

PRODUCT AND PRICING STRATEGIES

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GENERAL OBJECTIVES OF THE SUBJECT

At the end of the course, individuals will examine the principles of Product & Pricing and apply them within the companies need critically reflect Marketing behavior within companies *and* their impact on the development of this course.

9. PRODUCT & PRICING STRATEGIES

- 9.1 Overview of Products & Pricing
- 9.2 Product Mix
- 9.3 Stages of New Product Development
- 9.4 Package & Label
- 9.5 Pricing Strategy
- 9.6 Breakeven Analysis

9.1 Overview of Products & Pricing

This lesson deals with the first two components of a marketing mix: product strategy and pricing strategy. Marketers broadly define a **product** as a bundle of physical, service, and symbolic attributes designed to satisfy consumer wants. Therefore, product strategy involves considerably more than producing a physical good or service. It is a total product concept that includes decisions about package design, brand name, trademarks, warranties, guarantees, product image, and new-product development.

The second element of the marketing mix is pricing strategy. **Price** is the exchange value of a good or service. An item is worth only what someone else is willing to pay for it. In a primitive society, the exchange value may be determined by trading a good for some other commodity. A horse may be worth ten coins; twelve apples may be worth two loaves of bread. More advanced societies use money for exchange. But in either case, the price of a good or service is its exchange value.

Pricing strategy deals with the multitude of factors that influence the setting of a price. This chapter begins by discussing the classification of goods and services, the product mix, and the product life cycle. We then explain how products are developed, identified, and packaged and the service attributes of products. The second part of the chapter focuses on the pricing of goods and services, including pricing objectives, how prices are set, and different types of pricing strategies.

Classifying Goods and Services - Marketers have found it useful to classify goods and services because each type requires a different competitive strategy. Goods and

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services are classified as either consumer or industrial, depending on the purchaser and use of the particular item. Consumer and industrial product classifications can also be subdivided.

Classifying Consumer Goods - A variety of classifications have been suggested for consumer goods, but the system most typically used has three subcategories: convenience goods, shopping goods, and specialty goods. This system, based on consumer buying habits, has been used for about 70 years.

Convenience goods are products the consumer seeks to purchase frequently, immediately, and with a minimum of effort. Items stocked in 24-hour convenience stores, vending machines, and local newsstands are usually convenience goods. Newspapers, chewing gum, magazines, milk, beer, bread, and cigarettes are all convenience goods.

Shopping goods are products purchased only after the consumer has compared competing goods in competing stores on bases such as price, quality, style, and color. A young couple intent on buying a new television may visit many stores, examine perhaps dozens of TV sets, and spend days making the final decision. The couple follows a regular routine from store to store in surveying competing offerings and ultimately selects the most appealing set.

Specialty goods are particular products desired by a purchaser who is familiar with the item sought and is willing to make a special effort to obtain it. A specialty good has no reasonable substitute in the mind of the buyer. The nearest BMW dealer may be 40 miles away, but a buyer might go there to obtain what they considers one of the world's best-engineered cars.

This classification of consumer goods may differ among buyers. A shopping good for one person may be a convenience good for another. Majority buying patterns determine the item's product classification.

Marketing Strategy Implications - The consumer goods classification is a useful tool in marketing strategy. For example, once a new lawn edger has been classified as a shopping good, insights are gained about its marketing needs in promotion, pricing, and distribution methods.

Classifying Industrial Goods - The five main categories of industrial goods are *installations*, *accessory equipment*, *component parts and materials*, *raw materials*, and *supplies*. While consumer goods are classified by buying habits, classification of industrial goods is based on how products are used and product

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characteristics. Goods that are long-lived and usually involve large sums of money are called **capital items**. Less costly goods that are consumed within a year are referred to as *expense items*.

Installations are major capital items such as new factories, heavy equipment and machinery, and custom-made equipment. Installations are typically used for the production of other items. For example, General Motors purchased an automated monorail system from Litton Industries to transport cars on the GM assembly line. Installations are expensive and often involve buyer/seller negotiations that may last several years before a purchase decision is made.

Accessory equipment includes capital items that are usually less expensive and shorter-lived than installations. Examples are hand tools and word processors. Some accessory equipment, such as a portable drill, is used to produce other goods and services, while other equipment, such as a desk calculator, is used in administrative and operating functions.

Component parts and materials are industrial goods that become part of a final product. Seagate Technology, for example, makes magnetic disk drives that are sold as a component part to manufacturers of small computers. In some cases, component parts are visible in the finished good, such as the Goodyear tires used on tractors or automobiles. In other cases, component parts and materials are not readily seen.

Raw materials are similar to component parts and materials because they are used in the production of a final good. Raw materials include farm products such as cotton, wheat, cattle, and milk, and natural materials such as iron ore, lumber, and coal. Because most raw materials are graded, buyers are assured of standardized products of uniform quality.

Supplies are expense items used in a firm's daily operation, but they do not become part of the final product. Supplies include products such as paper clips, cleaning compounds, light bulbs, stationery, and bailing wire. These items are purchased regularly and little time is spent on the purchase decision.

