

# PRICE MANAGEMENT

Only study guide for  
**MNM2609**



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# PREFACE

Dear Student

We have great pleasure in welcoming you to Price Management (MNM2609). We would like you to share our enthusiasm for this field of study and, as a first step, we urge you to read this preface in detail. Refer to it as often as you need to, since it will definitely make studying this module a lot easier.

Marketing is a very exciting field without which no business would survive. Marketing managers are faced with new and stimulating challenges on a daily basis, involving their consumers, their products, their environment and even their competitors. During the course of this module you will get a feel for where marketing came from and how it developed, as well as for the major decision areas that marketing managers have to consider and learn in order to understand consumers better.

## 1 AIM OF THIS MODULE

The aim of this module is to enable students of the module MNM2609: Price Management to gain a better understanding of the various pricing decisions that must be made, as well as of the elements making up the price component of the marketing mix.

## 2 LEARNING OUTCOMES

After completing this module, you should be able to:

- define pricing and discuss the importance of price in the economy and in an organisation
- discuss the various cost constraints that affect the pricing decisions for a product
- explain the role of price in the marketing mix
- discuss the steps in the pricing model
- explain how to estimate demand and revenue relationships in pricing
- discuss the various pricing objectives that an organisation could set when establishing its pricing strategy
- explain how an organisation would go about selecting approximate price levels
- discuss the setting of list or quoted prices
- highlight the various adjustments that can be made to the list or quoted price

## 3 OVERVIEW OF THIS MODULE

Pricing is a lot more than just deciding what prices to charge. Price management is about finding a price level that suits the pricing objectives of the organisation and, at the same time satisfying the consumer by charging a price that he or she is willing and able to pay!

In this module, the first topic deals with the nature and role of price in the organisation. The topic also includes a discussion of the common pricing mistakes made and the importance of price in the organisation and in the economy.

Value and price are also examined, as well as the role of price in the marketing mix. The topic concludes with a discussion of the pricing model.

The second topic focuses on the steps taken in the setting of price. It does this by examining the various pricing constraints that need to be considered in pricing and by looking at how demand and revenue relationships are estimated. The various pricing objectives that an organisation can consider are also explained in this topic.

The third topic is all about determining the final price set by the organisation. How to select an approximate price level is explained, as well as how to set the list or quoted price. The various adjustments that an organisation can consider are also covered in this topic. Lastly, managing price changes is discussed in detail.

## **4 THE STUDY PACK**

The study material for this module consists of this study guide, a prescribed book and several tutorial letters. The tutorial letters and study guide will be sent to you during the course of the year. The prescribed book (which you must purchase yourself) is of vital importance because you will not be able to complete this module successfully without using it. In addition to the prescribed book, you are encouraged to consult other sources such as those available in the Unisa Library.

Please consult Tutorial Letter 101 for the details of your prescribed book and additional reading materials.

We strongly encourage you to make every effort to join myUnisa. You will remember from your Tutorial Letter 101, that myUnisa is our online community for this module. From time to time we will upload additional information and resources to myUnisa. Students who do not have access to the internet should contact us to find the closest Unisa computer centre or internet café.

## **5 THE APPROACH TO LEARNING AND TEACHING IN THIS MODULE**

The purpose of this study guide is to allow you the opportunity to put into practice those theoretical concepts introduced in the prescribed book and, at the same time, to give you some exercises and questions that will assist you in preparing for the examination. It is essential that you work through the study guide, as by doing so you will improve your chances of performing well in the examinations. However, there is no substitute for being thoroughly familiar with the theory as discussed in the prescribed book. Your prescribed book and study guide complement each another in that the study guide assists in the learning process, but studying it alone and ignoring the prescribed book will not equip you for success in the examinations.

## 5.1 *Suggestions on how to approach your studies in this module*

Tutorial Letter 101 and the study guide will direct you as to how to approach the learning, and all other, resources and to consider how you may use these to your benefit – for example, how to make the best use of myUnisa, peer collaboration groups, learning centres and career counselling. As a distance education student, you need to know whom to contact for academic and administrative matters, and know how to manage your time.

In the study guide, we make a definite distinction between the parts of the prescribed book that you simply have to read, and those parts that you have to study.

- Studying

The sections that have to be studied are clearly indicated and form the basis of assignments and examinations. To be able to do the activities and assignments for this module, to achieve the learning outcomes and to be successful in the examination, you will need a thorough understanding of the content of these sections in the study guide and the prescribed book. In order to understand the study material properly, you need to accept responsibility for your own studies and to realise that learning is far more than just memorising. You will be expected to show that you understand and are able to apply the information, not just remember it.

- Reading

Some parts of the study guide will tell you to read a certain section in the prescribed book or the study guide. This means that you should take note of the content of this section, as it usually forms useful background information or offers another perspective or further examples. It will give you some context, improve your ability to take notes and enhance your understanding.

You will need to spend at least 120 hours on this module. This includes approximately 40 hours of reading and studying of the study material, 20 hours of activities and assignments and 60 hours of preparation for the examination. We encourage you to follow the proposed schedule for the allocation of time for the various topics, study units and other activities as supplied in Tutorial Letter 101.

You may wish to read more widely than just the study guide and the prescribed book. When you read information in the prescribed book or in other sources, do not simply accept it without question. Critically evaluate the ideas and information that you come across.

Test your understanding of the ideas that you learn about in this module by doing your best to apply them to real-life situations.

## ***5.2 Importance of completing activities, assignments and self-assessment questions***

### ***5.2.1 Activities***

You will come across various types of activities in this study guide. They will require you to:

- reflect on work covered
- complete assessment questions
- do self-assessment

We consider your completion of the activities in the study guide and the assignments crucial to your successful completion of this module. Firstly, the activities in the study guide will help reinforce your learning and secondly they will help to prepare you for the type of application question that you will have to answer in your second year of studies and beyond.

### ***5.2.2 Assignments***

You will find the assignments for this module in Tutorial Letter 101. The completion of assignments is crucial to helping you achieve the learning outcomes. By completing the assignments, you will get a feel for the type of question you can expect in the examination and obtain first-hand feedback from the lecturer. The assignment questions also give you the opportunity to apply the theory to a case study or a practical situation related to your own workplace. We will inform you of the purpose of each assignment and which module outcomes will be assessed by the assignment. We will also supply the criteria for assessment so that you understand how to approach the answering of specific questions.

Details of the assignments, along with their associated assessment criteria and the format and requirements of the examination, are provided in Tutorial Letter 101.

### ***5.2.3 Assessment questions***

At the end of each section, you will be referred to a list of possible assessment questions based on the work covered in that section. We advise you to work through these questions diligently, since self-assessment plays a very important role in the mastery of learning outcomes.

You will find most of the answers to these questions in the study material in the study guide and prescribed book. We believe that you should not be faced with any surprises when you come to write the examination. Consequently, it is in your own interest to work through these assessment questions.

### ***5.2.4 Assessment of the module***

During the semester you will be assessed on your assignments, and in the examination at the end of the semester you will be assessed against transparent assessment criteria that link directly to the outcomes of the module.

The compulsory assignment mark(s) will count, with your final assessment, towards your total mark. Further details of the assessment and examination requirements of this module are supplied in Tutorial Letter 101.

## 6 EXAMINATIONS

### 6.1 *Prescribed material*

All of the study material is relevant for the examinations. In addition to understanding the theoretical principles provided, we expect you to be able to apply these principles to a practical situation in a given case study or scenario.

### 6.2 *Format of the examination paper*

The format of your examination papers is clearly explained in your Tutorial Letter 101. Your examination paper will have two sections. Section A is compulsory and consists of twenty (20) multiple-choice questions which each count two (2) marks. Section B consists of a short case study and three (3) essay questions, each counting fifteen (15) marks. You are required to select two (2) of the three (3) essay questions.

## 7 KEY CONCEPTS IN ASSIGNMENTS AND EXAMINATIONS

When we, your lecturers, formulate assignment and examination questions, we word them in specific ways so that you will know exactly what is expected of you. For example, we may ask you to *list, describe, illustrate or demonstrate* something, *compare* two things, or to *construct, relate, criticise, recommend or design* something.

Below is an explanation of the various levels of cognitive thinking that you will be expected to apply, and the kinds of instructions that we will give you with regard to each. This system is known as Bloom's taxonomy.






- Knowledge. This is essentially memorisation and the recall of information. At its simplest, it involves the recall of facts or terminology, such as names, dates and definitions. It can also involve the recall of principles and generalisations, or ways of doing things. Outcomes/instructions written at this level will typically use verbs (these are the words that tell you what you have to do) such as *name, list, define, label, select, state, write, describe, identify and recall*.
- Comprehension. This involves making sense of things, rather than just remembering them. Comprehension usually requires you to translate information into your own words. Outcomes/instructions written at this level will typically use verbs such as *convert, illustrate, distinguish, interpret, rewrite, discuss, give examples and summarise*.
- Application. This is the ability to use information and ideas in new situations, such as in solving problems that have a single or best answer. Outcomes/instructions written at this level will typically use verbs such as *calculate, demonstrate, construct, compute, solve, relate, show, use and apply*.






- **Analysis.** This is the ability to examine information in a systematic manner to identify the important ideas, the relative hierarchy of those ideas and the relations between the ideas. Outcomes/instructions written at this level will typically use verbs such as *analyse, differentiate, categorise, classify, relate, illustrate, outline, compare, contrast, discriminate, explain and hypothesise.*
- **Synthesis.** This is the ability to construct something new by combining several pieces of information to make a coherent whole (such as a plan). Outcomes/instructions written at this level will typically use verbs such as *plan, adapt, combine, create, compile, compose, construct, model, revise, design, develop, formulate and organise.*
- **Evaluation.** This is the ability to make judgements about the quality or value of things (either with reference to internal evidence or external criteria). Outcomes/instructions written at this level will typically use verbs such as *assess, judge, choose, criticise, rate, argue, justify, evaluate, decide, recommend and conclude.*

In this module, you will be asked to operate on all levels of Bloom’s taxonomy. Please make sure that you know what is expected of you in each question.

## 8 USE OF ICONS

The icons that will be used in this study guide are listed below, together with an explanation of what each means:

Icon	Description
	<b>Key concepts.</b> The key concepts icon draws your attention to certain keywords or concepts in the topic or study unit.
	<b>Learning outcomes.</b> The learning outcomes icon indicates which aspects of the particular topic or study unit you have to master. You will need to demonstrate that you have mastered these aspects.
	<b>Study.</b> The study icon indicates which sections of the prescribed book or the study guide you need to study and internalise.
	<b>Read.</b> The read icon will direct you to read certain sections of the prescribed book for background information.
	<b>Activity.</b> The activity icon refers to activities that you must complete in order to develop a deeper understanding of the study material.

Icon	Description
	<p><b>Assessment.</b> When you see the assessment icon you will be required to test your knowledge, understanding and application of the material you have just studied.</p>
	<p><b>Feedback.</b> The feedback icon indicates that you will receive feedback on your answers to the self-assessment activities.</p>
	<p><b>Time-out.</b> The time-out icon indicates that you should take a rest because you have reached the end of a study unit or topic.</p>
	<p><b>Reflection.</b> The reflection icon requires you to reflect on the important issues or problems dealt with in the study unit.</p>
	<p><b>Summary.</b> The summary icon indicates that a brief statement will be provided that summarises the main points discussed in each study unit.</p>

## 9 IMPORTANT ADVICE

The likelihood of your success will be improved if you consider the following hints:

- Study the prescribed study material conscientiously according to the guidelines provided.
- Discuss the subject matter with colleagues and specialists.
- Do the activities.
- Prepare in time for the submission of compulsory assignments and also do non-compulsory assignments.
- Apply your knowledge in practice.
- Prepare properly for the examinations.

## 10 WHAT YOU CAN EXPECT FROM UNISA

You can expect us to do the following:

- Provide you with up-to-date and relevant study material that is regularly compared with and benchmarked against similar local and international programmes.
- Keep the study material in line with the needs of industry and commerce by consulting regularly with the profession, and with industry leaders and government officials.

- Assist you as students by giving you the opportunity to develop competencies and skills at a certain level. You will be assessed according to the level descriptors of the National Qualifications Framework at level 6.
- Support you whenever you require assistance. You may contact your lecturers by making an appointment to see them in person, by telephone, via e-mail or via the internet. We understand that studying by means of distance learning is more challenging than attending a residential university.
- Provide you with clear indications of what we expect from you in terms of your assessment.
- Provide prompt feedback on assignments. We will return your assignment and our feedback within three weeks of the due date if you have submitted the assignment before the due date.

We hope you will enjoy your studies! We are certainly looking forward to being your partners in this endeavour.

Best wishes

Your Marketing Management lecturers



# TOPIC 1

## The importance of price

Before you can progress in your studies of price management, you need to understand where the concept of “price” comes from and what it really means. In this topic, which consists of four study units, we will begin by looking at the nature and role of price in the organisation. The second study unit will look at value and price. The role of price in the marketing mix will be discussed in study unit three, while the topic concludes with the pricing model in study unit four.

The contents of this topic are:

Topic 1	Study unit 1: The nature and role of price in the organisation
	Study unit 2: Value and price
	Study unit 3: The role of price in the marketing mix
	Study unit 4: The pricing model

When you have completed this topic, make sure that you are able to:

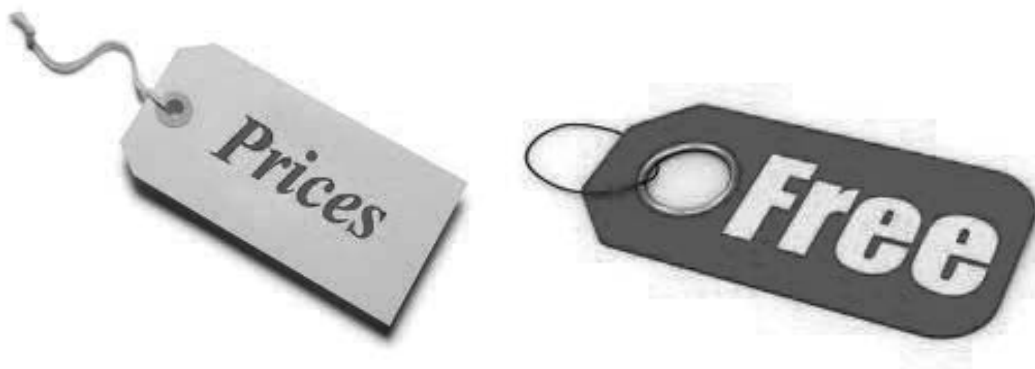
- define price and discuss the common pricing mistakes.
- discuss the importance of price in the economy and the organisation.
- explain value, as well as the difference between a cost and value orientation.
- discuss the role of price in the marketing mix.
- explain the steps in the pricing model.

# Study unit 1

## The nature and role of price in the organisation

### INTRODUCTION

In life, every transaction that occurs involves a price. We pay toll fees on the way to our holiday destinations, we pay for lunch at work, we pay to see our family doctor, we pay for the food we eat and we pay to watch our favourite television channels! In order for organisations to market a product or service successfully, the organisation must correctly establish the price that the consumer is charged in order to cover costs and make a profit for the organisation.



### OVERVIEW OF THIS UNIT

As can be seen from the title, this unit deals with the nature and role of price in an organisation. In simple terms, price is the value that a person puts on the usefulness or utility received from a product or service. For a consumer, price represents the amount of money that he or she pays for a product and the need satisfaction that he or she receives. As this is the first unit in this guide on pricing, we will begin by examining what pricing is, as well as by looking at common pricing mistakes made by organisations. We will also look at the importance of price in the economy and in the organisation.

You will need approximately two hours to work through this unit and ensure that you understand the topics covered.

## Contents

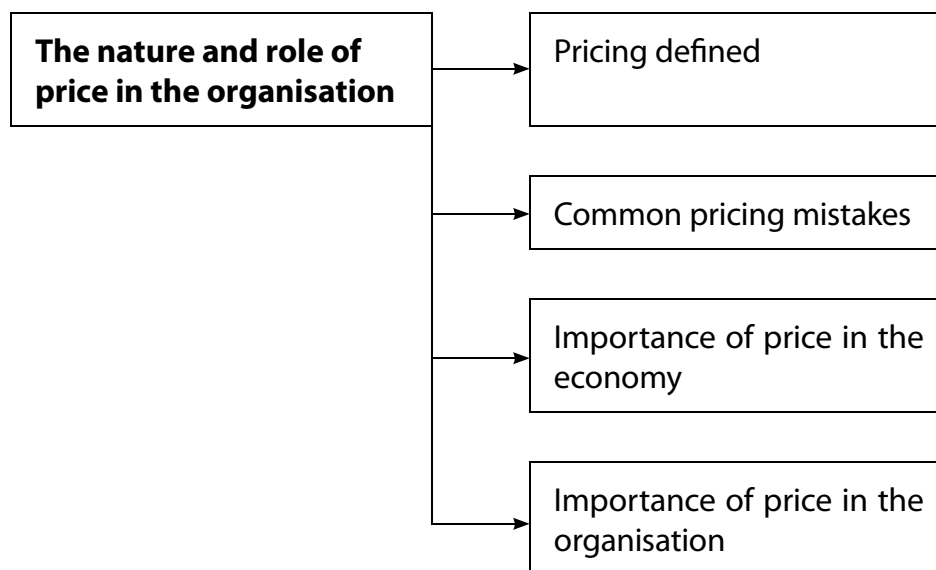
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### Key concepts

#### Overview of this unit

- 1.1 Pricing defined
  - 1.2 Common pricing mistakes
  - 1.3 The importance of price in the economy
  - 1.4 The importance of price in an organisation
  - 1.5 Assessment
  - 1.6 Reflection
  - 1.7 Summary
- 

This unit unfolds as follows:



### Key concepts

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You will need to master the following key concepts in order to meet the learning outcomes for this topic:

- Price
  - Buyer
  - Seller
  - Non-price factors
  - Cost-orientated
  - Market changes
  - Competition
-

## 1.1 PRICING DEFINED



(Study the relevant sections in your prescribed book.)

