

7.7: Marketing Strategy and Price

Learning Objectives

1. Understand the role of price in the marketing mix and to a company.
2. Understand the different pricing strategies that a small business can follow.
3. Understand price-quality signaling and its importance to the pricing decision.
4. Understand that the price of a product or a service lets customers know what to expect from a business.

Marketing, whether online or onground, is the only activity that generates revenue for most small businesses, and the price element in the marketing mix accounts for that. **Price** can be defined very narrowly as the amount of money charged for a product or a service. However, price is really more than that. It is “the sum of all values (such as money, time, energy, and psychic cost) that buyers exchange for the benefits of having or using a good or service.” Judy Strauss and Raymond Frost, *E-Marketing* (Upper Saddle River, NJ: Pearson Prentice Hall, 2009), 233. Ultimately, the meaning of price will depend on the viewpoints of the buyer and the seller. Judy Strauss and Raymond Frost, *E-Marketing* (Upper Saddle River, NJ: Pearson Prentice Hall, 2009), 233.

Deciding on a price for its products or services is one of the most important decisions that a small business will make. The price of a product or a service must be a price that the company’s target market is willing to pay and a price that generates a profit for the company. If this is not the case, the business will not be around for long. “Pricing a Product or Service,” *Small Business Notes*, accessed June 1, 2012, <http://www.smallbusinessnotes.com/marketing-service.html>.

Choosing the right pricing strategy is not an easy thing to do because there are so many factors involved. For example, competition, suppliers, the availability of substitute products or services, the target market, the image and reputation of a business, cost and profit objectives, operating costs, government regulation, and differentiation and positioning decisions will all impact price. Pricing is a complex activity, often seen as an art rather than a science. For small businesses that are marketing or want to market online, pricing strategies are even more complicated. For example, online buyers have increasing power that leads to control over pricing in some instances (e.g., online bidding on eBay). There is also **price transparency** where buyers and sellers can easily and quickly view and compare prices for products sold online, and some companies use **dynamic pricing** by varying prices for individual customers. Judy Strauss and Raymond Frost, *E-Marketing* (Upper Saddle River, NJ: Pearson Prentice Hall, 2009), 233.

There are several pricing strategies available to the small business owner. However, having the lowest price is not typically a strong position for small businesses because larger competitors can easily destroy any small business that is trying to compete on price alone. Darrell Zahorsky, “Pricing Strategies for Small Business,” *About.com*, accessed December 1, 2011, sbinformation.about.com/cs/bestpractices/a/aa112402a.htm. Think Walmart. The best choice for a small business will be the strategy that helps the business reach its sales and profit objectives, enhances the reputation of the company, satisfies the target market, and sends the correct price-quality signal. **Price-quality signaling** occurs when the cost of a good or a service reflects the perceived quality of that product or service. Dana Griffin, “Pricing Strategy Theory,” *Chron.com*, accessed December 1, 2011, smallbusiness.chron.com/pricing-strategy-theory-1106.html. However, pricing objectives must be formulated before a pricing strategy can be selected.

Pricing Objectives

Pricing objectives (i.e., what the company wants to accomplish with its pricing strategy) should be related to a company’s objectives and should follow the decision about where a company wants to position its products or services. Philip Kotler and Kevin Lane Keller, *Marketing Management* (Upper Saddle River, NJ: Pearson Prentice Hall, 2009), 383. Different small businesses in the same industry may have different pricing objectives based on size of the business; in-house capabilities; and whether the focus is on profit, sales, or government action. Dana-Nicoleta Lascu and Kenneth E. Clow, *Essentials of Marketing* (Mason, OH: Atomic Dog Publishing, 2007), 358–59.

- **Sales-based objectives.** Increasing sales volume and market share relative to the competition may involve **penetration pricing**, where a business prices a new product below that of the competition to quickly penetrate the market at the competitor’s expense, acquire a large market share, and then gradually raise the price. This objective might be appropriate for a small business that is introducing a new product or service to a very competitive marketplace.
- **Profit-maximization objectives.** Quickly recovering the costs of product development while providing customer value may involve **price skimming**, where a new product is priced higher than that of the competition to maximize profit. This objective

would work for a small business with customers who are more concerned with quality, uniqueness, and status rather than price. However, a product's image and quality must warrant the high price.

