Types of Strategy

- Cost based – use production costs as a base
  - Cost-plus, marginal cost, full cost, absorption
- Competition based – basing price on prices charged by rivals
  - Price-leader, predatory, going-rate
- Market-led – based on level of demand
  - Penetration, skimming, discrimination, loss-leader, psychological, promotional

P PRICE

Cost Based – Cost Plus

Taking the cost to produce the product and then adding a percentage (mark-up) to ensure a profit.

If cost = $6 and we want a profit of 50%, we add $3 to set a selling price of $9

Alternatively, if we want to make $4 on each sale, we would set a selling price of $10.

P PRICE

Cost Based – Cost Plus

Total Costs for producing 10,000 units	**£100,000**
Cost per Unit	**£10**
Add mark-up 100% of cost	**£10**
Selling price = cost + mark-up	**£20**

- Easy to calculate
- Doesn't take into account customer sensitivity to price

P PRICE

Competition Based – Price Leader

Often used for best-selling products/brands. Customers perceive there are few substitutes, so the dominant firm sets the price and competitors follow…

Also referred to as 'price maker', with smaller firms being 'price takers'

P PRICE

Market-Led - Penetration

When launching a NEW product, a firm may be enter with a low or high price.

Penetration pricing involves entering at a low price to establish the product, gain recognition and market share and encourage people to 'try it out'.

The price is usually raised to fall in line with competition.

P PRICE

Market-Led - Skimming

Skimming pricing involves entering technological or innovative products at a high price to recover R&D costs and create a unique, high-quality image.

'Early adopters' are happy to pay initial price.
The price will become lower once rivals develop their own versions of the new product or innovations make the product less 'exciting'

Prestige pricing involves setting and maintaining a high price to reinforce brand image through the life-cycle

P PRICE

Evaluation –importance of Price

- A firm's pricing strategy will consist of a combination of various pricing methods.
- It is vital that a balance is struck between profit objectives and the other elements of the marketing mix
- Qualitative factors (quality perception, brand image) and external factors (economy) will also be important considerations.

Marginal/Contribution Cost Pricing

Marginal Cost - the additional cost of producing one more unit of output.

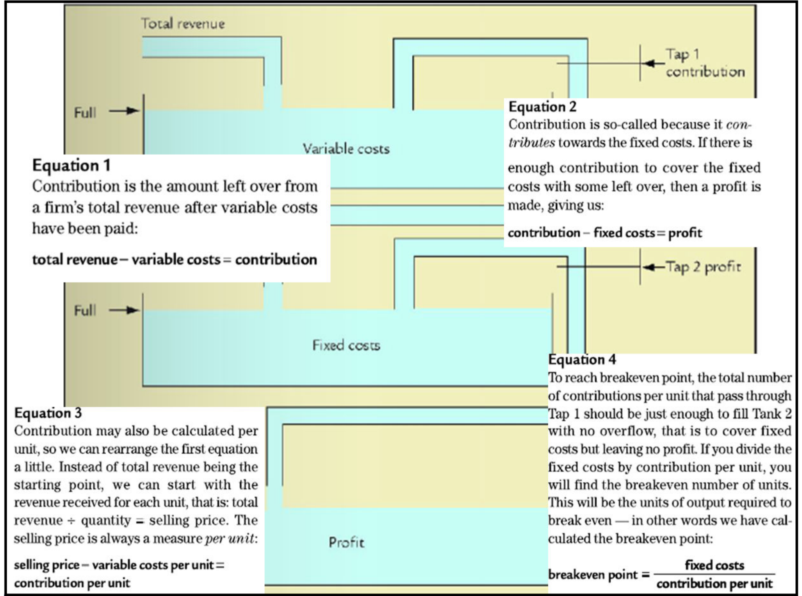
E.g. if it costs $400,000 to produce 100 units and $450,000 to produce 101, the marginal cost is $50

Contribution – the revenue gained from selling a product minus its marginal (variable direct) costs.

If the 101st unit is sold for $70, contribution/unit = $20.

The contribution values are used to pay off the overheads…so overheads payment relies on sales

P PRICE



Marginal/Contribution Cost Pricing

Read and follow through the information and worked example on page 459

Full Cost Pricing

Requires a business to allocate fixed costs between all products sold, enabling all costs of production to be covered by sales.

Uses a single criterion as a basis for allocation (simplistic, inaccurate?).

Worked example page 460 (including advantages/disadvantages)

Absorption Pricing

An extension of full cost pricing that allocates overheads based on usage – fairer, but more complicated.

Example pages 460-1