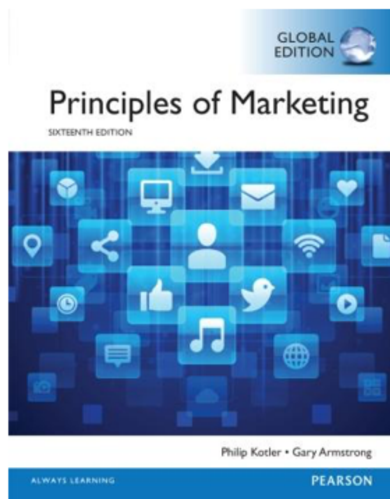


Principles of Marketing Global Edition

Kotler and Armstrong

Chapter 11: Pricing Strategies

Pricing Strategies - Conceptual Outlines

- New-Product Pricing Strategies
- Price/Quality Strategies
- Product Mix Pricing Strategies
- Price Adjustment Strategies
- Price Changes
- Public Policy and Marketing

Price is an important marketing mix tool for both creating and capturing customer value. You explored the three main pricing strategies—customer value-based, cost-based, and competition-based pricing—and the many internal and external factors that affect a firm's pricing decisions. In this chapter, we'll look at some additional pricing considerations: new-product pricing, product mix pricing, price adjustments, and initiating and reacting to prices changes. We close the chapter with a discussion of public policy and pricing.
this

New-Product Pricing Strategies

Penetration pricing/market penetration means setting a relatively low price to boost sales. It is often used when a new product is launched, or if the firm's main objective is growth.

Price/market skimming means setting a relatively high price to boost profits. It is often used by well-known businesses launching new, high quality, premium products.

Market-skimming Pricing

- **Market-skimming pricing** strategy sets high initial prices to “skim” revenue layers from the market.

<u>Necessary conditions:</u>

✓Product quality and image must support the price.

✓Buyers must want the product at the price.

✓The costs of producing a smaller volume cannot be so high that they cancel the advantage of charging more.

✓ Competitors should not be able to enter the market easily and undercut the high price.

Market-skimming Pricing

Market-penetration Pricing

- **Market-penetration pricing** involves setting a low price for a new product in order to attract a large number of buyers and a large market share.

The high sales volume results in falling costs, allowing companies to cut their prices even further.

Penetration pricing: Samsung has used low initial prices to make quick and deep inroads into emerging mobile device markets such as Africa and India.

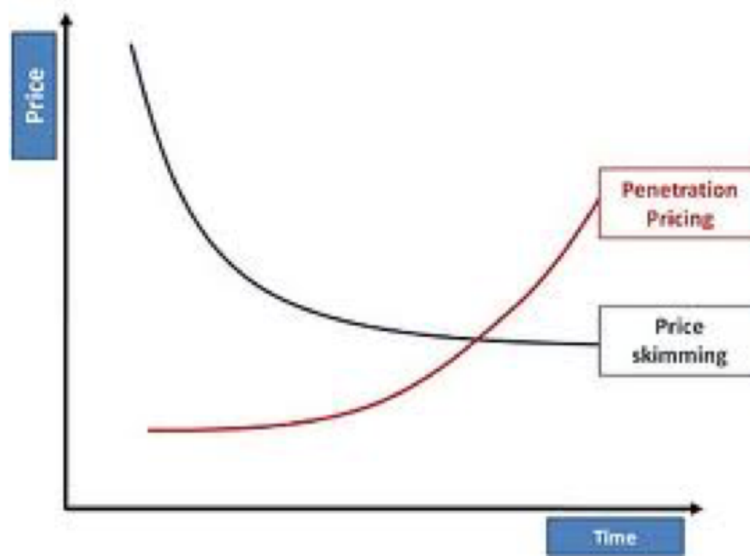
Rather than setting a high initial price to skim off small but profitable market segments, some companies use **market-penetration pricing**.

The high sales volume results in falling costs, allowing companies to cut their prices even further.

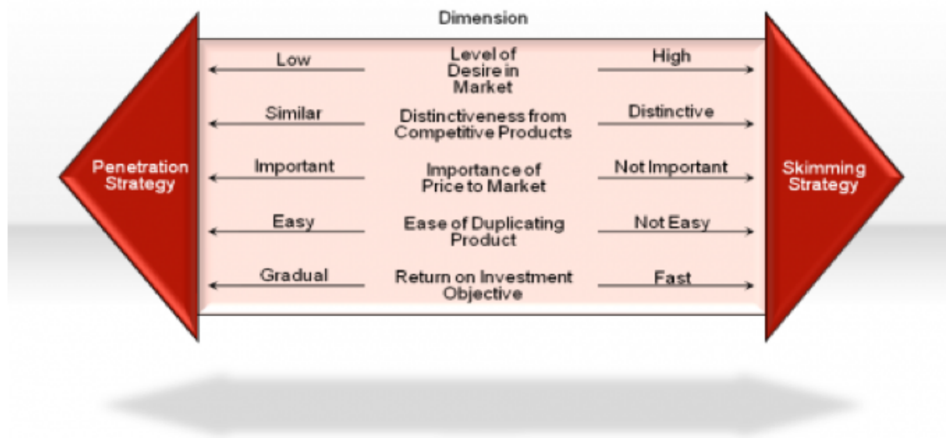
© Lou Linwei/Alamy

IKEA
宜家家居

Price skimming vs. penetration



When to Use a Penetration or Skimming Strategy for Pricing New Products



4 New-Product Pricing Strategies

		Promotion	
		High	Low
Price	High	Rapid-skimming strategy	Slow-skimming strategy
	Low	Rapid-penetration strategy	Slow-penetration strategy

Product Mix Pricing Strategies

-The strategies by which companies find a set of prices that maximizes the profits from the total product mix.

