Leadership, Attitude, Performance ...making learning pay!

Pricing LAP 2 Performance Indicator: PI:001

The Price Is Right

Nature of Pricing

What makes it right?

Its many names

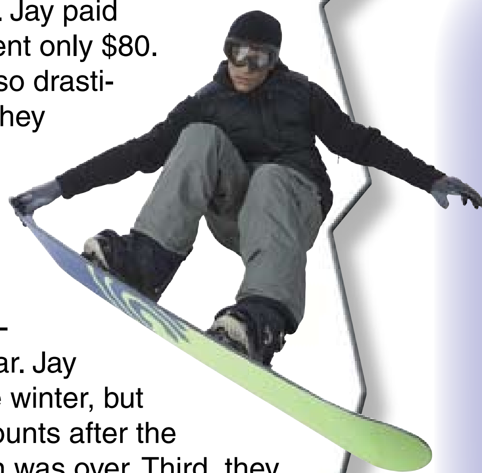
Mixing it up with the 4 Ps

Objective A

So What?

Pick a Price, Any Price

Jay and his friend Paolo both bought new snowboards this year. Jay paid $400, while Paolo spent only $80. Why were the prices so drastically different? First, they bought two different brands. Jay's is a premium Burton board, and Paolo's is an off-brand. Second, they bought at two different times of the year. Jay purchased just before winter, but Paolo waited for discounts after the snowboarding season was over. Third, they bought at different places. Paolo bought his board at a local store, but Jay special-ordered his online and had it shipped.



As you can see, pricing products isn't always a straightforward task for marketers. It is, however, a very important one. If you plan to pursue a career in business or marketing, you must be thoroughly familiar with the function of pricing and its effect on the marketing mix. Read on to learn more!

Objectives:

- A Describe the pricing function.
- B Explain the role of pricing in marketing.

What is pricing?

Pricing is a marketing function that involves the determination of an exchange price at which the buyer and seller perceive optimum value for a good or service. Effective pricing is important for customer satisfaction and for the continued success of a business. Pricing isn't as simple as just placing a tag on an item that tells customers how much they owe. Let's explore the definition a little further:

Determining an exchange price. When a good or service is sold, the buyers and sellers have agreed on a value for the product. That initial value is usually stated as a monetary amount, such as $39.99. At this point, the buyer has decided that s/he is willing and able to pay that amount of money to obtain the product, while the seller has decided that s/he will accept that amount as payment. This amount of money is known as the **exchange price**. Before sellers can set this exchange price, they must consider a number of factors.

Perceiving optimum value. Buyers and sellers must feel that they are receiving the most, or optimum, value from the product. When you buy something, you want to make sure that it is the best purchase you can make for your money. After all, when you spend your money on one product, you will no longer have it available to buy something else. Likewise, sellers want to feel that they are selling their products at the best price—the highest price that will still attract the most buyers. The price that the seller sets will affect the number of sales and the amount of income that the company will make.

Think about that for a minute. Pricing is really like a tug-of-war between the buyers and the sellers. Both are trying to get the most value from the good or service. Naturally, buyers want low prices, while sellers want high prices. The trick to pricing comes in balancing and satisfying both groups. Both buyers and sellers need to perceive that they are getting the best possible value they can. If this doesn't happen, several things might occur:

- Customers will spend their money elsewhere, either on a similar product (if one is available) or on an entirely different product.
- A business's sales will decline. The business will be forced to discontinue offering the product or to change its prices.

Effective pricing, therefore, is important for both customer satisfaction and the continued success of the business.

Characteristics of effective pricing

No single factor makes an effective price. Marketers must keep a number of characteristics in mind when setting effective prices. These include being realistic, flexible, and competitive.

Realistic prices. Believe it or not, prices can be set too low! Many businesses have found that if their prices are not what customers expect to pay, even if that price is lower than expected, customers will not buy. When these businesses increased their prices, their sales actually increased as well. Why would this happen? Customers associate price with quality—if the price is high, the quality is high; if the price is low, the quality is low. So, businesses must set prices that are realistic to customers—neither too high nor too low.

Flexible prices. Marketers must understand that the prices they set are written on paper—not in stone. Because pricing is a tug-of-war and a constant quest for balance, businesses must be willing to adjust their prices as necessary. These adjustments may be increases or decreases, depending on the circumstances the business faces. For example, during bad economic times, customers are quite cautious about how they spend their money. To attract these customers, businesses may need to lower prices. However, when economic conditions are good, businesses might increase prices because customers are less cautious with their spending.

