



## Warwick Summer School

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Pricing

# Pricing Methods

- Cost plus
- Competitor Parity
- Market-based pricing

# Nature of pricing

Price is the **sum of all the values that a customer exchanges** for the benefits of having or using a product or service

Has a direct effect on quantity sold through its effect on demand

Can have a direct effect on quality perceptions

Can be the basis for competitive advantage

# Pricing objectives



(Avonlitis et al.,  
2005)

# Factors influencing price

|                                 |                                   |
|---------------------------------|-----------------------------------|
| <b>Production costs</b>         | <b>Distributor margins</b>        |
| <b>Desired positioning</b>      | <b>Competitor pricing</b>         |
| <b>Marketing objectives</b>     | <b>Level of demand</b>            |
| <b>Fit within product range</b> | <b>Economic conditions</b>        |
| <b>Customer-perceived value</b> | <b>Customer price sensitivity</b> |

# Generic pricing approaches

|                         |  |
|-------------------------|--|
| <b>Cost-based</b>       | Simplest pricing method (unit cost plus mark-up) BUT ignores marketing context   |
| <b>Competitor-based</b> | Market-oriented BUT small firms may not be able to compete on price  |
| <b>Value-based</b>      | Reflects customer-perceived value BUT value is subjective; value is complex (includes monetary and non-monetary costs); customers may not have expertise to assess value correctly |

# Pricing strategies and tactics

|   |
|---|
| Dynamic (demand-based)                      |
| Subscriptions                               |
| Auctions                                    |
| Progressive (e.g., advance versus same day) |
| Initiation (trial)                          |
| Discriminatory (segment-based)              |
| Bundling/unbundling                         |
| Discounts                                   |
| Relational                                  |
| Metered                                     |
| Flat rate                                   |
| Psychological                               |

# Cost-plus pricing

- The product costs plus a margin decided on by the firm
- This is a firm-centric view and does not take into account market ability or willingness to pay



# What is a cost? Some relevant concepts

- Fixed Cost
- Variable Cost
- Economies of scale

# Mass Customisation



- Reduces impact of economies of scale
- Insides of swatch watches are standardized and produced in volume
- Cases are tailored in different colours and styles to target different consumer preferences

## **Competition-based pricing**

- Based on the prices of comparable competitive products
- Marketers take into account whether they are undercutting or charging a premium in relation to their competitors

# Market-oriented pricing

- Assesses the benefit being offered to the customer and determines the “price” that they will pay for this.

# Market-oriented Pricing





HEALTH NEWS

# FDA approves a new cancer drug targeted to genetic mutation, not cancer type

The new drug will cost \$393,000 a year wholesale, Bayer says.



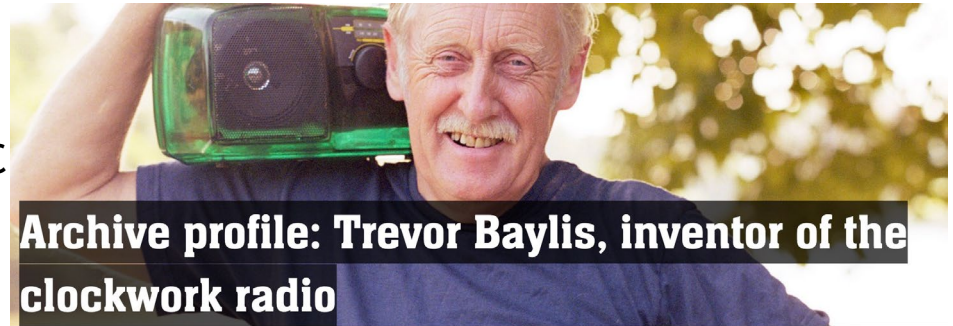
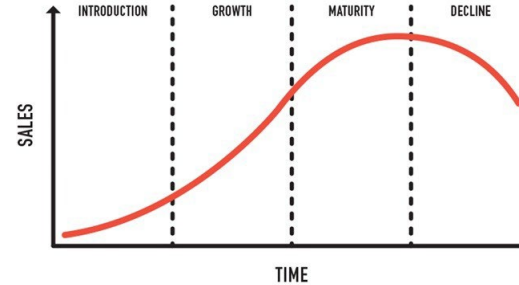
# EVC (Economic Value to the Customer)