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When you study this section from your prescribed book, you will note that price has a different meaning for consumers and the organisation. You must be able to explain this difference. To the consumer, price represents the amount paid for need satisfaction while, for the organisation, price relates directly to the business's income and profitability. According to Kotler and Keller (2009:416–417), organisations' pricing practices have changed significantly over the last few years as developments such as the internet have had a large influence on how organisations set prices. Internet shoppers can, for example, get access to free products, compare the prices of various organisations, as well as name the price that they would like to pay, and then search for organisations offering these prices, such as on the *priceline.com* website.

In the section that follows, we will be looking at the various common pricing mistakes that can be made by an organisation.

## 1.2 COMMON PRICING MISTAKES



(Study the relevant sections in your prescribed book.)

---

When studying this section in your prescribed book, you will have noted the following common pricing mistakes which you must be able to discuss in detail and identify from a practical scenario (such as in the activity below):

- pricing that is too cost-oriented
- pricing that is not revised as market conditions change
- pricing that does not take the rest of the marketing mix into account
- pricing that is not varied enough for different products and market segments



### Activity 1

---

From the mini case study below, identify two of the above common pricing mistakes made by Lerato's Chicken Wholesalers:

Lerato's Chicken Wholesalers is an organisation selling fresh chicken to various market segments, such as family restaurant chains, street vendors and cafés. The organisation is run by Lerato Khumalo, a businesswoman from Soweto who has owned the business for 20 years. Lerato's business has been struggling over the last three years due to the recession and Lerato has noticed that many of her regular clients' orders have become much smaller. She cannot understand why, as her prices have stayed the same and the quality of her chicken products, something she has always been proud of, has also remained constant. Lerato cannot understand why some of her competitors, such as Freddie's

Chicken, have introduced “real deals” to encourage their customers to buy more, as she feels that customers always associate price with quality.



### Feedback

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*You would have noted from the case study that Lerato did not revise her pricing strategy as market conditions changed, as she did not introduce lower prices or “real deals” when the economic downturn occurred. You might also have identified the fact that Lerato did not have a differentiated pricing strategy for the various market segments that she targets with her products. This is important for Lerato as the segments she targets with her offerings are substantially different from one another.*

---

In the section that follows, the importance of price in the economy will be discussed. It is very important for marketers to constantly be aware of changing conditions in the economy and, as we have just learnt, one of the most common pricing mistakes made by marketers is not revising prices as market or economic conditions change.

## 1.3 THE IMPORTANCE OF PRICE IN THE ECONOMY



(Study the relevant sections in your prescribed book.)

---

As consumers, we are becoming more and more aware of the impact that prices of basic products have on our limited budgets. For instance, every time the petrol price goes up, it influences the price of basic necessities such as bread and milk, as the prices of these products need to go up to cover increased transport costs. In the same way, marketers have to set the prices of their products carefully as these prices influence the price paid for labour and even factory property prices. As you can see from this illustration, price regulates the economic system and, for this reason, it is vital that marketers set prices accordingly.

Next we will be examining the importance of price in the organisation.

## 1.4 THE IMPORTANCE OF PRICE IN THE ORGANISATION



(Study the relevant sections in your prescribed book.)

---

As discussed above, marketers must constantly monitor the environment to establish what environmental factors will have an influence on the prices of the products they are marketing. In the case of organisations, the importance of pricing depends on whether an organisation is a price taker or price maker. Ensure that you understand the difference

between these two terms. When studying this section, also ensure that you understand what non-price competition is and are able to explain it.

## 1.5 ASSESSMENT



- (1) *Explain, in your own words, what is meant by the term “pricing”.*
- (2) *Discuss the common pricing mistakes that could be made by an organisation when pricing its products.*
- (3) *Highlight the importance of price in the economy with your own applicable examples.*
- (4) *Discuss the importance of price in an organisation.*
- (5) *Highlight the difference between a price-taker and a price maker in the price-setting process.*

## 1.6 REFLECTION



*By now you should have a good understanding of why price is such an important factor in the success of an organisation. Can you see the value of setting prices correctly and not making some of the common pricing mistakes when setting prices? Do you understand why price is such an important factor in the economy and in an organisation?*

## 1.7 SUMMARY



In order to introduce the basic concept of price and its importance in an organisation, we began by examining what price is and we considered the common pricing mistakes made by organisations. We also discussed the importance of price in the economy and in an organisation.

In the study unit that follows, we will be examining the important relationship between price and value.



# REFERENCES

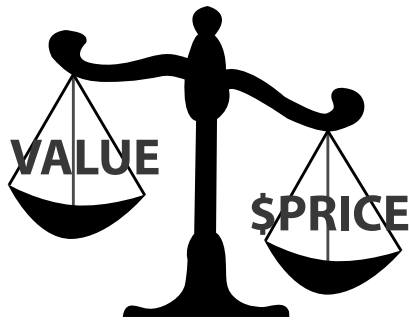
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- Cant, MC. (ed). 2005. *Pricing management*. 2nd ed. Claremont: New Africa Education.
- Kurtz, DL. 2008. *Principles of contemporary marketing*. 2nd ed. Mason, Ohio: Thompson South-Western.

# Study unit 2

## Value and Price

### INTRODUCTION

When you buy something, you pay a certain price for it. What value you derive from the product or service depends totally upon you. The value that a child derives from an ice cream or a bar of chocolate is much greater than that which (most) adults would derive. Now imagine that this same child has good business sense and wants to sell pieces of the chocolate to his friends. The price of each piece of chocolate may vary depending on the needs and wants of his friends. So in many ways, value is like beauty: it lies in the eyes of the beholder or, more, appropriately, the purchaser (Anon: 2010).



### OVERVIEW OF THIS UNIT

This unit deals with the nature and role of “value” when determining prices for goods and services. In simple terms, value refers to the price an individual is willing to pay for a specific product or service. This study unit will focus on the value concept as well as on the pricing perspectives of organisations and consumers. Not only will the difference between value and cost orientation be discussed, but the difference between the cost orientation and demand orientation approaches will be dealt with.

You will need approximately two hours to work through this unit and ensure that you understand the topics covered.

#### Contents

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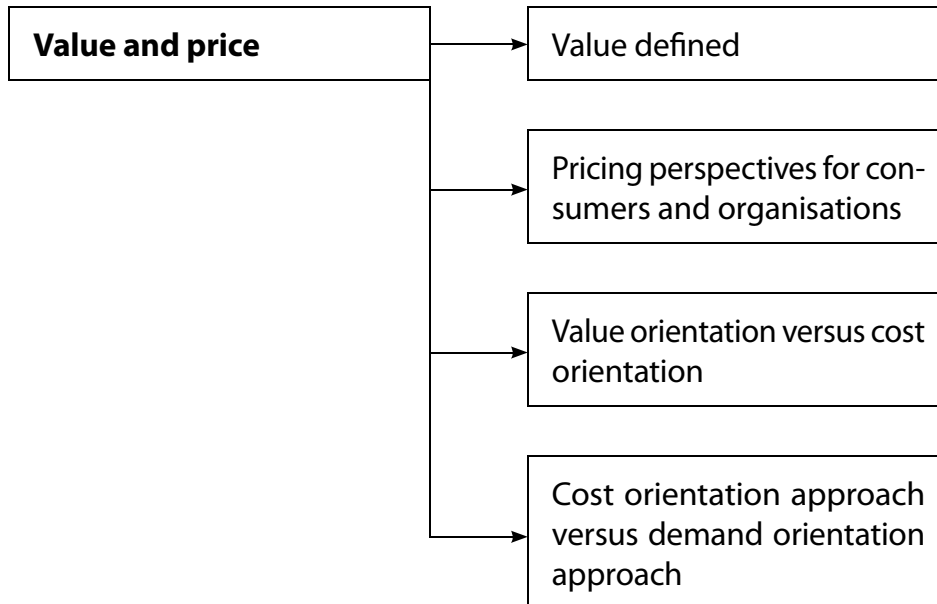
##### Overview of this unit

- 2.1 Value defined
- 2.2 Pricing perspectives for consumers and organisations
- 2.3 Value orientation versus cost orientation
- 2.4 Cost orientation approach versus demand orientation approach
- 2.5 Assessment

## Summary

---

This unit unfolds as follows:



### Key concepts

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You will need to master the following key concepts in order to meet the learning outcomes for this topic:

- cost
  - price
  - value
  - demand
  - cost-orientation
  - demand-orientation
- 

## 2.1 VALUE DEFINED



(Study the relevant sections in your prescribed book.)

---

Price can be defined as something that is charged for “something” and it can take different forms. For instance, tuition fees, consultancy fees, rent, interest on loans and lawyers set fees. Wherever there is a money exchange, it can be said that a price has been set. The “something” can be seen as a physical product such as a bar of soap, an intangible

product such as a quality guarantee attached to an item or even a pure service such as a haircut from the local barber.

The famous quote “*it’s better value for money*” can be used as a good example to explain that, when a customer determines value, he/she often links price with the actual perceived benefits derived from using a specific product or service.

For example, when an estate agent is selling a house for R700 000, three different buyers may respond to the price of the house in three very different ways. One prospect may fall in love with the property because he/she has been looking for that type of property for months. It is well worth R700 000 to the first prospect. Another prospect thinks it’s OK, but not great. And it’s a bit far from work. The value there might be R500 000. The third potential buyer doesn’t like the house at all. He wouldn’t even pay the estate agent R100 000 for the house.

**Value can be defined as a buyer’s overall evaluation of the utility of a product or service based on perception of the net benefits received, and what must be given up.**

Therefore, it is important to remember that value can be calculated as follows:

$$\text{Value} = \frac{\text{Perceived benefits}}{\text{Price}}$$

It is important to remember that the first three elements of the marketing mix, namely product, promotion and distribution are the tools that marketers use to determine value. You should be able to define the concept of value and provide practical examples to illustrate your understanding.

## 2.2 PRICING PERSPECTIVES FOR CONSUMERS AND ORGANISATIONS



(Study the relevant sections in your prescribed book.)

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We can look at price from the perspective of two different role-players in the economy, namely price from the consumer’s perspective and from the organisation’s perspective. Firstly, let’s look at price as seen from the customer’s point of view.



Customers have a tendency to relate price directly to value. This would seem to indicate that, as price goes up, so does value – and as price goes down, value goes down too. This is not a fact, however, and the old belief that paying a high price for a product or service indicates that you will receive a high quality product is not necessarily relevant in all cases. In most cases, value will reflect to what extent customer's expectations and requirements are met.



The following article will provide you with a more in-depth understanding of consumer perceptions of price as an indicator of value:

Galarza, MG & Saura, IG. 2006. Value dimensions, perceived value, satisfaction and loyalty: an investigation of university students' travel behavior. *Tourism Management*, 27 (1):437–452.

The following YouTube site will provide you a better understanding of price vs value:

<http://www.youtube.com/watch?v=h-6JobsOHMQ>

When looking at price from an organisational perspective, it is essential to remember that price is one of the most important factors in determining profit. Value can be seen by organisations in different ways, for example the assurance of quality on a product, repair facilities for a product, the packaging, the credit provided, guarantees, etc.

Organisations should keep in mind that the prices that they charge for products should cover several elements, including the following:

- discounts (eg, quantity, seasonal, cash, trade or temporary 'deals')
- allowances (damaged goods, advertising, stocking)
- taxes and tariffs
- customer mix (identify customers who are generally better for your business than others)
- costs (includes fixed and variable costs associated with the product)
- environmental factors (evaluate likely competitor actions, understand legal constraints, etc.)
- demand for the product

Make sure you can discuss price as seen by customers as well as by organisations.



## Activity 1

---

Read the mini case study below and answer the questions that follow.

### **Price vs Value**

John has managed his money carefully for the last few years. However, when it comes to his regular grocery shopping, he prefers Whole Foods supermarket.

Whole Foods is more expensive than other local supermarket and it does not have a wide variety of items. John also has to drive further to be able to shop at Whole Foods. He passes acceptable supermarkets on his way to Whole Foods, yet he chooses Whole Foods for a reason, and that reason is that he receives value for his money.

John receives more than just the item at Whole Foods. This grocery store goes the extra mile and creates a shopping experience for the customer. John is escorted by a knowledgeable staff member when he asks for a specific item; they will also, at his request, make recommendations on other items. He states that they are all about conscious consumption and community building, and that he receives fresh food. The higher prices, the longer drive and the lack of variety are quickly forgiven as the service is excellent.

Source: Adapted from: <http://www.donorbydesign.com/blog/price-vs-value/>

Based on the above case study, discuss the concept of “value for money” with the aid of practical examples.



## Feedback

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*Value refers to a buyer’s overall evaluation of the utility of a product or service based on perception of the net benefits received, and what must be given up. In other words, value can be seen as the perceived benefits derived from a product divided by the price of the product. If the consumer perceives that he/she receives a lot of benefits/advantages from a product that is not expensive, then the consumer will perceive the product as being good value for money.*

*In the case study, John perceived value for money because his perception of the benefits/advantages at shopping at the Whole Foods supermarket exceeded the price of shopping at Whole Foods supermarket. Did you have a similar answer?*

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## 2.3 COST ORIENTATION VERSUS VALUE ORIENTATION



(Study the relevant sections in your prescribed book.)

The differences between cost orientation and value orientation, in relation to pricing, are illustrated in the table below:

Table 2.1 Cost orientation vs value orientation

Cost orientation	Value orientation
Price is an afterthought to strategy.	Price is an integral part of strategy.
Price must cover costs and earn profit.	Determine costs to be incurred to arrive at the prevailing market price and to make a profit.
Determine the price that the customer will be willing to pay.	Determine the value of the product for the customer.
Justify price based on costs.	Communicate the value that justifies the price.
Determine price to achieve specific sales objectives.	Determine the most profitable sales volume.
Discount prices if consumers do not buy.	Use target marketing and product positioning.

Source: Strydom JW; Cant, MC and Jooste, C. 2006, *Marketing Management*. 5th ed. Cape Town: Juta.

As you can see in the table above, cost orientation is when the price of a product is directly linked to the cost of producing the product. In contrast, value orientation is when the demand and perceived value of the product in the consumer's eyes is used to determine the price.

It is important for you as a marketer to strive to balance the price being charged for a product or service against the actual value that the customer receives for the product or service (Cant, van Heerden, Ngambi 2010:231). Therefore, price should not be dependent only on cost, but should also be related to the value of a product or service.

## 2.4 COST ORIENTATION APPROACH VERSUS DEMAND ORIENTATION APPROACH



(Study the relevant sections in your prescribed book.)

In the past, pricing was primarily a matter of determining costs and adding a target return onto these costs. Price was seen as the only element that generated revenue, while

other elements generated costs. This can also be called a *cost-oriented approach* to price setting and it ignores the role of consumer demand in the process. If a customer was not prepared to purchase the product at the price that was set, then the standard approach would be to lower the price in the hope that the consumer would then purchase the product (Cant et al 2010:234).

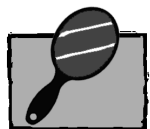
Recently, a more *demand-oriented* approach has been applied to price determination. This has meant that marketers have had to do research and undertake studies to establish how much consumers would purchase at different price levels. Using this method, marketers are able to set prices to achieve certain goals (Cant et al 2010:234).

## 2.5 ASSESSMENT



- (1) Provide a definition and a formula for value.
- (2) Explain what you understand under the concepts value and price.
- (3) Contrast price as seen by consumers and price as seen by organisations.
- (4) Define a cost-oriented approach to price setting by using an applicable practical example.
- (5) Explain a value-oriented approach to price setting by using an applicable practical example.

## 2.6 REFLECTION



*By now you should have a good understanding of the term “value”. Can you see why a product or service may seem expensive to one consumer and cheap to another consumer? Can you see why it is important for organisations to know how customers perceive their products and services?*

## 2.7 SUMMARY



This study unit provided you with an overview of the concept of value, namely that it is a buyer's overall evaluation of the utility of a product or service based on perception of the net benefits received, and what must be given up.

We looked at two perspectives, namely how consumers and organisations perceive price. Furthermore, in this study unit, we focused on the difference between a cost and value orientation to pricing. Table 2.1 provides a clear comparison between cost orientation and value orientation.

Finally, it is important to remember that if a product or service is not perceived as having any value to a customer, then there will be no market for it. Value is not only seen in the physical end product, but in a combination of all the factors that have gone into providing the final product.

It is this combination of factors that will be discussed next, as we examine the role of price in the marketing mix.



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# Study unit 3

## The role of price in the marketing mix

### INTRODUCTION

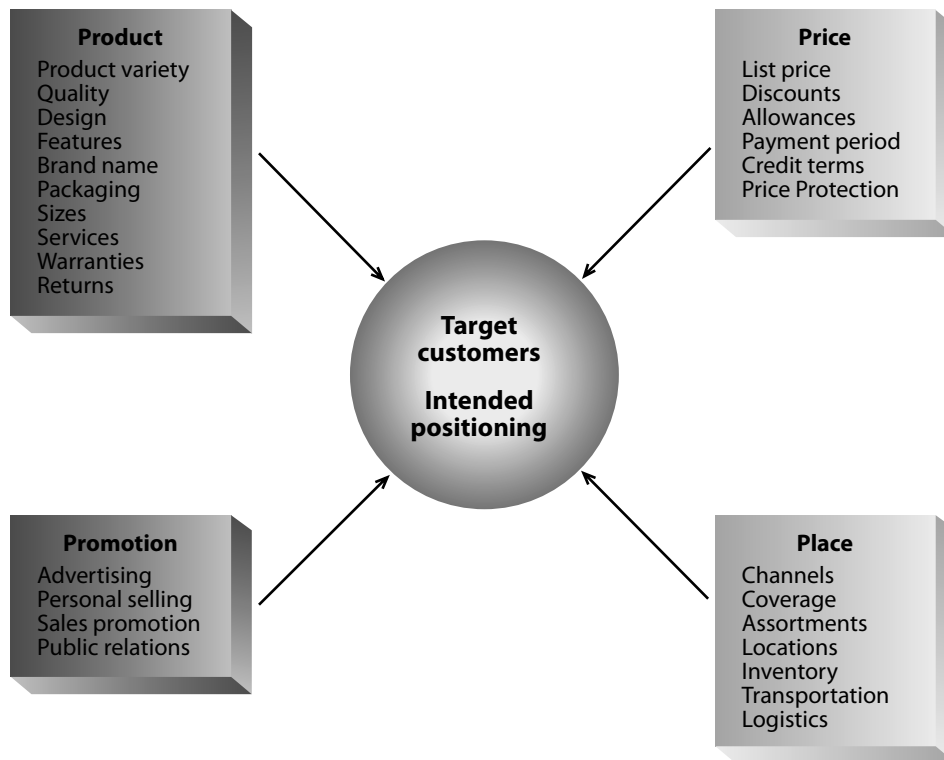
From the previous study units, we gained a general understanding that pricing is one of the traditional 4 Ps in marketing; hence it is a dominant issue in every marketing mix and marketing strategy. It is essential to gather a general understanding of the relationship between price and profitability, pricing for different stages of the product lifecycle, how pricing is perceived by customers, different pricing strategies and more.

