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Developing Pricing Strategies and Programs

Marketing Management:

An Asian Perspective

(5th edition)

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Developing Pricing Strategies and Program

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Price is the one element of the marketing mix that produces revenue; the other elements produce costs. Prices are perhaps the easiest element of the marketing program to adjust; product features, channels, and even promotion take more time. Price also communicates to the market the company's intended value positioning of its product or brand. A well-designed and marketed product can command a price premium and reap big profits. Consider Gillette.

Learning Objectives:

- Understand how consumers process and evaluate prices
- Understand how a company should set prices initially for products or services
- Understand how a company should adapt prices to meet varying circumstances and opportunities
- Understand when a company should initiate a price change
- Understand how a company should respond to a competitor’s price change

The essence of Chapter Fourteen:

Price is the one element of the marketing mix that produces revenue; the other elements produce costs. Prices are perhaps the easiest element of the marketing program to adjust; product features, channels, and even promotion take more time.
Price also communicates to the market the company's intended value positioning of its product or brand.

A well-designed and marketed product can command a price premium.

The essence of Chapter Fourteen:

Pricing decisions are clearly complex and difficult.

Holistic marketers must take into account many factors in making pricing decision—the company, customers, competition, and marketing environment.

Pricing decisions must be consistent with the firm's marketing strategy, its target markets and brand positionings.

UNDERSTANDING PRICING

Price is not just a number on a tag or an item. Price comes in many forms and performs many functions.

In the past, prices were set by negotiation between buyers and sellers.

Bargaining is still prevalent in many parts of Asia today.

In more traditional shops such as this coffee shop in Malaysia, the menu and prices are posted on the wall. Sometimes, they are even handwritten on a wall mirror.

Understanding Pricing

- Setting one price for all buyers is a relatively modern idea.
- Traditionally, price has operated as the major determinant of buyer choice.
- Price remains one of the most important elements determining market share and profitability.

How Companies Price:

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 effectively designing and implementing pricing strategies requires a thorough understanding of consumer pricing psychology and a systematic approach to setting, adapting, and changing prices.

A **Changing** Pricing Environment

- Today, many firms are avoiding the low-price trend and have been successful in trading consumers up to more expensive products and services by combining unique product formulations with engaging marketing campaigns.
- Today **the Internet** is partially reversing the fixed pricing trend.

The Internet & Pricing Effects on Sellers & Buyers

- Buyers can:
  - Get instant price comparisons - many vendors PriceScan.com
  - Name their price & have it met - Priceline.com
  - Get products for free - Open Source
- Sellers can:
  - Monitor customer behavior & tailor offers to them
  - Give some customers special prices – CDNOW
- Both buyers & sellers can:
  - Negotiate prices in online auctions & exchanges

Marketing Insight: Giving it all away

- Giving away products free via sampling has been a successful marketing tactic for years; today with the advent of the Internet software, product and service companies are following suit.

- **Ryanair** is an example.

Ryanair wants to earn revenue on everything but the seats on its airplanes. In addition to charging passengers for baggage and snacks and eliminating frills like entertainment and reclining seats, the carrier sells ad space on the interior and exterior of its planes. This Ryanair Boeing 737 is painted in a special sponsored Vodaphone color scheme.

Figure 14.1 Guidelines for a Successful Premium Strategy

1. **Have a product or service that truly stands out.** Its performance, ease of use, and reliability should be superior to those of current offerings.
2. **Know your up-selling plan from the beginning.** Before you even go into beta, make sure you have at least one paid, add-on premium service up your sleeve. Better yet, have more than one.
3. **Once you have decided that a product will be given away for free, don't change your mind.** The fundamental "what's for free" and "what's for pay" divide needs to be set early. If you make changes, you risk alienating customers accustomed to getting your product for free.
4. **Access to your product should be just one click away.** The fewer time-consuming plug-ins, downloads, and registration forms required, the better. Otherwise people may get bored or frustrated and abort.
5. **Make sure the major bugs have been exterminated.** Your product can be in beta but not so much in beta that it does not work well.
6. **Harness the collective intelligence of your users.** Customer suggestions can help speed up product improvements or inspire ideas for premium services.
7. **Keep improving the product to give users more reasons to stick with it.** "The reality is that offering a product for free can be far riskier than if you actually charged for your product," says Howard Anderson, a lecturer at the MIT Entrepreneurship Center. "Only one in 10 companies will succeed at pulling this off."
8. **Identify a range of revenue sources.** The Epocrates service, which offers medical professionals both free and premium access to reference material via PDAs, does not charge just for the premium information. It also charges fees to pharmaceutical firms for surveys it conducts of Epocrates customers. Similarly, MySQL makes money from customer service as well as from fees charged to firms that redistribute the software.
9. **Timing is everything.** Make sure that revenue from your premium service soon covers the cost of your free service. Otherwise, cut your losses and move on to the next start-up.

Consumer Psychology and Pricing

- Marketers recognize that consumers often actively process price information, interpreting prices in terms of their knowledge from prior purchasing experiences, formal communications, and point-of-purchase or online resources

Consumer Psychology and Pricing

A. Purchase decisions are based on how consumers perceive prices.
B. What they consider is the current actual price—not the marketer's stated price.
C. Consumers may have a lower price threshold below which prices may signal inferior or unacceptable quality.
D. Upper price threshold above which prices are prohibitive and seen as not worth the money.

Reference Prices

- When examining products, consumers often employ reference prices.
- In considering an observed price, consumers often compare it to an internal reference price (pricing from memory).

Table 14.1 Possible Consumer Reference Prices

- "Fair price" (what the product should cost)
- Typical price
- Last price paid
- Upper-bound price (reservation price or what most consumers would pay)
- Lower-bound price (lower threshold price or the least consumers would pay)
- Competitor prices
- Expected future price
- Usual discounted price

Source: Adapted from Russell S. Winer, "Behavioral Perspectives on Pricing: Buyer's Subjective Perceptions of Price Revisited." In Timothy Devinney, ed., *Issues in Pricing: Theory and Research*, (Lexington, MA: Lexington Books, 1988), pp. 35–57.