Marketing Strategy Implications - Each group of industrial goods requires a different marketing strategy. Because most installations and many component parts are marketed directly from the manufacturer to the buyer, the promotional emphasis is on personal selling rather than on advertising. By contrast, marketers of supplies and accessory equipment rely more on advertising to promote their goods, which are frequently sold through an intermediary such as a wholesaler. Producers of installations and component parts may involve their customers in new-product development,

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especially when the industrial good is custom made. Finally, firms marketing supplies and accessory equipment place greater emphasis on competitive pricing strategies than do other industrial goods marketers, who concentrate on product quality and servicing.

Classifying Services - Services can be classified as either consumer or industrial. Taco Bell's, gas stations, hair salons, childcare centers, and shoe repair shops provide services for consumers. The Pinkerton security patrol at a factory and Kelly Services' temporary clerical workers are examples of industrial services. In some cases, a service can accommodate both consumer and industrial markets. For example, when ServiceMaster employees clean the upholstery in a home, it is a consumer service. When a ServiceMaster crew cleans the painting system and robotics in a manufacturing plant, it is an industrial service.

9.2 Product Mix

Product mix is the assortment of goods and/or services a firm offers **raw materials** Farm and natural products used in producing final goods. **Supplies** Expense items needed in the firm's daily operation but not part of the final product.

Strategy, Convenience, Shopping Specialty & Factor Good - Store image unimportant is very important. Prices low relatively high promotion by manufacturer and retailer. It channel many whole-relatively very few length sellers and wholesalers. Although Borden Inc. is best known for marketing dairy products, the firm's product mix also includes pasta, snack items, niche grocery products (Campfire marshmallows and RealLemon juice), nonfood consumer goods (Rain Dance car-care products, Elmer's glue, wallpaper), and specialty industrial chemicals (adhesives, forest product resins, food-wrap items).

The product mix is a combination of product lines and individual offerings that make up the product line. A **product line** is a series of related products. Coleman's product mix includes other lines of outdoor recreational equipment, such as canoes, sleeping bags, cookers, tents, and camping trailers.

Marketers must continually assess their product mix to ensure company growth, to satisfy changing consumer needs and wants, and to adjust to competitors' offerings. Consider how these factors have influenced the product mix of Bic Corporation. Most of Bic's sales come from three product lines: disposable lighters, shavers, and pens. Lighters account for about 40 percent of Bic's \$290 million in sales. But Bic marketers realized the growth prospects for lighters are dim, given the dwindling number of smokers and the public's increasing antismoking sentiment. They expanded the lighter line by adding a smaller version, the Mini Bic, to increase the firm's share of the market.

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But to build overall company sales, they broadened their product mix by adding a new product line— quarter-ounce bottles of perfume. With the new line, Bic marketers hope to capture part of the huge \$3 billion fragrance market. In response to new products from foreign and domestic competitors, Bic expanded its line of pens and shavers. Bic added a roller pen after Mitsubishi Pencil Company introduced metal-point roller pens to the United States and gained 10 percent of the pen market. Bic's shaver sales dropped 5 percent after Gillette introduced the Microtrac razor. In an effort to recapture lost sales, Bic developed a similar shaver designed to reduce nicking.

Product mixes and product lines undergo constant change. To remain competitive, marketers look for gaps in their assortment and fill them with new products or modified versions of existing ones. A useful tool used by marketers in making product decisions is the product life cycle.

The Product Life Cycle - Successful goods and services, like people, pass through a series of stages from their initial appearance to death; this progression is known as the **product life cycle**. Humans grow from infants into children; they eventually become adults and gradually move to retirement age and, finally, death. The four stages through which successful products pass are introduction, growth, maturity, and decline.

The product life cycle concept provides important insights for the marketing planner in anticipating developments throughout the various stages of a product's life. Knowledge that profits assume a predictable pattern through the stages and that promotional emphasis must shift from product information in the early stages to heavy promotion of competing brands in the later ones should improve product planning decisions. Since marketing programs will be modified at each stage in the life cycle, an understanding of the characteristics of all four product life cycle stages is critical in formulating successful strategies.

In the early stages of the product life cycle, the firm attempts to promote demand for its new market offering. Because neither consumers nor distributors may be aware of the product, marketers must use promotional programs to inform the market of the item's availability and explain its features, uses, and benefits. New-product development and introductory promotional campaigns are expensive and commonly lead to losses in the first stage of the product life cycle. Yet these expenditures are necessary if the firm is to profit later.

Growth - Sales climb quickly during the product's growth stage as new customers join the early users who are now repurchasing the item. Person-to-person referrals and continued advertising by the firm induce others to make trial purchases. The company also begins to earn profits on the new product. But this encourages competitors to enter

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the field with similar offerings. For example, after the successful introduction of Lea & Perrins' sauce, H. J. Heinz and French's began marketing similar fish and poultry sauces. Price competition appears in the growth stage, and total industry profits peak in the later part of this stage. To gain a larger share of a growing market, firms may develop different versions of a product to target specific segments. Thomas J. Lipton added two variations—no sugar Homestyle and chunky vegetable Garden style—to its original-recipe Ragu spaghetti sauce.