The strategy for setting a product's price often has to be changed when the product is part of a product mix. In this case, the firm looks for a set of prices that maximizes its profits on the total product mix. Pricing is difficult because the various products have related demands and costs and face different degrees of competition.

Product Mix Pricing Strategies
- Product Line Pricing

Product line pricing takes into account the cost differences between products in the line, customer evaluations of their features, and competitors' prices.

Product line pricing

Product Line Pricing

Companies usually develop product lines rather than single products. In **product line pricing**, management must determine the price steps to set between the various products in a line. The product line could include a broad range of prices for the various products.

Optional Product Pricing

Pricing options is a sticky problem. Companies must decide which items to include in the base price and which to offer as options.

Product line pricing examples

Product line pricing in services

Mr. Clean CarWash

HOME | ABOUT | SERVICES | PROMOTIONS | LOCATIONS | V.I.P. CLUB | FRANCHISING

STORE LOCATOR

WASH PACKAGES | DETAIL SERVICES | OIL CHANGE PLUS | MAINTENANCE

More Than Just A Wash

Mr. Clean Car Wash is dedicated to the maintenance of your vehicle. Whether it's maintaining the showroom shine of your exterior, detailing and freshening up the interior or giving your engine the upkeep it deserves, we're here for you and your car. And with a host of wash packages ranging from a quick shine to an all over detail, there's a Mr. Clean Car Wash package for everyone.

INTERIOR & EXTERIOR

Includes: Hand Dry, Clean Windows, Vacuum, Wipe Dash & Console, Febreze Odor Eliminator

Pro — $14 Clean
- 1,000-Point Soft Cloth Wash
- Hand-Finished Wheels

Performance Includes Pro Pkg + — $20 Clean & Shine
- Under Body Wash
- Single Shine Polish
- Tire Shine

Mr. Clean Signature Shine Includes Performance Pkg + — $27 Clean, Shine & Protect
- Under Body Rust Inhibitor
- Triple Shine Polish
- Mr. Clean Surface Protectant
- Mr. Clean Wheel Guard™
- Air Freshener

EXTERIOR

Includes: 1,000-Point Soft Cloth Wash, Spot Free Rinse & Blow Dry

Bronze — $5 Clean
- 1,000-Point Soft Cloth Wash

Silver Includes Bronze Pkg + — $8 Clean & Shine
- Under Body Wash
- Single Shine Polish
- Tire Shine

Gold Includes Silver Pkg + — $12 Clean, Shine & Protect
- Under Body Rust Inhibitor
- Triple Shine Polish
- Mr. Clean Wheel Guard™
- Mr. Clean Surface Protectant

Privacy | Terms | Career | Contact Us | Press Release | Splash Net

The Procter & Gamble Company

Product Mix Pricing Strategies

- Optional Product Pricing

Optional product pricing takes into account optional or accessory products along with the main product.

Product Line Pricing

Companies usually develop product lines rather than single products. In **product line pricing**, management must determine the price steps to set between the various products in a line. The product line could include a broad range of prices for the various products.

Optional Product Pricing

Pricing options is a sticky problem. Companies must decide which items to include in the base price and which to offer as options.

Product Mix Pricing Strategies

- Captive Product Pricing

Captive product pricing sets prices of products that must be used along with the main product.

In the case of services, captive product pricing is called *two-part pricing*. The price of the service is broken into a *fixed fee* plus a *variable usage rate*.

Ex. at an amusement parks, you pay a daily ticket or season pass charge plus additional fees for food and other in-park features.

Captive product pricing: Nearly 73 percent of Keurig's sales come from its K-Cup portion packs. The brand must find the right balance between main-product and captive-product prices.

Examples of captive products are razor blade cartridges, videogames, printer cartridges, and e-books. Producers of the main products often price them low and set high markups on the supplies. For example, Amazon introduced its Kindle Fire tablet for as low as $199, a loss of an estimated $10 per machine. It hoped to more than make up for the loss through sales of digital books, music, and movies to be viewed on the devices.

However, companies that use captive product pricing must be careful. Finding the right balance between the main product and captive product prices can be tricky. Even more, consumers trapped into buying expensive captive products may come to resent the brand that ensnared them.

In the case of services, captive product pricing is called *two-part pricing*. The price of the service is broken into a *fixed fee* plus a *variable usage rate*. Thus, at Six Flags and other amusement parks, you pay a daily ticket or season pass charge plus additional fees for food and other in-park features.