High reference prices in the consumer electronics industry have trained consumers to gravitate toward "sale" prices.

Reference Prices

- An external frame of reference (posted "regular retail price").
- All types of reference prices are possible.
- When consumers evoke one or more of these frames of reference, their perceived price can vary from the stated price.
  - These "unpleasant surprises" can have a greater impact on purchasing power

Price- Quality Inferences

- A) Many consumers use price as an indicator of quality
- B) Some companies adopt exclusivity and scarcity to justify premium prices

For years the link between price and quality was what made Tiffany special. The luxury jeweller has recently tried to broaden its appeal to ever-younger consumers but must safeguard its high-end image.

Psychological pricing: What does the price suggest about the product and buying situation?

Price Endings

- Many sellers believe that prices should end in an odd number.
- Research has shown that consumers tend to process prices in a "left-to-right" manner rather than by rounding.
- Pricing cues like "sale" signs and prices that end in a 9 are less effective the more they are employed.

SmarTone Vodafone in Hong Kong prices its mobile phones with auspicious numbers such as “6,” “8,” and “9” which sound like “longevity”, “prosperity” and “sufficiency” respectively in Cantonese.

SETTING THE PRICE

A firm must set a price for the first time when it develops a new product, when it introduces its regular product into a new distribution channel or geographic area, and when it enters bids on new contract work.

Setting the Price

- The firm must decide where to position its product on quality and price.
- Most marketers have 3–5 price points or tiers.
- The firm has to consider many factors when setting its pricing policy.

Six-Step Procedure

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 the final price

Step 1: Selecting the Pricing Objective

- The company first decides where it wants to position its market offering. The clearer a firm's objectives, the easier it is to set a price.
- The five major objectives are: survival, maximum current profit, maximum market share, maximum market skimming, and product-quality leadership.

Pricing Objectives

- **Survival**
- Companies pursue survival as their major objective when they are plagued with overcapacity, intense competition, or changing consumer wants.
- Survival is a short-run objective.

Pricing Objectives

- **Maximum Current Profit**
- Many companies try to set a price that will maximize current profits.
- They estimate the demand and costs associated with alternative prices and choose the price that produces maximum current profit, cash flow, or rate of return on an investment.

Pricing Objectives

- **Maximum Market Share**
- Some companies want to maximize their market share. They believe that a higher sales volume will lead to lower unit costs and higher long-run profit.
- This practice is called **market-penetration pricing.**

IKEA used a price penetration strategy in China to dovetail with its price-sensitive and frugal customers. This has proved to be successful.

Conditions that favor setting a low price:

1. The market is highly price-sensitive, and a low price stimulates market growth.
2. Production and distribution costs fall with accumulated production experience.
3. A low price discourages actual and potential competition.

Pricing Objectives

- **Maximum Market Skimming**
- Companies unveiling a new technology favor setting high prices to maximize market skimming.
- This is also called **market-skimming pricing**, where prices start high and are slowly lowered over time.

Market skimming makes sense under the following conditions:

1. A sufficient number of buyers have a high current demand.
2. The unit costs of producing a small volume are not too high so that they cancel the advantage of charging what the traffic will bear.
3. A high initial price does not attract more competitors to the market.
4. A high price communicates the image of a superior product.

Pricing Objectives

- **Product-Quality Leadership**
- A company might aim to be the product-quality leader in the market.
- Many brands strive to be "affordable luxuries"—products or services characterized by high levels of perceived quality, taste, and status with a price just high enough not to be out of consumer's reach.

Pricing Objectives

- **Other Objectives**
- Nonprofit and public organizations may have other pricing objectives.
- Whatever the specific objective, businesses that use price as a strategic tool will profit more than those who simply let costs or the market determine their pricing.

