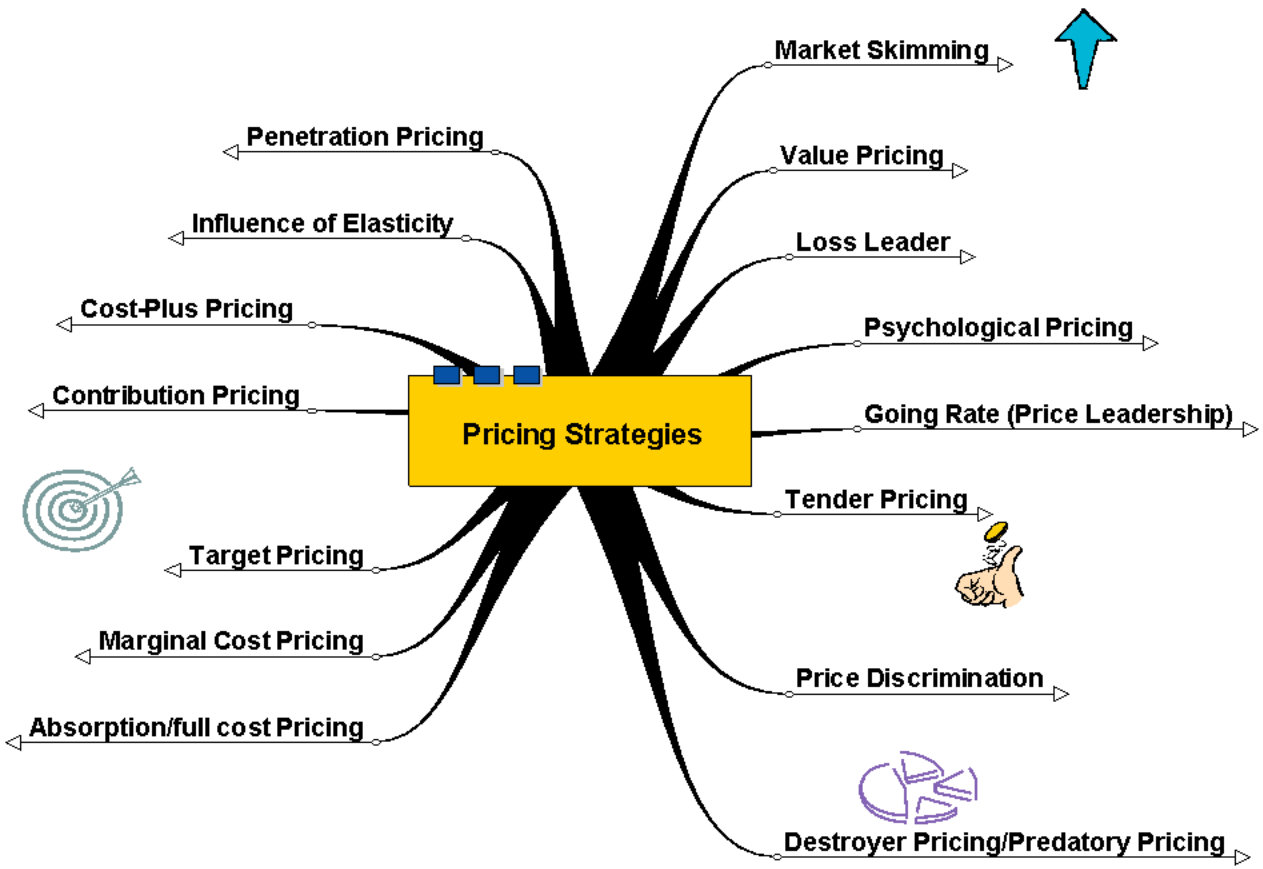
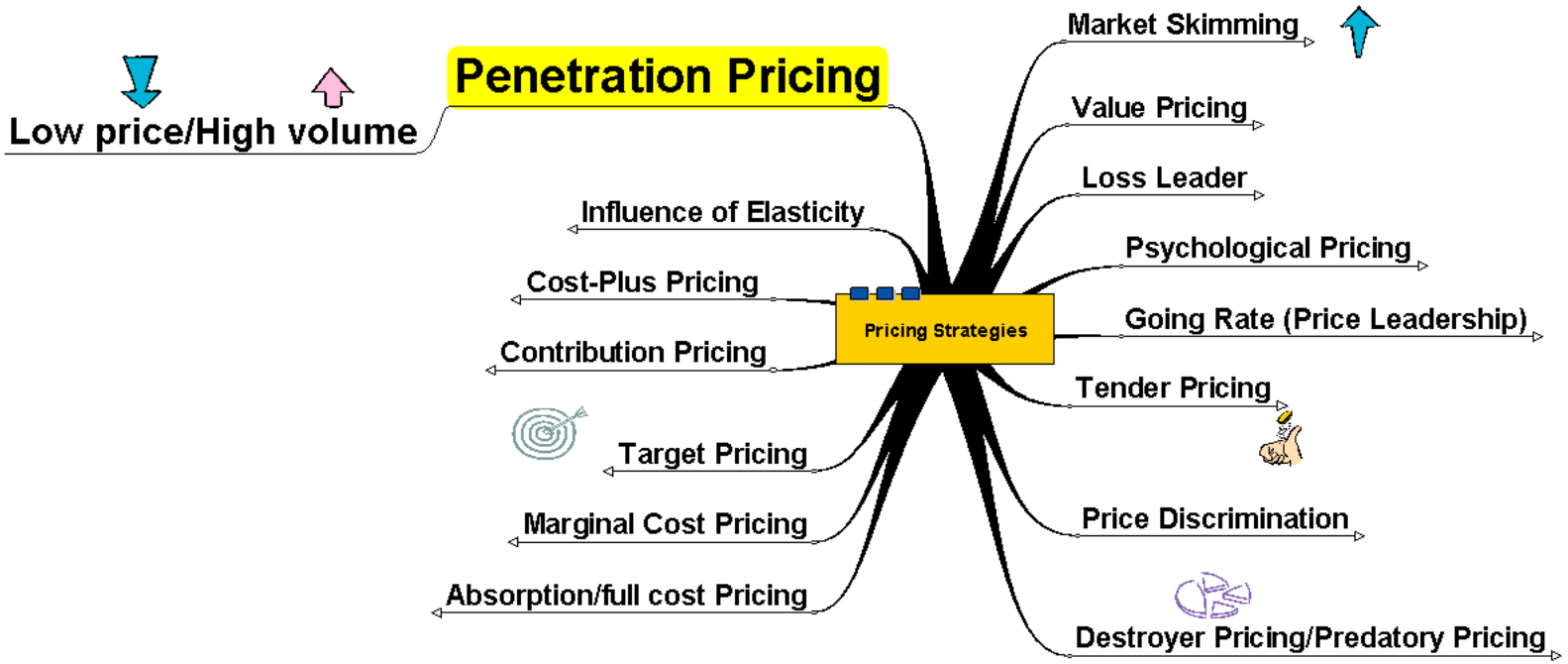
Pricing Strategies