However, organisations must pay attention to the rapidly changing role of pricing. The internet, the emphasis on shareholder value, and the availability of increasingly more sophisticated methods to measure value and price effects have begun to pull pricing to the forefront of strategic thinking.



### OVERVIEW OF THIS UNIT

As you know by now, the marketing mix consists of four basic elements, namely price, product, place, and promotion. This study unit discusses the strategic role played by price in any business organisation's marketing effort, and how it has an effect on product, distribution, promotion and positioning strategies. In simple terms, price is a common tool that organisations use to exchange their goods and services for income. In the figure on the next page, the elements of the marketing mix and how they influence each other are illustrated.



Source: <http://www.google.co.za/images/price/themarketingmix>

You will need approximately two hours to work through this unit and ensure that you understand the topics covered.

## Contents

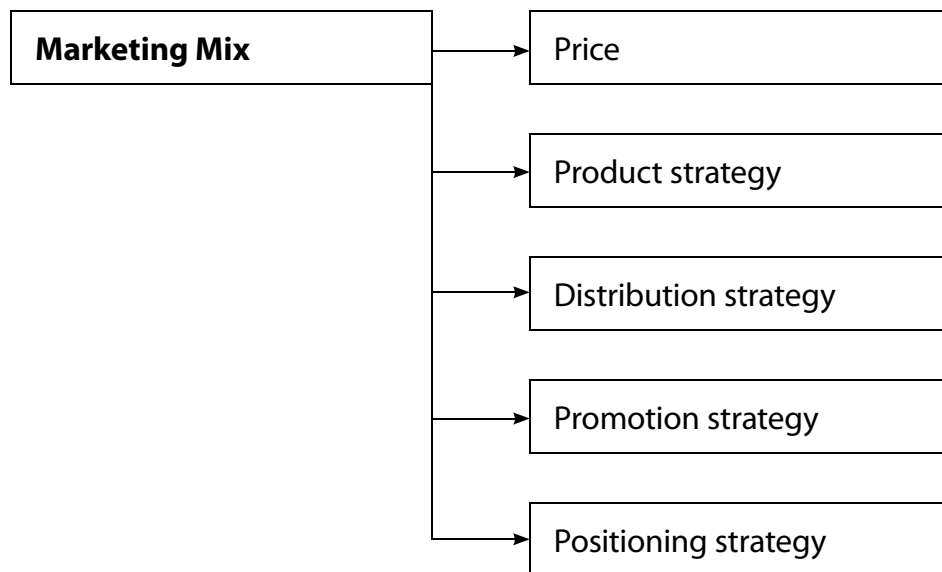
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### Key concepts

#### Overview of this unit

- 3.1 The role of price in the marketing mix
  - 3.2 Product strategy
  - 3.3 Distribution strategy
  - 3.4 Promotion strategy
  - 3.5 The use of price in the positioning strategy
  - 3.6 Assessment
  - 3.7 Reflection
  - 3.8 Conclusion
-

This unit unfolds as follows:



### Key concepts

---

You will need to master the following key concepts in order to meet the learning outcomes for this topic:

- Price
  - Marketing mix
  - Product strategy
  - Distribution strategy
  - Promotion strategy
  - Positioning strategy
- 

## 3.1 THE ROLE OF PRICE IN THE MARKETING MIX



(Study the relevant pages in your prescribed book.)

---

When you study this section from the prescribed textbook, you will note that pricing is one of the most important elements of the marketing mix – and that it must support the other elements of the mix. Pricing is complicated and must echo the supply and demand relationship, that is there must be a direct relationship between the price and the supply and demand (it is perceived that an increase in price causes a decrease in demand, and vice versa; and a decrease in demand will consequently result in a decrease in supply and minimised profits). Pricing a product too high or too low could mean a loss of sales for the organisation.

Again, pricing decisions should take the following factors into account:

- Fixed and variable costs, competition, company objectives, proposed positioning strategies, target group and willingness to pay.
- Price acts as the major influence on buyer choice. Non-price factors such as product features, brand name and so on also became important in buyer choice behaviour.

Therefore, one could say that price plays two major roles in marketing in that it influences, firstly, how much of a product consumers purchase and, secondly, whether selling the product will be profitable. You must be able to explain these two roles. In addition, ensure that you are able to discuss the role of pricing in the marketing mix. Touch on the important terminologies included in this section as well.



### Activity 3.1

---

From the case study below, explain how Kellogg's has addressed the elements of the marketing mix.

Kellogg's is constantly developing new breakfast cereals. The product element is the new product itself; getting the price right involves examining customer perceptions and rival products, as well as costs of manufacture; promotion involves engaging in a range of promotional activities, for example, competitions, product tasting, etc; and place involves using the best possible channels of distribution such as leading supermarket chains. The product is the central point on which marketing energy must focus. Finding out how to make the product, setting up the production line, providing the finance and manufacturing the product are not the responsibility of the marketing function. However, the marketing function is concerned with what the product means to the customer.



### Feedback

---

You would have noted from the case study that, when Kellogg's market their products, they need to create a successful mix of:

- *the right product*
- *sold at the right price*
- *in the right place, and*
- *using the most suitable promotion*

To create the right marketing mix, Kellogg's met the following conditions:

- *The product has to have the right features – for example, it must look good and work well to fit the lifestyles of potential customers.*
  - *The price must be right. Consumers will need to buy the product in large quantities to produce a healthy profit.*
  - *The goods must be in the right place at the right time. Making sure that the goods arrive when and where they are wanted is an important operation.*
  - *The target group needs to be made aware of the existence and availability of the product through promotion. Successful promotion helps a firm to spread costs over a larger output.*
- 

In the section that follows, the product strategy will be discussed.

## 3.2 PRODUCT STRATEGY



(Study the relevant sections in your prescribed book.)

---

Products can be designed to facilitate a segmented pricing strategy, appeal to price-sensitive buyers and to maximise a cost advantage. In reality, most companies have multiple products, thereby creating the need to price the entire product line simultaneously. A major influence in product line pricing is the presence of product substitutes and complementary products. For example, an organisation may decide to price its products on par with the available products in the market that consumers may use as substitutes. If Five Roses charges consumers R20 for a box of 100 teabags, they also need to consider that there are other competing companies, such as Glen and Freshpak, that have substitute products – and that these may decide to price the same product, with the same quality and quantity, at R18 per box.

It is a common understanding that customers tend to associate a high price with high quality, and low price with low quality, even though this is not always true. However, the quality and features of a product will affect price strategy. A high-quality product may require a high price to help establish a prestige position in the marketplace and to satisfy management's profit performance requirements.

When studying this section, you must be able to understand how the product strategy is influenced by pricing.

Next, the influence of price on distribution will be discussed.

## 3.3 DISTRIBUTION STRATEGY



(Study the relevant sections in your prescribed book.)

---

You are now aware that an effective distribution strategy will enable an organisation to use its sales channels effectively and maximise profits. Focusing on a small number of sales channels lets you invest in each one and build strong relationships with key intermediaries. Price is also influenced by the type of channel that is most suitable for the product, the distribution intensity required, and the channel configuration.

As you can see from this, your choice of sales channel will also be influenced by what you want it to do. You might need a channel that showcases your product or provides installation and customer support. If you want to build relationships with end users, you'll need a sales channel that gives you direct control. The right distribution strategy will fuel your business growth. Working with sales agents and companies with established customers, for example, is an excellent way to expand into new markets where the cost would otherwise limit your ability to reach customers.

We will now examine the promotion strategy and how it is influenced by price.

### 3.4 PROMOTION STRATEGY



(Study the relevant sections in your prescribed book.)

---

Price can be a promotional tool as it reflects the relationship between advertising and buyers' price sensitivity. Simultaneously, advertising may increase perceived substitutes, and have unique-value effects.

This study unit indicates that the prices of products and services also directly influence the promotional strategy of an organisation. High-quality, high-priced products should be advertised in media that, by association, complement or endorse the image of the product, whereas the use of inappropriate media could lower the image of the product. You must be able to discuss how pricing influences the promotion strategy within an organisation.

Let us now examine the use of price in the positioning strategy.

### 3.5 THE USE OF PRICE IN THE POSITIONING STRATEGY



(Study the relevant sections in your prescribed book.)

---

Price is used in various ways in the marketing positioning strategy – as a signal to the buyer, an instrument of competition, a means to improve financial performance, and a way to perform other marketing mix functions.

Ensure that you understand how price influences the positioning strategy of an organisation. When using price in the positioning strategy, you will be faced with three main options:

- Positioning your product against your competitors. For example, Pep Stores emphasises that its prices are “half of that you may find elsewhere for similar products”.
- Emphasising a distinctive, unique benefit. For example, Pastel Accounting clearly indicates that it is “the only book-keeping system that instantly calculates your taxes”.
- Affiliating your product with something the customer knows and values. For example, that Panado is “the GP’s choice”.

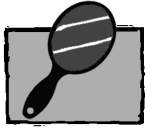
### 3.6 ASSESSMENT



- (1) *Discuss the role of price in the marketing mix of the organisation and indicate how it affects the other P's (promotion, product, and place) in the mix.*
- (2) *Discuss how pricing has an effect on the product strategy of the business and how an organisation may capitalise on the benefits thereof.*
- (3) *Describe how pricing influences the distribution strategy of an organisation and its distribution channels.*

- (4) Explain how pricing has an effect on the promotional strategy of an organisation, as well as the media chosen to advertise a particular product/service.
- (5) Elaborate on the use of price in the positioning strategy and give practical examples to illustrate the theory.

### 3.7 REFLECTION



Before you continue to the next study unit, reflect on the following questions:

- (1) Where do you think you will be able to use the skills you have learned in this study unit in your professional life?
- (2) What did you find difficult? Why do you think you found it difficult? Do you understand it now or do you need more help? What are you going to do about it?
- (3) What did you find interesting in this study unit? Why?
- (4) How long did you take to work through this study unit? Are you still on schedule or do you need to adjust your study programme?

### 3.8 SUMMARY



The emphasis in this unit was on the nature and role of pricing in the marketing mix of an organisation. The effect of price on the product, distribution, promotion and positioning strategies was also demonstrated in different instances.

In the study unit that follows, the steps in the pricing model that should be followed by an organisation when setting its prices will be discussed.

# REFERENCES

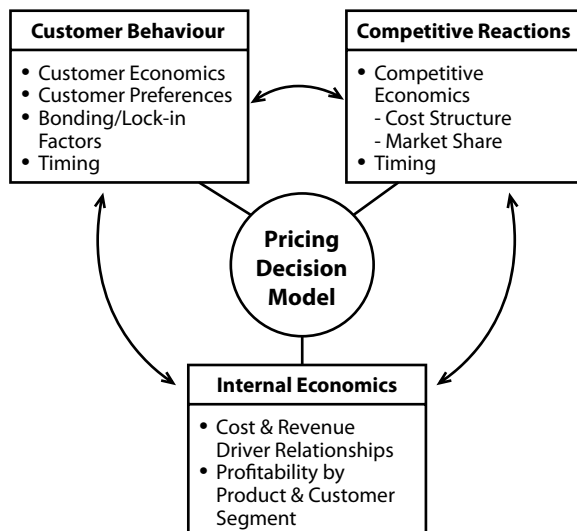
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# Study unit 4

## The Pricing Model

### INTRODUCTION

It is important to remember that not all buyers are created equal! Buyers have different objectives, growth and competitive pressures, financial resources and risk tolerance. All these factors impact on the amount that customers are willing to pay for a given product or service at a given time. Therefore, your target market will influence the price you are willing to set. This is only one example of a factor that influences the pricing decision. It is important for you as a marketer to understand *all* the factors that influence pricing decisions.



### OVERVIEW OF THIS UNIT

A step-by-step procedure of the factors (or pricing model) that influence pricing decisions will be discussed in this study unit. The pricing model consists of the following factors:

- factors that influence the pricing decision
- establishing pricing objectives
- determining the basic price, and
- the final price of a product

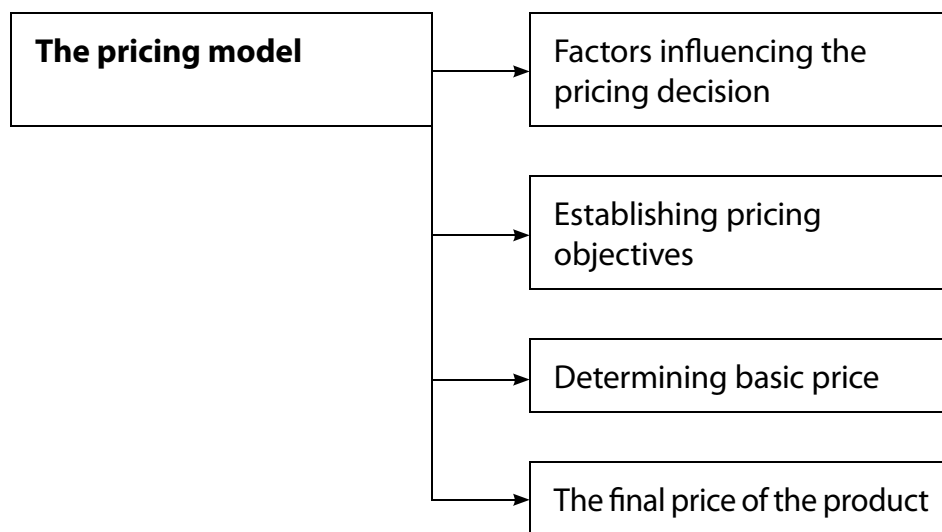
It is important that you understand all the factors involved in each step in order to finalise the price of a specific product or service.

You will need approximately two hours to work through this unit and ensure that you understand the topics covered.

### Overview of this unit

- 4.1 The pricing module
    - 4.1.1 Factors influencing the pricing decision
    - 4.1.2 Establishing pricing objectives
    - 4.1.3 Determining basic price
    - 4.1.3 The final price of the product
  - 4.2 Assessment
  - 4.3 Reflection
  - 4.4 Summary
- 

This unit unfolds as follows:



### Key concepts

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You will need to master the following key concepts in order to meet the learning outcomes for this topic:

- Pricing model
  - Internal factors
  - External factors
  - Elasticity of demand
- 

## 4.1 THE PRICING MODEL

Although many formulas and tools can assist you to determine the selling price for a specific product or service, there is no magical solution that will come up with the absolute price for every instance. The final price of a product depends not only on various internal and external factors and pricing objectives, but also on how badly the buyer wants to buy and how strongly the seller wants to sell. The pricing model is a step-by-step procedure

to be followed when a pricing decision is to be made. Study this pricing model and make sure that you understand the process that is followed.

#### 4.1.1 Factors that influence pricing



(Study the relevant sections in your prescribed book.)

---

As can be seen from the prescribed material, there are several factors that influence the final price of a product or service. Some of these factors may include price flexibility, discounts and allowances, legal environment, geographical pricing terms, mark-up chains in channels, competition, cost, demand, price of other products in the line and more (McCarthy: 2010).

There are external and internal factors that influence the final price decision (Anon: 2010).

**Internal factors** influencing price include elements within the organisation that are controllable. These factors include:

- Cost – the price customers pay must exceed the cost of producing a good or delivering a service.
- Marketing strategy – price is one of the marketing mix decisions and, since all marketing mix decisions should work together, the final price will be impacted by how other marketing decisions are made.
- Marketing objectives – all marketing decisions, including price, work to help achieve company objectives.
- Marketing mix variables – (which includes the price, promotion, distribution and place).

**External factors** influencing price include elements outside the organisation which cannot be controlled, but which will impact on pricing decisions. These factors include:

- Customer expectations – when deciding on a price, you need to conduct customer research to determine if the customer perceives the price that they pay for a product or service is of value.
- Competition – marketers should look to market competitors for indications of how prices should be set.
- Elasticity of demand – you should understand what effect a change in price is likely to have on the target market demand for a product or service.
- Government regulations – price regulations can come from any level of government and vary widely in their requirements.