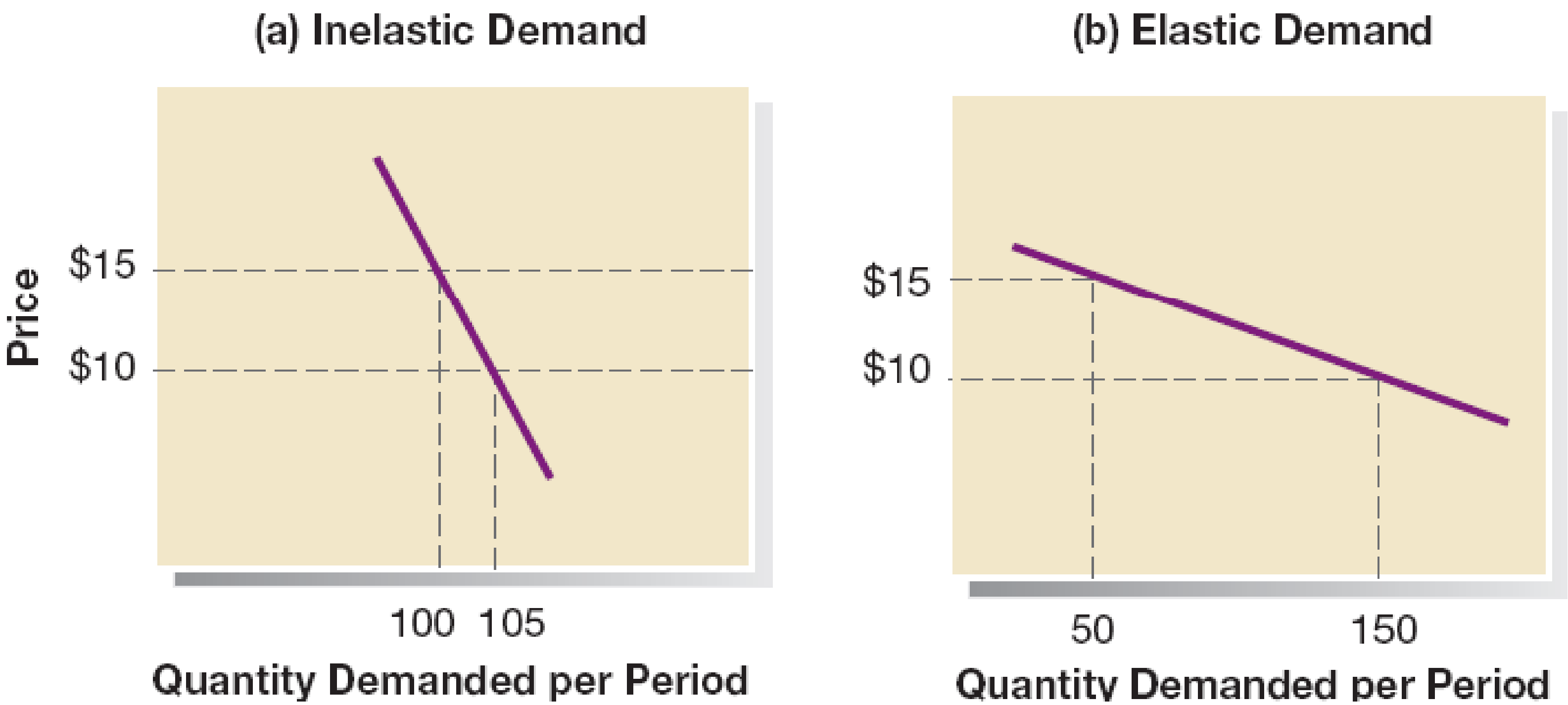
Step 2: Determining Demand

- Each price will lead to a different level of demand and therefore have a different impact on a company's marketing objectives.
- The relation between alternative prices and the resulting current demand is captured in a demand curve.

Price Sensitivity

- The demand curve shows the market's probable purchase quantity at alternative prices.
- The first step in estimating demand is to understand **what affects price sensitivity**.

Figure 14.2 Inelastic and Elastic Demand



Price Sensitivity:

- Generally, customers are most price-sensitive to products that cost a lot or are bought frequently.
- Customers are less price-sensitive to low-cost items or items they buy infrequently.
- They are also less price-sensitive when price is only a small part of the total cost of obtaining, operating, and servicing the product over its lifetime (total cost of ownership—TCO).
- Companies prefer customers who are less price-sensitive.

Estimating Demand Curves

- Most companies attempt to measure their demand curves using several different methods.
- Surveys can explore how many units consumers would buy at different proposed prices.

Estimating Demand Curves

- Price experiments can vary the prices of different products to see how the change affects sales.
- Statistical analysis of past prices, quantities sold, and other factors can reveal their relationships. These can be:
  - Longitudinal or
  - Cross-sectional

Price Elasticity of Demand

- Marketers need to know how responsive or elastic, demand would be to a change in price.

I. If demand hardly changes with a small change in price, we say the demand is **inelastic.**

II. If demand changes considerably, demand is **elastic.**

Price Elasticity

- If demand is elastic, sellers will consider lowering the price.
- A lower price will produce more total revenue as long as the costs of producing and selling more units do not increase disproportionately.

Table 14.2 Factors Leading to Less Price Sensitivity

- The product is more distinctive.
- Buyers are less aware of substitutes.
- Buyers cannot easily compare the quality of substitutes.
- The expenditure is a smaller part of the buyer's total income.
- The expenditure is small compared to the total cost of the end product.
- Part of the cost is borne by another party.
- The product is used in conjunction with assets previously bought.
- The product is assumed to have more quality, prestige, or exclusiveness.
- Buyers cannot store the product.

Price Elasticity

- Price elasticity depends on the **magnitude** and **direction** of the contemplated price change.
  - It may be negligible with a small price change.
  - Substantial with a large price change
  - It may differ for a price cut versus a price increase.
  - There may be a price indifference band within which price changes have little or no effect
- Long-run price elasticity may differ from short-run elasticity

Step 3: Estimating Costs

- Demand sets a ceiling on the price the company can charge for its product. Costs set the floor.

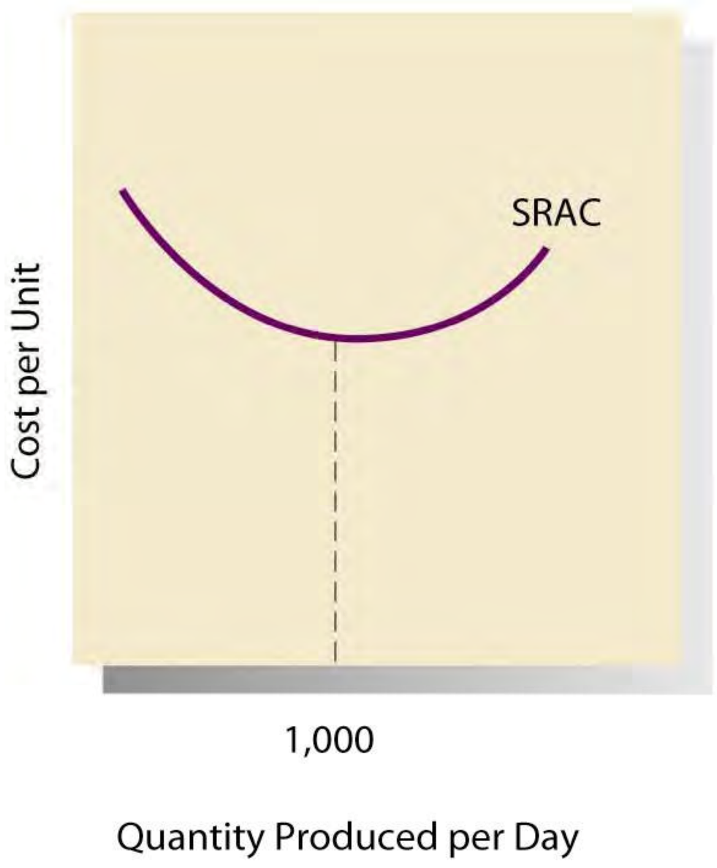
- Types of Costs and Levels of Production
- A company's costs take two forms, **fixed** and **variable**.

