Lesson n°04 : Pricing policy

Course objectives

The objective of this session is to present the main marketing studies that can be used today by companies to analyze their markets. Even if they are sometimes controversial, they remain an essential source of information in the decision-making of managers and constitute one of the main centers of expenditure of their marketing budget.

Course plan

1. Definition of price
2. Pricing policy development process
3. Price and consumers
4. A flexible pricing policy

1. Definition of price

The price is the monetary equivalent of a product and all the benefits attached to it. It is the only variable in the mix that constitutes income for the producer, while the others are expenditure centers!

The price has 3 main characteristics:

- an economic effect, it is a brake on the purchase
- a psychological effect is the image of the product
- an effect on the attitude of distributors who highlight it or not in their store

The price determines the profitability of the product.

The price is a factor of positioning the offer on the market.

The Retail Price to the Consumer (CRP) depends on the strategy of the manufacturer and that of the distributor.

The producer therefore does not directly control the selling price, except:

- if he sells his own products (EDF, etc.)
- if he has the right to impose his price on the distributor (publishing, automobile, cigarettes, etc.)

2. Pricing policy development process

1. Fixing the selling price

The setting of the selling price is based on 3 factors:

Costs: the selling price must make it possible to cover the costs and ensure the company a margin of profitability. The costs are partly linked to the company's relations with its suppliers.

Demand: the price must be consistent with consumer expectations in terms of price and also quality (see concept of psychological price, part 2).

Competition: the price must make it possible to position the offer in relation to those of its competitors. Price competitiveness ensures the company's market share and thus its profitability.

Pricing can then follow 3 logics:

* By the costs: we calculate the cost price, we add the desired margin. But does the price obtained correspond to consumer expectations? Is it competitive with competitors?

* By demand: the selling price is established according to the psychological price method: it is the one that maximizes consumer demand. The margin obtained then results from the difference between this selling price and the cost price of the product. But does this margin ensure the company's profitability?

* By competition: the selling price is set according to that of the product's direct competitors and the desired positioning: more or less expensive? In the event of a price war, this logic can lead the company to dangerously reduce its margin, or even to obtain a negative margin, which is not viable in the long term.

The setting of the selling price must therefore be based on the joint consideration of these 3 logics.

The price setting process follows 3 steps:

- Formulation of objectives and prioritization
- volume: sales and volume and value, market share
- profitability: gross margin, contribution, profit
- image: positioning
- range:
- positive impact: induced products
- negative impact: cannibalization on sales of other products in the range

Pricing policy development process

Example

Electric razor maker set to price new model

Priority objective:

maximize market share

Other objectives:

image : razor of excellence (but not a luxury model)

profitability : over 3 years, return on invested capital ≥ 30%

range : do not cannibalize more than 5% of the sales of the most expensive current model

It faces several constraints in terms of costs:

Cost constraint: to achieve the level of profitability that has been set and given the company's cost structure and the distributor's foreseeable margins, the minimum selling price to the consumer (RPC) is €140.

Competition and range constraints:

competition : the prestigious model from Braun, a luxury brand, is sold for €199. We cannot exceed 90% of this price (179 €).

range : the most expensive current model in the range is sold for €130. To avoid cannibalization, the new model must be sold at least 15% more expensive (150 €).

Customer acceptability constraints: a study of psychological prices showed that a price of €166 should not be exceeded because beyond that, the product is rejected because it is too expensive.

3. Price and consumers

Customers' price sensitivity

Price awareness and price sensitivity

Academic research shows that memorization is generally rather weak (Desmet & Zollinger 1997): only 70% to 80% of respondents quote a price and the exact price, within 5%, is quoted by less than 40% of respondents. Consumers' knowledge of prices is therefore imprecise: the price quoted may be accompanied by an error of 10 to 30%.

