

School of Engineering

Engineering Business Skills -
Pricing

Pricing

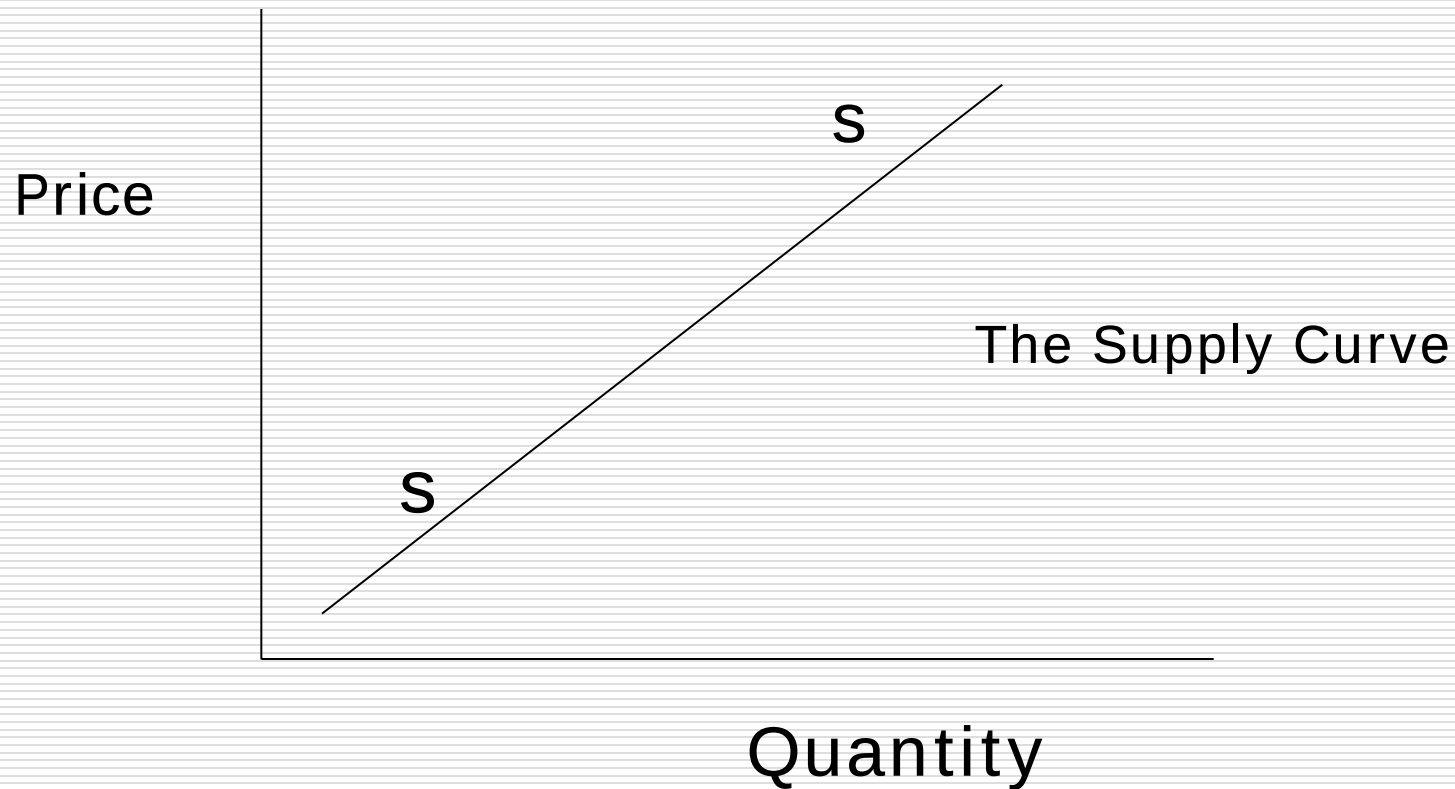
- ❑ The importance of price as a function of the marketing mix varies from market to market, but it is not always the most important factor in the buyer's decision-making process.
 - ❑ Price provides revenue, whilst other elements of the marketing mix represent cost
 - ❑ If a product is priced too high, customers may not purchase it. If a product is priced too low profit margins will also be low.
-

