Chapter 10

PRICING: UNDERSTANDING AND CAPTURING CUSTOMER VALUE

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TOPICS OF THE LECTURE

1. What is a Price?
2. Major Pricing Strategies
3. Other Internal and External Considerations Affecting Price Decisions

Pricing

Narrowly, Price is the amount of money charged for a product or service.

Broadly, price is the sum of all the values that consumers exchange for the benefits of having or using the product or service.

Dynamic Pricing: charging different prices depending on individual customers and situations.

Price is the only element in the marketing mix that produces revenue; all other elements represent costs.

Price has many names

- Rent
- Fee
- Rate
- Commission

- Tuition
- Fare
- Toll
- Bribe

- Salary
- Wage
- Interest
- Tax

Overview: Two Important factors for setting a price

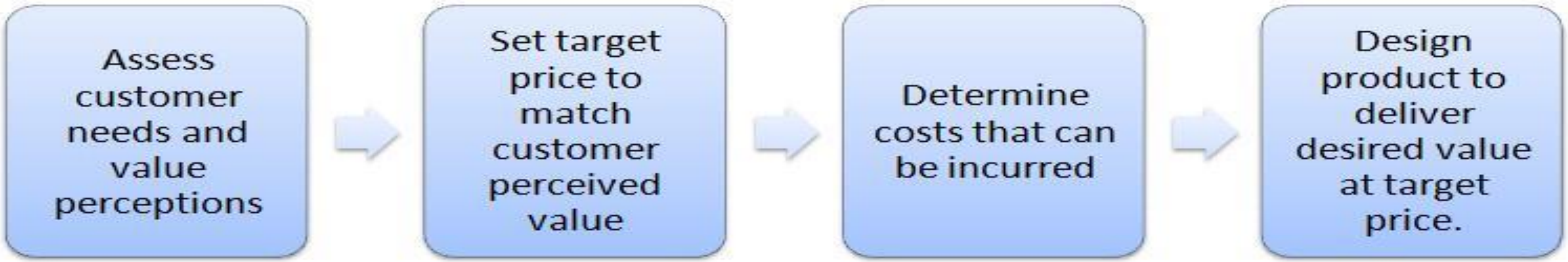
1. **Customer perceptions on value:** If customers perceive that the price is greater than the product's value – they will not buy it. **Set a price that consumers feels is "worth it"**.

2. **Company profits:** If company prices it too low, profitability will be affected.

Value Based Pricing

Complete understanding of the value that a product or service creates for a customer.

Value-based pricing uses the buyers' perceptions of value, not the sellers' cost, as the key to pricing.



Value Based Pricing

Good-Value Pricing

Value-added Pricing

Good-Value Pricing

Good value pricing: offering just the right combination of quality and good service at a fair price (e.g. Taco Bell & McDonald's offer value menu items).

Nowadays consumers number 1 answer of Value is 'Brand names for less'

Everyday low pricing (EDLP): charging a constant everyday low price with few or no price discounts (e.g. New Market, Bongo Bazaar, Walmart).

High-low pricing: charging higher prices on an everyday basis but running frequent promotions to lower prices (e.g. Bata SALE).

Value Added Pricing

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.

Value Added Pricing example

Competitors' price $ 90,000

Caterpillar price $ 110,000 why?

$ 90,000	is the equivalent of competitor's tractor
$ 7,000	is the price premium for superior durability
$ 6,000	is the price premium for reliability
$ 5,000	is the price premium for superior service
$ 2,000	is the price premium for longer warranty on parts
$110,000	is the normal price to cover Caterpillar's superior value
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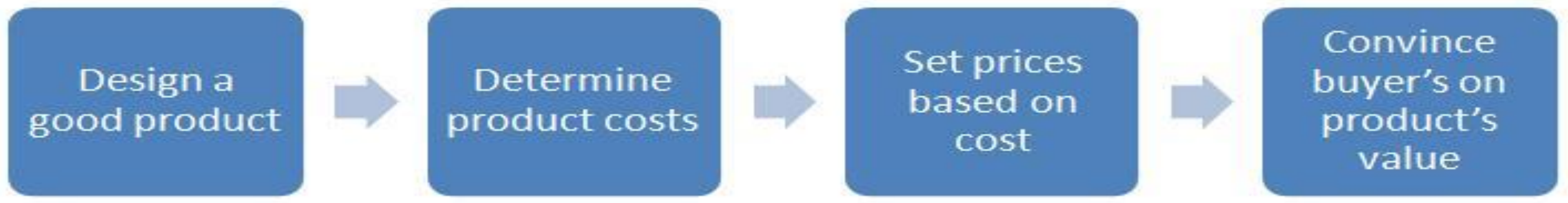
$110,000	Final Price

