Chapter 20: The marketing mix: price

The role of price in the marketing mix

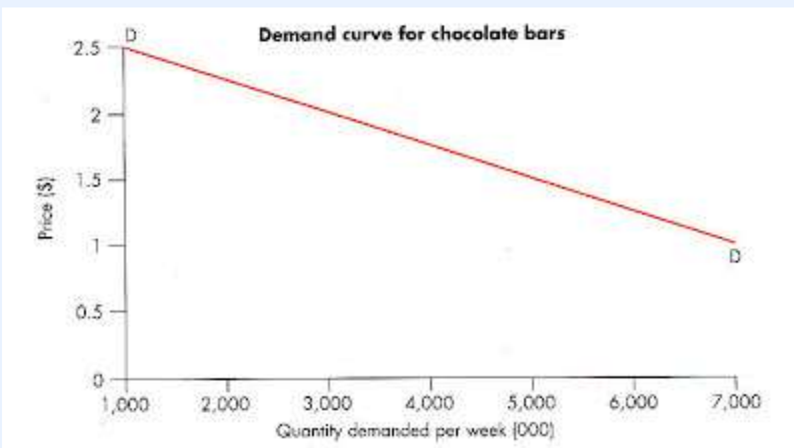
When pricing a product, a business needs to choose one that fits with the rest of the elements in the marketing mix. E.g. high price so that consumers thinks they are buying high quality goods, low price for low quality goods, or competitive prices in a market with a lot of competition.

Price determination in a free market

People think that prices are determined by the seller of the product, but that is not quite so. Prices are driven by market forces called **demand** and **supply**.

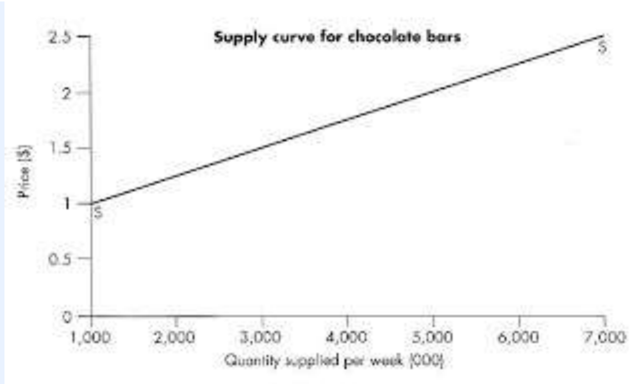
Demand

Demand is not only that people want to buy a product, but that they want it can are **willing to pay** for it. Prices can affect how much demand there is for a product. Normally, if the **price** goes **up**, **demand** goes **down**, and vice versa. This can be shown on the graph below:



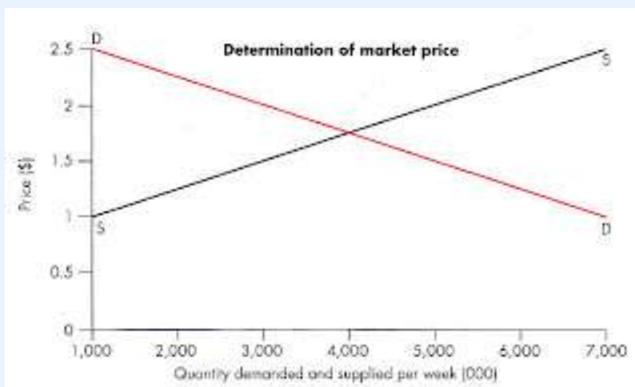
Supply

Supply also varies with price. However, it is different. If the **price** goes **up**, then the owners would want to be supplied with more products to take advantage of the high price, thus the **supply** goes **up** (and vice versa). This can be demonstrated on the graph below:



The market price

For the market price to be determined, demand and supply must all be put onto the same graph. The place where the two lines (called **curves**) cross is called the**equilibrium**, where the same number of goods are demanded and in supply resulting in **no leftovers**. All the products are demanded and all of them are sold.



Factors that affect demand and supply

The graphs above assume that the demand and supply of goods are fixed. But these things can change, which shifts the demand or supply curve to the left or the right in the graph. Changes in the **price** affects where you are on the **curves**. But changes in **other factors** affect the **position** of the **curve** on the graph.

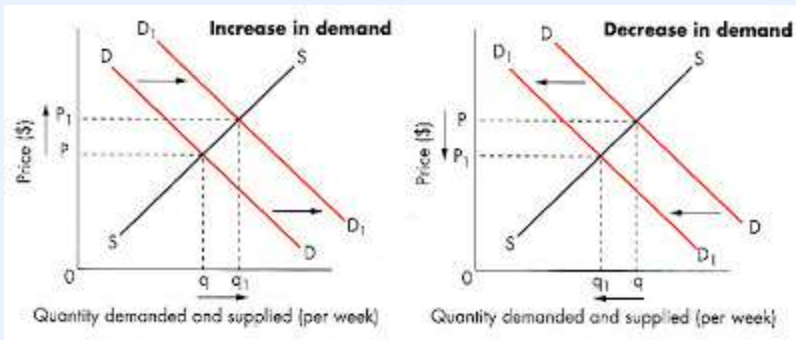
Factors affecting demand

- The popularity of **substitute products**. (products that can be used**instead of** the product)

- The popularity of **complementary products**. (products that require each other or are **used together**)

- Changes in **income**.
- Changes in **taste** and **fashion**.
- Changes in **advertising**.