Competitive prices. Would you pay $4.00 for a can of Pepsi? Under normal circumstances, probably not. You would know that you could get the same product for a much lower price at another store. When a similar product is offered by competitors, a business needs to be aware of the prices others are charging. If not, the business will probably lose customers because its prices are not competitive.

Prices must also be flexible when it comes to discounts, sales, markdowns, etc. Nearly all businesses lower prices from time to time in an attempt to sell more products and attract more customers. Marketers must stay on their toes to keep prices in line with current promotions and sales.

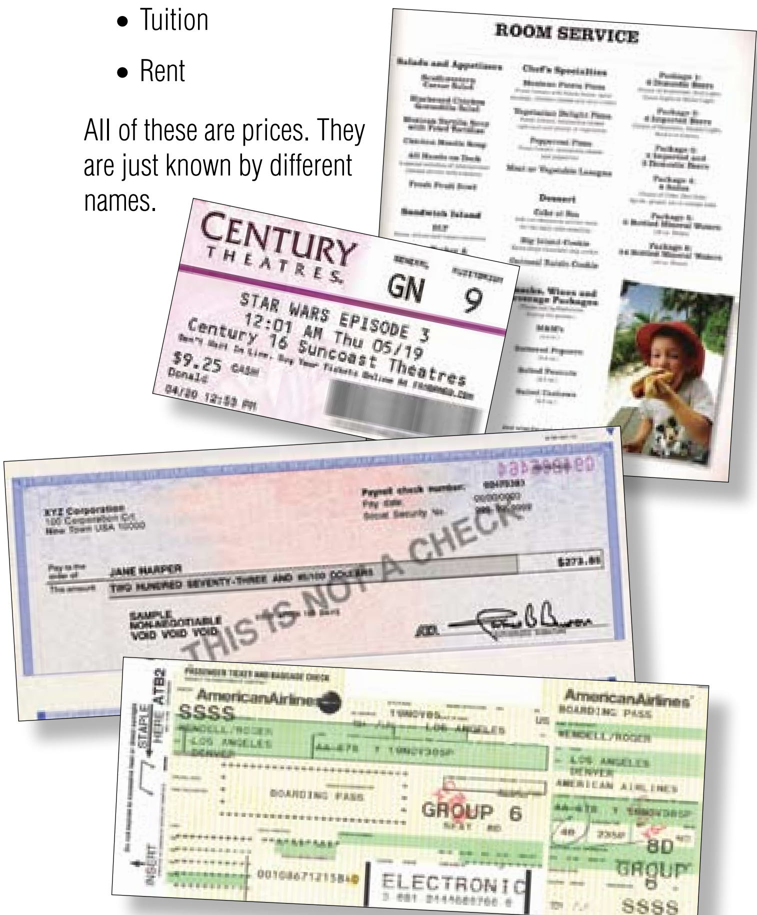
Objective A

Pricing goods and services

Quickly, think of five things that have prices attached to them. What did you come up with? Did you name only physical goods, such as cars, houses, or clothes? Actually, prices are attached to anything of value for which we are willing to make a money exchange. They are associated with such things as:

- A loan from a bank (interest)
- The work that you do (wages/salary)
- A lawyer's services (legal fees)
- Membership in a professional organization (dues)
- An airline or bus ticket (fare)
- A movie or theater ticket (admission)
- Service charge for room service
- Tuition
- Rent

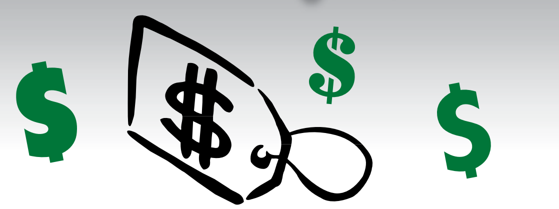
All of these are prices. They are just known by different names.



But, what is actually being priced? In the case of a car, it's not just the car itself. The price includes the car and all of the associated services—transportation and delivery charges, credit, etc. This makes pricing more difficult because marketers must look beyond the cost of the immediate product to consider its associated services.

Another important part of the pricing process is communicating prices to customers and clients. Not all prices can be conveyed using a tag or a sticker. Prices can also be communicated through catalogs, price sheets, web sites, and salespeople.

