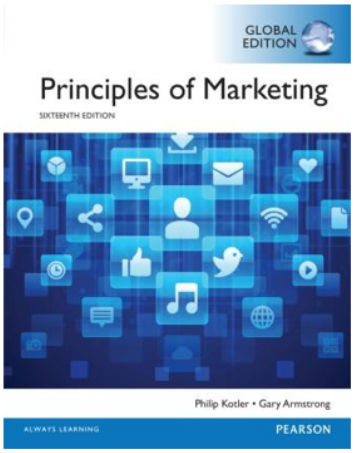


Principles of Marketing Global Edition

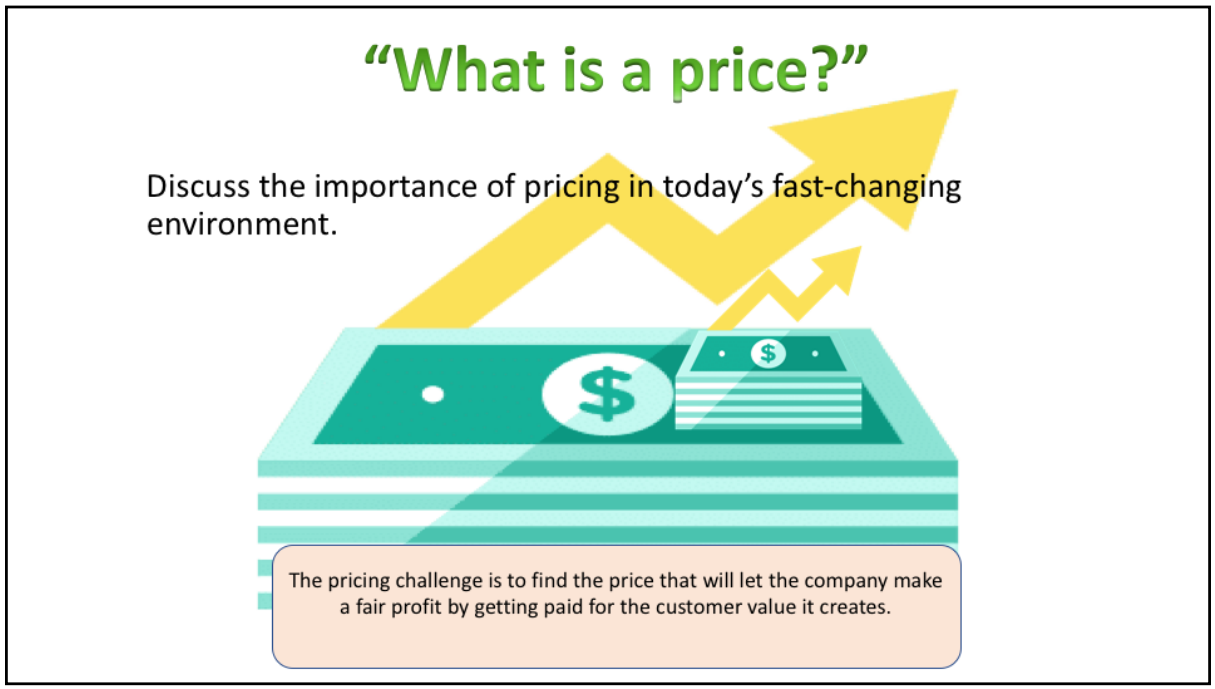
Kotler and Armstrong

Chapter 10:

Pricing Understanding and Capturing Customer Value

Opening Questions

- ✓How do consumers process and evaluate prices?
- ✓How should a company set prices initially for products or services?
- ✓How should a company adapt prices to meet varying circumstances and opportunities?
- ✓When should a company initiate a price change?
- ✓How should a company respond to a competitor's price challenge?



Objective 1 Answer the question "What is a price?" and discuss the importance of pricing in today's fast-changing environment.

Price can be defined narrowly as the amount of money charged for a product or service. Or it can be defined more broadly as the sum of the values that consumers exchange for the benefits of having and using the product or service. The pricing challenge is to find the price that will let the company make a fair profit by getting paid for the customer value it creates.

Despite the increased role of nonprice factors in the modern marketing process, price remains an important element in the marketing mix. It is the only marketing mix element that produces revenue; all other elements represent costs. More important, as a part of a company's overall value proposition, price plays a key role in creating customer value and building customer relationships. Smart managers treat pricing as a key strategic tool for creating and capturing customer value.

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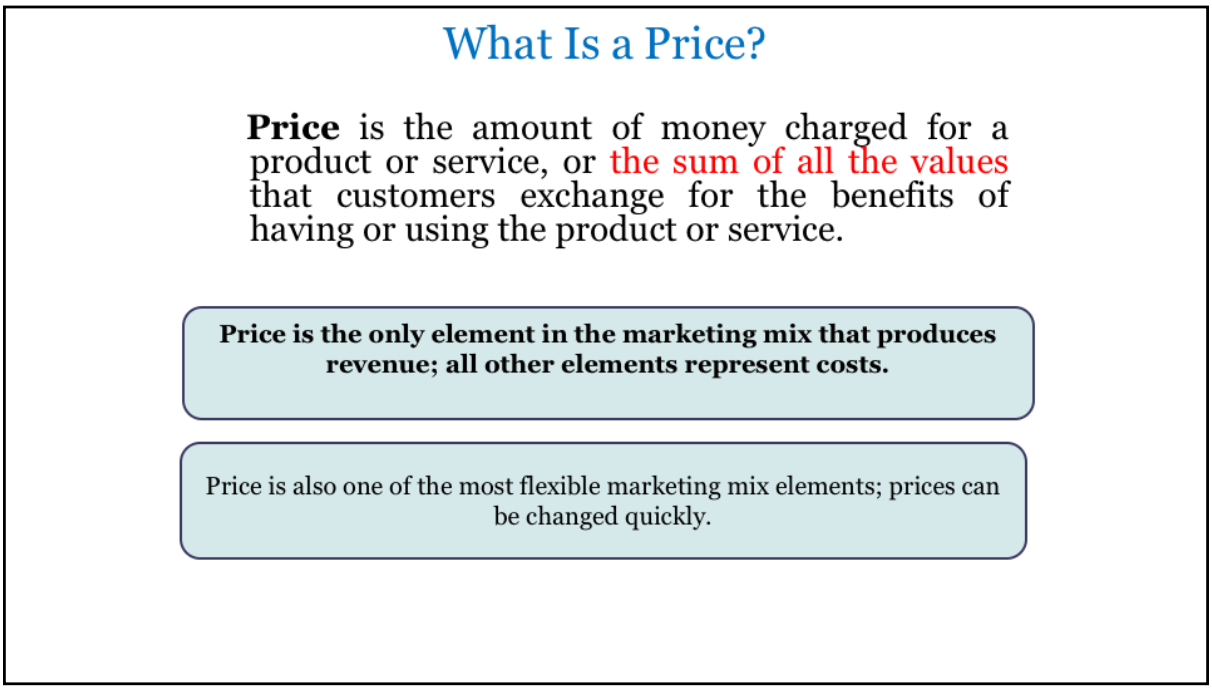


Discussion Question
How does a company like Starbucks price their products?

Historically, price has been the major factor affecting buyer choice. In recent decades, however, nonprice factors have gained increasing importance. Even so, price remains one of the most important elements that determines a firm's market share and profitability.

In the narrowest sense, **price** is the amount of money charged for a product or a service. More broadly, price is the sum of all the values that customers give up 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.

