### Pricing Concepts and Strategies

#### Learning Objective 01

**Pricing Objectives and the Marketing Mix**

<table>
<thead>
<tr>
<th>Pricing Objectives FOR – Profit Organizations</th>
<th>Pricing Objectives NOT FOR – Profit Organizations</th>
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<tbody>
<tr>
<td><strong>Objective</strong></td>
<td><strong>Description</strong></td>
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| **Profitability** | - Set prices with the objective of making profits in mind  
- Profits = Revenue (price x quantity) – Expenses  
- Marketers evaluate and adjust prices continually to accommodate changes in the environment  
- Consumer behavioural patterns also play a vital role  
- Profit maximization price is the point at which the additional revenue gained by increasing the price of a product equals the increase in total costs. Marketers use margin analysis (method of analyzing the relationship among costs, sales price and increased sales volume) to establish this  
- Marketers commonly set target return objectives (short run or long run pricing objectives of achieving a specified return on either sales or investment) in setting profitability objectives | **Profit Maximization** | - Profitability is not cited as a primary goal  
- They try to maximize their return on single events or series of events  
- Sometimes profit is referred to as the surplus |
| **Cost Recovery** | | **Cost Recovery** | - Main objective would be to recover the actual cost of operating the unit  
- The amount of recovered costs is often determined by tradition, competition or public opinion |
| **Volume** | - Market share is a volume related pricing objective in which the goal is to achieve control of a portion of the market for a firm's good or service  
- PIMS (Profit Impact of Market Strategies) project discovered a strong relationship between a firm’s market share and product quality and its return on investment | **Market Incentives** | - Follows a lower than average pricing policy or offer a free service to encourage increased usage of the goods or services |
| **Meeting Competition** | - Pricing objectives tied directly to meeting prices charged by major competitors deemphasize the price element and focus more strongly on non-price variables  
- Value pricing – pricing strategy emphasizing benefits derived from a product in comparison to the price and quality levels of competing offerings | **Market Suppression** | - Price set to discourage consumption  
- High prices help to accomplish social objectives independent of the costs of providing goods or services |
| **Prestige** | - Establishes a relatively high price to develop and maintain an image of quality and exclusiveness that appeals to status conscious consumers | | |
A. Price Determination in Economic Theory (Market Conditions)

Demand – Schedule of the amounts of a firm’s product that consumers will purchase at different prices during a specified period

Supply – Schedule of the amounts of a good or service that firms will offer for sale at different prices during a specified period

The interaction of demand and supply in determining prices will depend on the relative market structures in operations within a given economy.

Pure Competition – a market structure characterized by homogeneous products in which there are so many buyers and sellers that none has a significant influence on price.

Monopolistic Competition – Typifies most retailing featuring large numbers of buyers and sellers. They exchange relatively differentiated products giving marketers some control over price.

Oligopoly – relatively few sellers compete in an oligopoly. Pricing decisions by each seller are likely to affect the market but no one seller controls it. Attempt not to compete on prices.

Monopoly – only one seller of a product exist and for which there are no close substitutes. They do have control to set prices. There are many regulations against monopolies.

Costs and Revenue Curves

Elasticity and Pricing

- Elasticity – measure of responsiveness of purchases and suppliers to a change in price
- Elasticity is an important determinant in making pricing decisions
  - For products which are elastic in nature (shopping goods), a decrease in price will lead to a more than proportionate increase in quantities purchased and will result in revenue increases
  - Similarly for products with inelastic demand (convenience goods), an increase in price will not lead less than proportionate decrease in quantities purchased and will ultimately increase revenues
- Elasticity of a product is determined by
  - Availability of substitutes/complementary products
  - The numbers of buyers and sellers that compete in the market
### B. Price Determination through Cost Analysis

#### COST PLUS Pricing

**Definition**
- Practice of adding a percentage of specified dollar amount or mark up to the base cost of the product to cover unassigned costs and provide a profit.

**Formula**
- Selling Price = Cost of the Product + $ amount or mark up

**Example**
- Cost of the product = $10
- Mark up = 50%
- Selling Price = $10 + (10 x 50%) $5 = $15.00

**Advantages**
- Works well for a business that keeps its costs low. This will allow it to set prices lower than competition (assuming your costs are lower than competition).