Captive product pricing examples

Product Mix Pricing Strategies
- By-product Pricing*

By-product pricing refers to products with little or no value produced as a result of the main product. Producers will seek little or no profit other than the cost to cover storage and delivery.

Note to Instructor
Captive Product Pricing
Discussion Question: Students will quickly realize this is what their cell phone bill might be. Ask them how they feel about this pricing.
Companies that make products that must be used along with a main product are using **captive product pricing**. Examples of captive products are razor blade cartridges, videogames, printer cartridges, and e-books. Producers of the main products (razors, videogame consoles, printers, and tablet computers) often price them low and set high markups on the supplies. For example, Amazon introduced its Kindle Fire tablet for as low as $199, a loss of an estimated $10 per machine. It hoped to more than make up for the loss through sales of digital books, music, and movies to be viewed on the devices.
However, companies that use captive product pricing must be careful. Finding the right balance between the main product and captive product prices can be tricky. Even more, consumers trapped into buying expensive captive products may come to resent the brand that ensnared them. Just ask about any customer how he feels after buying a Gillette Fusion ProGlide razor at a giveaway price only to learn later how expensive the replacements cartridge are. The cartridges are so pricy that they've become a high-value target for professional thieves for black-market resale. Moreover, Gillette's captive pricing strategy has invited direct price challenges from competitors such as Schick and the Dollar Shave Club. Recent Schick ads proclaimed that the Schick Hydro 5 is "Preferred over Fusion ProGlide at a better price." And the direct-response Dollar Shave Club asks, "Do you like spending $20 a month on brand-name razors?" As an alternative, it offers twin-blade razors for $1a month ($3, including shipping and handling), and four- and six-blade models for $6 to $9, shipping and handling included.
In the case of services, captive product pricing is called *two-part pricing*. The price of the service is broken into a *fixed fee* plus a *variable usage rate*. Thus, at Six Flags and other amusement parks, you pay a daily ticket or season pass charge plus additional fees for food and other in-park features.

By-Product Pricing
Producing products and services often generates by-products. If the by-products have no value and if getting rid of them is costly, this will affect pricing of the main product. Using **by-product pricing**, the company seeks a market for these by-products to help offset the costs of disposing of them and help make the price of the main product more competitive.
The by-products themselves can even turn out to be profitable—turning trash into cash.

Price Mix Pricing Strategies

- Product Boundle Pricing

Product bundle pricing combines several products at a reduced price

Product Bundle Pricing

Using **product bundle pricing**, sellers often combine several products and offer the bundle at a reduced price. For example, fast-food restaurants bundle a burger, fries, and a soft drink at a "combo" price. Bath & Body Works offers "three-fer" deals on its soaps and lotions (such as three antibacterial soaps for $10). And Comcast, Time Warner, Verizon, and other telecommunications companies bundle TV service, phone service, and high-speed Internet connections at a low combined price. Price bundling can promote the sales of products consumers might not otherwise buy, but the combined price must be low enough to get them to buy the bundle.

Companies usually adjust their basic prices to account for various customer differences and changing situations. Here, we examine the seven **price adjustment strategies** summarized in Table 11.2: *discount and allowance pricing*, *segmented pricing*, *psychological pricing*, *promotional pricing*, *geographical pricing*, *dynamic pricing*, and *international pricing*.

Price Adjustment Strategies

- Discount and Allowance Pricing

Discount and allowance pricing reduces prices to reward customer responses such as making volume purchases, paying early, or promoting the product.

Discounts include cash discounts for paying promptly, quantity discounts for buying in large volume, or functional (trade) discounts for selling, storing, distribution, and record keeping.

Allowances include trade-in allowances for turning in old items when buying new ones and promotional allowances to reward dealers for participating in advertising or sales support programs.

Discounts include cash discounts for paying promptly, quantity discounts for buying in large volume, or functional (trade) discounts for selling, storing, distribution, and record keeping.

Allowances include trade-in allowances for turning in old items when buying new ones and promotional allowances to reward dealers for participating in advertising or sales support programs.

Os subsídios incluem subsídios de troca para troca de itens antigos ao comprar novos e subsídios promocionais para recompensar os revendedores por participarem em programas de publicidade ou de suporte de vendas.

Price Adjustment Strategies
- Segmented Pricing*

Segmented pricing involves selling a product or service at two or more prices, where the difference in prices is **not based** on differences in costs.

Movie Ticket Prices

Film Festival Ticket Prices

Sorry, no child or senior discounts for festival movies.

Product-form pricing: A roomier business class seat on a flight from New York to London is many times the price of an economy seat on the same flight. To customers who can afford it, the extra comfort and service are worth the extra charge.

In **segmented pricing** companies will often adjust their basic prices to allow for differences in customers, products, and locations.

Price Adjustment Strategies
- Segmented Pricing

- ✓Customer-segment pricing
- ✓Product-form pricing
- ✓Location-based pricing
- ✓Time-based pricing

Segmented pricing takes several forms.

Under *customer-segment pricing*, different customers pay different prices for the same product or service. Museums and movie theaters, for example, may charge a lower admission for students and senior citizens.