Cost Based Pricing

Cost based pricing is product driven. Setting prices based on the costs of producing, distributing and selling the product plus a fair rate of return for effort and risk.

Ignores consumer and competition's perspective



Types of Costs

Fixed costs	Variable costs	Total costs

Types of costs

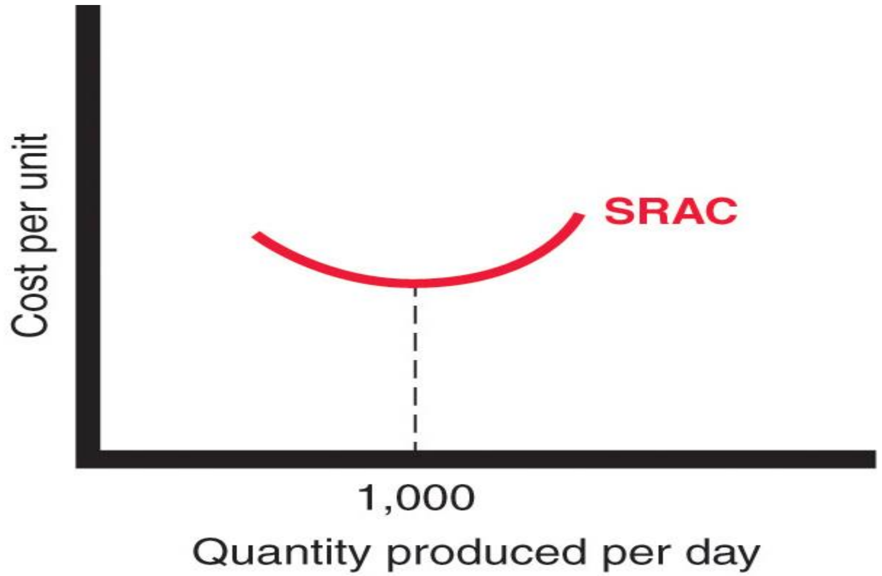
Fixed costs are the costs that do not vary with production or sales level e.g. Rent, Heat, Executive salaries.

Variable costs are the costs that vary with the level of production e.g. Packaging, Raw materials.

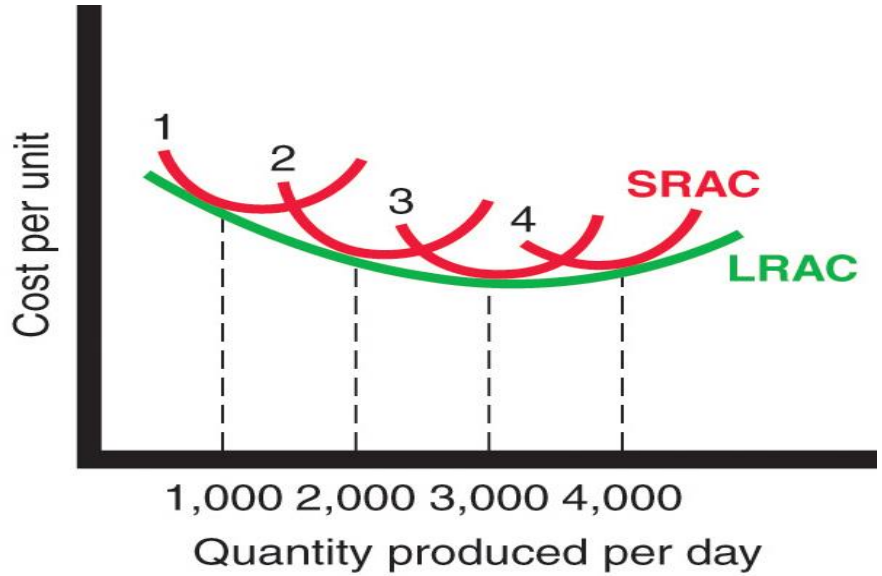
Total costs are the sum of the fixed and variable costs for any given level of production.