Pricing

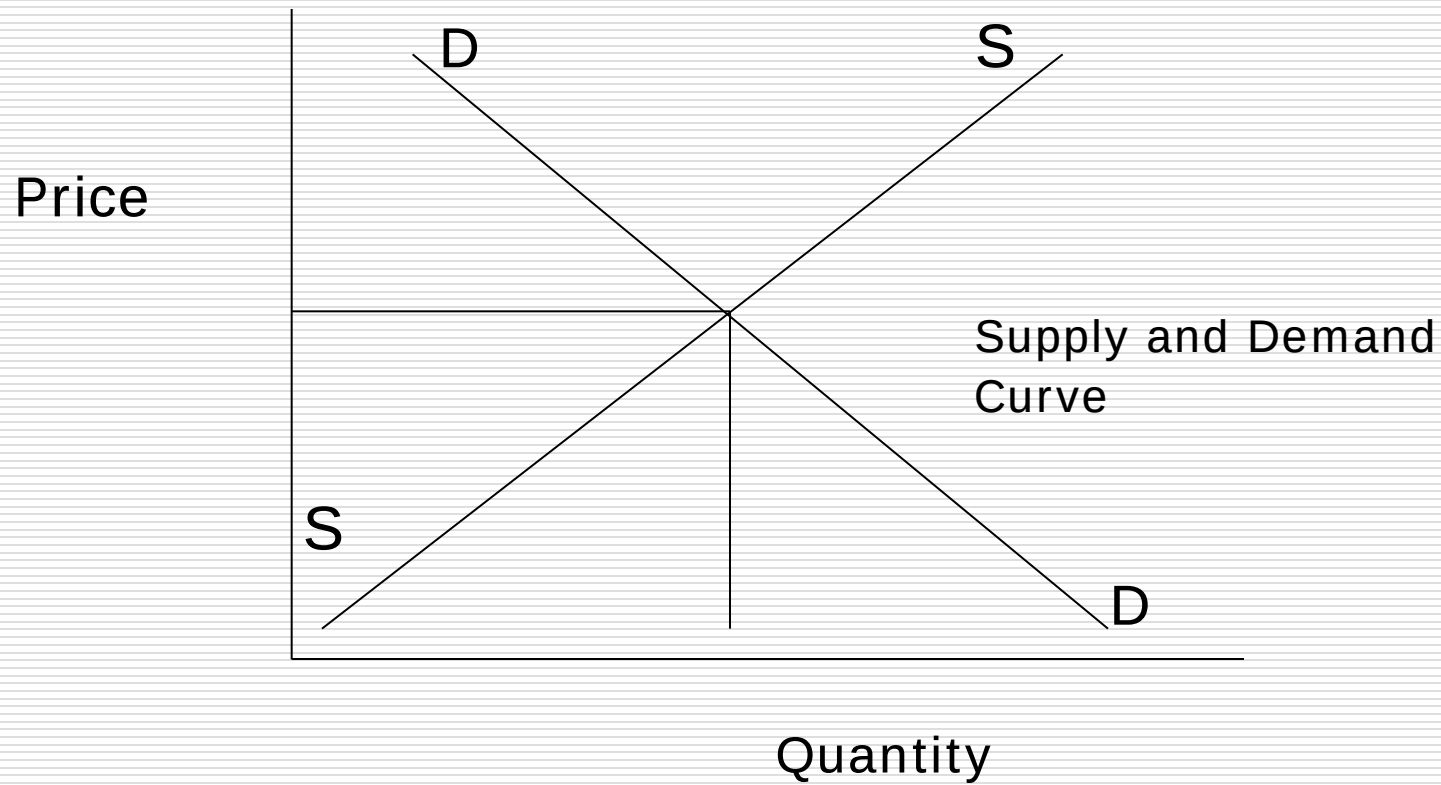
- ❑ Businesses are interested in the role of price in the buyer-seller relationship.
 - ❑ The buyer views price as a cost that is paid in return for a series of satisfactions
 - ❑ The seller sees price as a means of cost recovery and profit
-

