FACTA UNIVERSITATIS
Series: **Economics and Organization** Vol. 2, N° 3, 2005, pp. 189 - 199

INTEGRATIVE APPROACH TO THE CONTEMPORARY PRICING STRATEGIES

UDC 005.21:338.51

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Abstract. *The paper presents an integrative approach to the contemporary pricing strategies. The conditions of a complex and dynamic environment and intensive competition imply managers' holistic approach considering possible pricing strategies for new products and services or strategies for existing prices modification. The focus is on both the multidimensionality of price issue and on the selection of an adequate strategic alternative for product or service pricing. Managers should bear in mind changes in level and structure of firm costs, in quality and other factors of competitiveness, as well as external changes, concerning the market structure, production differentiation, demand level, competitors activities, stages in life cycle of the industry, price awareness, customers' attitude, their perception of prestige and their life style. The integration of all these factors regarding the selection of one of the analyzed pricing strategies, as well as the impact of successfully implemented pricing strategy on enterprise competitiveness and profitability increase, are crucial.*

Managers make decisions concerning pricing strategy in the context of general strategic orientation of enterprise in order to achieve competitiveness and to raise profit and return on invested capital. The fact is that the strategic approach is especially emphasized in the pricing process for a new product and in the case of price change. It is important to mention that the pricing goals could be different, but they are planed in accordance with the company's goals in general. Having in mind that many factors have various effects on pricing, a greater number of pricing strategies are implemented in practice. These are:

- Pricing strategies for new products,
- Prestige price strategy,
- Expansionistic pricing,
- Preventive price strategy,
- Pricing strategy to eliminate competition,

Received June 10, 2005

- Pricing strategy for a wide production program,
- Geographical pricing strategy,
- Price discounts strategy, and,
- Promotional pricing.

The ways of creating and realizing these strategies stress the importance of price as a factor of competitiveness, simultaneously indicating a complex and dynamic relationship between price and non- price factors of competitiveness.

PRICING STRATEGIES FOR NEW PRODUCTS

The new products/services pricing and the impact of these prices on the company's business results have become the subject of an increasing managers' interest in contemporary firms [5]. This issue is directly related to intensive innovating activities as well as the emergence of a considerable number of new products and services. Many enterprises often make efforts to achieve a competitive advantage by introducing a new product on market before all others.

The key managerial problem in the new product pricing process is the lack of reliable market demand information. The demand for a new product is hardly predictable until the consumers openly show their preferences by buying the given product. Therefore, the market research is indispensable. The company introducing a new product gathers information on the product demand, expecting that the value of this information would be higher than the cost of its collecting. The new product market testing is carried out very often by inquiries and surveys on a limited area. The difficulties arise due to the fact that there is no referential point on which a potential buyer could base his answers in the given inquiries and surveys. However, the market research should be carried out in order to get the base for an initial new product price level. Therefore, the first and the most important step is setting the initial price of a new product.

As a matter of fact, the initial price of a new product is set by implementing either an exclusive price strategy or a penetration price strategy. Which of these two strategies will be selected depends on several factors including the following: the time horizon of the company's business activities, the new product demand characteristics, the access barriers and the new product features on the market [12].

The exclusive price strategy comprises a relatively high initial product price, aimed at realizing as much profit from the product as possible [12]. This pricing strategy proved to be successful considering new, complex, unusual or highly ranged products, especially those which incorporate some technological innovation. Such cases imply high research and development expenses, together with the promotion ones, which are inevitable for a product to attract the attention of potential buyers. The implementation of this strategy could be effective in market segmentation, as well as in pricing the products which the consumers are not very familiar with. For example, when the first digital watches were presented, their prices were very high because their manufacturers realized that in the initial phase, the buyer is more aware of the prestige than the price itself. Implementing the exclusive price strategy, the demand for a new product is mostly limited to the buyers who are ready to pay a high price for the product, but therefore, the profit for each sold product unit is relatively high.

