

# Pricing Strategy I

CHAPTER 10: Understanding and Capturing Customer Value

**MK 201 Principles of Marketing**  
**By Aj.Suwalya K.**

# Objective Outline

- **Objective 1:** Answer the question “What is a price?” and discuss the importance of pricing in today’s fast-changing environment.
- **Objective 2:** Identify the three major pricing strategies and discuss the importance of understanding customer-value perceptions, company costs and competitor strategies when setting prices.
- **Objective 3:** Identify and define the other important external and internal factors affecting a firm’s pricing decisions.

# Objective 1: What is Price?

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# What is Price?

“Pricing: No matter what the state of economy, companies should sell value, not price.”



- ❖ Price: The amount of money charged for a product or service, or the sum of the values that customers exchange for the benefits of having or using the product or service.

# JCPENNEY: Struggling to Find a Successful Pricing Strategy



JC Penney faces a serious pricing challenge, one that's all too familiar to many retailers today. It can't live with sales prices, but it can't live without them either.

# Air Arabia: Customer-Value-Based Pricing

- With its “**Be Smart, Pay Less, Fly more**” tagline, Air Arabia puts customer value at the forefront of its strategy-offering the lowest fares in the market without sacrificing customer service.
- Air Arabia offers a **simple pricing plan** to its customers, and invites them to “Be smart, pay less, fly more” in its adverts.



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# Objective 2: Major Pricing Strategies

1. Customer Value-Based Pricing
2. Cost- Based Pricing
3. Competition-Based Pricing



# Customer Value –Based Pricing

- **Customer value-based pricing: Setting price based on buyers' perceptions of value rather than on the seller's cost.**

Figure 10.1 Considerations in Setting Price

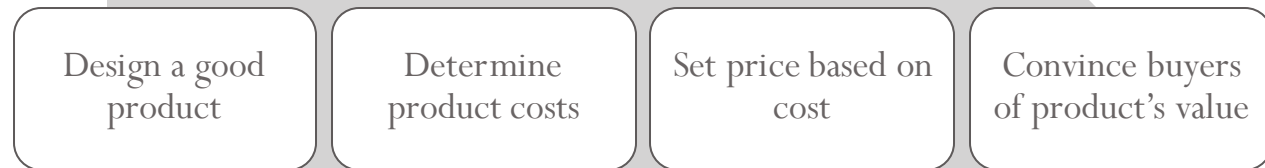
If customers perceive that a product's price is greater than its value, they won't buy it. If the company prices the product below its costs, profits will suffer. Between the two extremes, the "right" pricing strategy is one that delivers both value to the customer and profits to the company.



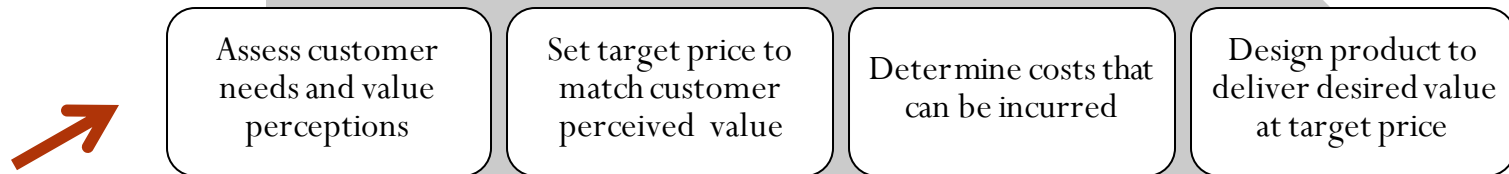
# Customer Value –Based Pricing

Figure 10.2 Value-Based Pricing vs. Cost-Based Pricing

## Cost-based pricing



## Value-based pricing



Costs play an important role in setting prices. But, like everything else in marketing, good pricing starts with the customer.

# Customer Value –Based Pricing



Perceived value: A Steinway piano-any Steinway piano-costs a lot. But to those who own one, price is nothing; the Steinway experience is everything.

# Customer Value –Based Pricing

- ❖ **Good-value pricing: Offering just the right amount combination of quality and good service at a fair price.**



Good-value pricing: With its no frills positioning and low prices, Snap Fitness is well positioned to take advantage of either good or bad economic conditions.