- Example:
  - John Deere make small bulldozers (less than 100HP)
  - Caterpillar make bulldozers 100 HP+
  - John Deere want to introduce new larger bulldozer which would compete with Caterpillar. They use technology from the smaller machine so that it has a tighter turning circle and can achieve more efficiency
  - Small machines sell to small jobbing builders, large machines to big construction projects.
  - **Should John Deere price at less than, same as or more than Caterpillar's comparable product?**



# Value and PLC

- Invented and launched clockworkradio
- Inspired by news coverage in 1991 of the value of education in stopping the spread of AIDS in Africa
- Lack of access to mains electric and the cost of batteries restricted access to communications in some parts
- Used the older, declining “clockwork” technology to create a radio launched in South Africa in 1995
- Winner of numerous awards including BBC Design Awards for Best Product and Best Design, an OBE for Services to Africa, the World Vision Award for Development Initiative, a Presidential Gold Medal from the Institute of Mechanical Engineering



# Government / Regulatory Price Controls

- Price Ceiling eg: pharmaceutical price caps by government or WHO
- Price Floor eg: to avoid price dumping eg: for energy providers, foreign investors, or on costs eg: minimum wage legislation

# Pricing Methods

- Market Penetration – lower price to larger number of customers
- Market Skimming – higher price to smaller number of customers



vs



# Pricing Methods



# Market Penetration Pricing

- Works on the basis that high volume x low margin can generate the same /similar profit to low volume x high margin.
- This is a Ford rather than a Ferrari pricing strategy
- McDonalds would be a good example of a market penetration pricing strategy
- Penetration pricing can also be used in some other specific situations eg:
  - to enter a market and create visibility
  - to create trial of products
  - to attack competitors







Shoes / Trainers / Wedge-trainers

## JIMMY CHOO

Diamond lizard-print velvet and patent-leather trainers

£650.00

Select Colour:

Bordeaux/black

Select Size:

