Session Questions

1. How do consumers process and evaluate prices?

2. How should a company set prices initially for products or services?

3. How should a company adapt prices to meet varying circumstances and opportunities?

4. When should a company initiate a price change?

5. How should a company respond to a competitor’s price change?

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What is Pricing?

• It's the only one of the marketing mix components that produces revenue all the other elements produce costs.

• Price is also the easiest element of the marketing mix to adjust, and communicates the intended value of the offering.
Pricing

• Pricing takes various forms including: rent, fees, commissions, rates, salaries, fares etc.

• Price has for a long time operated as the major determinant of the buyers choice.

• As a marketing mix element price can be changed quickly unlike the other elements.
Holistic marketers take into account the company, their customers, the competition, and the marketing environment in determining prices.

• Pricing decisions must be consistent with:
  ✓ the firm’s marketing strategy.
  ✓ its target market.
  ✓ brand positioning.
Pricing

Forms

Price

Components

Functions

Ksh3150

Ksh3350

Bargaining
Pricing Environment Changes

Among Buyers

I’ll pay Ksh.2000

Instant Price Comparisons e.g.
Shopping Mall boards, FMCG retail stores

Get Products Free e.g. Open source software

Name Your Own Price – “more concious shoppers”
Changing Price Environment

Among Sellers

Ksh 15k  Ksh.20K  Ksh.30K

Selective Pricing

Negotiate Prices

Monitor Customers
How Companies Price

Product-line Managers

Small Business Owner

Pricing Department
How Companies Price

Effectively designing and implementing pricing strategies requires:

• In-depth understanding of consumer pricing psychology.
• A systematic approach to setting, adapting, and changing prices.

Purchase decisions are made based on customer psychology on the perceived prices in relation to the product/service quality.
Perception And Value

Purchase decisions are made based on customer psychology on the perceived prices in relation to the product/service quality. Factors influencing customer pricing perception include:

• prior purchase experience
• Formal marketing communication: above-the-line
• informal marketing communication: below-the-line
• Point of sale communication—Ksh 499/=, 49,999/=
Purchase decisions are based on how consumers perceive prices and what they consider the current actual price to be—*not* on the marketer’s stated price.

**Reference prices**

compare an observed price to an internal reference price they remember or an external frame of reference such as a posted “regular retail price.”

**Price-quality inferences**

use price as an indicator of quality. Image pricing is especially effective with ego-sensitive products such as perfumes, expensive cars, and designer clothing.

**Price endings**

Many sellers believe prices should end in an odd number. Customers see an item priced at Ksh 49,999 as being in the Ksh.40,000 rather than the Ksh. 50,000 range; they tend to process prices “left-to-right” rather than by rounding. Another explanation for the popularity of “9” endings is that they suggest a discount or bargain.
Consumer Psychology and Pricing

Price-Quality Inferences

Reference Prices

Ksh. 49,999

Price Endings
“Pair of Shoe” shows the large part consumer psychology plays in determining three different prices for essentially the same item.

- Gent
- Clarks – 15,000
- Mark & Spencer – 10,000
- Bata – 4,900
Pricing Approaches

• When a firm introduces a new product into the market it must set the price for its distribution channels

• The firm will decide where it wants to position its product on quality and price

Price- points
These are pricing strategies followed by companies while positioning use price-segments

Nine (9) price quality strategies are identifiable according to Kotler
## Price-Quality Strategies

<table>
<thead>
<tr>
<th>Price</th>
<th>High</th>
<th>Medium</th>
<th>Low</th>
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Price-Quality Strategies

<table>
<thead>
<tr>
<th>Quality</th>
<th>Price</th>
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<tbody>
<tr>
<td>H</td>
<td>1. PS</td>
</tr>
<tr>
<td>M</td>
<td>2. HVS</td>
</tr>
<tr>
<td>L</td>
<td>3. SVS</td>
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<td>H</td>
<td>4. OS</td>
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<td>M</td>
<td>5. MVS</td>
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<td>L</td>
<td>6. GVS</td>
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<tr>
<td>H</td>
<td>7. ROS</td>
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<tr>
<td>M</td>
<td>8. FES</td>
</tr>
<tr>
<td>L</td>
<td>9. ES</td>
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</tbody>
</table>

A Strategies – 1, 5, 9 can co-exist they serve 3 groups of buyers of a product/service.

