

Introduction to the Marketing Mix – Pricing



Marketing

Before you can understand the Marketing Mix you should be sure that you understand what marketing is. The word 'marketing' is used frequently, but could you define what marketing really is?

Let's take the definition used by the Chartered Institute of Marketing:

'Marketing is the process which identifies, anticipates and satisfies customers' requirements profitably'.

In other words, marketing finds out what products or services customers want, either now or in the future, and provides those products or services to them at a price which leaves a profit for the business. You should be aware that marketing is about much more than simply selling.

Modern marketing focuses very clearly on the customers and always looks at the business from their point of view. It asks what customers really need and if the business is meeting that need. Market-driven businesses will change the product or service to suit the customer.

Sainsburys and Tesco are two businesses which are very committed to marketing and are now the most profitable retailers in Northern Ireland. Compare their position with that of Marks and Spencer who, until recently, were less aware of their customers' needs. They became criticised for selling clothing which many people thought dull and uninteresting. As a result, Marks and Spencer's profits plummeted and they are now having to work very hard to regain their position in that particular market.



Competitive marketing

'Competitive marketing' is another frequently used term and simply describes any market in which there are many businesses competing for customers.

ACTIVITY

Copy the following list and give the name of a competitor for each of these well-known retailers in Northern Ireland.

Business	Name of Competitor
Computer World

Activity continues on the next page

Activity continued

Debenhams
McDonald's
Woolworths

The Marketing Mix



Figure 4.3

The Marketing Mix is all the key activities which are used in marketing a business's products. This is frequently referred to as the four Ps: Price, Promotion, Place and Product

Some people argue that two other Ps should be added to the marketing mix: P for People who are, as we have seen, such an important part of marketing, and for Packaging, but packaging is really part of Promotion.

The idea of the Marketing Mix is the same idea as when mixing a cake. A baker will alter the proportions of ingredients in a cake depending on the type of cake he/she wishes to bake. The proportions in the Marketing Mix can be altered in the same way and differ from product to product.

A new brand of detergent, for example, would be marketed very differently from a new range of expensive jewellery.

The mix will also vary at different times throughout the life of a product. The price would be lowered or advertising might be increased at times when sales are falling off.

A business will manipulate the four elements of the Marketing Mix in whatever way it has to, in order to keep ahead of its competition.

In the next four units we shall study each of the elements of the Marketing Mix.



EXAMINATION QUESTION

Define the term 'Marketing Mix'.

(2 marks)

(CCEA Business Studies, GCSE, Paper 2 Foundation Tier, 2001)

Tips for answering this question:

This is a straightforward 'recall of knowledge' type of question in which you simply need to say what the Marketing Mix is, giving the names of the four elements of the mix.

Price

Pricing policies

There are a number of pricing policies which a business may adopt. The choice of policy depends on:

- the type of product being marketed
- the competition in that market
- the price which people would be willing to pay
- the costs of production which must be covered.

Market-led pricing

Market-led pricing is also referred to sometimes as 'competitive pricing'.

This method simply accepts the price which competitors are charging for a product and then prices its product at the same level or slightly lower in order to gain some advantage over the competitors.

Market-led pricing would operate in a market where there is strong competition and involves close monitoring of competitors and any changes they make to their prices.

This strategy is operated for products such as washing powder where customers will buy their favourite brand in whichever shop offers it at the lowest price.

Cost-based pricing

Cost-based pricing, also sometimes referred to as 'cost plus pricing', involves working out the business's total fixed and variable costs and then adding on a percentage profit. The business also has to consider the total number of items which it plans to produce and sell.

The calculation is simple:

$$\text{Cost-Based Price} = \frac{\text{Total Costs} + \text{Profit}}{\text{Total Sales}}$$

The big advantage of cost-based pricing is that the business is guaranteed to make a profit on its sales since it has covered its costs.

However, the danger is that the business may not be able to sell the expected quantity of the product, perhaps because competitors are offering the same goods at a lower price. Therefore, in operating cost-based pricing it is vitally important to be aware of competitors' prices and what the market will bear.

Skimming

Skimming is most often used in the case of new products when there is little competition in the market.

This strategy sets a relatively high price initially, in an attempt to 'skim' the market – like skimming the cream off the milk! Some people would be willing to pay the higher price because the product is new and unique and few other people would own it. Later on, other businesses will enter the market, setting up competition so, in order to maintain sales, the price would be reduced.