Figure 1 presents profit-maximizing price P* for output level of new product Q* when marginal revenue (MR) and marginal costs (MC) are equal [adapted according to 1, p.468]. P* is set in the intersection of market demand curve (D) and output level Q*. Each production unit after Q* point has marginal costs higher than the marginal revenue.

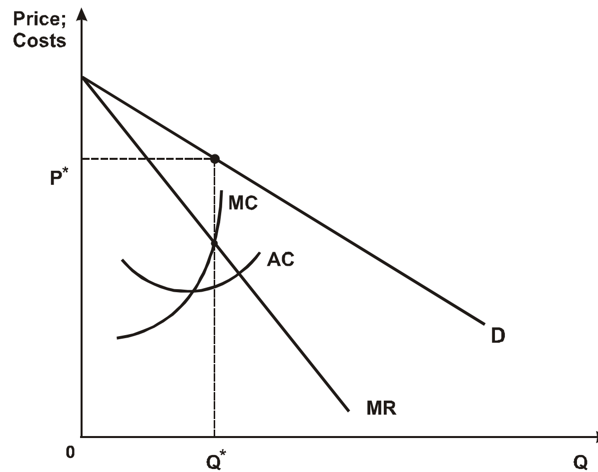

Fig. 1. Exclusive Price Maximizing Short-run Profit

The exclusive price strategy is also implemented when mangers forecast that the demand for new products will be realized only in a short time. This is the case with the so-called "hit" products, which generate instant customers' interests. Then the exclusive price of these products will maximize the short-run profit.

In general, the exclusive price strategy is often implemented by the enterprises whose main goal is short-run profit maximization. However, the exclusive price strategy could be also accepted by enterprises which have a longer time horizon related to a certain product sale that is by an enterprise whose goal is to maximize long-run profit [7]. Two cases when an enterprise maximizes a profit for a longer period of time, implementing the exclusive price strategy, should be emphasized.

The pricing strategy which maximizes long-run profit could be based on exclusive price, if there are insurmountable barriers for entering the market. During the new product introduction stage, the company has a monopolist position, due to the fact that a similar product does not exist in the market. In practice, the company can prevent its competitors' access by creating insuperable access obstacles, such as the patent right for the new products, or by an impenetrable approach to technology and specialized resources. When the entry of new firms is blocked, the company can maximize its long-run profit by an exclusive price.

Long-run profit maximization could be also achieved on the exclusive price base when the managers expect that, due to the selected high price, the customers and potential buyers will create a positive attitude towards the product quality. In that case the company presumes that the higher price will have an effect on product acceptance and its higher

quality evaluation. Therefore, the demanded quantity will be higher than in the case of lower price and the previously established attitude towards lower product quality.

The penetration price strategy is realized by setting a relatively low price for the new product aiming at reaching deeper market penetration in the current period and providing, as well as, a greater market share in subsequent periods [12]. This strategy is applied only in the case when the price of demanded product is at the level which provides a sales volume increase. This explains the following case in setting the price for a *Model T* in the company *Ford*. H. Ford was convinced that the low prices will result in the mass market for this type of car, as well as in a drastic cost decrease by the product unit [13]. This is what actually happened, after all, since the great sales volume and a high market share caused the cost reduction [3]. Therefore, in an industry where the considerable part of total costs could be reduced thanks to the economies of scale and experience, the justified penetration pricing application enables the company to realize greater a profit in the market. It is assumed that the penetration prices include minimal profit as a limit, that is, the penetration price is set only in the case when the minimal profit level is reached. In this sense, the penetration price strategy is analogous to the maximizing sales strategy with limited profit [1].

The Penetration pricing is applied in the following cases:

- when a lower price of product/services is a key buying factor for the consumers majority,
- if the low price is not attractive for competitors to enter the new product and service market (no possibility to realize high profit), and,
- when lower initial prices ensure the dominant market position for the enterprises promoting the new product.