Companies positioning on high quality; (1) Premium pricing
Companies positioning on a balance – (5) Medium pricing
Companies positioning on low price – (9) Economy pricing
Price-Quality Strategies

B. Pricing Strategies – 2,3,6 compete with firms following pricing strategies 1,5,9

Strategy 2 – positioning - we give same high quality but we charge
Strategy 3 – positioning - we offer super value but charge less.
Strategy 6 – positioning - we offer good value but charge less.
Price-Quality Strategies

C. Pricing Strategies – 4, 7, 8 Compete following the product in relation to the quality

Strategy 4 – positioning – offer same medium quality, we charge high.
Strategy 7 – positioning - we offer low quality but charge high.
Strategy 8 – positioning - we offer medium quality and medium price.

This pricing strategies sometimes overprice the products in relation to the quality and can adversely affect satisfaction and repeat business.
Pricing Policy - Setting the Price

A firm must consider these six factors in setting its pricing policy:

1. Pricing Objective
2. Determine Demand
3. Estimate Costs
4. Competitors
5. Price Method
6. Select Final Price

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1. Selecting the Pricing Objective(s)

- Survival
- Maximum Current Profit
- Maximum Market Share
- Maximum Market Skimming
- Product-Quality Leadership
Selecting the Pricing Objectives

The company decides where it wants to position its market offering. It can pursue any of the following objectives:

**Survival**: a short-run objective for firms to deal with overcapacity, intense competition, or changing consumer wants. The key strategy is lowering prices and giving away free goods and services e.g. Yu Mobile

**Maximize current profits**: emphasis current performance. Firms may sacrifice long-run performance by ignoring the effects of other marketing variables, competitors' reactions, and legal restraints on price.

**Maximum market share**: (uses a market-penetration pricing strategy), in which a higher sales volume will lead to lower unit costs and higher long-run profit.
Selecting the **Pricing Objectives**

*Maximum market skimming*: utilizes a market-skimming pricing strategy, in which prices start high and slowly dip over time. E.g., Celtel. This strategy can be fatal if competitors lower prices.

*Product Quality Leadership*: sets high prices to create high-quality perceptions. Characterized by high levels of perceived high quality, good taste, status goods, in vogue. Offers brands that are “affordable luxuries” – products or services characterized by high levels of perceived quality with a price just high enough not to be out of consumers’ reach. Products attract loyal customers. E.g., Land Rover.
2. Determining Demand

- Price sensitivity
- Estimating demand curves
- Price Elasticity of Demand
Determining Demand

Different prices lead to different demand levels. Demand curve captures the reactions of many individuals with different price sensitivities.

**Price Sensitivity – Price Elasticity**

*How responsive demand would be to changes in price.*

Customers are less price sensitive to low-cost items or items they buy infrequently.

They are also less price sensitive when:

a) there are few or no substitutes or competitors;
b) they do not readily notice the higher price;
c) they are slow to change their buying habits;
d) they think the higher prices are justified; and
e) price is only a small part of the total cost of obtaining, operating, and servicing the product over its lifetime.

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Determining Demand

The normally inverse relationship between price and demand is captured in a demand curve in the next slide. The higher the price, the lower the demand.
Inelastic and Elastic Demand

• Normally inverse relationship between price and demand

• The higher the price, the lower the demand.

• For prestige goods, the demand curve sometimes slopes upward.
3. Estimating Costs

Demand → Price Ceiling

Price

Profit

Costs

Price Floor
Estimating Costs

Demand sets the price ceiling while costs set the floor.

Costs include production, distribution, and selling expenses, plus a fair return (profit) to cover effort and risk. The company wants to charge a price that covers its cost of producing, distributing, and selling the product, including a fair return for its effort and risk.

Yet when companies price products to cover their full costs, profitability isn’t always the net result.
Estimating Costs

Types of costs

Fixed Costs (overhead) + Variable Costs = Total Costs
Estimating Costs

**Fixed costs**, also known as **overhead**, are costs that do not vary with production level 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; it equals total costs divided by production.