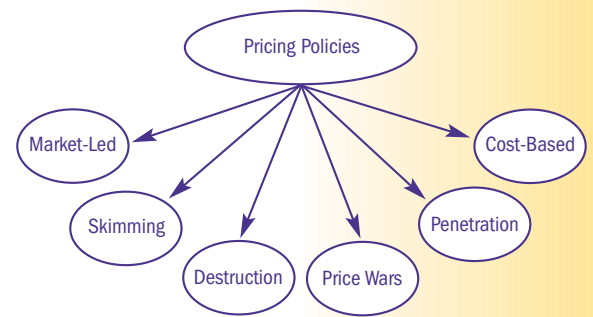


Figure 4.4 Market-led pricing



Figure 4.5 Price wars

The high initial price gives the impression of high quality and is justified by the manufacturers because the product usually would have had high costs in research and development. The danger of skimming is that some people would be deterred by the high price and prefer to wait until the price falls.

Pricing of mobile phones is an excellent example of skimming. When mobile phones were first produced they were expensive and few people owned them. Initially, they were something of a status symbol. Later they were produced in large numbers by a variety of manufacturers and the price fell to such an extent that today most people own mobile phones.

Penetration pricing

Penetration pricing is where a low price is set at the beginning in order to gain entry to an existing market, and where the price increases when the place in the market has been secured.

Penetration pricing would be used by a new business trying to break into – or penetrate – a market where other competitors already are well established. Obviously, this pricing strategy is suitable for a competitive market.

In order to attract customers to the new store, and away from the competitors, they have to be lured by low prices. The basic idea is that, once the customers have been lured by the lower prices, they will become regular customers. It is at that stage that prices would be raised.

This method of price setting ensures sales, at least in the short term. It is possible, however, that the price has to be set so low that profits may be minimal.



Figure 4.6 Destruction pricing

Destruction pricing

Destruction pricing is also known as 'destroyer pricing'. It is a ruthless strategy which is designed to destroy competitors' sales or even drive them out of business altogether.

This method operates by reducing the price of an existing product or selling a new product at an artificially low price. Sometimes this new low price may be below cost level so the business would be sustaining a loss for a period of time. Once the competitors have been driven out of the market, the prices would be raised again.

If the competitor is a small business it would be unable to reduce its prices in this way and may be forced to close. This has been the fate of so many of our corner shops and village stores in Northern Ireland.

Price wars

In very competitive markets such as the grocery market, businesses sometimes engage in price wars in which prices of some goods are cut to a very low level in order to secure sales.

The idea is to attract customers to their particular supermarket to buy the marked-down goods and encourage them to buy other goods while they are there.

Price wars are not popular with businesses, however, even though they often happen. They are risky because advantages gained over other businesses are short-lived and rival businesses tend to respond by slashing prices even further.

If pursued long enough, price wars would cut profits seriously and, in the end, only the customer benefits by the low prices.

ACTIVITY

Study the following situations and name the pricing strategy which is being described in each example.

1. A new hardback book is published at £20. Two months later, it is sold in paperback for £10.
.....
2. A new supermarket in Lisburn opens selling a particular chocolate bar at 50p. Existing supermarkets in the town lower their prices of the chocolate bar to 40p.
.....
3. Several stationery companies in Belfast keep lowering their prices of computer paper to take sales away from each other.
.....
4. A bicycle manufacturer introduces a new model at a low price in order to attract sales.
.....
5. A chemist shop in Lurgan researches the price of particular brands of toothpaste in all local outlets and then charges the same prices as they are charging.
.....
6. A florist in Lisnaskea sets her prices to cover her total costs plus a little profit.
.....



EXAMINATION QUESTION

CC Computers produce computer games and their major competitor has just launched a new game. Sales of their most popular game are declining.

Explain two pricing policies which CC Computers could use if they decide to introduce a new game.

(6 marks)

(Adapted from CCEA Business Studies, GCSE, Paper 2 Higher Tier, 2001)

Tips for answering this question:

You are asked to 'explain' two pricing policies. This means that you should give as much detail about two policies as you can in order to show that you fully understand them. You would be given 1 mark for correctly naming each suitable policy, and 2 marks for a good explanation of each one.