In addition, we observe differences depending on the product: knowledge is higher for products and brands purchased very frequently. Knowledge of price also varies according to social status: knowledge of price is inversely related to economic status

Several factors influence price sensitivity. Indeed, consumers are less price sensitive when:

- the product is original (differentiated)
- it is difficult to compare prices (different packaging, etc.)
- the purchase amount is low (and the purchase frequency is low)
- part of the price is reimbursed or reimbursed by third parties

Demand function and elasticity

Demand function and price

In principle, demand decreases when price increases: demand is therefore a decreasing function of price (see diagram) except when price is an index of quality: we then speak of the snobbery effect (also called the effect of Giffen) which causes demand to increase when the price increases (which is observed for luxury products or products that are positioned on price (for example the "most expensive perfume in the world")

We can draw the demand curve (in principle convex)

Price elasticity then measures the “slope” of the curve at a given point. It is a way of measuring the sensitivity of consumers to pr

Psychological evaluation of the price

Consumer price assessment

Companies generally put in place:

- round prices: 1 euro… This practice is widely used during sales or promotions. It simplifies prices for the consumer.
- the odd pricing (magic prices): 9.90, 199… This practice is very widespread (50% of the prices displayed contain a 9!). Its effectiveness - not demonstrated - is a matter of custom.

When the consumer makes his choice, he balances 2 factors:

- the importance of the sacrifice (the perceived cost of the purchase, a total cost which includes the money, the time spent, the constraints generated)
- the benefits, the advantages that he will be able to derive from the purchase.

The psychological price

When the consumer makes his choice, the price is for him a determining quality indicator. He assigns a price to the product, the reference price, corresponding to the price that he thinks the product is worth, taking into account its characteristics and the benefits, functional and symbolic, that he intends to derive from it. The reference price is generally lower than the actual price of the product.

Depending on the price of the product, the consumer will decide whether to reject the product or consider it as a possible purchase. There are two areas of rejection depending on the price of the product:

- A rejection zone because the price is too high (it represents too great a sacrifice for the consumer).
- A rejection zone because the price is too low (the consumer believes that given this price, the product will not provide him with enough benefits and advantages).

The methodology for determining the psychological price of a product is as follows. We ask a sample of potential customers, showing them (or not) a price list:

“Above what price do you consider this product to be too expensive? »

“Below what price do you consider this product to be of poor quality? »

The optimum psychological price is the one that maximizes the acceptability zone of the product.

This method has a main limitation: the price ranges are estimated from the predictions made by consumers. There remains therefore a bias: will what the respondents declare today correspond to the future reality when the consumer will really be confronted with his choice in the

4. A flexible pricing policy

Yield management _

" Yield Management, or the management of yields, consists in varying the price of a service with the aim of effectively managing capacities and maximizing the overall income of the company" (Marketing Management, Kotler, Dubois , Keller and Manceau, Pearson Education, p. 470).

The principle is to offer advantageous prices to customers who buy during off-peak periods in order to make the best use of production capacities. This practice is mainly used by service companies because their production cannot be stored.

The differentiated tariffs make it possible to amortize the fixed costs (FF). We can go as far as marginal cost pricing.

Example

Yield management is a common practice with airlines (which invented this concept in the 1970s), Club Med, SNCF, etc.

Difficulties of Yield Management:

Can generate dissatisfaction.

Complex to implement.

The 3 stages of yield management

The implementation of a Yield management policy requires 3 steps:

Anticipate: it is easy to analyze the seasonality of demand, but it is difficult to determine what demand would have been if prices had been higher.

Segment: Market segments must be determined based on people's price sensitivity (eg price sensitivity is greater for private travel than for business travel).

Communicate: it is necessary to communicate to its marketing targets the pricing policy which is complex by nature.

Illustration: the case of Air France

Objective: each seat sold must bring in as much money as possible!

Some numbers :

18 million different fares are issued each year by Air France.

There is a price gap of 1 to 5 between the price paid by some economy class passengers and their seat neighbors on a domestic flight.

43% of the turnover of a long-haul line is made by 15% of the passengers (1st and business).

Pricing criteria:

Based on the analysis of demand (economic situation, various events, etc.).

Based on competitive pricing analysis.

The keys to success:

Yield Management cell of 210 people including 90 flight analysts and 35 pricers which resembles a bank trading room.

Yield Management dialogues internally with the departments in contact with the customer (sales, marketing, station managers) .

Discretion and the cult of secrecy!

5. Pricing strategies _

The strategy of penetration and skimming