



# RAMA UNIVERSITY

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## E-Content BBA402- Marketing Management

### Lecture 22- Pricing Strategies

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## How Customers View Price

### PRICE-VALUE EQUATION

$$\text{VALUE} = \text{PERCEIVED BENEFITS} - \text{PERCEIVED COSTS}$$

# Psychology of Price

- Customers are more likely to buy products whose price points end in the number nine
- Anchoring can change customer perceptions of price



# Pricing Strategies.

1. Profit-oriented pricing
2. Competitor-oriented pricing
3. Customer-oriented pricing



# Profit Oriented Pricing

- Focus on finances of business and product

$$\text{profit} = \text{revenue} - \text{price}$$

- Price per product is set higher than the total cost of producing and selling cost
- Ensures company makes a profit on each sale

## Risks

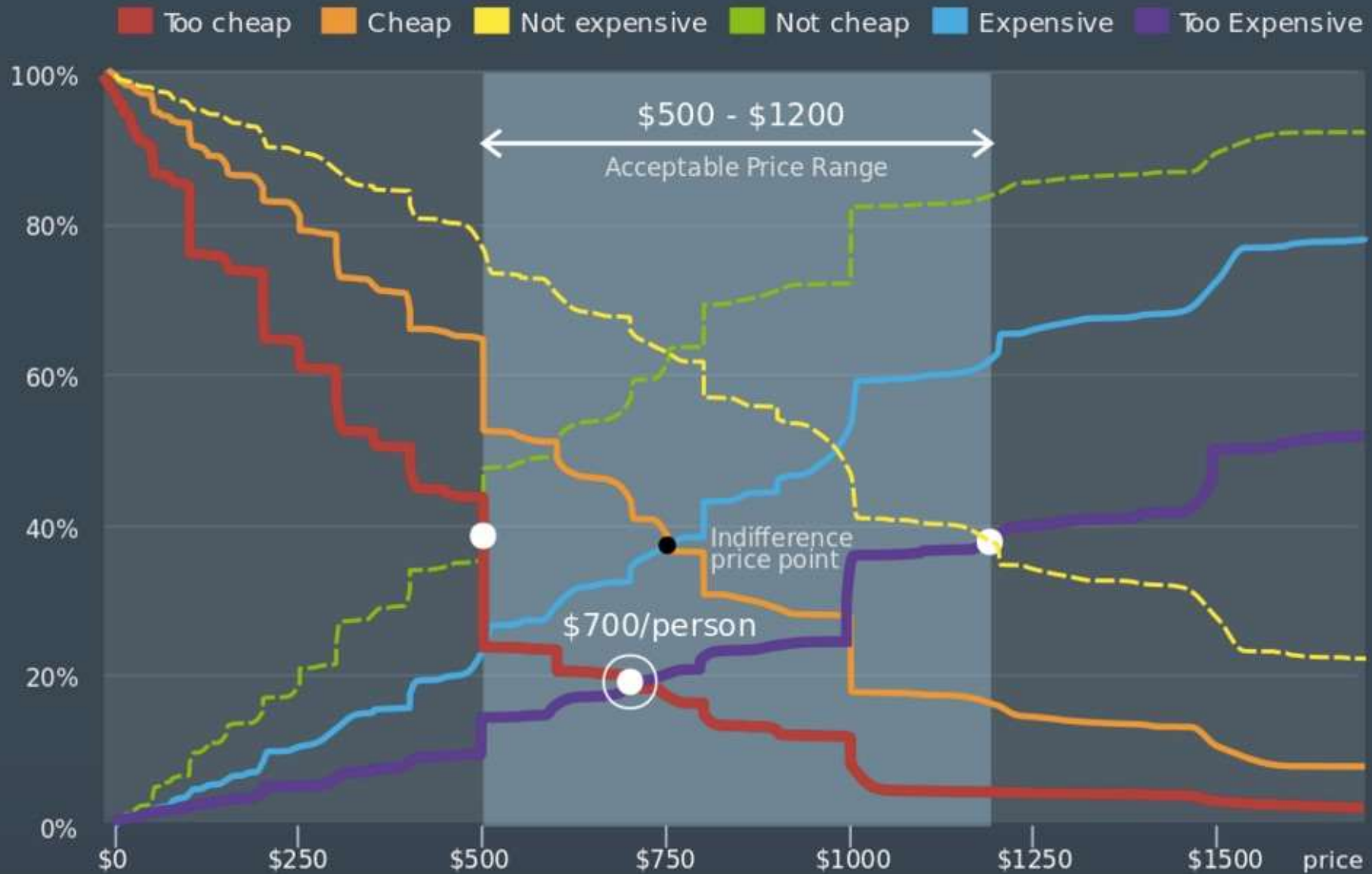
- Customers don't care about a company's costs
- Competitors can undercut pricing
- Limits pricing flexibility