The result is: if demand **falls**, the **market price** and **sales** will **fall**, and the demand curve will shift to the **left**. If demand **rises**, the **market price** and **sales**will **rise**, and the demand curve will shift to the **right**. It is illustrated on the graphs below.



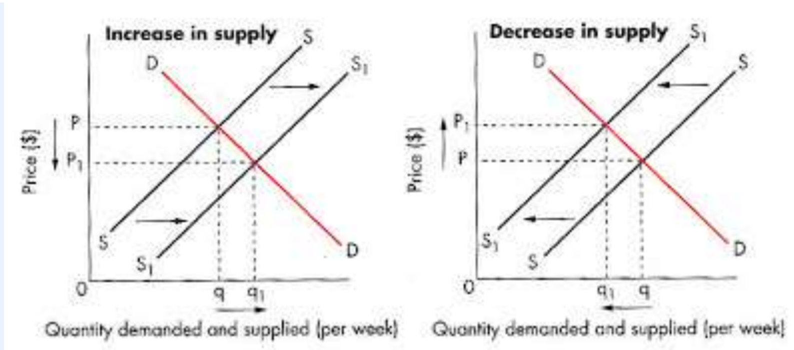
Elasticity of demand

Elasticity of demand is how **easily** demand can **change** when **prices change**. A product with an **elastic demand curve** would have a **higher change in demand**than a **change in price** (uses percentages). A product with an **inelastic demand curve** would have a **lower change in demand** than a **change in price**. The elasticity of demand of a product is mainly affected by **how many substitute**products that it has.

Factors affecting supply

- **Costs in supplying goods to the market:**
  - Price of raw materials.
  - Wage rates.
- **Improvements in technology:**
  - Makes it cheaper to produce goods.
- **Taxes and subsidies:**
  - Higher taxes mean higher costs.
- **Climate (for agricultural products):**
  - Supply of crops depend on weather.

The result is: if supply **falls**, the **market price** will **rise**, **sales** will **fall** and the supply curve will shift to the **left**. If supply **rises**, the **market price** will **fall**, **sales**will **rise** and the supply curve will shift to the **right**. It is illustrated on the graphs below.



Elasticity of supply

Elasticity of supply is how **easily** and **quickly** supply can **change** when **prices change**. How **quickly** means how quickly products can be produced and supplied, which is not very quick for products made by agriculture. A product with an **elastic supply curve** would have a **higher % change in supply** than a**change in price**. A product with an **inelastic supply curve** would have a **lower change in supply** than a **change in price**.

Pricing strategies

If a product is easily recognizable from other products, it would probably have a**brand name**. And if it has one, it would need a suitable **pricing strategy** to**complement** the brand name that should improve its **brand image**. Here are the strategies that are used:

Cost-plus pricing

Cost-plus pricing involves **covering all costs** and adding a percentage **mark-up**for profit.

- + **Easy** to apply.
- **-** You **lose** sales if your price is **higher** than your competitors price.

Penetration pricing

Penetration pricing is used to **enter** a **new market**. It should be lower than competitors' prices.

- + Ensures that **sales** are **made** when a product enters a market.
- **-** Prices will be low. Sales revenue will be **low**.

Pricing skimming

High prices are used when a **new product** is introduced into a market, partly because it has a **novelty factor**, and because of the high **development costs**. High prices could be charged because a product is **high quality**. One last use of it is to**improve** the **brand image** of a product, since people usually associate high price with good products.

- + Skimming can help **establish** a product as being **good quality**.

- **-** It may **lose potential customers** because of high price.

Competitive pricing

Competitive pricing means setting your price to a **similar** or **lower level** than your **competitors prices**.

- + Sales will be high because your price is at a **realistic level** (not under/over-priced).

- - You have to **research** on your competitors prices which costs **time**and **money**.

Promotional pricing

Promotional pricing means that you **lower** the prices of goods for a short time.

- + Help **get rid** of **unwanted** stock.

- + Can **renew interest** in a product.
- **-** Sales revenue will be **lower**.

Psychological pricing

Psychological pricing involves setting the price that **changes consumers perception** of a product. This may be by:

- Using high price to make using the product give the user a **status symbol**.

- Pricing a product at just below a **whole number** (e.g. $99) which gives it an **impression** that it is **cheaper**.
- Supermarkets charge low prices for products that are bought on a**daily basis** to give consumers an **impression** that they are being given **good value for money**.