For more information on the above factors, see the following website:

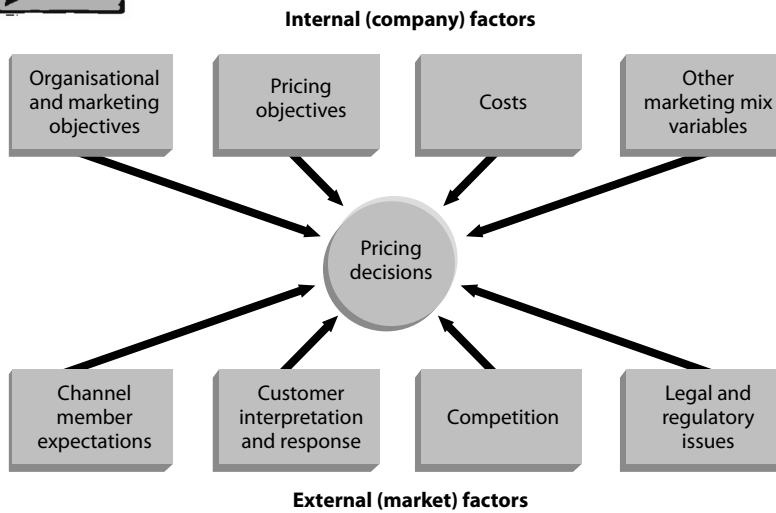
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<http://www.knowthis.com/principles-of-marketing-tutorials/pricing-decisions/external-factors-competitive-and-related-products/>



## Activity 1

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As can be seen from the figure above, there are internal and external factors that influence pricing decisions. Discuss, with the aid of practical examples, how external factors can influence a retail clothing organisation's final pricing decision.



## Feedback

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*External factors include elements outside the organisation which cannot be controlled, but which will impact on pricing decisions. External factors include customer expectations, competition, elasticity of demand and government regulations. You must be able to discuss these external factors in a case study context. For example, in the case of a clothing retailer that imports clothing, the government imposes import tariffs which could have a large effect on the specific retailer's pricing structures.*

### 4.1.2 Establishing pricing objectives



(Study the relevant sections in your prescribed book.)

---

As business and marketing conditions change, so does an organisation's objectives. Figure 4.1 provides three examples of types of pricing objectives that an organisation might set for itself.

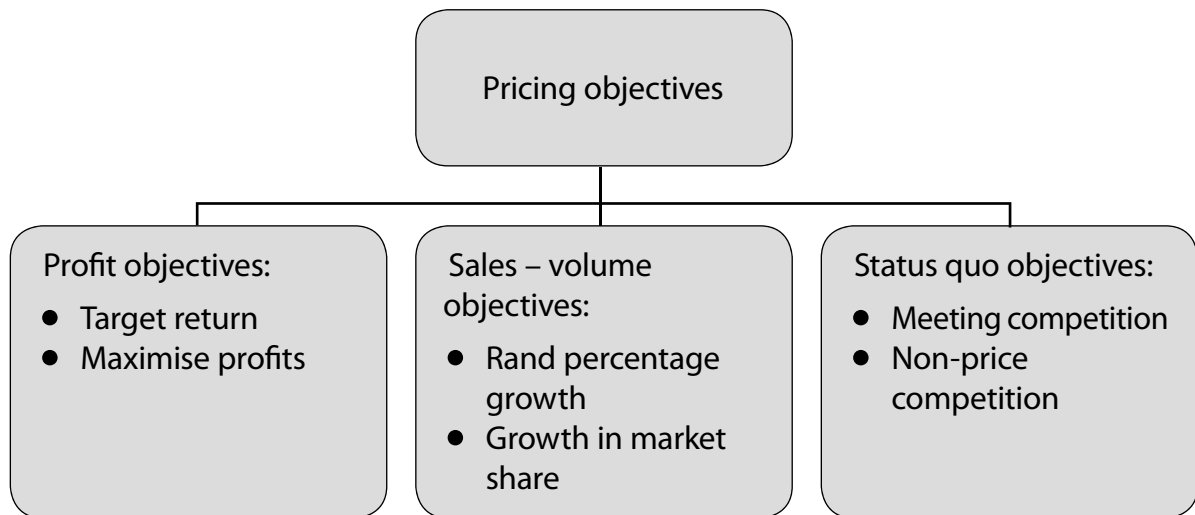


Figure 4.1 Types of pricing objectives

Source: Adapted from <http://www.witiger.com/marketing/pricingobjectives.htm>

Profit is the money left over for a business each month after all the bills are paid. Without profit, an organisation cannot afford to re-invest in capital or have money to pay its stockholders. Although profit maximisation is a major objective of an organisation, as can be seen in figure 4.1 above, it is not the only objective of an organisation. An organisation will have different long term and short term goals which will vary depending on the current business cycle. Can you think of specific pricing objectives for an organisation in a recession?

Sales volume objectives include sales maximisation and market-share goals, which are specified as a percentage of certain markets. In sales maximisation, management sets an acceptable level of profitability and then tries to maximise sales. This objective can lead to discounting or aggressive pricing strategies, such as rebates and sales.

When an organisation cannot compete with its competitors, does not have the resources to survive a price war, or have the ability to claim better quality to charge a higher price, that organisation needs to charge the same prices for its products/services as its competitors. This is referred to as a status quo objective of pricing. Therefore, as you can see in the figure above, meeting competitor prices and non-price competition are elements of status quo objectives for pricing. It is important to understand the role of pricing objectives within the pricing module. Pricing goals give direction to the whole pricing process.

You must be able to define pricing objectives and discuss the various profit objectives, sales-volume objectives and status quo objectives.

In the section that follows, determining the basic price will be discussed.

### 4.1.3 Determining the basic price



(Study the relevant sections in your prescribed book.)

---

Setting prices is one of the fundamental tasks of marketing and finance managers in that the price of a product or service often plays a significant role in that product's or service's success, not to mention in an organisation's profitability. Refer to the relevant section in your prescribed textbook to learn more about the elements to consider when determining the basic price for a product/service, namely cost-oriented methods, competition-oriented methods and customer (value)-oriented methods.

Price adjustments play a significant role in determining the basic price for a product or service delivered. Price adjustments include discounts (quantity, cash, trade and seasonal) price adjustments according to geographic location, adjustments according to the product mix, as well as initiating and responding to price changes.

You must be able to discuss the factors to consider when determining the basic price for a product or service in detail.

Once the basic price has been determined, the final price needs to be set by the organisation. This will be focused on next.

### 4.1.4 Final price of the product



(Study the relevant sections in your prescribed book.)

---

As a marketer, you need to consider all the factors that may have an influence on the final price of a product or service.

The figure in your prescribed book gives you a holistic view and illustrates the logical flow of the processes to be followed before you can make the decision of a final price. Ensure that you have studied these processes well before continuing to the next study unit.

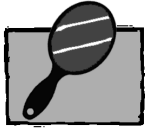
## 4.2 ASSESSMENT



*Discuss, with the aid of practical examples, the pricing module. Make reference to the following elements:*

- *internal and external influences that influence price setting*
- *establishing pricing objectives*
- *determining the basic price, and*
- *determining the final price for a product/service*

### 4.3 REFLECTION



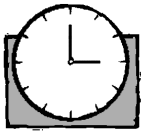
*By now you should have a good understanding of the steps in the pricing module. Each step is important and you must be able to discuss all of them and give practical examples.*

### 4.4 SUMMARY



A marketer's freedom to select a price for a given product or service is constrained by several factors. The pricing module will assist you as marketer to consider all these factors in order to make the decision of a final price for a product or service.

In the study unit that follows, we will be identifying various pricing constraints that organisations should consider when setting their prices. As discussed in this unit, this is important as both internal and external influences should be considered when setting prices.



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# TOPIC 2

## The steps in the setting of price

As a marketer, many factors must be taken into consideration when setting the prices of an organisation. Firstly, pricing constraints must be considered, as well as the influence of demand and supply on price levels. Lastly, the organisations price objectives must be kept in mind as the objectives set will also play a large role in the prices set. Each of these factors will be discussed in detail in this topic.

This topic consists of three study units:

Topic 2	Study unit 5: Identifying pricing constraints
	Study unit 6: Estimating demand and revenue relationships
	Study unit 7: Price objectives

When you have completed this topic, make sure that you are able to:

- Identify and explain the demand and cost constraints in pricing.
- Explain the various types of competitive markets.
- Explain how demand and supply establish prices.
- Discuss price elasticity and price sensitivity
- Explain how to estimate revenue relationships
- Discuss the relationship between cost, volume and profit
- Highlight the various types of pricing objectives

# Study unit 5

## Identifying pricing constraints

### INTRODUCTION

In determining pricing for products or services, a marketer has to consider adding the value added tax (or VAT) of 14% to the final price. It is also important for the marketer to think of the consumer's response to price changes, for example, when increasing the price of maize, the manufacturer must anticipate the change in the quantity of maize that will be bought and consumed, which can result in reduced quantities of maize being used. The latter example illustrates the elasticity of demand and price sensitivity by consumers due to an increase in the price of maize. This can then lead to an increase in the demand for bread as a substitute for the now higher-priced wheat.



### OVERVIEW OF THIS UNIT

In determining prices, it is essential that marketers must evaluate the internal and external factors that impact on the setting of pricing for various products and services. In the marketing context, these factors are known as pricing constraints that limit the choice as to the range of prices that may be charged. In this study unit, we will begin by discussing demand constraints in pricing, and the cost constraints that influence the price to be charged by marketers of products and services. We will also be discussing the other pricing constraints, such as the product life cycle, ethical considerations, general economic conditions, legal considerations and organisational and marketing mix variables as impediments in setting prices.

You will need approximately two hours to work through this unit and ensure that you understand the topics covered.

## Contents

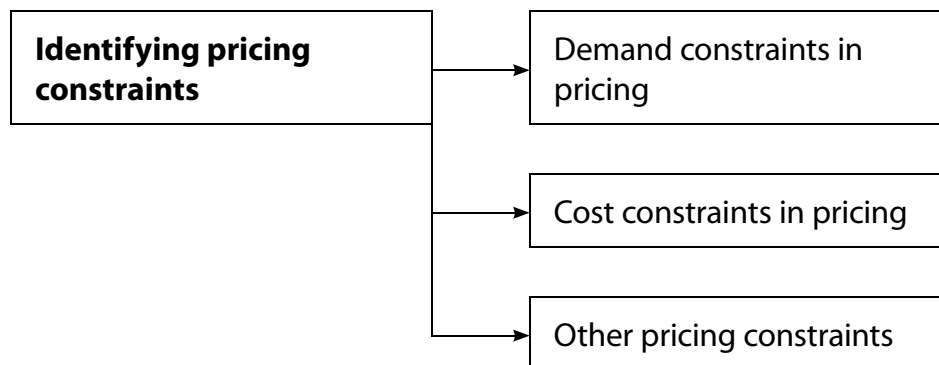
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### Key concepts

#### Overview of this unit

- 5.1 Demand constraints in pricing
  - 5.2 Cost constraints in pricing
  - 5.3 Other pricing constraints
  - 5.4 Assessment
  - 5.5 Reflection
  - 5.6 Summary
- 

This unit unfolds as follows:



### Key concepts

---

You will need to master the following key concepts in order to meet the learning outcomes for this topic:

- Pricing constraints
  - Demand constraints
  - Cost constraints
  - Product life cycle
  - Ethical considerations
  - General economic conditions
  - Legal considerations
  - Organisational and marketing mix variables
- 

## 5.1 DEMAND CONSTRAINTS IN PRICING



(Study the relevant sections in your prescribed book)

---

When studying this section in your prescribed book, you will notice that there are three demand constraints in pricing: demand according to the market structure, elasticity of demand and consumer price behaviour. Note that, as a future marketer, you need to

understand the relationship between demand and the price that is set for a product. In the marketing context, demand is the amount of product that will be sold in the market at various prices for a specific period of time. In a normal situation, demand and price are inversely related (related in reverse), in that the higher the price, the lower the demand. On the other hand, the lower the price is set, the more products consumers will demand. After studying this section you must be able to discuss demand constraints and provide practical examples relating to how they affect pricing.

We are now going to focus on the demand constraints in pricing that can be encountered by an organisation and explore practical examples relating to these constraints.

### 5.1.1 Demand according to the market structure

The demand for a product or service varies in line with different types of market structures, as per individual industry. The market structure of each individual firm can be a perfect competition, an oligopoly, a monopoly and monopolistic competition. As you study this part of the work, it is important that you are able to distinguish these market structures.

- Pricing under perfect competition or pure competition

Pricing under a perfect competition market structure involves the individual firm having no influence on the number of products supplied and, in turn, they cannot set prices without having to refer to the market to determine the going price. The market for wheat is an example where a single supplier or farmer would not be able to charge more than the going market price for wheat production, since supply is available elsewhere at the going price. Also note that the wheat farmer would avoid charging less than the going rate as the supplier would be unable to make enough profit.

- Pricing under oligopoly

Oligopolistic competition exists when there are relatively few firms marketing a particular product. These few businesses have control over the supply of this product. Products in oligopolistic competition may be homogeneous or similar, such as petrol, coal or steel. Also note that some of the products may be differentiated (having real or perceived differences), such as motor cars or cigarettes. This type of market structure is usually associated with the furniture and motor industries.

- Pricing under a monopoly or pure monopoly

A pure monopoly involves a market structure where an individual firm supplies a product with no real substitutes — this means that the firm is the only supplier. The firm essentially has complete control over the supply of the product in the entire market. In South Africa the following examples fall under a monopoly market structure, ArcelorMittal the main steel supplier and Eskom the main electricity supplier.

- Pricing under monopolistic competition

Here the market structure consists of many buyers and sellers who trade over a range of prices rather than at a single market price. The suppliers in this market structure are marketing the same or similar products. Each business attempts to differentiate its product to convince consumers that its product is the one to buy. The application of product

differentiation, as well as price and non-price competition, is used to differentiate each individual firm from other competing entities. Firms that produce soft drinks, coffee, tea, powder soap, and canned food are found in this market structure.

In the section that follows, the elasticity of demand or price sensitivity will be discussed.

### 5.1.2 Elasticity of demand or price sensitivity



(Study the relevant sections in your prescribed book)

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This section will focus on the elasticity of demand that may occur when a supplier increases or decreases the price of goods and services offered for sale in the marketplace. You need to understand that elasticity of demand measures the responsiveness of demand. This means a change in demand could occur if there is a change in price (price elasticity) or income (income elasticity), or a change in price of substitute or complementary goods (cross-elasticity). It is important that you are able to explain this part of the work after studying it.

- Price elasticity

In order to better understand the dynamics of demand, you need to consider the concept of price elasticity of demand. Price elasticity of demand is defined as the sensitivity of the demand for a product in reaction to changes in the price of the product, and it is obtained by dividing the change in the quantity demanded by the change in the price of the product. It is also essential to bear in mind that, sometimes, demand is not very responsive to the price change at all. This occurrence is usually termed price-inelastic demand and is common for products such as electricity, food and petrol.

Price elasticity of demand gives us a measure of how sensitive demand is to changes in price. The example of price elasticity of demand is often found in the car industry. When there is a price increase, the demand reduces as consumers are sensitive to the price change.

- Income elasticity of demand

The income elasticity of demand measures the sensitivity of the demand for a product according to changes in the consumers' income and is calculated by dividing the quantity demanded by the change in the consumers' income. You need to understand that it is generally accepted that, if there is a change in the consumers' income, their demand for products or service will automatically change. You need to be able to distinguish between the following income elasticities of demand: an income elasticity  $> 0$  and  $< 1$ , an income elasticity  $> 1$  and a negative income elasticity and be able to provide practical examples relating to various industries.

- Cross-elasticity of demand

The sensitivity of demand for a product in reaction to changes in the price of a substitute or complementary products is measured by using cross-elasticity of demand. Products are said to be positive substitutes or good substitutes if the decrease in price

of one product or brand (eg Omo in the washing powder category) results in a decrease in demand for the other product (eg Maq, also in the washing powder category). The decreased price of Omo prompts an increase in the demand for Omo, while at the same time contributing to a decreased demand for Maq as its price is perceived as high. The products are complementary if the price decrease of one product results in an increase in demand for the other product. For example, a fall in the price of DVD players will lead to more DVD players being purchased which then leads to more DVD videos being bought.

### 5.1.3 Consumers' price behaviour



(Study the relevant sections in your prescribed book)

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As a future marketer you need to understand that consumers' behaviour patterns influence the demand for a product. For example, when a consumer goes to a butcher to buy minced meat, only to find out that the minced meat is too expensive and that he/she does not have enough money to buy it, the consumer may decide to buy a close substitute such as soya mince or meat bones. The above scenario illustrates the principle of price sensitivity; if a product has close substitutes, price sensitivity usually increases because the option to switch products is available to the buyer if the price of the original product happens to increase. This is an indication of consumer price behaviour, in that the consumer evaluates the prices of products before he or she decides to buy – or not to buy – the products.

As a marketer you should strive to understand the way consumers evaluate the prices of products and services so that when you need to present prices they can be offered in a way that will lead consumers to buy and be interested in the product or service on offer. Note that consumer price behaviour encompasses the study of perceptions of price differences, formulation of reference prices, price-quality relationships, demand bands and price as a reflection of value.

In the next section, cost constraints in pricing will be briefly looked into.

## 5.2 COST CONSTRAINTS IN PRICING



(Study the relevant sections in your prescribed book)

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You must be aware that demand sets the ceiling on the range of possible prices an organisation might charge for a product or service, but costs determine the level or floor of the price to be charged. It is very important that the products price covers the costs of production and marketing, as well as fair return for the resources invested and the risk incurred by the organisation. As a result, understanding the role and behaviour of costs is critical for all marketing decisions and more so for pricing decisions. After studying this section you must be able to explain the cost constraints in pricing and be able to provide

relevant examples for each. Note that the cost constraints in pricing involve the following factors: different types of costs, cost-volume relationship and competitors' cost prices.

In the next section, the other five pricing constraints will be discussed.

### 5.3 OTHER PRICING CONSTRAINTS



(Study section in your prescribed book)

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You need to understand, and to be able to discuss, the other pricing constraints that could be considered in determining prices of products or services produced and marketed by various organisations. The more knowledgeable the marketer is about other pricing constraints, the more likely it is that effective pricing decisions in line with organisational and marketing objectives will be made. The following is a discussion of these other pricing constraints:

- The product life cycle

It is important to note that the stage of the product's life cycle does have an influence on the determination of a price for a product or service. If a product is in the introductory stage of its life cycle with little or no competition, the organisation is in a better position to set a price that will recover costs and attain a handsome profit. Innovative products, such as the iPhone from Apple Incorporated, could demand any price during the introductory and growth phases of its life cycle.