# Van Westendorp Price Sensitivity Questions

1. At what price would you consider the product to be so expensive that you would not consider buying it? (Too expensive)
2. At what price would you consider the product to be priced so low that you would feel the quality couldn't be very good? (Too cheap)
3. At what price would you consider the product starting to get expensive, such that it's not out of the question, but you would have to give some thought to buying it? (Expensive/High Side)
4. At what price would you consider the product to be a bargain—a great buy for the money? (Cheap/Good Value)

# Van Westendorp

## Price Sensitivity Meter





## Other Pricing Strategies

- Profit objective: For example, “Increase net profit in 2016 by 5 percent”
- Competitive objective: For example, “Capture 30 percent market share in the product category”



# Break-Even Price

The break-even price is the price that will produce enough revenue to cover all costs at a given level of production.

$$p = (Vn + FC) / n$$

$$n = FC / (p - V)$$

p is price

n is number of units sold

V is variable cost per unit

FC is fixed costs

# Competitive Pricing

- Matching competitor price requires competing on the other parts of the marketing mix
- Pricing above competition requires a clear advantage on some nonprice element of the marketing mix
- Pricing below the competition to increase sales volume with lower profit margins is effective if a significant segment of the market is price sensitive and/or the organization's cost structure is lower than competitors
- The risk of competing on price is a price war

# Value-based Pricing

- “Price is what you think your product is worth to that customer at that time.” This approach regards the following as marketing/price truths:
- To the customer, price is the only unpleasant part of buying.
- Price is the easiest marketing tool to copy.
- Price represents everything about the product.
- Still, value-based pricing is not altruistic. It asks and answers two questions:
- What is the highest price I can charge and still make the sale?
- Am I willing to sell at that price?

# Tactical Recommendations from Value-based Pricing

- Employ a segmented approach toward price that considers how each group of customers assesses value
- Establish the highest possible price level and justify it with comparable value
- Use price as one component in the market offering to create a total value across all elements of the offering



