Pricing Seminar

Lithuanian Sports University

Sport and Tourism Business Strategy

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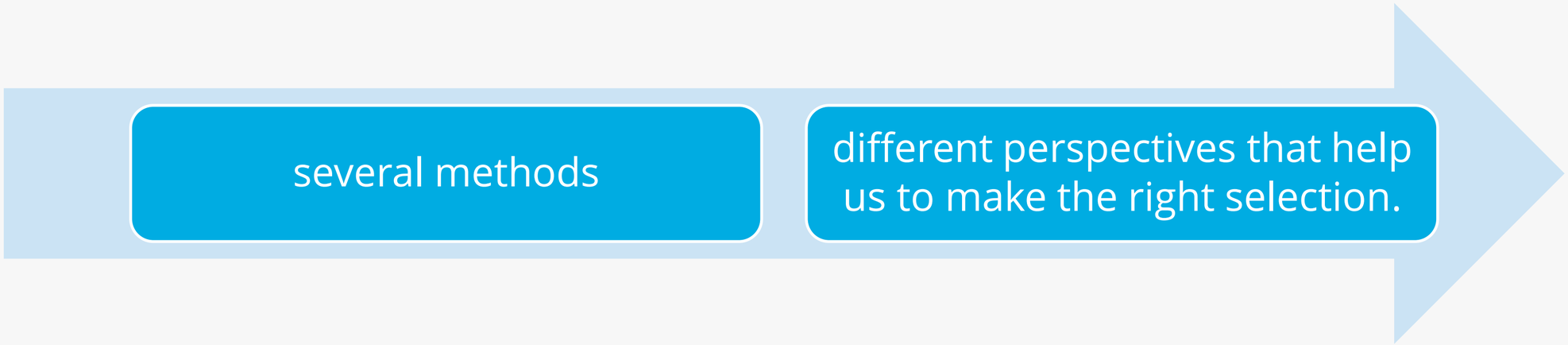

This pricing process is a continuous process of ongoing review.

Advisable to use several of these methods, with different views of a problem such as pricing

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There are three main methods of pricing:

- Cost-based methods (Cost analysis).
- Competition based methods (Competitive analysis).
- Market or demand based methods (Demand Analysis).

Cost sets the lower limit, demand sets the upper limit and competition sets the comparison that the customer makes with respect to the price and characteristics of other products that may be substitutes (reference prices).

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Cost-based methods (Cost Analysis)

These methods set the price based on costs. Really important for the sustainability of our company.

Weakness of being determined by internal factors of the company and with their backs to the market

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Cost-based methods (Cost Analysis)

Although there are several types of costs, if we simplify we have two main types:

- **fixed costs:** which are those that the company has regardless of the quantity sold.
- **variable costs:** which are those costs that are directly related to the quantity sold.

We also have to consider:

"Avoidable" and **"unavoidable"** or structural costs on the other. In many cases it is precisely these avoidable costs that are the only ones that are relevant when it comes to setting prices since the investment in the unavoidable costs has already been made.

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Competition-based pricing methods

Companies will set a price similar to that established in the sector, unless they have an advantage or disadvantage (in quality, availability, distribution or complementary services), in which case they will set prices above or below.

Complex:

- Different markets.
- Many competitors, each of them with different pricing discounts and promotions, reacting in a very different way to any price changes or any other changes in the market.

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Competition-based pricing methods

"Solution" Several possible alternatives:

- Set an average price similar to that of the competition when the products are similar or equivalent.
- The leader sets the tone → brand follows this price leader.
- Positioning in the market in a clearly superior or clearly inferior position with respect to the average prices of the sector.

Average prices of the market segment

Leader price

Clear positioning

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Competition-based pricing methods

how to react to a competitor's price change?

The advice is always calm and reasoning the possible alternatives and their consequences. It is always better "an action than a reaction". Several issues to consider according to Nagle and Holden (2002):

- Is there a response that would cost less than the avoidable loss of sales?
- If we react, is the competitor willing and able to reduce the price again to restore price differentials?
- Will the multiple responses needed to match the competitor still cost less than the avoidable loss of sales?
- Is our position in other markets (geographic or product) threatened if the competitor manages to gain more share? Does the value of the markets at risk justify the cost of reacting?