Pricing Strategies



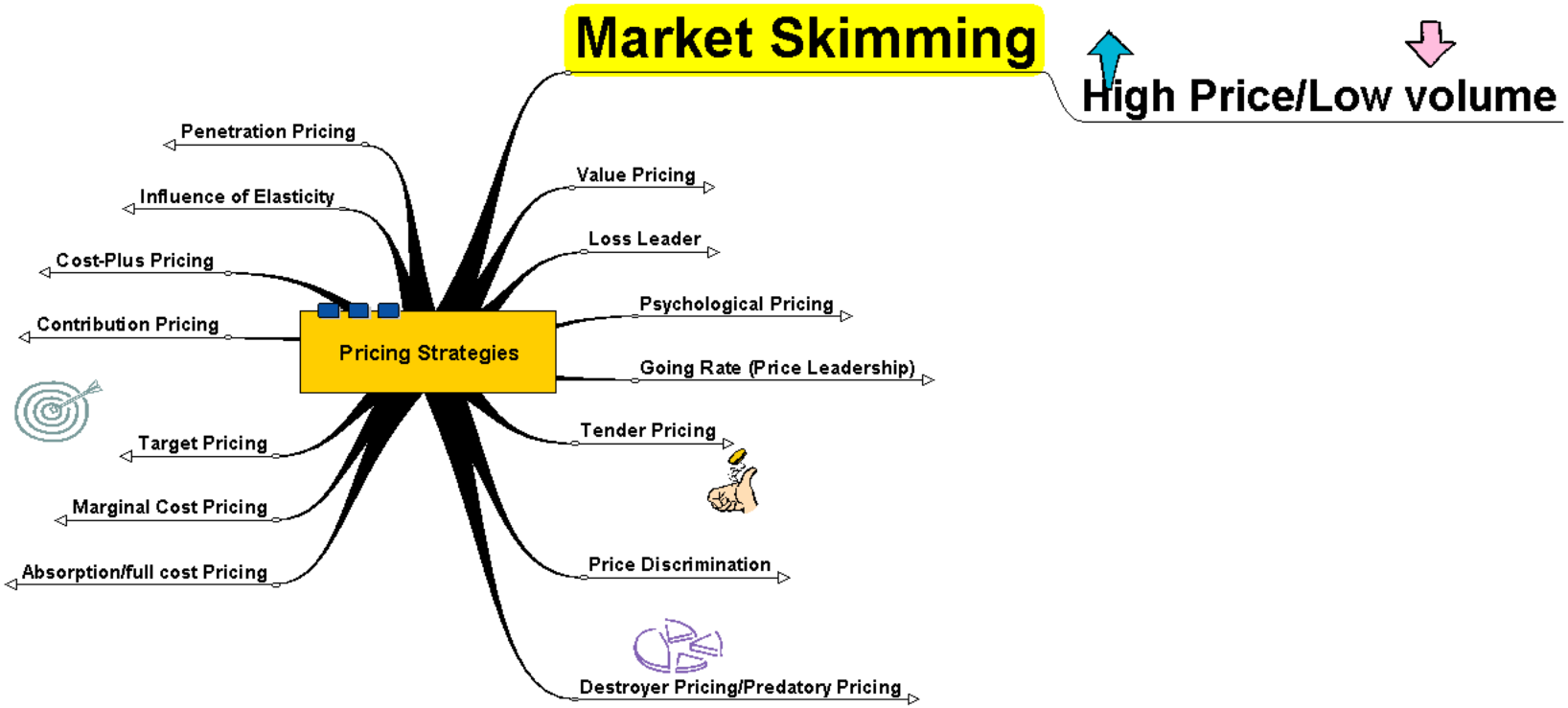
Penetration Pricing



Penetration Pricing

- Price set to ‘penetrate the market’
- ‘Low’ price to secure high volumes
- Typical in mass market products – chocolate bars, food stuffs, household goods, etc.
- Suitable for products with long anticipated life cycles
- May be useful if launching into a new market

Market Skimming

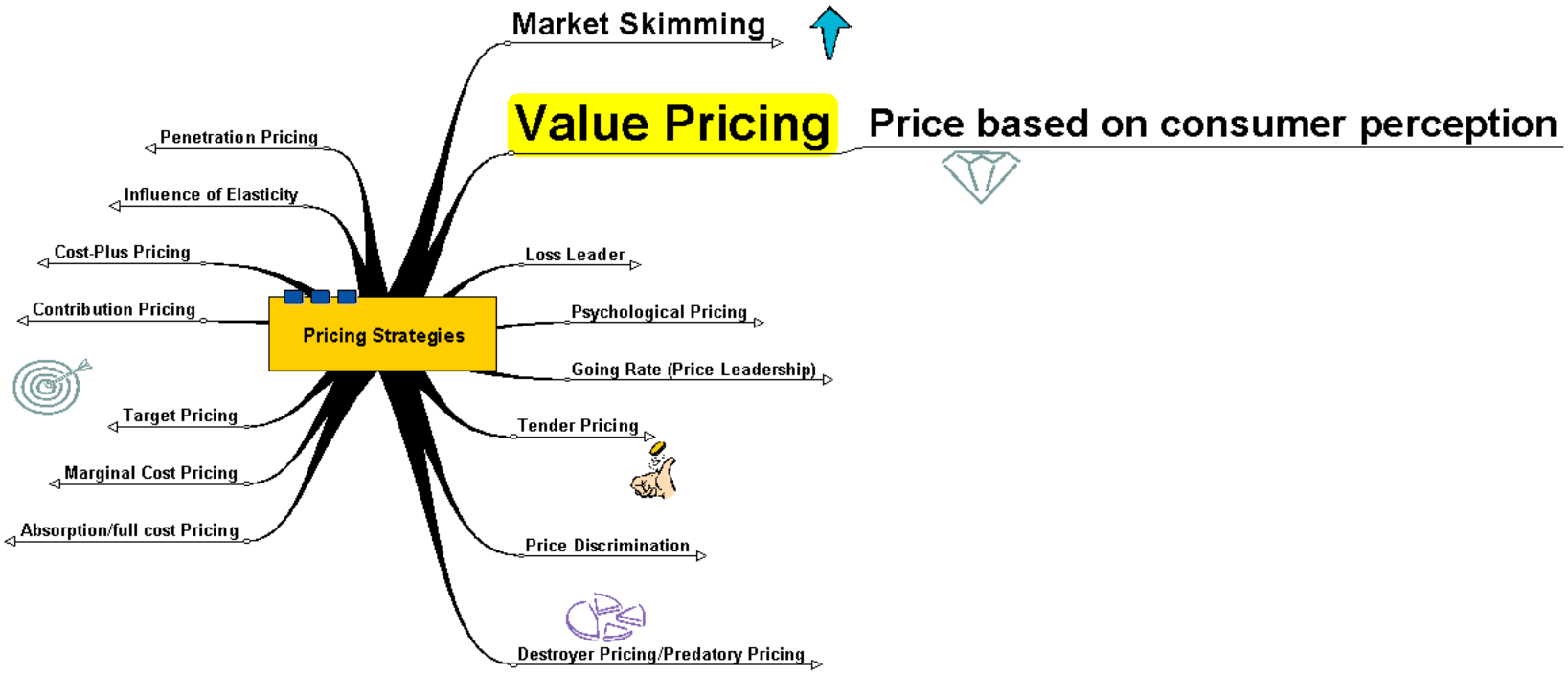


Market Skimming

Many are predicting a firesale in laptops as supply exceeds demand.