Costs:

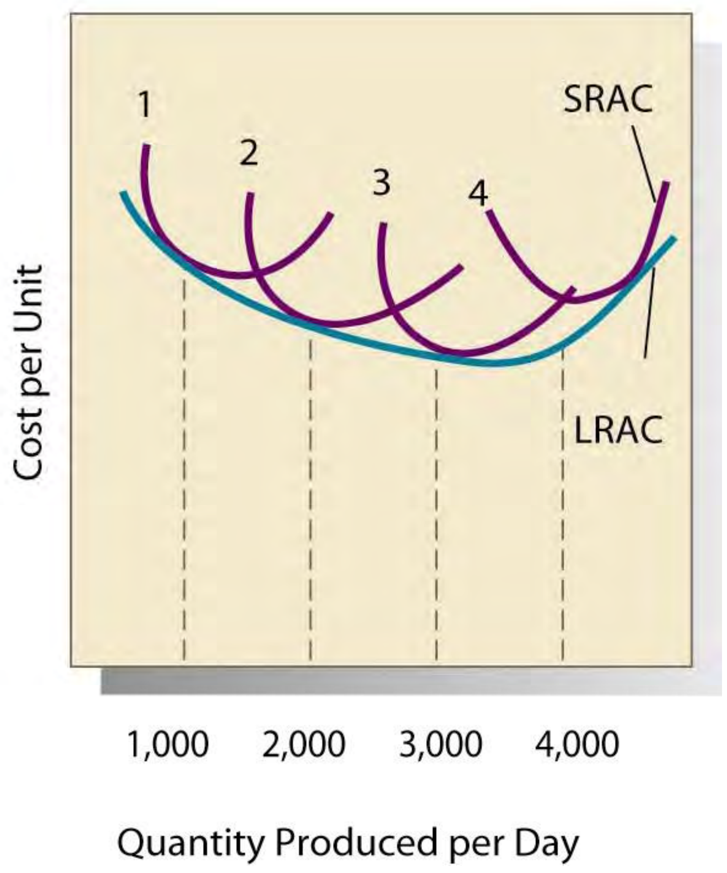
- Fixed costs (also known as overhead) are costs that do not vary with production or sales revenue.
- Variable costs vary directly with the level of production.
- Total costs consist of the sum of the fixed and variable costs for any given level of production.
- Average cost is the cost per unit at that level of production

Figure 14.3 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



Costs:

- Management wants to charge a price that will at least cover the total production costs at a given level of production.
- To price intelligently, management needs to know how its costs vary with different levels of production.

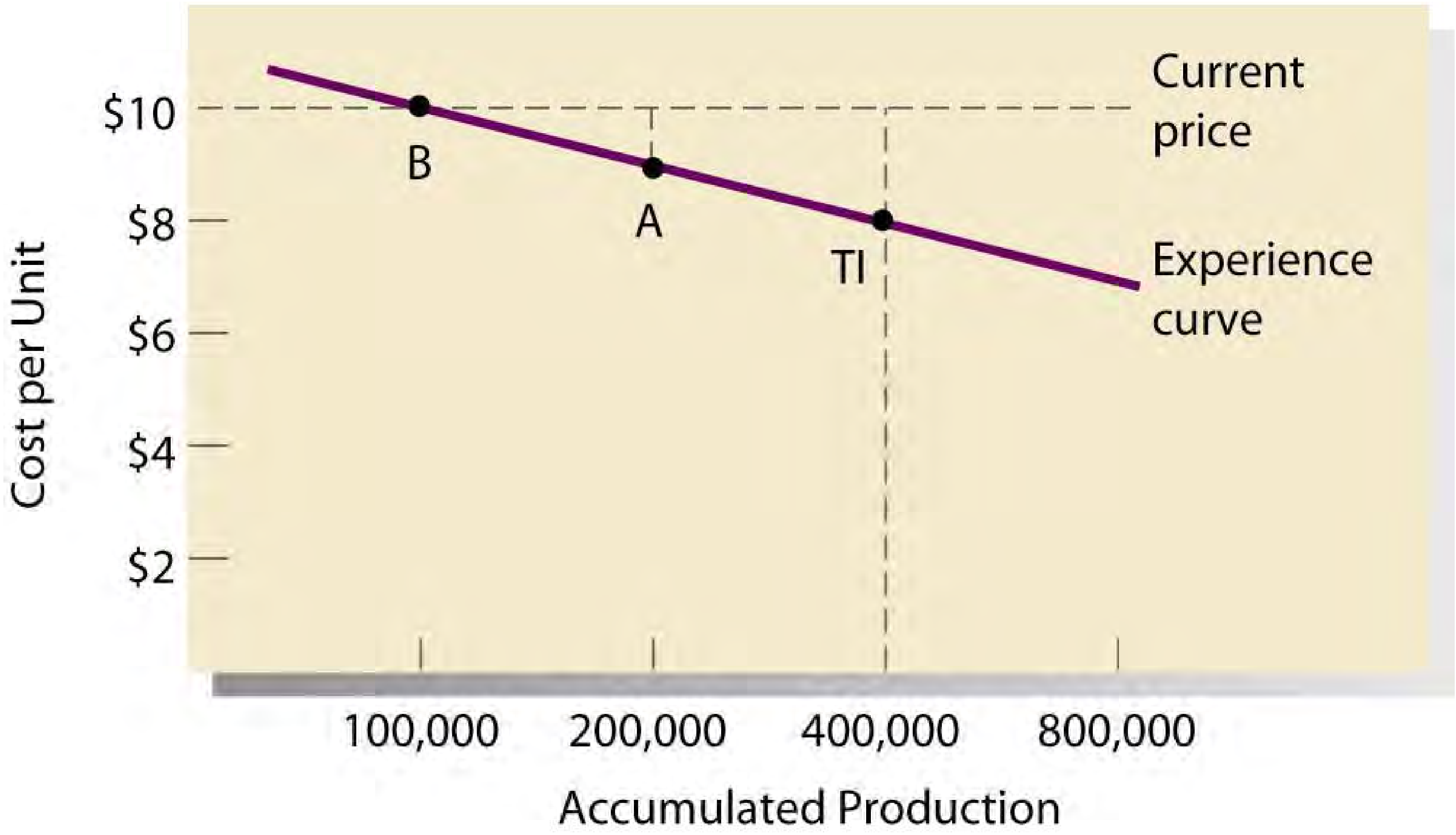
Activity-Based Accounting

- To estimate the real profitability of dealing with different retailers, the manufacturer needs to use activity-based accounting (ABC).
  - ABC accounting tries to identify the real costs associated with serving each customer.
- The key to effectively employing ABC is to define and judge "activities" properly.

