image differences
- **Channel pricing:** charging a different price depending on where the consumer buys the product
- **Location pricing**: the same product is priced differently at different locations
- **Time pricing**: prices are varied by season, day, or hour.

Traps in Price Cutting Strategies

- ***Low-quality trap.*** Consumers assume quality is low.
- ***Fragile-market-share trap.*** A low price buys market share but not market loyalty. The same customers will shift to any lower-priced firm that comes along.
- ***Shallow-pockets trap.*** Higher-priced competitors match the lower prices but have longer staying power because of deeper cash reserves.
- ***Price-war trap.*** Competitors respond by lowering their prices even more, triggering a price war

Methods for Increasing Prices

- **Delayed quotation pricing**: The company does not set a final price until the product is finished or delivered.
- **Escalator clauses**: The company requires the customer to pay today's price and all or part of any inflation increase that takes place before delivery
- **Unbundling:** The company maintains its price but removes or prices separately one or more elements that were part of the former offer, such as free delivery or installation
- **Reduction of discounts:** The company instructs its sales force not to offer its normal cash and quantity discounts.

Brand Leader Responses to Competitive Price Cuts

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

Thank You..