- **Status-quo-based objectives.** Used to minimize the impact of competitors, government, or channel members and to avoid a sales decline, these objectives are reactive rather than proactive, so they should be adopted for the short term only. Small businesses must be able to meet the needs of their target market.

Pricing Strategy

Once the pricing objectives are set, a small business must determine a pricing strategy. The small business owner can consider a variety of approaches. Discount pricing, cost-based pricing, prestige pricing, even-odd pricing, and geographic pricing are discussed here. In general, traditional pricing strategies can also be applied to the online environment. Judy Strauss and Raymond Frost, *E-Marketing* (Upper Saddle River, NJ: Pearson Prentice Hall, 2009), 247. How goods and services are priced tells consumers a lot about what to expect from a small business.

Discount Pricing

A small business might choose a **discount pricing** strategy. Diane Watkins, "What Is Discount Pricing Strategy?," *Chron.com*, accessed December 1, 2011, smallbusiness.chron.com/discount-pricing-strategy-794.html. If it is looking to drive traffic and sales short term or if it wants to be permanently seen as the value leader in an industry. Rick Suttle, "Industry Pricing Strategy," *Chron.com*, accessed December 1, 2011, smallbusiness.chron.com/industry-pricing-strategy-4684.html. Discount pricing is used with customers who buy in large quantities, customers who buy during off-peak times (seasonal), promotions used to increase traffic, and **loss leaders** (products that are discounted to get customers in the door in the hope that they will also buy more profitable products). Discount pricing can be used in the online environment in ways similar to brick-and-mortar stores. If the discounting is short term, inventory can be reduced, and revenues are increased temporarily. Diane Watkins, "What Is Discount Pricing Strategy?," *Chron.com*, accessed December 1, 2011, smallbusiness.chron.com/discount-pricing-strategy-794.html. An important disadvantage, however, is that customers often associate low price with low quality, particularly if a brand name is unfamiliar. A discount pricing strategy could lead to a product or a service being perceived as low quality. Also, price reductions can be easily matched by the competition, eliminating any but the earliest advantage. Diane Watkins, "What Is Discount Pricing Strategy?," *Chron.com*, accessed December 1, 2011, smallbusiness.chron.com/discount-pricing-strategy-794.html.

Cost-Based Pricing

Cost-based pricing is a very simple approach. A company figures out how much it costs to make a product or deliver a service and then sets the price by adding a profit to the cost. [citation redacted per publisher request]. For example, if it costs a small toy manufacturer \$10 to make its signature stuffed animal (taking into account fixed and variable costs) and the company wants a 20 percent profit per unit, the price to the retailer will be \$12. "Cost-Based Pricing," *Small Business Notes*, accessed December 1, 2011, www.smallbusinessnotes.com/marketing-your-business/cost-based-pricing.html.

Cost-based pricing is very easy to use. It is flexible (allowing different profit percentages to be added to different product lines), allows for easy price adjustments if costs go up or down, and is simple to calculate. On the downside, cost-based pricing ignores product demand, what the competition is doing with pricing, and positioning, and it provides no incentive for cost efficiencies. "The Highs And Lows of Cost-Based Pricing," *Fiona Mackenzie*, August 26, 2009, December 1, 2011, fionamackenzie.com.au/pricing-strategy/the-highs-and-lows-of-cost-based-pricing.html.

Prestige Pricing

Prestige pricing (or premium pricing) taps into the belief that a high price means high quality. Although this relationship exists in many instances, it is not true in all cases. Nonetheless, prestige pricing is "a strategy based on the premise that consumers will feel that products below a particular price will have inferior quality and will not convey a desired status and image." Dana-Nicoleta Lascu and Kenneth E. Clow, *Essentials of Marketing* (Mason, OH: Atomic Dog Publishing), 358–59. A small children's clothing store that carries only top-of-the-line merchandise would use a prestige pricing strategy. Clothing from this store would be seen as having a higher perceived value than clothing from Macy's but perhaps comparable in value to clothing from Bloomingdale's, Nordstrom, or Neiman-Marcus.

