Chapter 12
Developing Pricing Strategies and Programs

Chapter Questions
• How do consumers process and evaluate prices?
• How should a company set prices initially for its offerings?
• How should a company adapt prices to meet varying circumstances and opportunities?
• How should a company initiate a price change and respond to a competitor’s price change?

Price Has Many Names
• Rent
• Tuition
• Fare
• Monthly payment
• Fee
• Dues
• Interest
• Donation
Consumer Psychology and Pricing
- Reference prices
- Price-quality inferences
- Price cues (left to right)

Steps in Setting Price Policy
1. Select the pricing objective
2. Determine demand
3. Estimate costs
4. Analyze competitors’ costs, prices, and offers
5. Select a pricing method
6. Select the final price

Setting the Price

Figure 12.2: The Three Cs Model for Price Setting

<table>
<thead>
<tr>
<th>High Price (the possible demand at this price)</th>
<th>Low Price (the possible profit at this price)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customers’ assessment of unique product features</td>
<td>Competitors’ prices and prices of substitutes</td>
</tr>
<tr>
<td>Costs</td>
<td>Costs</td>
</tr>
</tbody>
</table>
Step 2: Determining Demand

- Price sensitivity
- Estimating demand curves
  - Survey consumers
  - Set different prices in similar territories
  - Statistical analysis of past prices, quantities sold, and other factors
- Price elasticity of demand
  - Inelastic—small change in demand with small change in price.
  - Elastic—considerable change in demand with small change in price.

Conditions Under Which Consumers are Less Price Sensitive:

- Product is more distinctive
- Buyers are less aware of substitutes
- Buyers cannot easily compare quality of substitutes
- The expenditure is small compared to the total cost
- Part of the cost is borne by another party
- The product is used with assets previously bought
- The product is assumed to have more quality, prestige, or exclusiveness

Step 3: Estimating Costs

- Types of costs:
  - Fixed costs—don’t vary with production or sales revenue.
  - Variable costs—vary directly with the level of production.
  - Total costs—sum of the fixed and variable costs.
  - Average cost—cost per unit at that level of production; equals total cost divided by production.
- Experience curve (or learning curve)—decline in average cost with accumulated production experience.
- Target costing—establish a new product’s desired functions, the price at which it will sell, and the desired profit margin.
Step 4: Analyzing Competitors' Costs, Prices, and Offers

- Does the firm offer features not offered by competitors?
- Given this point of comparison, should the price be higher, lower, or the same?
- Are we a market leader/challenger?
- Is the product new to the market/consumers?

Step 5: Price-Setting Methods

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

Step 6: Selecting the Final Price

- Factors to consider:
  - Impact of other marketing activities
  - Company pricing policies (pricing model of credit card companies)
  - Gain-and-risk sharing pricing
  - Impact of price on other parties
Price-Adaptation Strategies

- Geographical pricing (Barter, Compensation deal, Buyback arrangement, Offset)
- Price discounts and allowances (Cash, Quantity, Functional, Seasonal)
- Promotional pricing (Loss-leader pricing, Special-event pricing, Cash rebates, Low-interest financing, Longer payment terms, Warranties and service contracts, Psychological discounting)
- Differential pricing (customer-segment, product-form, image, channel, location, time)

Initiating Price Cut: Dangers

- Customers assume quality is low.
- A low price buys market share but not loyalty.
- Higher-priced competitors match the lower prices but have longer staying power because of deeper cash reserves.
- Trigger a price war.

Increasing Prices

- Delayed quotation pricing
- Escalator clauses
- Unbundling
- Reduction of discounts