Module 1: Pricing

Overview:

Product and service pricing is one of the most complex and difficult decisions that a business owner has to make as there are a number of different factors that have to be taken into consideration, in addition to how to price the product. One must also determine when payment will occur (e.g., prior to usage or delivery; during usage or delivery; or after usage or delivery). The bottom line is do not leave the pricing of products or services to the accountants!!! They should be involved **BUT** they are only a component of this process as we will see.

Learning Outcomes:

By the end of the module learners will

- Be able to analyse factors impacting pricing
- Evaluate different approaches to pricing

Factors affecting pricing

The factors around pricing that need to be taken into pricing decisions are both internal and external.

On the internal side we must consider organisational and marketing objectives and costs. Organisational and marketing factors are directly influenced by the strategy of the company. For example, if the organisation seeks to position itself at the "high-end" of the market then the pricing needs to match with this.

As you have seen in the Operational Management module, there are two key types of costs that need to be taken into consideration: fixed and variable. The fixed costs are going to occur

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whether we sell nothing or everything. The variable costs occur in relation to something we are selling.

Similarly, the costs also need to be considered. Bigger organisations, or organisations that buy more of a particular product can bargain a better cost for the items they sell. For example, IKEA purchases tens of thousands (or even millions) of a specific type of glassware, whereas a small retail shop may only buy a few hundred pieces. IKEA's overall costs, therefore, will be lower and they can then decide where they want to position themselves in the marketplace when it comes to such items.

On the external factors side we need to look at the economics of the marketplace; customers; competition; distribution channels; and any specific regulations (minimum or maximum price for certain products).

The economics of the marketplace needs to consider the demand for what it is that we are providing, versus how much customers are willing to pay for that. Some of the factors impacting what someone is willing to pay for what is being offered include: the values/benefits or quality of the offering; the differentiation of the offering versus other offerings; and whether there are alternatives for the offering.

The overall number of customers/consumers needs to be addressed, and how easily they can find substitutes for what we are providing. The amount of competition and competitive rivalry as well as how we get our products and/or services to customers (logistics, channels of distribution) will impact what we are able to price at. Finally, where applicable, the regulations related to particular products need to be evaluated (e.g., price controls). Finally, one also needs to consider the current environment (e.g., pandemic, economic crisis) and how this may impact the overall price.

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Activity 1:

Decide whether the statements below are true or false.

Statements	True/False
1. When demand is high, prices generally go up	
2. Customers are not willing to pay above market prices for goods	
3. When costs are reduced, pricing must go down	
4. The more competitors the lower the price	
5. Online distribution generally allows us to reduce prices	
6. Price is a psychological factor in deciding to purchase or not	

Breakdown of answers:

1. **True:** When there is many customers wanting to buy the same things, their prices may go up.

2. **False:** If the product is of high quality, handmade, etc. the customers may be willing to pay above market prices for such goods.

3. **False:** Not always. If you can reduce the costs of manufacturing, you don't need to reduce the price. Lower costs will generate higher profit.

4. **True:** If there are many competitors offering similar products, the competition among them may result in the drop of prices. On the contrary the more unique the product and fewer competitors, the prices are more resilient for the competition.

6. **True:** Online distribution avoids many of the costs typical for traditional/physical distribution.

7. **True:** Very often customers evaluate the product through its price. Too high or too low prices might scare them away.

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Different approaches to pricing:

At its core, there are three pricing approaches that companies generally follow: Cost-Based Pricing; Value-Based Pricing; and Competition Based Pricing. We also have pricing strategies related to new products/entrants into the marketplace and what is called psychological pricing.

Cost-Based Pricing:

In Cost-Based Pricing we can look at the overall costs associated with the item, and then mark-up the price by a percentage. Other options with this include break-even pricing which considers the point at which the price does not earn money but does not lose money either. Final target-return price looks at how much we wish to have in our pockets after selling, and this is translated into the price that needs to be charged.

Value-Based Pricing:

Value-Based Pricing requires a much more subtle approach to price determination. Here we must attempt to understand the perceived value of a product or service and then price accordingly. For example, your business is going to provide cooked Christmas turkeys to customers. How much is the perceived value of having a well presented, cooked, turkey delivered one's house on Christmas Day, given that the customer will not have to spend their entire day in the kitchen?

