PRINCIPLES OF Marketing

Chapter Ten

Pricing:

Understanding and Capturing Customer Value

Pricing: 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

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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.

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What Is a Price?

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

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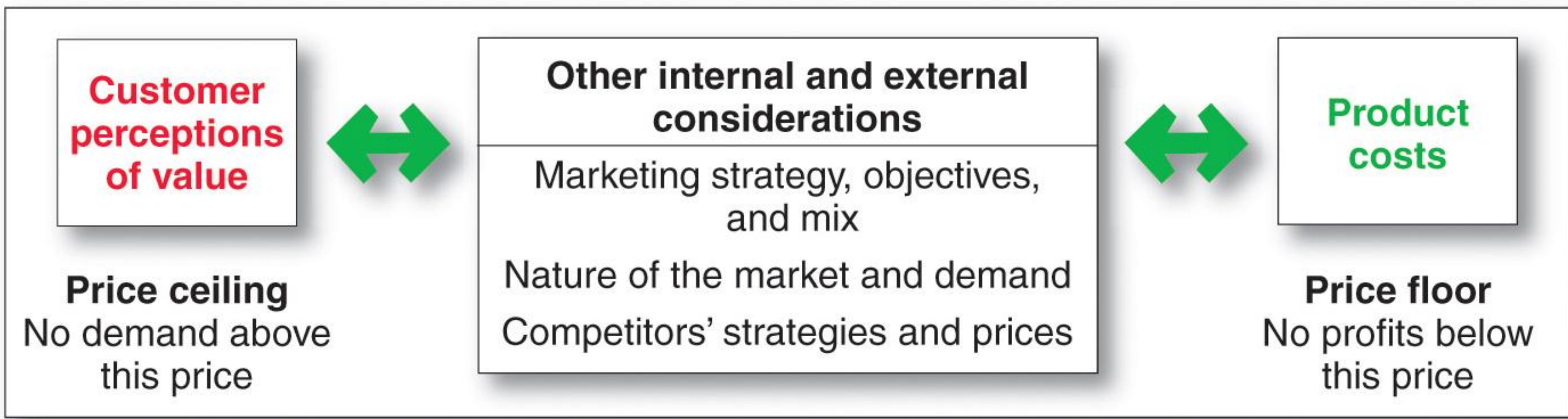
Factors to Consider When Setting Prices

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



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

Cost-based pricing

Design a good product → Determine product costs → Set price based on cost → Convince buyers of product's value

Value-based pricing

Assess customer needs and value perceptions → Set target price to match customer perceived value → Determine costs that can be incurred → Design product to deliver desired value at target price

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

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Factors to Consider When Setting Prices