EUR 38.5 / 5.5 UK WOMEN

Only 1 available

SIZE GUIDE →

Add to bag



PRODUCT DETAILS →

DELIVERY AND RETURNS →

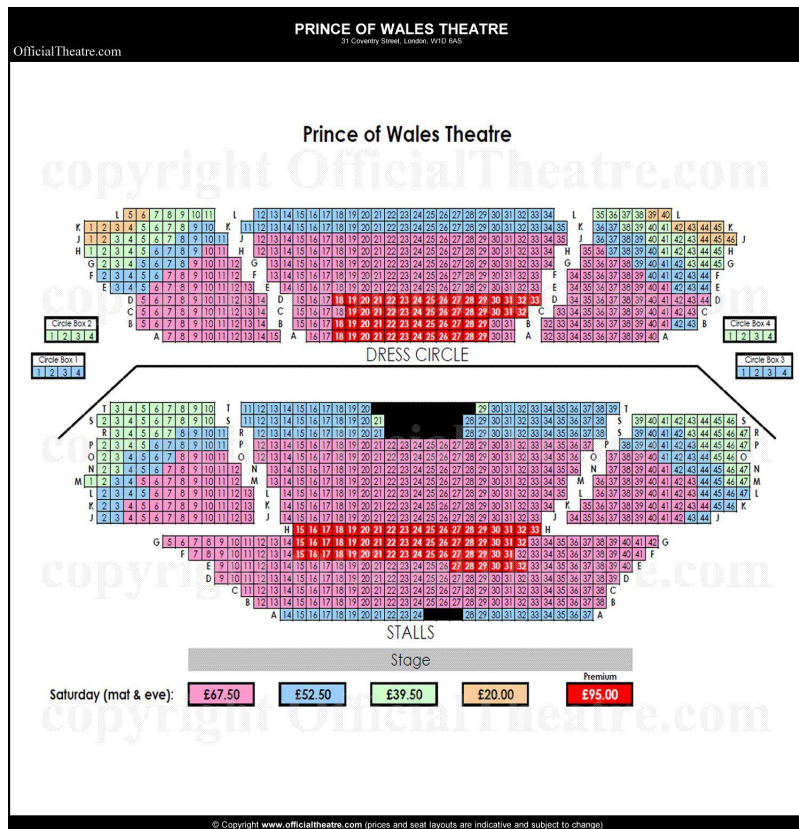


# Variable (Differential) Pricing

- Begins with the concept of differentiation
- Think of the example of theatres; seats in different parts of the theatre, for different shows with greater and lesser demand and on different days
- Why do you pay more for some seats than others?



# Variable Pricing Example



# Examples

- In our theatre example, not only would we have a difference between type of seat, day etc, but we might pay different prices for the same thing depending on when we buy our ticket and other algorithms to do with supply and demand.
- For airlines... what might happen if I announced an exciting opportunity overseas and you all went to book flights. What price might you expect the first person to book to receive compared with the 10<sup>th</sup> or 20<sup>th</sup> in close succession?
- What might happen to prices when only 2 or 3 seats remain?
- If 2 or 3 seats still remain one day ahead of our planned departure, what might happen to ticket prices then?

# Differential Pricing in Football at FC Barcelona

- Prices of tickets vary according to match category (E, D, C, B, A, A+, A++) which depends on opposition
- Prices also vary depending on where in the stadium you sit in Camp Nou



# Differential Pricing in Football at FC Barcelona

- FCB v Eibar 19/10/2014 C
- FCB v Celta Vigo 2/11/2014 C
- FCB v Sevilla 23/11/2014 A
- FCB v Espanyol 7/12/2014 B
- FCB v Cordoba 21/12/2014 D
- FCB v AT Madrid 11/01/2015 A
- ... FCB v Rayo 08/03/2015 E
- FCB v Real Madrid 23/03/2015 A++  
(No general sale tickets available)
- FCB v Valencia 19/04/2015 A+  
(General sale tickets available)





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# Dynamic Pricing

- This then leads us to the idea of dynamic pricing
- Dynamic pricing is changing prices in real time
- This is often done using an algorithm or using AI but can involve human judgement
- This might be based on:
  - Supply and demand
  - Inventory

# Price Bundling

- **Bundling** is when companies package several of their products or services together as a single combined unit, often for a lower **price** than they would charge customers to buy each item separately. This marketing strategy facilitates the convenient purchase of several products and/or services from one company
- Different prices at which consumers “value” different products eg: one Microsoft Office customer might only use Word, one might value Powerpoint via Excel or vice versa.
- “Bundling” these into one offer evens out the variability and makes the package of different products. You might gain extra for a product that otherwise the customer might not buy (eg: Microsoft Access, or different Cable TV channels in a bundle).
- Easier to calculate a mean value that the customer is prepared to pay.

# What is Segmentation?

“To divide the market into relatively homogeneous segments of customers; each of these groups, to be fully satisfied, needs its own marketing mix or product”.