Competition-Based Pricing:

Competition-Based Pricing is based on a carefully scanning of the marketplace to determine the "going price" for your product or service. We see this happen a lot with the price of fuel in some countries, where the price is set by the "market".

When new products or organisations enter the market, a market skimming or market penetration strategy is normally applied.

- In market skimming, an organisation will try to price at the "highest" possible price that customers who MOST want the product are willing to pay. A company needs to look at

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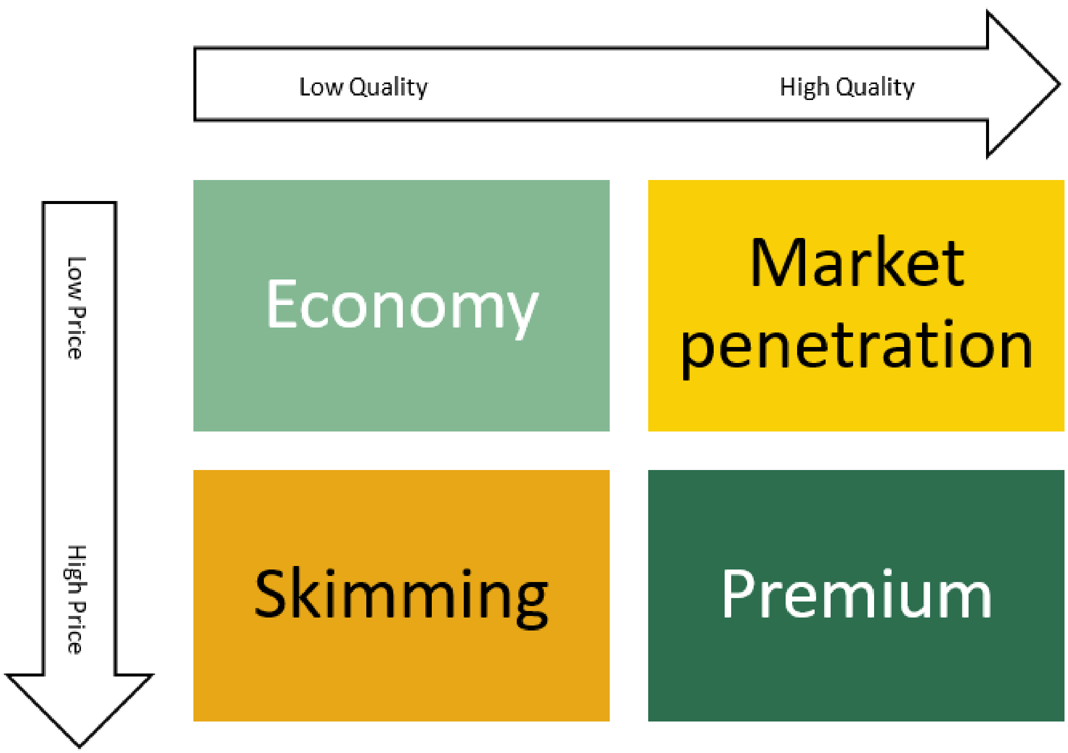
the perceived value of the product/service and how loyal customers are to the product/service. This is the strategy that Apple uses each time they bring a new iPhone to market.

- Market penetration pricing occurs when a company prices its product/service below the prices of competing brands in order to penetrate a market and sell a large volume of units. This can lead to faster adoption by the market, greater market share, and/or discourage competitors from entering the market or encourage them to leave the market. We have seen this strategy applied by new supermarket chains coming into a specific market



Pricing strategy:

A final pricing strategy is based on the psychology of customers. The three key categories include: prestige pricing; bundle pricing; and promotional pricing.

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- Prestige/premium pricing: this pricing is based on the overall prestige (luxury) of the company or the product itself.
- Bundle pricing: this strategy is based on a more attractive price based on the one-time purchase of a number of goods or services. For example, a company offers a 20% discount if a customer buys a kilo of tomatoes; a kilo of cucumbers; and salad cream.
- Promotional pricing: this is a limited time, special price, for the product/service. This is used to attract people into a store or website with the intention of selling other items as well.

It is important to note that psychological pricing strategies are not mutually exclusive and can be combined (e.g., bundle and promotional pricing- for a limited time a there may be a special price if you buy three different types of pasta).