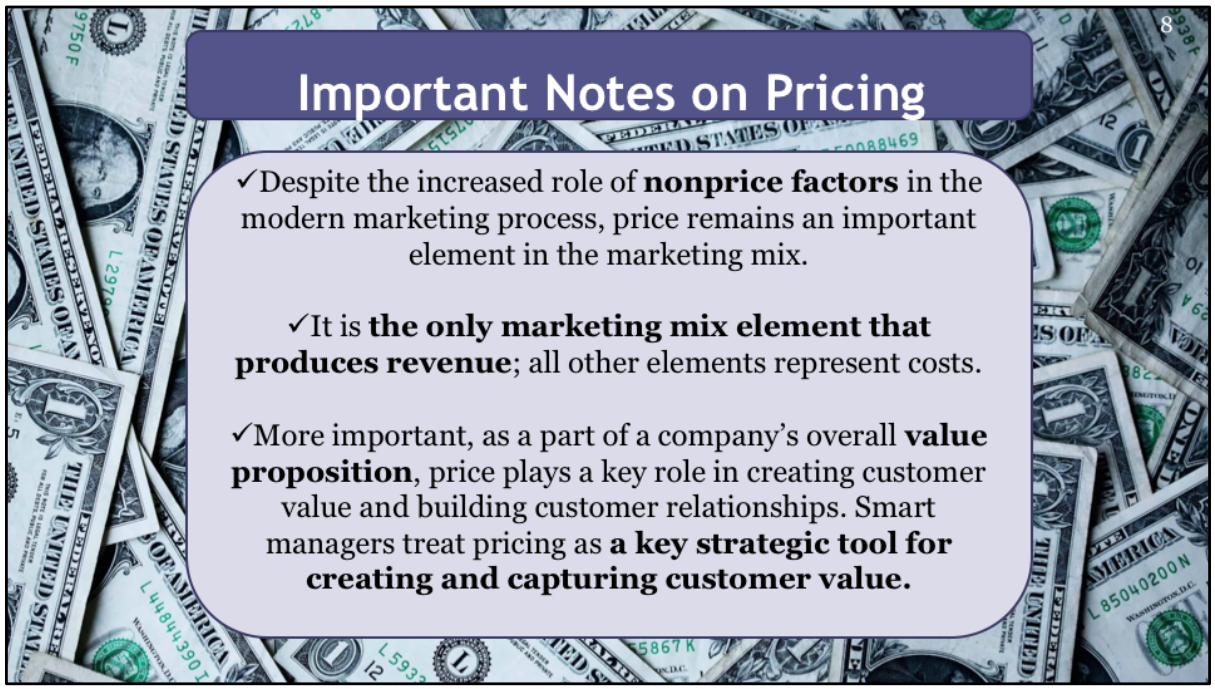
Price is also one of the most flexible marketing mix elements; prices can be changed quickly. Smart managers treat pricing as a key strategic tool for creating customer value and building customer relationships. Prices have a direct impact on a firm's bottom line.

International Pricing Decisions

- Pricing is a part of the marketing mix, and therefore pricing decisions must be integrated with the other three Ps of marketing mix.
- Pricing policy is an important strategic and tactical competitive weapon that, in contrast to the other elements of the global marketing mix, is highly **controllable and inexpensive to change** and implement.
- A company exporting for the first time, with little knowledge of the market environment that it is entering, is likely to **set a price that will ensure that the sales revenue generated at least covers the costs incurred.** It is important that firms recognize that the cost structures of products are very significant, but they should not be regarded as sole determinants when setting prices.

Discussion Question

How does a company like Starbucks price their products?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Important Notes on Pricing
✓Despite the increased role of **nonprice factors** in the modern marketing process, price remains an important element in the marketing mix.
✓It is **the only marketing mix element that produces revenue**; all other elements represent costs.
✓More important, as a part of a company's overall **value proposition**, price plays a key role in creating customer value and building customer relationships. Smart managers treat pricing as **a key strategic tool for creating and capturing customer value.**

Internal factors affecting international pricing:

- **Firm-level factors**

International pricing is influenced by past and current corporate philosophy, organization and managerial policies.

Internalactors affecting international pricing:

- **Product factors**

Key product factors include **the unique and innovative features** of the product and the **availability of substitutes**.

These factors will have a major impact on **the stage of the product life cycle,** which will also depend on the market environment in target markets.

Whether the product is a service or a manufactured or commodity good sold into **consumer or industrial markets** is also significant.

Product factors

- Stage in PLC
- Place in product line
- Most important product features: quality, service, etc.
- Product positioning (USP)
- Product cost structure (manufacturing, experience effects, etc.)

External factors affecting international pricing:

Environmental factors

- Government influences and constraints: import controls, taxes, price controls
- Inflation
- Currency fluctuations
- Business cycle stage

Market factors

- Customers' perceptions (needs, tastes)
- Customers' ability to pay
- Nature of competition
- Competitors' objectives, strategies and relative strengths/weaknesses
- Grey market appeal

Major Pricing Strategies

Customer Value-Based Pricing	Cost-Based Pricing	Competition-Based Pricing

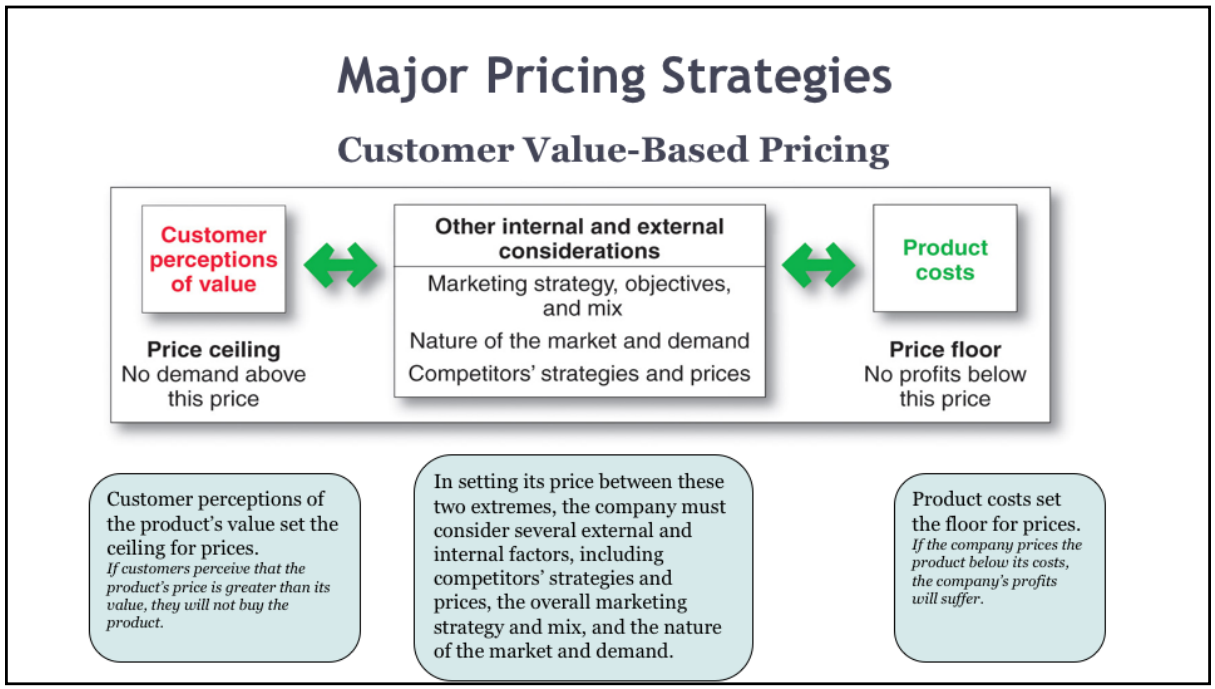


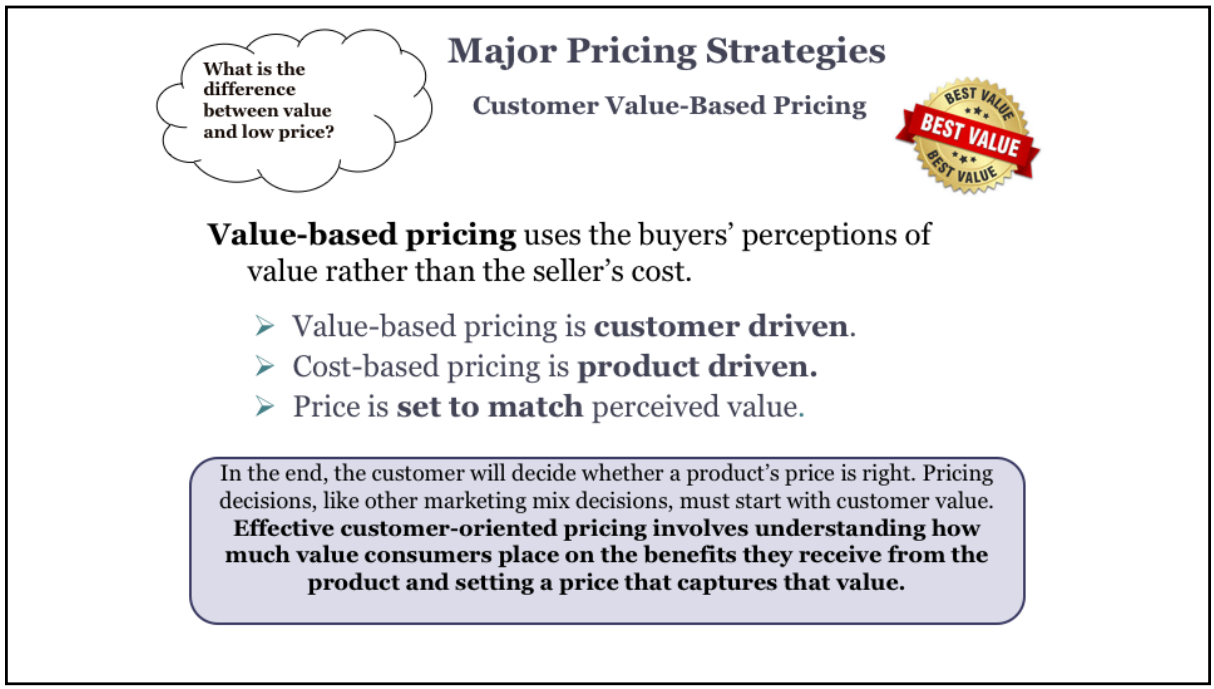
Figure suggests three major pricing strategies: customer value-based pricing, cost-based pricing, and competition-based pricing.