Management needs to know how its costs vary per unit with different levels of production.
Costs at Varying Levels of Production

(a) Cost Behavior in a Fixed-Size Plant

(b) Cost Behavior over Different-Size Plants
Accumulated Production

Experience curve/learning curve

refers to the decline in the average cost with accumulated production experience.
The Experience Curve

The curve shows average cost falls with accumulated production experience.
4. Analyzing Competitors’ Offers

- Price
- Costs
- Reaction

Worth to Customer

“A”
“B”
Analyzing Competitor 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 consideration.

If the firm’s 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.  
**i.e superior products will be charged higher**

If the competitor’s offer contains some features not offered by the firm, the firm should subtract their value from its own price.  
**i.e. inferior products will be priced lower than the competition.**

The firm can decide whether it can charge more, the same, or less than the competitor.  
**i.e. similar products will be priced closely**
Three Cs Model for Price Setting:

- the three major considerations in price setting.

Companies select a pricing method that includes **one or more** of these three considerations.
5. Selecting a Pricing Method

Having considered the 3Cs

- The **customers demand** schedule – set the ceiling price based on the customer assessment and perception of quality.
- **the costs** – set a floor to the costs.
- **competitor pricing** – together with substitutes set a orientation point

Prices fall between the price floor (costs) and price ceiling (customer demand based on their assessment of unique features). The price of competitive offerings and substitute goods serve as **an orientation point**.
Selecting a Pricing Method

Various pricing methods can be applied.

Pricing Methods

- Markup pricing
- Target-return
- Perceived-Value
- Value
- Going-rate
- Auction-type

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Selecting a Pricing Method

Having considered the 3Cs

• Mark-up Pricing – add a standard mark-up to the products cost

• Target Return Pricing - determines the price that would yield it targeted ROI

• Perceived Value Pricing – based on perceived customer value. Build perceived value through promotions
Markup Pricing

Basic method used to calculate price, used by construction companies, lawyers, and accountants. This method does not take into account current demand, perceived value, or competition.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
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<tbody>
<tr>
<td>Variable cost per toaster</td>
<td>$10</td>
</tr>
<tr>
<td>Fixed costs</td>
<td>$300,000</td>
</tr>
<tr>
<td>Expected unit sales</td>
<td>50,000</td>
</tr>
</tbody>
</table>

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

Markup price = \( \frac{\text{unit cost}}{(1 - \text{desired return on sales})} \) = \( \frac{$16}{1 - 0.2} \) = $20
In Target-return pricing, the firm determines the price that yields its target rate of return on investment.

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

\[
= 16 + \frac{0.20 \times 1,000,000}{50,000} = 20
\]
Perceived-Value Pricing

Customer’s perceived-value

- Performance Ksh
- Warranty Ksh
- Customer support Ksh.
- Reputation Ksh
Perceived-Value Pricing

Customer’s perceived value is determined by:

- the buyer’s image of the product performance,
- the channel deliverables,
- the warranty quality,
- customer support,
- softer attributes such as the supplier’s reputation, trustworthiness, and esteem.

Companies must deliver the value promised by their value proposition, and the customer must perceive this value.

Other firms use the other marketing program elements, such as advertising, sales force, and the Internet, to communicate and enhance perceived value in buyers’ minds.
Value Pricing

EDLP
THOUSANDS OF
LOW PRICES
EVERY DAY
throughout the store

Level of Quality

P 1  C1
P 2  C2

High Pricing
Low
Value Pricing

Value pricing is not just setting lower prices; it is a matter of reengineering the company’s operations to become a low-cost producer without sacrificing quality.

As shown in the previous slide, the company reduces costs from C1 to C2, while maintaining the same level of quality. Prices are reduced giving buyers greater value.

**EDLP** – Retailers that maintains an everyday low price policy charges a constant price with little or no price promotions and special sales. Consistent prices eliminates week-to-week price uncertainty.

Retailers adopt an EDLP as constant sales and promotions are costly and have eroded consumer confidence in everyday shelf prices.

