

CHAPTER 6  
**Strategic Pricing Methods**  
CLASS NOTES

OBJECTIVES—

- Identify three methods that firms use to set their prices.
- EDLP versus a high/low strategy
- How do consumers process and evaluate prices?
- Market penetration and market skimming
- How should a company adapt prices to meet varying circumstances and opportunities?

**I. Price, the second "P"—** it is the sum of all the values that consumers exchange for benefits of having the product/service.

- It has been the major factor affecting buyer choice.
- But nonprice factors have become increasingly important due to the increasing affluence of developed economies.
- Price is the only element in the marketing mix that produces revenues as the other represent costs, thus it is **CRITICAL** to understand thoroughly.
- Common pricing mistakes:
  1. Too cost-oriented rather than customer value-oriented.
  2. Not revised often enough to reflect market changes.
  3. Not taking the other 3 "Ps" into consideration.
  4. Not varied enough for different products (in the mix), market segments, or purchase occasions.

**II. Considerations for setting pricing strategies**

1. Cost-based methods
2. Competitor-based methods
3. **Value-based methods**

**III. Factors affecting pricing decisions**

**A. Step 1:** Selecting the pricing objective - internal factors

1. Organizational considerations; who should set the price???
2. Marketing Objectives; such as, Survival, Current Profit Maximization, Market Share Leadership, or Product Quality Leadership.
3. Marketing Mix Strategy; customers typically seek products that provide the best value in terms of benefits received.
  - $\text{Value} = \text{Benefits} / \text{Price}$
4. Market-skimming: setting a high price to "skim" maximum revenues from the target market, however probably will result in fewer, but more profitable, sales.
  - Product's quality and image must support the higher price.
  - Costs must be reasonable.
  - Market entry for competitor(s) should be limited.
5. Market-penetration: setting a lower price to "penetrate" the market quickly and deeply.
  - Market should be highly price sensitive so a low price produces rapid market growth.
  - Experience curve attributes must be operable.
  - Competition must be kept to a minimum.

## B. Step 2 – Determining demand - external factors

1. Reference price – how is this “set”?
2. Price-Quality inference – how does pricing affect value perception?
3. Nature of the market and demand; generally set the upper limit for pricing considerations.
  - Demand curve— How is the curve determined? Effective pricing requires understanding of how much value a consumer places on benefits received.
  - Price sensitivity is low when:
    - Product is high in quality, prestige, or exclusiveness.
    - Substitutes are hard to find.
    - Product price is low compared to consumer's income.
  - Price sensitivity has intensified, therefore marketers must differentiate:
    - Deregulation.
    - Internet.
4. Environmental factors
5. Summary: somewhere between product costs and market demand - tempered by consumers' perception of value.

## III. Step 3 – Estimating costs

1. Cost-Based pricing— adding a standard markup to product cost.
  - Simplest pricing method.
  - Ignores current demand and competition.
  - Much fairer to buyers and sellers???
2. Costs; generally set the floor for pricing considerations.
  - Fixed Costs + Variable Costs = Total Costs
  - Experience Curve; which way does it flow? Is it a great strategy? (Figure 6.4)

## IV. Step 5 – Selecting a pricing method

**Unit Cost** = variable cost + fixed costs / unit sales

**Markup Price** = Unit Cost / (1 – desired return on sales price)

(Markup pricing truly works only if the expected level of sales is reached.)

Or you can use this formula as explained in handout:  $COST + (\%) \text{ BASE} = \text{SELLING PRICE}$

Break-even analysis **Break-even volume** = fixed costs / price – variable cost/unit

1. Value-based pricing— uses buyer's perceptions of value as the key to pricing.
  - Cost-based: based on product considerations ending with the customer.
  - Valued-based: begins with the customer and ends with the product.
  - Marketer should continually strive for “More for Less.”
  - EDLP: what does it mean to the consumer?
  - High/Low strategy – promotion drives demand for both less price sensitive (high) and bargain consumers (low)
2. Competition-based pricing/going-rate —price represents the collective wisdom of the industry concerning the price when the demand elasticity is difficult to measure.

## V. Ethical considerations in pricing

- Deceptive/ illegal price advertising
- Predatory pricing
- Price discrimination
- Price fixing

## MARKUP CONSIDERATIONS

### Chapter 6

Using the cost-based approach, what is the unit total cost given the following:

Variable cost: \$15.25; Fixed cost: \$125,000; expected sales in units: 25,000.

What is the breakeven volume for a product given: fixed costs: \$5,000; variable cost per unit: \$2.10; Selling price per unit: \$8.25.

What is the breakeven volume for a product given: fixed costs: \$1,200,000; variable cost per unit: \$35.73; selling price per unit: \$70.00.

The marketing team of *Midnight Snack Restaurant* reduced the price of their special triple-decker with double cheese Gut Bomb from \$4.35 to \$3.75 in the hopes of stimulating sales during the month of March. The total fixed costs of *Midnight Snack* were increased to \$5,700 for the month due to the addition of the promotion of the special. The variable costs of the Gut Bomb remained the same at \$1.47.

1. How many Gut Bomb specials must be sold during March to breakeven with this new program?
  - A. 1311
  - B. 1520
  - C. 1980
  - D. 2500
  - E. 3876
2. What dollar profit would Midnight Snack Restaurant achieve if 2350 Gut Bombs were sold during March?
  - A. \$1068 PROFIT
  - B. \$1068 LOSS
  - C. \$342 PROFIT
  - D. \$342 LOSS
  - E. This would be a total disaster
3. What is the average total cost per unit at breakeven?
  - A. \$1.47
  - B. \$3.75
  - C. \$4.35
  - D. \$5.22
  - E. Cannot calculate it.