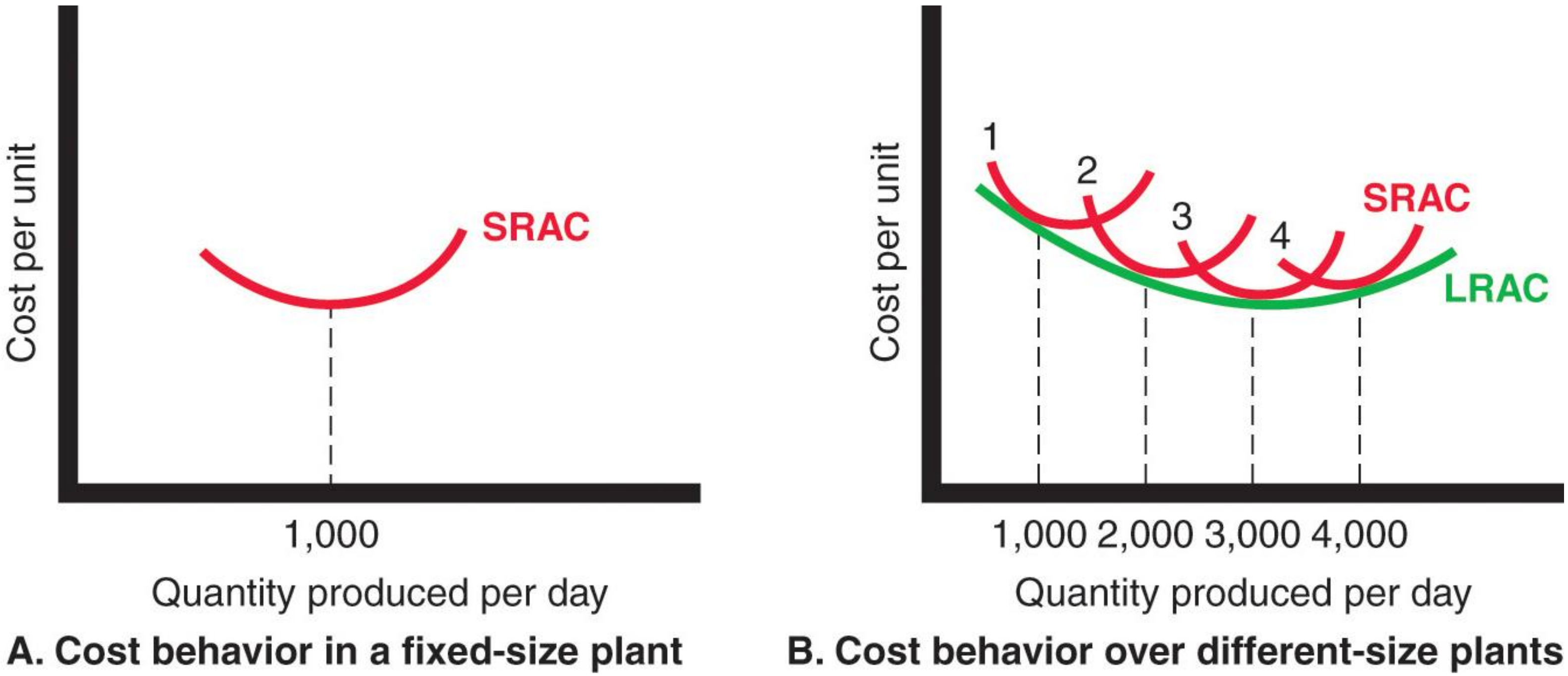
Company and Product Costs

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

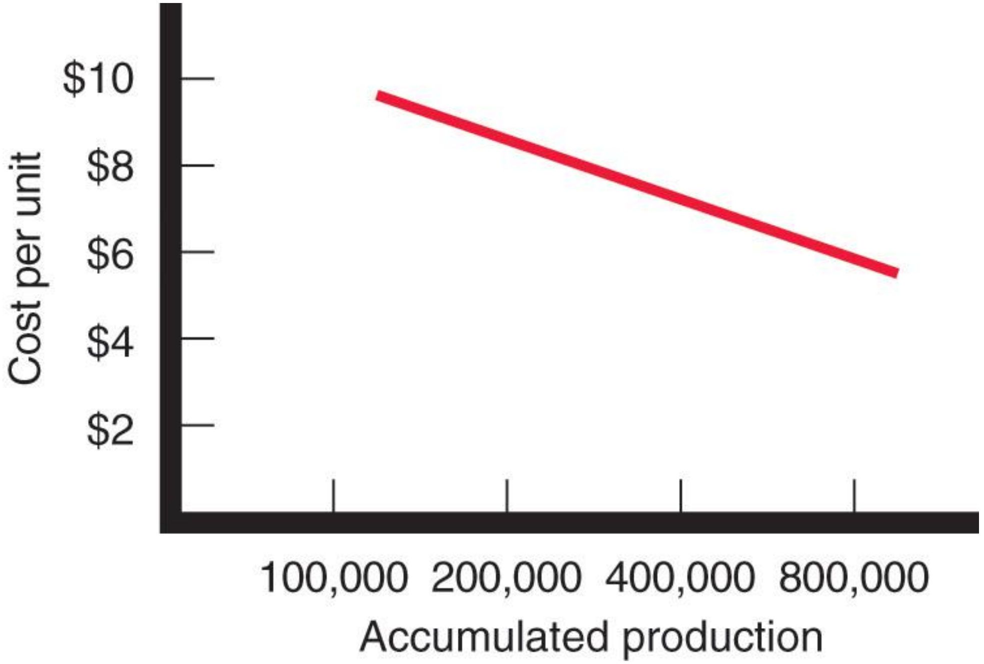
Costs at Different Levels of Production



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

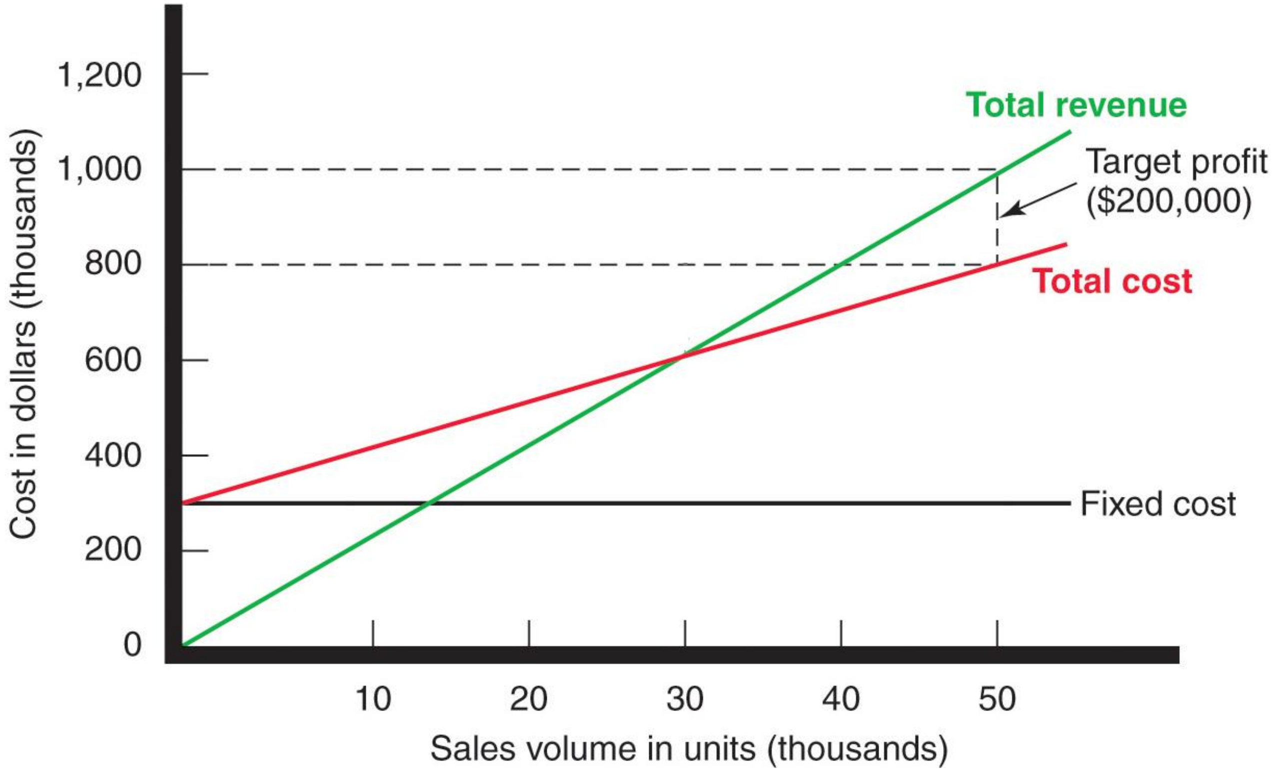
Break-Even Analysis and Target Profit Pricing

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

Break-Even Analysis and Target Profit Pricing



Considerations in Setting Price

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Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

- 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 Affecting Price Decisions

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

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Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

Organizational considerations include:

