SILESIAN UNIVERSITY

SCHOOL OF BUSINESS ADMINISTRATION IN KARVINA

Pricing Policy

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Strategic Marketing/subject code

OUTLINE OF THE LECTURE

1. Meaning of price for various market entities.
2. Types of markets and pricing practices.
3. Calculation equation.
4. Types of pricing strategies.
5. The proces of pricing strategy.
6. Price elasticity.

1. INTRODUCTION TO PRICE

- This element determines what the company is paid.
- Even when the marketer produces the right product, promotes it correctly and initiates the proper channel of distribution, the effort fails if the product is not properly priced.
- Setting the right price for a product can be the key to success or failure. Too high? Too low?
- A product price must reflect the quality/value the consumer perceives in the product (part of positioning). It is further complicated when the company sells its product to customers in different country markets.
- Internet changes the way of perceiving a price. Price was flexible, then hard set, now again flexible.

PRICE DEFINITION

- Price is the amount of money agreed on in the purchase and sale of goods and services provided as consideration for the provided performance.
- Price is controlled by:
  - Market – if there is a lot of competition then manufacturers have little effect and the customer can always select the lowest price.
  - The company - if it has sufficiently different products from competitors.
  - State - controlling prices of sensitive products.
- Compared to the product distribution and communication is highly flexible tool.
- Affects the firm's market position.
- It affects the company's financial result.
- Critical is a joint pricing policy with other elements of the marketing mix.

2. THE MEANING OF PRICE FOR VARIOUS SUBJECTS

- **Seller**:
- The only element of the marketing mix that generates revenue (other produce costs).
- It manifests externally corporate culture.

- **Purchaser**:
- It is a means to obtain the desired product.
- The price for the customer is often a measure of quality.
- It is an important element in the multi-criteria decision making of consumers.

THE FACTORS INFLUENCING PRICING

- **External:**
- Features of the market.
- Features of the demand.
- Price elasticity of supply.
- Competition.
- Customers.

- **Internal:**
- Strategic and marketing goals.
- Organization of pricing policy (who determines).
- Marketing mix.
- Product differentiation.

PRICING OBJECTIVES 1

- The customer buys a particular product after comparing the relationship of price and performance for other competitive offerings. The customer pays more for better value (whatever it is).
- Once the company has determined the performance of the product / service, it may determine the price. That is done with price targets, which are then pursued in the form of strategies.
- Financial objectives:
  - Return on investment.
  - Profit optimization.
  - Generating cash flow.
- Marketing objectives:
  - Survival.
  - Maximum market share.
  - Maximum market skimming.
  - Product-quality leadership.

PRICING OBJECTIVES 2

- In terms of profit - % of turnover / investment / max.
- In terms of turnover. (we can combine both objectives)
- Viewpoint of continued company existence – sale out.
- The perception of prices - cheap / expensive.
- Viewpoint of competition - defending, displacing.
- Viewpoint of image.

- Goals can be combined according to their suitability.

WHEN AM I SETTING PRICE?

- Launching new product.
- Change of market conditions (inflation, tax, disposable income, fashion etc.).
- Change of costs within my company.
- Change of costs outside of my company, e.g. suppliers, materials etc.

- B2B – price is set for each contract differently. Very hard negotiations.
- B2C – fixed prices for all customers. Prices are public and known.
- B2G - price determined as part of tenders and procurement.

PRICE EFFECTS

- Substitution effect.
- Veblen effect – luxury (Gibson Guitars).
- Guttenberg effect - discounts.
- Leverage (speculative) effect.

- Price takers (can not influence market prices) & Prize makers (determine the market price):
  - Monopoly.
  - Oligopoly.
  - Monopolistic competition.
  - Perfect competition.