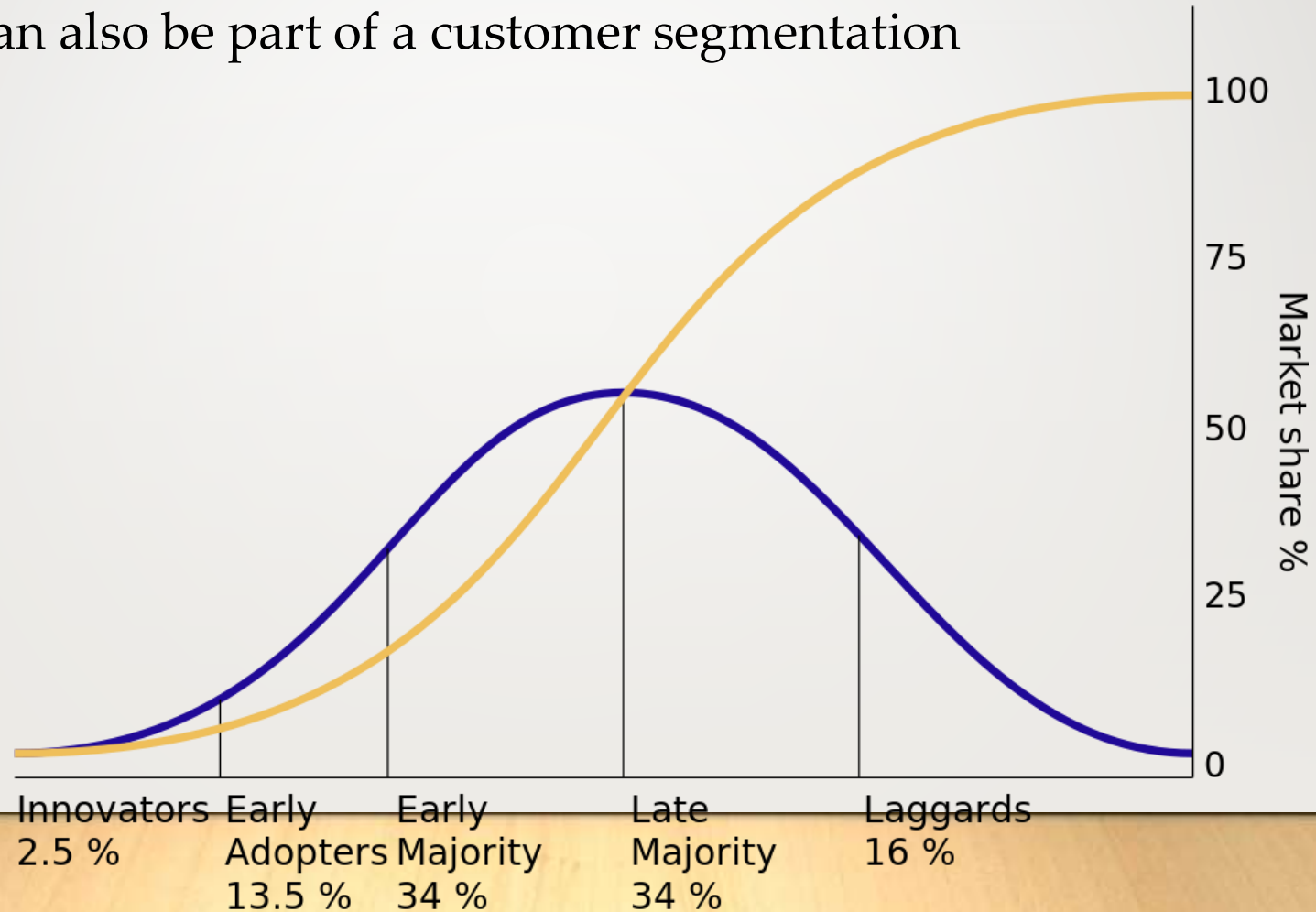
# Price Skimming

- A firm charges the highest initial price that customers will pay
- As the demand of the first customers is satisfied, the firm lowers the price to attract another, more price-sensitive segment



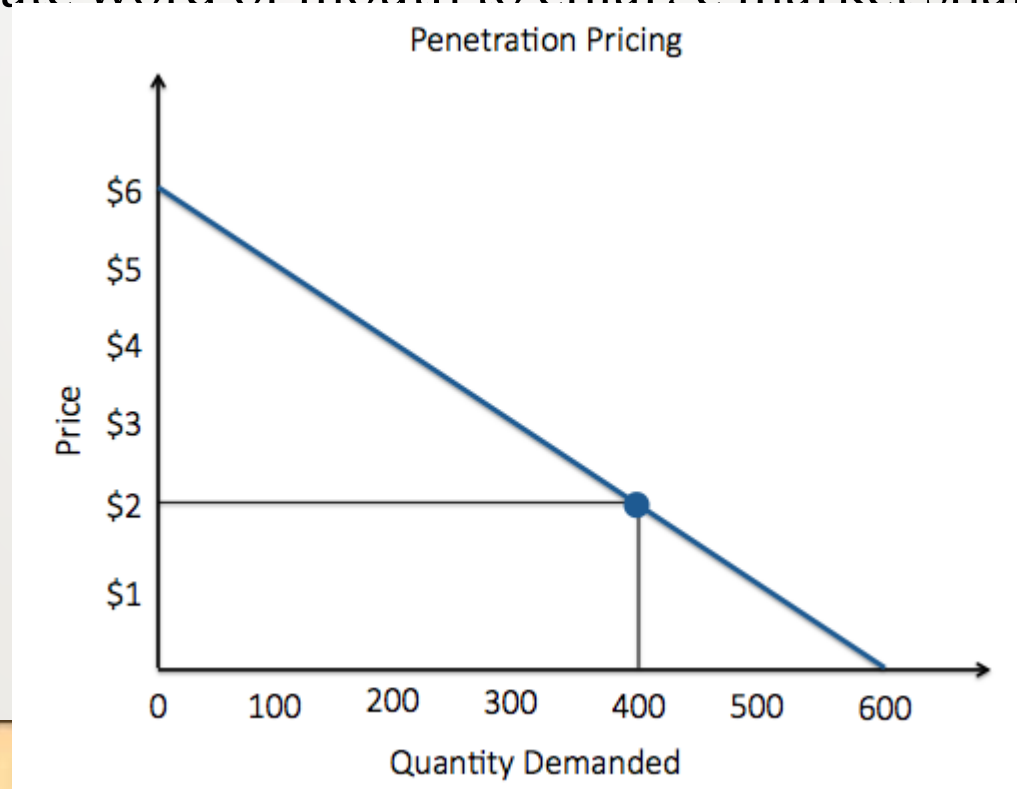
# Price Skimming and Customer Segmentation

