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Business Strategies 2023

View of Saint-Petersburg

Week 15

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Class starts at 08:00 (Beijing Time, GMT+8)

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Pricing Strategies

Why use pricing strategies to enhance marketing of products and services?

Choosing a price is as easy as picking a random number. As you'll discover in this module, however, finding the right price to achieve company objectives and provide sustained value to customers is much more complicated.

Learning Outcomes

- Discuss how price affects the value of the organization's products or services
- Explain the primary factors to consider in pricing
- Compare common pricing strategies
- Explain price elasticity and how it can be used to set price
- Explain the use of competitive bidding for B2B pricing

Outcome: Pricing Impact on Value of Products or Services

What you'll learn to do: discuss how price affects the value of an organization's products or services

The specific things you'll learn in this section include:

- Describe the customer view of value and pricing
- Discuss psychological factors in pricing

Learning Activities

- Demonstrating Customer Value
- The Psychology of Pricing
- Self Check: Pricing Impact on Value of Products or Services

The Customer's View of Price

Whether a customer is the ultimate user of the finished product or a business that purchases components of the finished product, the customer seeks to satisfy a need through the purchase of a particular product. The customer uses several criteria to decide how much she is willing to spend in order to satisfy that need. Her preference is to pay as little as possible.

PRICE-VALUE EQUATION

VALUE = PERCEIVED BENEFITS - PERCEIVED COSTS

The Psychology of Pricing

You will notice that when we discussed the value equation in the previous section, we referred to perceived benefits and perceived costs, rather than absolute/actual benefits and costs. Every customer perceives benefits and costs differently, and many of these perceptions aren’t even conscious.

There are very few buying decisions in which a customer meticulously lists and weighs the benefits and costs in order to determine value. More often the buying process involves snap judgments and decisions, and psychological factors likely come into play.

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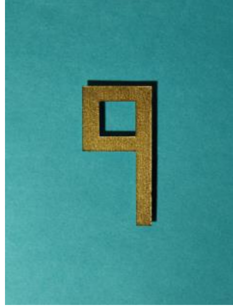

Studies of Psychology in Pricing

Most of our understanding about the psychology of pricing comes from research studies that explore buyer behavior.

The Case for the Number Nine

Many studies show that customers are more likely to buy products whose price points end in the number nine. That is, they prefer products that cost $99 over identical items priced at $100. Somehow the brain perceives greater value from a small price change that ends in nine.

https://pixabay.com/photos/digits-pay-eight-nine-zero-seven-273630/

Providing Pricing Options

Anchoring is a cognitive bias that describes the common human tendency to rely too heavily on the first piece of information offered (the “anchor”) when making decisions. During decision making, anchoring occurs when individuals use an initial piece of information to make subsequent judgments. Once an anchor is set, other judgments are made by adjusting away from that anchor, and there is a bias toward interpreting other information around the anchor.

In the presentation of pricing, anchoring has a powerful impact on buyer behavior. In negotiated pricing, the first price offered becomes the anchor. For example, the initial price offered for a used car sets the standard for the rest of the negotiations, so that prices lower than the initial price seem more reasonable even if they are still higher than what the car is really worth.

https://www.youtube.com/watch?v=XvDCqn7MrvM

5-minute break

Video: Value in Branded Eyewear

Many consumers pay a premium price for branded eyewear. How does the brand name influence the price and value? The following video shows the mechanics behind these brands and considers the impact on price.

Have you ever heard about the Luxottica, RayBan sunglasses brands and companies?

0:30

Self Check

Check Your Understanding:: Pricing Impact on Value of Products or Services

Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class

Jack uses several criteria to determine how much he is willing to spend to satisfy his needs. His preference is to pay ________.

- as much as possible
- as little as possible
  Correct
- a price that is between too much and too little

Outcome: Pricing Considerations

What you'll learn to do: explain the primary factors to consider in pricing

The specific things you'll learn in this section include:

- Explain company objectives in the pricing strategy
- Define break-even pricing
- Describe how competition affects pricing strategies
- Describe the benefit of value-based pricing for customers

Learning Activities

- Pricing Objectives
- Break-Even Pricing
- Competitor Impact on Pricing
- Benefits of Value-Based Pricing
- Self Check: Pricing Considerations

https://pixabay.com/photos/feet-footwear-nike-shoes-sneakers-1840619/

Pricing Objectives

Companies set the prices of their products in order to achieve specific objectives.

> “The ability to raise prices is a key long-term advantage in the branded apparel and footwear industry—we are particularly encouraged that Nike is able to drive pricing while most U.S. apparel names are calling for elevated promotional [and] markdown levels in the near-term,” said UBS analyst Michael Binetti. Binetti said Nike’s new strategy is an emerging competitive advantage.[1]

Common Pricing Objectives

Product pricing will impact each of the objectives below:

- Profit objective: For example, “Increase net profit in 2023 by 5 percent”
- Competitive objective: For example, “Capture 30 percent market share in the product category”
- Customer objective: For example, “Increase customer retention”.

A company’s “orientation” in pricing:

- Profit-Oriented Pricing,
- Competitor-Oriented Pricing,
- Customer-Oriented Pricing

https://pixabay.com/photos/accounts-banking-business-1238594/

5-minute break
Profit-Oriented Pricing

Profit-oriented pricing places an emphasis on the finances of the product and business. A business’s profit is the money left after all costs are covered. In other words, profit = revenue – costs. In profit-oriented pricing, the price per product is set higher than the total cost of producing and selling each product to ensure that the company makes a profit on each sale.