Under *product-form pricing*, different versions of the product are priced differently but not according to differences in their costs.

Using *location-based pricing*, a company charges different prices for different locations, even though the cost of offering each location is the same. For instance, state universities charge higher tuition for out-of-state students, and theaters vary their seat prices because of audience preferences for certain locations.

Finally, using *time-based pricing*, a firm varies its price by the season, the month, the day, and even the hour. For example, movie theaters charge matinee pricing during the daytime, and resorts give weekend and seasonal discounts.

Price Adjustment Strategies
- Segmented Pricing

Under ***customer-segment pricing***, different customers pay different prices for the same product or service. *Museums and movie theaters, for example, may charge a lower admission for students and senior citizens.*

Under ***product-form pricing***, different versions of the product are priced differently but not according to differences in their costs.

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Finally, using ***time-based pricing***, a firm varies its price by the season, the month, the day, and even the hour. *For example, movie theaters charge matinee pricing during the daytime, and resorts give weekend and seasonal discounts.*

Price Adjustment Strategies
- Segmented Pricing

For segmented pricing to be effective:

- ✓Market must be segmentable
- ✓Segments must show different degrees of demand
- ✓Costs of segmenting cannot exceed the extra revenue
- ✓Must be legal

Discussion Question
How have you benefited from price segmentation?
Most likely they have had student discounts. Ask them why that is effective given the criteria above.

It is most important that segmented prices reflect real differences in customers' perceived value. Consumers in higher price tiers must feel that they're getting their extra money's worth for the higher prices paid. By the same token, companies must be careful not to treat customers in lower price tiers as second-class citizens. Otherwise, in the long run, the practice will lead to customer resentment and ill will.

For example, in recent years, the airlines have incurred the wrath of frustrated customers at both ends of the airplane. Passengers paying full fare for business- or first-class seats often feel that they are being gouged. At the same time, passengers in lower-priced coach seats feel that they're being ignored or treated poorly.

Price Adjustment Strategies

- Psychological Pricing

- ✓**Psychological pricing** considers the psychology of prices and not simply the economics; the price is used to say something about the product.

- ✓**Reference prices** are prices that buyers carry in their minds and refer to when they look at a given product.

For example a grocery retailer might place its store brand next to a more expensive branded item or offer more expensive models that don't sell very well to make its less expensive but still high-priced models look more affordable by comparison.

Discussion Question

How well do you carry prices of coffee, pizza, and milk in your head?

It might be interesting to collect the prices of items sold near or on campus including coffee, pizza, and sandwiches. Ask students how well they know these prices, have them write down the price of these items, and then check themselves. You will often find that people do *NOT* know prices as well as they think they do.

With **psychological pricing**, consumers usually perceive higher-priced products as having higher quality. Who's the better lawyer, one who charges $50 per hour or one who charges $500 per hour?

Another aspect of psychological pricing is **reference prices** which might be formed by noting current prices, remembering past prices, or assessing the buying situation. Sellers can influence or use these consumers' reference prices when setting price. For example a grocery retailer might place its store brand next to a more expensive branded item or offer more expensive models that don't sell very well to make its less expensive but still high-priced models look more affordable by comparison.

Even small differences in price can signal product differences. A *9* or *0.99* at the end of a price often signals a bargain. High-end retailers might favor prices ending in a whole number and others use 00-cent endings on regularly priced items and 99-cent endings on discount merchandise.

Price Adjustment Strategies
- Promotional Pricing

Promotional pricing is temporarily pricing products below the list price, and sometimes even below cost, to increase short-run sales.

Promotional pricing: T-Mobile's "Break Free from WiFi" price promotion provides powerful buying and switching incentives, including discounts on T-Mobile 4G LTE tablets and a free data plan.

Promotional pricing, takes several forms.

- *Discounts* from normal prices to increase sales and reduce inventories
- *Special-event pricing* in certain seasons to draw more customers
- *Limited-time offers*, such as online *flash sales*, to make buyers feel they have gotten a deal
- *Cash rebates* to consumers who buy the product from dealers within a specified time
- *Low-interest financing*, *longer warranties*, or *free maintenance* to reduce the consumer's "price"

Promotional pricing, however, can have adverse effects. During most holiday seasons, for example, it's an all-out bargain war. Marketers carpet-bomb consumers with deals, causing buyer wear-out and pricing confusion. Used too frequently, price promotions can create "deal-prone" customers who wait until brands go on sale before buying them. In addition, constantly reduced prices can erode a brand's value in the eyes of customers.

Marketers sometimes become addicted to promotional pricing, especially in tight economic times. They use price promotions as a quick fix instead of sweating through the difficult process of developing effective longer-term strategies for building their brands. Companies must be careful to balance short-term sales incentives against long-term brand building.