- Ethical considerations

Organisations also need to take ethics into consideration when prices are set – more especially questions such as, should the price truly reflect the cost of the product and its value for the consumer? For example, if a product that is being manufactured is innovative and it has the ability to save people's lives, the ethical dilemma would be, is it acceptable to charge a high price for the product even if it is an innovative product, or should a low price be charged so as to save people's lives?

- General economic conditions

It is important for marketers to take general economic conditions into consideration when determining price levels. The influence of general economic conditions will usually depend on the type of product or service being offered in the marketplace. For example, for some basic commodities such as bread or petrol, the demand is largely insensitive to general economic conditions, whereas luxury goods, such as jewellery or fur coats are more sensitive to economic fluctuations and a lack of disposable income.

- Legal considerations

The marketer must, in many product categories, adhere to the laws and regulations set by different levels of government. For example, these could be laws and legal issues that set price controls, establish price levels that cannot be excluded, and that may even establish acceptable levels of price increases. The adding of taxes (value added tax–VAT) to the final prices of goods and services as required by the government is one such instance.

Again, some basic foodstuffs such as milk, eggs, and bread are exempted from VAT as legislated by the government.

- Organisational and marketing mix variables

Here, a marketer has to make sure that pricing decisions reflect the direction set through the organisational and marketing objectives. For example, Shoprite is a retailer that has made it its organisational mission to be an everyday low price store. As a result, they would not set premium prices for their products and services; instead they would price at reasonable levels relative to the product-quality of the various products they sell.

It is important to note that the marketing mix variables decisions are interrelated and they do not work in isolation from one another. What this means is that a decision taken in connection with price will influence subsequent decisions on product-quality, promotion to be undertaken and the distribution channel to be used. For example, a premium priced product, such as a Porsche motor car, will be distributed and promoted using exclusive promotional magazines or satellite broadcasts. Lower-priced products, such as soft drinks, will follow an intensive market strategy for distribution and will use below-the-line advertising.



#### Activity 5.1

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Provide a practical explanation outlining the importance of identifying the pricing constraints that may influence the final price range for the products of Tiger Brands, a branded, fast-moving consumer packaged goods company that operates mainly in South Africa and selected emerging markets.



#### Feedback

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*Tiger Brands Limited's management must collect information related to their industry's pricing constraints as this will help the company to set competitive prices for its product range. They need to know the relationship between demand and the price that will be set for their product range when it is sold in the market. The reason for understanding this relationship is that it will help them to determine price ranges that will stimulate demand for their product range, a range that includes groceries, beverages, grains, fish, perishables and many more.*

*They also have to analyse information on demand according to the market structure of their company, as well as look into the elasticity of demand and price and income elasticity concerning their product range. For example, when deciding to increase the price of bread in the Albany range, they will be able to rest assured that the demand will largely remain inelastic because consumers will continue buying bread as it satisfies their basic needs. This means that the demand for the Albany brand will remain unchanged and won't decrease due to the price increase. The types of cost involved in producing and marketing their product range will also be considered when making decisions on price settings. Tiger Brands Limited's management will also consider the current VAT rate and general economic conditions, such as the current inflation rate and interest rates, when choosing price ranges for their product range.*

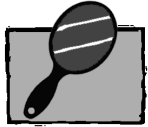
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## 5.4 ASSESSMENT



- (1) Discuss demand constraints in pricing and give practical examples relating to each.
- (2) Explain in detail the cost constraints in pricing and provide relevant examples for each.
- (3) Discuss five other pricing constraints that have been identified in this study unit and provide practical examples for each.

## 5.5 REFLECTION



*By now you should have a good understanding of why it is important for marketers to be aware of the demand constraints in pricing their products and services, as well as the cost constraints involved in pricing. You also have insight into other pricing constraints that could be considered before the final selling price is established. Where do you think you will be able to use the skills you have learned in this study unit in your professional life? What topic did you find interesting in this study unit? Why did it appeal to you? How long did you take to work through this study unit? Are you still on schedule or do you need to adjust your study programme?*

## 5.6 SUMMARY



In this study unit, we provided an introduction to the important concepts discussed in the guide, namely the issues and factors that have to do with pricing decisions. We began the study unit by discussing the demand constraints in pricing. We also discussed the cost constraints in pricing which entailed types of costs, cost-volume relationship and competitors' cost and prices. We ended the study unit with a discussion on the other pricing constraints that marketers need to consider in determining prices for their various products and services.

In the study unit that follows, estimating demand and revenue relationships will be discussed.

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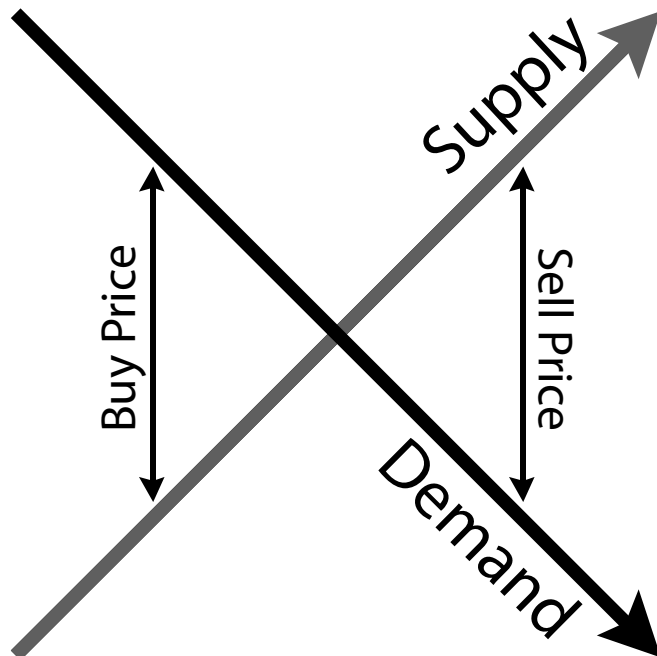
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# Study unit 6

## Estimating demand and revenue relationships

### INTRODUCTION

As price is the only element in the marketing mix that actually brings revenue, it is extremely important to an organisation. Depending on demand and supply, an organisation can estimate price levels for a specific product. Furthermore, the specific price for a product will determine the revenue that can be expected from the sale of this product. This unit will explain these concepts in detail so that you can understand more about demand and revenue relationships.



### OVERVIEW OF THIS UNIT

In the previous units, we looked at some factors that influence pricing. However, it is also important to note the influence that demand and supply will have on pricing. In this unit, we will look at understanding the concepts of demand, supply, price elasticity and revenue – as well as at the formulas required to action effective and profitable pricing.

You will need approximately five hours to work through this unit and ensure that you understand the topics covered.

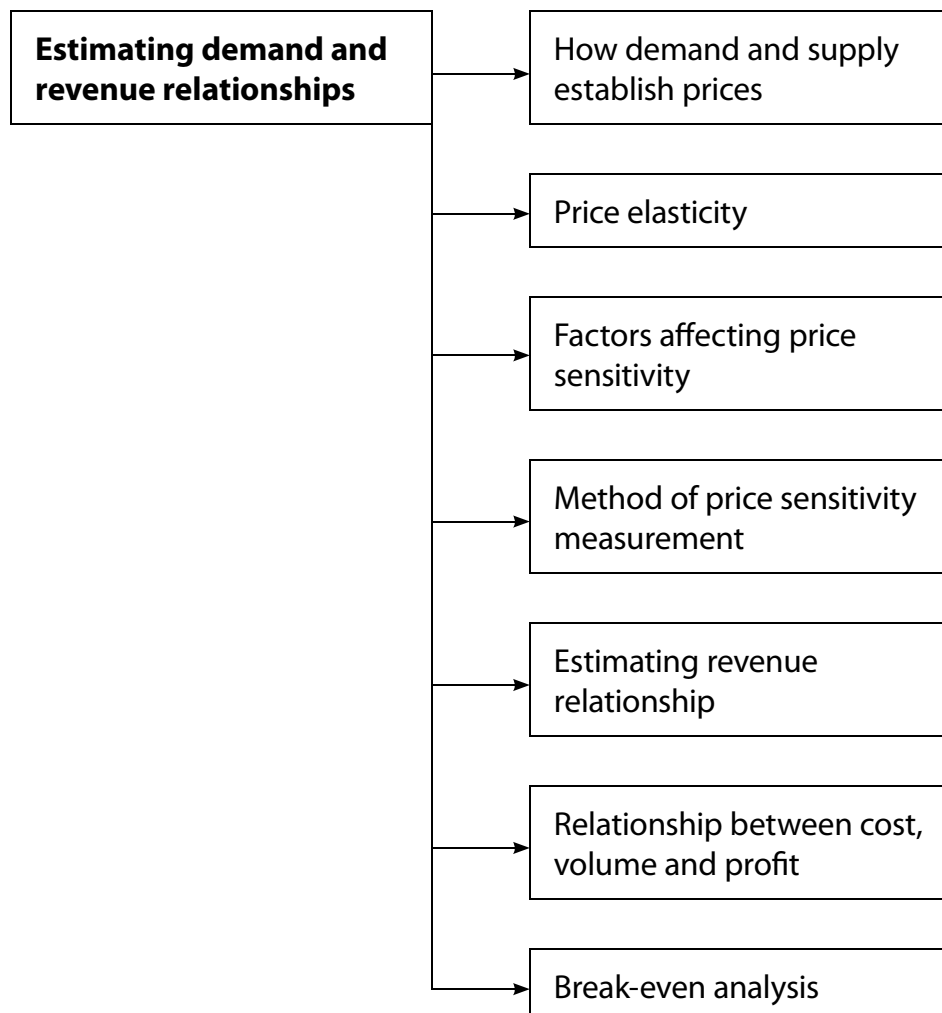
## Contents

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### Overview of this unit

- 6.1 How demand and supply establish price
  - 6.2 Price elasticity
  - 6.3 Factors affecting price sensitivity
  - 6.4 Methods of price sensitivity
  - 6.5 Establishing revenue relationships
  - 6.6 The relationship between cost, volume and profit
  - 6.7 Breakeven analysis
  - 6.8 Assessment
  - 6.9 Reflection
  - 6.10 Summary
- 

This unit unfolds as follows:





## Key concepts

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You will need to master the following key concepts in order to meet the learning outcomes for this topic:

- Demand
  - Supply
  - Price
  - Elasticity
  - Sensitivity
  - Revenue
  - Cost
  - Break-even analysis
- 

## 6.1 HOW DEMAND AND SUPPLY ESTABLISH PRICES



(Study the relevant sections in your prescribed book.)

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The quantity demanded is the amount of a product people are willing to buy at a certain price. The relationship between price and quantity demand is known as the demand relationship.

*Demand can be defined as the quantity of a product that will be sold in the market at various prices for a specific period of time.*

A demand curve is a graph of the quantity of products we expect to sell at various prices. You can see from figure 6.1 below that, the higher the price for a product, the lower the demand from consumers.

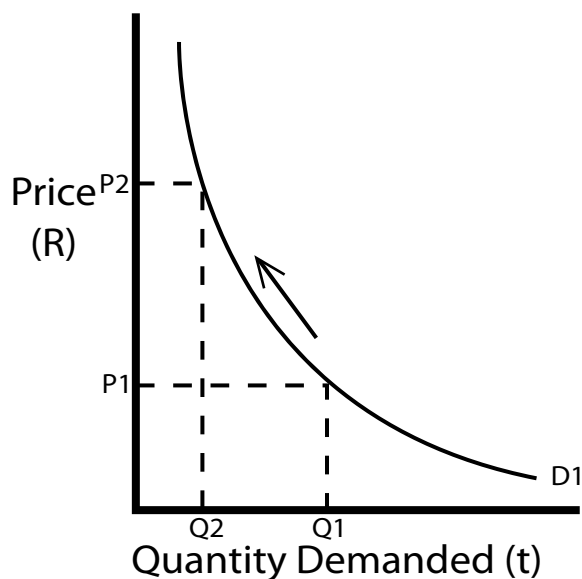


Figure 6.1 Demand curve

It is important to remember the relationship between demand and price:

- The higher the price, the lower the demand

It is important that the demand relationship is understood because it forms the basis for the discussion of the effect on demand on prices that will follow.

Supply, on the other hand, represents how much the market can offer. The quantity supplied refers to the amount of a certain good producers are willing to supply when receiving a certain price. The relationship between price and how much of a good or service is supplied to the market is known as the supply relationship. Price, therefore, is a reflection of supply and demand, and it is important to remember the relationship between price and supply:

- The higher the price, the more the marketers will supply

The price at which demand and supply are equal is called the *equilibrium price*. The graphs below illustrate the demand and supply curves and show the equilibrium price as the point where these meet.

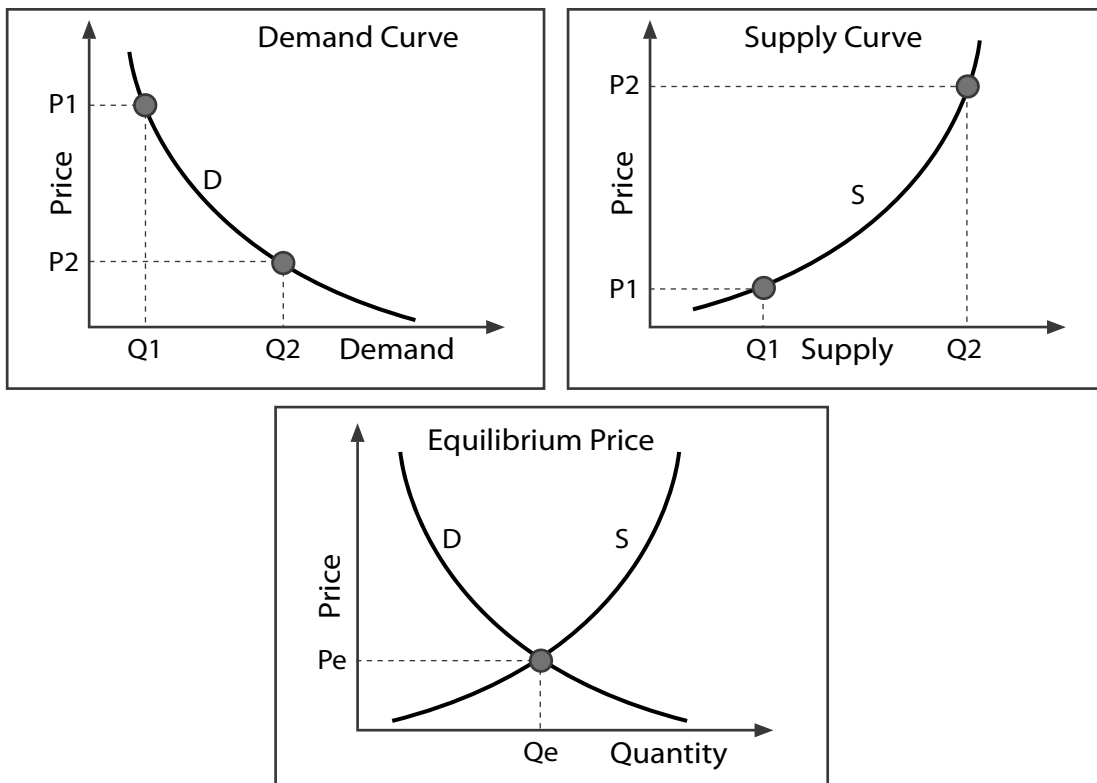


Figure 6.2 Equilibrium price



## Activity 1

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Let's look at the following example to enhance your understanding of the "demand and supply" concept.

The demand for steel is strongly linked to the demand for new vehicles and other manufactured products, so that when an economy goes into a downturn or recession, we would expect the demand for steel to decline likewise. The major producer of steel in the UK is Corus. They produce for a wide range of different industries; from agriculture, aerospace and construction industries to consumer goods producers, packing and the transport sector. Steel is a cyclical industry which means that the total market demand for steel is affected by changes in the economic cycle and also by fluctuations in the exchange rate.

Source: <http://tutor2u.net/economics/revision-notes/as-markets-demand.html>

Based on the mini case study above, discuss the relationship between demand and supply.



## Feedback

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*Demand can be defined as "the quantity of a product that will be sold in the market at various prices for a specific period of time". In other words, the quantity demanded is the amount of a product people are willing to buy at a certain price. It is evident from the case study that the demand for steel is strongly linked to the demand for new vehicles and other manufactured products. Thus, when an economy goes into a downturn or recession, the demand for steel would also be expected to decline. Steel is a cyclical industry which means that the total market demand for steel is affected by changes in the economic cycle and also by fluctuations in the exchange rate.*

*Supply refers to how much the market can offer. The quantity supplied refers to the amount of a certain good producers are willing to supply when receiving a certain price. Based on the case study, it is evident that the organisation produces for a wide range of different industries; from agriculture, aerospace and construction industries to consumer goods producers, packing and the transport sector.*

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In the section that follows, price elasticity will be discussed.

## 6.2 PRICE ELASTICITY



(Study the relevant sections in your prescribed book.)

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As can be seen from the prescribed material, the responsiveness of demand can be measured by the elasticity of demand. This depends on changes in the price, income and the price of complementary products. Therefore, changes in price can be defined as price elasticity. Price elasticity measures the sensitivity of the demand for a product in reaction to changes in the price of the product.

Price elasticity refers to the percentage change in quantity demanded, caused by a percentage change in price. For example, in South Africa, the amount of petrol consumed has not been affected significantly by the substantial price increases that have been implemented. The demand for cars, however, is price elastic as the volumes often increase when special deals are offered or just before a price increase is implemented.

You should understand the concept of price elasticity and the explanation of price-inelastic demand in order to grasp the estimating of demand and revenue relationships as a whole. Price elasticity can be calculated as follows:

$$\text{Price elasticity (E)} = \frac{\text{percentage change in quantity demand for a product}}{\text{percentage change in price of the product}}$$

Next, we will focus on the factors affecting price sensitivity.