Maturity - The industry sales at first increase in the maturity stage, but eventually reach a saturation level at which further expansion is difficult. Competition also intensifies, increasing the availability of the product. Firms concentrate on capturing competitors' customers, often dropping prices to further their appeal. Sales volume fades late in the maturity stage, and some of the weaker competitors leave the market.

Firms spend heavily on promoting mature products to protect their market share and to distinguish their products from those of competitors. For example, Goodyear Tire & Rubber Company spends between \$20 million and \$25 million each year on tire and service center advertising to hold its market leadership position in replacement tires for cars and light trucks. Its "Nobody fits you like Goodyear" campaign focuses on serving customer needs rather than on product features and benefits. The approach is intended to distinguish Goodyear from Firestone, Goodrich, Armstrong Rubber, and other competitors.

Decline - Sales continue to fall in the decline stage of the product life cycle. Profits also decline and may become losses as further price cutting occurs in the reduced market for the item. The decline stage is usually caused by a product innovation or a shift in consumer preferences. The decline stage of an old product can also be the growth stage for a new product. In the recording industry, for example, long-playing 33 rpm records and 45 rpm records have declined, casset recordings are in the decline stage and compact discs are in the growth stage.

Extending the Product Life Cycle - Sometimes it is possible to extend a product's life cycle considerably beyond what it would otherwise be. Some useful strategies include the following:

- Increase the frequency of use. Persuading consumers that they need to have additional smoke alarms and flashlights may result in increased purchases by each household. Some watchmakers are attempting to increase customers' purchase frequency by promoting watches as a fashion accessory rather than merely a time-keeping device.
- Add new users. Introducing the product abroad might accomplish this. Gerber

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Products increased the size of its baby-food market by creating specialty foods for foreign consumers, such as strained sushi for Japanese and strained lamb brains for Australian babies. To increase the number of users in the United States, Gerber developed special versions such as guava and mango for the growing Hispanic market.

- Find new uses for the product. Arm & Hammer baking soda is a classic example. Its original use in baking has been augmented by its newer uses as a refrigerator freshener, flame extinguisher, first-aid remedy, denture cleaner, cleaning agent, and pool pH adjuster.
- Change package sizes, labels, and product quality. Offering smaller portable color televisions led to many households' acquiring two or more models. Many food marketers are offering smaller-size packages that appeal to one-person households.

The marketer's objective is to extend the product life cycle as long as the item is profitable. Some products can be highly profitable during the later stages of their life cycle, since all of the initial development costs have already been recovered.

Marketing Strategy Implications of the Product Life Cycle - The product life cycle concept is a useful tool in designing a marketing strategy that is flexible enough to match the varying marketplace characteristics at different life cycle stages. For instance, knowledge that advertising emphasis will change from informative to persuasive as the product faces new competitors during the growth stage permits the marketer to anticipate competitive actions and make necessary adjustments.

These competitive moves may involve price (the significant reduction in the price of VCRs), distribution (the significant increase in the number of Japanese retail stores handling Kodak film to compete with Fuji film in its home base), product variations (Honda's introduction of the Acura Legend, an executive luxury car, to compete with Mercedes-Benz and BMW in the United States), or promotion (AT&T's shift from informative product advertising to persuasive advertising in its competition with MCI and Sprint for long-distance customers).

New-Product Development - The creation of new products is the lifeblood of an organization. *Products do not remain economically viable forever*, so new ones must be developed to assure the survival of an organization. For many firms, new products account for a sizable part of growth in sales and profits. The 260 new products General Mills introduced in the past ten years account for nearly one-third of the firm's U.S. food sales. Each year, thousands of new products are introduced. Some new

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products, such as the compact disc, represent major technological breakthroughs, while others are improvements or variations of existing products. The compact disc with graphics is a product improvement. Marketers made use of the unused space that exists on all compact discs by adding song lyrics and artist biographies that can be displayed on a television screen.

New-product development is expensive, time consuming, and risky. Only about one-third of new products become marketplace successes. Products fail for a number of reasons. Some are not properly developed and tested, some are poorly packaged, and some have inadequate promotional support or distribution. Other products fail because they do not satisfy a consumer need or want.

In the 1970s, Canfield Company, a regional soft-drink maker, created what the company thought would be a hit product—a banana-flavored drink. Canfield marketers gave the product a catchy name—Anna Banana—hired an artist to create an original painting for the can, and developed a coordinated marketing campaign to support the product. To publicize the drink, they sent key supermarket buyers 100 pounds of bananas and flew airplanes with advertising banners over local highways, beaches, and football stadiums. But at the supermarket, no one bought Anna Banana. Consumers had no desire for a banana-flavored drink. By contrast, Canfield's Diet Chocolate Fudge succeeded because of its wide appeal to dieters who love the taste of chocolate.

Most newly developed products today are aimed at satisfying specific customer needs or wants. New-product development has become more efficient and cost effective than it was in the past because marketers use a systematic approach in developing new products.

9.3 Stages in New-Product Development

The new-product development process has six stages:

- 1) new-product ideas
- 2) screening
- 3) business analysis
- 4) product development
- 5) test marketing, and
- 6) commercialization.