The Forms of Promotional Pricing

Promotional pricing, takes several forms:

- ***Discounts*** from normal prices to increase sales and reduce inventories
- ***Special-event pricing*** in certain seasons to draw more customers
- ***Limited-time offers***, such as online *flash sales*, to make buyers feel they have gotten a deal
- ***Cash rebates*** to consumers who buy the product from dealers within a specified time
- ***Low-interest financing, longer warranties, or free maintenance*** to reduce the consumer's "price"

Preços promocionais, assumem várias formas:

Descontos de preços normais para aumentar vendas e reduzir estoques
Preços de eventos especiais em certas temporadas para atrair mais clientes
Ofertas de tempo limitado, como as vendas flash online, para fazer com que os compradores sintam que conseguiram um acordo
Descontos em dinheiro aos consumidores que compram o produto de revendedores dentro de um prazo especificado
Financiamento de baixo interesse, garantias mais longas ou manutenção gratuita para reduzir o "preço" do consumidor,

Deal-prone customers

Promotional pricing can have adverse effects. During most holiday seasons, for example, it's an all-out bargain war. Marketers carpet-bomb consumers with deals, causing buyer wear-out and pricing confusion. Used too frequently, price promotions can create **"deal-prone" customers** who wait until brands go on sale before buying them. In addition, constantly reduced prices can erode a brand's value in the eyes of customers.

Price Adjustment Strategies

- Geographical Pricing

Geographical pricing is used for customers in different parts of the country or the world.

- ✓FOB-origin pricing
- ✓Uniform-delivered pricing
- ✓Zone pricing
- ✓Basing-point pricing
- ✓Freight-absorption pricing

Geographical Pricing

A company also must decide how to price its products for customers located in different parts of the United States or the world. Should the company risk losing the business of more-distant customers by charging them higher prices to cover the higher shipping costs?

Price Adjustment Strategies
- Geographical Pricing

FOB-origin (free on board) pricing is a geographical pricing strategy in which goods are placed free on board a carrier; the customer pays the freight from the factory to the destination.

Uniform-delivered pricing is a geographical pricing strategy in which the company charges the same price plus freight to all customers, regardless of their location.

Since a customer picks up its own cost, supporters of **FOB-origin pricing** feel that this is the fairest way to assess freight charges. The disadvantage, however, is that the company will be a high-cost firm to distant customers.

Uniform-delivered pricing is the opposite of FOB pricing. Here, the company charges the same price plus freight to all customers, regardless of their location. The freight charge is set at the average freight cost.

Price Adjustment Strategies

- Geographical Pricing

Zone pricing is a strategy in which the company sets up two or more zones where customers within a given zone pay the same price.

Basing-point pricing means that a seller selects a given city as a "basing point" and charges all customers the freight cost from that city to the customer.

Zone pricing falls between FOB-origin pricing and uniform-delivered pricing. The more distant the zone, the higher the price. In this way, the customers within a given price zone receive no price advantage from the company. For example, customers in Atlanta and Boston may pay the same total price even if the actual freight cost for Atlanta is significant less than Boston. One complaint about this strategy is that the Atlanta customer is paying part of the Boston customer's freight cost.

Using **basing-point pricing**, a company may set Chicago as the basing point and charge all customers the freight cost from Chicago to the customer's location. This means that an Atlanta customer pays the freight cost from Chicago to Atlanta, even though the goods may be shipped from Atlanta. If all sellers used the same basing-point city, delivered prices would be the same for all customers, and price competition would be eliminated.

Price Adjustment Strategies

- Geographical Pricing

Freight-absorption pricing is a strategy in which the seller absorbs all or part of the freight charges in order to get the desired business.

The seller who is anxious to do business with a certain customer or geographical area might use **freight-absorption pricing**. The seller might reason that if it can get more business, its average costs will decrease and more than compensate for its extra freight cost. Freight-absorption pricing is used for market penetration and to hold on to increasingly competitive markets.

Price Adjustment Strategies
- Dynamic and Internet Pricing

Dynamic pricing involves adjusting prices continually to meet the characteristics and needs of individual customers and situations.

Dynamic pricing is especially prevalent online. Services ranging from airlines and hotels to sports teams change prices on the fly according to changes in demand or costs, adjusting what they charge for specific items on a day-by-day or even hour-by-hour basis

Also thanks to the Internet, consumers can get instant product and price comparisons from thousands of vendors at price comparison sites and armed with this information, consumers can often negotiate better in-store prices.

Dynamic pricing: Kohl's and many other retailers are now using digital price tags that allow them to quickly adjust prices on individual items based on competitive and other market requirements.

Today, most companies use *fixed price* policies—setting one price for all buyers. However, some companies are now reversing the fixed pricing trend and are now using **dynamic pricing.**

Dynamic pricing is especially prevalent online. Services ranging from airlines and hotels to sports teams change prices on the fly according to changes in demand or costs, adjusting what they charge for specific items on a day-by-day or even hour-by-hour basis

Also thanks to the Internet, consumers can get instant product and price comparisons from thousands of vendors at price comparison sites and armed with this information, consumers can often negotiate better in-store prices.

In fact, many retailers are finding that ready online access to comparison prices is giving consumers *too* much of an edge. Store retailers are now devising dynamic pricing strategies to combat the consumer practice of *showrooming,* comparing prices online while in the store, and then buying the item online at a lower price.

Price Adjustment Strategies

- International Pricing

International pricing sets prices in a specific country based on many factors.