### 6.3 FACTORS AFFECTING PRICE SENSITIVITY



(Study the relevant sections in your prescribed book.)

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Price sensitivity relates to how sensitive customers are to a specific price and how this affects their purchase decisions.

The nine main factors that affect price sensitivity are:

1. *Unique value effect* – the better differentiated the product, the lower the price sensitivity.
2. *Substitute awareness effect* – the greater the number of substitutes available, the greater the price sensitivity.
3. *Difficult comparison effect* – the more difficult it is to make a direct comparison between difficult products, the lower the price sensitivity.
4. *Total expenditure effect* – the smaller the proportion of total spend this product represents, the lower the price sensitivity.
5. *End-benefit effect* – the greater and more valued the end benefit of the product, the lower the price sensitivity.
6. *Shared-cost effect* – a buyer bearing only part of the cost of a product will be less price sensitive.
7. *Sunk-investment effect* – buyers who have already bought complementary products, or who are “locked into” a system, will be price sensitive.
8. *Price-quality effect* – the higher the quality and the prestige image of the product, the lower the price sensitivity.
9. *Inventory effect* – buyers who hold stock of the product are more likely to be price sensitive than those who purchase for immediate consumption.

These determinants would apply equally, whether buying from a particular product category (laptop computer versus a DVD player) or buying a specific brand within a product

category (a Sony versus a Philips DVD player). The first example is termed primary demand price sensitivity and the latter inter-brand price sensitivity.

In the section that follows, the various methods of price sensitivity measurement will be examined.

## 6.4 METHODS OF PRICE SENSITIVITY MEASUREMENT



(Study the relevant sections in your prescribed book.)

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Now that we have learned about the factors that influence price sensitivity, let us look at the measurement methods for price sensitivity.

Methods of measuring price sensitivity include:

1. *Expert judgement* from market experts provides the lowest-realistic, highest-realistic and expected prices, and sales forecasts on all three levels.
2. *Customer surveys* are a method to indicate price sensitivity as one can ask customers directly or indirectly through the use of conjoint analysis. Telephone surveys, mail surveys and web surveys are all different types of surveys organisations can use.
3. *Price experimentation*, either in the field or in a laboratory, can be done.
4. *Economical studies* based on time series data or panel data. Panel data refers to multi-dimensional data observed over multiple time periods for the same customer or organisation. Scanner data has greatly facilitated this type of analysis, which is information obtained at the point of purchase by an electronic device such as a barcode scanner.

You must be able to discuss the factors and methods affecting price sensitivity both theoretically and practically.

The methods mentioned above hold advantages and disadvantages. The information gained using them is useful for the following reasons:

- Firstly, it can indicate the direction that prices are taking should changes occur. This can, in turn, assist the marketer to stimulate demand and increase turnover.
- Secondly, it is useful because it allows a comparison of the elasticity of competing brands. This can result in identifying the best way to withstand a price increase.
- Thirdly, this information brings with it more knowledge of what is going on within the same product category – and this, in turn, can help in adjusting prices.
- Lastly, demand shifts from one brand to another can occur. The information gained with the help of these measures can help the marketer to protect his or her company against shifting demands.

You must be able to discuss the four different methods of measuring price sensitivity and apply them in a practical case study context

Now that we have discussed the various methods of measuring price sensitivity, we will move onto a discussion of estimating revenue relationships.

## 6.5 ESTIMATING REVENUE RELATIONSHIPS



(Study the relevant sections in your prescribed book.)

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The total revenue, the average revenue and the marginal revenue are three concepts that relate to demand curves and that deal with revenue. These three concepts are explained below.

*Total revenue* is the total income received from the sale of a product. It is calculated by multiplying the total quantity sold, or demand, by the unit price of the product. In other words, total revenue can be seen as the total sales an organisation has for a specific month. It bears no relation to profit. For example, if you owned a pizza parlour and sold 10 pizzas for R10 each, you would have recorded R100 of revenue, regardless of your profit or loss. The calculation for total revenue is as follows:

- Total revenue (TR) = Unit price of product (P) x Quantity of product sold (Q)  
In other words TR = P x Q

*Marginal revenue* is the change in total revenue obtained by selling one additional unit of product. For example, if baseball bats are being sold at a constant price of R10 a piece, a one-unit increase in sales (one baseball bat) translates into an increase in total revenue of R10. But it is often the case that additional output can be sold only if the price is reduced, and that leads to a consideration of marginal cost – the added cost of producing one more unit.

Marginal revenue can be calculated as follows:

- Marginal revenue (MR) =  $\frac{\text{change in TR}}{1 \text{ unit increase in Q}} = \frac{\Delta \text{TR}}{\Delta Q}$

*Average revenue* is the average amount of income resulting from selling one additional unit of the product. This is obtained by dividing total revenue by the quantity sold.

- Average revenue (AR) =  $\frac{\text{Total revenue (TR)}}{\text{Quantity sold}} = P$

Refer to your prescribed textbook for a clear explanation and understanding of total revenue, marginal revenue and average revenue.

## 6.6 THE RELATIONSHIP BETWEEN COST, VOLUME AND PROFIT



(Study the relevant sections in your prescribed book.)

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The word cost relates to *the input required to produce a product or supply a service*. Cost needs to be taken in consideration within the organisation when establishing the price that will be charged. By understanding the role and behaviour of costs, it is possible for

you to make more informed pricing decisions. There are four cost types that are important in pricing decisions, namely:

*Total cost* – this is the sum of all expenses incurred in the production and marketing of a product. Total cost is the sum of the fixed and variable costs. Fixed cost and variable cost will be explained below.

*Fixed costs* – these are all the costs in an organisation that will remain unchanged irrespective of the level of production and marketing. Examples of fixed costs include the cost of buildings, rent, management salaries, and insurance.

*Variable costs* – these are the costs that increase in direct relation with the volume of product being produced. The variable costs per unit remain constant, regardless of the quantity of units manufactured. Raw materials, components, and direct labour used to assemble or manufacture a product would be examples of costs that vary with production.

*Marginal/incremental cost* – the change in total cost that results from producing and marketing one additional unit.

## 6.7 BREAK-EVEN ANALYSIS



(Study the relevant sections in your prescribed book.)

*Break-even analysis* is used in the pricing process in order to evaluate whether an organisation is able to cover all its costs with a set price. It can also be used to determine the volume of product that needs to be sold at a certain price to cover costs. The level of sales at which total revenue equals total costs is called the break-even point. The advantages of break-even analysis are illustrated in the table below.

Table 6.1 Advantages and disadvantages of break-even analysis

Advantages of break-even analysis	Disadvantages of break-even analysis
Easy to calculate, provided costs are known	Focuses internally on cost structures
Shows the impact on contribution to fixed costs and profit at different price levels	Relationship between price and sales is fairly simplistic
Useful in situations where fixed costs are a high proportion of total costs	Ignores the possible effect of the other marketing techniques on sales
Helps to establish lowest price without making a loss	Price sensitivity of demand not explicitly considered

## 6.8 ASSESSMENT



Read the following case study and answer the questions that follow.

### Executive Information System

**Situation:** Gold Rush Corporation relies heavily on its sales trends to predict future demand for the high quality gold watches that it manufactures and sells to jewellery and watch stores around the country. In the past, the sales information has been passed on to production managers, sometimes up to month after large orders for popular watch styles have been ordered.

**Problem:** The production managers are grateful for the information they do receive from the sales department because they base most of their production estimates on these numbers. However, the production managers could avoid costly production overruns, as well as shortages in product, if they had the information readily available to them.

**Solution:** Gold Rush Corporation decides to implement an executive information system – available to all of its senior level managers, including the production managers – which carries information regarding real time sales and orders of Gold Rush's products. Thanks to this new system, production managers are able to more accurately estimate the inventory levels they must realise in order to achieve demand. As an added benefit, the production managers have decided that the executive information system provides them with such valuable and accurate real time information that they hope to move to a just in time inventory model to cut down on holding costs.

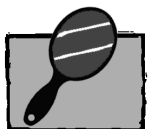
As the case study indicates, open dissemination of information through the executive information system is really able to enhance the efficiency of the corporation. As the company realises better efficiency levels, its bottom line should improve. Large corporations often struggle with widespread distribution of information. However, utilising an executive information system can help eradicate some of the problems that large companies are prone to.

Source: <http://www.buzzle.com/editorials/3-29-2006-92191.asp>

Assume that you are the CEO of Gold Rush Corporation. The sales department has asked you to explain certain concepts and theory to them, namely:

1. The methods that can be used to estimate price sensitivity
2. The equilibrium price in terms of demand and supply
3. The different types of cost, with the aid of practical examples
4. How marginal analysis can assist the marketer in setting prices

## 6.9 REFLECTION

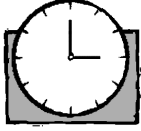


*By now you should have a good understanding of why price is such an important factor in the success of an organisation. Can you also see why it is important to consider demand and supply as a factor in the price setting process? Do you understand the concepts of equilibrium price, price elasticity and breakeven analysis? Can you discuss the factors and methods affecting price sensitivity, as well as the revenue relationships?*

## 6.10 SUMMARY



In this study unit, we focused on how demand and supply establish prices, on price elasticity, on factors affecting price sensitivity and on methods of price sensitivity measurement. Furthermore, we looked at estimating revenue relationships, the relationship between cost, volume and profit, and at break-even analysis. Study unit 7 will focus on pricing objectives and will discuss the different types of pricing objectives.



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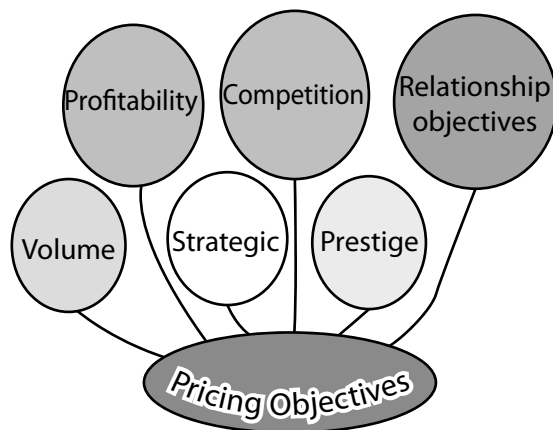
# Study unit 7

## Price objectives

### INTRODUCTION

From the marketer's point of view, an efficient price is a price that is very close to the maximum that customers are prepared to pay. In economic terms, it is a price that shifts most of the consumer surplus to the producer. A good pricing strategy would be one which could balance between the price floor (the price below which the organisation ends up making losses) and the price ceiling (the price beyond which the organisation experiences a no-demand situation).

However, although consumers may have trouble choosing among the different prices, suppliers probably have more trouble setting them. Suppliers must consider numerous factors in their complex price-setting process. Firstly, they need to consider their overall marketing objectives and the role of price in the marketing mix. The company must also consider its costs – the production costs, storage costs, customer service costs, etc.



(Source: <http://www.google.co.za/images/price/pricingobjectives>).

### OVERVIEW OF THIS UNIT

In determining a price for your product, it is important to know what the pricing objectives of the organisation are. For example, does the organisation want to achieve maximum sales or does it want to achieve a large share of the market? Once these objectives are known, the organisation can select an approximate price level (to be discussed in study unit 8).

You will need approximately one hour to work through this unit and ensure that you understand the topics covered.

## Contents

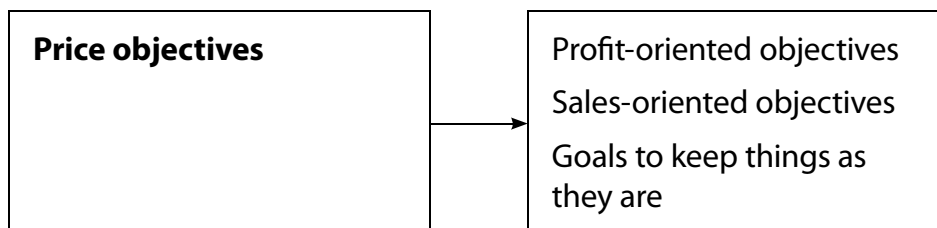
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### Key concepts

#### Overview of this unit

- 7.1 Introduction
  - 7.2 Types of pricing objectives
  - 7.3 Assessment
  - 7.4 Reflection
  - 7.5 Summary
- 

This study unit unfolds as follows:



### Key concepts

---

You will need to master the following key concepts in order to meet the learning outcomes for this topic:

- Profit-oriented objectives
  - Sales-oriented objectives
  - Goals to keep things as they are
- 

## 7.1 INTRODUCTION



(Read the relevant sections in your prescribed book.)

---

Organisations today work in a competitive and fast-changing pricing environment. Price decisions have become much more important over recent years and, therefore, organisations have changed the way in which they decide on and set prices. Nowadays, organisations base their price setting much more on consumer demand, not merely on the profit goals of the organisation, although these goals are still very important.

In this study unit, we will be examining the various types of pricing objectives that an organisation could consider.

## 7.2 TYPES OF PRICING OBJECTIVES



(Study the relevant pages in your prescribed book.)

---

As you may have noticed from your prescribed textbook, there are various types of pricing objectives which you must be able to discuss and apply in a practical manner. These objectives include:

- *Profit-oriented objectives*, which include targeting the return on investment and getting the highest profits possible.
- *Sales-oriented objectives*, which include selling more of the product and increasing the market share, or keeping it the same.
- *Objectives to keep things as they are*, which include stabilising prices in the industry and meeting the competition.

When studying this section, ensure that you can explain each group as well as the types of objectives in each group.



### Activity 7.1

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Discuss which of the above objectives you think are applicable to an organisation manufacturing motor vehicles in a booming or growing economy.



### Feedback

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*In a booming or growing economy, an organisation manufacturing motor vehicles could consider setting sales-oriented objectives in order to increase its market share. Did you mention the same objective?*

---

## 7.3 ASSESSMENT



- (1) *Explain the types of pricing objectives, supplying relevant practical examples to illustrate each type.*

## 7.4 REFLECTION



*After going through this study unit, you should have a clear understanding of the different types of pricing objectives, and how they influence the different profitability structures of an organisation. Are you able to see that every organisation needs these objectives when setting prices for its goods/services?*

## 7.5 SUMMARY



Pricing is very important in marketing and, depending on the circumstances in the environment in which an organisation operates, an organisation will select direct pricing objectives in order to achieve its overall marketing objectives.

In the study unit that follows, we will examine how an organisation goes about selecting an approximate price level.



# REFERENCES

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# TOPIC 3

## Determining the final price

An organisation must take many factors into consideration when setting the final prices of its products and services. Firstly, an approximate price level must be selected and then the list or quoted price must be set. Lastly, the organisation must consider the various adjustments that must be made to the list or quoted price. Each of these concepts will be discussed in detail in this topic.

This topic consists of three study units:

Topic 3	Study unit 8: Selecting an approximate price level
	Study unit 9: Setting the list or quoted price
	Study unit 10: Adjustments to the list or quoted price

When you have completed this topic, make sure that you are able to:

- discuss the various cost-based pricing methods
- highlight the various forms of profit-based pricing
- explain demand-based pricing and the various types of demand-based pricing that an organisation could consider
- discuss the various new product pricing strategies
- comment on the various types of competition-based pricing methods
- explain one price versus flexible price policies
- discuss pricing to cover cost plus profit
- highlight the importance of balancing the incremental costs and revenue
- explain the other influences that must be considered when setting prices
- distinguish between the various types of discounts and allowances
- explain segmented, psychological and geographic pricing strategies

# Study unit 8

## Selecting an approximate price level

### INTRODUCTION

When motor manufacturer Toyota determined the selling price for its Hilux product range (prices range from R166 600 to R360 000), it would have gone through a process of selecting and setting the approximate price level, depending on the model to be bought. It is important for Toyota to consider the cost of producing and marketing its products, as well as a satisfactory profit to be generated, in the selection of an approximate price level.



**SELLING PRICE:** R309,900.00

**MODEL:** Toyota Hilux

### OVERVIEW OF THIS UNIT

Most organisations have at their disposal various methods that they can consider in selecting and setting an approximate price level for their products and services. The approximate price level involves the setting of a basic selling price that will satisfy the consumer and that will also achieve the profitability objective of the organisation. In this study unit, we will begin by discussing cost-based pricing and profit-based pricing. We will also be discussing demand-based pricing and new-product pricing strategies. We will end the study unit with a discussion on the selection of an approximate price level – focusing on competition-based pricing.

You will need approximately three hours to work through this unit and ensure that you understand the topics covered.