Each stage requires a "**go/no go**" decision" by management. ***New-Product Ideas.*** The starting point in the new-product development process is the generation of ideas for new offerings. Ideas come from many sources, including customers, suppliers,

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employees, research scientists, marketing research, inventors outside the firm, and competitive products. *The most successful ideas are directly related to satisfying a customer need.* A recent new-product success is Certified Stainmaster Carpet by E.I. du Pont de Nemours & Company. Du Pont's marketing research indicated consumers wanted carpets that were more stain resistant, and the company developed a product to fill that need.

Screening - This stage deals with the elimination of ideas that do not mesh with overall company objectives or cannot be developed given the company's resources. Some firms hold open discussions of new-product ideas among representatives of different functional areas in the organization. Spectrum Control Inc., a producer of electronic filters and other specialty electronic products, holds meetings once every three months during which product managers, company scientists, and other managers evaluate new-product ideas.

Business Analysis - Further screening is done in this stage. Does the idea fit with the company's product, distribution, and promotional resources? The analysis also involves assessing the new product's potential sales, profits, growth rate, and competitive strengths. Sometimes concept testing is used at this stage.

Concept testing refers to marketing research designed to solicit initial consumer reaction to a new-product idea before the product is developed. Seven-Up Company marketers used concept testing to measure consumer attitudes and perceptions about a new soft-drink idea. They added maraschino cherry juice to 7Up and served the drink to consumers, who liked both the flavor and the drink's pale pink color. This was a repeat of a non-alcoholic drink called a "**Shirley Temple.**" These positive responses led to development of Cherry 7Up, one of the most successful new products in recent years.

Product Development - An actual product is created at this stage. It is then subjected to a series of tests and revised. Both the product's actual features and its consumer perceptions are studied. Inadequate testing during the development stage can doom a product—and even a company—to failure. Such was the fate of an all-natural shampoo and conditioner marketed by Nature's Organics Plus Inc.

The firm previously had launched a line of hair-care products that brought in annual sales of \$23 million. Several years later, it introduced the all-natural shampoo and conditioner without fully testing them. Retailers bought \$11 million worth of the products. Yet, without preservatives, the shampoo and conditioner self-destructed on store shelves and turned an unappealing yellow-green color. The company had to buy back most of the products from retailers. To avoid bankruptcy, the owner sold the company's assets and personally lost more than \$1 million.

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Testing. The product is actually sold in a limited area during the **test marketing** phase. The company is examining both the product and the marketing effort they are using to support it. Cities or television coverage areas that are typical of the targeted market segments are selected for such tests. Test-market results help managers determine the product's likely performance in a full-scale introduction. Kraft test marketed its spicy Bull's-Eye barbecue sauce to determine whether it could capture 5 percent of the sauce market and to explore a premium pricing strategy and two levels of national advertising spending (\$9 million and \$5 million).

Test results indicated Kraft would get the market share it desired, could put a high price on the product, and could use the lower advertising spending level. Not all products, however, are test marketed. Colgate-Palmolive introduced two major new products—Fab 1 Shot, an all-in-one laundry product, and Palmolive Automatic, a liquid dishwasher detergent—without test marketing them in order to beat competitors to the marketplace.

Commercialization - This is the stage at which the product is made generally available in the marketplace. Sometimes it is referred to as a product launch. Considerable planning goes into this stage. The firm's promotional, distribution, and pricing strategies must all be geared to support the new-product offering.

Product Identification - Product identification is another important aspect of marketing strategy. Products are identified by brands, brand names, and trademarks. A **brand** is a name, term, sign, symbol, design, or some combination thereof used to identify the products of one firm and to differentiate them from competitive offerings. Wolverine World Wide identifies its brand of footwear with the symbol of a basset hound and the name Hush Puppies

A **brand name** is that part of the brand consisting of words or letters included in a name used to identify and distinguish the firm's offerings from those of competitors. The brand name is the part of the brand that can be vocalized. A recent survey revealed the most recognizable brand names in the United States are Coca-Cola, Campbell's, Pepsi-Cola, AT&T, McDonald's, American Express, Kellogg's, IBM, Levi's, and Sears.

A **trademark** is a brand that has been given legal protection. The protection is granted solely to the brand's owner. Trademark protection includes not only the brand name, but also pictorial designs, slogans, packaging elements, and product features such as color and shape. Rolls-Royce Motor Cars Inc. has received trademark protection not only on the Rolls-Royce brand name, mascot, and badge, but also for the automobile's radiator grille.

Brands are important in developing a product's image. If consumers are aware of a

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particular brand, its appearance becomes advertising for the firm. The RCA trademark of the dog at the phonograph, for example, is instant advertising to shoppers who spot it in a store. Successful branding is also a means of escaping some price competition. Well-known brands often sell at a considerable price premium over their competition.

Selecting an Effective Brand Name - Good brand names are easy to pronounce, recognize, and remember. Short names like Gulf, Crest, Kodak, Visa, and Avis meet these requirements. Multinational marketing firms face a real problem in selecting brand names in that an excellent brand name in one country may prove disastrous in another.