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Competitor-Oriented Pricing

Sometimes prices are set almost completely according to competitor prices. A company simply copies the competitor’s pricing strategy or seeks to use price as one of the features that differentiates the product. That could mean either pricing the product higher than competitive products, to indicate that the firm believes it to provide greater value, or lower than competitive products in order to be a low-price solution.

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Customer-Oriented Pricing

PRICE-VALUE EQUATION

VALUE = PERCEIVED BENEFITS - PERCEIVED COSTS

Customer-oriented pricing is also referred to as value-oriented pricing. Given the centrality of the customer in a marketing orientation (and this marketing course!), it will come as no surprise that customer-oriented pricing is the recommended pricing approach because its focus is on providing value to the customer.

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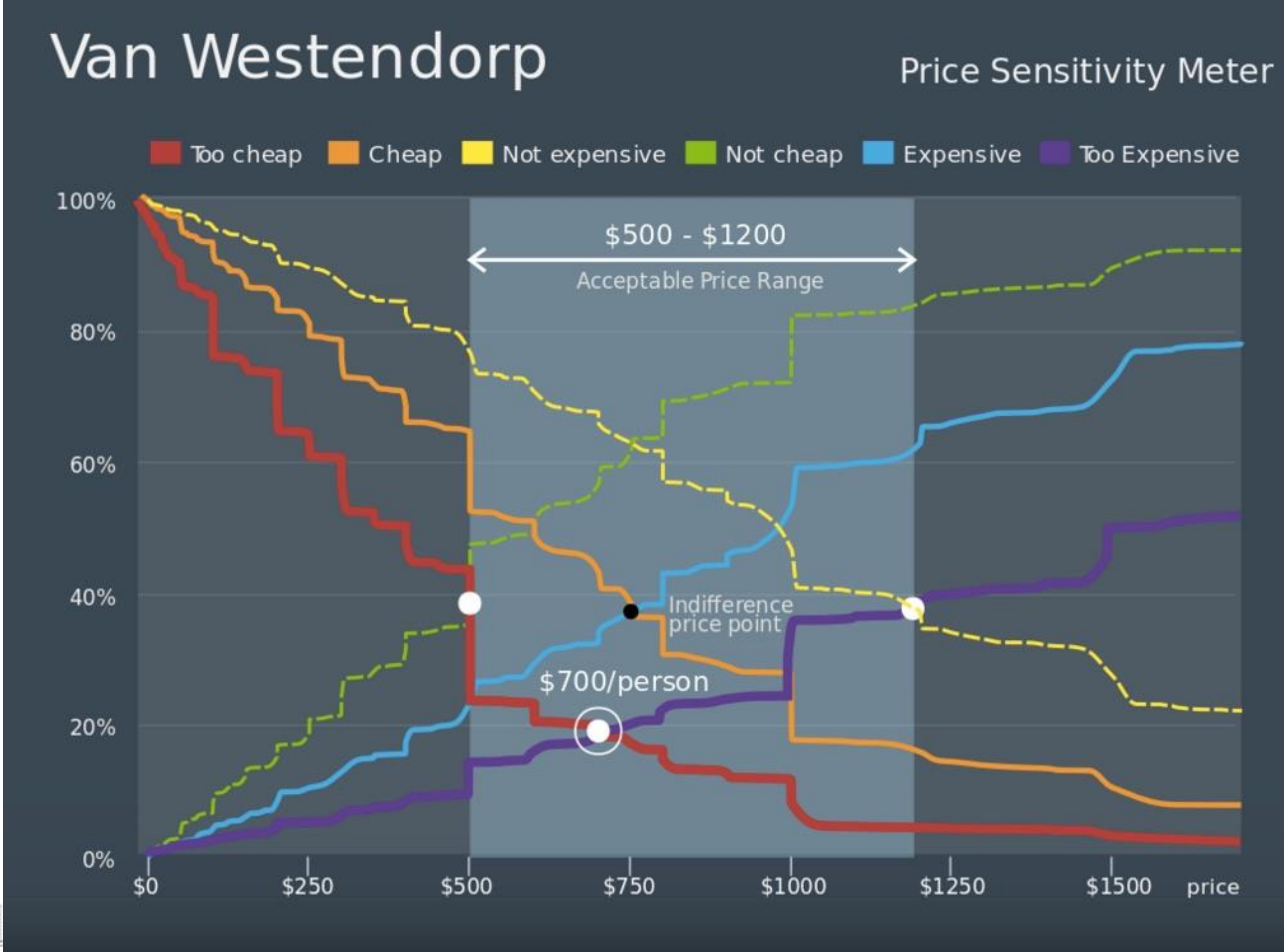
Van Westendorp
Price Sensitivity Meter
Too cheap
Cheap
Not expensive
Not cheap
Expensive
Too Expensive
$500 - $1200
Acceptable Price Range
Indifference price point
$700/person
100%
80%
60%
40%
20%
0%
$0
$250
$500
$750
$1000
$1250
$1500
price

Break-Even Pricing

Regardless of the pricing strategy a company ultimately selects, it is important to do a break-even analysis beforehand. Marketers need to understand break-even analysis because it helps them choose the best pricing strategy and make smart decisions about the short- and long-term profitability of the product.

Understanding Breakeven

Let’s begin with a very simple calculation of breakeven and build from there.

Imagine that you decide to hold a bake sale and sell cookies in the student union as a social event for students. You don’t want to lose money on the cookies, but you are not trying to make a profit or even cover your time.

Break-Even Price = Costs / Units

Break-Even Quantity (in terms of units) = Costs / Price

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Understanding Breakeven

You spend a very convenient 240 RMB on groceries and bake 4 dozen cookies (48 cookies). What is your break-even price for the cookies? It's the total cost divided by the number of cookies that you expect to sell, represented by the formula below:

- **Break-Even Price = Costs / Units**

So, it would be 240 / 48 = 5, or 5 RMB per cookie. What if you sell only 40 cookies? The calculation would be 240 / 40 = 6 RMB. Your break-even price goes up if you sell fewer cookies.