Prestige pricing can be very effective at improving brand identity in a particular market. However, it is not typically used when there is direct competition because such competition tends to have a downward effect on pricing. Unique products usually have the

best chance of succeeding with prestige pricing. Lisa Magloff, “What Is Premium Pricing Strategy?,” *Chron.com*, accessed December 1, 2011, smallbusiness.chron.com/premium-pricing-strategy-1107.html.

Even-Odd Pricing

Also known as the “nine and zero effect,” Ivana Taylor, “8 Pricing Strategies You Can Implement Right Now,” August 19, 2008, accessed December 1, 2011, *Small Business Trends*, smallbiztrends.com/2008/08/8-pricing-strategies-you-can-implement-right-now.html. **even-odd pricing** can be used to communicate quality or value. It assumes that consumers are not perfectly rational, which is true. Emotion plays a much larger role in consumer behavior than rationality.

Even-numbered pricing, or setting selling prices in whole numbers (e.g., \$20), conveys a higher-quality image. A small, high-end gift shop, for example, would use even pricing for most if not all its products, with odd-numbered prices (e.g., \$18.97) used for products that are on sale. Odd-numbered prices give consumers the impression that they are getting a great value. It is a psychological effect with no basis in logic. But it does work in practice.

Geographic Pricing

Some small companies will use a **geographic pricing** strategy. This pricing strategy takes the geographic location of a customer into consideration, the rationale being that distribution can increase product delivery costs and thus the cost of the product. Dana-Nicoleta Lascu and Kenneth E. Clow, *Essentials of Marketing* (Mason, OH: Atomic Dog Publishing), 369. Taxes, the cost of advertising, competitors who benefit from government subsidies, consumer demand, differences in costs of living, and the general cost of doing business are other factors that enter into the decision to use geographic pricing. Small businesses that sell outside the United States would likely encounter the need for geographic pricing. This strategy might also be appropriate when selling in different states.

KEY TAKEAWAYS

- Marketing is the only activity that generates revenue for most small businesses.
- Price accounts for revenue.
- Determining a price for its products or services is one of the most important decisions that a small business will make.
- There are many factors involved in choosing the right pricing strategy.
- Having the lowest price is not typically a strong position for small businesses.
- Pricing objectives should be created before a pricing strategy is selected.
- In general, traditional pricing strategies can be applied to the online environment.
- Discount pricing, cost-based pricing, prestige pricing, even-odd pricing, and geographic pricing are pricing strategies that can be considered by a small business.
- How goods and services are priced tells consumers a lot about what to expect from a small business.

EXERCISES

1. Frank’s All-American BarBeQue is planning to significantly expand its takeout business. Currently, customers come into the restaurant and order from the menu. With the new Darien facility and website, customers will be able to order online or fax an order to the restaurant. Frank and Robert have been arguing over how to structure the takeout portion of their operations. Frank wants to maintain the approach where customers order items from the menu. Robert believes that in today’s world, it would be more convenient for customers to order complete prepackaged meals. Father and son have argued about the nature of these meals. Frank has suggests a limited number of standard meals that could be prepared during the day and sold in the evening when commuters are returning home. However, this might mean that excess inventory would be built up on unwanted items. Robert wants to offer greater variety. These would include a main course, two side dishes, and a dessert. Because there could be a large number of combinations, most would have to be made after the receipt of an order. The “rush” to make these meals would drive up costs. How would you go about pricing these two types of meals?
 2. Visit two small businesses—one that you think would use even-numbered pricing and one that you think would use odd-numbered pricing. Were you right? If not, how would you describe their pricing strategies? Be as specific as you can.
 3. Visit [NapaStyle](http://NapaStyle.com), and analyze its pricing strategy.
 4. Select a product or a service that you purchased recently from an onground small business and an online small business. The two businesses should be different. Evaluate the price that you paid. What appears to be the pricing strategy of each business? Do you think the price was fair? Why or why not? How would you assess the value that you received for the price you paid?
- Adapted from David L. Kurtz, *Contemporary Business* (Hoboken, NJ: John Wiley & Sons, 2011), 488. *Tip*: If you are not sure

whether an online business can be considered a small business, type in the name of the business plus “corporate HQ” into Google or your preferred search engine. The search should return results that include the number of employees. As long as the company has fewer than five hundred employees, you are all set.

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