Every language has a short "a," so *Coca-Cola* and *Texaco* are pronounceable in any tongue. But an advertising campaign for E-Z washing machines failed in the United Kingdom because the British pronounce z as "zed." An effective brand name for a line of high-quality bakery products marketed by Anheuser-Busch in Spain was "Bimbo". But the name would be less effective in the United States, where Anheuser-Busch uses the Earth Grains brand name for its premium bakery goods. Brand names should give the right image to the buyer. *Accutron* suggests the quality of the high-priced and accurate Bulova timepiece. Lite beer by Miller creates an image of a beer with reduced calories and carbohydrates. Federal Express suggests a fast delivery service that covers a broad geographic range. Dep Corporation marketers recently changed the brand name of Ayds diet candy to Diet Ayds because they were concerned that the single word *Ayds* would project a negative image to consumers who might associate it with the similar sounding AIDS virus.

Brand names must also be legally protectable. Trademark law states that brand names cannot contain words in general use, such as *television*, or *automobile*. Generic words—words that describe a type of product—cannot be used exclusively by any organization. The task of selecting an effective and legally protectable brand name is becoming more difficult as the number of new-product introductions increases each year. In 1996, about 70,000 new-product names were registered with the U.S. Patent and Trademark Office, double the number of 20 years ago. Many firms hire professional name smith consultants to create new-product names. By using computers to link word fragments into new combinations, one such firm, Name Lab, generated Compaq computers and Honda's Acura.

Brand Categories - A brand offered and promoted by a manufacturer is known as a **national brand**, or a manufacturer's brand. Examples are Tide, Jockey, Gatorade, Swatch, and DoveBar. But not all brand names belong to manufacturers. Some are the property of retailers or distributors.

A **private brand** (often known as a house, distributor, or retailer label) identifies a product that is not identified as to manufacturer but instead carries the retailer's label.

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The Sears line of DieHard batteries and The Limited's Forenza label are examples. Many retailers offer a third option to manufacturers' and private brands: the **generic product**. These items have plain packaging, minimal labeling, and little if any advertising, and meet minimum quality standards.

Generic products sell at a considerable discount from manufacturers' and private brands. Generics were developed in Europe and first appeared in the United States in 1977. Sales of generic products peaked in the early 1980s when inflation was high but have declined steadily since then as the economy has improved.

Stages of Brand Loyalty - Although branding is very important, the degree of brand loyalty varies widely from product to product. In some categories, consumers insist on a specific brand. A home food shopper, for example, may insist on buying Birds Eye Frozen Foods. For other purchases, such as paper towels, they might readily accept a generic product. Brand recognition, brand preference, and brand insistence are three stages used to measure brand loyalty.

Brand recognition simply means that the consumer is familiar with the product or service. Free samples and discount coupons are often used to build this familiarity. A recognized brand is more likely to be purchased than an unknown one.

Brand preference is the stage of brand loyalty at which the consumer will be loyal if the brand is available. Many consumer products like beer and soft drinks fall into this category. A considerable portion of all marketing expenditures are intended to build brand preference.

Brand insistence is the stage of brand loyalty at which consumers will accept no substitute for their preferred brand. If it is not readily available locally, the consumer will special-order it from a store, or turn to mail-order or telephone buying. Brand insistence is the ultimate degree of brand loyalty, and few brands obtain it.

Family Brands and Individual Brands - Another branding decision marketers must make is whether to use a family branding strategy or an individual branding strategy.

A **family brand** is a single brand name used for several related products. Kitchen Aid, Johnson & Johnson, Xerox, and Dole Food Company use a family brand name for their entire line of products. When a firm using family branding introduces a new product, both customers and retailers recognize the familiar brand name. The promotion of individual products within a line benefit all the products because the family brand is well known.

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Some firms utilize an **individual branding** strategy by giving products within a line different brand names. For example, Procter & Gamble has individual brand names for its different laundry detergent products—Tide, Cheer, Dash, and Oxydol. Each brand targets a unique market segment. Consumers who want a cold-water detergent can buy Cheer rather than Tide or Oxydol instead of purchasing a competitor's brand. Individual branding stimulates competition within a firm and enables the company to increase overall sales.

9.4 The Package and Label

Except for generic products, packaging also plays an important role in product strategy. The original purpose of packaging was protection against risks like damage, spoilage, and theft. But over the years, packaging also acquired a marketing objective.

Because the package must help sell the product, packages were made more attractive and appealing to consumers. Marketers are now very concerned about how a package will be perceived in the marketplace. For instance, when the sales and market share of Gillette Company's Soft & Dri ladies deodorant began declining, the firm held focus group interviews to determine the cause. Gillette marketers learned the product was well received by women under 30, the product's target market, but the packaging was outdated and not in keeping with the image the young women wanted to project. After studying 60 package designs and soliciting retailers' opinions, Gillette relaunched Soft & Dri with contemporary packaging that appealed to its target audience.

Marketers' emphasis on targeting specific market segments and satisfying consumers' desire for convenience have increased the importance of packaging as an effective way to promote products. When Mott USA wanted to build the sales of its applesauce, the firm's marketers developed Fruit Paks, a six-pack of applesauce in 4-ounce portable containers. In six months, Fruit Paks sales increased 600 percent, with about three-fourths of consumption coming from children under age 12. "The size of the package drove the sales," said Mott's product manager.