One challenge of calculating breakeven is that all of the variables can change, and some are unknown. For instance, it may be impossible to know exactly the quantity that you will sell. For that reason, companies often calculate the break-even *quantity* rather than the break-even *price*. Focusing on quantity enables the marketer to answer the following question: "Given this set of costs and this price, how many products must I sell to break even?" The break-even quantity is shown by the following formula:

- **Break-Even Quantity (in terms of units) = Costs / Price**

In our cookie example, once you have spent 240 RMB on groceries, you know your cost. What if you plan to sell the cookies for 10 RMB a piece? According to the equation above, units = cost / price, so in our case, units = 240 / 10, or 24 cookies.

Of course, this is a very simple example, but it gives you a sense of why breakeven matters, and how you would calculate it.

Including Fixed and Variable Costs

Revenue (sales revenue) = P*n = V*n + FC

p = price

n = number of units sold

V = variable cost per unit

FC = fixed costs

With this equation we can calculate either the break-even price or the break-even quantity.

Calculating Break-Even Price

- In fact, you rent a commercial kitchen space and hire an experienced baker named Xiao Bao to do the baking. Your break-even point just went up dramatically. Now you need to cover the costs of your kitchen and an employee. let's assume that Xiao Bao (小宝) works a set number of hours every week—20 hours—and that you pay her 200 元 per hour including all taxes and benefits. You rent the kitchen for 1000RMB per week, and that price includes all the equipment and utilities. Those are costs that are not going to change no matter how many cookies you sell. If you baked nothing, you would still need to pay 1000 元 per week in rent and 4000 元 per week in wages. Those are your fixed costs. Fixed costs do not change as the level of production goes up or down. Your fixed costs are 5000 RMB per week.
- Now you need to buy ingredients for the cookies. Once you add up the food costs of making a single large batch of cookies, you find that it's a total of 72 RMB for a batch of 12 dozen (144) cookies. If you divide that out, you can tell that each cookie costs 0.5 RMB in food costs (72 / 144 cookies = 0.5 RMB or 50 Miao). In other words, every cookie you sell is going to have a variable cost of 5 jiao. Variable costs do change as production is increased or decreased.

Calculating Break-Even Price

Chances are good that you can only bake a certain number of cookies each week—let’s say it’s 2,500 cookies—so, based on that information, you can calculate the break-even price. The formula to do that is the following:

p = (Vn + FC) / n

n = 2,500

V = 0.5 RMB

FC = 5000 RMB

Therefore, p = ((0.5 x 2,500) + 5000) / 2,500

p = (1250 + 5000) / 2,500

p = 2.5 RMB

Your break-even price for your cookies is 2.5 RMB. That doesn’t mean it’s the right market price for the cookies; nor does it mean that you can definitely sell 2,500 cookies at whatever price you choose. It simply gives you good information about the price and quantity at which you will cover all your costs.

Calculating Break-Even Quantity

Now let’s assume that you have set your price and you need to know your break-even quantity. You are an exceptional marketing student, so you have talked to the people who are likely buyers for your cookies, and you understand what price is a bargain and what price is too expensive. You have compared the price with competitor prices. And, you have considered the price of your cookie compared to the price of doughnuts and ice cream (both are “substitutes” for your product). All of this analysis has led you to set a price of 20 RMB per cookie, but you want to make sure that you don’t lose money on your business: You need to calculate the break-even quantity. The formula to do that is the following:

$n = FC / (p – V)$

Using the same inputs for the variables, your equation looks like this: $n = 5000 / (20 – 0.5)$

$n = 5000 / 19.50$

$n = 256.41$ cookies

So, let’s round up and just call the break-even quantity 257 cookies. Does that mean that you keep the full 20 RMB as profit for every cookie after 257? Sadly, no. First, you have to cover the variable cost for each cookie (0.5 per cookie), which means you make just 19.5 per cookie you sell (after you’ve surpassed the break-even point). Second, our simple break-even example did not include all of the costs. After you’ve locked down the product costs and the pricing, you will need to invest in promotion and distribution of the cookies. You’ll also probably want to cover your time (i.e., pay yourself) and add some profit into the total fixed costs. For instance, if you wanted to earn a profit of 6000 each week, then you would need to add that to the 5000 fixed costs of the kitchen and Xiao Bao.

Breakeven in the Marketing Strategy

Now that we have a cost example, it's a little easier to think about the pricing objectives. If you decided to price your cookies with a profit orientation, then you would simply add a profit (10 RMB per cookie, say,) to the break-even price. That approach doesn't take the customer into account at all, though, since a profit orientation is only about the business.

What if you found that your campus stores and vending machines sell a national chain of cookies for 75 Miao? Using a competitor-oriented pricing approach, you might decide to match that price and compete on that basis. The drawback is that this approach does not take into account the value your customers find in a fresh, local product—i.e., your cookies—made from high-quality ingredients.

A customer-oriented pricing approach allows you to treat the break-even data as one input to your pricing, but it goes beyond that to bring your customers' perceptions and the full value of your product into the pricing evaluation.

Competitor Impact on Pricing

It’s important to remember that pricing is just one component of the marketing mix, and even very specific pricing decisions need to take into account the other components. This is particularly true in a competitive marketplace. Actions by different competitors integrate all elements of the marketing mix and do not focus on price alone. A competitor might make a change to a product or initiate a promotion that impacts customers’ perceptions of value and, therefore, their perceptions of price.