ACTIVITY

Six pricing policies are described in the column on the left. You should link each one to the appropriate name in the column on the right. The first one is done for you.

Activity continues on the next page

Description	Pricing Policy
This policy is based on the prices charged by competitors	Destruction pricing
This policy charges a high price at the beginning and reduces it later	Market-led pricing
This policy cuts prices very low in order to take sales away from competitors	Cost-based pricing
This policy tries to put other firms out of business	Penetration pricing
This policy sets a low price at the beginning and increases it later	Skimming
This policy is based on the costs incurred in making and selling the goods	Price wars

Factors that affect price

Price has to be carefully worked out for every item put on the market. Several factors have to be considered:



Costs of production

The producer has to calculate the total costs incurred in manufacturing the goods. These costs would include factory overheads and raw materials.

The retailer has to calculate the costs incurred in offering the goods for sale such as transport charges, wages to sales staff and shop overheads.

The price charged to the consumer has to be set at a level which would cover all these costs.

Need to make a profit

The overall aim of any business owner is to make a profit from the business, so the goods must be priced at a level which not only covers the total costs but also leaves a margin of profit for both the manufacturer and the retailer.

The owners would expect the level of profit on their investment in the business to be at least as much as the interest they could have earned if they had left their money in the bank. A healthy profit margin also encourages other investors to buy into the business.

The highest level of profit, however, will not necessarily be made by charging the highest prices since this could discourage sales.

Competition in the market

We have already seen in this unit how competitors' prices are monitored in order to increase sales. The aim in business is to set the price at a level which would encourage customers away from competitors.

To do this, the price has to be slightly lower than that charged by the competition if the goods are exactly the same.

Price which the market could bear

It is most important that the business is sensitive to the price which customers can afford and are willing to pay. This is also linked to the type of product.



If the goods being sold are luxury items they would be targeted at a wealthier market so that particular market could bear a higher price. Goods being sold in a shop in a less well-off area will have to be priced at a level which the customers there could afford.

Whatever the circumstances, the price charged has to be the one at which the highest level of sales would be made.

Season of the year

The demand for certain items rises at particular times of the year. The highest sales of toys are made in November and December, for example, for the Christmas market. At these times of greatest demand the price is at its highest and falls immediately after the event. This is why it is possible to buy Christmas cards very cheaply in January.

The red rose you bought for your girlfriend or boyfriend for St Valentine's Day was very expensive, but the next day the price would have been considerably lower!

Quantity of stock in hand

At times when there is a glut of goods in stock a retailer will hold a sale in order to reduce stocks. The price charged to the consumer obviously is affected.

This also happens with airline tickets which can be bought much more cheaply immediately before the date of the flight. In this case, it is better for the airline company to sell the remaining seats at a reduced price rather than fly with a half-empty aeroplane.

In business, this is referred to as 'underused capacity'.

ACTIVITY

Six factors which affect prices are described on the left. You should link each one to the appropriate name in the column on the right. The first one is done for you.

Description	Pricing Policy
The price charged has to cover all costs of production and selling the goods	Season of the year
The price is set so that the owners make some money for themselves	Price the market could bear
The price depends on the time of the year	Cost of production
The price depends on how much people can afford to pay	Need to make a profit
The price depends on what other firms are charging for the same goods	Quantity of stock in hand
The price is determined by how much of the goods the business has	Competition in the market

Relationship between Price and Demand



Before exploring the relationship between price and demand, you should be sure that you understand the business meaning of 'demand' and how it differs from 'needs'.

We all have needs and wants.

We **need** food, basic clothing and shelter in order to survive.

We **want** a range of fashionable clothes, a more luxurious house or a bigger car but these items are not essential for our survival.

The total of our wants become 'demand' when those wants are backed up by money or when we are able to pay for them. So we can now define demand:

Demand is the quantity of goods which will be bought at a given price.

Successful businesses are those who can satisfy consumer demand and can get:

the right goods to the right place at the right time and at the right price.