Packaging is responsible for one of the biggest costs in many consumer products. As a result, marketers are now devoting more attention to it. Cost-effective packaging is one of industry's greatest needs. Labeling is often an integral part of the packaging process. Soft drinks, frozen vegetables, milk, and snack foods are examples. Labeling must meet federal requirements as set forth in the *Fair Packaging and Labeling Act* (1966). The intent is to provide adequate information about the package contents so consumers can make value comparisons among competitive products. Other requirements—like the Food and Drug Administration's rule on nutritional content listing—may also apply.

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Another important aspect of packaging and labeling is the **Universal Product Code (UPC)**, the bar code read by optical scanners that print the name of the item and the price on a receipt. First introduced in 1974, the UPC is a labor-saving innovation that has improved inventory control, improved checkout time, and cut pricing errors. It has also become a major asset in collecting marketing research data.

Customer Service - The customer service components of product strategy include warranty and repair service programs. Consumers want to know that an adequate service program is available if something goes wrong with the product. Products with inadequate service backing quickly disappear from the market as a result of word-of-mouth criticism. Warranties are also important.

A **warranty** is simply a promise to repair, refund money paid or replace a product if it proves unsatisfactory. The *Magnuson-Moss Warranty Act (1975)* authorized the Federal Trade Commission to establish warranty rules for any product covered by a written warranty and costing \$15 or more. This legislation does not require warranties, but it does say they must be understandable and that a consumer complaint procedure must be in place.

A growing number of service marketers, such as airlines and hotels, and producers of goods are making warranties an important element of their competitive strategy. Federal Express guarantees next-day package delivery by 10:30 a.m. in most major metropolitan areas, and L. L. Bean, a retailer and mail-order house, guarantees customers can return a product at any time and receive either a replacement, refund, or credit.

To promote good customer relations, many firms operate a consumer hot-line. Complaints from users of goods and services often prompt firms to make improvements. Oscar Mayer Company responded to consumer complaints that meat packages leaked by developing re-sealable hot dog packages.

9.5 Pricing Strategy

After a good or service has been developed, identified, and packaged, it must be priced. This is the second aspect of the marketing mix. As noted earlier, price is the exchange value of a good or service. Pricing strategy has become one of the most important features of modern marketing.

All goods and services offer some utility, or want-satisfying power. Individual preferences determine how much utility a consumer will associate with a particular good

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or service. One person may value leisure-time pursuits while another assigns a higher priority to acquiring property, automobiles, and household furnishings.

Consumers face an allocation problem: Their scarce resource of a limited amount of money and a variety of possible uses for it. The price system helps them make allocation decisions. A person may prefer a new personal computer to a vacation, but if the price of the computer rises, they may reconsider and allocate funds to the vacation instead. The emphasis on low prices in the Los Angeles Zoo advertisement in Figure 12.8 may influence how a family decides to allocate leisure funds. Low admission prices make a day at the zoo a bargain compared to the higher cost of an amusement park outing.

Prices help direct the overall economic system. A firm uses various factors of production, such as natural resources, labor, and capital, based on their relative prices. High wage rates may cause a firm to install labor-saving machinery. Similarly, high interest rates may lead management to decide against a new capital expenditure. Prices and volume sold determine the revenue received by the firm and influence its profits.

Pricing Objectives - Marketing attempts to accomplish certain objectives through its pricing decisions. Research has shown that multiple pricing objectives are common among many firms. Pricing objectives vary from firm to firm. Some companies try to maximize their profits by pricing their offerings very high. Others use low prices to attract new business. The three basic categories of pricing objectives are:

- 1) profitability objectives
- 2) volume objectives
- 3) other objectives, including social and ethical considerations, status quo objectives, and image goals.

Profitability Objectives - Most firms have some type of profitability objective for their pricing strategy. Management knows that $\text{Profit} = \text{Revenue} - \text{Expenses}$ and that revenue is a result of the selling price times the quantity sold: $\text{Total Revenue} = \text{Price} \times \text{Quantity Sold}$. Some firms try to maximize profits by increasing their prices to the point where a disproportionate decrease appears in the number of units sold. A 10 percent price hike that results in only an 8 percent volume decline increases profitability. But a 5 percent price increase that reduces the number of units sold by 6 percent is unprofitable.

Profit maximization is the basis of much of economic theory. However, it is often difficult to apply in practice, and many firms have turned to a simpler profitability

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objective—the **target return goal**. For example, a firm might specify the goal of a 9 percent return on sales or a 20 percent return on investment. Most target return pricing goals state the desired profitability in terms of a return on either sales or investment.

Volume Objectives - Another example of pricing strategy is **sales maximization**, under which management sets an acceptable minimum level of profitability and then tries to maximize sales. Sales expansion is viewed as being more important than short-run profits to the firm's long-term competitive position.

A second volume objective is **market share**—the percentage of a market controlled by a certain company, product, or service. One firm may seek to achieve a 25 percent market share in a certain industry. Another may want to maintain or expand its market share for particular products or product lines.

