# AS Business
## Price

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There are a wide variety of pricing strategies available to businesses. Businesses must take into consideration the effects of supply and demand in the marketplace before they decide what pricing strategy they will use.

### Price Takers

The market mechanism, through the interaction of supply and demand, will set the price of products and also determine the quantity supplied. The whole marketing mix is used to influence the pattern of demand in the marketplace, so businesses can have some control over price. However, in certain circumstances, businesses will have to accept the price set by the market. This type of business is known as a price taker. Accepting the market price (being a price taker) is the only option under perfect competition.

### Price Makers


When a business is not a price taker, which is the case in the majority of markets, then it has the opportunity of using pricing strategies.

Pricing strategies fall into two broad groups:

1. **Market-orientated strategies** – businesses are market-orientated when they produce what the market wants. With regard to price, this means that a market-orientated business will set a price at the level the market is willing to accept.
2. **Cost-based strategies** – Businesses that concentrate on internal costs when pricing products are known as product-orientated businesses. Pricing strategies used are based around the costs of production.

### Penetration Pricing

**Definition:** In this case, the objective is to gain market share. It involves pricing a product at a low level so that retailers and consumers are encouraged to purchase the product in large quantities.

- used by businesses seeking to gain a foothold in a market
- raise price once a certain market share is gained.

☑ This pricing strategy can help **establish brand loyalty** – when the price of the product does rise from the initially low level, customers will continue to purchase it.

☒ However, if the price is set too low, **customers may think that the product is low quality** and therefore they will not purchase it in the first place.

☒ Businesses using this policy to break into a new market **may initially lose revenue**. If the life cycle of the product is relatively short, this policy should be avoided, as the business will not have enough time to recover the cost of this strategy. There must be enough time for market share to grow and then the price can be gradually raised and the initial cost of the penetration strategy can be recovered.

### Going Rate Pricing

**Definition:** For many small businesses, accepting the current market pricing structure is all they are able to do. When this is the only option there is a strong element of being a price taker. They must sell their goods or services at a price broadly in line with the price charged by their competitors.

Normally as new entrants enter the market, the price charged will have to be similar to that of the market leader.

### Price Skimming

**Definition:** Market skimming (creaming) involves charging a high price for a product that has a unique selling point (USP) for a limited period. This involves selling a product to the most profitable segment of the market before it is sold to a wider market at a lower price.

Why use the price skimming strategy:

☑ **To take advantage of the newness of the product and gain as much revenue/profit as possible** while it remains unique in the market, i.e. before competitors come into the market with a similar product.

☑ To **generate revenue in a short period of time** so that high R&D costs can be recovered quickly and/or further investment in the product can be made or to cover launch costs/R&D costs.



### Destroyer/Predatory Pricing

**Definition:** This involves setting a price low enough to drive competitors out of the market. This type of pricing is not only used by the largest businesses on a national scale, but it can also appear in battles between local businesses.

Destroyer pricing is often seen as anti-competitive and therefore illegal. Microsoft has been investigated by competition authorities in the US and Europe for allegedly using destroyer pricing strategies through the bundling of free programmes (such as Windows Media Player) within its operating systems.

## Loss Leader Pricing

**Definition:** This strategy involves the selling of products at a loss, with the expectation that this will generate further sales of some form elsewhere in the business. The additional sales that occur will hopefully recoup the initial loss and subsequently make a profit for the business.

Examples include:

- Supermarkets selling goods, like bread, beer and wine, at a loss or heavily discounted in order to attract customers into their stores.
- Free mobile phones, where profits will be made on line rentals. Most mobile phones are now sold on a loss leader basis.

## Psychological Pricing

**Definition:** Using this strategy, prices are set at the level that matches what consumers may expect to pay. Consumers perceive that they are receiving value from the price paid.

For example, a producer of shirts that has established a reputation for quality and style would set a price well above what a high street store such as Marks and Spencer might charge, even though the difference in quality may be marginal. This will help to reinforce the image of the company and will be in line with the advertising messages that the business has put in place.

The policy of pricing goods just a little below a round figure, such as £19.99, is also an example of psychological pricing. Businesses using this tactic hope to convince potential purchasers to buy their goods in the belief that they are getting value for money.

## Cost-Based Pricing Strategies

Businesses that concentrate on internal costs when pricing products are known as product-orientated businesses. Pricing strategies used are based around the costs of production.

## Contribution Pricing

**Definition:** This is another variation on the same theme, but in this case price will be based on the variable costs plus a contribution towards overheads and profits.

This method can give flexibility because orders can be accepted on a different contribution basis for different products. This flexibility allows pricing strategies, such as price discrimination between different buyers, to be used.

## Cost Plus Pricing

**Definition:** Using this method, a profit percentage is added to the average cost of producing the good. This is known as adding a mark-up. Therefore, if the production costs of the good are £1, and the business adds a profit percentage of 40%, then the business will sell the good at £1.40.

Advantage of this simple method of pricing:

- ☑ Changes in costs can be passed directly on to the buyer.
- ☑ Every good sold is sold at a profit.

Disadvantages:

- ☒ Actions of competitors are often totally ignored. This can lead to loss of sales or loss of profits if a higher price could be charged because of little or no competition.
- ☒ Also, for exporters, this method makes no allowance for currency changes that will affect the price of goods and order levels.

## Why is Getting the Right Pricing Strategy Important?

**Advantages of using pricing strategies to maintain the sales of their products:**

- ☑ right strategy will increase sales – increase revenue – profits will rise
- ☑ prices can be applied to specific niche – market segment
- ☑ prices can reflect the market for the product – skimming may work in some markets, i.e. high income and penetration in others
- ☑ prices can take into account actions of competitors – stopping switching etc.

**Disadvantages of using pricing strategies to maintain the sales of their products:**

- ☒ competitors may follow pricing strategy – so no effect – no increase in sales
- ☒ competitors may not follow pricing strategy – customers not attracted
- ☒ need for expensive advertising to promote pricing strategy – so profits not as expected
- ☒ some segments may not be happy with pricing strategy – allowing less well-off to afford expensive products.