- Price skimming can also be part of a customer segmentation strategy.



# Penetration Pricing

- The price of a product is initially set low to rapidly reach a wide fraction of the market and initiate word of mouth to enlarge market share and exploit economies of scale



# Advantages of Penetration Pricing

- It can result in fast diffusion and adoption across the product life cycle
- It can create goodwill among the Innovators and Early Adopters
- It establishes cost-control and cost-reduction pressures from the start, leading to greater efficiency
- It discourages the entry of competitors and takes existing competitors by surprise
- It can generate high stock turnover throughout the distribution channel, which creates important enthusiasm and support in the channel



# Disadvantages of Penetration Pricing

- Can create long-term price expectations for the product and image preconceptions for the brand and company that make it difficult to raise prices later
- low profit margins may not be sustainable long enough for the strategy to be effective



# Cost-plus Pricing

*Cost-plus pricing, sometimes called gross margin pricing*

- Most widely used pricing method
- The manager selects as a goal a particular gross margin that will produce a desirable profit level
- Gross margin is the difference between how much the goods cost and the actual price for which it sells
- This gross margin is designated by a percent of net sales
- The percent chosen varies among types of merchandise

# Markup

- When middlemen use the term markup, they are referring to the difference between the average cost and price of all merchandise in stock, for a particular department, or for an individual item



# Discounting Strategies

- Quantity discounts
- Seasonal discounts
- Cash discounts
- Trade discounts (given to middlemen)
  
- Personal allowances (rewards to salespeople)
- Trade-in allowances (cars)
- Price bundling (cable) package)



# Price Elasticity

Price elasticity measures the responsiveness of quantity demanded to a change in the product price

$$\text{price elasticity} = \frac{\% \text{ change in quantity}}{\% \text{ change in price}}$$

- When the absolute value of the price elasticity is  $>1$ , the price is elastic
- When the absolute value of the price elasticity is  $<1$ , the price is inelastic



# What Determines Price Elasticity

- Substitutes
- Absolute price
- Importance of use
- Competitive dynamics

# Competitive Bidding

- A competitive bid is a procurement process in which bids from competing suppliers are solicited
- Advertises the requirements and specifications of solutions and invites suppliers to provide a proposal about how they will meet the need and at what price.
- opportunity to tailor pricing for a specific customer's needs

## STAGES OF ORGANIZATIONAL BUYING



# Don't Compete on Price Alone

- Price is not a sustainable competitive advantage
- Low prices can jeopardize a company's ability to profitably deliver sustained value







## Practice Question

Compare and contrast price skimming and penetration pricing.

# Quick Review

- How does price affect the value of the organization's products or services?
- What are the primary factors to consider in pricing?
- Compare common pricing strategies.
- What is price elasticity and how can it be used to set price?
- What is competitive bidding and how is it used for B2B pricing?