# Ryanair: Really Good-Value Pricing-Fly for Free



**Good –value pricing: Ryanair’s sometimes outrageous CEO, Michael O’Leary, hopes one day to “make flying free.”**

# Real Marketing 10.1

ALDI: Impressively High Quality at Impossibly Low Prices, Every Day



Good-value pricing: ALDI keeps costs low so that it can offer customers "impressively high quality at impossibly low prices" every day.

# Customer Value –Based Pricing

- ❖ Value-added pricing: Attaching value-added features and services to differentiate a company's offers and charging higher prices.





Value-added pricing: Rather than cutting services to maintain lower admission prices, premium theaters such as AMC's Cinema Suites are adding amenities and charging more. "Once people experience it...they don't want to go anywhere else."

# Cost-Based Pricing

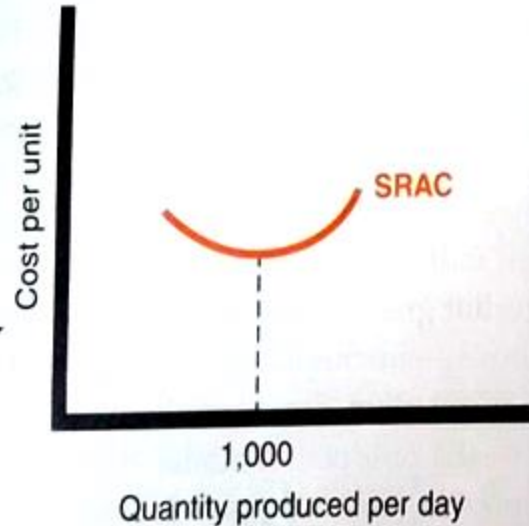
## Types of Costs

- ❖ **Fixed costs (overhead):** Costs that do not vary with production or sales level
- ❖ **Variable costs:** Costs that vary with the level of production
- ❖ **Total costs:** The sum of the fixed and variable costs for any given level of production

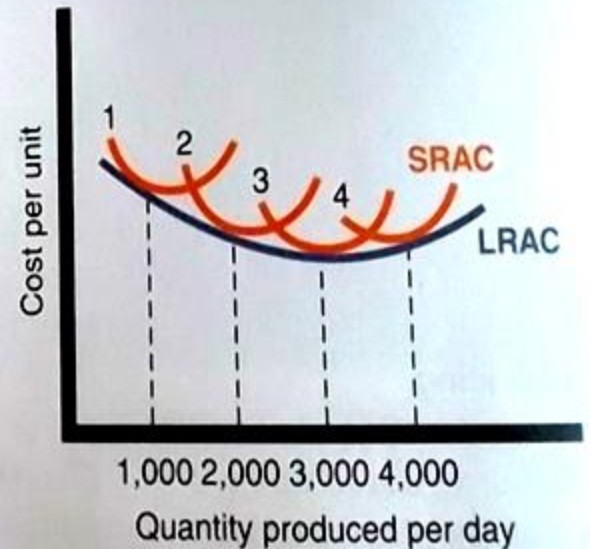
# Cost-Based Pricing

- Costs at Different Levels of Production

Figure 10.3 Cost per Unit at Different Levels of Production per Period



A. Cost behavior in a fixed-size plant



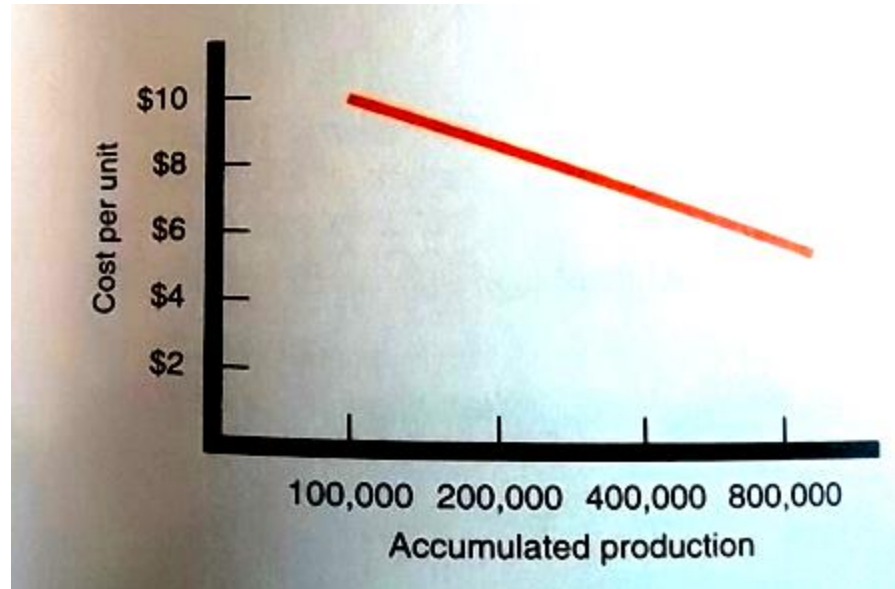
B. Cost behavior over different-size plants



