Green up

Subtopic 4.10: Pricing strategies

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INTRODUCTION

In this lecture, we will learn about the critical role of pricing in business success. Setting the right price is essential for profitability, market positioning, and customer perception. We will discuss various price setting models, including cost-based, value-based, competitive-based, and dynamic pricing. Additionally, we will explore pricing strategies such as penetration pricing, skimming pricing, psychological pricing and value pricing. Through real-world examples and practical insights, we aim to equip you with the knowledge to make informed pricing decisions.

IMPORTANCE OF PRICING

- Pricing is a critical element of business success. It directly impacts **profitability, market positioning, and customer perception**. The right pricing strategy can drive sales, maximize revenue, and enhance brand value.
- Pricing decisions must consider various factors, including **costs, competition, and customer value.**
- Effective pricing helps businesses achieve a balance between profitability and customer satisfaction. It **influences customer perceptions of product value, quality, and exclusivity.**
- Pricing strategies shape market dynamics and can be used to gain a competitive advantage.
- Pricing flexibility allows businesses to respond to market changes and demand fluctuations.

FACTORS INFLUENCING PRICE SETTING DECISIONS

1. **Production Costs:** The cost of producing a product or service directly impacts pricing decisions. Businesses need to consider expenses such as raw materials, labour, manufacturing, and overhead costs when determining the price. Cost-based pricing models often take into account these production costs.
2. **Market Demand and Competition:** Understanding customer demand and assessing the competitive landscape helps businesses set pricing levels that align with market dynamics. Factors like supply and demand, customer preferences, and competitor pricing strategies need to be considered.
3. **Value Perception by Customers:** The perceived value that customers attribute to a product affects their willingness to pay. Factors such as brand reputation, customer experience, product quality, and the benefits derived from the product contribute to the perceived value.
4. **External Factors:** External factors like economic conditions, industry trends, regulations, and market dynamics can impact price setting decisions. Businesses must consider factors such as inflation rates, exchange rates, governmental policies, and legal requirements that may influence pricing strategies.

COST-BASED PRICING MODEL

- Cost-based pricing is a pricing model that determines the price of a product or service by considering the production and operational costs, along with a desired profit margin. **In its essence it means calculating the total cost per unit and adding a markup to ensure profitability.**
- This model takes into account various cost components, including direct costs (such as raw materials, labour, and manufacturing expenses) and indirect costs (such as overhead expenses, utilities, and administrative costs). By accurately assessing these costs, businesses can establish a baseline for setting prices.
- Once the total cost per unit is determined, a markup percentage is added to ensure the business achieves its desired profit margin. The markup accounts for factors like risk, market conditions, and business goals
- While cost-based pricing provides a straightforward approach, it has limitations. **It does not account for external market factors, customer demand, or perceived value**. It is important to regularly review and update cost data to ensure pricing remains aligned with the market and to adjust pricing strategies as needed.

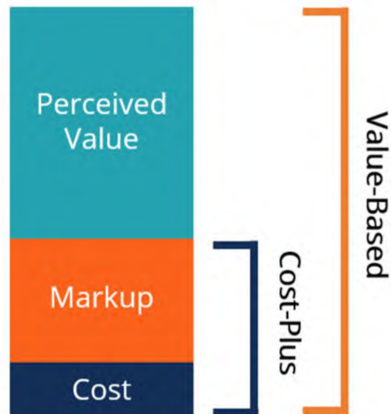
VALUE-BASED PRICING MODEL

Value-based pricing is a pricing model that sets the price of a product or service based on the perceived value it provides to customers. It focuses on capturing a fair share of the value customers attribute to the offering, rather than solely relying on production costs. It recognizes that customers are willing to pay based on the benefits, quality, and unique features they perceive in a product or service.

Businesses adopting this model must understand their target customers, their preferences, and the specific value propositions their product offers. By conducting market research and customer surveys, businesses can gain insights into customer value perceptions and preferences.

Value-based pricing strategies include premium pricing, where prices are set higher than competitors to emphasize superior quality or exclusivity. Bundling strategies, offering different price tiers, or implementing dynamic pricing based on customer segments can also be part of a value-based pricing approach.