Major Pricing Strategies

Customer Value-Based Pricing

Understanding how much value consumers place on the benefits they receive from the product and setting a price that captures that value.

The price the company charges will fall somewhere between one that is too low to produce a profit and one that is too high to produce any demand. Figure 10.1 summarizes the major considerations in setting price. Customer perceptions of the product's value set the ceiling for prices. If customers perceive that the product's price is greater than its value, they will not buy the product. Likewise, product costs set the floor for prices. If the company prices the product below its costs, the company's profits will suffer. In setting its price between these two extremes, the company must consider several external and internal factors, including competitors' strategies and prices, the overall marketing strategy and mix, and the nature of the market and demand.



Students often confuse value with low price. You might want to bring up a product that some of them will value even at a high price. You can bring up the latest iPhone product or a luxury car. Some students will feel that the price for these products is too high, however, others will see the value these products offer to the consumer.

Customer Value-Based Pricing
In the end, the customer will decide whether a product's price is right. Pricing decisions, like other marketing mix decisions, must start with customer value. Effective customer-oriented pricing involves understanding how much value consumers place on the benefits they receive from the product and setting a price that captures that value.

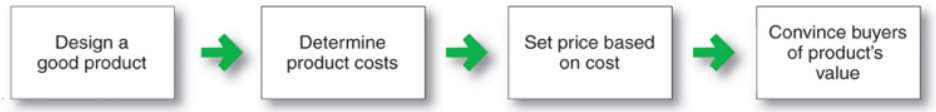
Figure 10.2 (shown on the next slide) compares value-based pricing with cost-based pricing. Although costs are an important consideration in setting prices, cost-based pricing is often product driven and sets a price that covers costs plus a target profit. Marketing must then convince buyers that the product's value at that price justifies its purchase. If the price turns out to be too high, the company must settle for lower markups or lower sales, both resulting in disappointing profits.

In the end, the customer will decide whether a product's price is right. Pricing decisions, like other marketing mix decisions, must start with customer value. When customers buy a product, they exchange something of value (the price) to get something of value (the benefits of having or using the product). Effective, customer-oriented pricing involves understanding how much value consumers place on the benefits they receive from the product and setting a price that captures that value.
Customer value-based pricing uses buyers' perceptions of value as the key to pricing. Value-based pricing means that the marketer cannot design a product and marketing program and then set the price.
Figure 10.2 compares value-based pricing with cost-based pricing. Although costs are an important consideration in setting prices, cost-based pricing is often product driven. The company designs what it considers to be a good product, adds up the costs of making the product, and sets a price that covers costs plus a target profit. Marketing must then convince buyers that the product's value at that price justifies its purchase. If the price turns out to be too high, the company must settle for lower markups or lower sales, both resulting in disappointing profits.
Value-based pricing reverses this process. The company first assesses customer needs and value perceptions. It then sets its target price based on customer perceptions of value. The targeted value and price drive decisions about what costs can be incurred and the resulting product design. As a result, pricing begins with analyzing consumer needs and value perceptions, and the price is set to match perceived value.
It's important to remember that "good value" is not the same as "low price." For example, a Steinway piano—any Steinway piano—costs a lot. But to those who own one, a Steinway is a great value.

Major Pricing Strategies

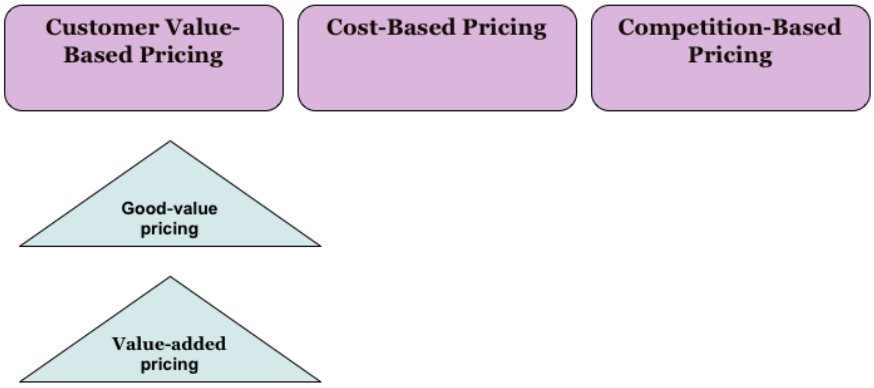
Customer Value-Based Pricing

Cost-based pricing



Value-based pricing

Major Pricing Strategies



Customer Value-Based Pricing

Good-value pricing
offers the right combination of quality and good service at a fair price

- ✓introducing less-expensive versions of established, brand-name products
- ✓redesigning existing brands to offer more quality for a given price or the same quality for less
- ✓some companies even succeed by offering less value but at very low prices


Note to Instructor
Existing brands are being redesigned to offer more quality for a given price or the same quality for less price.
In many cases good-value pricing includes less expensive items. ***Good-Value Pricing***
The Great Recession of 2008 to 2009 caused a fundamental and lasting shift in consumer attitudes toward price and quality. In response, many companies have changed their pricing approaches to bring them in line with changing economic conditions and consumer price perceptions. More and more, marketers have adopted **good-value pricing** strategies—offering the right combination of quality and good service at a fair price.
In many cases, this has involved introducing less-expensive versions of established, brand-name products. For example, fast-food restaurants such as Taco Bell and McDonald's offer value menu and dollar menu items. Every car company now offers small, inexpensive models better suited to tighter consumer budgets and thriftier spending habits. P&G has introduced "Basic" versions of its Bounty and Charmin brands that sell for less and recently launched bargain-priced Gain dish soap, its first new dish soap in almost 40 years. The company has also reduced the size of some Tide laundry detergent packages from 100 ounces to 75 ounces and sells the smaller size packages for 20 percent less at Walmart and other discount stores. "Today, when you ask the consumer, 'What is value?' the No. 1 answer is 'brand names for less,'" says a pricing expert.
In other cases, good-value pricing has involved redesigning existing brands to offer more quality for a given price or the same quality for less. Some companies even succeed by offering less value but at very low prices. For example, passengers flying low-cost European airline Ryanair won't get much in the way of free amenities, but they'll like the airline's unbelievably low prices See Christine Birkner, "Marketing in 2012: The End of the Middle?" *Marketing News,* January 31, 2012, pp. 22-23.

Major Pricing Strategies

Customer Value-Based Pricing

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

Good-value pricing: ALDI keeps costs low so that it can offer customers “impressively high quality at impossibly low prices” every day.

Everyday low pricing (EDLP)

pingo doce

Biedronka
Codziennie niskie ceny

Customer Value-Based Pricing

High-low pricing* involves charging higher prices on an everyday basis but running frequent promotions to lower prices temporarily on selected items.

Department stores such as Sears and Macy's practice high-low pricing by having frequent sale days, early-bird savings, and bonus earnings for store credit-card holders.