The Gray Zone



Predatory pricing is the practice of selling a product at a very low price in an attempt to drive competitors out of the market. In many countries, including the United States, this practice is illegal. However, some people, even economists, consider the concept of predatory pricing to be a myth—they believe it is nothing but fair competition. They claim that in a private enterprise system, businesses should be allowed to price their products as low as they want to. If businesses price their products irrationally low, then they are only hurting themselves and will soon be out of business. What do you think? Should predatory pricing be illegal? Even if it were legal, would it be ethical?

Who sets prices?

Depending on the size of the business, many people may be involved in establishing prices. In a smaller business, the person most often responsible for setting prices is the manager or owner. This person will check competitors' prices and use the company's own records to establish prices for the goods and services the business offers.

In larger companies, an entire department (part of marketing) is usually responsible for setting prices for the company. The department may use more sophisticated means to determine prices for the company's products. It may analyze market research, conduct customer surveys, study competitors' prices, and analyze current and past sales records and trends to help with pricing decisions.

Factors that affect prices

When working with prices, you'll need to know that many factors, both internal and external, affect the final price decision. These include important influences, such as the following:

- Costs
- Supply and demand
- Economic conditions
- Competition
- Government regulations
- Channel members
- Company objectives and strategies

Each of these factors is discussed in detail in a separate LAP.

Summary

Pricing is a marketing function that involves the determination of an exchange price at which the buyer and seller perceive optimum value for a good or service. Effective pricing is important for customer satisfaction and for the continued success of a business. Pricing is like a tug-of-war between buyers and sellers. Effective prices are realistic, flexible, and competitive. Prices go by many different names, including fees, dues, and admission. Many factors affect the final price decision, such as costs, economic conditions, and company objectives and strategies.

1. What is pricing?
2. Why is pricing important?
3. What are the characteristics of effective pricing?
4. Who sets prices?
5. What factors affect prices?

Objective B

How Pricing Affects the Marketing Mix

Pricing plays a key role in the **marketing mix** (product, price, place, and promotion). The elements of the marketing mix are interdependent because a change in one will affect the others. Let's look at how pricing affects the other "Ps."

Product

Product decisions involve determining what goods, services, or ideas to produce or sell that will satisfy customers' needs and wants. Pricing affects product decisions in the following ways:

Research. Pricing affects the type of research conducted, the length of the research project, and the amount of money spent on research. Research costs money. If a company wants to introduce a new, low-priced laundry detergent, it cannot afford to spend millions of dollars on research. Instead, the company will probably choose a less expensive method of research and may spend only three to six months conducting it.

Materials used in production. Which costs more—a silver ring or a platinum ring? The quality of materials used in production is reflected in the product's price. Companies, therefore, must decide what materials to use in the production of their products. If they want to charge lower prices, they may not be able to use more expensive materials. Can you think of more examples of similar products with prices that vary due to the materials used?

Profit decisions. Just because a good or service looks great on paper, it doesn't mean that the good or service will ever hit the market. Companies must first determine if there is a market for the product and if there will be sufficient demand for it. Before introducing a new product, a company must first determine if it will be profitable. Companies must ask the following questions:

- Can we make a profit by selling this product?
- Can we achieve the return on investment we want?
- Can we set our prices high enough to answer the first two questions with a YES?

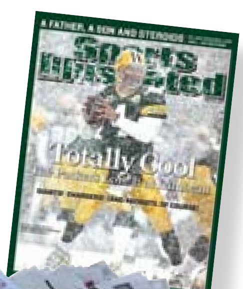
Customer decisions. Different companies seek to attract different types of customers. Low prices attract customers who are looking for bargains, while high prices attract customers looking for prestige and high quality. A company's pricing strategies will determine the type of customers its products attract.

Company image. What type of image does a company want to project? Pricing will help determine that image. Stores that have low prices are thought of as discount stores. Consider retailers such as Wal-Mart or a dollar store. On the other hand, stores with very high prices usually are perceived as having more prestigious name brands and higher quality products. Can you think of any stores like this in your area?

Promotion

Promotion involves the various types of communications that marketers use to inform, persuade, or remind customers of their products. Pricing affects promotion decisions in the following ways:

Choice of medium. Products with very low profit margins are usually promoted in lower priced media. Radio, which is relatively inexpensive compared to other media, is used quite often by companies that have small profit margins or do not have a large promotion budget. Products that have high profit margins are usually promoted in a combination of media, including radio, television, newspapers, and magazines. Also, the bigger the advertisement, the higher its cost. A one-page ad in your local newspaper will cost more than a two-column or a ¼-page ad. A 10-second television commercial costs less than a 30- or 60-second commercial.