In an attempt to gain a larger share of the \$51 billion-a-year lodging industry market, national hotel and motel firms that previously concentrated on moderate and high-priced lodging are now developing products that appeal to budget-conscious business and pleasure travelers, a segment with significant growth potential. Marriott Corporation, a market leader in the quality, full-service lodging segment, entered the low-priced market by offering Fairfield Inns, with room rates under \$40. By moving into the economy segment, Marriott hopes to increase its overall share of the lodging market.

Market share objectives have become popular for several reasons. One of the most important is the ease with which market share statistics can be used as a yardstick for measuring managerial and corporate performance. Another is that increased sales may lead to lower production costs and higher profits. On a per-unit basis, it is cheaper to produce 100,000 pens than it is to manufacture just a few dozen.

Other Objectives - Objectives not related to profitability or sales volume—social and ethical considerations, status quo objectives, and image goals—are often used in pricing decisions. Social and ethical considerations play an important role in some pricing situations. For example, the price of some goods and services is based on the intended consumer's ability to pay. For example, some union dues are related to the income of the members.

Many firms have status quo pricing objectives: That is, they are inclined to follow the leader. These companies seek stable prices that will allow them to put their competitive efforts into other areas such as product design or promotion. This situation is most common in oligopolistic markets.

Image goals are often used in pricing strategy. The price structures of major department stores, for example, are set to reflect the high quality of the merchandise. Discount

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houses, however, may seek an image of good value at low prices. So a firm's pricing strategy may be an integral part of the overall image it wishes to convey.

Price Determination - While pricing is usually regarded as a function of marketing, it also requires considerable inputs from other areas in the company. Accounting and financial managers have always played a major role in the pricing task by providing the sales and cost data necessary for good decision making. Production and industrial engineering personnel play similarly important roles. Computer analysts, for example, are in charge of the firm's computer-based marketing information system, which provides up-to-date information needed in pricing. It is essential for managers at all levels to realize the importance of pricing and the contribution that can be made to correct pricing by various areas in the organization. Price determination can be viewed from two perspectives. Economic theory provides an overall viewpoint, while cost-based pricing looks at it from a practical, "**hands-on**" approach.

Economic Theory - Economic theory assumes a profit maximization objective. It says market price will be set at the point at which the amount of a product desired at a given price is equal to the amount suppliers will provide at that equilibrium price: where the amount demanded and the amount supplied are in equilibrium. In other words, the demand curve is a schedule of amounts that will be demanded at different price levels.

At \$3 per pound, 5,000 pounds of fertilizer might be sold. A price increase to \$4 per pound might reduce sales to 3,200 pounds, and a \$5 per pound price might result in sales of only 2,000 pounds, as some would-be customers decide to accept less expensive substitutes or to wait for the price to be reduced. Correspondingly, the supply curve is a schedule that shows the amounts that will be offered in the market at certain prices. The intersection of these schedules is the equilibrium price that will exist in the marketplace for a particular good or service.

Cost-Based Pricing - Although this economic analysis is correct in regard to the overall market for a product, managers face the problem of setting the price of individual brands based on limited information. Anticipating the amount of a product that will be bought at a certain price is difficult, so businesses tend to adopt cost-based pricing formulas.

Although these are simpler and easier to use, executives have to be flexible in applying them to each situation. Marketers begin the process of cost-based pricing by totaling all costs associated with offering an item in the market, including production, transportation, distribution, and marketing expenses. They then add an amount to cover profit and expenses not previously considered. The total becomes the price. Many smaller firms calculate the markup as a percentage of their total cost. Suppose, for

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example, that the total cost of manufacturing and marketing 1,000 portable stereos is \$100,000, or \$100 per unit. If the manufacturer wants a selling price that is 25 percent above its costs, the selling price will be \$100 plus 25 percent of \$100, or \$125 per unit.

There are actually two calculations for cost-based pricing; mark-up and profit margin. mark-up pricing is based on the cost of the item and profit margin is based on the sales price. To illustrate; our \$100 unit to have a 20% mark-up, the sales price is calculated by using the formula: $\text{Cost} / (100\% - \text{mark-up } \%)$.

Markup pricing is easy to apply, and it is used by many businesses (mostly retailers and wholesalers). However, it has two major flaws. The first is the difficulty of determining an effective markup percentage. If this percentage is too high, the product may be overpriced for its market; then too few units may be sold to return the total cost of producing and marketing the product. On the other hand, if the markup percentage is too low, the seller is "giving away" profit that it could have earned simply by assigning a higher price. In other words, the markup percentage needs to be set to account for the workings of the market, and that is very difficult to do.

The second problem with markup pricing is that it separates pricing from other business functions. The product is priced after production quantities are decided on, after costs are incurred, and almost without regard for the market or the marketing mix. To be most effective, the various business functions should be integrated. Each should have an impact on all marketing decisions.

9.6 **Breakeven Analysis: A Tool in Cost-Based Pricing**

Marketers often use **breakeven analysis** as a method of determining the minimum sales volume needed at a certain price level to cover all costs. It involves a consideration of various costs and total revenue.