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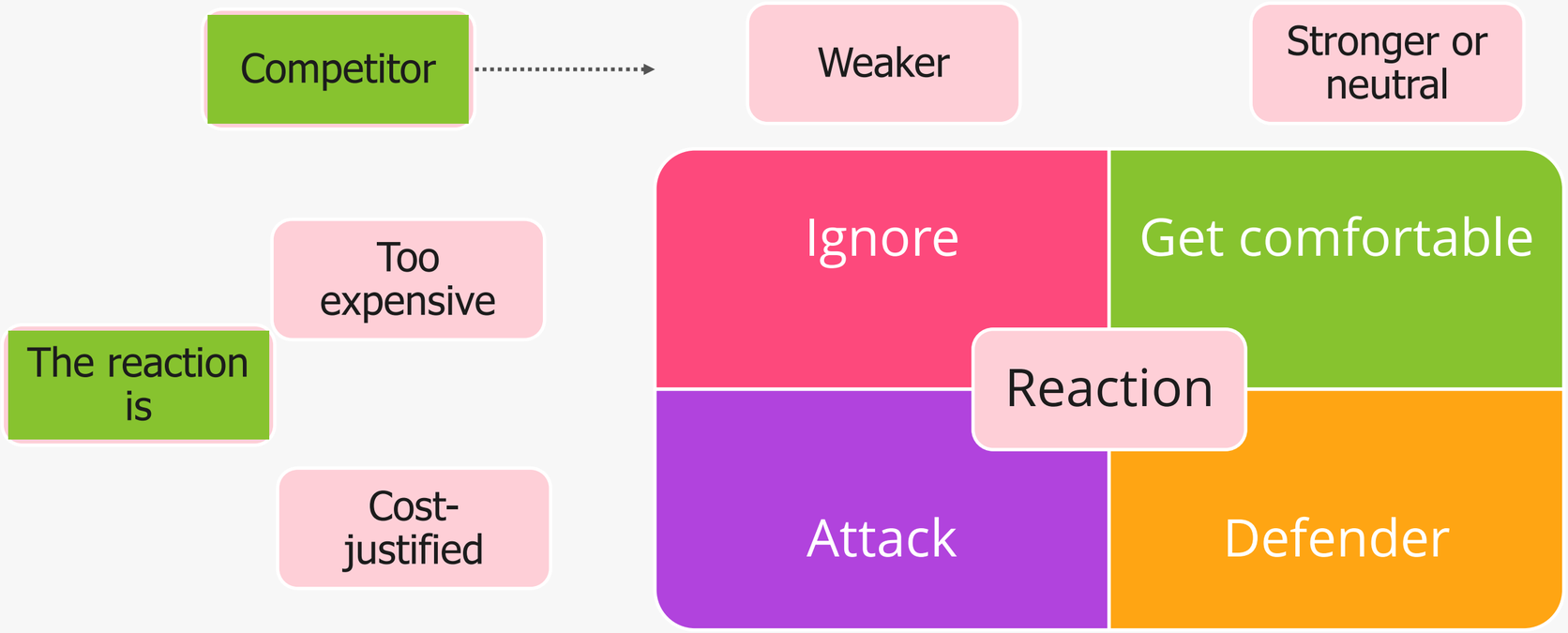
Competition-based pricing methods

Several options to react to price competition (Nagle & Holden, 2002):



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Market or demand-based pricing methods

Prices are set considering consumer psychology or the elasticity of demand of different market segments.

Thus price is a function of the following factors (Vázquez and Trespalacios, 1998):

- Originality and degree of product differentiation.
- Knowledge of substitute products.
- Possibility to compare qualities of different products.
- The relative importance of spending.
- The price paid by the buyer in relation to the total cost of the product..
- Effect of perceived value for money
- Possibility of storage.
- Existence of reference prices.

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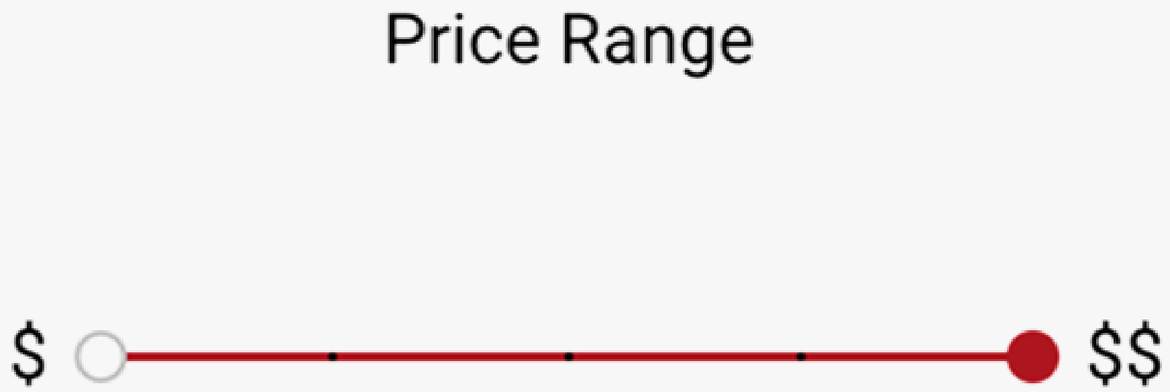
Market or demand-based pricing methods

Depending on the stage in which the product is in its life cycle, different prices: Launch, growth, development, maturity, decline…

Consumers establish high and low price thresholds. It is in this interval where the consumer finds the prices that he considers acceptable to buy a particular product or service.



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Through perceived value

Perceived value is made up of various elements such as image, product delivery systems, warranty quality, customer services, supplier reputation, accountability, etc. (Kotler, 2006).

This means that marketing actions generate value for the consumer that then reverts to a higher price: which actions, communicate value to consumers.