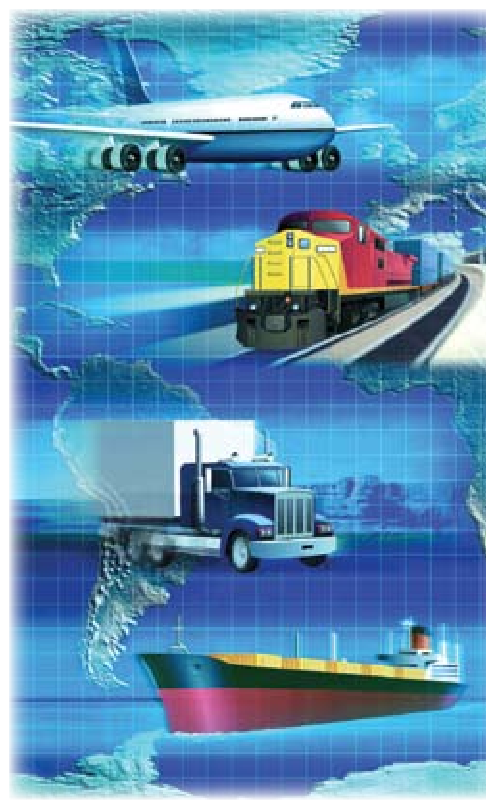
The amount of money spent. Most companies have promotional budgets. The amount of money spent on an advertising campaign is built into the cost of the product. The higher the promotional budget for a good or service, the higher the price of the good or service for customers.

Time allocated to the promotion. Since the cost of promotion is built into the cost of the product, goods and services tend to cost more when they are promoted over a long period of time. Products that are promoted through displays, television, and radio over a six-month period will probably be priced higher than products that are promoted for only one month.

Place

Place involves shipping, handling, and storing products and determining when and where they will be available. Pricing affects place decisions in the following ways:

Choice of transportation channels. There are a variety of ways that companies can ship their products to their final destinations. Trucks, planes, trains, and ships are all used to transport products across town, across the country, and across the globe. The cost of each type of transportation varies. Companies will choose the method that fits within their budget. Again, remember that the cost of the transportation will be built into the price of the product. For example, trucking is less expensive than flying, so an item transported by truck may be less expensive than one transported by plane (think about the cost of goods in remote areas such as Hawaii). Marketers must also consider time when it comes to distribution channels—one channel may be cheaper but might take longer for products to get to their destinations. This factor will have an impact on pricing decisions.



Price

Pricing is a unique element of the marketing mix because it is the most *adjustable* of the four "Ps." This means that pricing decisions can be changed much more quickly than decisions about product, place, or promotion.

Where the product is offered. A product's price affects where it is sold. Goods and services with high prices will be carried by stores that sell higher priced items. If a product is priced inexpensively, it will sell at a different type of store. Take haircuts for example. A $100 haircut is a service you will most likely find at a fine salon or day spa. A $10 haircut is a service you will most likely find at a discount salon.

Pricing objectives

Each company wants or needs something unique from its pricing strategies. These **pricing objectives** or goals are the guiding influences in how marketers go about making pricing decisions. There are a number of different types of pricing objectives that companies have. They may relate to profitability—making as much profit as possible or simply covering costs. They may relate to sales—selling as many units as possible or gaining a certain market share. Objectives may also relate to the competition—keeping prices competitive is very important in many industries, such as the airline industry. Lastly, pricing objectives may relate to image or prestige. Companies may set prices that will help them maintain a certain image in customers' minds—think about luxury cars or jewelry. Companies may use any combination of these pricing objectives when setting prices for goods or services.

Summary

Pricing plays a key role in the marketing mix (product, price, place, and promotion). The elements of the marketing mix are interdependent because a change in one will affect the others. Pricing affects product decisions in terms of research, materials used in production, profit decisions, customer decisions, and company image. It affects promotion decisions in terms of choice of medium, amount of money spent, and time allocated to promotion. It affects place decisions in terms of choice of transportation channels and where products are offered. Companies keep a variety of pricing objectives in mind when making pricing decisions. These goals greatly influence final price decisions.

1. How does pricing affect product decisions?
2. How does pricing affect promotion decisions?
3. How does pricing affect place decisions?
4. Describe pricing objectives.

Make It Pay!

How much did you pay for your most recent pair of jeans? How do you think the final purchase price was set? What factors contributed to the amount you paid?
Consider:

- The prices of competing brands
- The prices of competing stores
- How the jeans have been promoted
- The availability of the jeans in your area
- The type of store at which you purchased them

Discuss your thoughts with the class.