- Economic conditions
- Competitive situations
- Laws and regulations
- Wholesaling and retail systems

Price escalation resulting from differences in selling strategies, market conditions, or simply a result of the higher costs of selling in another country plays an important role in setting international prices.

International pricing: To lower prices in emerging markets, such as Indonesia shown here, Unilever developed smaller, single-use packets of its Sunsilk, Ponds, Dove, and other brands that sell at prices even the world's poorest consumers can afford.

Companies that market their products internationally must decide what prices to charge in different countries. In some cases, a company can set a uniform worldwide price. For example, Boeing sells its jetliners at about the same price everywhere. However, most companies adjust their prices to reflect local market conditions and cost considerations.

Consumer perceptions and preferences also may vary from country to country, calling for different prices. Or the company may have different **marketing objectives** in various world markets, which require changes in pricing strategy.

For example, Apple introduces sophisticated, feature-rich, premium smartphones in carefully segmented mature markets in highly developed countries using a market-skimming pricing strategy. By contrast, it's now under pressure to discount older models and develop a more basic phone for sizable but less affluent markets in developing countries, supported by penetration pricing.

Price escalation resulting from differences in selling strategies, market conditions, or simply a result of the higher costs of selling in another country plays an important role in setting international prices.

Price has become a key element in the international marketing strategies of companies attempting to enter less affluent emerging markets. Typically, entering such markets has meant targeting the exploding middle classes in developing countries. More recently, however, as the weakened global economy has slowed growth in both domestic and emerging markets, many companies are shifting their sights to include a new target—the so-called "bottom of the pyramid," the vast untapped market consisting of the world's poorest consumers.

“Bottom of the pyramid”

Courtesy Godrej & Boyce Mfg. Co. Ltd.

Features of Tata Nano
New type of seats with integrated head rests
No radio, no a/c, no passenger side mirror
Similar door handles & mechanisms for left & right side doors
Rear-mounted engine layout eliminates drive-shaft (space and weight savings)
Two-cylinder engine for lower cost & better fuel efficiency with Euro IV compliance
Plastic panels innovatively designed to eliminate the need for screws
Just one wind-shield wiper
Instrument cluster located in the center with only analog display
Extensive use of Hydroforming and roll-forming
www.RushLane.com
Figure 1

Price Changes

Initiating Pricing Changes

The key issues related to initiating and responding to price changes:

Price cuts occur due to:

- Excess capacity
- Increased market share

Price increases occur due to:

- Cost inflation
- Increased demand
- Lack of supply

When raising prices, the company must avoid being perceived as a *price gouger*. Customers have long memories, and they will eventually turn away from companies or even whole industries that they perceive as charging excessive prices.

Initiating Price Cuts

Several situations may lead a firm to consider cutting prices. One such circumstance is excess capacity. Another is falling demand in the face of strong price competition or a weakened economy. In such cases, the firm may aggressively cut prices to boost sales and market share. Cutting prices in an industry loaded with excess capacity may lead to price wars as competitors try to hold on to market share.

A company may also cut prices in a drive to dominate the market through lower costs. Either the company starts with lower costs than its competitors, or it cuts prices in the hope of gaining market share that will further cut costs through larger volume. For example, computer and electronics maker Lenovo uses an aggressive low-cost, low-price strategy to increase its share of the PC market in developing countries.

Initiating Price Increases

A successful price increase can greatly improve profits. For example, if the company's profit margin is 3 percent of sales, a 1 percent price increase will boost profits by 33 percent if sales volume is unaffected. When a company cannot supply all that its customers need, it may raise its prices, ration products to customers, or both—consider today's worldwide oil and gas industry.

When raising prices, the company must avoid being perceived as a *price gouger*. Customers have long memories, and they will eventually turn away from companies or even whole industries that they perceive as charging excessive prices. In the extreme, claims of price gouging may even bring about increased government regulation.

There are some techniques for avoiding these problems. One is to maintain a sense of fairness surrounding any price increase. Price increases should be supported by company communications telling customers why prices are being raised.

Wherever possible, the company should consider ways to meet higher costs or demand without raising prices, such as by:

- using more cost-effective ways to produce or distribute its products.
- "unbundling" its market offering and price elements separately.
- shrinking the product or substituting less-expensive ingredients.

Price Changes influence on Brand Image

Should We Raise Prices?

	Before	After	
Price	$10	$10.10	(a 1% price increase)
Units sold	100	100	
Revenue	$1,000	$1,010	
Costs	–970	–970	
Profit	$30	$40	(a 33 1/3% profit increase)

It can be worthwhile to raise prices. A successful price increase can raise profits considerably. If the company's profit margin is 3 percent of sales, a 1 percent price increase will increase profits by 33 percent if sales volume is unaffected. This situation is illustrated in table above. The assumption is that a company charged $10 and sold 100 units and had costs of $970, leaving a profit of $30, or 3 percent on sales. By raising its price by 10 cents (a 1 percent price increase), it boosted its profits by 33 percent, assuming the same sales volume.

A major circumstance provoking price increases is cost inflation. Rising costs unmatched by productivity gains squeeze profit margins and lead companies to regular rounds of price increases. Companies often raise their prices by more than the cost increase, in anticipation of further inflation or government price controls, in a practice called anticipatory pricing *(preços antecipados)*.