INTERNET CHANGED PRICING

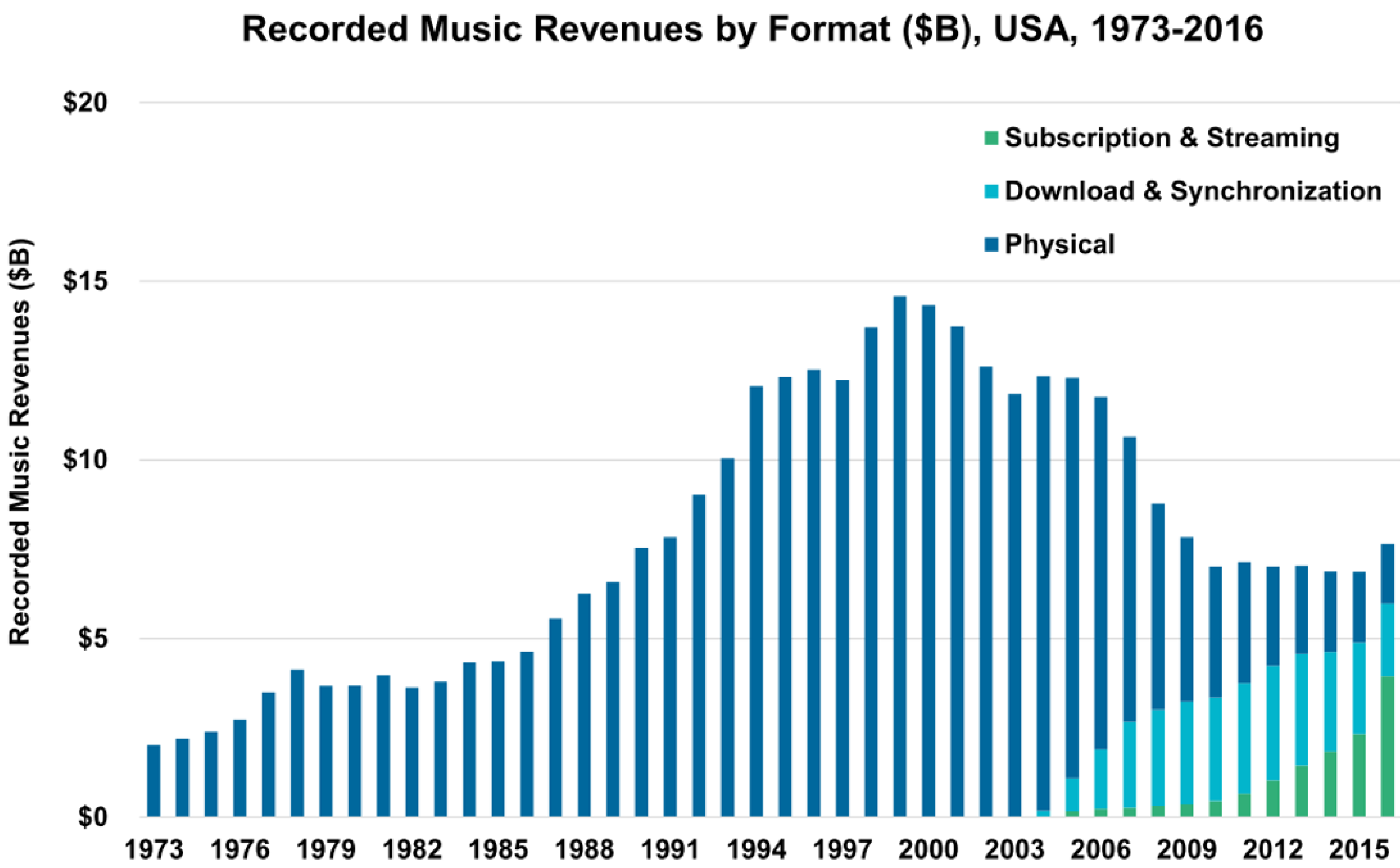
- Dynamic pricing.
- I can order from anywhere.
- Price comparison.
- Open source solutions.
- New business models C2B and C2C.