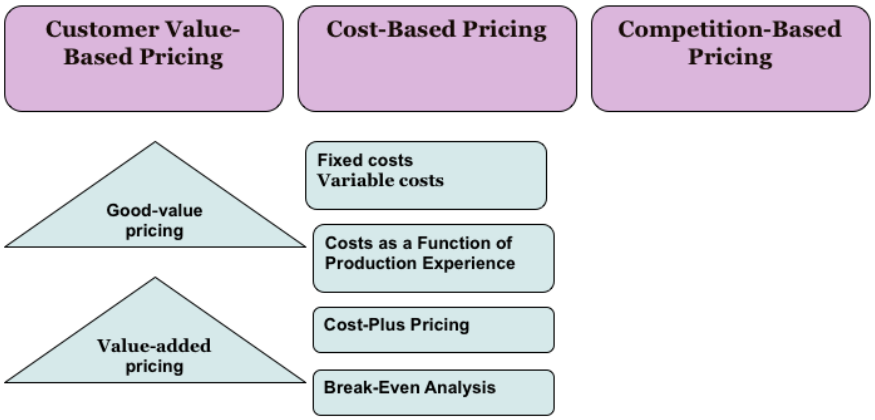
Customer Value-Based Pricing

Value-added pricing* attaches value-added features and services to differentiate the companies offers and thus their higher prices.

Value-based pricing doesn't mean simply charging what customers want to pay or setting low prices to meet competition. Instead, many companies adopt **value-added pricing** strategies rather than cut prices to match competitors.

For example, even as frugal consumer spending habits linger, some movie theater chains are *adding* amenities and charging *more* rather than cutting services to maintain lower admission prices.

Major Pricing Strategies



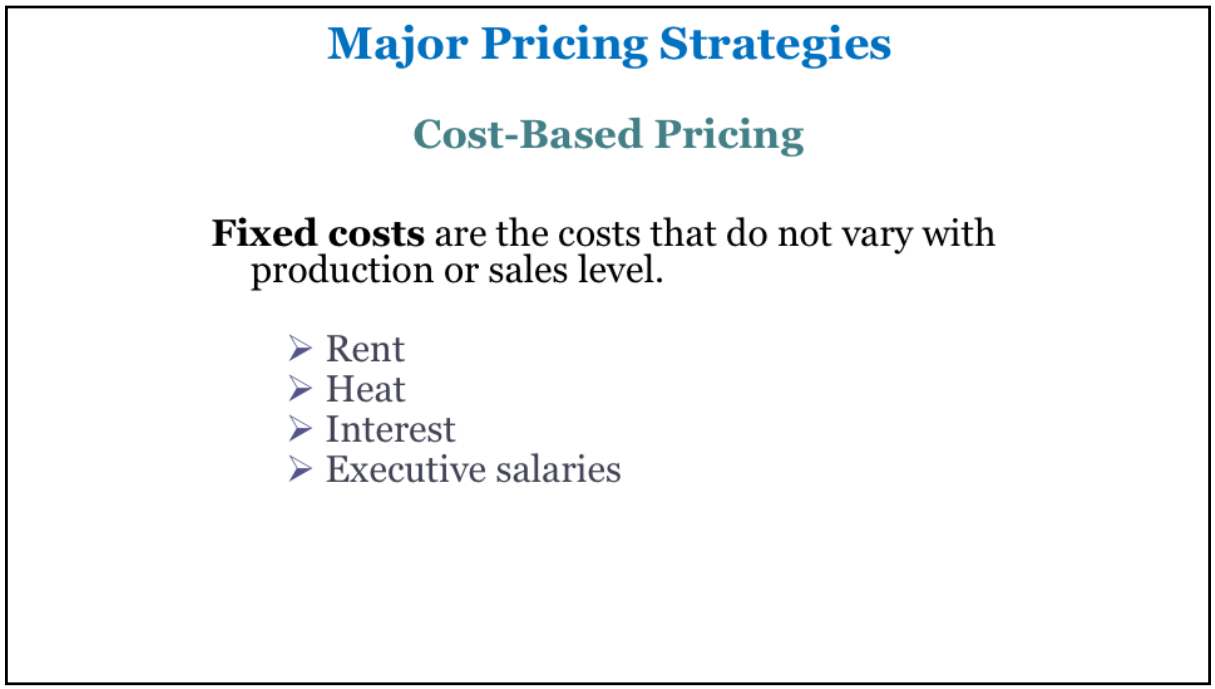
Cost-Based Pricing

Cost-based pricing sets prices based on the costs for producing, distributing, and selling the product plus a fair rate of return for effort and risk.

Some companies, such as Walmart or Southwest Airlines, work to become the *low-cost producers* in their industries. Companies with lower costs can set lower prices that result in smaller margins but greater sales and profits. However, other companies—such as Apple, BMW, and Steinway—intentionally pay higher costs so that they can add value and claim higher prices and margins.

Whereas customer-value perceptions set the price ceiling, costs set the floor for the price that the company can charge.

Some companies, such as Walmart or Southwest Airlines, work to become the *low-cost producers* in their industries. Companies with lower costs can set lower prices that result in smaller margins but greater sales and profits. However, other companies—such as Apple, BMW, and Steinway—intentionally pay higher costs so that they can add value and claim higher prices and margins.



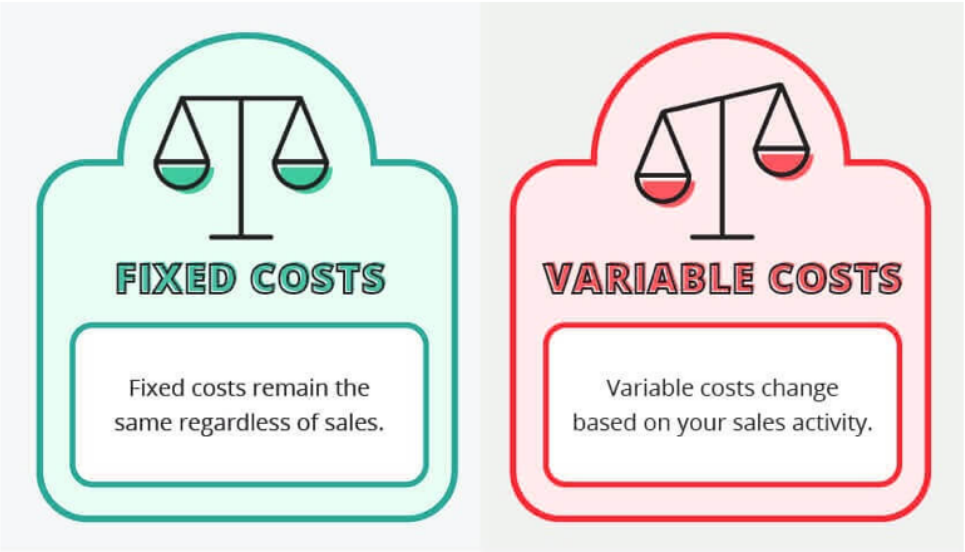
Fixed costs (also known as **overhead**) are costs that do not vary with production or sales level.

Cost-Based Pricing

Variable costs vary directly with the level of production.

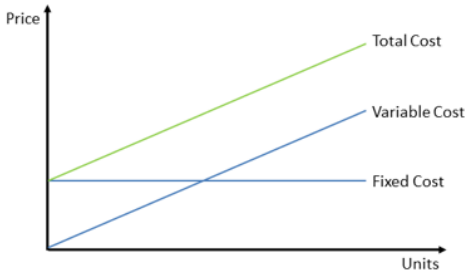
- Raw materials
- Packaging*

Variable costs vary directly with the level of production. Each PC produced by HP involves a cost of computer chips, wires, plastic, packaging, and other inputs. Although these costs tend to be the same for each unit produced, they are called variable costs because the total varies directly with the number of units produced.


FIXED COSTS
Fixed costs remain the same regardless of sales.
VARIABLE COSTS
Variable costs change based on your sales activity.

Cost-Based Pricing

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



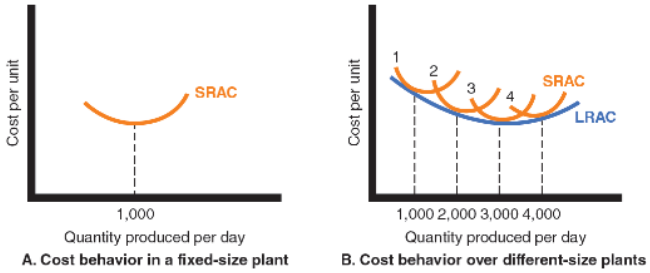
Total Costs = Fixed Costs + Variable Costs

anagement wants to charge a price that will at least cover the total production costs at a given level of production.

The company must watch its costs carefully. If it costs the company more than its competitors to produce and sell a similar product, the company will need to charge a higher price or make less profit, putting it at a competitive disadvantage.