It can be worthwhile to raise prices. A successful price increase can raise profits considerably. If the company's profit margin is 3 percent of sales, a 1 percent price increase will increase profits by 33 percent if sales volume is unaffected. This situation is illustrated in Table 14.6. The assumption is that a company charged $10 and sold 100 units and had costs of $970, leaving a profit of $30, or 3 percent on sales. By raising its price by 10 cents (a 1 percent price increase), it boosted its profits by 33 percent, assuming the same sales volume.

A major circumstance provoking price increases is cost inflation. Rising costs unmatched by productivity gains squeeze profit margins and lead companies to regular rounds of price increases. Companies often raise their prices by more than the cost increase, in anticipation of further inflation or government price controls, in a practice called anticipatory pricing.

Price Changes

Buyer Reactions to Pricing Changes

Price increases	Price cuts
• Product is "hot" • Company greed	• New models will be available • Models are not selling well • Quality issues

Customers do not always interpret price changes in a straightforward way. A price *increase* may have positive meanings for some buyers while others may think the company is simply being greedy by charging what the traffic will bear.

Similarly, consumers may view a price *cut* as **getting a better deal** on an exclusive product. Or price cuts may be associated with **reductions in quality** or **the brand's image being tarnished.**

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Price Changes

Competitor Reactions to Pricing Changes

A firm considering a price change must worry about the reactions of its competitors as well as those of its customers. Competitors are most likely to react when the number of firms involved is small, when the product is uniform, and when the buyers are well informed about products and prices.

- Why did the competitor change the price?
- Is the price cut permanent or temporary?
- Is the company trying to grab market share?
- Is the company doing poorly and trying to increase sales?
- Is it a signal to decrease industry prices to stimulate demand?

A firm considering a price change must worry about the reactions of its competitors as well as those of its customers. Competitors are most likely to react when the number of firms involved is small, when the product is uniform, and when the buyers are well informed about products and prices. How can the firm anticipate the likely reactions of its competitors?

The problem is complex because, like the customer, the competitor can interpret a company price cut in many ways. The company must guess each competitor's likely reaction. Figure 11.1 on the next slide explores this issue further.

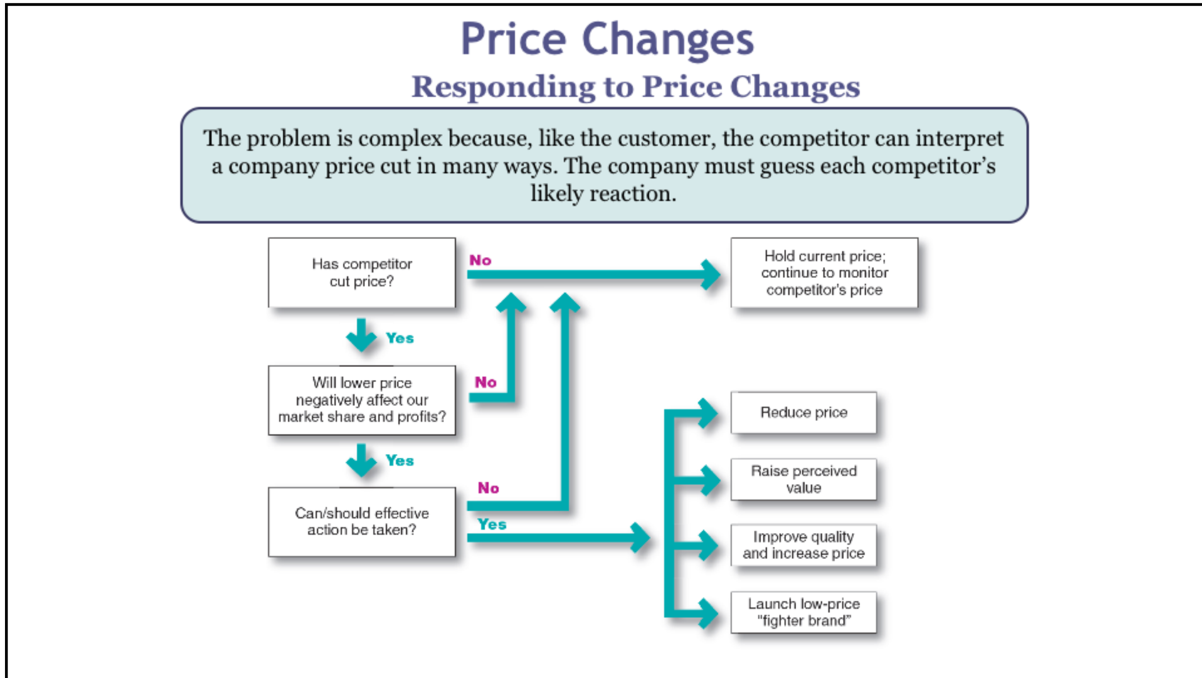

Figure 11.1 shows the ways a company might assess and respond to a competitor's price cut. Suppose the company learns that a competitor has cut its price and decides that this price cut is likely to harm its sales and profits. It might simply decide to hold its current price and profit margin. The company might believe that it will not lose too much market share, or that it would lose too much profit if it reduced its own price. Or it might decide that it should wait and respond when it has more information on the effects of the competitor's price change. However, waiting too long to act might let the competitor get stronger and more confident as its sales increase.

