

3.5: Reading- Competitor Impact on Pricing



Figure 3.5.1: Shoe store in Trinidad. Credit: Bud Ellison, Flickr.com, CCBY

Introduction

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

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.

The key to implementing a strategy of meeting competitive prices is to have an accurate definition of competition and a knowledge of competitors' prices. A maker of handcrafted leather shoes is not in competition with mass producers. If he/she attempts to compete with mass producers on price, higher production costs will make the business unprofitable. A more realistic definition of competition in this case would be other makers of handcrafted leather shoes. Such a definition along with an understanding of competitors' prices would enable management to put the strategy into effect.

The banking industry often uses this strategy by using technology to actively monitor competitors' rates, fees, and packages in order to adjust their own prices.

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.

Betting on that advantage is increasingly dangerous in today's information-rich environment, however. Online shoppers can get quick price comparisons and read customer or expert reviews to evaluate other elements of the value proposition. This is true for both business-to-consumer and business-to-business offerings. Many consumers also take advantage of their smartphones when they shop: it's easy enough to stand in one store and compare price and distribution options for the same product and for

competitive products. Customers' access to information puts more pressure on marketers to understand customer value and provide an offering whose price, relative to competitors' prices, contributes to the value.

You'll recall our earlier example of Nike using a strategy of raising prices—while its competitors were holding pricing flat or reducing prices—because its analysis showed that it was providing sufficient value to sustain a higher price.

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.

Such a strategy can be effective if a significant segment of the market is price sensitive and/or the organization's cost structure is lower than competitors'. Costs can be reduced by increased efficiency, economics of scale, or by reducing or eliminating such things as credit, delivery, and advertising. For example, if a firm could replace its field sales force with telemarketing or online access, this function might be performed at lower cost. Such reductions often involve some loss in effectiveness, so the trade-off must be considered carefully.

One of the worst outcomes that can result from pricing lower than a competitor is a "price war." Price wars usually occur when a company believes that price-cutting will increase market share, but it doesn't have a true cost advantage. Price wars are often caused by companies misreading or misunderstanding competitors. Typically, they are overreactions to threats that either are nonexistent or are not as big as they seem. You will remember our example of the airline price war, in which the stock price of airlines plummeted because stockholders reacted negatively to price reductions, fearing that a price war would eliminate profits and put the health of the industry at risk.

Another example is the ride-sharing service Uber. Uber has successfully undercut the taxi industry with a product that improves services while lowering prices, which has led to extremely rapid growth and success for the company. When lower prices are part of a complete, compelling value proposition, pricing can provide a powerful solution and create a challenging competitive environment for existing players.

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