The marketing mix - Price

Why is price a key part of the marketing mix?

Most of the following points are what you learn in economics. There is just a brief summary:

- **Price elasticity of demand (PED)**
  - *For marketing purposes, the elasticity is important for pricing decisions*
  - *Making more accurate sales forecasts*
- Factors that **determine price elasticity**:
  - *Necessity*
  - *Competition*
  - *Consumer loyalty*
  - *Price of product in proportion to consumers' incomes*

Evaluation of price elasticity of demand

While PED has its uses, it should be used with caution:

- PED assumes that nothing else has changed
- Obsolescence of PED over time
- In reality, it is not always possible or easy to calculate the PED accurately

The pricing decision:

There many determinants of the pricing decision (for more than can be listed here)

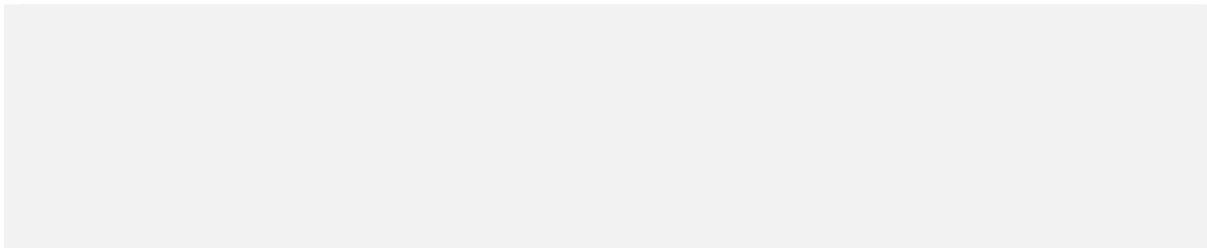
1. Cost of production	
2. Competitive conditions	
3. Competitors decisions	
4. Business and marketing decisions	
5. PED	
6. New or existing product	

Pricing methods:

There are several different pricing methods that can be used and these are broadly categorised into COST-BASED methods and MARKET/COMPETITION-BASED methods.

Cost-based pricing:

The basic idea is



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Mark-up

This pricing method is usually by ________________ who take the price they pay the producer or manufacturer for the product and then ____________________________.

It usually depends on:

Example 1:

Total cost of brought-in materials	Mark-up on cost	Selling price
$40	50% =	$
$100	25% =	$
$23	10% =	$
$50	% =	$150
	25% =	$75

Target pricing:

1. If a company has **costs** of **$400,000** when making **10,000** units of output and has an **expected rate** of return of **20%,** then it will set its price by working out its **TOTAL COST** and expected returns and then dividing the amount of output.
2. If a company has **costs** of **$250,000** when making **20,000** units of output and has an **expected rate** of return of **25%,** then it will set its price by working out its **TOTAL COST** and expected returns and then dividing the amount of output.

Example 2:

1.	2.
Total output costs for 10,000 units = $400,000 Required returns of 20% on sales = $80,000 Total revenue **needed** = $480,000 Price **per unit** 480,000/10,000 = **$48**	

Full-cost (absorption) pricing

It is not always possible to allocate or divide the entire costs o a firm to specific product, especially one that makes a range of products. It is especially difficult to allocate ________________

Example 3:

Full cost pricing: a business makes industrial training DVDs:	

• Annual **overheads** and **fixed costs** are: **$10,000**
• **Variable costs** are **$5** per DVD
• Business produces 5,000 per year
  o **TC** are $10,000 + $5,000 x ($5) = **$35,000**
• **Average** or **unit cost** of making each DVD
  o $35,000/5,000 = **$7**
The business will have to charge at least **$7 per unit** to break even
The firm can now add a 300% profit margin. The final selling price becomes **$28**	

Contribution-cost (or marginal-cost) pricing

This method doesn't try to allocate the fixed costs to specific products.
Instead of this, the firm calculates a **unit variable** for the product in question and then **ADDS** an extra amount that is known as a contribution to fixed costs. IF enough units are sold, the TOTAL contribution will be enough to cover the **FIXED COSTS** and return a profit.