Economic Theory - supply

As price increases the quantity supplied increases



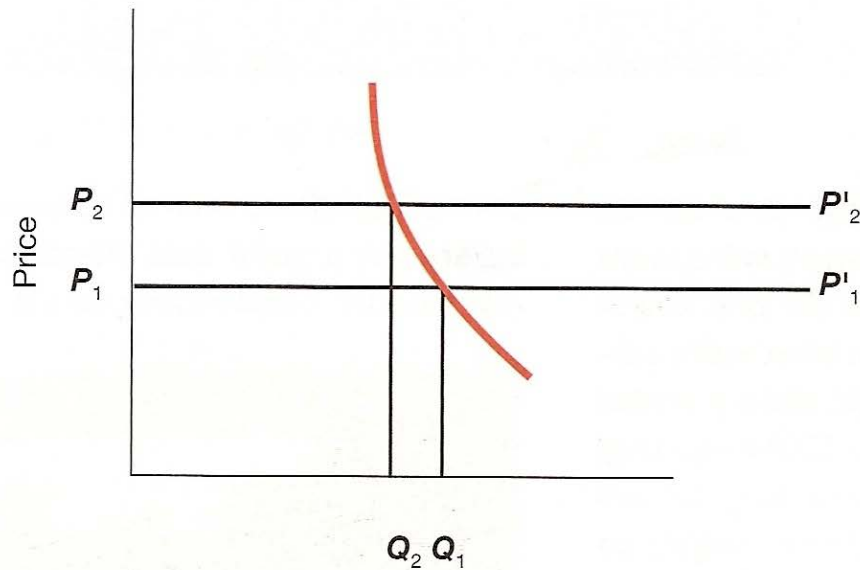
Economic Theory



Economic Theory –supply and demand

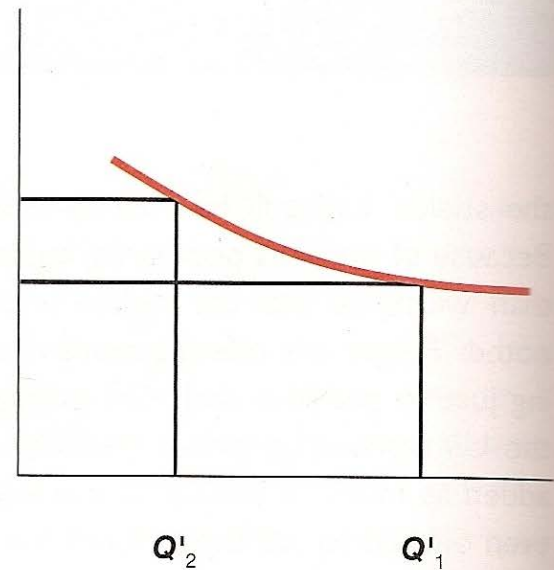
- ❑ When demand schedule is plotted companies must consider elasticity of demand
 - ❑ Elasticity describes the sensitivity of consumers to changes in price
 - ❑ A product can be said to have elastic demand when price changes greatly affect levels of demand
 - ❑ Inelastic demand is relatively insensitive to price changes
 - ❑ Even when demand is elastic, there is usually some point on the demand curve where a further price reduction makes little or no difference to demand
-

Economic Theory – Elastic pricing



Quantity demanded per period

A. Inelastic demand



Quantity demanded per period

B. Elastic demand

Mazda MX5 pricing



Pricing Objectives

- ❑ **Improvement in market share**: maintenance of market share is at least key to survival, and price carries much of the burden of responsibility in a marketing mix designed to maintain or improve market share
 - ❑ The acquisition of market share for its own sake is a contentious issue, although high market share companies enjoy advantages over smaller competitors, and market share is regarded as the key to profitability
 - ❑ Certainly market share is an accepted indicator of a firm's general health and decline in share is a significant danger signal
-