- High price, Low volumes
- Skim the profit from the market
- Suitable for products that have short life cycles or which will face competition at some point in the future (e.g. after a patent runs out)
- Examples include: Playstation, jewellery, digital technology, new DVDs, etc.

Value Pricing



Value Pricing

- Price set in accordance with customer perceptions about the value of the product/service
- Examples include status products/exclusive products

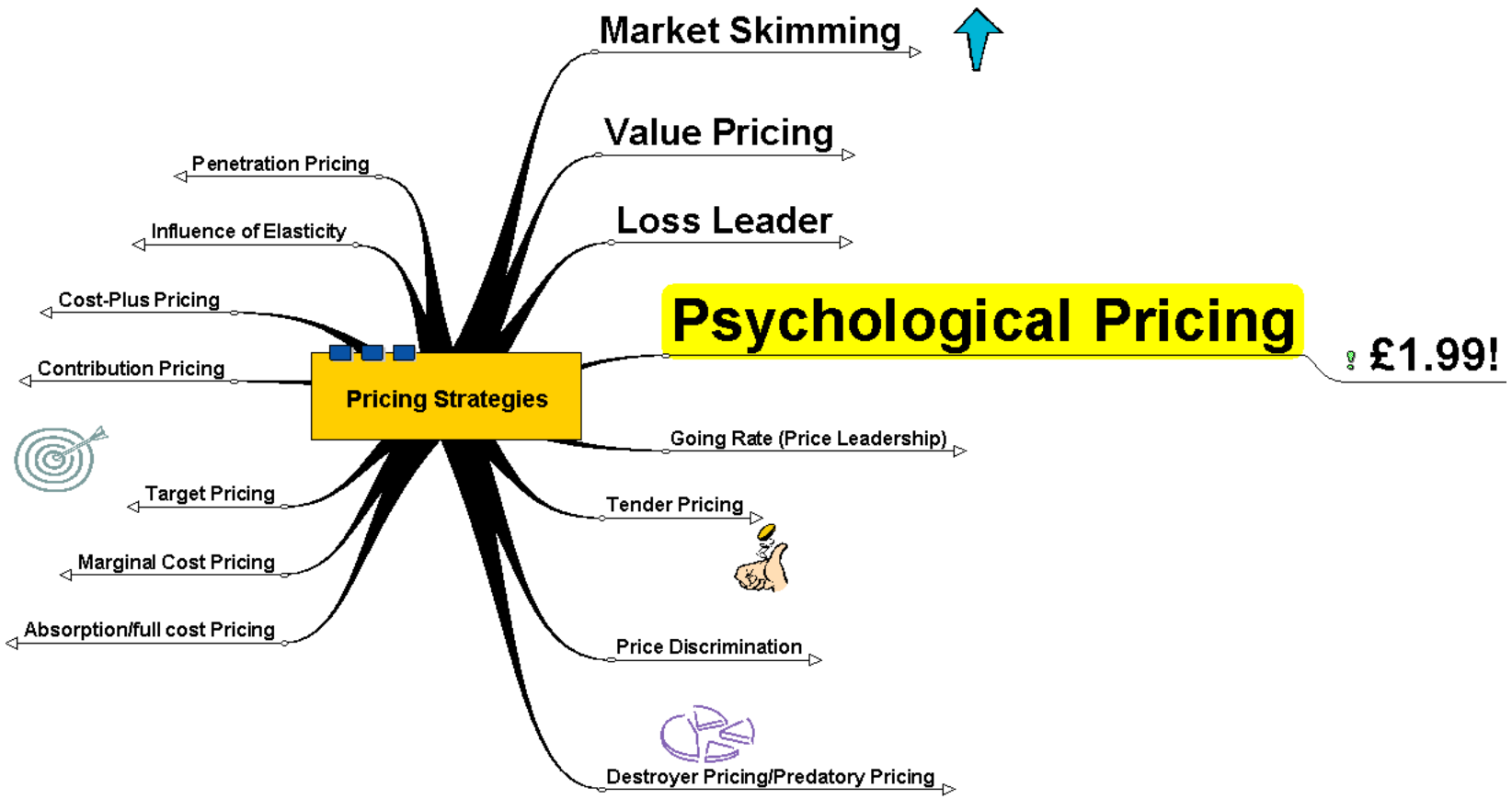
Companies may be able to set prices according to perceived value.

Loss Leader

Loss Leader

- Goods/services deliberately sold below cost to encourage sales elsewhere
- Typical in supermarkets, e.g. at Christmas, selling bottles of gin at £3 in the hope that people will be attracted to the store and buy other things
- Purchases of other items more than covers ‘loss’ on item sold
- e.g. ‘Free’ mobile phone when taking on contract package