What's the point of all the cost curves in this and the next few figures? Costs are an important factor in setting price, and companies must understand them well.

# Cost-Based Pricing

- Costs as a Function of Production Experience
- ❖ Experience curve(learning curve): The drop in the average per-unit production cost that comes with accumulated production experience.
- Figure 10.4 Cost per Unit as a Function of Accumulated production: The Experience Curve



# Cost-Based Pricing

## ❖ Cost-Plus Pricing (or markup pricing): Adding a standard markup to the cost of the product.

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

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

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

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

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

- The manufacturer would charge dealers \$20 per toaster and make a profit of \$4 per unit. The dealers, in turn, will mark up the toaster. If dealers want to earn 50 percent on the sales price, they will mark up the toaster to \$40 (\$20 + 50% of \$40). This number is equivalent to the markup on cost of 100 percent (\$20/\$20).

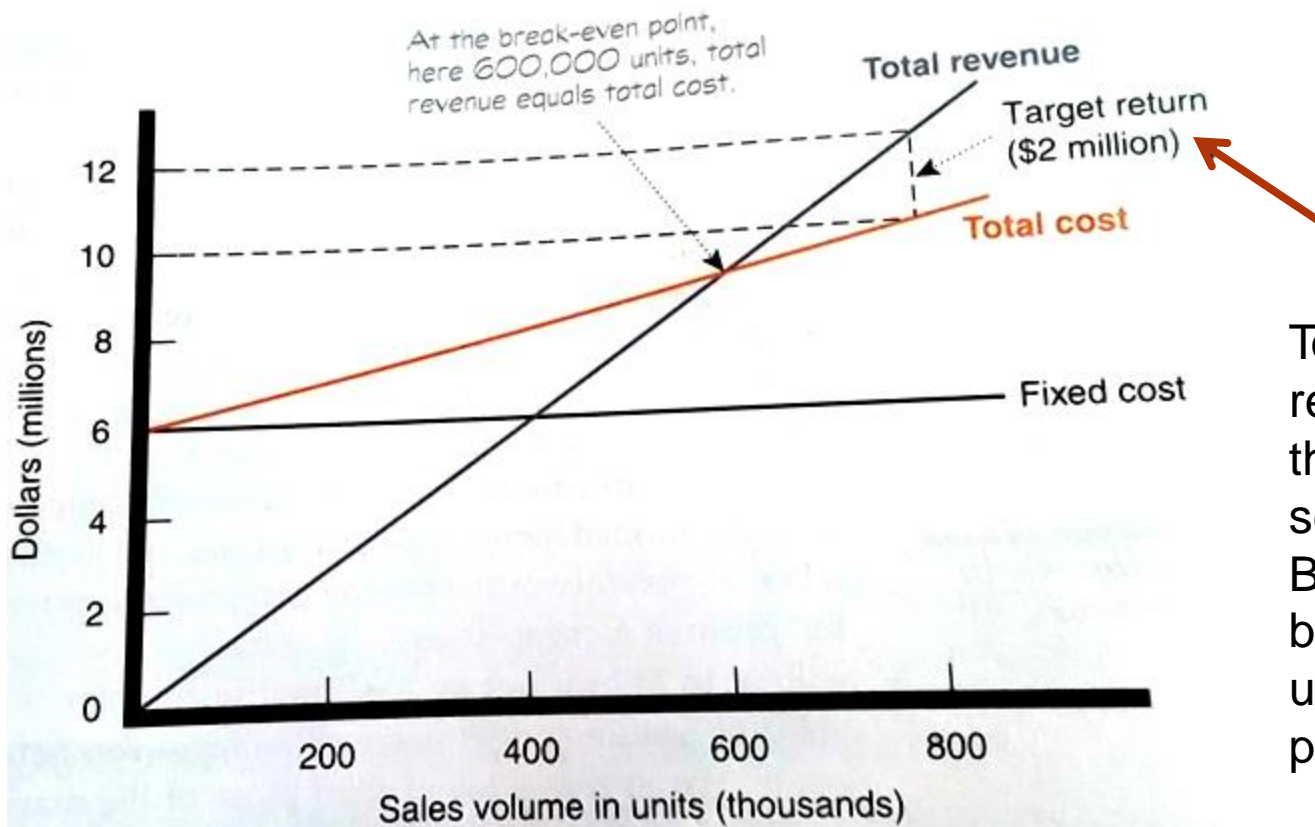
# Cost-Based Pricing

- Break-Even Analysis and Target Profit Pricing
- ❖ Break –even pricing(target return pricing): Selling price to break even on the costs of making and marketing a product, or setting price to make a target return.



# Cost-Based Pricing

Figure 10.5 Break –Even Chart for Determining Target-Return Price and Break-Even Volume



To make a target return of \$2 million, the company must sell 800,000 units. But will customers buy that many units at the \$15 price?

# Cost-Based Pricing

$$\begin{aligned}\text{Break-even volume} &= \text{fixed cost} / \text{price} - \text{variable cost} \\ &= \$300,000 / \$20 - \$10 = \\ &30,000\end{aligned}$$

● **Table 10.1 | Break-Even Volume and Profits at Different Prices**

<b>Price</b>	<b>Unit Demand Needed to Break Even</b>	<b>Expected Unit Demand at Given Price</b>	<b>Total Revenue (1) × (3)</b>	<b>Total Costs*</b>	<b>Profit (4) – (5)</b>
\$14	75,000	71,000	\$994,000	\$1,010,000	-\$16,000
16	50,000	67,000	1,072,000	970,000	102,000
18	37,500	60,000	1,080,000	900,000	180,000
20	30,000	42,000	840,000	720,000	120,000