Total cost (TC) is composed of *total variable costs (TVC)* and *total fixed costs (TFC)*. **Variable costs** are those that change with the level of production (such as labor and raw materials costs), while **fixed costs** are those that remain stable regardless of the production level achieved (such as the firm's insurance costs). Total revenue is determined by multiplying price by the number of units sold.

Marketers can use breakeven analysis to determine the profits or losses that would result from several different proposed prices. Since different prices will produce different breakeven points, the calculations of sales necessary to break even could be compared with estimated sales obtained from marketing research studies. This comparison can then be used to identify the most appropriate price, one that would attract sufficient customers to exceed the breakeven point and earn profits for the firm.

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Skimming Pricing involves setting the price of the product relatively high compared to similar goods and then gradually lowering it. This strategy is used when the market is segmented on a price basis, that is, where some people may buy the product if it is priced at \$10, a larger group may buy it at \$7.50, and a still larger group may buy it at \$6. It is effective in situations where a firm has a substantial lead on competition with a new product. The skimming strategy has been used effectively on such products as color televisions, pocket calculators, personal computers, and VCRs.

A skimming strategy allows the firm to recover its cost rapidly by maximizing the revenue it receives. But the disadvantage is that early profits tend to attract competition, thus putting eventual pressure on prices. For example, most ball-point pens now sell for less than \$1, but when the product was first introduced after World War II, it sold for about \$20. Some firms continue to use skimming pricing throughout the product's life cycle. For example, Bausch & Lomb's Ray-Ban sunglasses range in price from \$50 to \$140.

The company plans to continue the high-price strategy, even though "**knock-off**" imitations of Ray-Ban products sell for as low as \$12. Lower-priced products do not pose a threat to Ray-Ban because Ray-Ban customers are brand loyal. The firm's marketing research indicates 90 percent of Ray-Ban customers would buy the brand again.

Penetration Pricing - The second strategy, **penetration pricing**, involves pricing the product relatively low compared to similar goods in the hope that it will secure wide market acceptance that will allow the company to raise its price. Soaps and toothpastes are often introduced this way. Penetration pricing discourages competition because of its low profits. It is often used when the firm expects competition with similar products within a short time and when large-scale production and marketing will produce substantial reductions in overall costs.

Product Line Pricing - Under **product line pricing**, a seller offers merchandise at a limited number of prices rather than having individual prices for each item. For instance, a boutique might offer lines of women's sportswear priced at \$120, \$150, and \$200. Product line pricing is a common marketing practice among retailers. The original five- and ten-cent stores are an example of its early use. Today's *99¢ Stores* are a recent example.

As a pricing strategy, product line pricing prevents the confusion common in situations where all items are priced individually. It makes the pricing function easier. But marketers must clearly identify the market segments to which they are appealing. Three

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high-priced lines might not be appropriate for a store located in a low-to-middle-income area.

A disadvantage of product line pricing is that it is sometimes difficult to alter the price ranges once they have been set. If costs go up, the firm must either raise the price of the line or reduce its quality. Consumers may resist these alternatives. While product line pricing can be useful, its implementation must be considered carefully.

Consumer Perception of Prices - Marketers must be concerned with the way consumers perceive prices. If a buyer views a price as too high or too low, the marketer must correct the situation. Price quality relationships and psychological pricing are important in this regard.

The Price-Quality Relationship - Research shows that the consumer's perception of product quality is related closely to the item's price. The higher the price of the product, the better its perceived quality. Most marketers believe the perceived price-quality relationship exists over a relatively wide range of prices, although extreme prices may be viewed as either too expensive or too cheap. Marketing managers need to study and experiment with prices because the price-quality relationship can be of key importance to a firm's pricing strategy.

Jerome Rowitch, a California restaurateur, conducted an interesting experiment that substantiates the price-quality relationship. When Rowitch opened his Sculpture Gardens restaurant in an unfashionable section of Venice, he devised a promotion designed to attract the affluent residents of nearby suburbs. He mailed a promotional flier to households with incomes of \$50,000 or more, a segment that would appreciate the restaurant's fare, which includes black spaghetti in roasted red pepper and New Zealand cockles in white wine. The flier made this offer: Patrons could pay whatever price they thought their meal was worth. On average, those who took advantage of the promotion paid about \$7.50 more for their meal than the price listed on the standard menu.

Psychological Pricing - Psychological pricing is used throughout the world. Many marketers believe certain prices are more appealing than others to buyers. The image pricing goals mentioned earlier are an example of psychological pricing. Have you ever wondered why retailers use prices like \$39.95, \$19.98, or \$9.99 instead of \$40, \$20, or \$10? Before the age of cash registers and sales taxes, this practice of **odd pricing** was employed to force clerks to make the correct change, thereby serving as a cash-control technique for retailers. It is now a common practice in retail pricing because many retailers believe that consumers are more attracted to odd prices than to ordinary ones. In fact, some stores use prices ending in 1, 2, 3, 4, 6, or 7 to avoid the look of ordinary

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prices like \$5.95, \$10.98, and \$19.99. Their prices are more likely to be \$1.11, \$3.22, \$4.53, \$5.74, \$3.86, or \$9.97.