Accumulated Production

- **Experience curve** or **Learning curve** Decline in average cost with accumulated production
- ***Experience-curve pricing***: major risks
  i. Might give product a cheap image
  ii. Assumes competitors weak followers
- All costs can be improved

Figure 14.4
Cost per Unit as a Function of Accumulated Production: The Experience Curve



Target Costing

- Costs change with production scale and experience.
- They can also change as a result of a concentrated effort to reduce them through target costing.
- The objective is to bring the final cost projections into the target cost range.

Step 4: Analyzing Competitors' Costs, Prices, and Offers

- Within the range of possible prices determined by market demand and company costs, the firm must take competitors' costs, prices, and possible price reactions into account.

Competitors' Costs, Prices, and Offers

A. The firm should first consider the nearest competitor's price.
B. The introduction of any price or the change of any existing price can provoke a response from customers, competitors, distributors, suppliers, and even the government.
C. How can a firm anticipate a competitor's reactions?
   - One way is to assume the competitor reacts in the standard way to a price being set or changed.

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.

A. Costs set the floor to the price.

B. Competitors' prices and the price of substitutes provide an orienting point.

C. Customers' assessment of unique features establish the price ceiling.

Figure 14.5
The Three Cs Model for Price Setting

- Summarizes 3 major considerations in price setting
- Select a pricing method that includes one or more of these 3 considerations

Six price-setting methods:

1. Markup pricing
2. Target-return pricing
3. Perceived-value pricing
4. Value pricing
5. Going-rate pricing
6. Auction-type pricing

1. Mark-Up Pricing

MARKUP PRICING =

product's cost + standard markup

- Ignores demand, value & competition

- **Why is it popular?**

I. Costs easier to estimate than demand

II. Prices similar if all firms use method

III. Viewed as fair to seller & buyer

Mark-Up Pricing

Suppose a toaster manufacturer has the following costs and sales expectations:

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

The manufacturer's unit cost is given by:

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

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

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

2. Target-Return Pricing

TARGET-RETURN PRICING:

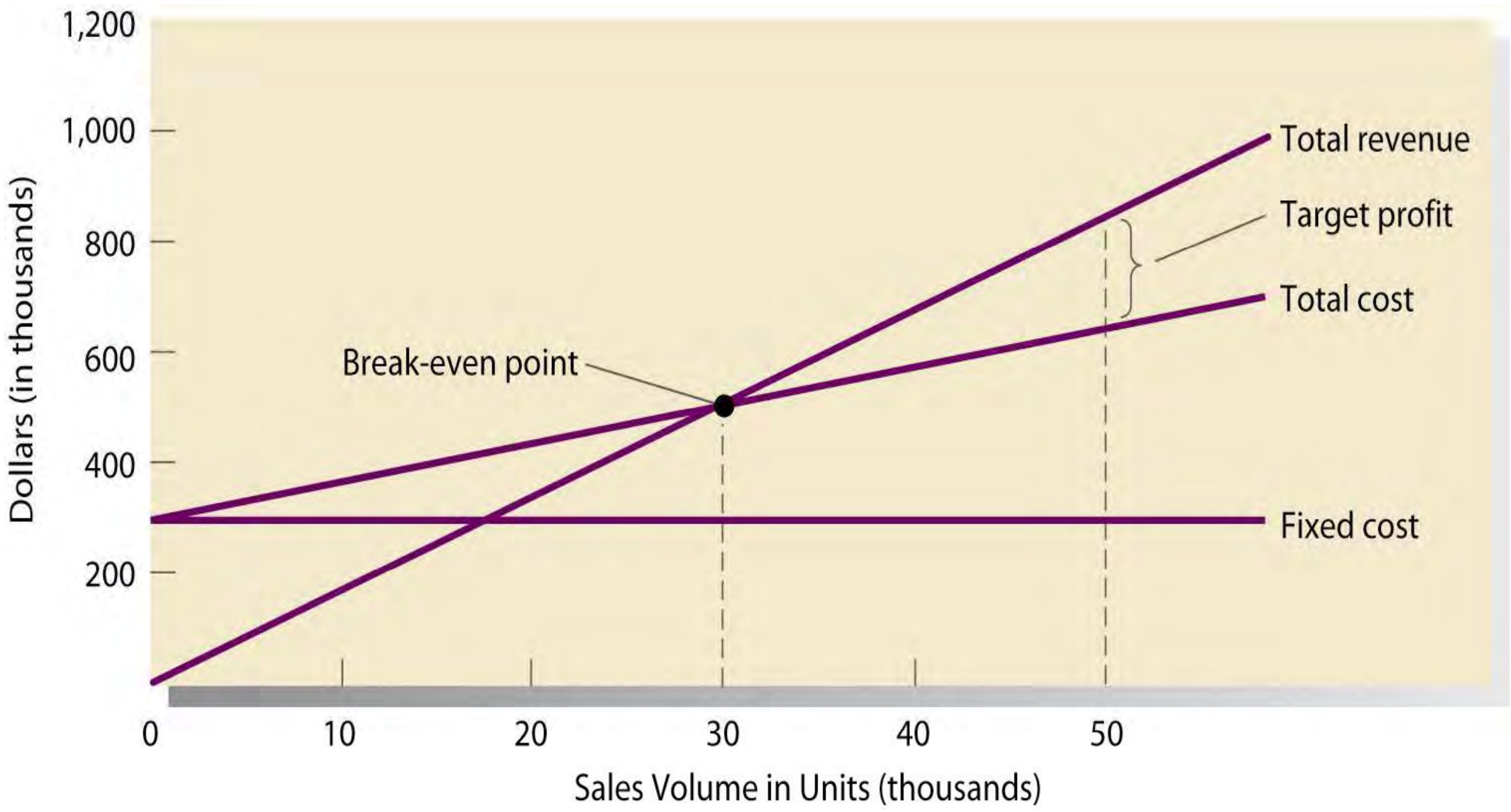
- Price that would yield its target rate of return on investment (ROI)