22	25,000	23,000	506,000	530,000	-\$24,000

\*Assumes fixed costs of \$300,000 and constant unit variable costs of \$10.

# Competition-Based Pricing

- ❖ **Competition-based pricing: Setting prices based on competitors' strategies, prices, costs and market offerings.**



Pricing against larger, lower-price competitors: Fast-growing clothing boutique Hot Mama isn't likely to win a price war against giants Macy's or Kohl's. Instead, it relies on personal service, a mom and kid-friendly atmosphere, and its knowledgeable staff to turn harried moms into loyal patrons. "It's like shopping with a girlfriend."

# Objective 3: Other Internal and External Considerations Affecting Price Decisions



# Overall Marketing Strategy, Objectives, and Mix

- ❖ **Target Costing:** Pricing that starts with an ideal selling price, then targets costs that will ensure that the price is met.





suggested retail \$7,750,000

introducing the 2014 Titus Entry Pro 2.0. A bicycle that you can't live without. **TITUS**

Positioning on high price: Titus features its lofty prices in its advertising “suggested retail price: \$7,750,000.”



Nonprice positioning: Luxury smartphone maker Vertu puts very high value into its products and charges sky-high prices to match that value. Average price: nearly \$6,000

# Real Marketing 10.2

Trader Joe's Unique Price-Value Positioning: "Cheap Gourmet"



Trader Joe's unique price-value strategy has earned it an almost cult- like following of devoted customers who love what they get for the prices they pay.

# Organizational Considerations

- **Management should decide** on who in the organization should set the price.
- The Industries in **which pricing is a key factor-** airlines, aerospace, steel, railroads, oil companies), companies often have pricing departments to set the best prices or help others set them.
- The **departments report** to the marketing department or top management (others who have influence on pricing are involved)

# The Market and Demand

- Pricing in Different Types of Markets



Pricing in monopolistic competition: Honda sets its Odyssey minivan apart through strong branding and advertising, reducing the impact on price. Its tongue-in-cheek “Van of Your Dreams” ads tell parents “the new Odyssey has everyone one would dream about in a van, if one had dreams about vans.”

