

Price The Neglected “P”

Martin James



The argument has been put forward that the marketing role in many large companies has eroded over time to little more than the co-ordination of advertising and promotional activity. New product development is under the control of boffins in R&D, distribution is almost exclusively the mandate of the Sales Department, and the Finance Department sets prices.

Marketers resultantly spend many hours intensely evaluating the story-line, the script, the on-screen copy, the music, proposed TARP measures and the general “creativity” of commercials. On the other hand, even very senior Marketing Managers play only a marginal role in the setting of prices. Typically their role is restricted to arguing the benefits of “a cheap price in order to deliver maximum sales” or “a high price to support a premium position”. Nebulous advertising “ROI” calculations are sometimes proffered, but seldom supported by any meaningful analysis. The Finance Department typically than ignores this advice and sets prices using standard cost mark-up pricing ratios.

This is a million miles away from both marketing theory and economic practise. Most marketers simply do not quantitatively know the elasticity of demand their brands face. However, in the absence of an understanding of their product’s demand elasticity, much price setting is very qualitative indeed. The dangers of this approach are very serious indeed. If consumer reaction to pricing policies is incorrectly estimated, the cost to the firm is typically far greater than the cost of airing a poor commercial. If price is set too high, demand will not be met. The danger of this is that the ability of the brand to generate repeat purchase is restricted, and repeat purchase is the key determinant of long term brand share. On the other hand the opportunity cost of setting prices too low can be large. Yes, maximum sales will be generated by the lowest price, but all too often the demand response at the lowest end of the pricing spectrum is small. Margin is simply handed over to those consumers who would have purchased the brand at a higher price.

The increase or decrease in demand for competitor products as our price changes (“cross-elasticity” of demand) is also seldom understood. Once again, by not understanding this impact upon consumer sales, it is all too easy to misjudge pricing levels.

Some marketers have acknowledged this somewhat obvious shortcoming in their marketing knowledge and are increasingly adopting the ever more sophisticated forecasting capabilities developed by Researchers and academics in recent times. Modellers are now capable of providing reasonably accurate sales forecasts based not only on pricing responses and advertising spend, but, additionally, the incremental price that can be charged for additional features and benefits added to the brand.

Great advertising builds long term brand equity. Adept pricing decisions results in immediate financial benefits.

Martin James is managing director of Celsius Research.