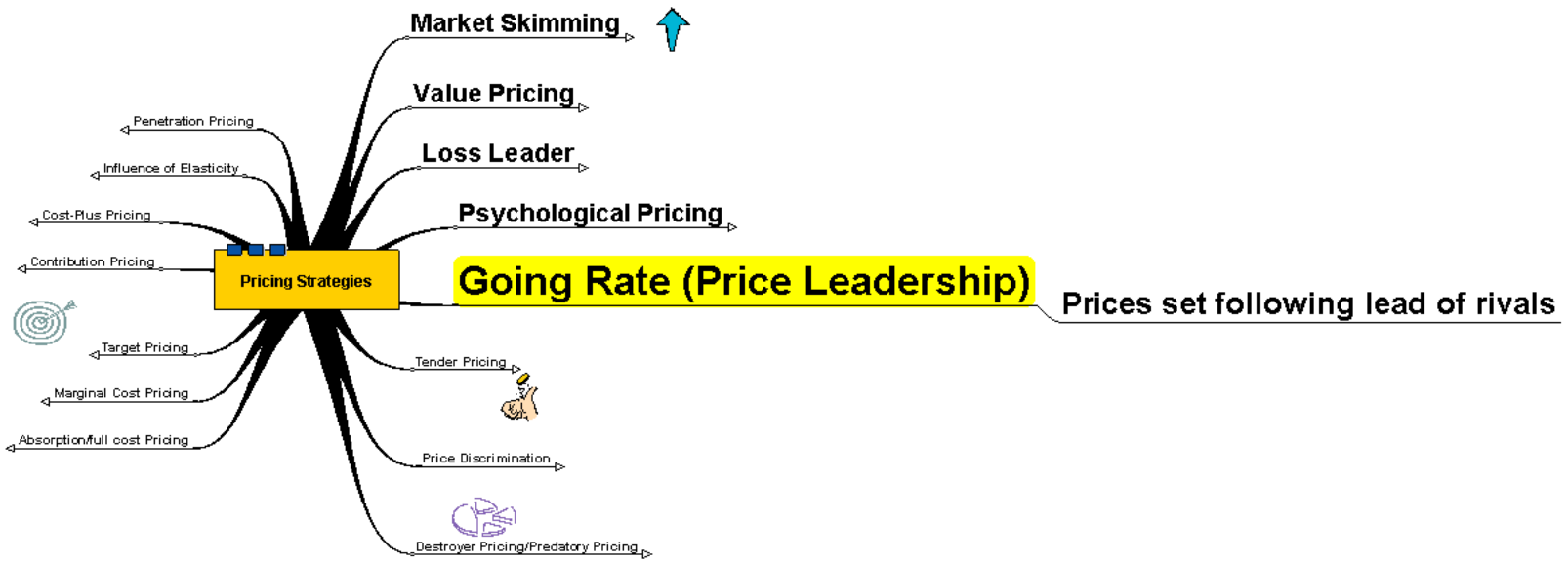
Psychological Pricing



Psychological Pricing

- Used to play on consumer perceptions
- Classic example - £9.99 instead of £10.99!
- Links with value pricing – high value goods priced according to what consumers THINK should be the price

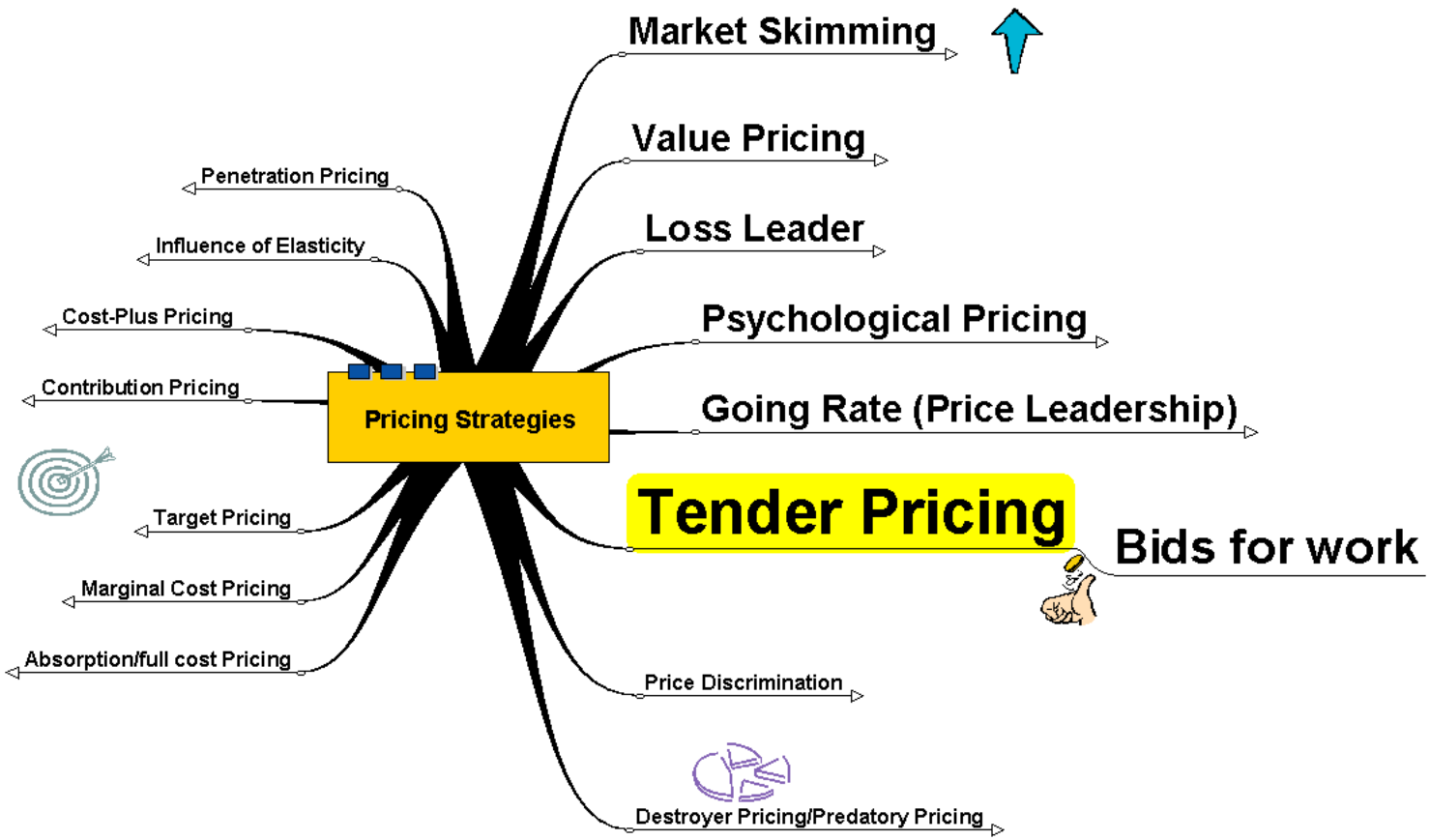
Going Rate (Price Leadership)



Going Rate (Price Leadership)

- In case of price leader, rivals have difficulty in competing on price – too high and they lose market share, too low and the price leader would match price and force smaller rival out of market
- May follow pricing leads of rivals especially where those rivals have a clear dominance of market share
- Where competition is limited, 'going rate' pricing may be applicable – banks, petrol, supermarkets, electrical goods – find very similar prices in all outlets