However, the penetration pricing has effects only under the following conditions:

- when the product has an elastic demand,
- in the case when the product has certain competitive advantages, and,
- if price modification could be performed in different phases.

The key factors in setting the initial price for a new product are: the type and nature of barriers for competitors in the process of market entering, the new product features and the company's time horizon [12]. It is obvious that if the entering barriers are relatively high and if it is expected that the enterprise, entering the market, will have relatively high production costs, the price limit will be relatively high, that is it will be defined as an exclusive price. Alternatively, if the entering barriers are relatively low, and the existing enterprise expects low or no cost advantages in relation to an enterprise which enters the market, then, the pricing limit will be rather low, that is, it will be set at the level of the penetration price.

The exclusive price strategy could be accepted in the case when the main goal of a firm is short-run profit maximization, when the entering barriers of competitors are unsurpassable and when the product/services demand is short-termed. This strategy will be also adequate when the consumers form a positive attitude towards the "price-quality" relation of the product or the service. The penetration price strategy is applied if the goal of an enterprise is to maximize its long-run profit and if the product/service demand is long-lasting.

PRESTIGE PRICE STRATEGY

Unlike the exclusive price, the prestige price is set to be maintained through the whole product life cycle because of quality and prestige which are added to the product features. The high price itself could be the key factor for consumers' motivation for buying certain products. The buyers of luxurious cars, cameras, perfumes, watches and other products have satisfaction because of the prestige they acquired by using these expensive products. The business history of a number of enterprises showed that the price reductions for certain prestige products have resulted in the sales decrease. For some population categories, a lower price has the same effect as the prestige image removing, which could be an instrument for providing specific products buying. Therefore, the lower prices could interfere in buying instead of increasing it.

In a broader sense, the prestige and quality often become two basic motifs for buying a product and using a service. Therefore, in practice, besides using the term "prestige pricing setting," the term "quality pricing" is simultaneously used. This term has a positive meaning and explains the relationship between realized buyers satisfaction and a product and its pricing structure. The consumers' attention is drawn to the ways in which products and services could, to certain extent, meet their expectations and needs [3].

EXPANSIONISTIC PRICING

The expansionistic pricing is a strategy of very low pieces aimed at establishing mass markets, often at the expense of other competitors. This strategy is developed in the case of products whose price elasticity of demand is high, so that setting low prices results in a considerable increase of sales volume. Nowadays, many enterprises try to win new markets or to widen the existing ones for their products and services applying the expansionistic pricing.

The famous Japanese car companies *Toyota* and *Honda* have implemented this pricing strategy in order to realize the acceptance of their products in the global market. The standardized versions of cars with low production costs *Toyota Corolla* and *Honda Civic* have been successfully introduced in order to provide satisfactory market acceptance [16, 14]. Later on, some more expensive models were offered [3].

Basically, dumping is a negative domination strategy which comprises the product sales abroad below their production costs. If applied to the extreme, damping can force the domestic manufacturers of some country to get out of business. Damping can be considered as an extreme case of expansionistic pricing. Anti-damping laws were introduced in many countries in order to prevent this pricing practice.

The expansionistic pricing strategy has been used effectively by some publishers of magazines and papers. The sale has drastically increased by decreasing annual subscription rates for many well-known magazines and papers. The publishers' benefits resulted from an income earned owing to higher advertising rates [3]. These changes have increased the publication sales level. A similar method for realizing the expansionistic pricing strategy has been used by many book clubs in order to increase the number of members, which should result in greater business success.

