Price quotes and pricing decisions applied problems

Business

Problem a) Under a skimming strategy, an organization prepares a high original price. The aim in this case is to pursue s who are ready and willing to meet the high price. The objective of the company in this case is to recover its investment as fast as possible.

Under Penetration pricing strategy, an organization sets a low initial price. This may be due to the presence of competing products in the market.

It is a fact of business that Firms use diverse strategies for their products. The strategy preferred depends on the stage of life cycle in which the product is in. Products may be in different stages of their life cycle in various markets. My advice to the " Honest Company" would be to embrace the penetration pricing strategy for the following reasons:

Jessica is a famous actress and her name is common in most households. She may even have a cult like following meaning everything she endorses will be popular with the masses, this factor can make penetration pricing successful.

The products they are dealing with are basic consumer products used in the house hold on a daily basis. Penetration pricing would set of a " price war" enabling them to market a product at the price that is the lowest in comparison with all competitors. Though the price is lower that the value of the product, it will draw in new customers to try the products

The products that the " Honest Company" deals in are in a growing market as the population is more demanding and knowledgeable requiring more quality cleaning items, more nutritious food stuffs etc. hence penetration pricing is recommended.

Penetration pricing can prevent competitors from cutting into your market at lower price points. If your upfront price is low and your product or service is of reasonable quality, the burden falls on other providers to justify higher prices on similar offerings

b)

Yes they will continue to make profits in the long term. The Honest Company will be able to enter the five different markets faster using penetration pricing as potential customers will venture to try the product. This will in turn grow their market share and generate economic profits based on this market share even in the long term.

Penetration pricing will create goodwill and even loyalty among the early adopters segment. This will create more trade through word of mouth and this will result in economic profits.

Penetration pricing also creates high stock turnover throughout the distribution channel which will result in economic profits and increased enthusiasm and support in the supply chain for the product in the long term.

No they will not continue to make profits. It is argued against penetration pricing in that in the long term penetration pricing establishes long term price expectations for the product, and image preconceptions for the brand and company. This makes it difficult to eventually raise prices.

Some have argued against penetration pricing claiming that it only attracts the switchers (bargain hunters), and that they will switch away as soon as the price rises. Another potential disadvantage of penetration pricing is that the low profit margins may not be sustainable long enough for the strategy to be effective.

a) I would advise the Honest Company to use a variation of the price penetration strategy in the long term. This variation seeks to bait and hook the potential customer by introducing the product at the starter at a very low price but requiring more expensive replacements which are sold at a higher price e. g. such as refills. Thus the company will make more money from the refills or replacements than it does for the product itself.

The honest company can also use the noncompetitive approach to ensure profits in the long term. This is possible through emphasizing product features, service, quality etc. this will build customer loyalty towards the brand as it is distinguished through unique product features. Customer must be able to perceive the differences in brand which will result in higher turnover and consequently in economic profits. Any Price differences or increases must be offset by the perceived benefits and desirability in the customers view.

Problem 2:

Our company

Incremental costs are 268, 000

Incremental costs plus 60-80 % 60% x 268, 000 = 160, 800

Total incremental costs 160, 800+ 268, 000= 428, 800

Our own company full costs 440, 000

Full cost plus the incremental e: 440, 000+ 428, 800= 868, 800

Rival A

Incremental costs are 10% more than ours i. e. 110% of 268, 000 = 294, 800

Incremental cost plus 35- 50% i. e. 35% x 294, 800 = 103, 180

Total incremental cost 103, 180+ 294, 800 = 397, 980

Full cost + the incremental cost 440, 000+ 397 980 = 797, 980

Rival B

Has a similar cost structure to our own

Full cost of rival B is 8 – 12 % more therefore: 440, 000 x 108% = 475, 200

Incremental costs are also similar to ours i. e. 428, 000 = 428, 000

Full cost + Incremental cost 475, 200 + 268, 000= 904, 000

Rival C

This company has Full cost plus 10- 15% and 20% lower incremental costs

Full cost therefore will be 110% x 440, 000 = 484, 000

Incremental costs are 20% lower i. e. 80% x 268, 000 = 214, 400

Full cost + incremental cost is therefore 484, 000 + 214, 400 = 698, 400

a) What price would you bid if you must win the project?

For our company to win the tender, we must quote a price lower than Rival B, who have quoted 793, 980. We should quote lower than 793, 980.

This is because analyzing the other companies on the criteria given Rival C has the lowest price, but they also have the lowest capacity to deliver, they also have no goodwill in the market and this doesn’t concern them in the least bit. The kind of project is also not ideal for them as it’s a standard project that doesn’t give room for much creativity.

Rival B has a similar cost structure to ours, moderate goodwill and the bid price is much higher than ours therefore no threat. The decision maker is also looking to move companies therefore lack commitment to do much about the bid.

This leaves Rival A as our main competitors seeing that their bid price is lower than ours and the decision maker is a relative to the buyer they are strong competitors.

They cons they face however is that there operations are small and inefficient so we can improve our efficiency and quote a lower bid price. They also do not like working winter jobs and this is a winter job.

b) What price would you bid if you want to maximize the expected value of the contribution from this contract?

To maximize the expected value of this contribution our company should increase capacity and efficiency and reduce the percentage of our incremental cost to less than our Rival A i. e. less than 35%

E. g. if we used 33% . the calculation would therefore be 268, 000+ 88, 440 (33% x 268000) + 440, 000 = 796, 440

The price we should bid at is 796, 440