Price Changes

Responding to Price Changes

Effective Action Responses

- ✓Reduce price to match competition
- ✓Maintain price but raise the perceived value through communications
- ✓Improve quality and increase price
- ✓Launch a lower-price “fighting” brand

If the company decides that effective action can and should be taken, it might make any of four responses shown on this slide.

Public Policy and Pricing

Pricing Within Channel Levels

Price fixing legislation requires sellers to set prices without talking to competitors.

Predatory pricing legislation prohibits selling below cost with the intention of punishing a competitor or gaining higher long-term profits by putting competitors out of business.

Price competition is a core element of our free-market economy. In setting prices, companies usually are not free to charge whatever prices they wish. Many federal, state, and even local laws govern the rules of fair play in pricing. In addition, companies must consider broader societal pricing concerns. In setting their prices, for example, pharmaceutical firms must balance their development costs and profit objectives against the sometimes life-and-death needs of drug consumers.

The most important pieces of legislation affecting pricing are the Sherman Act, the Clayton Act, and the Robinson-Patman Act, initially adopted to curb the formation of monopolies and regulate business practices that might unfairly restrain trade.

Price-fixing is illegal per se—that is, the government does not accept any excuses for price-fixing. As such, companies found guilty of these practices can receive heavy fines. Recently, governments at the state and national levels have been aggressively enforcing price-fixing regulations in industries ranging from gasoline, insurance, and concrete to credit cards, CDs, and computer chips. Price-fixing is also prohibited in many international markets.

For example, European Union regulators recently fined consumer products giants Unilever and P&G a combined $456 million for fixing laundry detergent prices in eight EU countries. France also fined the two consumer products giants, along with competitors Colgate and Henkel. It claimed that officials from the four companies met regularly at hotels and restaurants in Paris to agree to limits on the size of discounts and on price differences between their laundry detergent brands.

Sellers are also prohibited from using *predatory pricing*—selling below cost with the intention of punishing a competitor or gaining higher long-run profits by putting competitors out of business. This protects small sellers from larger ones who might sell items below cost temporarily or in a specific locale to drive them out of business.

The biggest problem is determining just what constitutes predatory pricing behavior. Selling below cost to unload excess inventory is not considered predatory; selling below cost to drive out competitors is. Thus, a given action may or may not be predatory depending on intent, and intent can be very difficult to determine or prove.

Public Policy and Pricing

Pricing Across Channel Levels

Retail (or resale) price maintenance is when a manufacturer requires a dealer to charge a specific retail price for its product, which is prohibited by law.

Although the seller can propose a manufacturer's *suggested* retail price to dealers, it cannot refuse to sell to a dealer that takes independent pricing action, nor can it punish the dealer by shipping late or denying advertising allowances.

For example, the Florida attorney general's office investigated Nike for allegedly fixing the retail price of its shoes and clothing. It was concerned that Nike might be withholding items from retailers who were not selling its most expensive shoes at prices the company considered suitable.

Public Policy and Pricing

Pricing Across Channel Levels

Deceptive pricing occurs when a seller states prices or price savings that mislead consumers or are not actually available to consumers

- ✓ Scanner fraud, failure of the seller to enter current or sale prices into the computer system
- ✓ Price confusion results when firms employ pricing methods that make it difficult for consumers to understand what price they are really paying

Deceptive pricing occurs when a seller states prices or price savings that mislead consumers or are not actually available to consumers. This might involve bogus reference or comparison prices, as when a retailer sets artificially high "regular" prices and then announces "sale" prices close to its previous everyday prices. For example, Overstock.com recently came under scrutiny for inaccurately listing manufacturer's suggested retail prices, often quoting them higher than the actual price. Such comparison pricing is widespread.

Although comparison pricing claims are legal if they are truthful, the FTC's *Guides Against Deceptive Pricing* warn sellers not to advertise (1) a price reduction unless it is a savings from the usual retail price, (2) "factory" or "wholesale" prices unless such prices are what they are claimed to be, and (3) comparable value prices on imperfect goods.

Other deceptive pricing issues include *scanner fraud* and price confusion. The widespread use of scanner-based computer checkouts has led to increasing complaints of retailers overcharging their customers. Most of these overcharges result from poor management, such as a failure to enter current or sale prices into the system. Other cases, however, involve intentional overcharges.

Many federal and state statutes regulate against deceptive pricing practices. For example, the Automobile Information Disclosure Act requires automakers to attach a statement on new vehicle windows stating the manufacturer's suggested retail price, the prices of optional equipment, and the dealer's transportation charges. However, reputable sellers go beyond what is required by law. Treating customers fairly and making certain that they fully understand prices and pricing terms is an important part of building strong and lasting customer relationships.

"FTC Guides Against Deceptive Pricing," www.ftc.gov/bcp/guides/decptprc.htm, accessed June 2012.