PREVENTIVE PRICE STRATEGY

The preventing pricing is a strategy of low prices, designed to discourage possible market competition. As a result, the price prevailing in the market is unattractive for possible competitors. This strategy is especially accepted when an enterprise does not have remarkable advantage in relation to its competitors (for example, it does not have protected patent or any differentiation advantage in relation to other enterprises), and when the market entering is relatively easy. The postponing of the competitors market penetration gives a chance to the enterprise to acquire a market share, to reduce costs, based on economies of scales, to make profit and to create its recognizable image. For example, the management of *RCA Corporation* chose the preventing pricing strategy during fifties (of the last century) when promoting, at that time, their new product-color TV set on the market [15]. The low price was intended to provide necessary time for the experts of *RCA Corporation* to improve new technology for the color TV set production before market competition with the same or a similar product appears, thus establishing the strong market position for the corporation [3].

PRICING STRATEGY TO ELIMINATE COMPETITION

The pricing strategy, aimed at complete eliminating competition is a strategy of low prices, whose task is to ruin market competition. During the realization of this strategy an enterprise set a price under the level of production costs. Once the competition is eliminated, the product/services prices are increased to the profit levels.

The same strategy was used by *Standard Oil* at the end of nineteenth century *in* order to get rid of market competition. Decreasing prices in local regions up to the level of half production costs, the competition was eliminated, and then, other competitors were bought out at nominal prices by *Standard Oil* [3]. Afterwards this company made up the losses in non-competitive fields by selling their products and services on high level prices.

The above-mentioned experience showed that the pricing strategy regarding complete elimination of competition could be applied by a company if it has a dominant position in industry and a strong financial position in the market and if it is able to bear temporary monetary losses caused by the strategy's implementation. This practice was connected with the attempts to establish a monopoly market position. In contemporary conditions some enterprises use a mild form of this strategy, selectively realizing it on particular articles within the production line.

PRICING STRATEGY FOR A WIDE PRODUCTION PROGRAM

The pricing strategy for a wide production program implies managers' decisions on mutual relation between the prices for products and services of the firm. It is important to establish a relationship among between the product demand in the form of "independent-complementary" or substitutes [8]. The relevant reliable data on the existing competition (number of enterprises in market, their market share by product and the similarity level of competitors' products in relation to the firm products) could be available. The evaluation of potential competitors is more complex and less reliable.

The managers in enterprises with a wide production program should be cautious not to disturb good mutual balance among product prices in the production program. Trying to use different elasticity of demand in certain market segments, enterprises could introduce many new products in the production program, from those with a rather low quality and price, up to the ones with a high quality and price (for example, deluxe and super deluxe models of the basically same product) [8]. The practice has proved that the intention to fulfill needs of certain market segments, regarding the quality and the product price, provides buyers' loyalty and profit increase.

The prices of optional and added products accompanying the main product are difficult to be established. Many enterprises include them into the main product price, but their prices could also be defined separately. In the case of by-products, unless they have the market value, getting rid of their costs should be included in price of the main product. When the by-products have their market value, mangers make efforts to cover at least the costs of warehousing and sale.

In the case when a new product is introduced, its price must be in accordance with the existing production line. Many enterprises prefer widening the production line to lower the price of the existing brands when the price competition exits.

It is very important to calculate cross-price elasticity of demand *(Ecp),* for analyzing competition between two concrete products by measuring the responsiveness of changes in the quantity demanded of one product to changes in the price of another product:

$$Ecp = \frac{\frac{\Delta D_1}{D_1}}{\frac{\Delta P_2}{P_2}} = \frac{\Delta D_1 \cdot P_2}{\Delta P_2 \cdot D_1},$$

where there are:

$\frac{\Delta D_1}{D_1}$ – percentage change in quantity demanded of product 1 and

$\frac{\Delta P_2}{P_2}$ – percentage change in the price of product 2.

If the cross-price elasticity of demand is positive, then the products are substitutes. On the other hand, in the case of complementary products, cross-price elasticity of demand is negative.

The risk of adding a substitute brand into the production line is connected to possible transfer of demand from the old to the new brand. However, in spite of this, managers, especially in the case when an enterprise has a high market share, often make decisions on widening the production line aimed at further increase of its market share, attracting new buyers and strengthening the market position, offering more products to the buyers so they could make their own choice in buying process. The best examples for this are various manufacturers of soups, soft drinks, cars, detergents, bread and biscuits. Considering the potential risk, the goal of the pricing strategy for production line is to maximize profit.