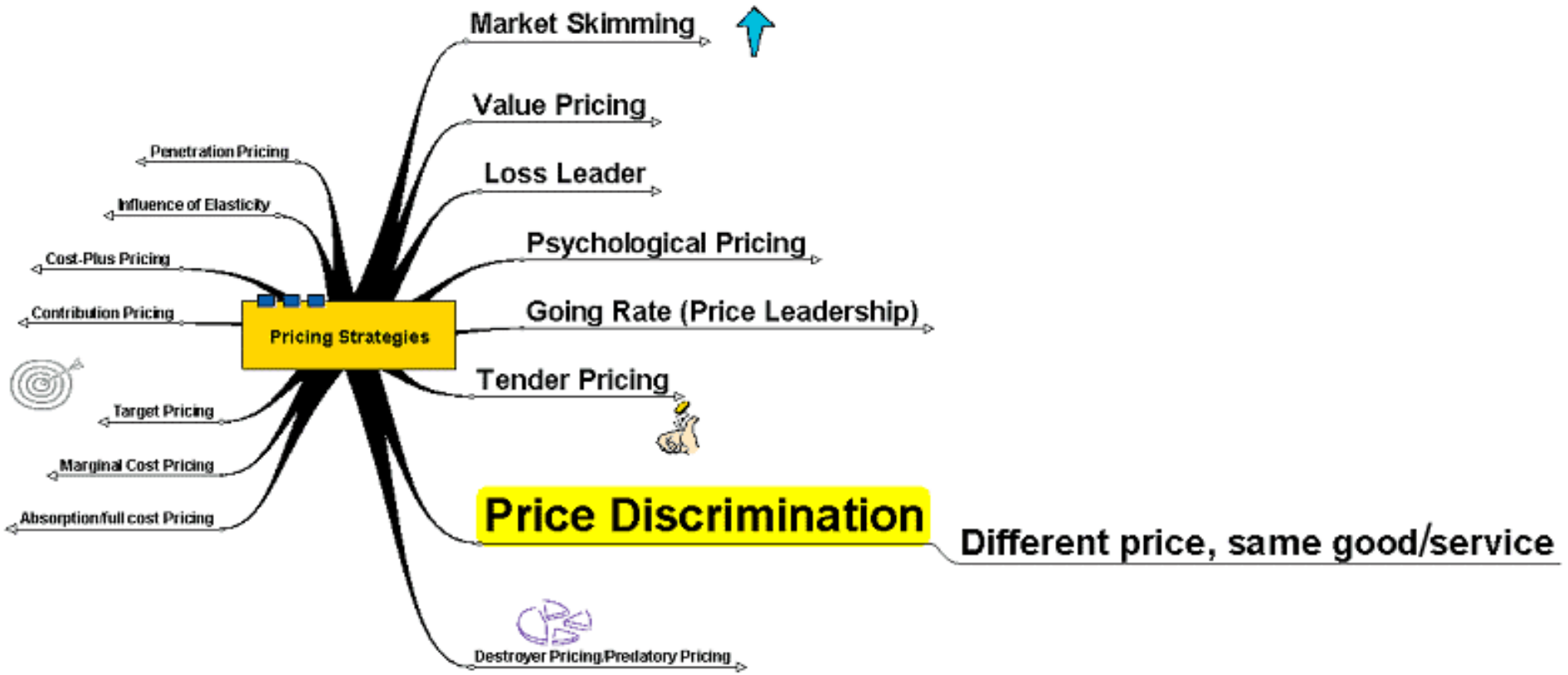
Tender Pricing



Tender Pricing

- Many contracts awarded on a tender basis
- Firm (or firms) submit their price for carrying out the work
- Purchaser then chooses which represents best value
- Mostly done in secret

Price Discrimination

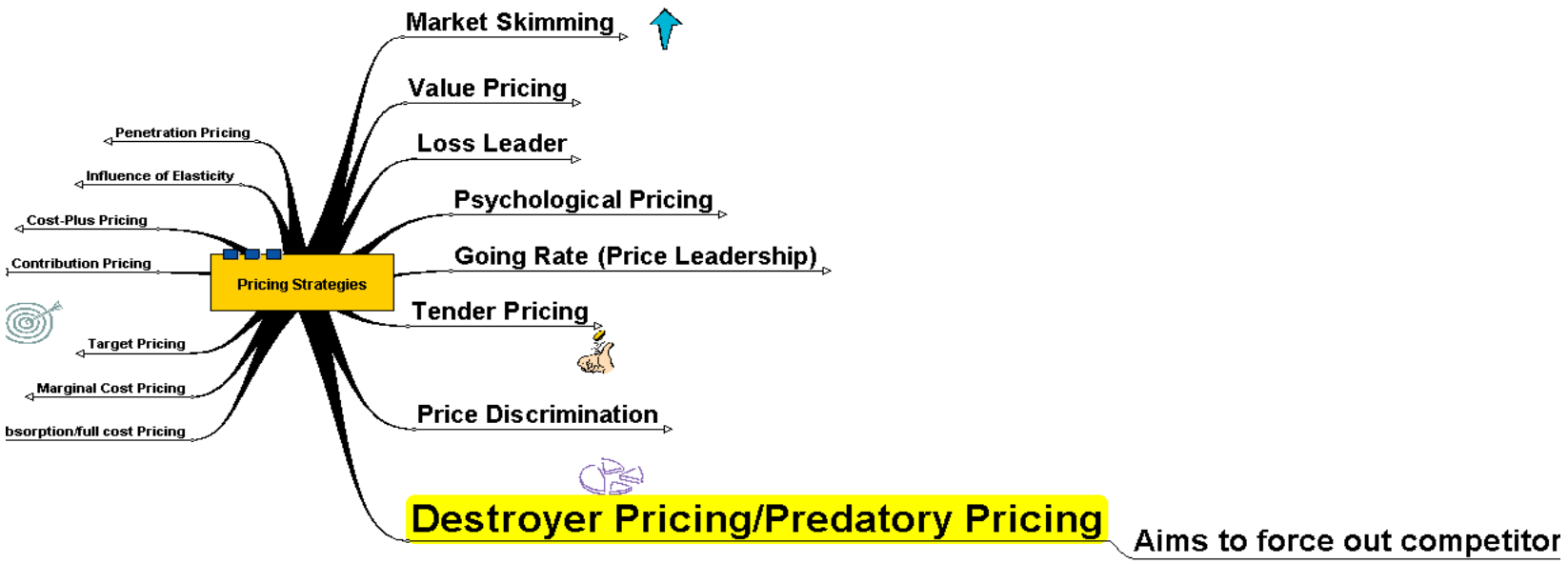


Price Discrimination

Prices for rail travel differ for the same journey at different times of the day

- Charging a different price for the same good/service in different markets
- Requires each market to be impenetrable
- Requires different price elasticity of demand in each market