Cost-Based Pricing

SRAC - short-run average cost curve



LRAC - long-run average cost

FIGURE | 10.3 Cost per Unit at Different Levels of Production per Period

It is best to use an example like the Texas Instruments (TI) example given in the book:

Suppose TI has built a plant to produce 1,000 calculators per day. Figure 10.3A shows the typical short-run average cost curve (SRAC). It shows that the cost per calculator is high if TI's factory produces only a few per day. But as production moves up to 1,000 calculators per day, average cost falls. This is because fixed costs are spread over more units, with each one bearing a smaller share of the fixed cost. TI can try to produce more than 1,000 calculators per day, but average costs will increase because the plant becomes inefficient. Workers have to wait for machines, the machines break down more often, and workers get in each other's way.

If TI believed it could sell 2,000 calculators a day, it should consider building a larger plant. The plant would use more efficient machinery and work arrangements. Also, the unit cost of producing 2,000 calculators per day would be lower than the unit cost of producing 1,000 units per day, as shown in the long-run average cost (LRAC) curve (Figure 10.3B).

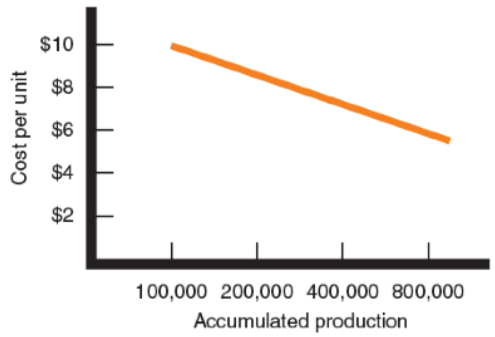
In fact, a 3,000-capacity plant would even be more efficient, according to Figure

10.3B. But a 4,000-daily production plant would be less efficient because of increasing diseconomies of scale—too many workers to manage, paperwork slowing things down, and so on.

Figure 10.3B shows that a 3,000-daily production plant is the best size to build if demand is strong enough to support this level of production.

Cost-Based Pricing

Costs as a Function of Production Experience



The drop in the average cost with accumulated production experience is called the **experience curve** (or the **learning curve**).

FIGURE | 10.4 Cost per Unit as a Function of Accumulated Production: The Experience Curve

Note to Instructor

The TI example continues as follows with Figure 10.4:

Suppose TI runs a plant that produces 3,000 calculators per day. As TI gains experience in producing calculators, it learns how to do it better. This drop in the average cost with accumulated production experience is called the **experience curve** (or the **learning curve**).

If a downward-sloping experience curve exists, this is highly significant for the company. Not only will the company's unit production cost fall, but it will fall faster if the company makes and sells more during a given time period. But the market has to stand ready to buy the higher output. And to take advantage of the experience curve, TI must get a large market share early in the product's life cycle. This suggests the following pricing strategy: TI should price its calculators low; its sales will then increase, and its costs will decrease through gaining more experience, and then it can lower its prices further. Some companies have built successful strategies around the experience curve.

Cost-Based Pricing

Cost-plus pricing (or **markup pricing**) adds a standard markup to the cost of the product.

Benefits

- Sellers are certain about costs.
- Price competition is minimized.
- Buyers feel it is fair.

Disadvantages

- Ignores demand and competitor prices

The simplest pricing method is **cost-plus pricing** (or **markup pricing**). Price is calculated by adding a standard markup to the manufacturer's costs.

To illustrate markup pricing, **suppose a manufacturer of toasters has a cost of $16/unit**. If the manufacturer wants to earn a 20 percent markup on sales, the price is calculated by the following:

markup price = unit cost/(1 - desired return on sales) =$16/(1 - .2) = $20

The manufacturer would charge dealers $20 per unit and make a profit of $4 per unit. The dealers, in turn, will mark up the toaster. If dealers want to earn 50 percent on the sales price, they will mark up the toaster to $40 ($20 + 50% of $40). This number is equivalent to a *markup on cost* of 100 percent ($20/$20).

Does using standard markups to set prices make sense? Generally, no. Any pricing method that ignores demand and competitor prices is not likely to lead to the best price. Still, markup pricing remains popular for many reasons.

- Sellers are more certain about costs than about demand
- By tying the price to cost, sellers simplify pricing.
- There is no need to make frequent adjustments as demand changes.
- If the industry uses this method, prices tend to be similar and price competition is minimized.
- Many people feel that cost-plus pricing is fairer to both buyers and sellers.
- Sellers earn a fair return but do not take advantage of buyers if demand becomes great.

To calculate **the markup**, first we need to calculate the **unit cost.**

- Variable cost $10
- Fixed costs $300,000
- Expected unit sales 50,000

The manucacturer's cost per unit:

Unit cost = variable cost + fixed costs/unit sales

$10 + $300,000/50,000 = $16

To illustrate markup pricing, **suppose a manufacturer of toasters has a cost of $16/unit**. If the manufacturer wants to earn **a 20 percent** markup on sales, the price is calculated by the following:

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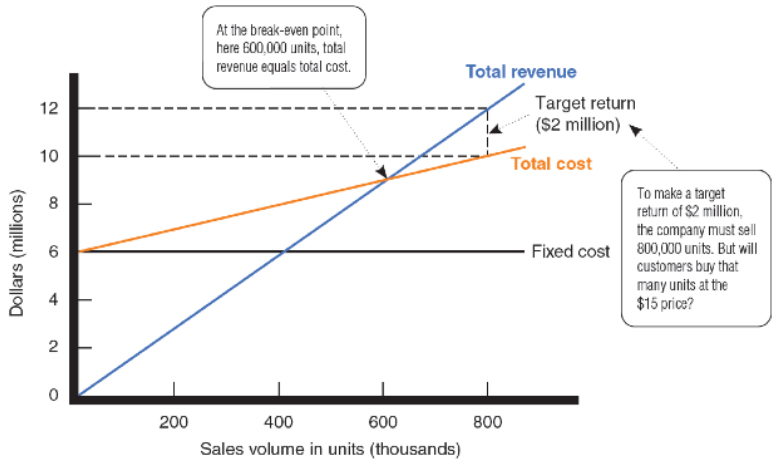
Major Pricing Strategies

Cost-Based Pricing

Break-even pricing (target return pricing)* is setting price to break even on costs or to make a target return.



Another cost-oriented pricing approach is **break-even pricing** (or a variation called **target return pricing**). The firm tries to determine the price at which it will break even or make the target return it is seeking.

Target return pricing uses the concept of a *break-even chart*, which shows the total cost and total revenue expected at different sales volume levels.

Major Pricing Strategies

Cost-Based Pricing

Table 10.1 | **Break-Even Volume and Profits at Different Prices**

Price	Unit Demand Needed to Break Even	Expected Unit Demand at Given Price	Total Revenue (1) × (3)	Total Costs*	Profit (4) – (5)
$14	75,000	71,000	$994,000	$1,010,000	–$16,000
16	50,000	67,000	1,072,000	970,000	102,000
18	37,500	60,000	1,080,000	900,000	180,000
20	30,000	42,000	840,000	720,000	120,000
22	25,000	23,000	506,000	530,000	–$24,000

*Assumes fixed costs of $300,000 and constant unit variable costs of $10.

From the toaster example on the previous two slides, the manufacturer should consider different prices and estimate break-even volumes, probable demand, and profits for each. This is done in Table 10.1. The table shows that as price increases, the break-even volume drops (column 2). But as price increases, the demand for toasters also decreases (column 3).

The manufacturer should consider different prices and estimate break-even volumes, probable demand, and profits for each. This is done in Table 10.1. The table shows that as price increases, the break-even volume drops (column 2). as price increases, the demand for toasters also decreases (column 3).

Formula

The break-even point formula is calculated by dividing the total fixed costs of production by the price per unit less the variable costs to produce the product.