Example 4:

Contribution-cost (marginal costing) **pricing**:

- A firm produces a single product that has direct costs of **$2 per unit**
- Total costs of the firm are **$40,000 per year**
- The firms sets a contribution of **$1 per un**it and so sells the **product at $3**
- Every unit sold makes a **contribution of $1** towards the fixed costs.
- If the firm sell **40,000** units, then the **fixed costs** will be **covered**.
- Every unit over **40,000** will return a **profit**
- If the firm sells **60,000 units** then it will make a profit of $20,000

Example 5:

- A firm produces a **single product** that has a **variable cost** (VC) of **$4 per unit**
- Annual **fixed costs** and **overheads** are **$80,000**
- Firm decided on a **contribution** of **$2 per unit sold** (contribution = SP-VC)
- Therefore, the **selling price** (SP) is **$6.**
- *If the firm sells 50,000 units in one year:*
  - *the total contribution to FC becomes **50,000 x $2 = 100,000***
- This **exceeds** fixed costs by **$20,000** and so a **profit** has been made
- The firm will have to sell **at least 40,000** unit per year to **break even**

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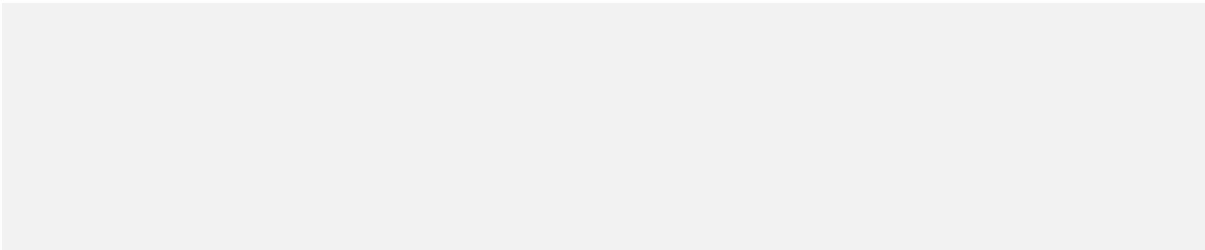
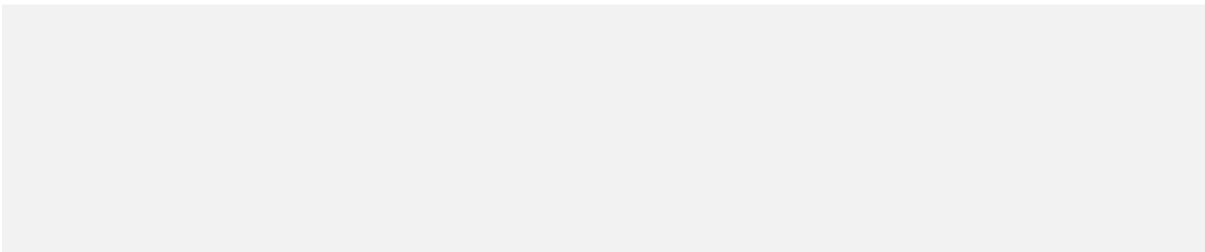
Competition priced pricing

- *Price leadership*
- *Aligning with the competition – especially Oligopoly markets*
- *Destroyer pricing – also called Predatory pricing and often illegal in many countries*
- *Consumer-priced pricing*

Perceived-value pricing (customer –value pricing)



Price discrimination



New product pricing strategies

1. **Penetration pricing**

2. **Market skimming**

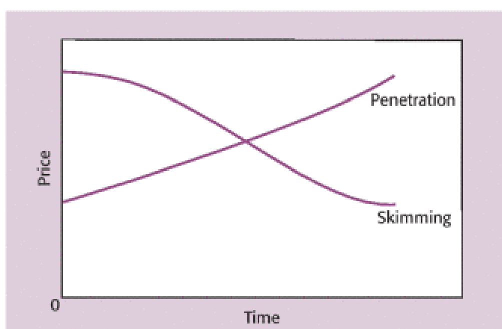


Figure 16.8 Market-skimming and penetration pricing strategies

PRICING TACTICS

Once the pricing strategy has been decided, it can also use price as a tactical promotional tool. This will involve TEMPORARY, short-term changes in prices to attract customers to particular products for a period.

PRICING TACTICS MAY include:

- BOGOF
- Loss leaders (milk and bread are typical in the UK)
- Introductory offers
- Seasonal discounts; loyalty member offers.

Pricing decisions – some additional issues

Different **types** of markets

- Easier entry into a market often means more competitive market conditions
- Reference to **perfect competition**
    - Firms are **price takers**
- **Monopolists** are single sellers of a good or service
    - They set the price – **price makers**
- **Oligopoly**
    - Price wars to gain market share
    - Non-price competition
    - Collusion
- **Loss leaders** – common tactic used by retailers
- **Psychological pricing -**

Pricing decisions – an evaluation

- **Unlikely** that a firm will use **only** one pricing method
    - Apply **different methods** to its **portfolio** of products
- Price levels should be researched to understand impacts on demand
- 'Good value' is seen as important, not just about low price. Image, price and quality.
    - *Price should match **perception** and **expectations** of consumers*
    - *Pricing often forms a **perception***

Activity 16.6: Does the price fit?

Summary of the worksheet in your own words (in English and Chinese):

Vocabulary check:

English	Chinese