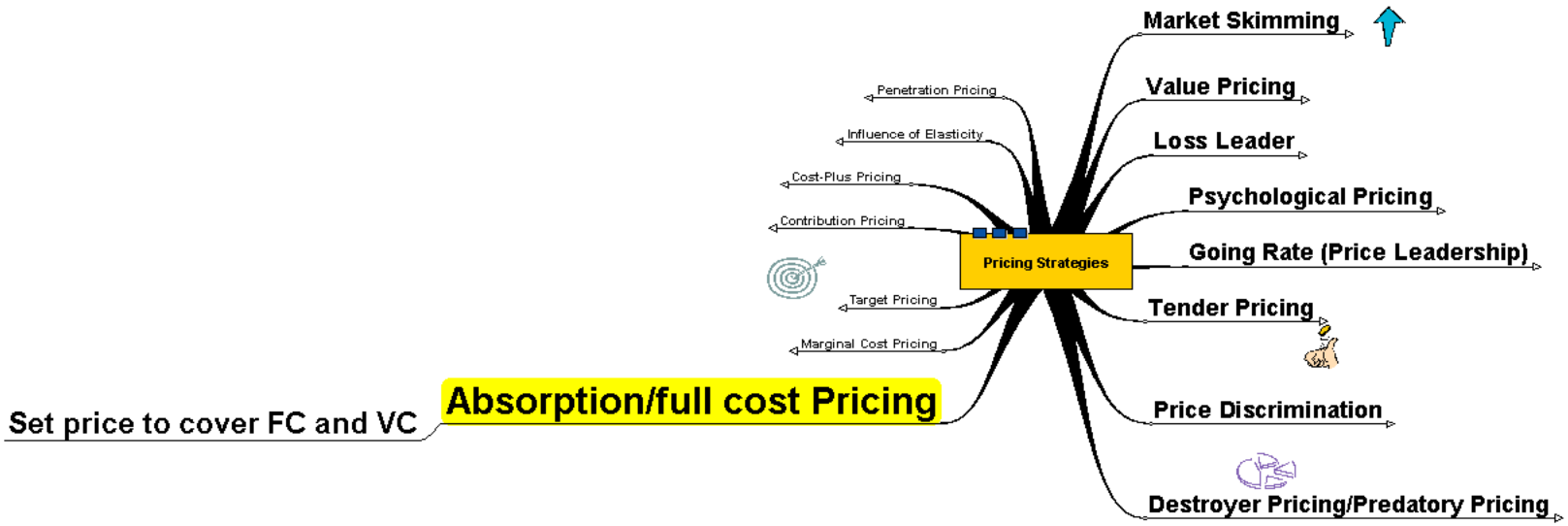
Destroyer Pricing/Predatory Pricing



Destroyer/Predatory Pricing

- Deliberate price cutting or offer of ‘free gifts/products’ to force rivals (normally smaller and weaker) out of business or prevent new entrants
- Anti-competitive and illegal if it can be proved

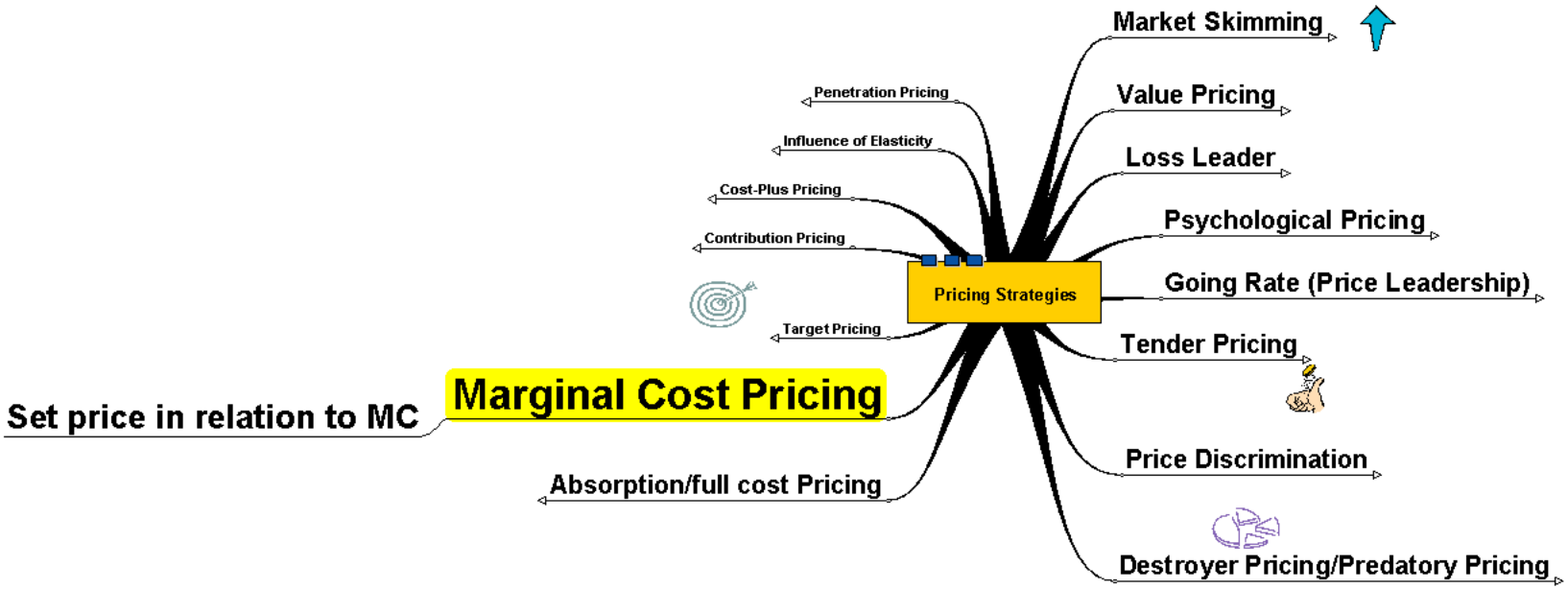
Absorption/Full Cost Pricing



Absorption/Full Cost Pricing

- Full Cost Pricing – attempting to set price to cover both fixed and variable costs
- Absorption Cost Pricing – Price set to 'absorb' some of the fixed costs of production

Marginal Cost Pricing



Marginal Cost Pricing

- Marginal cost – the cost of producing ONE extra or ONE fewer item of production
- MC pricing – allows flexibility
- Particularly relevant in transport where fixed costs may be relatively high
- Allows variable pricing structure – e.g. on a flight from London to New York – providing the cost of the extra passenger is covered, the price could be varied a good deal to attract customers and fill the aircraft

Marginal Cost Pricing

- Example:

Aircraft flying from Bristol to Edinburgh – Total Cost (including normal profit) = £15,000 of which £13,000 is fixed cost*

