1

What is a cynic? A man who knows the price of everything and the value of nothing.

Oscar Wilde (1854 - 1900)
Lady Windermere's Fan, 1892, Act III

# Pricing Strategy & Policy

Dr. Paurav Shukla

3

## Objectives

- Setting the Price
- Adapting the Price
- Initiating & Responding to Price Changes

4

## The price game

- Joel Urbany's experiment
  - You sell sunglasses for $10 with a unit cost of $7 and you are thinking of cutting the price by 50c.
  - According to the best sales estimate
    - If you hold the price you will have a 100% chance of selling 1,000 units
    - If you cut the price to $9.50 you have an 80% chance of selling 1,250 unit and a 20% chance of selling only 1,000.
  - What would you do?

Urbany, Joel E. (2001), "Are your prices too low?" Harvard Business Review, 79 (9), pp. 26-8.

5

## Why do we pay (more…)?

- Customers are willing to pay much more for a pack of strawberry they buy at a sporting event than from a local grocery store…
- They are willing to pay more for a jeans they buy at Levis company store than for clothing they buy at Tesco…
- They pay more for "hot" items like Nintendo Wii than they should…
- They want to purchase expensive perfume for gifts and for themselves rather than cheap perfume even though the cost of manufacturing is not much different…

6

## Some critical facts about pricing

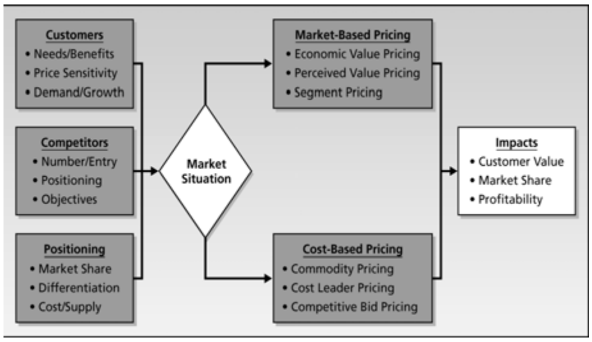
- Price is like a thermometer in that the higher we can push the price, the better job we have done with uncovering consumer needs and designing the marketing mix.
- It doesn't take any marketing skill to sell a product at a "fire sale" price. Marketers earn their keep by getting a premium price for products and services.
- Reference price is an important concept in pricing strategy. There is an external reference price—what everyone else is paying for the product—and an internal reference price—what you think you should pay given your past experience and the buying situation.
- Price is the most abstract of any of the four marketing mix elements. It is a signal of product quality and status. It is inherently subjective and tied to consumer perceptions rather than objective reality.

## Why focus on pricing?

- Price is determined by what the **customer is willing to pay**, not the cost to manufacture, distribute, and promote.
  - The buying context
    - Buying situation
    - Differences in customers
    - Perceptions of customers
  - Core dimension of the product
    - Level of involvement
    - Understanding of the product

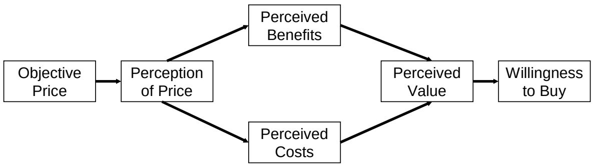


## The market dynamics






## Price and Perceived Value: The Economic Perspective

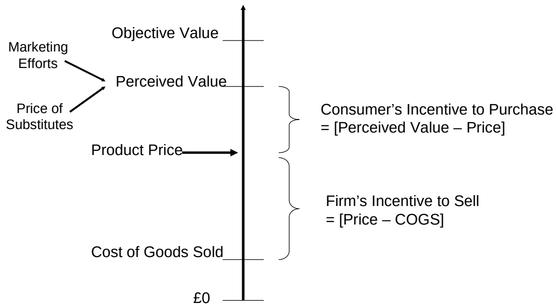



**So, according to the economic perspective, consumers will purchase whenever**

**Perceived Value > 0**



## Price and Perceived Value: The Economic Perspective






## The behavioural component

| Consumer Willingness to Buy | = | Economic Utility of the Transaction | + | Fairness of the Transaction |
|---|---|---|---|---|

Perceived Value – Actual Price

1. **Relative Incentives**

   $\frac{\text{Perceived Value – Actual Price}}{\text{Actual Price}}$

2. **Reference Prices**

   Actual Price – Reference Price

3. **Cost of Goods Sold**

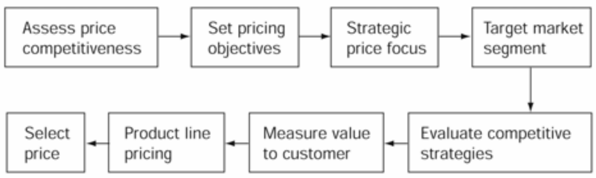
   Actual Price – COGS

4. **Nature of the product**

   discretionary vs. necessary
   luxury vs. utilitarian



## Developing a pricing strategy




Doyle, P. (2002), Marketing management and strategy, Harlow: Prentice Hall.

13

## Setting 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 final price

Kotler, P. (2003), Marketing management, Upper Saddle River, NJ: Prentice Hall

14

## Identification of price competitiveness

- Identify the dimension of quality
- Weight quality dimension
- Measure competitors along dimensions
- Discover price quality preferences

15

## Setting pricing objectives

- Survival
- Maximizing sales revenue
- Maximizing profit
- Maximizing growth (unit sales)
- Market penetration
  - Experience curve
- Market skimming
  - Inelastic demand
  - Unique and patented product
  - Uncertain product and marketing cost
  - Capacity constraints in production
  - High perceived value
- Product quality leadership

16

## Penetration vs. Skimming

| Determinant | Penetration | Skimming |
|---|---|---|
| Objective | Long-run market share | Short-run profit |
| Demand | Price elastic | Price inelastic |
| Competition | Deter new competitors<br>Few barriers to entry | Accept new competitors<br>High barriers to entry |
| Product | Image seen unimportant<br>Long PLC | Seeks prestige image<br>Short PLC |
| Price | Pressure for prices to fall | Prices can be sustained |
| Promotion | Customers understand product | Unfamiliar product |
| Distribution | Existing system | Unfamiliar channels |
| Production | High scale economies | Few scale economies |
| Finance | High investment | Low investment |

Doyle, P. (2002), Marketing management and strategy, Harlow: Prentice Hall.