Pricing Objectives

Maintaining price stability

- ❑ Provide a company's returns are considered adequate, there is considerable justification for maintaining the status quo by meeting competitive prices established by the market leaders
 - ❑ Price adjustments are usually only made in response to changing market conditions
 - ❑ During the introduction and growth stages of the product life cycle, price usually plays a less significant role
 - ❑ During maturity and growth (where most products are situated) the major 'price wars' are usually fought
-

Pricing Objectives

Maintaining price stability

- ❑ Whilst changes in market share can be achieved by price cutting, as a general rule, this is to be avoided as it works to the detriment of everyone
 - ❑ Companies can improve their market share by shrewd use of the marketing mix, whilst at the same time pursuing a price stability objective
 - ❑ The party with ultimate influence in price setting is usually customers, although they have less influence in some markets than others. For example, the market for petrol is one where the consumer has no real choice of substitutes and consequently little influence on price
-

Steps in Price Determination

- ☐ To ensure profitability, prices must ultimately exceed costs
 - ☐ Pricing strategy should begin with the consumer and work 'backwards' to the company
 - ☐ Costs cannot be ignored, but pricing must be consumer or customer orientated
-

Steps in Price Determination

1. Identify the potential consumer or market
 2. Demand estimation
 3. Anticipating competition prices and reactions
 4. Market share analysis
 5. Cost analysis
-

Steps in Price Determination

Demand estimation

- ☐ Likely volume of sales will directly affect a manufacturer's costs and the price necessary for profit maximisation
 - ☐ Demand analysis should provide the company with a schedule of predicted demand levels at differing prices
 - ☐ Demand analysis should provide the following basic information
 - General marketing information
 - Income
 - Substitute products
-

