

*Consumers not only form reference prices before the purchase occasion but also at the time of purchase.*



*Price strategies will vary depending on who applies them and on the intended target audience*



### Price

The selling price of products and services represents one of the most important elements in a brand Marketing Mix.

In our own experience, having modeled the sales of many brands from very different sectors, price is of key importance, and it is becoming more and more important for companies to know, with the greatest precision possible, the willingness of customers to pay for their products. This will allow them to evaluate the effect that price changes may have on volume of sales and on the company profitability.

Therefore, companies need to design models which will allow them to predict and evaluate customers' price acceptance.

### Price Strategies

The main goal of companies is to achieve the greatest profitability possible. Present price policy represents a sphere of special interest due to the repercussions it has on the results in the short-term and in the long-term.

One of the strategies most widely used usually consists in making price changes and give promotional discounts. And this, to such an extent that in the last decade, some companies have spent more in actions of this kind than on Advertising.

Price strategies are used on the basis of various reasons, depending on whether from the point of view of the Manufacturer, the Distributor or the Consumer.

- For the **Manufacturer** the main reasons are, among others, the following:
  - Introduce a new product to the market
  - Increase Brand sales
  - Increase his market share
  - Reduce stocks

*Distributors will expect to make profits from global sales and not from the sales of a specific brand.*



*The more price-sensitive consumers will always look for the lowest prices; while the less price-sensitive ones will rather look for quality.*

(1) Martínez Ruiz, M. P. (2004) La influencia de las características del descuento de precio promocional y de la marca en el incremento de las ventas: aplicación de la metodología SVM con datos de escáner minorista. Alicante: Biblioteca Virtual Miguel de Cervantes, [disponible en <http://cervantesvirtual.es>].

(2) J.C. Gázquez Abad y M. Sánchez Pérez (2007). Consideración de la heterogeneidad en el comportamiento de elección del consumidor a través de modelos logit: enfoque paramétrico vs. semiparamétrico. Cuadernos de Economía y Dirección de la Empresa. Núm. 30, 2007, 233-264

• We can summarize the price strategies for the **Distributor**, in the following table prepared by Martínez Ruiz (2004 <sup>1)</sup>) in which, besides listing the reasons and the authors who have analyzed them, he discusses the way to carry them out:

**Razones que justifican el uso de la estrategia de precios por el Distribuidor**

Razón	Autor/es que lo han estudiado	Mecanismo para su articulación
Aumento del Tráfico de clientes al establecimiento	Kahn y McAlister, 1977	Ofrecer descuentos en marcas líderes
Incrementar la retabilidad total del establecimiento	Kahn y McAlister, 1997	Ofrecer descuentos en las categorías de producto con menor rotación para impulsar sus ventas
Aumentar el grado de implicación del consumidor en la compra	Ortmeyer et al. 1991	Ofrecer distintos descuentos de precio y rebajas promocionales de tipo lúdico
Comunicación de una imagen de precios competitivos	Kahn y McAlister 1997	Ofrecer descuentos en productos clave para los consumidores
Mejora de los beneficios	Hoch et al. 1994	Elevar el margen de beneficio en las categorías de producto no descontadas

• Finally, according to J.C. Gázquez Abad and M. Sánchez Pérez (2007<sup>(2)</sup>), there are two fundamental variables which determine the behavior of the **Consumer** when faced with price strategies: Sensitivity to the Selling Price and Brand Loyalty.

In the following table we can see the adequate price strategies for each type of customers, as well as their effects:

**Estrategia de Precio en función del tipo de Consumidor**

	LEALES	Buscadores de Marca	Buscadores de Precio
<b>Sensibilidad al Precio</b>	Media	Media-Alta	Muy alta
<b>Lealtad a la Marca</b>	Leales	Lealtad Media	No Leales
<b>Estrategia de Precios</b>	Precios constantes	Variaciones de Precio no muy frecuentes	Variaciones de Precio muy frecuentes
<b>Efecto de las Estrategias de Precio</b>	Muy Bajo	Medio	Muy alto



*It is crucial to strike the right balance between the short-term benefits and avoiding possible brand image damage.*



*High quality brands benefit more from discounts than the low quality ones.*

### ***Effects of price strategies***

In terms of the effects of price strategies on the consumer, we can distinguish different types:

#### **1. Short-term effects.** Mainly based on **immediate profitability**:

1. Stockpiling Effect (consumers purchase an item in larger than usual quantities).
2. Acceleration Effect (acceleration of product purchases).
3. Brand Switching (non-loyal consumers switch brands depending on the price strategy).
4. Change of commercial establishment (consumers change of establishment to benefit from the price strategy).

#### **2. Long-term effects.**

1. Consumer brand **Loyalty**
2. Brand **Image**.

**3.** Additionally, price changes of a specific brand can have **intra-category effects** over the rest of the brands competing in the same category, which will be affected, to a greater or lesser extent, depending on their price and their perceived quality. This is what is known as:

**Asymmetric cross-price effect**, according to which, a high quality brand benefits more from price reductions than a low quality brand. On the other hand, brands with a high perceived quality are less vulnerable in the face of temporary price increases than those of a low quality.