Competitive Pricing

Competitive Pricing

Once a business decides to use price as a primary competitive strategy, there are many well-established tools and techniques that can be employed. The pricing process normally begins with a decision about the company's pricing approach to the market. Price is a very important decision criterion that customers use to compare alternatives. It also contributes to the company's position. In general, a business can price its offering to match its competition, or it can price higher or price lower. Each has its pros and cons.

Pricing to Meet Competition

Many organizations attempt to establish prices that, on average, are the same as those set by their more important competitors. Automobiles of the same size with comparable equipment and features tend to have similar prices, for instance. This strategy means that the organization uses price as an indicator or baseline. Quality in production, better service, creativity in advertising, or some other element of the marketing mix is used to attract customers who are interested in products in a particular price category.

Pricing **Above** Competitors

Pricing above competitors can be rewarding to organizations, provided that the objectives of the policy are clearly understood and the marketing mix is developed in such a way that the policy can be successfully implemented by management.

Pricing above competition generally requires a clear advantage on some nonprice element of the marketing mix. In some cases, that advantage may be due to a high price-quality association on the part of potential buyers.

Pricing Below Competitors

While some firms are positioned to price above competition, others wish to carve out a market niche by pricing below competitors. The goal of such a policy is to realize a large sales volume through a lower price and lower profit margins. By controlling costs and reducing services, these firms are able to earn an acceptable profit, even though profit per unit is usually less.

Benefits of Value-Based Pricing

The Customer and the Pricing Decision.

We have discussed common company objectives that affect pricing and the competitive impact on pricing. The most important perspective in the pricing process is the customer's. Value-based pricing brings the voice of the customer into the pricing process. It bases prices primarily on the value to the customer rather than on the cost of the product or historical prices determined by competitors.

Customer-Related Factors

Several customer-related factors are important in value-based pricing; one of them is understanding the customer buying process. For a convenience good, customers often spend little time, planning, or effort in the buying process, and purchases are more often made on impulse. With a shopping product, the consumer is more likely to compare a number of options when evaluating quality, cost, and features; as a result, he or she will require a better understanding of price in order to assess value.

Competitor-Related Factors

A second factor influencing value-based pricing is competitors. We asserted above that the primary driver of value-based pricing is the customer's estimation of value—not costs or historical competitor prices. Still, competitors do influence the customer's view of value. The marketing mix of competitive products have an impact on customer expectations because they are an important part of the decision-making context. Customers are shopping across products and brands and take price differences into account when evaluating the quality and benefits of competitive products. These direct comparisons have tremendous impact on the customer's perceptions of value.

0:30

Self Check

Check Your Understanding:: Pricing Impact on Value of Products or Services

Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class

________ places an emphasis on the finances of the product and business.

- Profit-oriented pricing
  Correct
- Customer-oriented pricing
- Competitor-oriented pricing

Outcome: Common Pricing Strategies

What you’ll learn to do: compare common pricing strategies

The specific things you’ll learn in this section include:

- Explain why a company would use skim pricing
- Explain why a company would use penetration pricing
- Explain why a company would use cost-oriented pricing
- Explain how price discounting is used and why it can be effective

Learning Activities

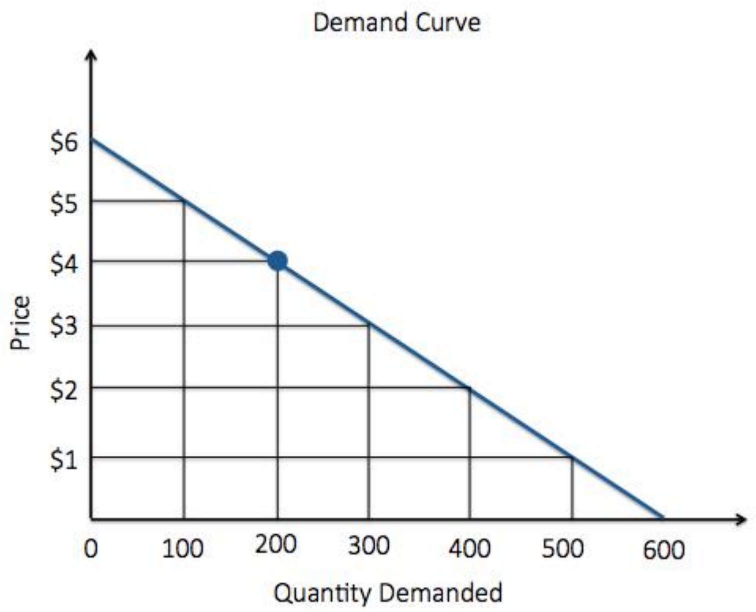
- Skim Pricing
- Penetration Pricing
- Cost-Oriented Pricing
- Discounting Strategies
- Self Check: Common Pricing Strategies

Skim Pricing

With a totally new product, competition either doesn't exist or is minimal, and there's no market data about customer demand. How should the price be set in such a case? There are two common pricing strategies that organizations use for new products: skim pricing and penetration pricing.

Skim Pricing
The Economics of Price and Demand

In order to understand these pricing strategies, let's review the demand curve. In a typical economic analysis of pricing, the demand curve shows the quantity demanded at every price.