Cost Based Pricing

Costs at Different Levels of Production



A. Cost behavior in a fixed-size plant



B. Cost behavior over different-size plants

Cost Based Pricing

Cost-plus pricing

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

Then the manufacturer's cost per toaster is given by the following:

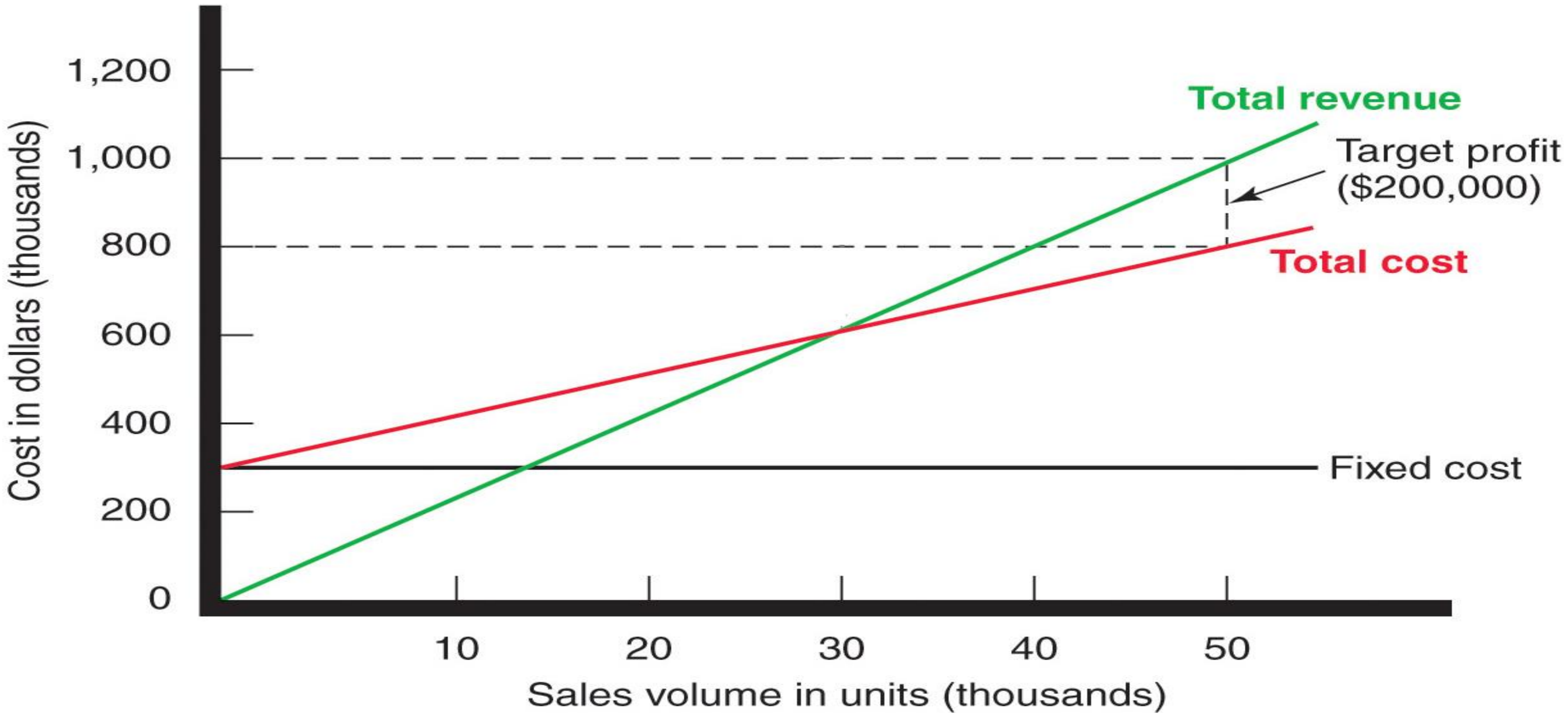
$$\text{unit cost} = \text{variable cost} + \frac{\text{fixed costs}}{\text{unit sales}} = \$10 + \frac{\$300{,}000}{50{,}000} = \$16$$

