Lecture 9

- Understanding Price
- Pricing Policy
- Setting the price
- Selecting the Pricing Objective
- Adapting the price

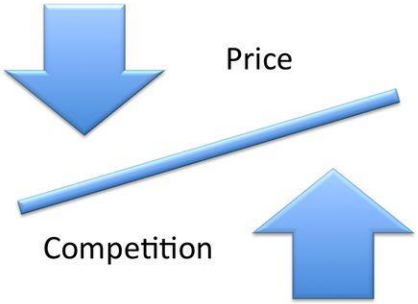
Understanding Price

Traditionally, price has operated as the major determinant of buyer choice. This is still the case in poorer nations, among poorer groups, and with commodity-type products. Although non-price factors have become more important in recent decades, *price still remains one of the most important elements determining market share and profitability.*

Consumers and purchasing agents have today more access to price information and price discounters. However, the pressures within the value chain are more powerful:

- consumers put pressure on retailers to lower their prices…
- retailers put pressure on manufacturers to lower their prices…

….the result is a marketplace characterized by heavy discounting and sales promotion



Pricing Policy

Active marketing in several countries compounds the number of pricing problems and variables relating to price policy.

The country in which business is being conducted, the type of product, variations in competitive conditions, and other factors affect pricing activity.

The more control a company has over the final selling price of a product, the better it is able to achieve its marketing goals.

However, controlling end prices is not always possible: ***the broader the product line and the larger the number of countries involved, the more complex the process of controlling prices to the end user.***