$$\text{Target-return price} = \text{unit cost} + \frac{\text{desired return} \times \text{invested capital}}{\text{unit sales}}$$

- Ignores price elasticity & competitors' prices
- Total costs = fixed + variable costs

Figure 14.6 Break-Even Chart for Determining Target-Return Price and Break-Even Volume

$$\text{Break-even volume} = \frac{\text{fixed cost}}{(\text{price} - \text{variable cost})}$$



3. Perceived Value Pricing

- An increasing number of companies based on their price of the customer's perceived value.
- They must deliver the value promised by their value proposition, and the customer must perceive this value.
- The key to perceived-value pricing is to deliver more value than the competitor and to demonstrate this to prospective buyers.

3. Perceived Value Pricing

- Perceived value is made up of several characteristics:
  - **Buyer's image of the product performance**
  - **Channel deliverables**
  - **The warranty quality**
  - **Customer support**
  - **Supplier's reputation**
  - **Trustworthiness**
  - **Esteem**

4. Value Pricing

- In recent years, several companies have adopted value pricing: they win loyal customers by **charging a fairly low price for a high-quality offering.**
- Value pricing is not a matter of simply setting lower prices.
- It is a matter of reengineering the company's operations to become a low-cost producer without sacrificing quality.
- Lowering pricings significantly helps to attract a large number of value-conscious customers.

Value Pricing: EDLP and High-Low

- An important type of value pricing is everyday low pricing (EDLP) that takes place at the retail level.
- A retailer who holds to an EDLP pricing policy charges a constant low price with little or no price promotions and special sales.
- In high-low pricing, the retailer charges higher prices on an everyday basis but then runs frequent promotions in which prices are temporarily lowered below the EDLP level.

Value Pricing: EDLP and High-Low

- The two different pricing strategies have been shown to affect consumer price judgments.
- Deep discounts (EDLP) can lead to lower perceived prices by consumers over time than frequent shallow discounts (high-low) even if the actual averages are the same.
- Some retailers have even based their entire marketing strategy around what could be called extreme everyday low pricing.

5. Going-Rate Pricing

- In going-rate pricing, the firm bases its price largely on competitor's prices.
- The firm might charge the same, more, or less than major competitor (s).
- Going-rate pricing is quite popular where costs are difficult to measure or competitive response is uncertain.

Breakthrough Marketing: EBAY

- Talks about how, Ebay, by helping buyers get the best price for their items and letting customers decide the price they want to pay, created a pricing revolution.

Auction-type pricing

AUCTION-TYPE PRICING: 3 auction types:

I. ***English auctions (ascending bids)***
   i. One seller, many buyers. Top price

II. ***Dutch auctions (descending bids)***
   i. One seller, many buyers: starting high price slowly lowered
   ii. One buyer, many sellers: lowest price

III. ***Sealed-bid auctions***
   i. One bid & others' bids secret

Step 6: Selecting the Final Price

- Pricing methods narrow the range from which the company must select its final price.
- In selecting the 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.

Marketing Insight: Stealth price increase

- Companies trying to figure out how to increase revenue without really increasing prices are increasingly charging additional fees for what once had been free features / services.

Impact of Other Marketing Activities

- **Final price to reflect brand's quality & advertising relative to competition**
  - Average quality, high advertising - premium prices
  - Higher prices for known products
  - High quality & advertising- highest price
  - Low quality & advertising- lowest price
- **Price not as important as quality & other benefits in market offering**

Company Pricing Policies:

- Price consistent with pricing policies
- But not averse to pricing penalties
- Pricing department - policies & decisions to ensure prices are reasonable

Gain-and-Risk Sharing Pricing

- Buyers may resist accepting a seller's proposal because of a highly-perceived level of risk.
- The seller has the option of offering to absorb part or all of the risk if he does not deliver the full promised value.

Impact of Price on Other Parties

- Management must also consider the reactions of other parties to the contemplated price:

1. How will distributors and dealers feel about it?
2. Will the sales force be willing to sell at that price?
3. How will competitors react?

Impact of Price on Other Parties

4. Will suppliers raise their prices when they see the company's price?
5. Will the government intervene and prevent this price from being charged?
6. Marketers need to know the laws regulating pricing in the local market.

ADAPTING THE PRICE

Companies usually do not set a single price, but rather a pricing structure that reflects variations in different market circumstances.

Adapting the Price:

- Geographical demand and costs
- Market-segment requirements
- Purchase timing
- Order levels
- Delivery frequency
- Guarantees
- Service contracts
- Other factors

Adapting the Price:

- As a result of discounts, allowances, and promotional support, a company rarely realizes the same profit from each unit of a product it sells.

Geographical Pricing (Cash, Countertrade, Barter)

- **Geographical pricing** involves the company in deciding how to price its products to different customers in different locations and countries.

Geographical Pricing:

- Should the company charge higher prices to distant customers to cover the higher shipping costs or a lower price to win additional business?
- How should exchange rates and the strength of different currencies be accounted for?
- Another issue is how to get paid.
  - Many buyers want to offer other items in payment, a practice known as countertrade.

Procter & Gamble sets different prices for different customers in different locations, often by making slight changes in the product. Clean White, for instance, is the lower-priced version of its detergent for the Chinese market and lacks stain removal ingredients and fragrance.