Now suppose the manufacturer wants to earn a 20 percent markup on sales. The manufacturer's markup price is given by the following:[9]

$$\text{markup price} = \frac{\text{unit cost}}{(1 - \text{desired return on sales})} = \frac{\$16}{1 - .2} = \$20$$

Cost Based Pricing

Break-Even Analysis and Target Profit Pricing



Competition based pricing

A pricing strategy based on what all other competitors are doing. The price can be set at, above, or below competitor's price.

Example: Some firms offer a price matching what their competitors are offering. Malindo Air, Air Asia.

Pricing in Different Types of Markets

- Pure competition
- Monopolistic competition
- Oligopolistic competition
- Pure monopoly

Price-Demand Relationship

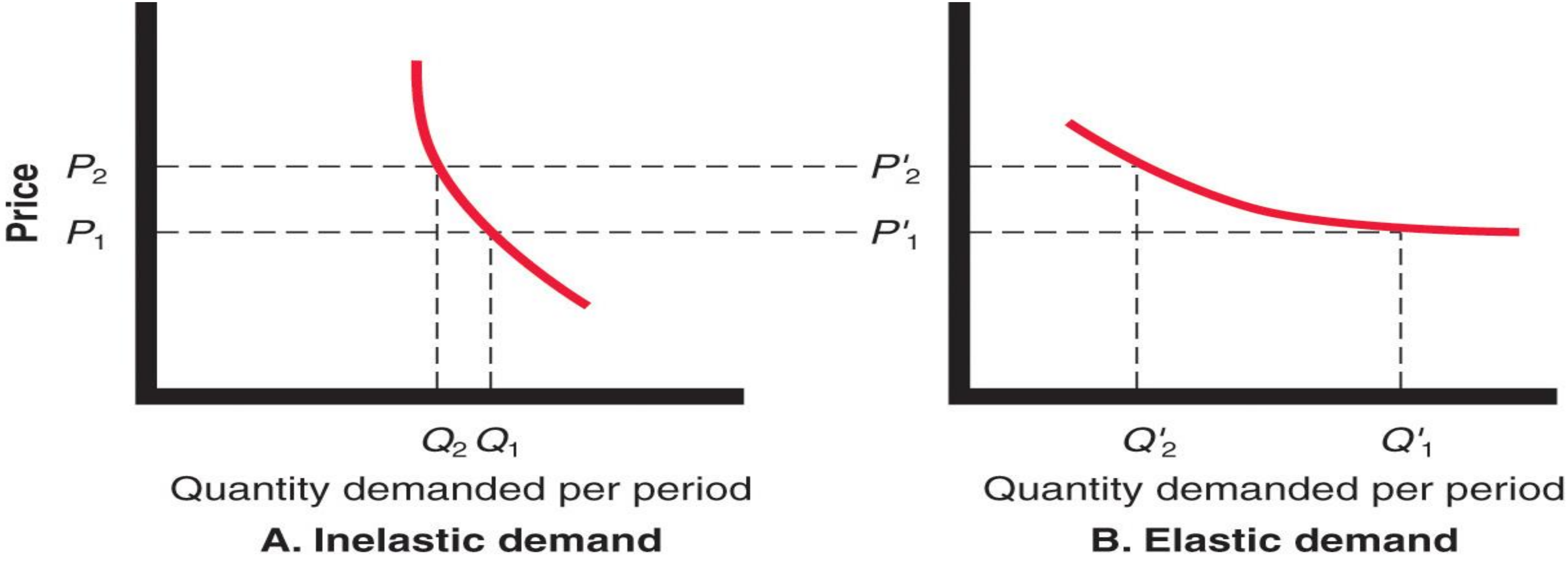
The demand curve (next slide) shows the number of units the market will buy in a given period at different prices.

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

Other Internal and External Considerations Affecting Price Decisions



Thank you