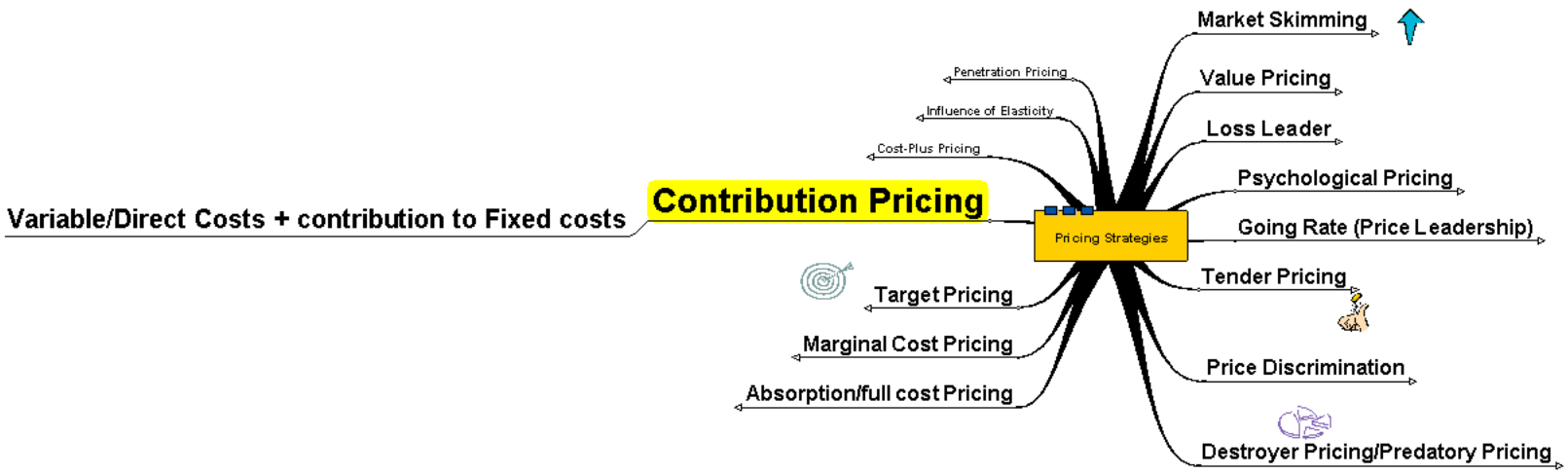
Number of seats = 160, average price = £93.75

MC of each passenger = 2000/160 = £12.50

If flight not full, better to offer passengers chance of flying at £12.50 and fill the seat than not fill it at all!

***All figures are estimates only**

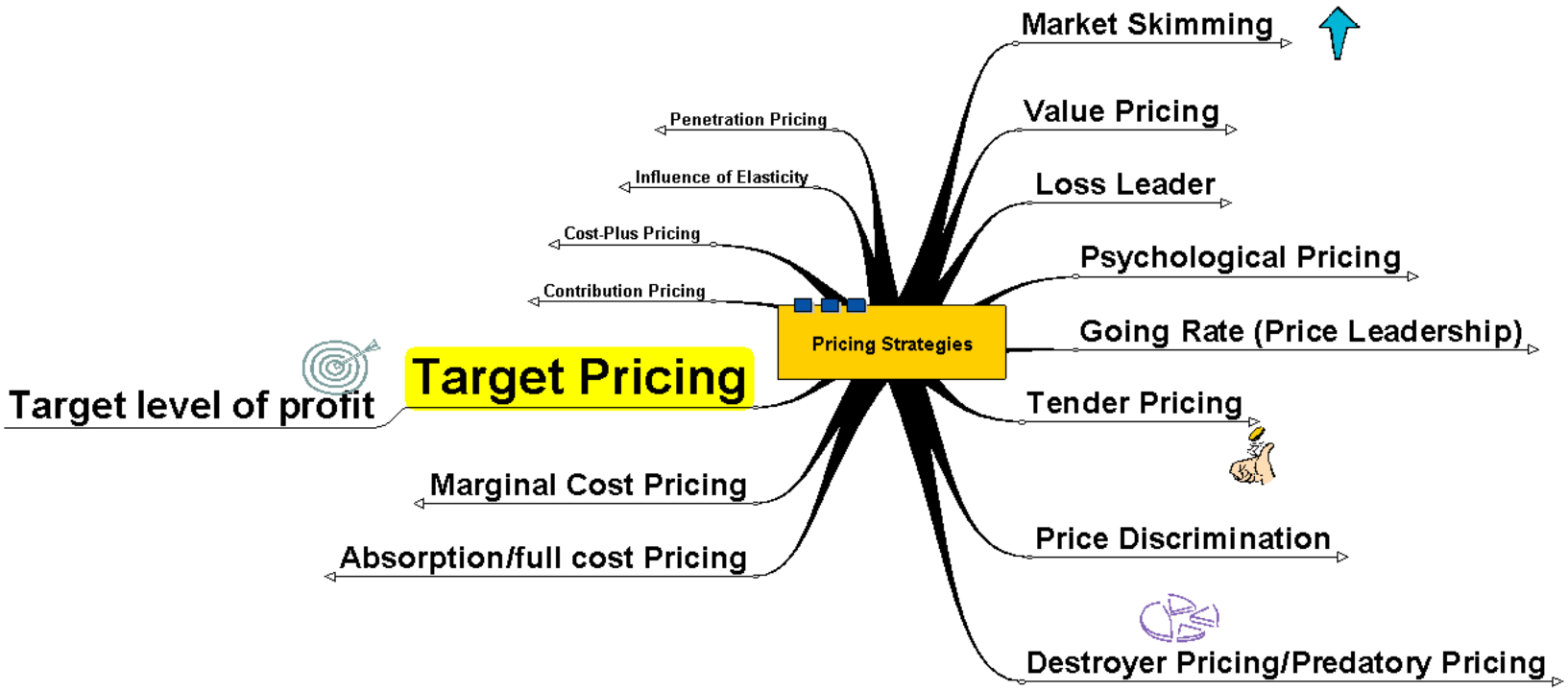
Contribution Pricing



Contribution Pricing

- **Contribution = Selling Price – Variable (direct costs)**
- Prices set to ensure coverage of variable costs and a ‘contribution’ to the fixed costs
- Similar in principle to marginal cost pricing
- Break-even analysis might be useful in such circumstances