Steps in Price Determination

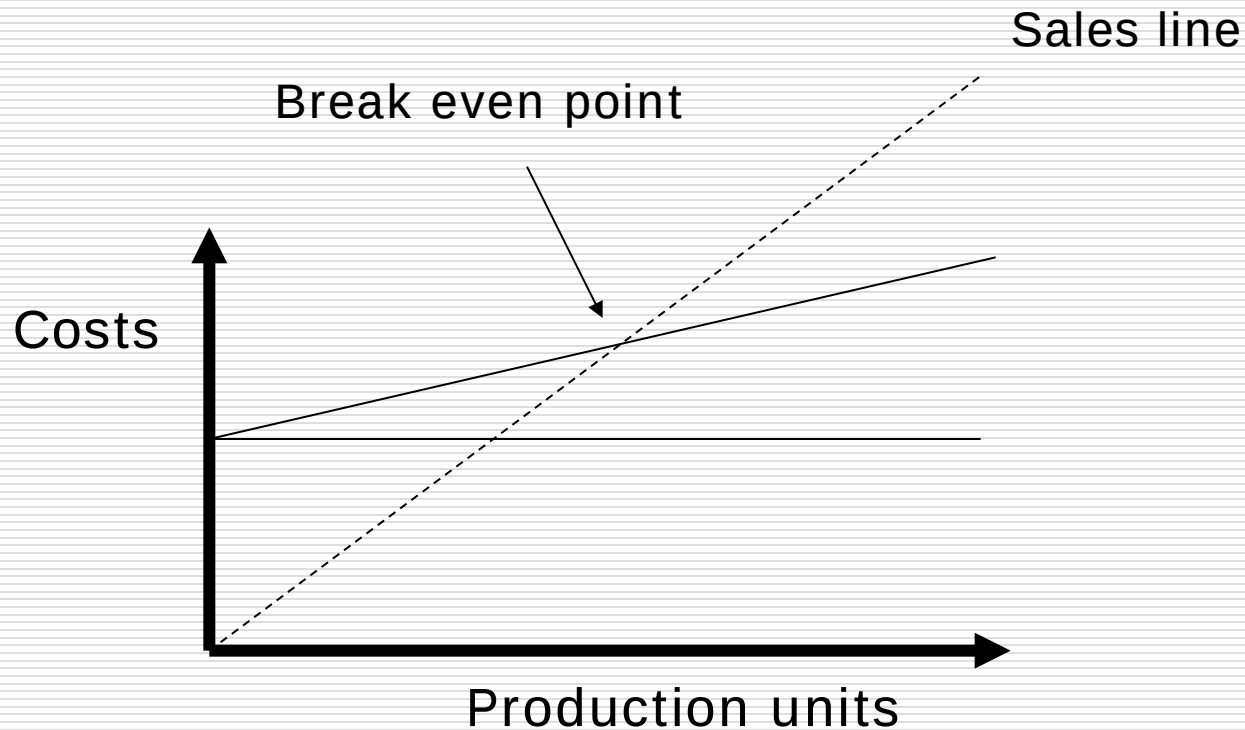
Cost analysis

- In order to ascertain the viability of such a price and level of output a break-even point must be calculated from an analysis of the relationship between costs and output
-

Break even point

Price determination

□ Total costs



Steps in Price Determination

Cost analysis

A company has already estimated that £1.80 is a desirable price in market terms. Using the following equation it is possible to calculate the number of units required to break-even at this price

$$\text{BEPU} = \frac{\text{Fixed Costs}}{\text{Selling price per unit} - \text{Variable costs per unit}}$$

Cost Plus Pricing

- Works by calculating the cost of manufacturing the product, including distribution, overhead costs and R&D costs, then add on a fixed percentage profit to this figure in order to arrive at the selling price
-

Cost Plus Pricing

Item	Cost per unit
Labour costs	£2.52
Raw materials	£4.32
Electricity	£0.27
Tooling costs	£1.78
Overheads	<u>£3.43</u>
Total cost per unit	<u>£12.32</u>
Plus profit of 20%	<u>£2.46</u>
Selling price	<u>£14.78</u>

Mark-Up Pricing

- The retailer takes the cost price of the product and adds to this a percentage mark-up that is sufficient to cover overhead costs and provides a predetermined percentage profit.
Mark-up can be calculated as follows:

$$(100\% + \text{required \% mark up}) \times \text{cost} = \text{Selling price}$$

Market Skimming

- ❑ To reach this wider group of customers, the company must reduce prices progressively while at the same time 'skimming' the most advantageous prices from each successive customer group
 - ❑ The signal for each planned price reduction is a slowing down in sales
 - ❑ Price reductions are successively introduced until the product has ultimately been offered to the bulk of the overall target market
-

Market Skimming

- ❑ For a skimming strategy to be successful, the product must be distinctive enough to exclude competition who might be encouraged to enter the market by the high prices that a company is able to charge in the earlier stages
 - ❑ The advantage of this method is that the cost of developing the product is returned fairly quickly, so that the product can later be sold near the marginal cost of production
-

Penetration Pricing

- ❑ Used when a firm wants to capture a large part of the market quickly
 - ❑ It relies on the assumption that a lower price will be perceived as offering better value for money
 - ❑ The new product is then sold at substantially lower prices, even if this cuts profits below an acceptable level
 - ❑ The intention is to capture the market quickly before the competitors can react with even lower prices
-

Pricing Tactics

- **Geographical pricing** – it is widely believed that individuals in the south of England have higher levels of disposable income than in the North. Therefore many companies have different selling prices, depending on the geographical location of customers.
 - **Psychological pricing** – relies on emotional responses from the consumer. Higher prices are often used as indicator of quality, so some firms will use prestige pricing
-

Pricing Tactics

- ❑ **Off-peak pricing** – many companies encourage customers to buy goods at ‘off peak’ rates. An example of this can be seen on trains. Travel is much cheaper after 10.00 am
 - ❑ **Trade discounts** – Intermediaries often receive trade discounts for buying in bulk. This allows the intermediary to make higher profits, or to pass the discount onto its customers
-

Pricing Tactics

- ❑ **Optional feature pricing** – customers are given the option of additional features on a product. Each additional feature increases the selling price of the product
 - ❑ **Promotional pricing** – companies often offer promotional prices to encourage sales. Products may have lower prices for certain periods
-

Mazda MX5 – aftermarket upgrades