**Issues**
- Arriving at cost per unit is not simple as it seems. In more complex manufacturing situations, this calculation becomes complex. If the organization’s cost structure is higher, then the set prices may not be very competitive. It does not consider competition or demand conditions.

**Variations/Applications**
- Two alternatives to COST PLUS pricing is
  - Full Cost Pricing – considers all applicable variable costs. Also it allocates those fixed costs that cannot be directly attributed the specific item been priced
  - Incremental Cost Pricing – pricing method that attempts to use only costs directly attributable to a specific output in setting prices

#### Breakeven Pricing

**Definition**
- Pricing technique used to determine the number of products that must be sold at a specified price to generate enough revenue to cover total costs.

**Formula**
- Breakeven Point (units) = \[
\frac{\text{Total Fixed Costs}}{\text{Contribution per Unit} \ [\text{Selling Price} \ - \ \text{Variable Cost}]}
\]

**Example**
- Suggested selling price = $10, Variable cost per unit = $5, Fixed costs = $40,000
- Breakeven point (units) = $40,000/($10-$5) = 8000 units
- Breakeven point ($) = $40,000/1-($10/$5) = $80,000

**Advantages**
- Once the organization achieves breakeven, additional sales will generate unit profits when the contribution per unit is positive. Marketers can reduce price (still maintain a smaller positive contribution per unit) and if able to generate more volume, the entire positive contribution will lead to profits.

**Issues**
- Model assumes that costs could be divided into fixed and variable. It also assumes that unit variable costs do not change (times it may change due to fluctuations in raw material prices. Does not consider demand.

**Variations/Applications**
- Target Returns
  - Organizations are not merely interested to breakeven but also eager to make profits
  - Target returns incorporate the intended target profit dollar amount to identify the units that are requested to sell to make that profit
  
  \[
  \text{Target Return} = \frac{\text{Total Fixed Costs} + \text{Target Profit}}{\text{Contribution per Unit} \ [\text{Selling Price} \ - \ \text{Variable Cost}]}
  \]

#### Yield Management
- A pricing strategy that allows marketers to vary prices based on such factors as demand, even though the cost of providing those goods or services remains the same; designed to maximize revenues in situations where the costs are fixed.
### Pricing Strategies
Pricing Strategies grow out of the marketing strategies organizations formulate to accomplish organizational objectives.

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<tr>
<th>Pricing Strategies</th>
<th>Pricing Policies</th>
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<tr>
<td><strong>Market Skimming (Market Plus Pricing)</strong> – Pricing strategy involving the use of an initial high price relative to competitive offerings. Price is dropped in incremental steps as supply begins to exceed demand, or when competition catches up.</td>
<td><strong>Psychological Pricing</strong> – pricing policy based on the belief that certain prices or price ranges make a good or service more appealing than others to buyers.</td>
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<td><strong>Penetrative Pricing Strategy (Market Minus Pricing)</strong> – pricing strategy involving the use of a relatively low entry price compared with competitive offerings, based on the theory that this initial low price will help secure market acceptance.</td>
<td><strong>Odd Pricing</strong> – pricing policy based on the belief that a price ending with an odd number just under a round number is appealing, for instance, $9.97 rather than $10.</td>
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<td><strong>Everyday Low Pricing</strong> – pricing strategy of continuously offering low prices rather than relying on such short term price cuts as cents of coupons, rebates and special sales.</td>
<td><strong>Unit Pricing</strong> – pricing policy in which prices are stated in terms of a recognized unit of measurement or a standard numeric count.</td>
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<td><strong>Competitive Pricing</strong> – pricing strategy designed to de-emphasize price as a competitive variable by pricing a good or service at the general level of comparable offerings.</td>
<td><strong>Price Flexibility</strong> – pricing policy permitting variable prices for goods and services.</td>
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<td><strong>Opening Price Point</strong> – another form of competitive pricing where setting an opening price below that of the competition, usually on a high quality private label item.</td>
<td><strong>Product Line Pricing</strong> – practice of setting a limited number of prices for a selection of merchandise and marketing different product lines at each of these price levels.</td>
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### Reductions from List Price