17

## Price-quality strategies

| Product Quality \ Price | High | Medium | Low |
|---|---|---|---|
| High | Premium Value | High Value | Super Value |
| Med | Overcharging | Medium Value | Good-Value |
| Low | Rip-Off | False Economy | Economy |

Doyle, P. (2000), Value-based marketing: Marketing strategies for corporate growth and shareholder value, Chichester: Wiley

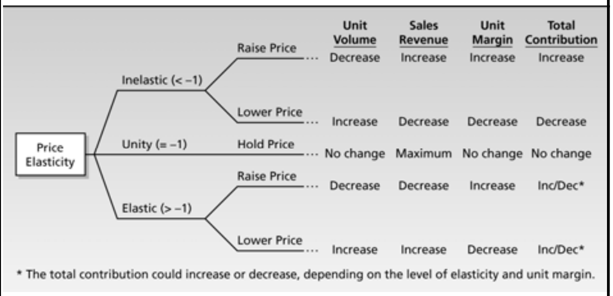
18

## Determine demand

- Each price the company might charge will lead to a different demand and will therefore have a different impact on its marketing objectives.
- The demand curve shows the number of units the market will buy in a given time period at alternative prices.
- In the normal case, demand and price are inversely related, that is, the higher the price, the lower the demand.

19

## Price elasticity and performance




20

## Factors affecting price sensitivity

- Unique value
- Substitute awareness
- Difficult comparison
- Total expenditure
- End benefit
- Shared cost
- Sunk investment
- Price quality
- Inventory

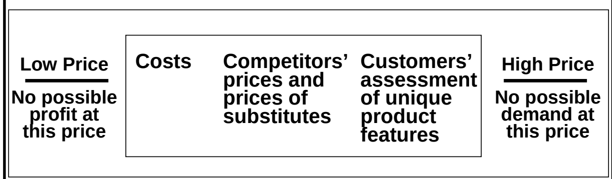
21

## Methods of estimating demand

- Lab test
- Field test  (in store)
- Natural experiment

22

## Estimating & analyzing costs




23

## Pricing Methods

- Markup Pricing
  - Largely used in SMEs
  - Unit cost = variable cost + (fixed cost/unit sales)
  - Markup price = unit cost / (1 – desired return on sales)
- Target Return Pricing
  - Largely used in public sector
  - Target return price = unit cost + (desired return x invested capital)/unit sales
  - The firm here should keep a clear focus on break even point
- Perceived Value Pricing
- Going-Rate Pricing
- Sealed-Bid Pricing

24

## Promotional Pricing

- Loss-leader pricing
- Special-event pricing
- Cash rebates
- Low-interest financing
- Longer payment terms
- Warranties & service contracts
- Psychological discounting

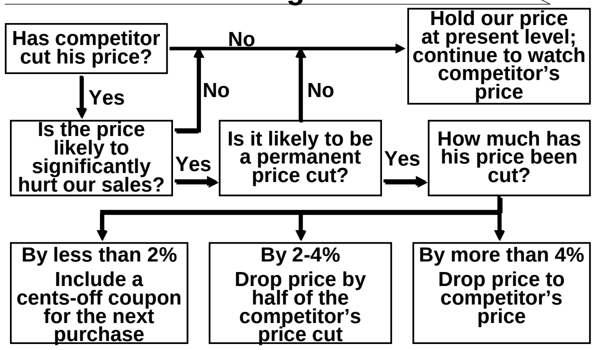
25

## Selecting final price

- Influence of other marketing mix elements
- Company pricing policies
- Impact of price on other parties

26

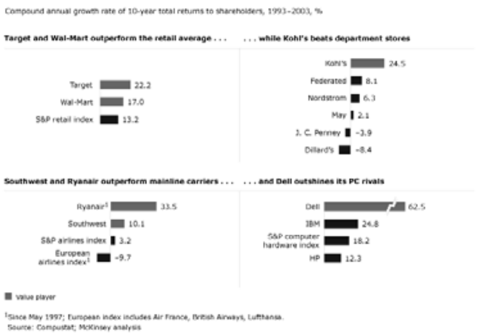
## Price-Reaction Program




Kotler, P. (2003), Marketing management, Upper Saddle River, NJ: Prentice Hall

27

## When your competitor delivers more for less




28

## Some really interesting papers

- Nagle, T. and Holden, R. (2001), The strategy and tactics of pricing, Upper Saddle River, NJ: Prentice Hall.
- Baker, W., Marn, M., and Zawada, C. (2001), Price smarter on the Net, Harvard Business Review, February, 122-27.
- Ailawadi, K., Lehmann, D. and Neslin, S. (2001), Market response to a major policy change in the marketing mix: learning from P&G value pricing strategy, Journal of Marketing, 65 (January), 44-61.
- Rhim, H., & Cooper, L. G. (2005). Assessing potential threats to incumbent brands: New product positioning under price competition in a multisegmented market. *International Journal of Research in Marketing, 22*(2), 159-182.
- Trout, J. (1998), Prices: simple guidelines to get them right, Journal of Business strategy, November-December, 13-16.