GEOGRAPHICAL PRICING STRATEGY

The geographic pricing strategy is based on respecting the fact that the buyers could be situated in different locations, even in different countries and regions, that is, at diverse distances from the delivery spot. The main issue is whether to absorb the costs requested for a product to reach a buyer, or to transfer these costs to customer which would result in a price increase. First of all, transportation costs treatment, depending on concrete area distance, is very important. This pricing strategy is applied in different ways, depending on various business activities and goals which firm intends to realize.

- It often happens that pricing based on production costs does not include costs of product transfer to a buyer. Once an enterprise defines a price for the goods on this principle, a buyer pays transportation costs, taking a risk regarding the goods. This pricing strategy is inconvenient for the buyers from distant locations, who, in that case, bear higher transportation costs. Practically, an enterprise offer is more inconvenient for these buyers in relation to those who are near the delivery place.
- On the contrary, the price could include all transportation costs or goods delivery costs. It is the price including insurance and freight charges.
- Pricing policy according to delivery zones presents a specific combination of former mentioned cases of geographic pricing. The main fact is that an enterprise divides a total market into specific zones according to the distance level of certain zones from their sites. All buyers within the specific zone pay the same price, whereas the price should be higher in more distant zones. In practice, this pricing strategy has significant advantages, especially in the case of market expansion, when an enterprise has to identify changes, in order to be competitive. That is especially important if the transportation costs are high for the concrete product.
- Pricing strategy according to the basic point system accepts the fact that all the buyers bear transport costs from the site that present the basic point to the delivery site, regardless of the shop location or the delivery location warehouse. This strategy is often applied in the case of homogenous or massive products, which include a great deal of transportation costs within total costs, such as cement, iron or steel, sugar or lumber products. One should bear in mind that nowadays in some cases a greater number of basic points is used.
- In the case when the price is formed by selective undertaking of transportation costs, the manufacturer transports the purchased goods at his own expense only to certain buyers that the manufacturer wants to animate or keep them buying its products. All other buyers, of less importance for the seller, do not have this privilege.

PRICE DISCOUNTS STRATEGY

The price differentiation based on distinction between buyers is designed separately for every buyer according to certain criteria. This differentiation is realized by rebate, by various types of discounts, financial and material stimulations, which should stimulate the buyers to buy products and services of concrete enterprise, providing the significant market penetration. The most often discounts and stimulations are: cash discount, quantity discount, season discount, functional discount, stimulations for promotion and allowance – "old for new" type.

- Cash discount is a precisely established discount percentage which is offered to the buyers who promptly or in a certain short time period pay bills for the received goods or services. This type of buyers' stimulation is of great importance for sellers which have liquidity problem.
- Quantity discount is a price reduction offered to buyers who buy large volume of products, which encourages buyers to increase their orders. This discount can be offered on each order placed (for each individual buying), or as cumulative, when larger buying is stimulated in a given period of time. The quantity discount causes decrease stock costs and contributes to higher competitiveness.
- Season discount is price reduction to the buyers who buy products or services out of season. This enables a seller to provide relatively stable sale of seasonal products all over the year. This discount is commonly applied in the realization of the company's competitive strategy regarding fashion industry, as well as in the case of hotels and airlines.
- Functional or trade discount is approved to trade-channel members if they perform distinct functions such as selling, warehousing, record keeping.
- Stimulations for promotion refer to compensations for:
  - enterprise product promotion stimulation offered by distributors,
  - making special efforts in enterprise product/service selling, and,
  - support and assistance in organizing exhibitions, tasting, fairs and other presentations.
- The allowance referring to the sale so-called "old for new" implies the buying process based on exchange of an old product for the same new one, applied by manufacturers of furniture, bicycles, household appliances, etc.