Break Even Point

$$\text{Break Even Point in Units} = \frac{\text{Fixed Costs}}{\text{Sales Price per Unit - Variable Cost per Unit}}$$

Break Even Point

$$\text{Break Even Point in Dollars} = \text{Sales Price per Unit} \times \text{Break Even Point in Units}$$

Variable cost	$10
Fixed costs	$300,000
Expected unit sales	50,000
Unit cost	$16
Markup price	$20

1

Break Even Point

$$\text{Break Even Point in Units} = \frac{\text{Fixed Costs}}{\text{Sales Price per Unit - Variable Cost per Unit}}$$

Result: 30.000 units

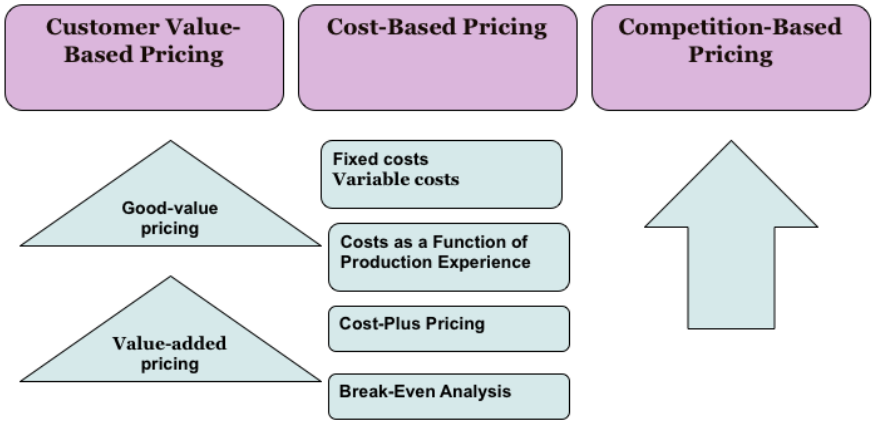
2

Break Even Point

Break Even Point in Dollars = Sales Price per Unit x Break Even Point in Units

Result: 600.000$

Major Pricing Strategies



Competition-based pricing

In assessing competitors' pricing strategies, the company should ask:

1. How does the company's market offering compare with competitors' offerings in terms of customer value?
2. How strong are current competitors and what are their current pricing strategies?

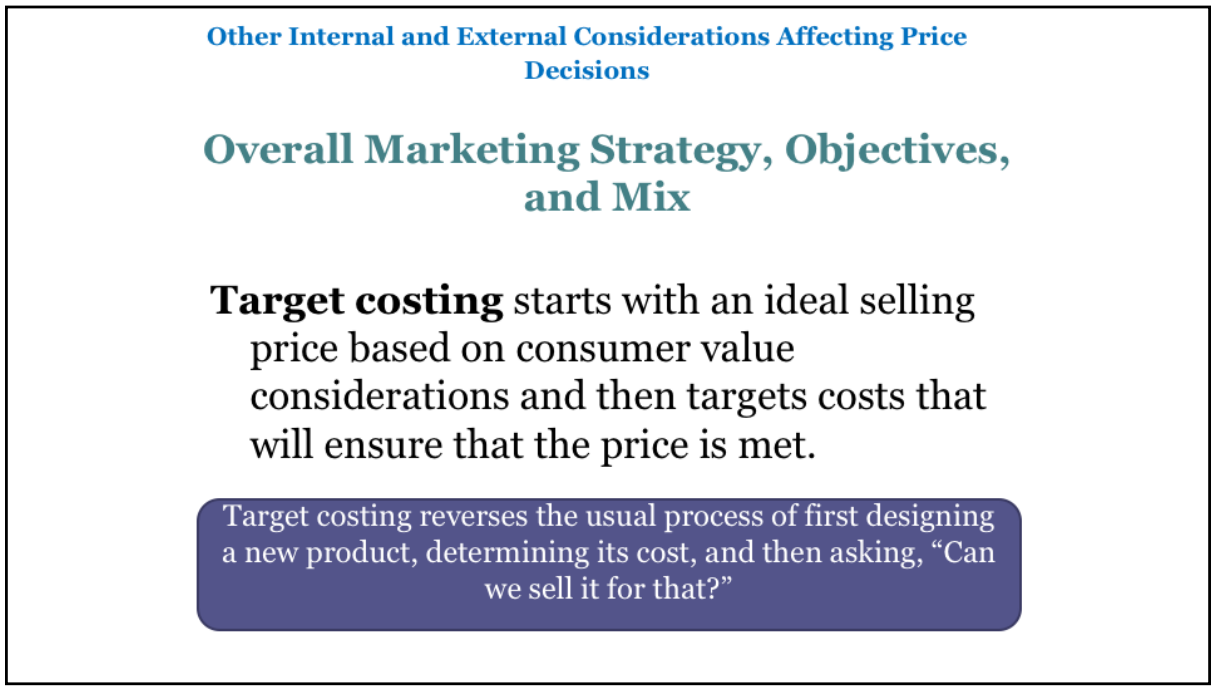
Competition-based pricing is setting prices based on competitors' strategies, costs, prices, and market offerings.

Pricing against larger, lower-price competitors: Pharmaca targets small niches with value-added services at higher prices. It's the relationships with Pharmaca's highly qualified professional staff, not low prices, that bring customers back.

Competition-based pricing involves setting prices based on competitors' strategies, costs, prices, and market offerings. Consumers will base their judgments of a product's value on the prices that competitors charge for similar products.

In assessing competitors' pricing strategies, the company should ask:

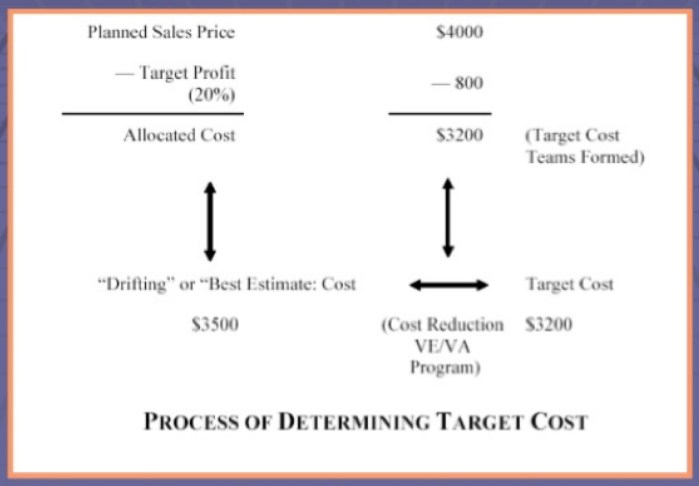
1. How does the company's market offering compare with competitors' offerings in terms of customer value?
2. How strong are current competitors and what are their current pricing strategies?



Companies often position their products on price and then tailor other marketing mix decisions to the prices they want to charge. Here, price is a crucial product-positioning factor that defines the product's market, competition, and design.

Many firms support such price-positioning strategies with a technique called **target costing**. Target costing reverses the usual process of first designing a new product, determining its cost, and then asking, "Can we sell it for that?"

Target Costing Process



PROCESS OF DETERMINING TARGET COST

TARGET PRICING

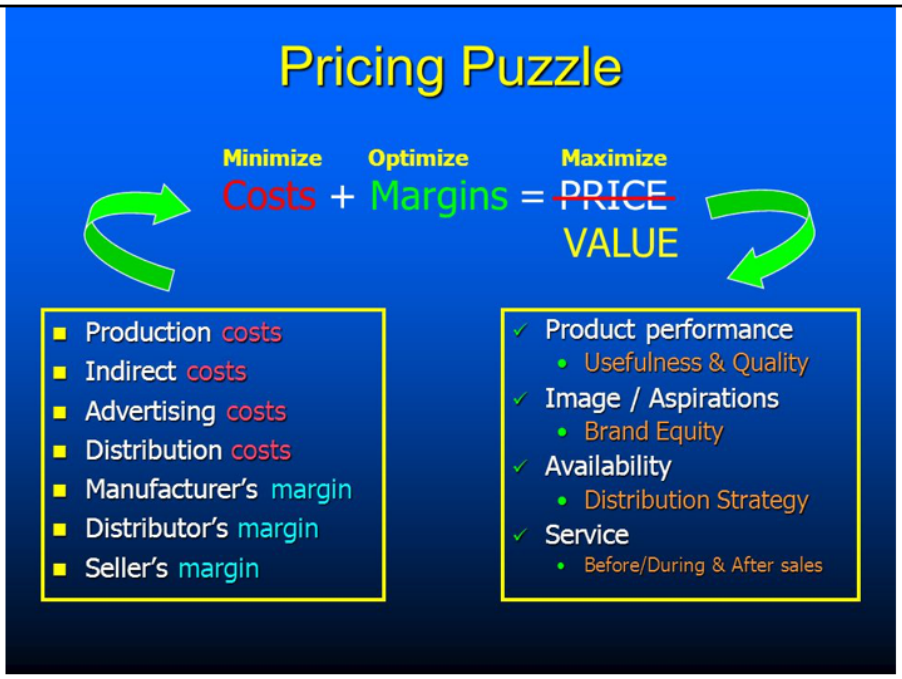
The cost is known. The manufacturer desires to achieve a certain profit margin say 20%. If so the cost would be 1 - profit margin. On this basis, the price can be worked out.

