Chapter Ten

Pricing:
Understanding and Capturing
Customer Value
Pricing: Understanding and Capturing Customer Value

Topic Outline

• What Is a Price?
• Customer Perceptions of Value
• Company and Product Costs
• Other Internal and External Considerations Affecting Price Decisions
Price is the amount of money charged for a product or service. It is the sum of all the values that consumers give up in order to gain the benefits of having or using a product or service.
Price is the only element in the marketing mix that produces revenue; all other elements represent costs.
Factors to Consider When Setting Prices

Customer Perceptions of Value

Understanding how much value consumers place on the benefits they receive from the product and setting a price that captures that value
Factors to Consider When Setting Prices

Customer Perceptions of Value

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Factors to Consider When Setting Prices

Customer Perceptions of Value

Value-based pricing uses the buyers’ perceptions of value, not the sellers cost, as the key to pricing. Price is considered before the marketing program is set.

- Value-based pricing is customer driven
- Cost-based pricing is product driven
Factors to Consider When Setting Prices

Customer Perceptions of Value

**Cost-based pricing**
- Design a good product
- Determine product costs
- Set price based on cost
- Convince buyers of product’s value

**Value-based pricing**
- Assess customer needs and value perceptions
- Set target price to match customer perceived value
- Determine costs that can be incurred
- Design product to deliver desired value at target price
Factors to Consider When Setting Prices

Customer Perceptions of Value

- Value-based pricing
- Good-value pricing
- Value-added pricing
Factors to Consider When Setting Prices

Customer Perceptions of Value

**Good-value pricing** offers the right combination of quality and good service to fair price

Existing brands are being redesigned to offer more quality for a given price or the same quality for less price
Factors to Consider When Setting Prices

Customer Perceptions of Value

Everyday low pricing (EDLP) involves charging a constant everyday low price with few or no temporary price discounts.

High-low pricing involves charging higher prices on an everyday basis but running frequent promotions to lower prices temporarily on selected items.
Factors to Consider When Setting Prices

Customer Perceptions of Value

• Value-added pricing attaches value-added features and services to differentiate offers, support higher prices, and build pricing power

• Pricing power is the ability to escape price competition and to justify higher prices and margins without losing market share
Factors to Consider When Setting Prices

Company and Product Costs

Cost-based pricing involves setting prices based on the costs for producing, distributing, and selling the product plus a fair rate of return for its effort and risk.
Factors to Consider When Setting Prices

Company and Product Costs

Cost-based pricing adds a standard markup to the cost of the product
Factors to Consider When Setting Prices

Company and Product Costs

Types of costs

Fixed costs
Variable costs
Total costs
Factors to Consider When Setting Prices

Company and Product Costs

**Fixed costs** are the costs that do not vary with production or sales level

- Rent
- Heat
- Interest
- Executive salaries
Factors to Consider When Setting Prices

Company and Product Costs

Variable costs are the costs that vary with the level of production

- Packaging
- Raw materials
Factors to Consider When Setting Prices

Company and Product Costs

**Total costs** are the sum of the fixed and variable costs for any given level of production.

**Average cost** is the cost associated with a given level of output.
Factors to Consider When Setting Prices

Costs at Different Levels of Production

A. Cost behavior in a fixed-size plant

B. Cost behavior over different-size plants
Factors to Consider When Setting Prices

Costs as a Function of Production Experience

Experience or learning curve is when average cost falls as production increases because fixed costs are spread over more units.

![Graph showing the relationship between accumulated production and cost per unit. As accumulated production increases, cost per unit decreases.]
Factors to Consider When Setting Prices

Cost-Plus Pricing

- Cost-plus pricing adds a standard markup to the cost of the product

Benefits
- Sellers are certain about costs
- Prices are similar in industry and price competition is minimized
- Consumers feel it is fair

Disadvantages
- Ignores demand and competitor prices
Factors to Consider When Setting Prices

Break-Even Analysis and Target Profit Pricing

**Break-even pricing** is the price at which total costs are equal to total revenue and there is no profit.

**Target profit pricing** is the price at which the firm will break even or make the profit it’s seeking.
Factors to Consider When Setting Prices

Break-Even Analysis and Target Profit Pricing
Considerations in Setting Price

- **Customer perceptions of value**
  - Price ceiling
  - No demand above this price

- **Other internal and external considerations**
  - Marketing strategy, objectives, and mix
  - Nature of the market and demand
  - Competitors’ strategies and prices

- **Product costs**
  - Price floor
  - No profits below this price
Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

• Customer perceptions of value set the upper limit for prices, and costs set the lower limit

• Companies must consider internal and external factors when setting prices
Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

Target costing starts with an ideal selling price based on consumer value considerations and then targets costs that will ensure that the price is met.
Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

Organizational considerations include:

• Who should set the price
• Who can influence the prices
Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

The Market and Demand

• Before setting prices, the marketer must understand the relationship between price and demand for its products
Factors to Consider When Setting Prices

Other Internal and External Consideration Affecting Price Decisions

Competition

Pure competition

Monopolistic competition

Oligopolistic competition

Pure monopoly
Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

The demand curve shows the number of units the market will buy in a given period at different prices

- Normally, demand and price are inversely related
- Higher price = lower demand
- For prestige (luxury) goods, higher price can equal higher demand when consumers perceive higher prices as higher quality
Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

Quantity demanded per period
A. Inelastic demand
B. Elastic demand
Factors to Consider When Setting Prices

Other Internal and External Considerations Affecting Price Decisions

Price elasticity of demand illustrates the response of demand to a change in price.

- **Inelastic demand** occurs when demand hardly changes when there is a small change in price.
- **Elastic demand** occurs when demand changes greatly for a small change in price.

Price elasticity of demand = \( \frac{\% \text{ change in quantity demand}}{\% \text{ change in price}} \)
Factors to Consider When Setting Prices

Other Internal and External Considerations

Competitor's Strategies

• Comparison of offering in terms of customer value
• Strength of competitors
• Competition pricing strategies
• Customer price sensitivity
Factors to Consider When Setting Prices

Other Internal and External Consideration Affecting Price Decisions

- Economic conditions
- Reseller’s response to price
- Government
- Social concerns