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<th>Geographic Considerations</th>
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<td><strong>List Price</strong> – establish price normally quoted to potential buyers.</td>
<td>These include prices quoted for buyers who live across different geographical regions to take into consideration differences in cost of freight and handling.</td>
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<td><strong>Market Price</strong> – price a consumer or a marketing intermediary actually pays for a product after subtracting any discounts, allowances or rebates from the list price.</td>
<td><strong>FOB Pricing</strong> – price quotation that does not include shipping charges.</td>
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<td><strong>Cash Discounts</strong> – price reduction offered to the consumer, business user, or marketing intermediary in return for a prompt payment of a bill.</td>
<td><strong>Uniform Delivered Pricing</strong> – pricing system for handling transportation cost under which all buyers are quoted the same price, including transportation expenses. Sometimes known as post stage stamp pricing.</td>
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<tr>
<td><strong>Trade Discounts</strong> – payment to a channel member or buyer for performing marketing functions. Also known as a functional discount.</td>
<td><strong>Zone Pricing</strong> – pricing system for handling transportation cost under which the market is divided into geographic regions and a different price is set in different region.</td>
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<tr>
<td><strong>Quantity Discounts</strong> – price reductions granted for a large volume purchase. Cumulative quantity discounts are determined by amounts of purchases over a period of time whereas a non-cumulative quantity discount is offered on a one time basis.</td>
<td><strong>Base Point Pricing</strong> – system used in some industries during the early 20th century in which the buyer paid the factory price plus freight charges for the basing point city nearest the buyer.</td>
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<td><strong>Allowances</strong> – specify deduction from list price, including a trade-in or promotional allowances.</td>
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<td><strong>Trading in</strong> – credit allowance given for a used item when a customer purchases a new item.</td>
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<td><strong>Promotional Allowance</strong> – promotional incentive in which a manufacturer agrees pay the re-seller a certain amount to cover the cost of special promotion displays or advertising.</td>
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<td><strong>Minimum Advertised Pricing</strong> – fees paid to retailers who agree not to advertise below set prices.</td>
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<td><strong>Rebates</strong> – refund of a portion of the purchase price, usually granted by the products manufacturer.</td>
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**Learning Objective 06**

**Special Topics in Pricing**

- **Competitive Bidding and Negotiated Pricing**
  - Competitive bidding is inviting potential suppliers to quote prices on proposed purchases or contracts.
  - Negotiated prices are where favoured or preferred suppliers are chosen and a contract is negotiated.

- **Transfer Pricing Dilemma**
  - Cost assessed when a product is moved from one profit centre in a firm to another.
  - Typical questions include what rate of profit one profit centre should transfer to another.
  - When this is done between profit centres across countries, exchange rate differences, fluctuations, tariff rates, and government regulations need to be considered.

- **Online Pricing Considerations**
  - Online bots (software program that allows online shoppers to compare price of a particular product offered by several online retailers) force marketers to keep prices low.

- **Cannibalization Dilemma**
  - Loss of sales of an existing product due to competition from a new product in the same line.
  - Offering lower prices for consumers who buy product online did cause some of these cannibalization effects.
  - Moves across standardized pricing across multiple shopping channels by retailers have minimized this.

- **Bundle Pricing**
  - Offering two or more complementary products and selling them for a single price.
  - Helps a marketer to recover fixed costs or make profits by incremental sales targeting a single customer.

**Learning Objective 07**

**Pricing and the Law**

- **Competition Act** – the most comprehensive legislation in Canada designed to help both consumers and business by promoting a healthy competitive environment.
  - The purpose of the act is:
    - Promote the efficiency and adaptability of the Canadian economy.
    - Expand opportunities for Canadian participation in world markets while recognizing the role of foreign competition in Canada.
    - Ensure small and medium size companies have an equitable opportunity to participate in the Canadian economy.
    - Provide consumers with competitive prices and product choices.
  - It focuses on the following pricing related practices attempting to protect consumers, other business from unfair business practices.

- **Price Discrimination** - Occurs when some customers pay more than others for the same product.
  - Marketers should justify cost differences associated with price differences.

- **Price Fixing** – a form of collusion in which sellers get together to collude to set prices higher than they would otherwise be in a free market. This is considered to be illegal.

- **Bid Ringing** – occurs when sellers get together and collude to set prices with respect to one or more requests for competitive proposals.

- **Predatory Pricing** – occurs when companies set prices below their cost for a sufficiently long period of time to discourage or eliminate competition and then raise their prices or otherwise interfere with competition.

- **Falls or Misleading Price Representations** – one form of misleading form of advertising.