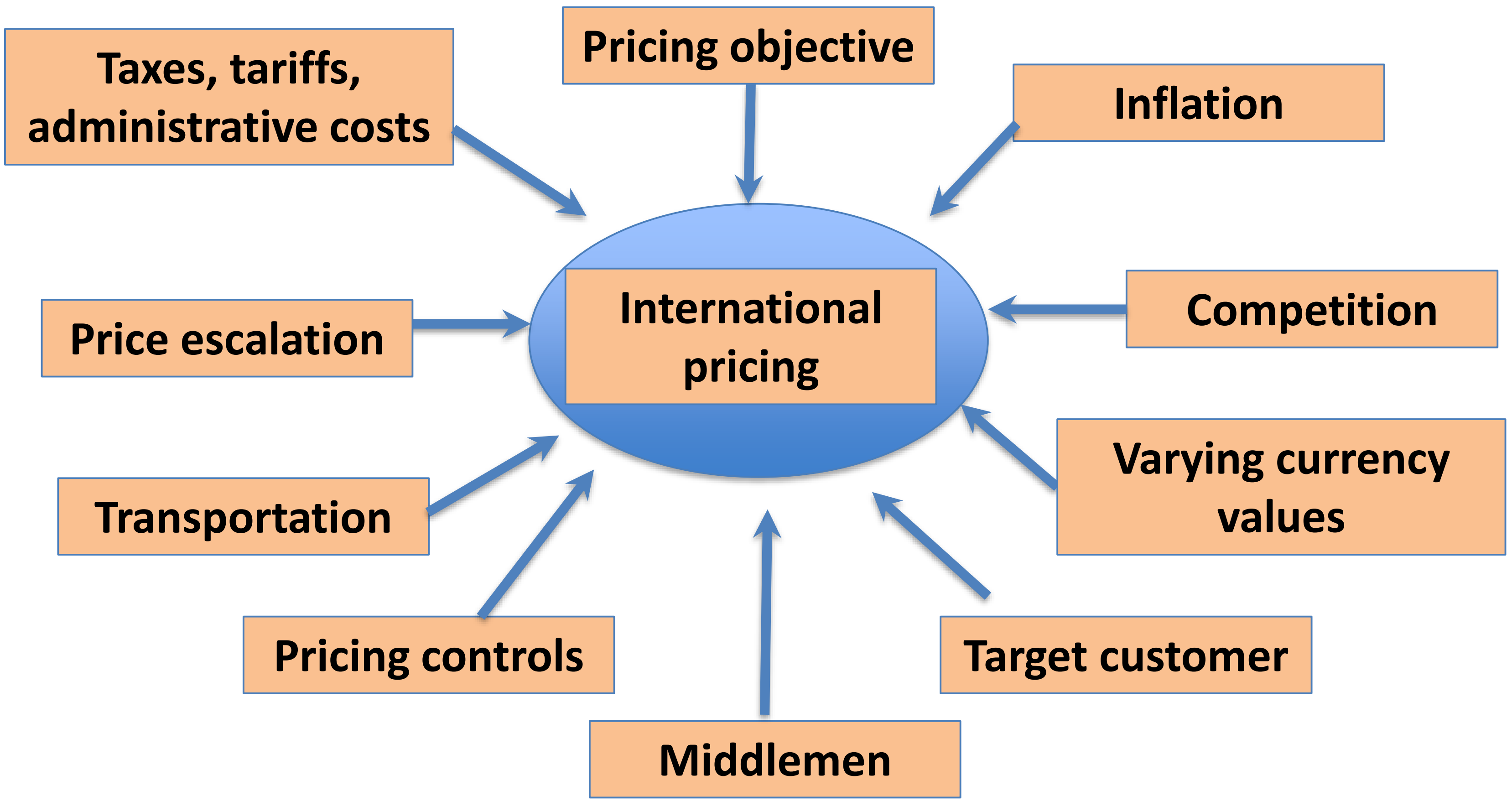
Role of Pricing

Price decisions are viewed in two ways:

- Pricing as an *active instrument* of accomplishing marketing objective – the company *sets* prices rather than *following* market prices to achieve its goals (e.g. returns on profit and market share).

- Pricing as a *static element* in a business decision – company exports only excess inventory, places a low priority on foreign business, and views its export sales as passive contribution to sales volume.

Factors influencing international pricing



Setting the price

A firm must set a price for the first time when it develops a new product and when it introduces its regular product into a new distribution channel or geographical area. The firm must decide where to position its product on quality and price.

There is a six-steps procedure to set pricing policy:

1. Selecting the pricing objective
2. Determining demand
3. Estimating costs
4. Analysing competitors' costs, prices, and offers
5. Selecting a pricing method
6. Selecting the final price

Selecting the Pricing Objective (I)

Which are the objectives that the company wants to pursue through pricing?

A. **SURVIVAL** – *as long as price covers variable costs and some fixed costs, the company survives* (this objective is chosen in case of company's overcapacity, intense competition, changing consumer wants).

B. **PRODUCT-QUALITY LEADERSHIP** – *a company might aim to be the product-quality leader in the market*, in creating "affordable luxuries", which are products or services characterized by high levels of perceived quality, taste, and status with a price just high enough not to be out of consumers' reach (e.g. Starbucks coffee, Victoria's Secret lingerie, and BMW cars are leaders in their categories, combining quality, luxury, and premium prices with an intensely loyal customer base).

Selecting the Pricing Objective (II)

C. **MAXIMUM MARKET SHARE** – some companies want to *maximize* their *market share*; they believe that higher sales volume will lead to lower costs and higher long-run profit.

D. **MAXIMUM CURRENT PROFIT** – *the firm estimates demand and costs and chooses the price that produces maximum profit, cash flow or rate return on investment* (it may sacrifice long-run performance).

E. **MAXIMUM MARKET SKIMMING** – companies offer new technologies, innovative products or services and set high prices to *maximize market skimming* (e.g. luxury clothes brands).

How to approach the market through Pricing

MAXIMUM MARKET SHARE

MARKET PENETRATION PRICING STRATEGY

- the market is price sensitive and low price stimulates market growth
- production and distribution costs fall with accumulated production experience
- low price discourages actual and potential competition (e.g. Wal-Mart)

MAXIMUM MARKET SKIMMING

MARKET-SKIMMING PRICING STRATEGY

- sufficient number of buyers have a high current demand
- the unit costs of producing a small volume are not so high that they cancel the advantage of future price reduction
- the high initial price does not attract more competitors to the market
- the high price communicates the image of a superior product

Demand and price

Each price will lead to a different level of demand and therefore have a different impact on a company's marketing objectives. In the normal case, demand and price are inversely related: the higher the price, the lower the demand. However, the demand curve sometimes grows with an increasing price, such as in the case of prestige goods.

PRICE SENSITIVITY – *the demand curve shows the market's probable purchase quantity at alternative prices.* Companies need to understand the price sensitivity of their customers and prospects and the trade-off people are willing to make between price and product characteristics.

ESTIMATING DEMAND CURVES – in measuring the price-demand relationship, the market researcher must *control for various factors that will influence demand* (tools: statistical analysis of past prices, quantities sold, price experiments, and surveys).

PRICE ELASTICITY OF DEMAND – marketers need to know how responsive, or *elastic*, demand would be a change in price (*if demand changes considerably, demand is elastic)*

Costs and price

Demand represents a *ceiling* on the price the company can charge for its product. Costs set the *floor*. The company wants to charge a price that covers its costs of *producing distributing and selling plus a fair return for its effort and risk*.