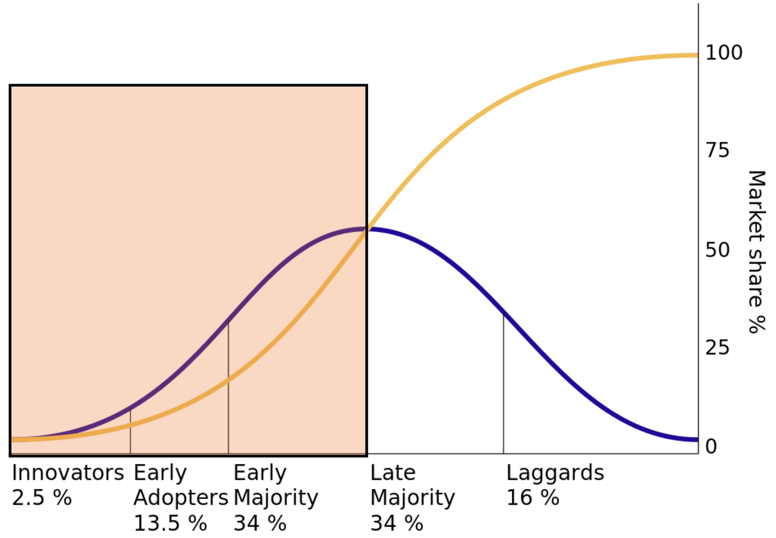


What Is Skim Pricing?

Price skimming involves the top part of the demand curve. A firm charges the highest initial price that customers will pay. As the demand of the first customers is satisfied, the firm lowers the price to attract another, more price-sensitive segment.

Why Might Skim Pricing Make Sense?

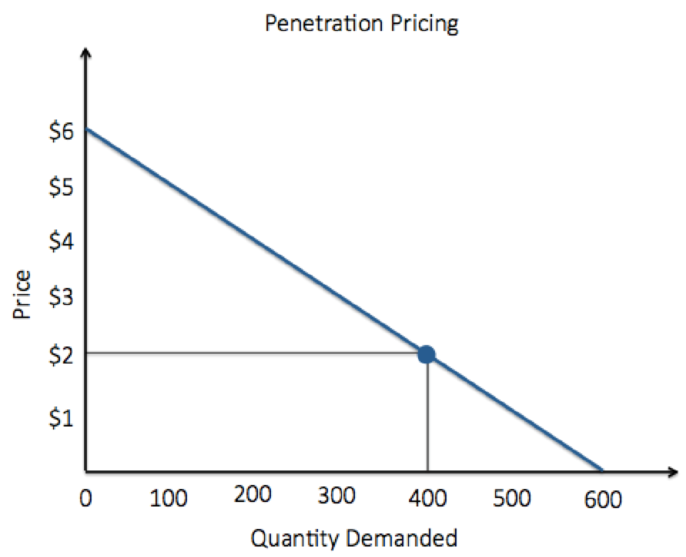
There are a number of reasons why an organization might consider a skimming strategy. Sometimes a company simply can't deliver enough of a new product to meet demand. By setting the price high, the company is able to maximize the total revenue that it can generate from the quantity of product that it can make available.



Penetration Pricing

What Is Penetration Pricing?

Penetration pricing is a pricing strategy in which the price of a product is initially set low to rapidly reach a wide fraction of the market and initiate word of mouth. The strategy works on the assumption that customers will switch to the new product because of the lower price. Penetration pricing is most commonly associated with marketing objectives of enlarging market share and exploiting economies of scale or experience.



Why Might Penetration Pricing Make Sense?

Like skim pricing, penetration pricing shows an awareness of the dynamics in the product life cycle. The advantages of penetration pricing to the firm are the following:

- It can result in fast diffusion and adoption across the product life cycle. The strategy can achieve high market penetration rates quickly, taking competitors by surprise and not giving them time to react.
- It can create goodwill among the Innovators and Early Adopters, which can generate more demand via word of mouth.
- It establishes cost-control and cost-reduction pressures from the start, leading to greater efficiency.
- It discourages the entry of competitors.
- It can generate high stock turnover throughout the distribution channel, which creates important enthusiasm and support in the channel.

Cost-Oriented Pricing

- Cost-Plus Pricing

Cost-plus pricing, sometimes called gross margin pricing, is perhaps the most widely used pricing method. The manager selects as a goal a particular gross margin that will produce a desirable profit level. Gross margin is the difference between how much the goods cost and the actual price for which it sells. This gross margin is designated by a percent of net sales. The percent chosen varies among types of merchandise. That means that one product may have a goal of 48 percent gross margin while another has a target of 33.5 percent or 2 percent.

Markups

The term markup, the difference between the average cost and price of all merchandise in stock, for a particular department, or for an individual item. The difference may be expressed in dollars or as a percentage. For example, a man’s tie costs $14.50 and is sold for $25.23. The dollar markup is $10.73. The markup may be designated as a percent of the selling price or as a percent of the cost of the merchandise. In this example, the markup is 74 percent of cost ($10.73 / $14.50) or 42.5 percent of the retail price ($10.73 / $25.23).

Cost-Oriented Pricing of New Products

Certainly costs are an important component of pricing. No firm can make a profit until it covers its costs. However, the process of determining costs and setting a price based on costs does not take into account what the customer is willing to pay at the marketplace. This strategy is a bit of a trap for companies that develop products and continually add features to them, thus adding cost. Their cost-based approach leads them to add a percentage to the cost, which they pass on to customers in the form of a new, higher price. Then they are disappointed when their customers do not see sufficient value in the cost-based price.

https://www.istockphoto.com/photo/seesaw-with-old-new-buzzword-cubes-3d-rendering-gm1149818587-311032201

Discounting Strategies

In addition to deciding about the base price of products and services, marketing managers must also set policies regarding the use of discounts and allowances. There are many different types of price reductions–each designed to accomplish a specific purpose. The major types are described below.