#### **4. Neighborhood cross-price effect.**

Effect according to which price strategies take away more sales from the brands that are more similar in price to the brand being promoted.

*The Price of a product or service is a function of multiple variables acting on it at a given time.*



*Consumers differ in their perception of reality.*

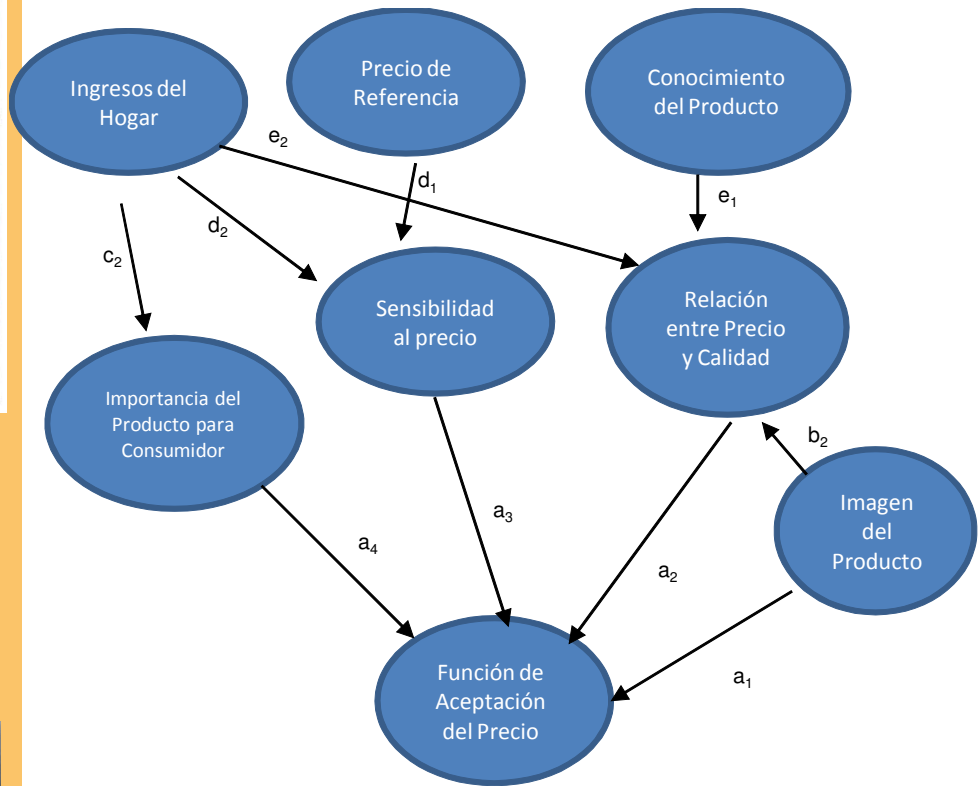


**Variables affecting price:**

It is very important to determine the variables affecting the price of a product or service. Based on them, and through what we will call **Price Acceptance Function**, we will be able to evaluate the importance and influence of these variables over the price. And that, as a prior step to being able to act on the price.

Next, we will show a Price Acceptance Function model with some of the variables having a greater incidence on price.

We would be leaving out other variables such as, for example, the Seasonability of the Product.



Once the price structure of our product is known we are in a position to profit from price strategies.

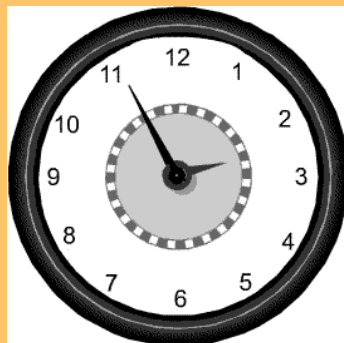
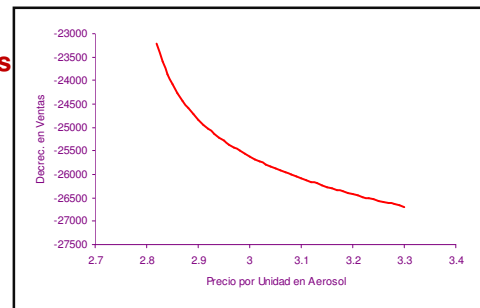
Mathematical models allow us to optimize the use of promotions and maximize results.

### Price Strategies Management

Modeling the effects of price strategies will allow us to broaden our knowledge about the impact of discounts on sales profitability. And this greater knowledge will contribute to greater effectiveness of the implemented strategies, as much for the Manufacturers as for the Distributors..

What does the Price Model tell us?

- Optimal Price **increases/decreases**
- Optimal **Length** of the Price strategy.
- Optimal **Frequency** of the Price strategy.



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It is of fundamental importance to perform proper management of the Price strategies, since they affect the consumer's reference price and the products image, which may end up affecting profitability.

### Conclusions

Price management of products or services seeks to obtain maximum profitability. But we have to bear in mind that profitability is not the same for the different actors in the process: Manufacturers, Distributors and Buyers. But price changes should not be made arbitrarily, since, among other things, customer satisfaction, as well as price awareness, are built from his perception of price fairness.

And this perception is influenced as much by the product past price as by the competitors' price and the costs of the retailer.