PROMOTIONAL PRICING

The promotional pricing refers to a special pricing strategy, used by an enterprise to stimulate psychologically buyers to buy its products and services. One segment of this strategy is a special "trick" used by sellers in order to attract buyers. There are several types of promotional prices such as a "loss-leader price", occasional prices, psychological discounts and a psychologically designed price.

- "Loss-leader price" (a "price decoy" or "price hook") is intentional price reduction of the product well known to buyers in order to convince them that the prices of the other products are lower than the competitors'. This strategy is sometimes applied by supermarkets and big stores, but this can provoke the protest of the manufacturers whose products are the object of "loss-leader pricing" due to a possible future bad image of their products.
- Occasional prices are designed in specific circumstances - during holydays, celebrations, various manifestations or at the end of the season, aimed at attracting more buyers who are, already, "tired" of shopping.
- Psychological discounts are realized in several ways. A method often used in trade is that a seller intentionally sets a rather high price for some product and then gives a considerable discount so that the potential buyers have an impression of special price convenience.

- Psychological pricing often implies that product whose sale is to be stimulated, having a popular price, is intentionally presented with some other similar expensive product which intensifies the sale of the first.

BASES OF THE STRATEGIC APPROACH TO THE DISCRIMINATORY PRICING AND THEIR IMPLICATIONS ON MANAGERIAL DECISION MAKING

Having in mind the above mentioned, one could conclude that there are several bases for a strategic approach to the discriminatory pricing realization. These pricing strategies refer to designing price differentiation for different customers, types of products, locations and time of delivery.

The initial point is often the variety of buyers or group of buyers and their preferences. In that sense, "buyer as a base" is a pricing concept which implies that different buyers are charged different prices for the same product or service. The "product as a base" means that various products are priced differently, but not proportionally to their respective costs. In general, the mentioned pricing is specially aimed at stimulating the sale of certain products whose stock is high or which generate higher profit.

"Location as a base" in the sense of the location pricing is accepted if different locations of product or service delivery determine the different prices. First of all, this is applied due to the fact that the delivery costs are not the same in all locations because of different transportation costs.

"Time as a base" serves for price discrimination regarding seasonal products or the ones which are perishable and expiring. The price discrimination could be carried out by months and weeks, as well as by days and hours.

The fact is that prices, set by some of the mentioned methods, sometimes should be corrected in one way or another (lower or higher), depending on numerous factors and circumstances which managers should evaluate separately. No matter if it is the general price increase tendency of all products, or changes in demand domain occur, or new strategies are implemented by competitors, the managers must always act wisely, rationally and effectively.

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INTEGRATIVNI PRISTUP SAVREMENIM STRATEGIJAMA FORMIRANJA CENA

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U radu je prezentiran integrativni pristup savremenim strategijama cena. Uslovi kompleksnog i dinamičkog okruženja i intenzivne konkurencije podrazumevaju holizam u stavovima menadžera prilikom razmatranja mogućih strategija formiranja cena novih proizvoda i usluga ili strategija modifikovanja postojećih cena. Fokus je na samoj multidimenzionalnosti problematike cena i na izboru adekvatne strategijske alternative za određivanje cena proizvoda ili usluga konkretnog preduzeća. Menadžeri moraju uzeti u obzir promene u nivou i strukturi troškova preduzeća, u kvalitetu i ostalim faktorima konkurentnosti, kao i eksterne promene vezane za:tržišnu strukturu, stepen proizvodne diferencijacije, nivo tražnje, aktivnosti konkurenata, životni ciklus delatnosti, svesnost o cenama, stavove kupaca, njihovu percepciju prestiža i njihov životni stil. Suština je u svojevrsnom integrisanju svih ovih faktora kod selekcije jedne od analiziranih strategija cena i uticaju uspešno realizovane strategije na povećanje konkurentnost i profitabilnosti preduzeća.