Countertrade:

- Countertrade may account for 15 to 25 percent of the world's trade and takes several forms:
  - Barter
  - Compensation deal
  - Buyback arrangement
  - Offset

Price Discounts and Allowances

- Adjust price & give discounts & allowances for:
  - Early payment
  - Volume purchases &
  - Off-season buying

Price Discounts and Allowances

- Discount pricing has become the modus operandi of a surprising number of companies offering both products and services.
- Some product categories tend to self-destruct by always being on sale.
- Discounting can be a useful tool if the company can gain concessions in return.

Table 14.3 Price Discounts and Allowances

Cash Discount:	A price reduction to buyers who pay bills promptly. A typical example is "2/10, net 30," which means that payment is due within 30 days and that the buyer can deduct 2 percent by paying the bill within 10 days.
Quantity Discount:	A price reduction to those who buy large volumes. A typical example is "$10 per unit for less than 100 units; $9 per unit for 100 or more units." Quantity discounts must be offered equally to all customers and must not exceed the cost savings to the seller. They can be offered on each order placed or on the number of units ordered over a given period.
Functional Discount:	Discount (also called *trade discount*) offered by a manufacturer to trade-channel members if they will perform certain functions, such as selling, storing, and recordkeeping. Manufacturers must offer the same functional discounts within each channel.
Seasonal Discount:	A price reduction to those who buy merchandise or services out of season. Hotels, motels, and airlines offer seasonal discounts in slow selling periods.
Allowance:	An extra payment designed to gain reseller participation in special programs. *Trade-in allowances* are granted for turning in an old item when buying a new one. *Promotional allowances* reward dealers for participating in advertising and sales support programs.

Price Discounts and Allowances

- Sales management needs to monitor the proportion of customers who are receiving discounts.
- Higher levels of management should conduct a net price analysis to arrive at the "real price" of their offering.

Promotional Pricing

- Techniques to stimulate early purchase:

1. *Loss-leader pricing*
2. *Special-event pricing*
3. *Cash rebates*
4. *Low-interest financing*
5. *Longer payment terms*
6. *Warranties and service contracts*
7. *Psychological discounting*

- **Promotional-pricing strategy: zero-sum game**

Differentiated Pricing:

- **Price discrimination:** product/service sold at 2 or more prices that do not reflect proportional difference in costs. Three types:
- **1st-degree: price to each customer - demand intensity**
- **2nd-degree: charges buyers less - larger volume**
- **3rd-degree: different charges to different classes of buyers**

Differentiated Pricing:

3^{rd}-degree price discrimination

- *Customer-segment*
- *Product-form*
- *Image*
- *Channel*
- *Location*
- *Time*

Yield pricing:

- Discounted but limited early buys
- Higher-priced late purchases &
- Lowest rates - unsold inventory before expiry

Conditions for Price Differentiation:

I. Market segmentable - different demand intensities
II. Low-price cannot be resold to high-price
III. Competitors cannot undersell in higher price
IV. Segmenting costs not > extra revenue – no resentment & ill will
V. Not illegal

INITIATING AND RESPONDING TO PRICE CHANGES

Companies often face situations when they may need to cut or raise prices.

Initiating Price Cuts

- Several circumstances might lead a firm to cut prices:
  1. Excess plant capacity
  2. Companies may initiate a price cut in a drive to dominate the market through lower costs.
  3. Either the company starts with lower costs or initiates price cuts in hope of gaining market share and lower costs.

Initiating Price Cuts

- A price-cutting strategy involves possible traps:
  - Low-quality trap
  - Fragile-market-share trap
  - Shallow-pockets trap

Initiating Price Increases

- A successful price increase can raise profits considerably.
- A major circumstance provoking price increases is cost inflation.
- Rising costs unmatched by productivity gains squeeze profit margins and lead companies to regular rounds of price increases.

Initiating Price Increases

- Companies often raise their prices by more than the cost increase in anticipation of further inflation or governmental price controls, in a practice called anticipatory pricing.
- Another factor leading to price increase is **over-demand**.

Initiating Price Increases

- The price can be increased in the following ways:
  1. Delayed quotation pricing
  2. Escalator clauses
  3. Unbundling
  4. Reduction of discounts

Initiating Price Increases

- In initiating price increase:

1. To decide
    - Sharp price rise ONCE or
    - Small price rises, several times
2. Avoid looking like price gouger
3. Premiums of strong brands - not excessive

Initiating Price Increases

Techniques - prevent sticker shock & hostile reaction in customers:

- Fairness surrounding price increase
- Advance notice - can forward buy
- Sharp price increases explained
- Making low-visibility price moves

Making low-visibility price moves

a) Eliminating discounts

b) Increasing minimum order sizes

c) Curtailing production of low-margin products

d) Creating new economy brands

Responding to Competitor's Price Changes

- How should a firm respond to a price cut initiated by a competitor?

- The best response **varies with the situation.**

Responding to Competitor's Price Changes

CUSTOMER REACTIONS: Customers usually question the motivation behind price changes

- How **price cut** can be interpreted?

1. Item to be replaced by new model
2. Item - faulty, not selling well
3. Firm - financial trouble
4. Price – to come down further
5. Quality - reduced

Responding to Competitor's Price Changes

CUSTOMER REACTIONS: Customers question motivation behind price changes

- How **price increase** can be interpreted?

1. Normally deters sales
2. Item is "hot" - unusually good value

Responding to Competitor's Price Changes

COMPETITOR REACTIONS:

- Few firms, homogeneous product & buyers highly informed

Anticipate competitor's reactions **HOW**?

1. React in a fixed way to price changes
2. Treat price change as a challenge & react according to self-interest

Responding to Competitor's Price Changes

- Different competitor interpretations on price cut:

1. Company - steal market, do poorly & try to boost sales, **or**
2. Company wants industry to reduce prices to stimulate total demand

Responding to Competitor's Price Changes

- Price cut in homogenous market?