There are many factors which cause a change in the demand for particular goods:

- The price being charged for the goods
Usually, the higher the price being charged, the lower the demand for the goods.
- Customers' tastes
People buy what they like or according to the prevailing fashion. For example, even if alcohol were free, some people would still not buy it because they are teetotal.
- Level of income
Customers usually buy what they can afford. As income increases, people would not necessarily buy more goods but they probably would buy better-quality goods.
- Price of other goods
Some goods act as substitutes and can be bought instead. For example, if potatoes were very expensive, people might eat pasta instead.

Other goods are complementary goods which means they are often used together. For example, if the price of fish fell, people would eat more fish. This might cause extra demand for potatoes because we often eat fish and chips together.

- Advertising
Increased advertising, if successful, would cause an increase in demand.
- Credit rates
At times when the lending rate is low, people will be able to borrow more from banks and building societies and demand for goods will increase as they buy more goods.

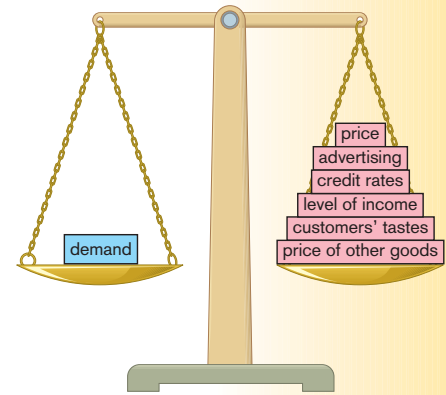


Figure 4.7

ACTIVITY

Damien is a butcher who has a large stock of beef in his shop. Unfortunately, there has been a recent health scare which has put some people off buying beef.

- Advise Damien on ways to increase demand for beef
- What else might Damien do in order to increase trade generally in his shop?

The relationship between price and demand is best illustrated graphically, with price on the vertical axis and quantity demanded on the horizontal axis.

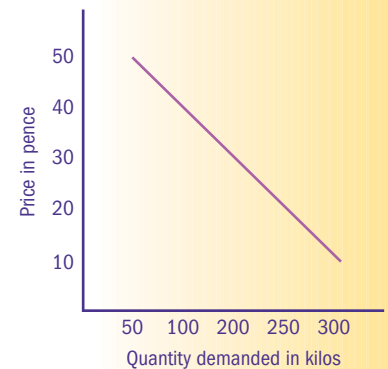
As price falls, demand rises.

This fact can be shown on a demand line which always slopes downward to the right:

This graph illustrates the demand for potatoes:

50 kilos are demanded at 50p per kilo.

300 kilos are demanded at 10p per kilo.



ACTIVITY

Study the above graph showing the demand for potatoes.

- Read off the number of kilos of potatoes which would be demanded if they were priced at 40p per kilo.
- Find out how many kilos would be demanded if the potatoes were priced at 30p per kilo.
- What do your answers prove about the relationship between price and demand?

REVISION

At this stage you should understand:

- factors which affect price
- relationship between price and demand
- factors which cause a change in demand for goods.

You should also know the meaning of:

Marketing

Market-led pricing

Penetration pricing

Marketing Mix

Cost-based pricing

Destruction pricing

Demand

Skimming

Price wars

As revision, look each one up in the Glossary at the end of the book.

The Marketing Mix – Promotion



The second part of the marketing mix which we will study is **promotion**. This is another commonly used term, but could you define it?

Promotion is the process by which businesses inform customers about their products and encourage them to buy those products.

Promotion is a very important element of the marketing mix because even the best products will not be sold if consumers do not know about them.

Promotion is important not only at the introduction of a new product, but as an ongoing process throughout its life, because customers need to be reminded about it if sales levels are to be maintained.

Promotion also keeps the name of the company and the name of its product(s) at the forefront of customers' minds. This creates an image for the company and also helps to keep it ahead of its competitors.

ACTIVITY

Study the above information, then copy and complete the following statements to show what effective promotion does for a company.

- a Promotion is important at the of a ... product.
- b Promotion makes aware of ... products.
- c Promotion keeps customers about products.
- d Promotion maintains for the company.
- e Promotion creates an for the company.
- f Promotion helps to keep the company

There are many methods of promotion, but the four types illustrated on the right are the most usual:

Sponsorship

It is quite common for businesses to sponsor sporting events, charity events or school events. All of these activities portray the business as being public spirited and interested in its local community. The business donates the funds necessary to run the event, and, in return, the players wear kit displaying the company logo. The company

Methods of Promotion