- Quantity Discounts
- Seasonal Discounts
- Cash Discounts
- Trade Discounts

Quantity Discounts

Quantity discounts are reductions in base price given as the result of a buyer purchasing some predetermined quantity of merchandise. A noncumulative quantity discount applies to each purchase and is intended to encourage buyers to make larger purchases. This means that the buyer holds the excess merchandise until it is used, possibly cutting the inventory cost of the seller and preventing the buyer from switching to a competitor at least until the stock is used.

https://pixabay.com/photos/bicycles-rental-barcelona-1306298/

Seasonal Discounts

Seasonal discounts are price reductions given for out-of-season merchandise—snowmobiles discounted during the summer, for example. The intention of such discounts is to spread demand over the year, which can allow fuller use of production facilities and improved cash flow during the year.

https://pixabay.com/photos/vegetable-produce-fresh-sales-2573149/

Cash Discounts

Cash discounts are reductions on base price given to customers for paying cash or within some short time period. For example, a 2 percent discount on bills paid within 10 days is a cash discount. The purpose is generally to accelerate the cash flow of the organization and to reduce transaction costs.

https://pixabay.com/photos/clock-money-growth-grow-time-2696234/

Trade Discounts

Trade discounts are price reductions given to middlemen (e.g., wholesalers, industrial distributors, retailers) to encourage them to stock and give preferred treatment to an organization’s products. For example, a consumer goods company might give a retailer a 20 percent discount to place a larger order for soap. Such a discount might also be used to gain shelf space or a preferred position in the store.

Source: https://pixabay.com/illustrations/twenty-percent-off-discount-sale-1424812/

Personal Allowances

Source:https://pixabay.com/illustrations/social-media-social-marketing-5187243/

Personal allowances are similar strategies aimed at middlemen. Their purpose is to encourage middlemen to aggressively promote the organization’s products. For example, a furniture manufacturer may offer to pay some specified amount toward a retailer’s advertising expenses if the retailer agrees to include the manufacturer’s brand name in the ads.

Trade-In Allowances

Trade-in allowances also reduce the base price of a product or service. These are often used to help the seller negotiate the best price with a buyer. The trade-in may, of course, be of value if it can be resold. Accepting trade-ins is necessary in marketing many types of products.

Office is rebranding to Microsoft 365

The rebrand would start with Office.com in November 2022, followed by Microsoft's free cloud-based versions, the Office app on Windows and Office mobile app, in January 2023. However, this does not mean that the Microsoft Office brand is going away completely.

13 Oct 2022

Price Bundling

Price bundling is a very popular pricing strategy. The marketer groups similar or complementary products and charges a total price that is lower than if they were sold separately. Comcast and Direct TV both follow this strategy by combining different products and services for a set price. Similarly, Microsoft bundles Microsoft Word, Excel, Powerpoint, OneNote, and Outlook in the Microsoft Office Suite. The underlying assumption of this pricing strategy is that the increased sales generated will more than compensate for a lower profit margin. It may also be a way of selling a less popular product—like Microsoft OneNote—by combining it with popular ones. Industries such as financial services, telecommunications, and software companies make very effective use of this strategy.

0:30

Self Check: Common Pricing Strategies

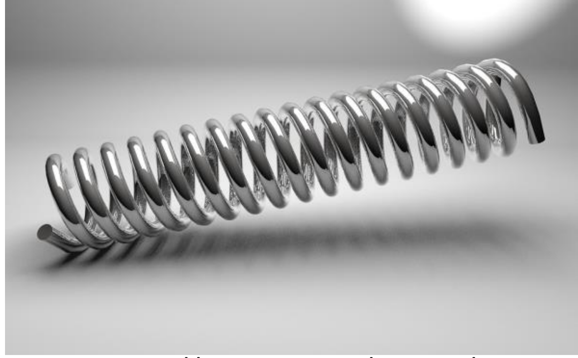
Check Your Understanding:

Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class

A company introduces a new technology product to the market. It sets the product's price at the highest price it thinks customers will pay. Which type of pricing strategy is the company using?

- skim pricing
  Correct
- penetration pricing
- break-even pricing

Outcome: Price Elasticity



https://pixabay.com/photos/spiral-feather-metal-technical-1962819/

What you'll learn to do: explain price elasticity and its impact on price

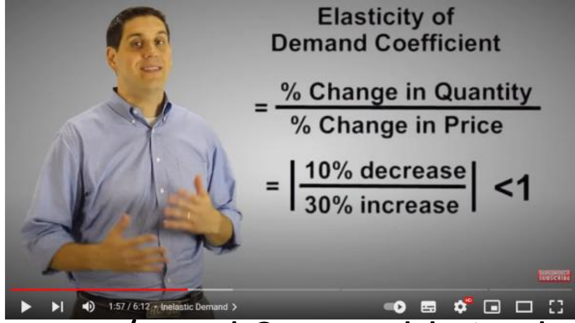
The specific things you'll learn in this section include:

- Define elasticity
- Explain the impact of elasticity on price changes
- Identify examples of products with elastic and inelastic demand

Learning Activities

- Elasticity and Price Changes
- Products with Elastic and Inelastic Demand
- Self Check: Pricing Elasticity