1. Enhance augmented product
2. Reduce prices

- Price hike in homogenous market?

1. Others – unable to match it unless price increase benefits industry

Responding to Competitor's Price Changes

- **Non-homogenous market**

1. Why does the competitor change the price?
2. Planned price change temporary/permanent?
3. What happens next - market share, profits if does not respond?
4. Competitor's & other firms' responses to each other.

- Market leaders - price cutting by smaller firms trying to build market share

Responding to Competitor's Price Changes

- When faced with lower-priced brands, a brand leader can:

1. *Maintain price*
2. *Maintain price and add value*
3. *Reduce price*
4. *Increase price and improve quality*
5. *Launch a low-price fighter line*

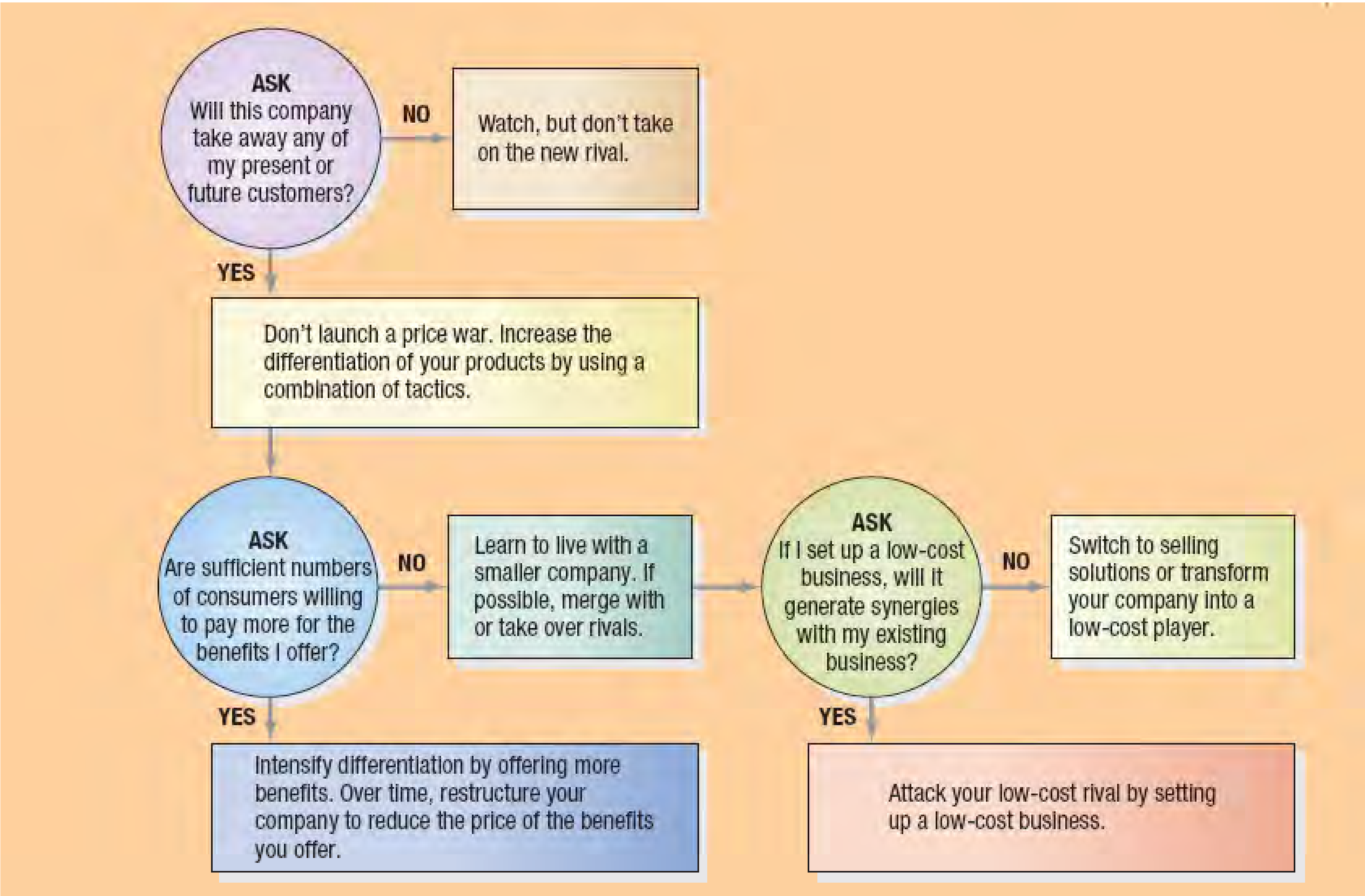
The company has to consider the products:

1. Stage in the life cycle.
2. Its importance in the company's portfolio
3. The competitor's intentions and resources.
4. The market's price and quality sensitivity
5. The behavior costs with volume.
6. The company's alternative opportunities.

Marketing Memo: How to fight low-cost rivals

- The first approach to competing against cut-price players is to differentiate the product or service through various means.
- Secondly, companies must not use differentiation tactics in isolation; companies must be able to persuade consumers to pay for the additional benefits; companies must first bring costs and benefits in line.

Figure 14.7 A Framework for Responding to Low-cost Rivals



Final discussion

Marketing Debate – Is the Right Price A Fair Price?

Prices are often set to satisfy demand or to reflect the premium that consumers are willing to pay for a product or service. Some critics shudder, however, at the thought of $2 bottles of water, $150 running shoes, & $500 concert tickets.

Take a position: Prices should reflect the value that consumers are willing to pay *versus* Prices should primarily just reflect the cost involved in making a product or service.

Marketing Discussion

Think of the various pricing methods - markup pricing, target return pricing, perceived value-pricing, value pricing, going rate pricing, & auction-type pricing. As a consumer, which method do you personally prefer to deal with. Why? If the average price were to stay the same, which would you prefer: (1) for firms to set one price & not deviate or (2) to employ slightly higher prices most of the year, but slightly lower discounted prices or specials for certain occasions.