This value creation is done through a process called by Nagle and Holden (2002) as the five C's:

- Understand what **constitutes** sustainable value for consumers.
- **Create** value for consumers.
- **Communicate** the value that is created, in its tangible and intangible aspects.
- **Convince** consumers that they have to pay for the value they receive.
- **Capture** value with appropriate units of measure and price segmentation fences.

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Task

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Let's put into practice the information we have learned about pricing strategies.

1. We will see how to calculate the unit price of our product.
2. We must think of a sports service (or another entity), and propose some action that will increase the value of the service for the customer.
3. Case: How to react to a price change as proposed by Nagle & Holden, 2002).

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Cost-based methods (Cost Analysis)

Unit cost: The unit cost is not only the material, we have fixed and variable costs.

Unit cost= variable cost + fixed costs/unit sales

Limit price

The price limit must be this unit cost, if it is below, we are losing money on every sale.

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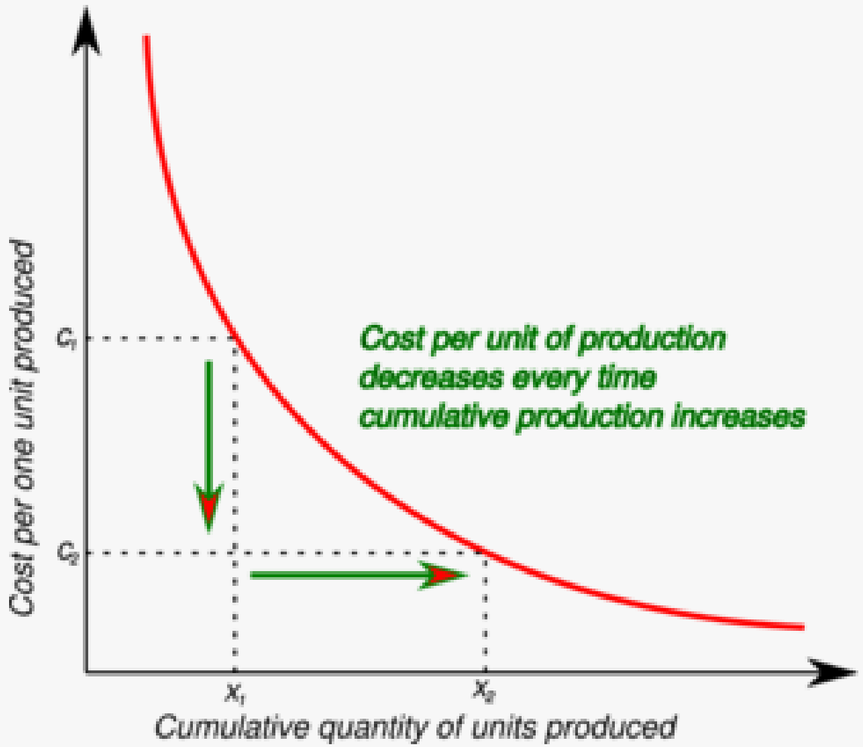
Cost-based methods (Cost Analysis)

Other costs to consider:

These are the costs of marketing, sales and distribution...



The experience curve:

The experience curve indicates that costs go down as you learn to manufacture the product over time and with the number of units. Costs go down as volume increases. However, this phenomenon is neither automatic nor does it always occur.

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Cost-based methods (Cost Analysis)

1. Unit cost

Variable cost: 10 euros

Fixed cost: 10.000 euros (one month)

Unit sales: 5.000 (one month)

CALCULATE THE UNIT COST

Unit cost= variable cost + fixed costs/unit sales

10+10.000/5.000= 12 euros Unit cost

what are we missing? Add our margin (25%)

12+25%= 15 euros is our selling price to stores.

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Cost-based methods (Cost Analysis)

When total revenues equal total costs (i.e. when profit is zero) we are at the **break-even point.**

Continuing with the previous example, how to calculate the total costs?

Break-even Point in Units = Fixed Costs / (Sales Price per Unit – Variable Cost per Unit)

FC= 10.000 euros

Sales price= 15 euros

Unit cost= 12

Break-even point= 10.000 / 15-12= 3.333 so we need to sell at least 3.333 rackets to balance the cost. That is our break-even point

Questions

2. Added value

Think of a sports service that has a cost X. You must think of an action that you could carry out that would add value for the client.

What action would it be? Why would it add value? Explain your decision.

3. Pricing reactions

You are a small/medium sized sports store. Your competitor is Decathlon. Decathlon has decided to change its prices but your company has assessed the situation and the cost of adapting your strategy is too high.

According to Nagle & Holden (2002) what reaction should you have and why?

Sumary Ideas

Price is a strategic variable integrated within the Marketing-mix.

- Price is a function highly related to the quality and quantity of information available to the buyer.
- Price is a fundamental part of the exchange relationship between a buyer and seller, but it is not everything.
- When it comes to setting prices companies are not totally free, they are constrained by a number of internal and external factors that must be considered.
- Price is a highly complex concept that is affected and influenced by a large number of variables.
- The price elasticity of demand for a product is an important and complex relationship that must be understood and studied by marketing managers.
- You don't buy products at a price, you buy profit and value at a cost.
- The Internet has changed everything, including the price.

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