Known Cost		Formula 1- 20%		Target Price
2000	divide by	80%	=	2500

TARGET COSTING

This reverse of Target Price. Here price is known or can be ascertained from the market for similar product. From this price, a profit margin is deducted. The result is target cost. Engineers are asked to produce the product with the target cost.

Market Price	-	Profit Margin	=	Target Cost
2,500		20%		2,000


Pricing Puzzle
Minimize
Optimize
Maximize
Costs + Margins = PRICE
VALUE
Production costs
Indirect costs
Advertising costs
Distribution costs
Manufacturer's margin
Distributor's margin
Seller's margin
Product performance
Usefulness & Quality
Image / Aspirations
Brand Equity
Availability
Distribution Strategy
Service
Before/During & After sales

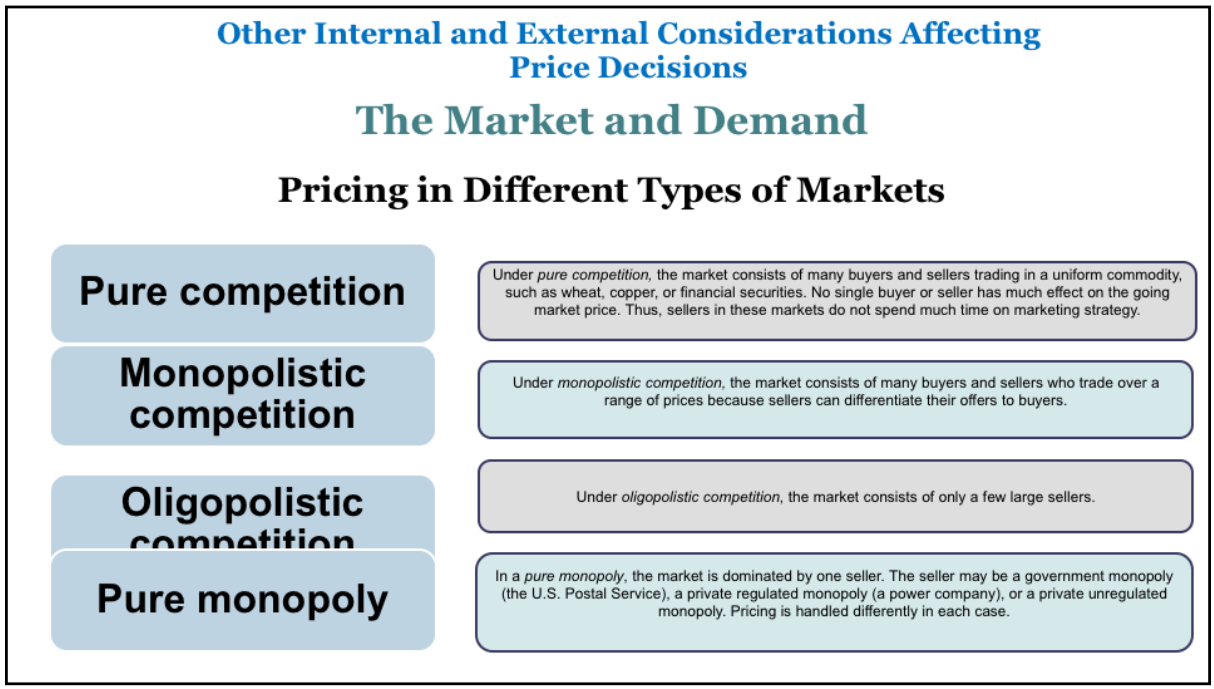
Other Internal and External Considerations Affecting Price Decisions

The Market and Demand

Before setting prices, the marketer must understand the relationship between price and demand for its products.

As noted earlier, good pricing starts with an understanding of how customers' perceptions of value affect the prices they are willing to pay. Both consumer and industrial buyers balance the price of a product or service against the benefits of owning it.

We now take a deeper look at the price-demand relationship and how it varies for different types of markets. We then discuss methods for analyzing the price-demand relationship.



Discussion Question
Discuss how the Internet has changed pricing competition?

Under *pure competition,* the market consists of many buyers and sellers trading in a uniform commodity, such as wheat, copper, or financial securities. No single buyer or seller has much effect on the going market price. Thus, sellers in these markets do not spend much time on marketing strategy.

Under *monopolistic competition,* the market consists of many buyers and sellers who trade over a range of prices because sellers can differentiate their offers to buyers.

Under *oligopolistic competition*, the market consists of only a few large sellers. For example, only four companies—Verizon, AT&T, Sprint, and T-Mobile—control more than 90 percent of the U.S. wireless service provider market. Each seller is alert and responsive to competitors' pricing strategies and marketing moves.

In a *pure monopoly*, the market is dominated by one seller. The seller may be a government monopoly (the U.S. Postal Service), a private regulated monopoly (a power company), or a private unregulated monopoly (De Beers and diamonds). Pricing is handled differently in each case.

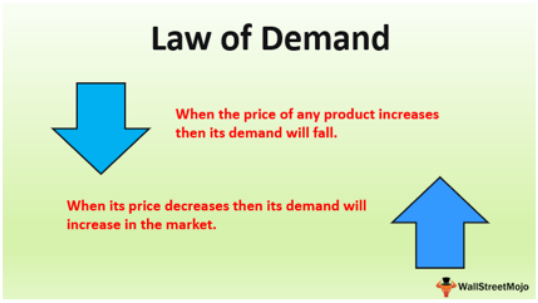
Other Internal and External Considerations Affecting Price Decisions

The Market and Demand

Analyzing the Price–Demand Relationship

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

- Demand and price are inversely related.
- Higher price = lower demand

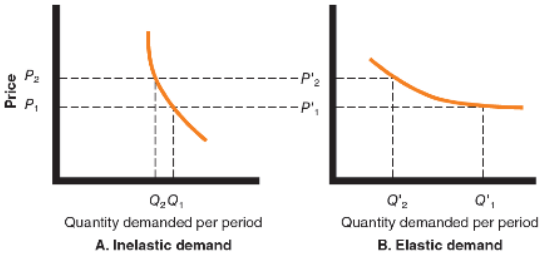


Each price the company might charge will lead to a different level of demand. The relationship between the price charged and the resulting demand level is shown in the **demand curve** in Figure 10.6. The demand curve shows the number of units the market will buy in a given time period at different prices that might be charged. **In the normal case, demand and price are inversely related—that is, the higher the price, the lower the demand.** Thus, the company would sell less if it raised its price from P_1 to P_2. In short, consumers with limited budgets probably will buy less of something if its price is too high.

The Market and Demand

Price Elasticity of Demand

If demand hardly changes with a small change in price, we say the demand is *inelastic*.

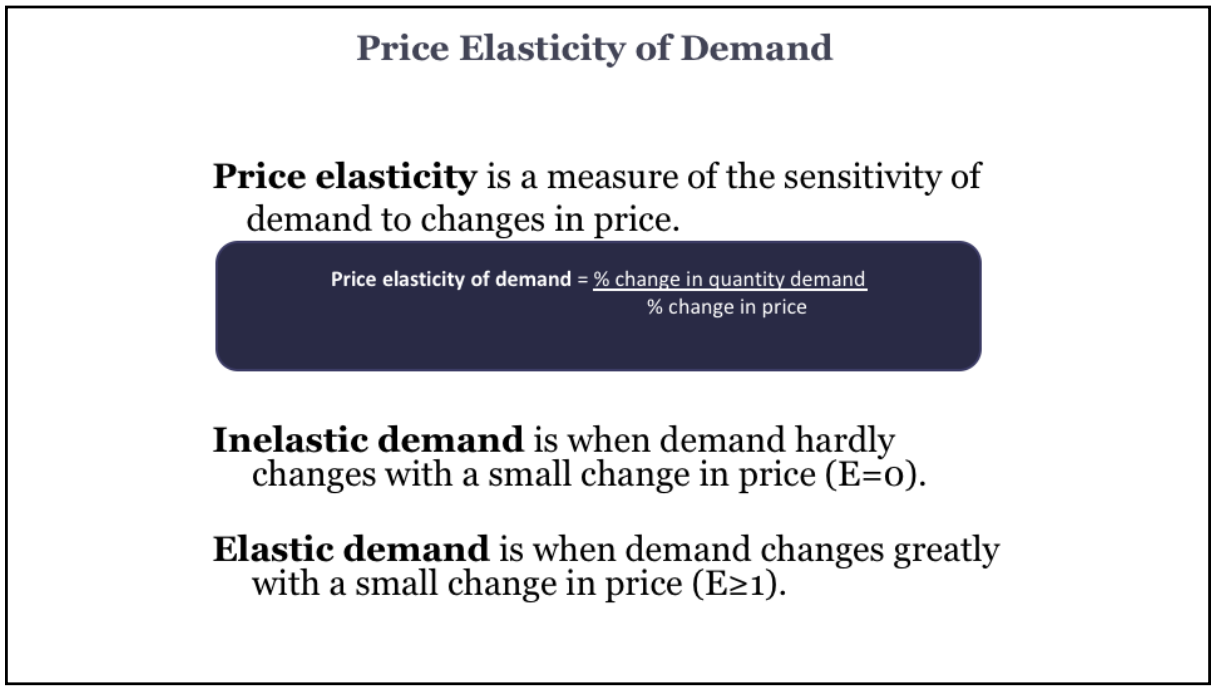


If demand changes greatly, we say the demand is *elastic*.