Ships to Czech Republic
$\$109^{99}$ ~~$199.99~~

- Get a new iPhone every year
- AppleCare+ coverage included[1]
- Works with your carrier
- Starting from $35.33/month[2]

List Price: ~~$69.99~~
Price: $24.99 + $16.89 Shipping
You Save: $45.00 (64%)

PRICE OF MUSIC INDUSTRY



3. CALCULATION EQUATION

1. Direct material (material immediately needed for production).
2. Direct wages (wages of workers producing the product).
3. Manufacturing overhead (overhead = joint production costs).
4. TOTAL 1 + 2 + 3: OWN COSTS OF PRODUCTION
5. Administrative overheads (common costs on the administrative apparatus).
6. Supply arrangement (et al. Supply costs for the enterprise).
7. TOTAL 4 + 5 + 6: OWN COSTS OF PERFORMANCE
8. Distribution costs / overheads (linked to sales - sales).
9. TOTAL 7 + 8: FULL OWN COSTS OF PERFORMANCE
10. Profit.
11. TOTAL 9 + 10: PRICE BEFORE TAX
12. VAT.
13. SUM 11 + 12: FINAL PRICE

4. BASIC PRICING STRATEGIES

- Methods oriented on costs:
  - Often used in practice.
  - Costs determine the lower limit of price.
  - It leads to a mismatch between the interests of the customer and the company.
  - Adaptation of prices to costs.
- Methods oriented on competition:
  - Concentrating on monitoring and matching competitors' prices.
  - Frequent on markets with the price leader.
- Methods oriented on demand:
  - Based on psychological and behavioral processes in the purchasing decisions of consumers.

PRICE / QUALITY STRATEGY

		Price		
		High	Mid	Low
Quality	High	1. Leading strategy	2. Strategy of high value	3. Strategy of extra value
	Mid	4. Overpricing strategy	5. Strategy of average value	6 .Strategy of good value
	Low	7. Blackmailing strategy	8. Strategy of false economy	9. Strategy of economy

STRATEGY OF ACTIVE PRICING COMPETITION

- Pricing policy focused on the competition.
- The risk of price wars.
- Prices oscillate around the demand curve.
- The more unique the product is, the higher the price that can be set by the seller.
- Price reduction in order to protect market space is possible.
- Typicall for retail, food etc.

BASIC PRICING STRATEGIES

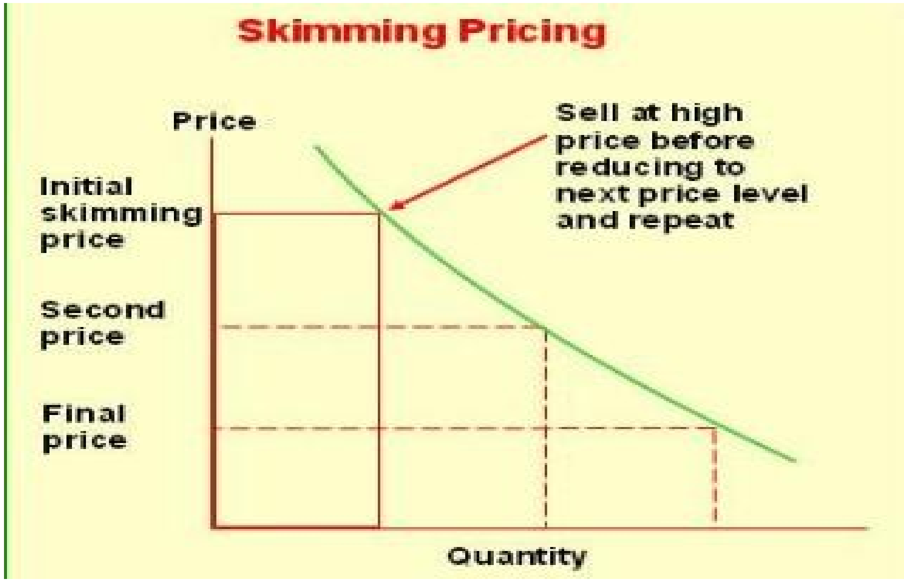
- Strategy of low prices and costs.
- Strategy of high prices and product image.
- Combined Strategy.
- Strategy of market leaders adaptation.
- Strategy of price vs. quality.
- Active vs. passive price competition.

TYPES OF PRICES

- Cream price
- Penetration price
- Competitive price/Price leader
- Current market price
- Segmented price
- Price accepted by customer
- Cost price
- Discount price
- Geographic price

SKIMMING PRICING

- "Skim the cream" pricing involves selling at a high price to those who are willing to pay before aiming at more price-sensitive consumers.
  This expression comes from the farming practice of milking cows - the cream rises to the top and you skim it off.



