UNDERSTANDING PRICING

*Price is not just a number on a tag or an item.*

A) Throughout most of history prices were set by negotiation between buyers and sellers.
B) Setting one price for all buyers is a relatively modern idea.
C) Today the Internet is partially reversing the fixed pricing trend.
D) Traditionally, price has operated as the major determinant of buyer choice.
E) Price remains one of the most important elements determining market share and profitability.

How Companies Price

*Companies do their pricing in a variety of ways.*

A) In small companies, prices are often set by the boss.
B) In large companies, pricing is handled by division and product-line managers.
C) In large companies, top management sets general pricing objectives, policies, and often approves the prices proposed by lower levels of management.
D) In industries where pricing is a key factor, companies will often establish a pricing department to set or assist others in determining appropriate prices.
E) Many companies do not handle pricing well.
F) Others use price as a key strategic tool.
   1) There are customized prices and offerings based on segment value and costs.
G) Effectively designing and implementing pricing strategies requires a thorough understanding of consumer pricing psychology and a systematic approach to setting, adapting, and changing prices.
HISTORY OF PRICING

BARGAINING – still a sport in some areas for all buyers

ONE PRICE for all customers $\rightarrow$ relatively modern idea; circa late C19th; rise of large-scale retailing. FW Woolworth $\rightarrow$ too many items and too many employees

REVERSAL OF ONE PRICE CONCEPT:

Priceline.com: customer names the price

e-Bay.com: online auction

Buying groups: volume aggregating sites $\rightarrow$ combine orders of many customers and press supplier for a deeper discount
PRICE = key determinant of buyer choice

* Esp in poorer countries

* with commodity-type products

price = key to profits and market share
consumers with access to more price info and price discounters

Consumers pressure retailers to lower price
Retailers pressure mfg to lower prices
RESULT: marketplace with heavy discounting and sales promotion
HOW FIRMS FAIL TO HANDLE PRICING WELL

* too cost-oriented

* price not revised often enough to capitalize on market changes

* price set too independent of rest of MM rather than as an intrinsic element of market-positioning strategy

* price not varied enough for diff product items, market segments, distribution channels, and purchase occasions

HOW FIRMS DO THEIR PRICING

* SMALL FIRMS: prices set by the boss

* LARGE FIRMS: handle by division or product-line managers; yet to be approved by top mgrs

* PRICE A KEY FACTOR: aerospace, railroads, oil companies → pricing dept to set or assist in determining appropriate prices → cross-disciplinary team: marketing, accounting, finance, and production managers

* NATURAL MONOPOLIES: utilities, power, water → commissions or boards to study cost issues and impact of pricing
SETTING THE RIGHT PRICE

STEPS IN SETTING THE RIGHT PRICE
Establish pricing goals
Estimate demand, costs, and profits
Choose a price strategy
Fine tune with pricing tactics
Results lead to the right price

PRICING OBJECTIVES
Profit-oriented pricing objectives
Sales-oriented pricing objectives
Status-quo pricing objectives

PRICING STRATEGY
A basic, long-term pricing framework, which establishes the initial price for a product and the intended direction for price movements over the PLC

BASIC STRATEGIES FOR SETTING PRICES
Price skimming
Penetration pricing
Status-quo pricing

SITUATIONS WHEN PRICE SKIMMING IS SUCCESSFUL
Inelastic demand; unique advantages/superiority; legal protection of product; tech breakthroughs; blocked entry to competitors

Penetration pricing: a pricing policy whereby a firm charges a relatively low price for a product initially as a way to reach the mass market
Pros: discourages or blocks competition from market entry; boosts sales and provides large profit increases
Cons: requires gear up for mass production; selling large volumes at low prices; strategy to gain MS may fail

Status quo pricing
Pros: simplicity; safest route to long-term survival for small firms
Cons: strategy may ignore demand and/or cost

THE LEGALITY AND ETHICS OF PRICE STRATEGY: ISSUES THAT LIMIT PRICING DECISIONS
Unfair trade practices: Laws that prohibit wholesales and retailers from selling below cost
Price fixing: an agreement between 2 or more firms on the price they will charge for a product
Price discrimination: The Robinson-Patman Act of 1936: prohibits any firm from selling to 2 or more different buyers at different prices if the result would lessen competition
RPA Defenses for seller: cost; market conditions; competition
Predatory pricing: the practice of charging a very low price for a product with the intent of driving competitors out of biz or out of a market

TACTICS FOR FINE TUNING THE BASE PRICE
Discounts; geographic pricing; special pricing tactics

Quantity discounts; promotional allowances; cash rebates; rebates; functional discounts; value-based pricing; seasonal discounts; zero % financing

