Lesson 22

PENETRATION PRICING

Penetration Pricing is the Pricing technique of setting a relatively low initial entry price, a price that is often lower than the eventual market price.

The expectation is that the initial low price will secure market acceptance by breaking down existing brand loyalties.

Penetration pricing is most commonly associated with a marketing objective of increasing market share or sales volume, rather than short term profit maximization.

The **Advantages** of Penetration Pricing to the firm are:

- It can result in fast diffusion and adoption. This can achieve high market penetration rates quickly. This can take the competition by surprise, not giving them time to react.
- It can create goodwill among the all-important early adopter segment. This can create valuable word of mouth
- It creates cost control and cost reduction pressures from the start, leading to greater efficiency.
- It discourages the entry of competitors. Low prices act as a barrier to entry
- It can create high stock turnover throughout the distribution channel. This can create critically important enthusiasm and support in the channel.

The main disadvantage with penetration pricing is that it establishes long term price expectations for the product, and image preconceptions for the brand and company. This makes it difficult to eventually raise prices.

Some commentators claim that penetration pricing attracts only the switchers (bargain hunters), and that they will switch away from you as soon as you increase prices. There is much controversy over whether it is better to raise prices gradually of a period of years (so that consumers don't notice), or employ a single large price increase (which is more efficient).

A common solution to the price expectations problem is to set the initial price at the long term market price, but include an initial discount coupon. In this way, the perceived price points remain high even though the actual selling price is low. Another potential disadvantage is the low profit margins may not be sustainable long enough for the strategy to be effective.

Price Penetration is most appropriate when:

- Product demand is highly price elastic.
- Substantial economies of scale are available.
- The product is suitable for a mass market (sufficient demand).
- The product will face stiff competition soon after introduction

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Loss Leader

In marketing, a loss leader is an item that is sold below cost in an effort to stimulate other profitable sales. It is a kind of sales promotion. There are several varieties of this profitable technique.

Sales of other items in the same visit

One use of a loss leader is to draw customers into a store where they are likely to buy other goods. The vendor expects that the typical customer will purchase other items at the same time as the loss leader and that the Profit made on these items will be such that an overall profit is generated for the vendor.

An example would be a supermarket selling sugar or milk at less than cost to draw customers to that particular supermarket chain. Wal-Mart uses some toys as a loss leader, leading to the potential demise of toy-only competitors like Toys "Я" Us and FAO Schwarz.

Under some jurisdictions, this is considered dumping and is illegal.

A related example is the practice by some auto repair shops of offering required inspections at loss-leading prices; if a problem is found preventing the inspection from being passed, they are then in a position to offer to fix it.

Price War

Price war is a term used in business to indicate a state of intense competitive rivalry accompanied by a multi-lateral series of price reductions.

One competitor will lower its price, then others will lower their prices to match .If one of the reactors reduces their price below the original price cut, then a new round of reductions is initiated

In the short-term, price wars are good for consumers who are able to take advantage of lower prices. Typically they are not good for the companies involved. The lower prices reduce profit margins and can **threaten survival.**

In the long term, they can be good for the dominant firms in the industry however. He, who laughs last, laughs best.

Typically the smaller more marginal firms will be unable to compete and will shut down. The remaining firms absorb the market share of the terminated ones. The main losers then, are the marginal firms and the People that invested in them. In the long-term, the consumer could lose also. With fewer firms in the industry, prices tend to increase, sometimes to a level higher than before the price war.