Pricing strategies

Penetration Pricing

Price set to ‘ penetrate the market’

‘ Low’ price to secure high volumes

Typical in mass market products – chocolate bars, foodstuffs, household goods, etc. Suitable for products with long anticipated life cycles

May be useful if launching into a new market

Market Skimming

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, digitaltechnology, new DVDs, etc.

Value Pricing

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

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

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 (PriceLeadership)

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

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

PriceDiscrimination

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/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

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 – 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

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

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

Calculation of the average cost (AC) plus a mark up

AC = Total Cost/Output

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

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

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