VALUE-BASED PRICING
The price is set at a level that seems to the customer to be a good price compared to the prices of other options

COMMON METHODS OF GEOGRAPHIC PRICING
FOB origin pricing; uniform delivered pricing; zone pricing; freight absorption pricing; basing-point pricing

FOB origin pricing: the buyer absorbs the freight costs from the shipping point (free on board)
Uniform delivered pricing: the seller pays the freight charges and bills the purchaser an identical, flat freight charge
Zone pricing: the US is divided into zones and a flat rate is charged to customers in a given zone
Freight absorption pricing: the seller pays for all or part of the freight charges and does not pass them on to the buyer
Basing-point pricing: the seller designates a location as a basing point and charges all buyers the freight costs from that point

SPECIAL PRICING TACTICS
Single-price tactic: all goods offered at the same price
Flexible pricing: different customers pay different price
Professional services pricing: used by professionals with experience, training or certification
Price lining: several line items at specific price points
Leader pricing: sell product at near or below cost
Bait pricing: lure customers though false or misleading price ads
Odd-even pricing: odd-number prices imply bargain; even-number prices imply quality
Price bundling: combining 2 or more products in a single package
2-part pricing: 2 separate charges to consume a single good

CONSUMER PENALTIES: BIZ IMPOSE CONSUMER PENALTIES IF ..
An irrevocable loss of revenue is suffered
Additional transaction costs are incurred

PRODUCT LINE PRICING
Setting prices for an entire line of products
RELATIONSHIPS AMONG PRODUCTS
Complementary; substitutes; neutral

JOINT COSTS
Costs that are shared in the mfg and marketing of several products in a product line

PRICING DURING DIFFICULT ECONOMIC TIMES:
INFLATION: cost-driven tactics; demand oriented tactics

PROBLEMS WITH COST-ORIENTNED TACTICS
A high volume of sales on an item with a low profit margin may still make the item highly profitable
Eliminating a product may reduce economies of scale
Eliminating a product may affect the price-quality image of entire line

COST-ORIENTED TACTICS
Delayed quotation pricing: a firm price is not set until the item is either finished or delivered
Escalator pricing: the final selling price reflects cost increases incurred between the time the order is placed and when delivery is made

COST-ORIENTED TACTICS: MAINTAINING A FIXED GROSS MARGIN
Decreased demand; increased production costs; price increase

PRICE SHADING
The use of discounts by salespeople to increase demand for one or more products in a line

DEMAND-ORIENTED TACTICS: STRATEGIES TO MAKE DEMAND MORE INELASTIC
Cultivate selected demand
Create unique offerings
Change the package design
Heighten buyer dependence

PRICING DURING RECESSION: TACTICS
Value-based pricing:
Bundling or unbundling:

SUPPLIER STRATEGIES DURING RECESSION: COST-SAVING STRATEGIES WITH SUPPLIERS
Renegotiating contracts; offering help; keeping the pressure on; paring down suppliers
INITIATING PRICE CUTS

Why? Reasons

• excess plant capacity
• declining market share
• drive to dominate market thru low costs
• responding to economic recession

CAUTION: Low price traps

• low quality trap – consumers assume low quality
• fragile mare-share trap – lower price buys MS but not market loyalty; may encourage brand switching behavior
• shallow-pockets trap – competitors may have deeper pockets in price war

INITIATING PRICE INCREASES

Why? Reasons

• cost inflation
• anticipatory pricing
• over-demand

How? Methods

• delayed quotation pricing – do not set final price
• escalator clauses
• unbundling
• reduction of discounts
REACTIONS TO PRICE CHANGES

Customers’ reactions:

• question motivation behind changes
• Negative: new model coming; financial trouble; price will decline further; quality reduced
• Positive: item is “hot”; good value
• Response depends on price sensitivity of customers

Competitors’ reactions:

• when competitors are likely to react:
  - few firms
  - homogenous products
  - buyers are highly informed

• anticipating competitors’ response:
  - immediate price change
  - self-interest – strategy MS?

RESPONDING TO COMPETITORS’ PRICE CHANGES

Homogenous vs non-homogenous products

Homogenous: no choice but to respond

Non-homogenous: more latitude

Questions:

• Why the competitor change the price?
• Price change – temporary or permanent?
• What will happen to MS? Profit? If do not respond?
• Other companies will respond too?
• What are the competitor’s and other firms’ likely response to each possible action? Snowball effect?
Possible responses:

- maintain price
- maintain price and add value
- reduce price
- increase price and improve quality
- launch a low-price fighter – fighting brand