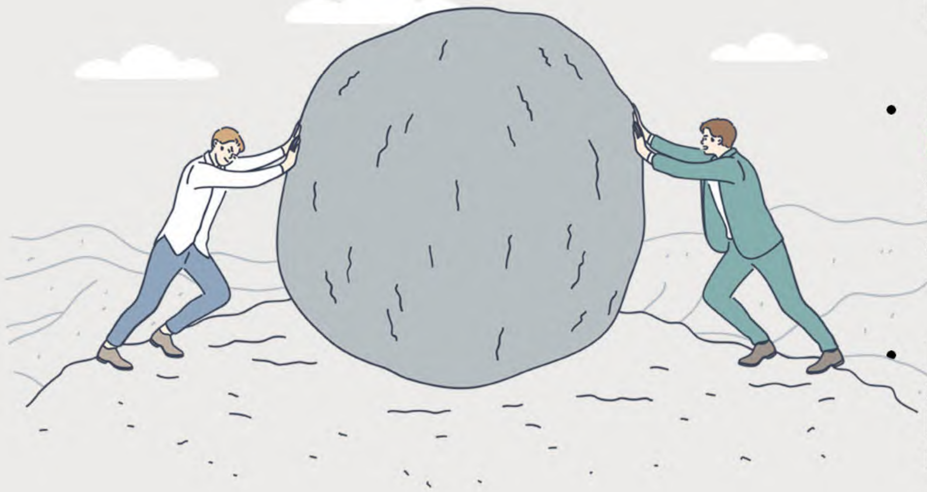
VALUE PRICING STRATEGY



- The perceived value of a product is not only determined by the physical product itself, but also by number of other factors such as:
- **Brand reputation:** A strong, well-regarded brand can increase the perceived value of a product.
- **Customer experience:** This includes everything from the shopping experience, customer service, packaging, and after-sales service.
- **Location of the Store:** A convenient and desirable location can add to the perceived value of a product. If your store is located in a high-end shopping district, customers might perceive your products to be of higher value.
- **Look of the Store:** A well-designed, clean, and inviting store can enhance the shopping experience and increase the perceived value of your products.
- **Social Proof:** Positive reviews, testimonials, and endorsements can significantly boost the perceived value of your product.

Implementing a successful value-based pricing strategy requires not only a deep understanding of your customers and the value they perceive in your product but also effective communication of that value and holistic approach to increasing it.

COMPETITIVE-BASED PRICING MODEL



- Competitive-based pricing is a pricing model that **determines the price of a product or service based on the prices set by competitors** in the market. It involves setting prices relative to the competition to position the offering effectively and maintain competitiveness.

- Businesses adopting this model must conduct thorough market analysis to understand the pricing strategies of their competitors. This includes researching competitors' pricing levels, discounts, promotions, and value propositions to assess their market positioning.

- Based on the competitive analysis, **businesses can choose to set prices lower, higher, or at par with competitors**. Lower prices may be employed to gain market share, while higher prices can convey premium quality or exclusivity. Pricing at par can demonstrate fairness or comparable value.

- It requires **ongoing monitoring** of market dynamics and competitor activities. Regularly reviewing competitor pricing strategies allows businesses to make timely adjustments to maintain competitiveness and respond to market changes effectively.

DYNAMIC PRICING MODEL

- Dynamic pricing is a pricing model where **prices are adjusted in real-time** based on demand, market conditions, and customer behavior. This helps businesses optimize pricing, maximize revenue, and adapt to market changes by monitoring and analyzing data, making timely price adjustments for greater profitability and competitiveness.
- Businesses employing dynamic pricing continuously monitor market conditions, competitor pricing, and customer demand. They use this data to make rapid pricing adjustments, taking advantage of opportunities or mitigating risks.
- It offers benefits such as increased revenue potential, improved competitiveness, and better inventory management. However, challenges include the need for **sophisticated data analysis, potential customer perception issues, and maintaining fairness and transparency in pricing.**

Let's watch the video:
https://www.youtube.com/watch?v=vTWhsgs3ZRA

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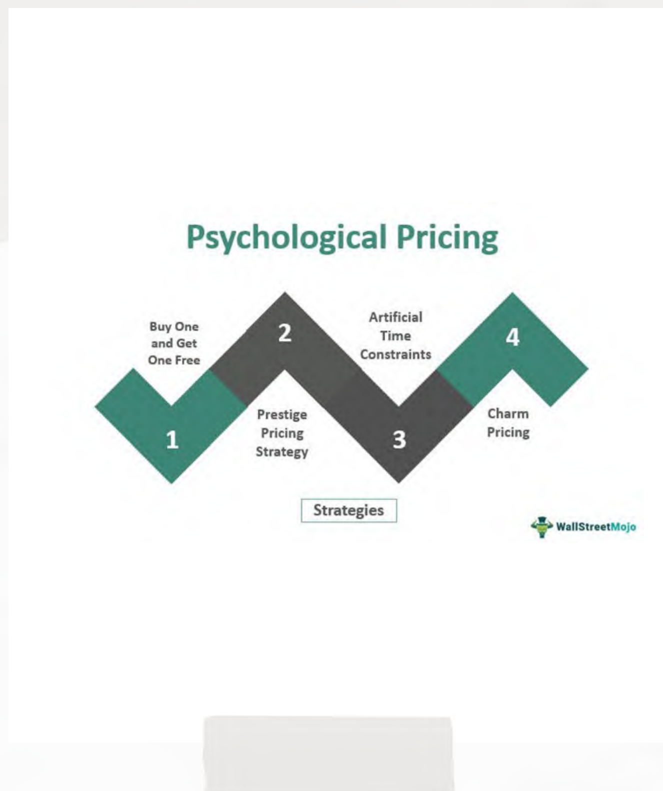
PENETRATION PRICING STRATEGY