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

Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

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 Affecting Price Decisions

Competition

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

Factors to Consider When Setting Prices

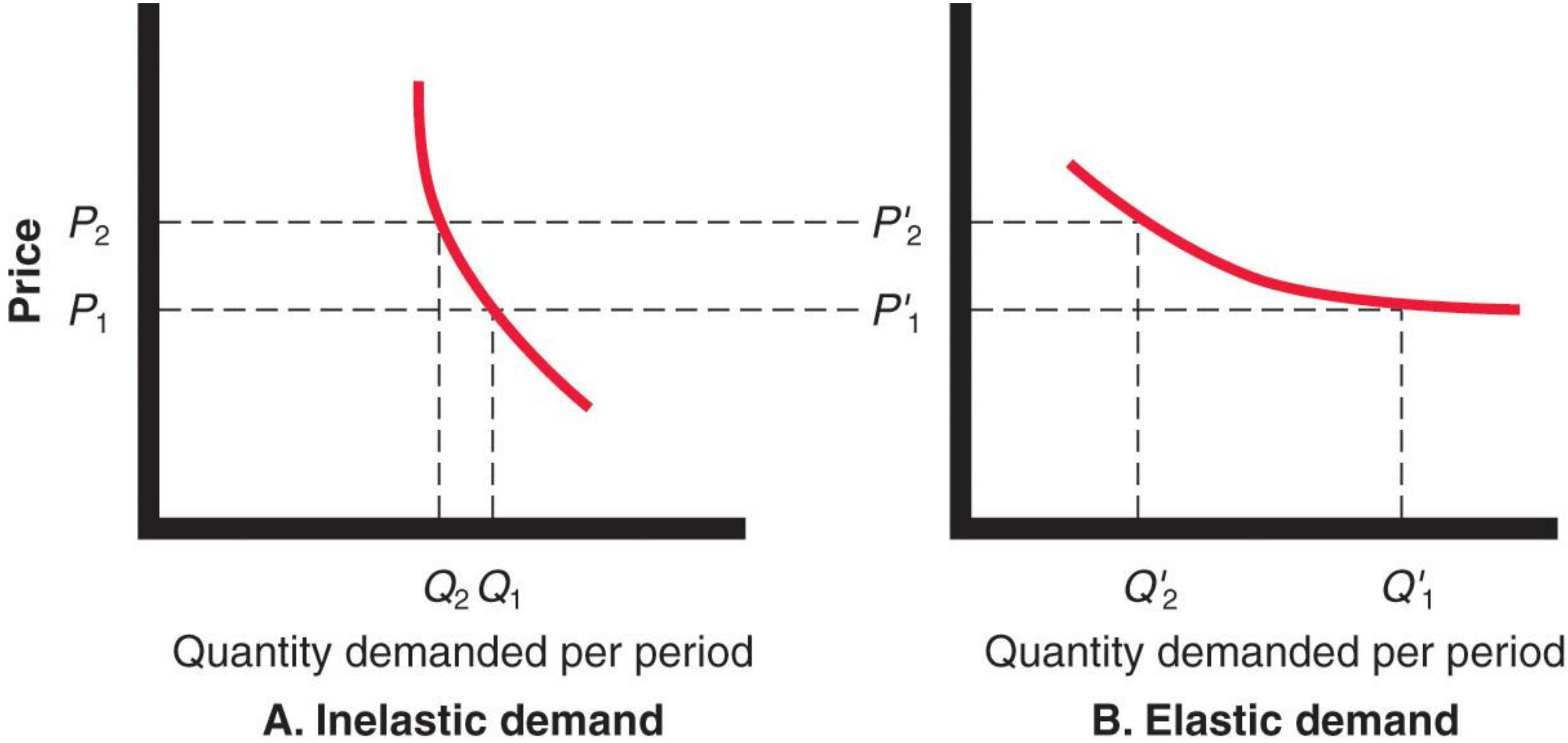
Other Internal and External Considerations Affecting Price Decisions

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 Affecting Price Decisions



Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

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

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

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 strategi
- Customer price sensitivity

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Factors to Consider When Setting Prices

Other Internal and External Consideration Affecting Price Decisions

- **Economic conditions**
- **Reseller's response to price**
- **Government**
- **Social concerns**