**High-low pricing** is where the retailer charges higher prices on an everyday basis but runs frequent promotions with prices temporarily lower than the EDLP level.
Going-Rate Pricing

• Basing prices on competitor pricing

• Popular for commodities as maize, steel, paper, and fertilizer as all firms normally charge the same price. Small firms follow the leader, changing prices when the market leader prices change.
Auction Pricing

English auction
(ascending bids)

Dutch auction
(descending bids)

Sealed-bid auction
Auction Pricing

Auction-type pricing is growing more popular in the electronic marketplaces.

**English auctions (ascending bids)** have one seller and many buyers. e.g., eBay, Amazon.com.

**Dutch auctions (descending bids)** feature one seller and many buyers (an auctioneer announces a high price for a product and then slowly decreases the price until a bidder accepts), or one buyer and many sellers (the buyer announces something he or she wants to buy, and potential sellers compete to offer the lowest price).

**Sealed-bid auctions** let would-be suppliers submit only one bid; they cannot know the other bids. Common in most commonwealth countries and in the U.S. government which often uses this method to procure supplies.
7. Selecting the Final Price

In selecting the final price the company will consider:

- Psychological pricing
- Impact on other Parties
- Brand Quality
- Pricing Policies
- Gain-and-risk-sharing

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Selecting the Final Price

**Psychological pricing** – many customers use price as an indicator of quality

**Other marketing Mix elements** – brand equity and advertising relative to the competition. Are we positioned stronger

**Company pricing policy** – are we consistent with the company pricing policy?

**Impact on other parties** – distribution channel, competitors, suppliers government reactions to price changes

**Gain-and-risk-sharing pricing** – loss/gain of business to competitor and market share etc

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Adapting the Price

Geographic Pricing

Price Discounts and Allowances

Promotional Pricing

Differentiated Pricing
Adapting the Price

Several price-adaptation strategies companies usually use are:

- geographical pricing,
- price discounts and allowances,
- promotional pricing,
- differentiated pricing.

These strategies are adapted by companies because they rarely realize the same profit from each unit of a product that it sells due to variations in geographical demand and costs, market-segment requirements, purchase timing, order levels, delivery frequency, guarantees, service contracts, etc.

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Product-Mix Pricing

Product-mix pricing is necessitated if product demand and costs are interrelated and face different types of competition. Examples of product-mix include:

1. **Product Line Pricing**: many customers use price as an indicator of quality. Use price points i.e different price levels for the product lines.
2. **Optional-Features Pricing**: offer optional product features, add-ons and services together with the main product e.g. cars, restaurants, hotels
3. **Captive Product Pricing**: products requiring ancillary or captive products. Main product is low priced and ancillary product is highly priced e.g. Gillete razors, Pen refills, ink cartridges
4. **Two-Part Pricing**: consists of a fixed price and a usage price e.g monthly minimum charges for leases. Fixed cost should be low and main profits comes from usage billing.
5. **Product –Bundling Pricing**: bundling of product, service and features at a set price e.g. supply, delivery, installation and service equipment

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Promotional Pricing

Pricing Techniques to stimulate new product

1. **Loss Leader Pricing**; drop price to encourage more purchases especially of top brands

2. **Seasonal/Special events pricing**; establishing special prices in certain seasons e.g. BATA back to school

3. **Cash Rebates**; special offers of certain products over a short period

4. **Warranties and service contracts**; companies offer free or low cost warranties to stimulate demand.

5. **Psychological discounting**; set an artificial high price and then lower it e.g 499/= now 399/= 

These strategies are easily copied and can be money loser.
Dealing with Price Changes

Raising Prices

Cutting Prices

Competitor Moves
Competitor Price Changes

How should a company respond?
When a competitor changes prices key questions to ask?

i. Why did the competitor change the price-market share, utilize excess capacity, lead industry change?
ii. Does the competitor plan to make the price changes temporary or permanent?
iii. How will this price change affect the company market share and profitability if it does not respond? And are other industry players going to respond?
iv. What are the competitor and other firms going to respond?

Possible responses by industry/brand leaders:
i. Enhance augmented products e.g M-shwari.
ii. Differentiate the offering
iii. Introduce low cost brands to compete with the low cost brand e.g EABL