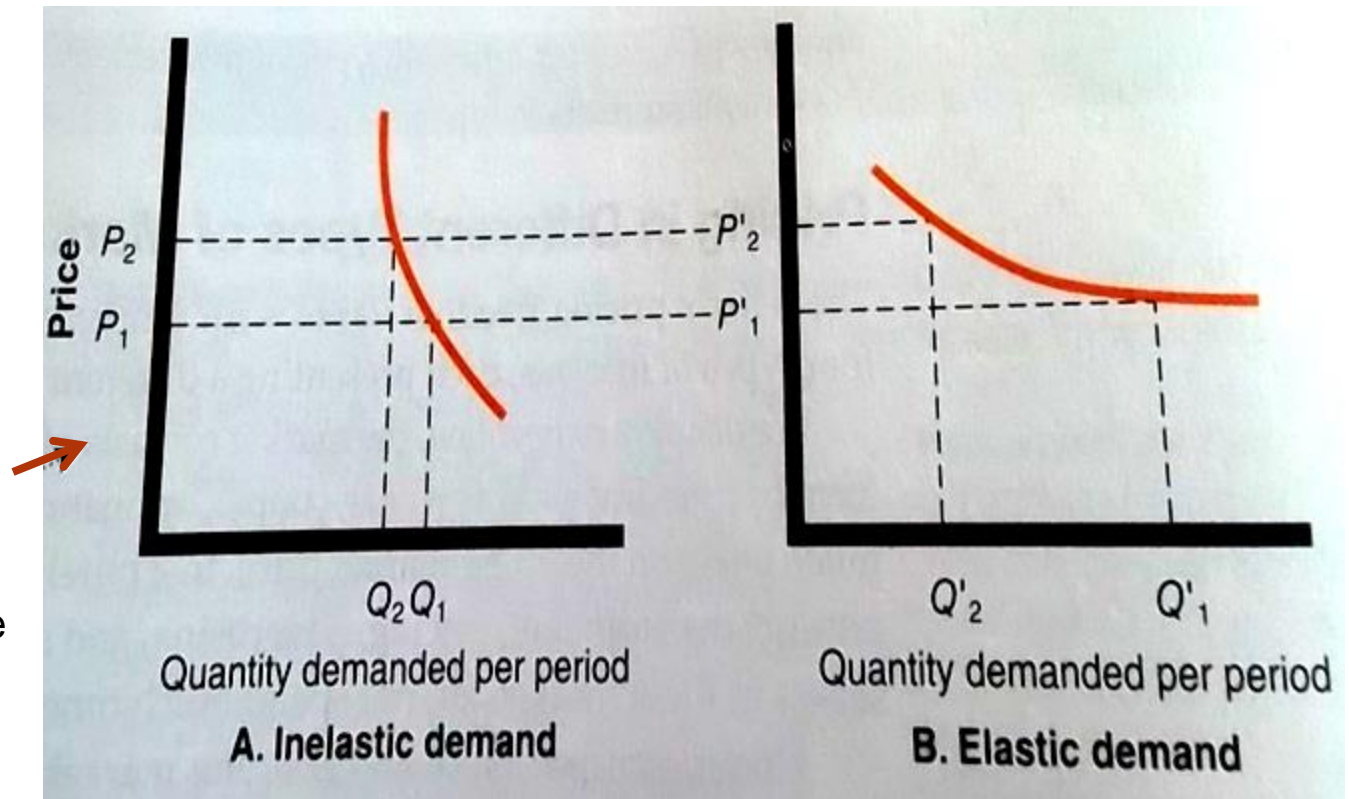
# The Market and Demand

- Analyzing the Price-Demand Relationship
  - ❖ Demand Curve: A curve that shows the number of units the market will buy in a given time period at different prices that might be charged.



# The Market and Demand

Figure 10.6 Demand Curves



Price and demand are related-no big surprise there. Usually, higher prices result in lower demand. But in the case of some prestige goods, the relationship might be reversed. A higher price signals higher quality and status, resulting in more demand, not less.