The advantage of using a Skimming price policy is that you can theoretically get the maximum profit from each level of customer.

SKIMMING AND PENETRATION PRICING

- Based on how much we spend on marketing communications and how high our price is, we can distinguish 4 different strategies.

Marketing Communications

Price

Rapid-skimming strategy	***Slow-skimming strategy***
Rapid-penetration strategy	***Slow-penetration strategy***

„FORBIDDEN“ STRATEGIES

- **Transfer price** - big international companies make use of different costs of production inputs (e.g. raw materials, labour force, financial resources) and tax expense.
- **Dumping** - The products are sold below their costs of production. Selling goods in a foreign market below the price of the same goods in the home market. EU has had anti-dumping legislation from its inception.
- **Cartels** - Various companies producing similar products cooperate to control markets. The cartel association may use formal agreements to set prices, establish levels of production and sales for the participating companies, allocate market territories and even redistribute profits. Its illegal!

BARTER

- The direct exchange of goods between two parties in a transaction without the use of a medium, such as money.

- It is said that barter is 'inefficient' because:
  - There needs to be a 'double coincidence of wants,.
  - There is no common measure of value.
  - Indivisibility of certain goods.
  - Lack of standards for deferred payments.
  - Difficulty in storing wealth.

- BUT! Around 20% of global trade is done by barter.

5. SETTING THE PRICE – IN DEPTH LOOK

- 1. Pricing objectives
- 2. Determining demand
- 3. Estimating costs
- 4. Analysing competitors costs, prices and offers
- 5. Selecting a pricing method
- 6. Selecting final price

STEP 1: SELECTING THE PRICING OBJECTIVE

- What is the organisation trying to achieve?

- FINANCIAL OBJECTIVES
- Return on investment
- Profit optimization
- Generating cash flow

- MARKETING OBJECTIVES
- Survival
- Maximum market share
- Maximum market skimming
- Product-quality leadership

STEP 2: DETERMINING DEMAND

- All pricing decisions are, in the end, dependant on the level of market demand, and on “what the market will bear”.
- The market demand for luxury products, such as Rolls Royce cars, is very small, and so is the supply. Supply and demand meet at a very high price, because there are a few customers that are willing to pay a lot extra for a luxury product because of its prestige value, etc.
- On the other hand, most customers for toothpaste are only prepared to pay a relatively small amount for each tube, rationalising that there is a limit to the value added potential of the product, which in any case they purchase relatively frequently.

STEP 3: ESTIMATING COSTS

- Full cost pricing: this type of cost pricing calculates all costs together, fixed costs and variable costs per unit, and adds a margin (profit for the company). It also takes into account sales estimates that are used as a dividing number. After a certain breakpoint, be it a month, a quarter year, or a year, the total costs of production are calculated and the price is set accordingly.
- Direct cost pricing: direct cost pricing is sometimes called marginal cost pricing. It includes the calculation of only those costs that are likely to rise as output increases. The obvious problem is that this price does not cover full costs and so the company would be making a loss selling a product at this low price.

STEP 4: ANALYSING COMPETITORS COSTS, PRICES, AND OFFERS

- Within the range of possible prices determined by market demand and company costs, the firm must take competitor’s costs, prices, and possible price reactions into account. If the firms offer contains features not offered by the nearest competitor, it should evaluate their worth to the customer and add that value to the competitor’s price. If the competitors offer contains some features not offered by the firm, the firm should subtract their value from its own price. Now the firm can decide whether it can charge more, the same, or less than the competitor.
- The introduction or change of any price can provoke a response from customers, competitors, distributors, suppliers, and even government.

STEP 5: SELECTING A PRICING METHOD

- Given the customers demand schedule, the cost function, and competitors' prices, the company is now ready to select a price. Costs set a floor to the price. Competitors' prices and the price of substitutes provide an orienting point. Customers' assessment of unique features establishes the price ceiling. Companies select a pricing method that includes one or more of these three considerations.
- There are 6 basic price-setting methods: mark-up pricing (adding a standard mark-up to the products cost), target-return pricing (the firm determines the price that yields its target rate of return on investment), perceived-value pricing (based on the value perceived by the customer), value pricing (offering a good value for low price), going-rate pricing (the firm bases its price largely on competitors prices), and auction-type pricing (price is settled in an auction).