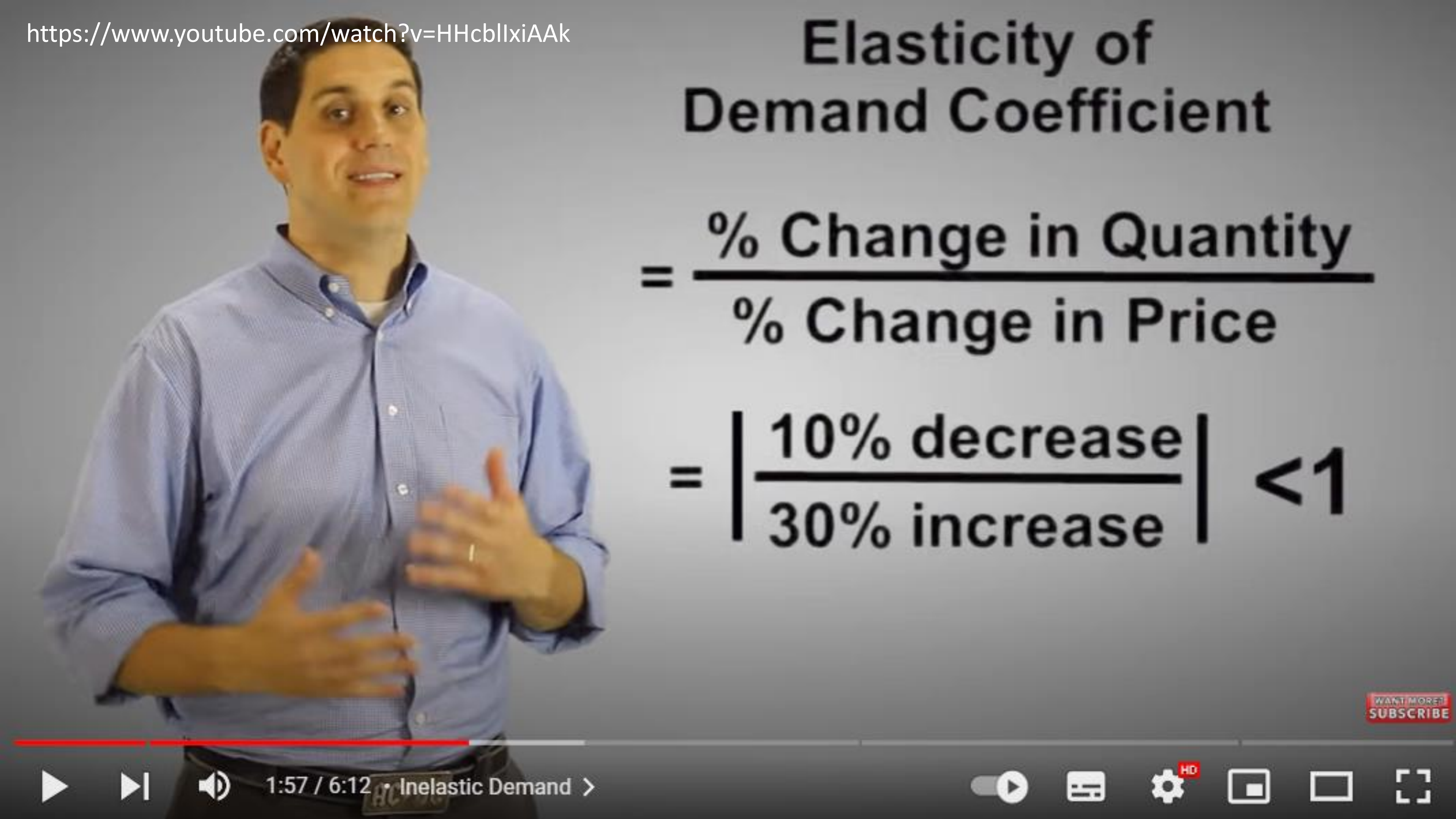
Price Elasticity



https://www.youtube.com/watch?v=HHcblIxiAAk

- Price elasticity measures the responsiveness of quantity demanded to a change in the product price
- The calculation for price elasticity is the percentage change in quantity demanded divided by the percentage change in price
- When the absolute value of the price elasticity is >1, the price is elastic and people are very sensitive to changes in price
- When the absolute value of the price elasticity is <1, the price is inelastic and people are insensitive to changes in price

https://www.youtube.com/watch?v=HHcblIxiAAk



Elasticity and Price Changes

With a good understanding of what elasticity means and how it is calculated, we can now investigate its impact on pricing strategies. In order to do this, we'll look at a couple of examples and answer the following questions:

- How much of an impact do we think a price change will have on demand?
- How would we calculate the elasticity, and does it confirm our assumption?
- What impact does the elasticity have on the business or pricing objectives?

Example 1: The Student Parking Permit

The photo is taken by Ivan Monich in 南宁 in 2020

Let’s consider a community college campus where all of the students commute to class. Required courses are spread throughout the day and the evening, and most of the classes require classroom attendance (rather than online participation). There is a reasonable public transportation system with busses coming to and leaving campus from several lines, but the majority of students ride to campus (电动车). How elastic is the demand for student parking passes？

Example 1: The Student Parking Permit

If the college increases the price of a parking permit from 40 to 48 RMB, will fewer students buy parking permits?

If you think that the change in price will cause many students to decide not to buy a permit, then you are suggesting that the demand is elastic—the students are quite sensitive to price changes. If you think that the change in price will not impact student permit purchases much, then you are suggesting that the demand is inelastic—student demand for permits is insensitive to price changes.

In this case, we can all argue that students are very sensitive to increases in costs *in general*, but the determining factor in their demand for parking permits is more likely to be the quality of alternative solutions. If the bus service does not allow students to travel between home, school, and work in a reasonable amount of time, many students will resort to buying a parking permit, even at the higher price. Because students don’t generally have extra money, they may grumble about a price increase, but many will still have to pay.