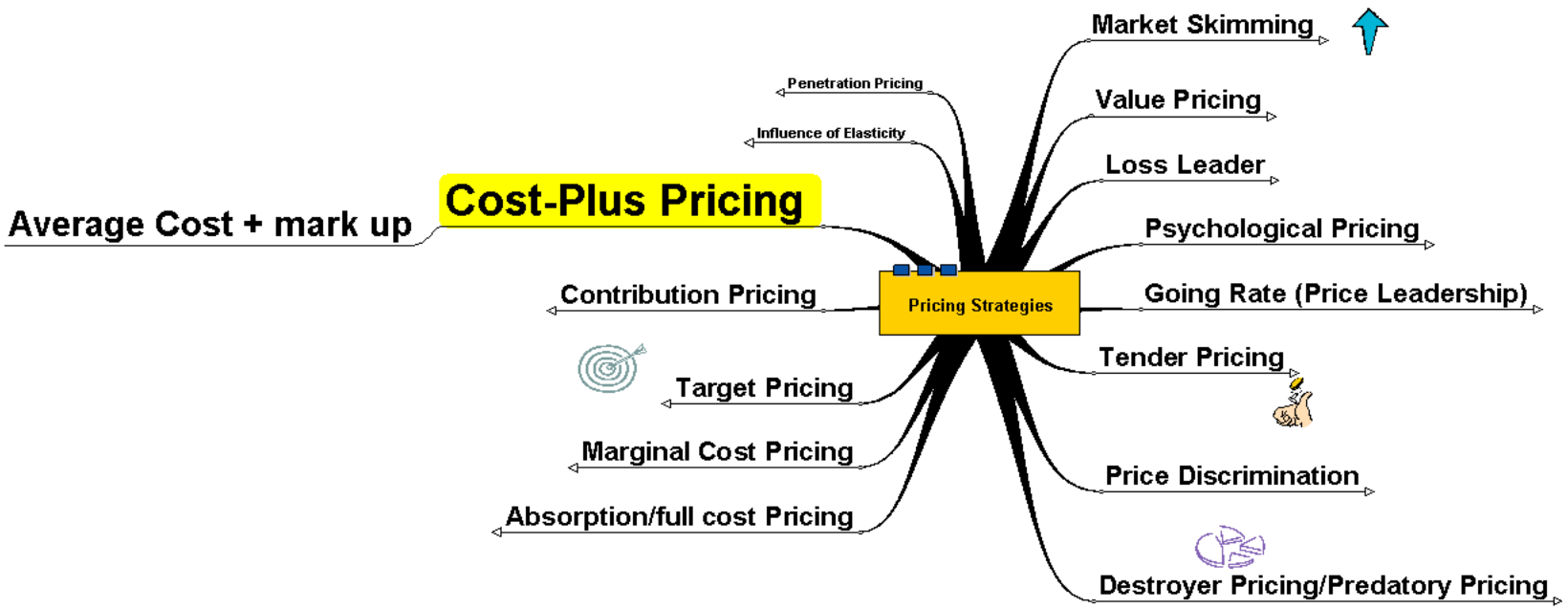
Target Pricing



Target Pricing

- Setting price to ‘target’ a specified profit level
- Estimates of the cost and potential revenue at different prices, and thus the break-even have to be made, to determine the mark-up
- Mark-up = Profit/Cost x 100

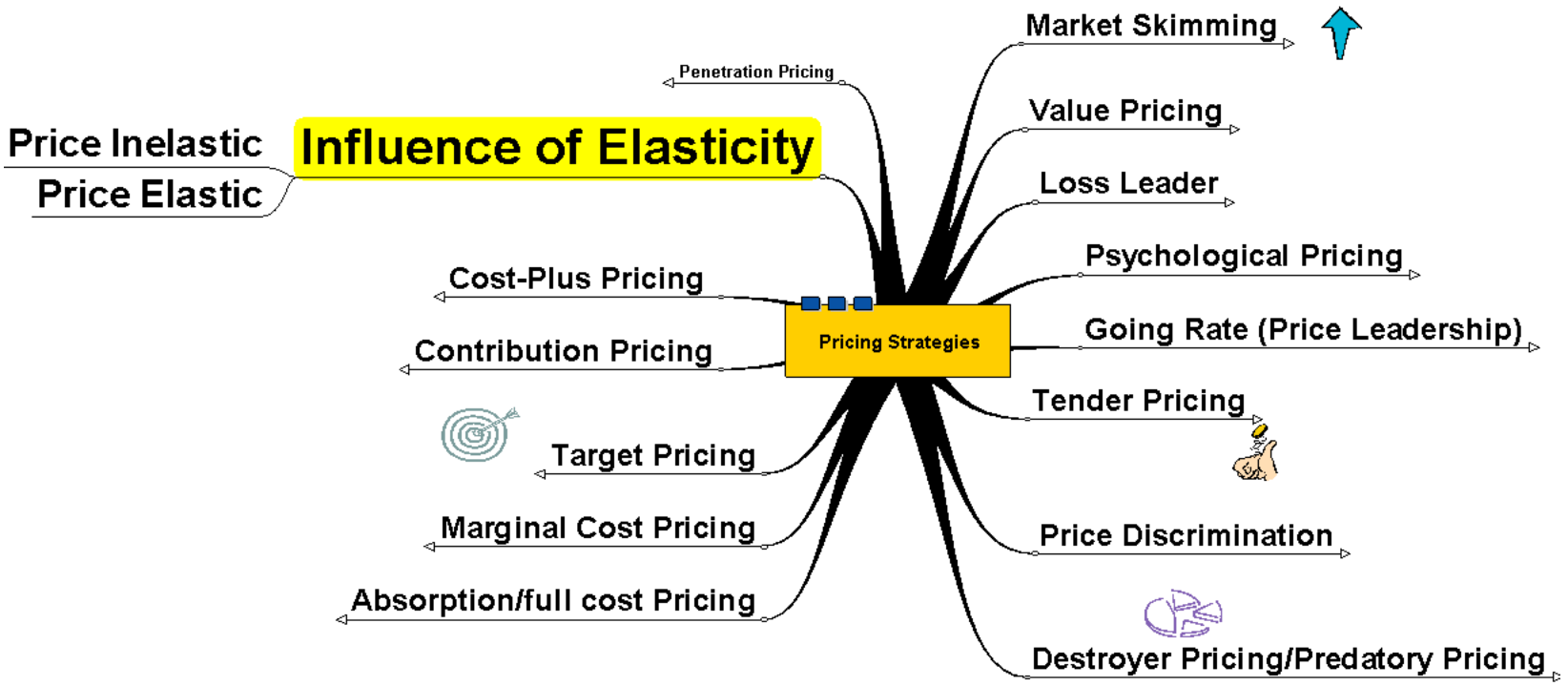
Cost-Plus Pricing



Cost-Plus Pricing

- Calculation of the average cost (AC) plus a mark up
- AC = Total Cost/Output

Influence of Elasticity



Influence of Elasticity

- Any pricing decision must be mindful of the impact of price elasticity
- The degree of price elasticity impacts on the level of sales and hence revenue
- Elasticity focuses on proportionate (percentage) changes
  - **PED = % Change in Quantity demanded / % Change in Price**

Influence of Elasticity

- **Price Inelastic:**
- % change in Q < % change in P
- **e.g.** a 5% increase in price would be met by a fall in sales of something less than 5%
- Revenue would rise
- A 7% reduction in price would lead to a rise in sales of something less than 7%
- Revenue would fall

Influence of Elasticity

- **Price Elastic:**
- % change in quantity demanded > % change in price
- **e.g.** A 4% rise in price would lead to sales falling by something more than 4%
- Revenue would fall
- A 9% fall in price would lead to a rise in sales of something more than 9%
- Revenue would rise