Consider the two demand curves in Figure 10.6. In Figure 10.6A, a price increase from P_1 to P_2 leads to a relatively small drop in demand from Q_1 to Q_2. In Figure 10.6B, however, the same price increase leads to a large drop in demand from Q'_1 to Q'_2.

If demand hardly changes with a small change in price, we say the demand is *inelastic*.

If demand changes greatly, we say the demand is *elastic*.



Marketers also need to know **price elasticity**—how responsive demand will be to a change.

Price elasticity of demand = $\frac{\text{\% change in quantity demand}}{\text{\% change in price}}$

If demand is elastic rather than inelastic, sellers will consider lowering their prices. A lower price will produce more total revenue. This practice makes sense as long as the extra costs of producing and selling more do not exceed the extra revenue.

At the same time, most firms want to avoid pricing that turns their products into commodities in some consumers' eyes.

Exercise:

Price elasticity of demand = $\frac{\text{\% change in quantity demand}}{\text{\% change in price}}$

- Old price: 1.6€
- New Price: 2€

- Demand before the price change: 20.000
- Demand after the price change: 18.000

Percent Change

$$\text{Percent Change} = \frac{\text{New Value} - \text{Old Value}}{\text{Old Value}} \times 100\%$$

If the result is positive, it is an increase.
If the result is negative, it is a decrease.

Numerical Measure of Elasticity of Supply	Terminology	Description
1. $E_S = 0$	Perfectly Inelastic	Quantity supplied does not change as price changes.
2. $E_S < 1$	Relatively Inelastic or Inelastic	Quantity supplied changes by a smaller percentage than price change.
3. $E_S = 1$	Unitary Elastic	Quantity supplied changes in the same proportion as the price.
4. $E_S > 1$	Relatively Elastic	Quantity supplied changes by a large percentage than price.
5. $E_S = \infty$	Perfectly Elastic	Supply changes are immeasurable.

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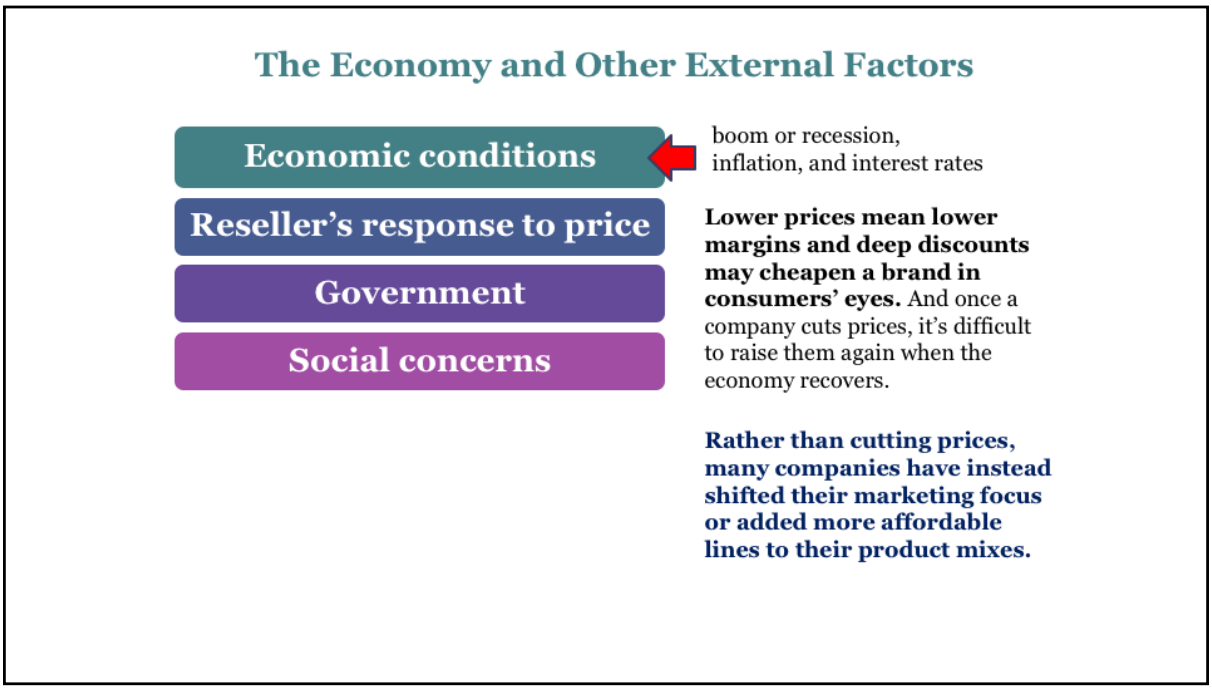
ASE STUDY :

ice Elasticity of Demand In The Real World

COMMODITY	ELASTICITY	
Urban India	Short run	Long run
Butter	1.478	2.78
Petrol	0.3	0.9
Tea	0.712	1.14
Clothing	1.1	2.88
United States		
Clothing	0.9	2.90
Beer	1.72	2.17
Electricity	0.13	1.89
Gasoline	0.25	0.92



The Economy
Economic conditions can have a strong impact on the firm's pricing strategies. Economic factors such as a boom or recession, inflation, and interest rates affect pricing decisions because they affect consumer spending, consumer perceptions of the product's price and value, and the company's costs of producing and selling a product.

Consumers have tightened their belts and become more value conscious. The most obvious response to the new economic realities is to cut prices and offer discounts. Many companies have done just that to help spur short-term sales. However, lower prices mean lower margins and deep discounts may cheapen a brand in consumers' eyes. And once a company cuts prices, it's difficult to raise them again when the economy recovers.

Rather than cutting prices, many companies have instead shifted their marketing focus or added more affordable lines to their product mixes.

Other companies are holding their price positions but redefining the "value" in their value propositions. Remember, even in tough economic times, consumers do not buy based on prices alone. They balance the price they pay against the value they receive. Thus, no matter what price they charge—low or high—companies need to offer great *value for the money*.

Other External Factors
The company must consider several other factors in its external environment when setting prices.

- The company should set prices that give resellers a fair profit, encourage their support, and help them to sell the product effectively.
- The government is another important external influence on pricing decisions.
- Social concerns may need to be taken into account. In setting prices, a company's short-term sales, market share, and profit goals may need to be tempered by broader societal considerations.

What other issues beyond the market and the economymust marketers consider when setting prices?

Other *internal* factors that influence pricing decisions include the company's overall marketing strategy, objectives, and marketing mix, as well as organizational considerations. Price is only one element of the company's broader marketing strategy. If the company has selected its target market and positioning carefully, then its marketing mix strategy, including price, will be fairly straightforward. Common pricing objectives might include customer retention and building profitable customer relationships, preventing competition, supporting resellers and gaining their support, or avoiding government intervention. Price decisions must be coordinated with product design, distribution, and promotion decisions to form a consistent and effective marketing program. Finally, in order to coordinate pricing goals and decisions, management must decide who within the organization is responsible for setting price.

Other *external* pricing considerations include the nature of the market and demand and environmental factors such as the economy, reseller needs, and government actions. Ultimately, the customer decides whether the company has set the right price. The customer weighs the price against the perceived values of using the product—if the price exceeds the sum of the values, consumers will not buy. So the company must understand such concepts as demand curves (the price–demand relationship) and price elasticity (consumer sensitivity to prices).
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