Activity 2:

Frank, Ioannis, Anna, and Petya are about to open a new hair salon called Top Cuts Hair Style. Their mission is to be the preferred hair salon in their city for those that truly care about making a fashion statement. Besides cutting hair, the four entrepreneurs have also decided to have a small retail shop in their hair salon that will sell hair care related products (e.g., shampoo, conditioner, brushes, hair-dryers). Based on the information provided choose 3 top pricing strategies applicable for this case.

** There is no single correct answer to this exercise, it will help you develop your judgement.

Pricing Strategies	Selection
1. Cost-Based	
2. Value-Based	
3. Competition-Based	
4. Market Skimming	
5. Market Penetration	

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6. Prestige/premium Pricing	
7. Bundle Pricing	
8. Promotional Pricing	

Breakdown of answers:

1. **Cost-Based:** This strategy is based on the overall costs associated with the particular item and then mark-up the price by a percentage. This strategy is generally universal for most businesses.
2. **Value-Based:** This strategy is based on attempting to understand the perceived value of a product or service, and then pricing accordingly. This strategy could be used in this case if customers will value the services offered by the hair salon.
3. **Competition-Based:** This strategy is based on careful scanning of the marketplace to determine the "going rate" for your product or service. This strategy could be used in this case, if the prices in the hair salon will be much higher than in hair salons nearby, then the customers wouldn't be attracted.
4. **Market Skimming:** This strategy is based on an approach where an organisation will try to price at the "highest" possible price that customers who MOST want the product are willing to pay. This strategy is risky in this case, as the customers may perceive the services as overpriced.
5. **Market Penetration:** This strategy is based on an approach where a company prices its product/service below the prices of competing brands in order to penetrate a market and sell a large volume of units. This strategy could be useful at the beginning as lower prices could attract more customers.
6. **Prestige/Premium Pricing:** This strategy is based on the overall prestige (luxury) of the company or the product itself. This strategy could be used in the long-term if the hair salon would manage to become top of the hair salons in the city.
7. **Bundle Pricing:** This strategy is based on a more attractive price based on the one-time purchase of a number of goods or services. This strategy could be used in the retail shop, as well as for the customers who use more services (or use services systematically).

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8. **Promotional Pricing:** This is a limited time, special price, for the product/service. This is used to attract people into a store or website with the intention of selling other items as well. This strategy could be useful at the beginning as lower prices could attract more customers.

Quiz: Check your understanding

- Competition-based Pricing focuses on:
    A. The overall costs associated with the particular item and then marking-up the price by a percentage.
    B. The overall prestige (luxury) of the company or the product itself.
    C. Scanning of the marketplace to determine the "going rate" for your product or service.
    D. More attractive price based on the one-time purchase of a number of goods or services.
- When your product is high quality, but you decide to price it low, you would follow the:
    A. Market penetration strategy.
    B. Economy strategy.
    C. Market skimming strategy.
    D. Bundle pricing strategy.
- "A limited time, special price, for the product/service, used to attract people into a store or website with the intention of selling other items as well" is the definition of which pricing strategy?
    A. Competition-based strategy.
    B. Promotional pricing strategy.
    C. Value-based strategy.
    D. Prestige/premium pricing strategy.

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Breakdown of answers:

1. **C** Competition-Based Pricing is based on a carefully scanning of the marketplace to determine the "going rate" for your product or service. We see this happen a lot with the price of fuel in some countries, where the price is set by the "market".
2. **A** This strategy is based on an approach where a company prices its product/service below the prices of competing brands in order to penetrate a market and sell a large volume of units.
3. **B** Promotional Pricing is a limited time, special price, for the product/service. This is used to attract people into a store or website with the intention of selling other items as well. This strategy could be useful at the beginning as lower prices could attract more customers

References and further reading:

1. The Pricing Strategy Matrix: Selling Your Product or Service at the Ideal Price. https://www.mindtools.com/pages/article/pricing-strategy-matrix.htm
2. Pricing Strategies https://open.lib.umn.edu/principlesmarketing/chapter/15-3-pricing-strategies/
3. Real-World Pricing Strategy Examples available on: https://www.freshbooks.com/hub/leadership/12-real-world-pricing-strategy-examples

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