## Contents

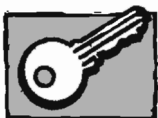
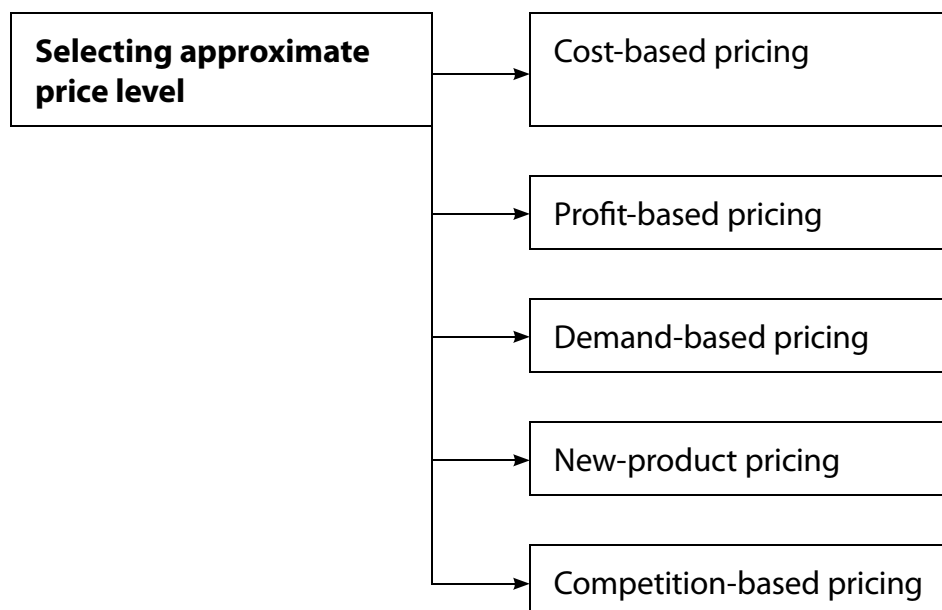
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### Key concepts

#### Overview of this unit

- 8.1 Cost-based pricing
  - 8.2 Profit-based pricing
  - 8.3 Demand-based pricing
  - 8.4 New-product pricing strategies
  - 8.5 Competition-based pricing
  - 8.6 Assessment
  - 8.7 Reflection
  - 8.8 Summary
- 

This unit unfolds as follows:



### Key concepts

---

You will need to master the following key concepts in order to meet the learning outcomes for this topic:

- Cost-based pricing
- Break-even analysis
- Profit-based pricing
- Demand-based pricing
- Price skimming
- Penetration pricing
- Competition-based pricing

## 8.1 COST-BASED PRICING



(Study the relevant sections in your prescribed book)

---

It is generally accepted that marketers often choose one of several pricing strategies based on the costs involved in producing and marketing the product, as well as making provision for some profit. It must be noted that cost-based strategies are simple to calculate and are a relatively safe means of pricing. You need to understand cost-based pricing, as well as to be able to relate it practically to various businesses in the form of case studies.

In this section, we are going to discuss cost-based pricing methods that an individual organisation can apply in determining its approximate price level for its products or for a service it plans to offer in the marketplace.

- Cost-plus pricing (or standard mark-up pricing)

Cost-plus pricing is the simplest pricing method in that it involves adding a standard mark-up to the cost of the product. This method of pricing is convenient and easy to apply and, as a result, it is widely used by wholesalers, supermarkets, retailers, construction companies and other service firms such as law and accounting firms.

The cost-plus pricing method largely ignores the sensitivity of price to demand. In cost-plus pricing, the marketer determines the unit costs for producing an item (variable and fixed costs per unit) and adds a margin to meet a profit objective or desired return on sales. For example, a restaurant owner might quite simply mark a bottle of whisky up by 80%. A bottle of whisky that costs R220 (fixed cost) and R30 (variable cost) would sell for R450 (R220 plus R30 plus R200 standard mark-up) no matter what the consumer demand might be. The problem with this method is that it ignores demand and competitors' prices. The restaurant owner might be using this method because he or she is more certain about costs than about demand and will not have to make a lot of adjustments if demand changes. The disadvantage of this pricing method might be that, if the mark-up percentage is too high, the product becomes expensive and may not sell well. In addition, there is no guarantee that it will produce a final price in line with what consumers' are willing to pay.

- Cost-plus percentage pricing

Cost-plus percentage is one of the variations of cost-plus pricing highlighted above. Some manufacturing, architectural and construction businesses use a variation of standard mark-up pricing. Using the cost-plus percentage variation on cost pricing, they add a fixed percentage to the production or construction cost. This is often used to price one- or few-of-a-kind items – such as when an architectural company charges a fee of 10% of the construction costs of a house. Thus, for a house owner whose construction cost was R500 000 where the architectural fee was 10% of construction cost (or R50 000) the final price would be R550 000.

- Cost-plus fixed fee pricing

This is the second variation of cost-plus pricing that can be used to determine the final price of products or services provided by a company. This method of pricing is used when buying highly technical, few-of-a-kind products, such as aircraft. In such cases,

governments tend to find that their contractors are reluctant to specify formal fixed prices for procurement. They therefore use cost-plus fixed fee pricing. This means that a supplier is reimbursed for all costs, regardless of what they turn out to be, but is allowed only a fixed fee as profit – and that fee is independent of the final cost of the project. For example, suppose that the SANDF agreed to pay British Aerospace (BAe) R500 million as the cost of an order of fighter jets, and that it agreed to pay BAe a R100 million fee for providing these jets. Even if BAe's costs were to increase to R1 billion for the fighter jets, its fee would remain at R100 million.

- Price determination according to experience curve

Note that it is generally acceptable for the cost of a product to decrease as and when the organisation concerned gains more experience in producing and delivering a particular product. This cost saving can lead to lower prices, but the organisation must be careful because consumers often maintain a price-quality association and lower prices might give the product a cheaper image. The higher the price of a product, the better it is perceived to be. As a result, it is advisable that the cost savings be used to pay for extra promotion in order to drive a higher demand. This requires that the marketing manager must consider the cost-based price very carefully for it to produce and generate the desired results for the firm.

- Price determination according to break-even analysis

This pricing method is based on a break-even analysis which aims to determine, firstly, at which sales level the firm would cover its costs, given a specific price per unit. Secondly, a desired sales level can be estimated if a specific profit target is added to the equation. The level of sales at which total revenue equals total costs is called the break-even point. At this point the company does not make a profit or a loss, but stands at a threshold. This pricing method is useful only if combined with both the demand-based and profit-based pricing methods since the break-even analysis uses two variables – a selling price and a profit target.

In the next section, the profit-based pricing method will be discussed.

## 8.2 PROFIT-BASED PRICING



(Study section in your prescribed book)

---

A marketer may choose to balance both revenues and costs to set price using profit-based pricing methods. This might translate to a target of a specific rand volume of profit, or the target profit may be expressed as a percentage of sales or investment. Here you will be expected to be able to discuss the profit-based pricing approaches and give practical examples of each.

- Target profit pricing

Target profit pricing is the simplest profit-based method of pricing if variable and fixed cost and units sold can be accurately estimated. To use this method, an organisation sets an annual target of a specific rand volume of profit.

- Target return–on-sales pricing

A difficulty with target-profit pricing is that, although it is simple and the target involves only a specific rand volume, there is no benchmark of sales or investment used to show how much of the organisation’s effort is required to achieve the target. By way of illustration, most supermarket chains use target return-on-sales pricing to set typical prices that will give the company a profit that is specified as a percentage, for example 1% of the sales volume will be required to achieve the profit target.

- Rate-of-return pricing (or target return-on-investment pricing – ROI)

Here it must be noted that companies often set annual return-on-investment (ROI) pricing targets such as a ROI of 20%. Rate-of-return pricing is a method of setting prices to achieve this predetermined target. This approach thus brings the cost of capital tied up in producing and distributing the product into the pricing decision. The objective is to set a price yielding a target rate of return on investment.

Operationally, this pricing approach demands firstly that managers estimate the unit sales volume of the product; secondly that they determine unit costs (variable costs plus overhead attributable to the product); thirdly, that they estimate the amount of capital involved in producing and selling the product; and fourthly that they select a target rate of return on investment. The price can then be determined as follows:

$$\text{Target return price} = \text{Unit cost} + \frac{\text{Desired \% return} \times \text{Capital invested in product}}{\text{Number of units sold}}$$



### Activity 8.1

---

Assume that Bling Furniture Manufacturers has invested R1 000 000 in facilities and equipment to produce and distribute wardrobes, kitchen units and wooden frames, and wants to make a return of 20% on the investment. The estimated number of units of furniture to be distributed and sold is 80 000. If the cost price per unit is R350, calculate what the target return price would be?



### Feedback

---

*The calculation of the target price is as follows:*

$$\begin{aligned} \text{Target return price} &= R350 + \frac{0,2 \times R1\,000\,000}{80\,000} \\ &= R350 + \frac{1\,200\,000}{80\,000} \\ &= R365 \end{aligned}$$

*Did you get the same answer? If not, where did you go wrong?*

---

In the next section, the demand-based pricing methods will be evaluated.

## 8.3 DEMAND-BASED PRICING (ALSO KNOWN AS CUSTOMER-ORIENTED PRICING)



(Study the relevant section in your prescribed book)

---

The demand-based pricing methods focus on the marketer's understanding of demand and the price behaviour of buyers, thus placing greater emphasis on customer tastes and preferences, and on consumers' perception of value, than on factors such as profit, cost and competition. In this part of the work you must be able to explain and provide practical examples of each demand-based method. The following are demand-based methods that can be used by a marketer.

- Value-pricing methods

This method assigns a price to a product or service based upon its value to the customer in the use of the product. A mathematical relationship of this method is illustrated as follows:

$$\text{Value} = \frac{\text{Perceived benefits}}{\text{Price}}$$

Here, the marketers' emphasis is to use non-price variables in the marketing strategy to build on perceived benefits or value in the customers' mind. Price is set so as to reflect the value perceived by the customer.

- Demand-backward pricing

This pricing technique is an excellent way of determining the price of a product or service. By doing some market research, the organisation will be able to determine what the final consumer is prepared to pay for a certain product or service. The process of demand-backward pricing involves the organisation starting with the final price, then working backwards to determine the mark-up percentages for the intermediaries – and at the same time ascertaining the cost price for the organisation. This provides the marketer with valuable information to determine in advance if it is possible to manufacture a product or render a service at a profit.

- Prestige pricing

When companies use a prestige pricing strategy they set a high price so that status-conscious consumers will find the product attractive and buy it. People often think a product with a high price is also a product of high quality.

The company has to understand how much value the consumer places on the benefits they receive from the product. For example, when a fancy restaurant sets a price, it has to assign a value to the taste of its food, the environment, the atmosphere and the status of the restaurant, not only to the cost of the ingredients of the meal.

- Odd-even pricing

This refers to prices ending with an odd number such as 1, 3, 5, 7, or 9. A small difference in price can suggest a large difference in the product. For example R99.95 appears to be much less than R100.00. R99.95 may be seen as a bargain price where R100.00 might

suggest higher quality. Supermarkets use odd pricing while professional fees, such as doctor's fees, are normally expressed in even numbers.

- Price lining

This is used when marketers set a limited number of different specific prices, called price points, for items in a product line. A manufacturer of refrigerators might have a small fridge for R1 000.00, an average-sized fridge for R2 000.00 and a large one with lots of special features for R4 000.00. Different market segments such as low, middle and high-income groups would buy the different sized refrigerators based on their price and affordability. Price lining provides the different ranges necessary to satisfy each segment.

- Traditional pricing

Traditional pricing refers to the practice of maintaining the retail price of a product at the same level over the long term. This happens when tradition – or a standardised channel of distribution, or other competitive factors – dictates the price. For example, cold drinks or snacks offered through standard vending machines have a customary price of R6,00 and a significant departure from this price may result in a loss of sales for the supplier.

- Bundle pricing

This is used when a company combines several products and offerings in a bundle at a reduced price. A hotel, for example, might offer a package that includes bed and breakfast. McDonald's restaurant offers a burger, chips and Coca-Cola in a bundle (or meal) that would cost more if each item were to be purchased separately.

In the section that follows, we will discuss the new-product pricing strategies that can be pursued by an organisation that intends to sell new products in the market.

## 8.4 NEW-PRODUCT PRICING STRATEGIES



(Study the relevant section in your prescribed book)

---

After studying this section you must be able to understand and discuss new-product pricing strategies, as well as be able to practically relate each strategy to any business which is in the process of introducing a new product or service.

- Price skimming

This method is generally used in the introductory phase of a new product. If the company uses price skimming, it will initially sell the product at a high price that the customers are willing to pay. This method will be used if the company wants to recover its investment in the new product as quickly as possible, or if there are only a few potential competitors and the customers know little about the products. If the price is too high it can be reduced at a later stage.

- Penetration pricing

This method can also be used in the introductory phase of a new product. The company sets a low initial price to appeal to the mass market. Penetration pricing will be used if

the company can save production costs by manufacturing bigger quantities. If there is a strong possibility of potential competitors, a low price also makes it more difficult for these competitors to enter the market.

In the last section in this unit we are going to evaluate competition-based pricing methods that can be pursued by an organisation.

## 8.5 COMPETITION-BASED PRICING



(Study the relevant section in your prescribed book)

---

Consumers judge the value of products based on the prices that competitors charge for the same kinds of products. Competition-based pricing is used when a business sets prices based on the prices that competitors charge for similar products. After studying this part of the work, ensure that you are able to identify and explain competition-based pricing methods that can be pursued by an organisation in selecting an approximate price level.

- **Going-rate pricing**

In this method, a company bases its prices mainly on competitor's prices and pays less attention to its own costs or to the demand for the product. Small companies may "follow the leader" and change their prices when the leaders change theirs.

- **Above-market pricing**

A company may use the prices of competitors as a point of departure and then determine a higher price. They might use above-market pricing to create an image of high quality. The company that sells Rolex watches, for example, uses this approach and takes pride in the fact that it makes one of the most expensive watches a person can buy.

- **Below-market pricing**

In this case, the price is lower than those of competitors. Reasons for this can be that the product is of lower quality, or is manufactured at a lower cost, or a company simply wants to increase its sales volumes.

- **Customary pricing**

These prices are based on the "traditional" price for an item – and the prices charged by competitors will be the same. This is usually found in the case of vending machines where snacks and beverages are sold. For example, a cold drink bought at a vending machine will cost R6.00 and all the brands in the machine will cost the same amount.

- **Loss-leader pricing**

Companies use this form of pricing when they conduct promotions and sell their product at a price lower than its cost for a short period of time. Supermarkets use loss-leader pricing to attract customers to their stores in the hope that they will buy other items at their normal prices. Game, for example, might sell disposable diapers at less than cost in order to attract family buyers who make larger-than-average purchases per trip.

- Sealed-bid pricing

Competition-based pricing is also used when firms bid for jobs or when tenders are issued by the government. The use of sealed-bid pricing involves an organisation basing its prices on how it thinks competitors will price, rather than on its own costs or on the demand. Here, the organisation wants to win a contract or tender that requires pricing lower than those of the other companies competing for the same bid.

## 8.6 ASSESSMENT



- (1) Explain the five cost-based pricing methods and provide practical examples of each.
- (2) Discuss three profit-based pricing approaches and provide practical examples of each.
- (3) Explain seven demand-based pricing approaches and provide practical examples of each.
- (4) Discuss two new-product pricing strategies that could be applied by Apple Incorporated in launching new or innovative products.
- (5) Identify and explain six competition-based pricing methods that could be used by BMW South Africa when pricing its new entry level vehicle model.

## 8.7 REFLECTION



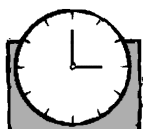
*By now you should have a good understanding of and insight into why it is important for marketers to be aware of the various methods that can be used when selecting an approximate price level for their products and services. Where do you think you will be able to use the skills you have learned in this study unit in your professional life? What topic did you find interesting in this study unit? Why did it appeal to you? How long did you take to work through this study unit? Are you still on schedule or do you need to adjust your study programme?*

## 8.8 SUMMARY



In this study unit, we provided a discussion of the cost-based pricing methods and its variations. We continued by looking into profit-based pricing and demand-based pricing techniques. We also discussed two new product strategies, namely price skimming and penetration pricing. We ended the study unit with a discussion of competition-based pricing methods, which included a description of going-rate and above-market pricing, as well as below-market pricing and customary pricing. Lastly we provided a description of loss-leader pricing and sealed-bid pricing.

In the study unit that follows, the setting of the list or quoted price will be discussed and evaluated.



# REFERENCES

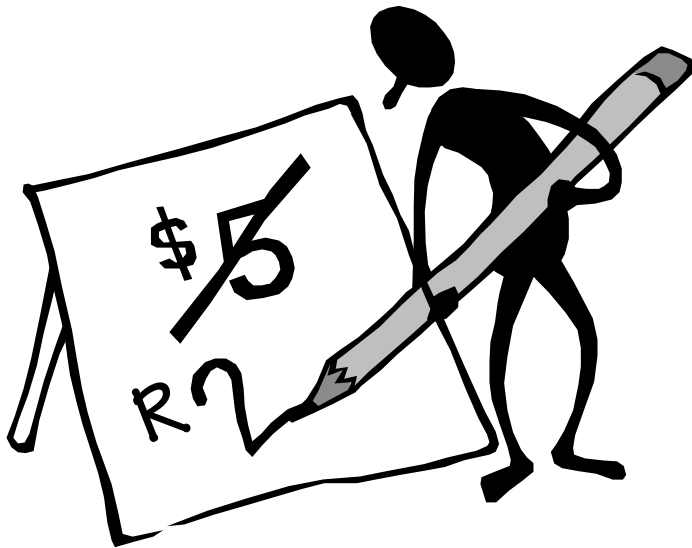
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# Study unit 9

## Setting the list or quoted price

### INTRODUCTION

Clearly, price is a critical element in an offering's perceived value. Marketers must establish clear pricing objectives and related strategies, supported by well-executed pricing tactics. In setting the exact price, it is best to compare several approaches before making a decision. Setting the list price for your product involves evaluating various market conditions and financial factors and one should be aware of a buyer's frame of mind. Consider the following factors: if you set the price too high, your product won't sell, even if it is good. On the other hand, if you price too low you will short-change yourself. Your product will sell promptly, yes, but you will make less on the sale than if you had set a higher price.



### OVERVIEW OF THIS UNIT

In order to stimulate demand for specific products, to increase store patronage, and to offer a wide variety of merchandise at a specific price point, special pricing tactics such as single-price, flexible pricing, pricing to cover cost plus profit, and balancing incremental costs and revenue should be considered.

These concepts will be discussed in this unit.