(Kotler & Armstrong, 2014)

A priori segmentation is a process whereby a company chooses to break out customer groups by generally accepted classifications. This can be the result of company tradition, recognized industrial groups, or some other external or internal criteria

(Mazanec, 2000)



# Warm Up Exercise – What Do These Groups of People Have in Common and Different?



# Segmentation Re-Cap

## Psychographic Bases for Market Segmentation

- C
- Activities
- Interests
- Opinions, Attitudes & Values
- (AIO) surveys for measuring lifestyle.
- Personality
- Self-image

- Behavioural
- actual behavior toward product itself. A good starting point for segmentation
- Benefits sought
- Usage rate
- Brand loyalty
- User status: potential, 1st-time, regular etc.
- Readiness to buy
- Occasions: holidays & events that stimulate purchases



## Geo-Demographic

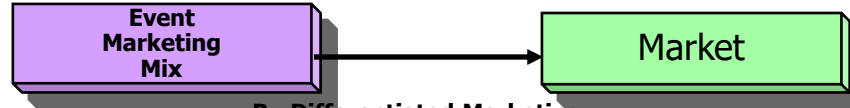
- Demographic
- Gender
- Age
- Family life cycle
- Race/Ethnic group
- Social class
- Education
- Income
- Occupation
- Family size
- Religion
- Home ownership

- Geographic
- Country
- Region
- Urban/Suburban/Rural
- Population density
- City size
- Climate

# Step 2. Market Targeting

## Market Coverage Strategies

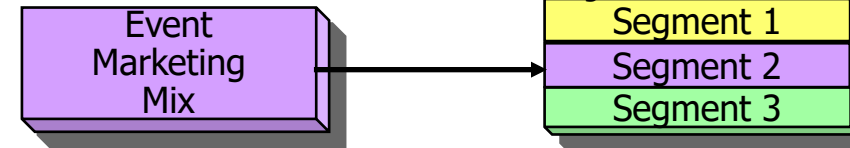
### A. Undifferentiated Marketing



### B. Differentiated Marketing



### C. Concentrated Marketing



# McDonalds



# Segment Attractiveness

- **Identifiable**
- **Reachable**
- **Responsive**
- **Substantial and Profitable**

# Age

| Chronological age   | Number of years that you have lived since birth   |
|---------------------|---|
| Biological age      | An estimate of your present position with respect to your potential lifespan  |
| Social age          | Age in terms of social roles and habits; this is concerned with different roles you take during the life cycle indicating your standing in society  |
| Cognitive age       | This is your self-perceived age (the age you perceive yourself to be, related to your self-concept); this can include subjective age and personal age   |
| Subjective age      | Your self-perception with reference to other age groups (e.g. middle-aged, elderly, old)  |
| Personal age        | This is also based on your self-perceptions and comprises four age dimensions: feel age (how old you feel), look age (how you look), do age (how involved you are in doing things favoured by someone important in your life); and interest age (how similar your interests are to those of a particular age group) |
| Other perceived age | This is a subjective evaluation of your age status as assessed by others  |

Source: Based on B Barak and LG Schiffman, Cognitive Age: A Non Chronological Age Variable, *Advances in Consumer Research*, Vol 8 (1981), pp 602-606. Reproduced by permission of the Association for Consumer Research

(Barak and Schiffman 1981)

# Public Sector Pricing Methods

Pricing options include:

- Going rate (price leadership)
- Destroyer Pricing (removing competition)
- Loss leader (attracting visitors who then spend on other services)
- Value pricing (higher price to suggest added value)
- Penetration pricing (to attract new participants to establish a new activity)
- Psychology pricing ( £1.99 as opposed to £2.00)
- Absorption pricing (an attempt to recover costs based on variable and fixed)
- Comparison Pricing

# Concessions

Concessions Typical concessions are applied by most authorities, although the detail can vary widely.

- Registered disabled
- Registered unemployed
- Income support
- Student ☐ Junior (under 16)
- 60 and over In addition some authorities include the following not exclusive list:  
Carers.
- Armed services personnel ☐ Foster carers ☐ Housing benefit claimants ☐ Elite athletes
- Free school meal recipients.



# Discussion

- Does price bundling add value for consumers?

# Summary

- Approaches to price: cost-plus, competitor parity, market-oriented pricing
- Differential pricing
- Dynamic pricing

# References

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