Pricing

Topic Gateway Series No. 18

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About Topic Gateways

Topic Gateways are intended as a refresher or introduction to topics of interest to CIMA members. They include a basic definition, a brief overview and a fuller explanation of practical application. Finally they signpost some further resources for detailed understanding and research.

Topic Gateways are available electronically to CIMA members only in the CPD Centre on the CIMA website, along with a number of electronic resources.

About the Technical Information Service

CIMA supports its members and students with its Technical Information Service (TIS) for their work and CPD needs.

Our information and accounting specialists work closely together to identify or create authoritative resources to help members resolve their work related information needs. Additionally, our accounting specialists can help CIMA members and students with the interpretation of guidance on financial reporting, financial management and performance management, as defined in the CIMA Official Terminology 2005 edition.

CIMA members and students should sign into My CIMA to access these services and resources.

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Definition

Pricing is defined as the:

‘Determination of a selling price of the product or service produced.’

*CIMA Official Terminology, 2005*

There are a number of different pricing methodologies and strategies which may be used in pricing. The strategy chosen depends on the individual organisation producing the product or service.

Context

In the current syllabus, CIMA students will learn and may be examined on this topic in Paper 5, Integrated Management.

Related concepts

Transfer pricing refers to the pricing of goods and services within a multi-divisional organisation. For example, goods from the production division may be sold to the marketing division. Equally, goods from a parent company may be sold to a foreign subsidiary.

Overview

The price of an offering is a key element of an organisation’s marketing mix. The mix comprises price, product or service, place of distribution and promotion factors. These factors communicate with potential customers and influence the consumer’s perception of the offering.

In determining price, organisations should be aware of their mission and objectives, together with costs and constraints.

Organisations may adopt one of several pricing strategies. These include cost-plus pricing, discount pricing, penetration pricing, pre-emptive pricing, prestige pricing, price skimming and target pricing. (See table in Application for further details). The price, once set, should support the achievement of the organisation’s mission.

The price(s) set and pricing practices may vary between markets, market segments and geographical regions. They also vary over time, according to customer wants and organisational objectives.
In the case of transfer pricing, the choice of price affects the division of total profit among different parts of the company. It can be advantageous to choose transfer prices so that, in book keeping terms, most of the profit is made in a low tax country. However, most countries have tax laws and regulations that limit how transfer prices can be set.

**Application**

In setting price, producers of goods and services need to take a number of different issues into account. The key factors to consider include:

- production costs (labour, materials, overheads)
- distribution costs
- marketing costs
- competition pricing and activity
- perceived value (by the customer)
- government influence
- trade requirements
- volume targets (high price/low volume versus low price/high volume).

There are a number of tried and tested pricing strategies:

<table>
<thead>
<tr>
<th>Penetration pricing</th>
<th>Enter market with special offer pricing to get market share quickly. This was used by utilities entering deregulated European markets.</th>
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</thead>
<tbody>
<tr>
<td>Discount pricing</td>
<td>Tactically reducing price occasionally to steal competitor share.</td>
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<tr>
<td>Skim the cream</td>
<td>Start with a high price to get the early adopters and then gradually reduce. This happens in technology markets such as PCs and Hi-Fi.</td>
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<tr>
<td>Pricing Strategy</td>
<td>Description</td>
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<tr>
<td>Premium pricing</td>
<td>Adopt a platform of high prices and stick to it, for example, Rolex watches.</td>
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<tr>
<td>Cost plus pricing</td>
<td>Doesn’t work in a dynamic market but sometimes used in government contracts or controlled economies.</td>
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<td>Going rate</td>
<td>Fitting the market price of competitors with like-for-like comparison.</td>
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<tr>
<td>Target pricing</td>
<td>Fixing price by market segments or distribution channels.</td>
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<td>Price discrimination</td>
<td>For example, fixing a price too high (or too low) to exclude certain customers. For instance, some airport customers will pay extra to park in the short term or business car park while others won’t.</td>
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<td>Quantum pricing</td>
<td>Fix price high and lowering until sales occur. For instance, Amazon Internet model.</td>
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<tr>
<td>Odd number pricing</td>
<td>Psychologically, ending a price with a nine makes it appear disproportionately cheaper. For example, £4.99 seems considerably cheaper than £5.00.</td>
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</table>
In the supply chain, there is great flexibility in pricing if the customer is not the end user. One example is the traditional retailer model where the seller can discuss discounts, margins, buy-in incentives, promotions and offers to influence stocking levels.

**Pricing and the internet**

For many organisations, the growing acceptance and implementation of B2B commerce and web enabled trading has had a dramatic effect on pricing. The length of the supply chain, from manufacturer to customer, via wholesalers and retailers, has become shortened. Customers are now increasingly able to deal directly with the manufacturer.

Both customers and potential competitors can benefit through increased price transparency and comparability. This has come about through the use of search engines and dedicated price comparison sites. Where there are low barriers to market entry, the speed of price changes, including reductions, is likely to increase.

The benefits of these changes are two-fold. Customers may gain from the opportunity of direct price comparison. Suppliers have the opportunity to exploit the benefits of increased market segmentation.

**Further information**

**Articles**

Full text for Business Source Corporate through My CIMA

www.cimaglobal.com/mycima


Lawrence, B. *Calculating pricing optimization*. Industrial Distribution, August 2006, Vol. 95, Issue 8, pp 26-27


Abstract from Business Source Corporate through My CIMA

www.cimaglobal.com/mycima


Other recommended articles


Books


New York: John Wiley and Sons

**CIMA publications**


**CIMA Mastercourses**

Effective transfer pricing: a practical introduction to transfer pricing: the management and operational issues. To book via www.cimamastercourses.com please go to Find and key in the course code TRPR.

Accounting for marketing. To book via www.cimamastercourses.com please go to Find and key in the course code ACMK.
Websites
Businesslink offers practical advice for business. www.businesslink.gov.uk

An archive of individual articles from 1922 to the present can be accessed from Harvard Business Review using Business Source Corporate on MY CIMA.
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