## Contents

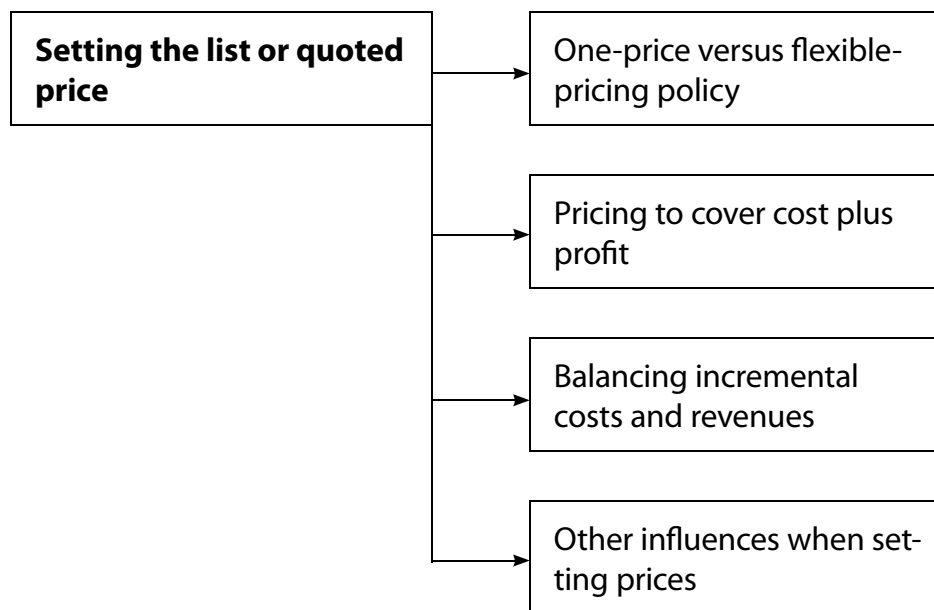
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### Key concepts

#### Overview of this unit

- 9.1 One-price versus flexible price policy
  - 9.2 Pricing to cover cost plus profit
  - 9.3 Balancing incremental costs and revenue
  - 9.4 Other influences
  - 9.5 Assessment
  - 9.6 Reflection
  - 9.7 Summary
- 

This study unit unfolds as follows:



### Key concepts

---

You will need to master the following key concepts in order to meet the learning outcomes for this topic:

- List prices
  - Quoted price
  - One-price policy
  - Flexible price policy
  - Profit
  - Revenue
  - Costs
- 

## OVERVIEW

In this study unit, we will begin by discussing the one-price versus flexible price policy. We will also be discussing the pricing to cover cost plus profit and the balancing incre-

mental costs and revenue policies. We will end the study unit with a discussion on the other influences such as competitive influence, company influence and customer effects.

You will need four hours to work through this study unit.

## 9.1 ONE-PRICE VERSUS FLEXIBLE PRICE POLICY



(Study the relevant sections in your prescribed book)

---

You should note that various pricing strategies (policies) are adopted by marketers in their efforts to achieve certain price objectives. These pricing strategies include customary pricing, variable pricing, flexible pricing, one-price policy, price lining, odd pricing, multiple pricing, bundle pricing, leader pricing, bait-and-switch pricing and private label brand pricing.

As you read about each approach, don't think of it as a standalone strategy, but instead consider how it might work in tandem with other approaches that marketers might decide to employ. As you have seen, there are various pricing policies. In this section, we will focus only on the one-price policy versus the flexible price policy.

Under a one-price policy, the same price is set for similar customers who buy the same product and quantities under the same conditions. This means that a business charges all of its customers the same price for an item. For example, all people buying the same CD at a local retailer will pay the same price. This policy means efficiency and fairness in handling customer transactions in a large store. It also speeds up transactions and reduces the need for highly skilled salespeople.

On the other hand, a flexible price policy, means offering the same product and quantities to different customers at different prices. This policy is generally used in situations calling for personal selling. The advantage of using this policy is that the salesperson can make price adjustments based on the customer's interest, a competitor's price, a past relationship with the customer, or the customer's bargaining ability. Most jewellery stores and automobile dealerships use this pricing policy, although not all customers like it.

When studying this section from your book, you should be able to summarise the differences between these pricing policies.

As there are many methods that can be used in setting price, let us now look at the pricing to cover cost plus profit method.

## 9.2 PRICING TO COVER COST PLUS PROFIT



(Study the relevant section in your prescribed book)

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When you study this section, you should know that, when setting an exact price for an offering, be it goods or a service, marketers should consider several calculations to arrive

at the *optimal price*. This implies that prices set by a company must cover all costs and contribute to profit; otherwise the organisation will go out of business.

Cost-plus pricing is perhaps the simplest and most commonly used pricing method and entails adding a standard mark-up to the cost of the product. This form of cost plus mark-up pricing is convenient and easy to apply and is therefore popular amongst retailers and wholesalers who have to decide on the prices of thousands of items. First, an estimate of costs involved must be developed. For example, many different types of costs can be considered, including fixed and variable costs, direct costs and indirect costs, and shared or overhead costs, which might be allocated to the offering on some prorated basis.



### Activity 9.1

Calculate the mark-up price of a kettle manufacturer, as well as a retailer selling kettles, based on the following facts:

Variable cost	R10, 00 per unit
Fixed cost	R300 000,00
Expected unit sales	50 000
Manufacturer's mark-up	20% on sales
Dealer's mark-up	50% on sales price



### Feedback

The manufacturer's cost per kettle is given as follows:

Variable cost		R10, 00 per unit
Fixed cost		R300 000,00
Expected units sales		50 000
Manufacturer's mark-up		20% on sales
Dealer's mark-up		50% on sales price
Unit cost	= variable cost	+ fixed cost/ unit sales
	= R10, 00	+ R300 000,00/ 50 000
	= R10, 00	+ R6, 00
	= R16, 00	

The manufacturer's mark-up price is given as follows:

$$\begin{aligned}
 \text{Manufacturer's mark-up price} &= \text{unit cost}/1 - \text{desired return on sales} \\
 &= R16,00/1 - 0,20 \\
 &= R 20, 00 \text{ (Profit = R4, 00 per unit)}
 \end{aligned}$$

The dealer's mark-up price, in turn, is given as follows:

$$\begin{aligned}
 \text{Dealer's mark-up price} &= \text{average cost per unit}/1 - \text{desired return on sales} \\
 &= 20/1 - 0, 50 \\
 &= R 40, 00
 \end{aligned}$$

The dealer's /retailer's mark-up on cost is 100% (R20, 00/R20, 00)

Suppose the kettle manufacturer charged R20, 00, but sold only 30 000 kettles instead of 50 000. The unit cost would then have been higher since the fixed costs would be spread over fewer units, and the realised percentage mark-up on sales would be lower. Mark-up pricing works only if the price actually brings in the expected level of sales.

Still, mark-up pricing remains popular for a number of reasons. Firstly, sellers are more certain about costs than about demand. By tying the price to cost, sellers simplify pricing – they do not have to make frequent adjustments as demand changes. Secondly, when all companies in the industry use this pricing method, prices tend to be similar and price competition is thus minimised. Thirdly, many people feel that cost-plus pricing is fairer to both buyers and sellers. Sellers earn a fair return on their investment, but do not take advantage of buyers if and when buyer demand increases.

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In the next section, balancing incremental costs and revenue will be discussed.

### 9.3 BALANCING INCREMENTAL COSTS AND REVENUE



(Study the relevant section in your prescribed book.)

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When studying this section in your prescribed book, you should be able to explain the following concepts: marginal analysis, marginal cost and marginal revenue.

Marginal analysis involves a continuing, concise trade-off of incremental costs against incremental revenue, while marginal cost is the change in total costs associated with a one-unit change in output. Similarly, marginal revenue is the extra revenue associated with selling an extra unit of output.

In the section that follows, we will discuss the other influences that need to be considered by an organisation when setting the list price.

### 9.4 OTHER INFLUENCES



(Study the relevant section in your prescribed book.)

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When studying this section from your prescribed book, ensure that you know the other influences that need to be considered when setting the list price. These include competitive influence, company influence and customer effects. These are discussed briefly below.

#### *Competitive influence*

Strong competition in the market plays the fundamental role in setting the list price. Under this situation, companies cannot simply decide on a price; they have to look at the pricing of their competitors. This becomes evident under the following conditions:

- When goods or services are not well differentiated;
- When industry growth is so low that market share gains are the sole source of growth;

- When the industry has excess capacity;
- When economies of scale are significant or the product is perishable; and
- When companies own a large amount of specialised production assets that are difficult to sell.

#### *Company influence*

Companies also have an influence in setting the list price. They usually develop product lines rather than price single products. The marketer usually decides on the price to set for the various products in a specific line.

#### *Customer effects*

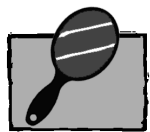
Companies should consider customers when setting the list price. It is therefore important for the marketer to understand the meaning of price from the customer's point of view, and to price products in accordance with the value the customer places on the benefits offered.

## 9.5 ASSESSMENT



- (1) Explain the differences between a one-price and a flexible price policy.
- (2) Discuss what is meant by pricing to cover cost plus profit.
- (3) Highlight why it is important to balance incremental costs and revenue.
- (4) Briefly discuss, with practical examples, the other influences that need to be considered by an organisation when setting the list price of a product.

## 9.6 REFLECTION



- (1) Do you understand why setting the list price is important?
- (2) Did you learn more about what the pricing policies entail?
- (3) How long did it take you to work through this study unit? Are you still on schedule or do you need to adjust your study programme?
- (4) What topic did you find interesting in this study unit? Why did it appeal to you?

## 9.7 SUMMARY



In this study unit, we discussed the setting of the list price – also known as the company's official price subject to discounts. This is the price that might appear in a catalogue or be quoted by a salesperson. The list price is sometimes the same as the final selling price, but in the majority of cases, the manufacturer makes some adjustments to the list price.

In the next study unit, we will look at the last step in arriving at a final price, namely making a special adjustment to the list price.

# Study unit 10

## Adjustments to the listed or quoted price

### INTRODUCTION

In most cases, adjustments to the list or quoted price are made to reduce that price in an effort either to stimulate interest in the product or to pay channel partners indirectly for the services they offer when handling the product. Under some circumstances, the adjustment goes the other way, leading to price increases in order cover additional costs incurred when selling to different markets. It should be noted that many companies do not make adjustments to their listed price, particularly those selling directly to final customers.



### OVERVIEW OF THIS UNIT

As can be seen, the adjustments to the listed prices are often made both to the trade and to the final customer. When IBM offers a discount to computer retailers buying a large number of personal computers, when Jacob's Coffee offers a price promotion on its coffee, or when Nissan authorises its dealers to offer trade-in allowances on used vehicles, these companies are adjusting their listed price downward. In this study unit, we will consider the different types of discounts and allowances, followed by a look at segmented pricing, psychological pricing, and geographical pricing.

You will need approximately three hours to work through this unit and ensure that you understand the topics covered.

## Contents

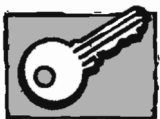
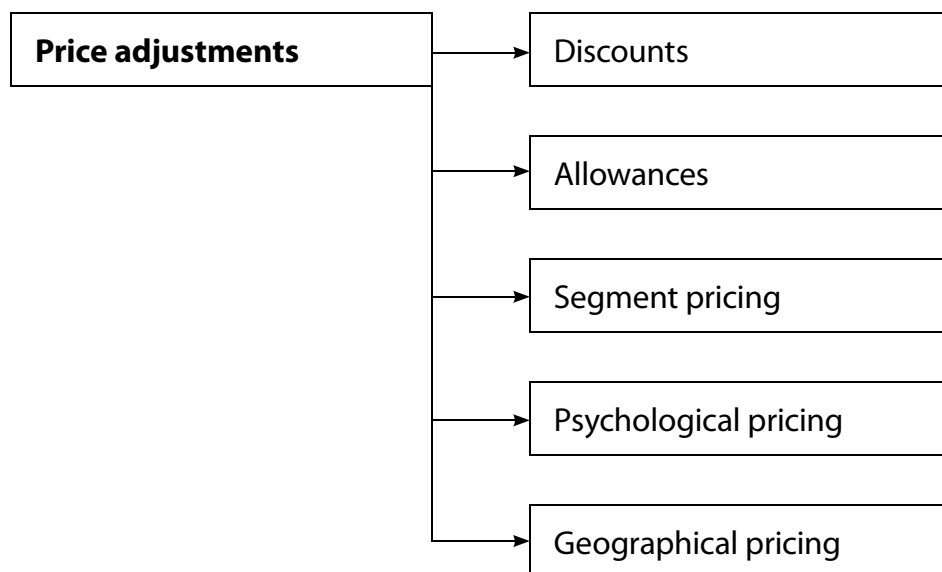
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### Key concepts

#### Overview of this unit

- 10.1 Discounts
  - 10.2 Allowances
  - 10.3 Segment pricing
  - 10.4 Psychological pricing
  - 10.5 Geographic pricing
  - 10.6 Assessment
  - 10.7 Reflection
  - 10.8 Summary
- 

This study unit unfolds as follows:



### Key concepts

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You will need to master the following key concepts in order to meet the learning outcomes for this unit:

- Price adjustment
  - Discounts
  - Allowances
  - Segment pricing
  - Psychological pricing
  - Geographical pricing
-

## 10.1 DISCOUNTS



(Study the relevant sections in your prescribed book.)

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As you go through the learning material, you will notice that discounts are reductions to a basic price of goods or services offered by the seller, offered if the buyer takes certain actions that reduce the seller's costs. The discount could be based on an incentive to buy in bigger quantities, perform certain marketing functions, buy at a certain time of the year, or pay accounts quickly.

They can occur anywhere in the distribution channel, modifying either the manufacturer's listed price (determined by the manufacturer and often printed on the package), the retail price (set by the retailer and often attached to the product with a sticker), or the listed price (which is quoted to a potential buyer, usually in written form).



### Activity 10.1

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Fly <b>2,000 miles</b> with BlueSky Taxi and receive...	<b>10% OFF</b> - for your next flight
Fly <b>4,000 miles</b> with BlueSky Taxi and receive...	<b>20% OFF</b> - for your next flight
Fly <b>6,000 miles</b> with BlueSky Taxi and receive...	<b>30% OFF</b> - for your next flight
Fly <b>8,000 miles</b> with BlueSky Taxi and receive...	<b>one Free flight</b> within 340 miles radius

Explain the types of discounts that are used by this airline company.



### Feedback

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*In your answer, you could have mentioned that the airline company provides customers with an incentive to buy in larger quantities by offering customers a much larger discount (30% compared to 10%) for flying further. Did you have a similar answer?*

---

In the section that follows we will examine allowances.

## 10.2 ALLOWANCES



(Study the relevant sections in your prescribed book.)

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As you may have noticed, allowances, like discounts, are reductions from listed or quoted prices to buyers for performing some activity. To elaborate on this matter further, trade-in and promotional allowances are discussed below:

- Trade-in allowances: In simple terms, these are price reductions given when a used product forms part of the payment on a new product. Trade-ins are an effective way to lower the price the buyer has to pay without formally reducing the listed price.
- Promotional allowances: These are price reductions given to the buyer for performing some promotional activity. These may include an allowance for creating and maintaining an in-store display, or a co-op advertising allowance.

You should be able to differentiate between the different types of allowances, and be able to explain/discuss them in relation to a given case study or scenario.

In the section that follows, segmented pricing will be discussed.

## 10.3 SEGMENTED PRICING



(Study the relevant sections in your prescribed book.)

---

Basically, segmented pricing is when two prices are set for one product without a difference in production or distribution costs.

As an example, imagine that your business only offers one product priced at R5. But some consumers are willing to pay up to R8. Other consumers are more price-sensitive and are only willing to pay R3. You do not get any of their business. By using price segmentation and charging three prices (namely R3, R5 and R8) instead of just one, more revenue can be generated.

You must ensure that you can explain segmented pricing and be able to discuss how an organisation may be able use this strategy to its best advantage.

In the section that follows, psychological pricing will be discussed.

## 10.4 PSYCHOLOGICAL PRICING



(Study the relevant sections in your prescribed book.)

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From your studies and general understanding, psychological pricing, or price ending, is a marketing practice based on the theory that certain prices have a psychological impact.

Retail prices are often expressed as “odd prices”: a little less than a round number, for example, R19.99 or R2.98. The theory is that this drives demand to a greater degree than would be expected if consumers were perfectly rational. Psychological pricing is one cause of price points.

In the section that follows, geographical pricing will be discussed.

## 10.5 GEOGRAPHICAL PRICING



(Study the relevant sections in your prescribed book.)

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As you may have noticed from the prescribed book, geographical pricing is – in simple terms – the practice of modifying a basic listed price based on the geographical location of the buyer. It is intended to reflect the costs of shipping to different locations.

When studying this section, you must be able to differentiate between and define the following types of geographic pricing: FOB origin, uniform delivery pricing, zone pricing, basing point pricing, and freight-absorption pricing. You also need to be able to discuss how these types of geographic pricing influence the general pricing of an organisation.

## 10.6 ASSESSMENT



- (1) Discuss the factors to be considered by marketers when adjusting the listed price or quoted price within the marketing environment.
- (2) Explain how retailers, manufacturers and wholesalers use discounts and allowances to increase the demand for products in the market.
- (3) Explain the segmented, psychological and geographical pricing methods, and the different types thereof that sellers may use. Use practical examples to illustrate your discussion.

## 10.7 REFLECTION



*At this stage you should have a general understanding of the efforts organisations take to adjust the listed or quoted price. You must be aware of all the different types of price adjustments that organisations can use. Can you see how manufacturers use discounts and allowances to increase their sales figures and maximise profitability? Can you see the importance for organisations to know the difference between segmented, geographic and psychological pricing strategies in order to manipulate consumers?*

## 10.8 SUMMARY



Companies selling multiple items in a product category often use price lining – offering all items in certain categories at a limited number of prices. Managers use discounts and allowances to win consumer loyalty. They use these techniques effectively in order to price their merchandise to win the market competition and end-consumers. We also

examined the various types of geographical and psychological pricing methods that can be used by marketers when pricing their products.

We have now come to the end of this guide on price management. We hope that you have enjoyed this module and have found it beneficial to your understanding of the pricing element of the marketing mix. We look forward to joining you as you study further in the exciting field of marketing management.



# REFERENCES

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