STEP 6: SELECTING THE FINAL PRICE

- Pricing methods narrow the range from which the company must select its final price. In selecting that price, the company must consider additional factors, including the impact of other marketing activities, company pricing policies, gain-and-risk-sharing pricing, and the impact of price on other parties.

PRICE ADAPTATION 1

- Companies usually develop a pricing structure that reflects variations in geographical demand and costs, market-segment requirements, purchase timing, order levels, delivery frequency, guarantees, service contracts, and other factors. As a result of discounts, allowances, and promotional support, a company rarely realizes the same profit from each unit of a product that it sells.

- **Geographical pricing**: the company decides how to price its products to different customers in different locations and countries. The effects of distance and market strategy take effect. Another issue closely connected is how to get paid, this leads to barter, compensation deals, offsets and buyback arrangements.

PRICE ADAPTATION 1

- **Price discounts and allowances**: companies can use discounts in many ways, for example for early payment, volume purchases, off-season buying, etc. Company must never forget that it may attract new customers but it may also harm the image and it definitely decreases income.
- **Promotional pricing**: this includes special event pricing, cash rebates, longer payment terms, etc. These strategies get often copied by the competition and lose their effectiveness early.
- **Differentiated pricing:** also called price discrimination. It occurs when a company sells a product or service at two or more prices that do not reflect a proportional difference in costs. The pricing can be differentiated: customer-segment pricing, product-form pricing, image pricing, channel pricing, location pricing, time pricing.

PRICING AND ETHICAL ISSUES

- **Price fixing**: it can be in the interests of producers to agree among themselves not to compete on price (cartel). This is an act of collusion and is banned in many countries and regions.
- **Predatory pricing**: a firm cuts its prices with the aim of driving out the competition. The firm is content to incur losses with the intent that high profits will be generated through higher prices once the competition is eliminated.
- **Deceptive pricing**: occurs when consumers are misled by the price deals offered by companies. Two examples are misleading price comparisons (a store sets high prices for short time and then claims to lower them later) and “bait and switch” (customer is baited in a store on discounted prices but the salesperson persuades to switch to higher-priced product).
- **Price discrimination**: occurs when a supplier offers a better price for the same product to one buyer and not to another, resulting in an unfair competitive advantage.

PSYCHOLOGICAL EFFECTS IN PRICING

- Psychological meaning of numbers
- Using 1.99 instead of 2.
- Everything for XX.
- Monthly payments instead of the total price.
- Sale! X + 1 free.
- High prices and a subsequent "drastic" discount.

- Consumers generally perceive the first number of the price and how many digit the number has.
- This effect is further enhanced with price tags where these items are printed in smaller letters (€ $3.^{98}$).
- Prices quoted to the penny suggest to the consumer that the goods are sold at the lowest possible price.
- The importance of setting the right price is growing with the development of web sites for comparison goods.

DISCRIMINATION PRICING

- Prices can be set to be better for certain customers while discriminating other.

- Based on segments: students, seniors etc.
- Based on place: movie theaters, stadiums, aeroplanes etc.
- Based on time: seasonal vacations, elektricity tarifs, monile operator services etc.

- Loss leader! Selling with a price set under the costs = losing money on each sold product …. but gaining profit somewhere else. Example – Sony Playstation, Amazon Kindle Fire etc.

6. PRICE ELASTICITY

- The change of demand quantity because of price change.

$$EP = \frac{\%\ \text{quantity change (Demand)}}{\%\ \text{price change}}$$

$$EP = \frac{(Q_2 - Q_1)}{(Q_1 + Q_2)/2} : \frac{(P_2 - P_1)}{(P_1 + P_2)/2}$$

$|EP| > 1$ flexible demand

$0 < |EP| < 1$ non-flexible demand

$|EP| = 1$ unit flexible

$|EP| = 0$ totally non-flexible demand

THE END

Thank you for your attention.
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