There are several methods to estimate costs, for example:

TYPES OF COSTS AND LEVELS OF PRODUCTION – management needs to know how its costs vary with different levels of production

- <u>variable-cost pricing</u>: the concern is about the marginal or incremental cost of producing goods to be sold in overseas markets; used when a company has high fixed costs and unused production capacity
- <u>full-cost pricing</u>: the focus in on fixed costs; suitable when a company has high variable costs relative to its fixed costs; the price is set on total costs plus a profit margin

ACCUMULATED PRODUCTION – the experience in producing allows to reduce costs (*experience curve* or *learning curve*)

Analyzing Competitors and Selecting a pricing method

The firm should first consider the nearest competitor's and decides whether it can charge more, the same, or less than the competitor. But competitors can change their price in reaction to the price set by the firm (*interdependent actions*).

Given the customers' demand, the cost function, and competitors' prices, the company is ready to select a price through different pricing methods.

(e.g. the *mark-up pricing* which implies the increasing of a standard mark-up to the product's cost; *perceived-value pricing* where the firm bases its price on the customer's perceived and must deliver the value promised by their value proposition, and the customer must perceive this value)

Adapting the price (I)

Companies usually do not set a single price, but rather a pricing structure that reflects *variations* in geographical demand and costs, market-segment requirements, purchase timing, order levels, delivery frequency, guarantees, service contracts, and other factors.

Pricing strategy takes into account some elements like:

GEOGRAPHICAL AREA

PROMOTIONAL INITIATIVES

BEHAVIOURAL ATTITUDE

Geographical pricing

The company decides how to price its products to different customers in different locations and countries.

The COUNTERTRADE is a pricing tool that every international marketer must be ready to employ. There are different types of countertrade:

- **barter** – direct *exchange* of goods, with no money and no third party involved
- **compensation deal** – the seller receives some percentage of the payment in *cash* and the rest in *products*
- **buyback arrangements** – the seller sells the plant, equipment, or technology to another country and agrees to accept as partial payment *products* manufactured with the supplied equipment (e.g. in the chemical industry)
- **offset** – the seller receives full payment in *cash* but agrees to spend a substantial amount of the money in that country within a stated time period

Promotional pricing

Price is used to attract customers and persuade them to buy the product.

There are several techniques to stimulate purchase:

- **Loss-leader pricing** – supermarkets and department stores often drop the price on well-know brands to *stimulate additional store traffic*
- **Special-event pricing** – sellers establish special price in certain *seasons* to draw in more customers
- **Low-interest financing** – instead of cutting price, the company can offer customers *low-interest financing* (e.g. automakers)
- **Warranties and service contracts** – companies can promote sales by adding a free or low-cost *warranty* or *service* contract
- **Psychological discounting** – to set an *artificially high price* and then offer the product at substantial savings (“was $ 359, now $ 299”)

Behavior and attitude in pricing strategy

DIFFERENTIATED PRICE – companies adjust their price to accommodate differences in customers:

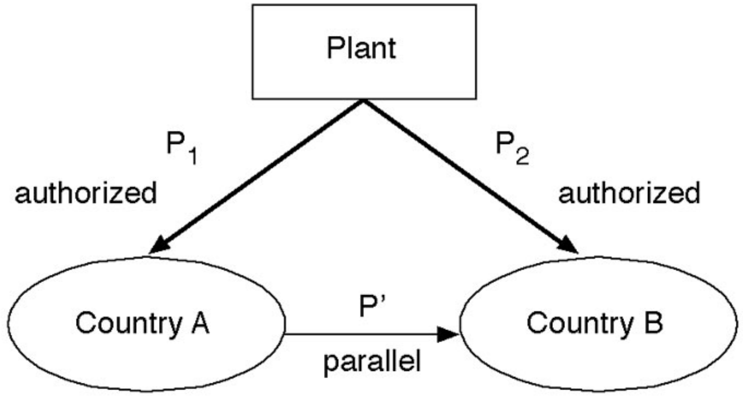
- **customer-segment pricing** – price responds to different customer needs in term of spending power and attitude to purchase
- **channel pricing** – price is adapted to specific distribution and intermediaries (e.g. Coca-Cola in a bar or in a fine restaurant)
- **time pricing** – price is adjusted to time and particular environmental conditions (e.g. variability by season, day, hour; rates' hotels during weekends)

Parallel imports ("*gray market*")

Besides having to meet price competition country by country and product by product, companies have to guard against competition form *within* the company and their own customers. Products realized by different brunches or subsidiaries can be in competition among them.

Since price differ market by market, a product sold in one country may be exported to another and undercut the prices charged in that country (*parallel imports*).

These parallel imports develop when importers buy a product from distributors in one country and sell them in another to distributors who are not part of the manufacturer's regular distribution system.



Dumping

It is a controversial practice differently defined by various economists:

a. An international shipping is dumped if the products are sold below their cost production

b. Dumping as a selling products in a foreign market below the price of the same goods in the home market