7 Price

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"How much?" is a phrase heard the world over, between shopkeeper and customer, in organisations and in general conversation. Prices can start at no monetary value; Gillette patented his razor and blade system (for shaving beards and moustaches) in 1904, but was said to have given razors away, knowing that customers would buy his disposable blades and that he would make a profit in this way. Although this story turned out to be a myth (Picker, 2011) some products are still given free as an incentive to purchase more with the ultimate aim of making a profit. Price is about value to the customer. Organisations that are able to continuously offer the right mix of goods and services at the right price will create the best customer value and are more likely to be successful.

First considerations

When buying a product, price may not be the first consideration. The features and benefits of the product may be prioritised and if the product solves a particular problem then price may become a secondary factor. This alludes to the concept of utility, which in an economic sense is the sum of benefits gained from consumption (Dibb et al 2012), which often decline through further consumption (Free, 2010). Eventually, as one navigates through the buying process, the price of the product will become of some importance. At its narrowest, price "is the amount of money charged for a product or service" (Armstrong and Kotler, 2013:285). However, money is not the only thing that might need to be sacrificed to buy a product. For example if the purchase is an iPhone, the benefits of an Android phone will be foregone. Equally, if the purchase is an Android phone, the benefits of an iPhone would be lost, unless both are purchased with consequent costs. A broader appreciation of price includes money and the other elements of value given up to buy a particular product. Dibb et al. summarise price as "the value placed on what is exchanged" (Dibb et al., 2012:593). This concept of value can be expressed in diagram form:

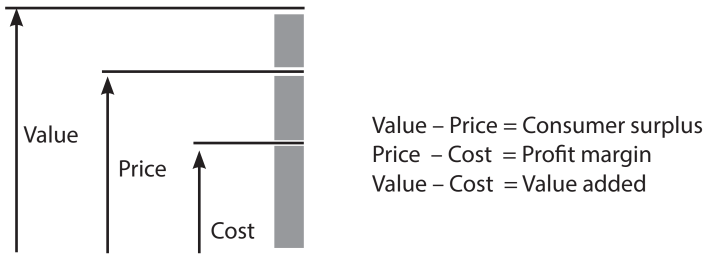

Figure 7.1: The components of value

Brassington and Petitt (2006:1221) propose that value is "a customer's assessment of the worth of what they are getting in terms of a product's functional or psychological benefits". This implies that the benefits of a product can be converted into a sum of money for each customer as expressed in Figure 7.1. The marketer's task is to use the marketing mix to communicate maximum value to the customer, allowing the price to be set to minimise the consumer surplus element and enhance the profit margin for the organisation at the same time.

Exercise: Find two or three further definitions/explanations of 'value' to check and enhance your understanding of this concept.

At first glance, the idea of free products seems to be at odds with the value diagram above. However, Osterwalder and Pigneur (2010: 96) use the term '*Fremium*', coined by Jarid Lukin, to explain business models that combine free but basic services with premium services that must be paid for. This works well with an internet based business where the cost of each extra user to the organisation is virtually zero and examples include LinkedIn, Strava and Dropbox. Incentives can be given by the organisation (Kumar 2014) for users to refer friends and this is more likely to work when the basic service is free. Upgrade options are then offered from which the organisation can obtain revenue.

The word *price* is the general term but other names have been developed over time to indicate price in different contexts. Table 7.1 gives a selection of these:

Table 7.1: Alternative terms used for price. Adapted from Dibb et al (2012)

Product/service context	Term used	Product/service context	Term used
Accountant	Fee	Parking Violation	Fine
Ad-hoc payment for service	Tip	Payment for labour	Wages
Estate agent	Commission	Reserving goods and/or services	Deposit
Government services	Tax	Travel e.g. Bus, train or plane	Fare
Insurance	Premium	Use of equipment or property	Rent
Loans, mortgages	Interest		

Exercise: Is there any alternative terminology used within your region not shown in Table 7.1?

Considering the other elements of the marketing mix, they all represent a cost. Price, on the other hand, represents the opportunity to obtain revenue for a product. This revenue gathering is governed by the following equations:

$$\text{Total revenue} = \text{Volume sold} \times \text{Unit price}$$

$$\text{Profit} = \text{Total revenue} - \text{Total costs}$$

These equations form the financial bedrock of the pricing decision. Note that organisations who do not seek to make a profit, such as government organisations and charities, still need to cover their costs and preferably make a surplus to cover future investments. Using a formula makes price setting seem a totally rational and therefore mechanical or scientific process, however this chapter will demonstrate that price is much more involved, incorporating a rational process but embodying emotion too.

Approaches to pricing

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Firms determine their approach to the pricing of their products based on their marketing strategy and their understanding of the context in which the product is centred:

Figure 7.2: Factors that influence price