- Penetration pricing is a pricing strategy that involves **setting a relatively low initial price for a product or service to enter a market quickly and gain market share**. It aims to attract customers by offering an attractive price point compared to competitors.
- The primary objective of penetration pricing is to capture a significant market share rapidly. By setting a lower price than competitors, businesses can encourage customer trial and adoption. **This strategy appeals to price-sensitive customers and can generate initial sales momentum and brand recognition.**
- Although penetration pricing may result in lower profit margins initially, it can lead to long-term profitability. Once a customer base is established, businesses can leverage upselling, cross-selling, and subsequent price adjustments to increase profitability over time. The strategy also helps create barriers to entry for potential competitors by establishing a strong market presence and customer loyalty.

SKIMMING PRICING STRATEGY

- Skimming pricing is a pricing strategy that **involves setting a relatively high initial price for a new product or service**. It targets early adopters and customers who are willing to pay a premium for innovative or exclusive offerings. It also aims to capitalize on the willingness of certain customer segments to pay higher prices for new and unique products. By setting a higher price, businesses can maximize initial revenue and profitability, especially during the early stages of product introduction.
- Over time, as market demand evolves and competition intensifies, businesses employing skimming pricing **often gradually reduce prices to attract a broader customer base**. Lowering prices enables market expansion, reaching more price-sensitive customers, and maximizing long-term sales volume and market share.

PSYCHOLOGICAL PRICING STRATEGY



- Psychological pricing is a pricing strategy that **takes advantage of consumer psychology and perception to influence purchasing decisions.** It involves setting prices that create a certain perception or emotional response, leading customers to perceive the price as more favourable.
- It recognizes that customers often make purchasing decisions based on emotions and perceptions rather than solely on rational analysis. **By setting prices slightly below round numbers (e.g., $9.99 instead of $10), businesses can create the perception of a lower price, even though the difference is minimal.** It also employs various tactics to influence customer perception. These include using charm prices, offering bundle pricing, or emphasizing discounts and savings to create a sense of value for customers.
- Psychological pricing taps into customers' tendencies to seek perceived bargains, associate lower prices with affordability, and respond to pricing cues that trigger positive emotions. This strategy can stimulate impulse purchases, increase perceived value, and drive sales volume.

EXAMPLES AND CASE STUDIES

- **Apple Inc. - Skimming Pricing Strategy:** Apple has successfully employed a skimming pricing strategy for its flagship products like iPhones and iPads. By initially setting higher prices upon product release, Apple captures the **willingness of early adopters to pay a premium for the latest technology.** As the product lifecycle progresses, Apple gradually lowers prices to reach broader customer segments, ensuring sustained demand and market penetration.
- **McDonald's - Penetration Pricing Strategy:** McDonald's implemented a penetration pricing strategy when introducing its McCafé line of beverages. By initially setting lower prices compared to competitors, McDonald's aimed to attract customers and gain market share in the competitive coffee industry. The strategy enabled McDonald's to establish itself as a viable player in the coffee market and later adjust prices to reflect market conditions.

CONCLUSION

1. Pricing is a crucial aspect of business success: Setting the right price for a product or service is essential for profitability, market positioning, and customer perception.
2. Different pricing models and strategies cater to different business goals: Cost-based pricing considers production costs, value-based pricing focuses on customer value perception, competitive-based pricing relates to market competition, and dynamic pricing adapts to real-time market conditions.
3. Choosing the appropriate pricing strategy requires understanding customers and market dynamics: By analyzing factors such as customer preferences, competition, and market demand, businesses can determine the most effective pricing strategy to maximize revenue, gain a competitive edge, and satisfy customer needs.

By mastering the art of pricing, businesses can achieve financial success, build strong market positions, and foster customer loyalty in today's dynamic business landscape.

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THANK YOU!