# The Market and Demand

- Price Elasticity of Demand
- ❖ Price Elasticity: A measure of the sensitivity of demand to changes in price

Price elasticity of demand =

$$\frac{\% \text{ change in quantity demanded}}{\% \text{ change in price}}$$



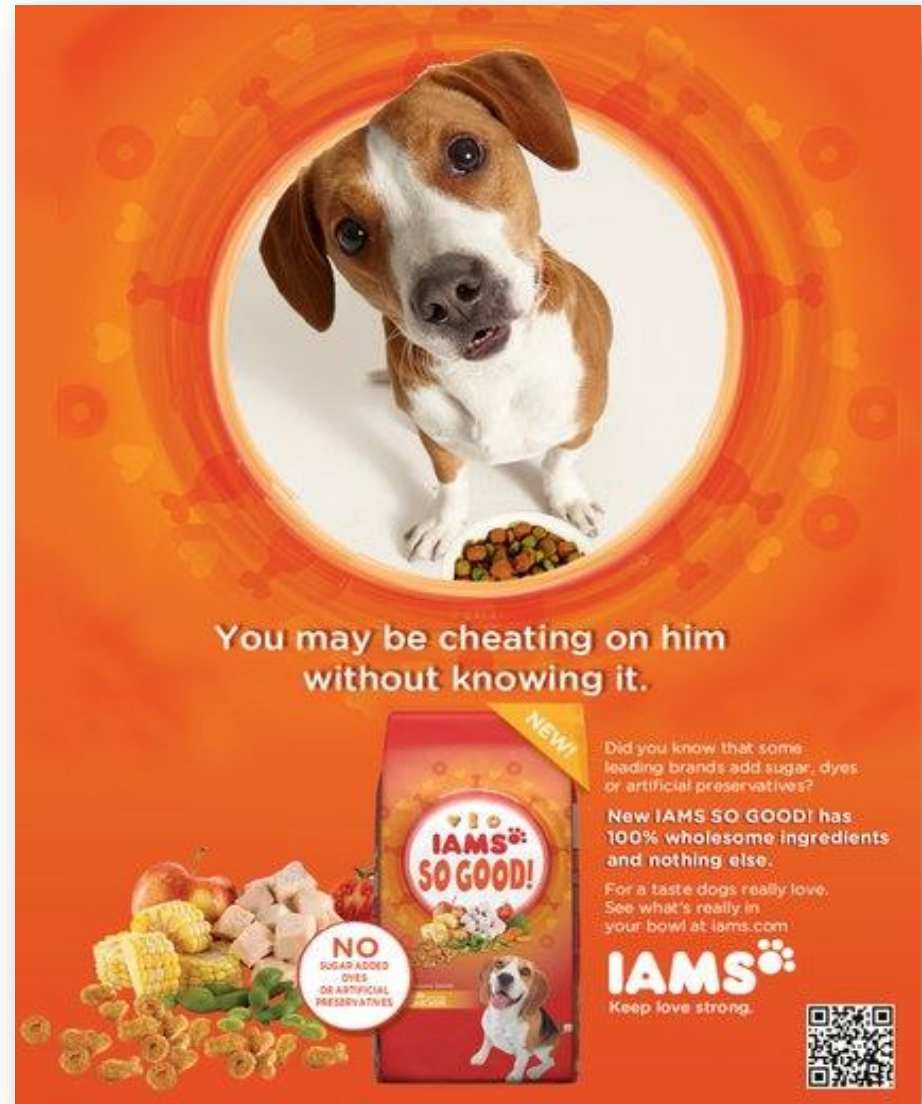
# The Economy



When the economy dipped, rather than cutting everyday prices, Whole Foods set out to convince shoppers that it was, in fact, an affordable place to shop. It even assigned workers to serve as “value tour guides.” Like the one shown here, to escort shoppers around stores pointing out value items.

# The Economy

Pricing and the economy: In line with tighter consumer budgets and thriftier spending habits, P&G launched Iams So Good dog food, a line designed as a "more accessible" addition to its premium Iams brand.



**You may be cheating on him without knowing it.**

Did you know that some leading brands add sugar, dyes or artificial preservatives?

**New IAMS SO GOOD! has 100% wholesome ingredients and nothing else.**

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Keep love strong.

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