Let’s add some numbers and test our thinking. The college implements the proposed increase of 8 RMB. If we divide that by the original price (40) then we can see that the price increase is 20% (8 / 40 = 0.20). Last year the college sold 12,800 student parking passes. This year, at the new price, the college sells 11,520 parking passes—which is a decrease of 10%, as shown below:

12,800 – 11,520 = 1,280

1,280 / 12,800 = 1 / 10 = 10%

Example 1: The Student Parking Permit

% change in quantity demanded / % change in price = absolute value of price elasticity

10% / 20% = 0.10 / 0.20 = 0.50, 0.50 < 1

When the absolute value of the price elasticity is < 1, the demand is inelastic. In this example, student demand for parking permits is inelastic.

What impact does the price change have on the college and their goals for students? First, there are 1,280 fewer e-bikes (电动车) taking up parking places. If all of those students are using alternative transportation to get to school and this change has relieved parking-capacity issues, then the college may have achieved its goals. However, there's more to the story: the price change also has an effect on the college's revenue, as we can see below:

Year 1: 12,800 parking permits sold x 40 per permit = 512,000 RMB

Year 2: 11,520 parking permits sold x 48 per permit = 552,960 RMB 四万多元 in revenue

In this case, student demand for parking permits is inelastic. A significant change in price leads to a comparatively smaller change in demand. The result is lower sales of parking passes but more revenue.

Note: If you attend an institution that offers courses completely or largely online,
the price elasticity for parking permits might be completely inelastic.
Even if the institution gave away parking permits, you might not want one.

Products with Elastic and Inelastic Demand

Now that you've had some practice calculating the value of elasticity, let's turn to some of the factors that play a role in whether a product is likely to have elastic or inelastic demand. The following factors can have an effect on elasticity:

- Substitutes
- Absolute price
- Importance of use
- Competitive dynamics

COFFEE

Specialty Coffee Drinks

Many coffee shops have developed branded drinks and specialized experiences in order to reduce substitutes and build customer loyalty. While black coffee is available almost universally, there are few substitutes for a Starbucks Java Chip Frappuccino. Demand for such products is more **inelastic**.

HEALTH

Medical Procedures

Essential medical procedures have inelastic demand. The patient will pay what she can or what she must. In general, products that significantly affect health and well-being have **inelastic** demand.

Soft Drinks

Soft drinks and many other nonessential items have highly **elastic** demand. There is competition among every brand and type of soda, and there are many substitutes for the entire category of soft drinks.

Concert Tickets

Only Taylor Swift can offer a Taylor Swift concert. She holds a monopoly on the creation and delivery of that experience. There is no substitute, and loyal fans are willing to pay for the experience. Because it is a scarce resource and the delivery is tightly controlled by a single provider, access to concerts has **inelastic** demand.

Airline Tickets

Airline tickets are sold in a fiercely competitive market. Buyers can easily compare prices, and buyers experience the services provided by competitors as being very similar. Buyers can often choose not to travel it the cost is too high, or to substitute travel by car or train. This makes the demand **elastic**.

0:30

GASOLINE

Gasoline (Generic Need)

The demand for gasoline generally is fairly **inelastic**. Car travel requires gasoline. The substitutes for car travel offer less convenience and control. Much car travel is necessary for people to move between activities and cannot be reduced to save money.

Gas from a Specific Station

The demand for gasoline from any single gas station, or chain of gas stations, is highly **elastic**. Buyers can choose between comparable products based on price. There are often many stations in a small geographic area that are equally convenient.

COLLEGE TEXTBOOKS

Traditional Textbooks

Generally an instructor assigns a textbook to the student, and the student who wants access to the learning materials must buy it, regardless of the price. Because the student can't easily identify another textbook or resource that will ensure the same content and grade for the class, he has no substitutes and must buy the book at any price. Thus the demand is **inelastic**.

New Textbook Distribution Channels

Increasingly, students have new options to buy the same textbooks from different distribution channels at different price points. The introduction of new distribution channels is increasing options for buyers and having an impact on the price elasticity for publishers.

0:30

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Black Coffee

Coffee is generally widely available at a level of quality that meets the needs of most buyers. The combination of a low price, relative to the buyer's spending power, and the fact that the product is sold by many different suppliers in a competitive market make the demand highly **elastic**.

TICKETS

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0:30

Self Check

Check Your Understanding:

Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class

A measure of sensitivity or responsiveness to price is the definition of ________?

- break-even pricing
- elasticity

  Correct
- competitor impact pricing

Competitive Bidding

What you'll learn to do: explain the use of competitive bidding for B2B pricing.

The specific things you'll learn in this section include:

- Describe the competitive bidding process
- Describe the role of pricing in the competitive bid

Learning Activities

- Competitive Bidding
- Price in the Competitive Bid
- Self Check: Competitive Bidding

Competitive Bidding

When we discussed buyer behavior, we identified the stages that organizations go through to make a purchase decision. When it comes to pricing consideration, two of these stages are especially relevant: proposal solicitation and supplier selection.

Price in the Competitive Bid

What role does the price play in the competitive bid process? The answer to this question can vary significantly, but in every case, the marketer has a specific goal: to minimize the role of price in the proposal. To understand what this means, let’s consider two different scenarios.

Scenario 1: The value proposition of all solutions is identical; there is absolutely no differentiation between the products, companies, or brands. In such a case, suppliers can only compete on price. Each proposal must slash prices to the lowest possible level in hopes of coming in below the other bids.

Scenario 2: Each solution is differentiated in every element of the marketing mix. Price is different for each solution and is based on the value provided by the product, the service and relationship commitments, the brand, and the expected customer experience.

0:30

Self Check

Check Your Understanding:

Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class

Which step of the organizational buying process involves qualified suppliers who are invited by a company in a B2B scenario to submit a bid to become its supplier?

- proposal solicitation step
  Correct
- supplier search step
- supplier selection step

0:30

Thank you