



RINK: Taking at look at types of pricing policies

By **DAVID RINK**

Tribune guest columnist

— In the June 18 column, we discussed various pricing objectives. Today, we will cover pricing policies, which should be consistent with the firm's pricing objective. Pricing policies will have a direct impact upon the selected price-setting method. Pricing policies detail what price situations the firm will likely confront and how it will deal with them.

These policies should spell out: how flexible prices will be; at what level prices will be established across the product's sales cycle; when price discounts and allowances will be granted as well as to whom; and how transport expenses will be treated. The first two pricing policies will now be discussed; the last two will be covered in the next column.

- **Price flexibility:** Most firms charge the same price to all buyers who purchase similar quantities of their products. This one-price policy simplifies pricing for the firm and preserves customer goodwill. Over time, however, it can lead to price paralysis as in the case of major traditional retailers (e.g., Sears) when mass merchandisers (e.g., Wal-Mart) entered the industry.

Under a flexible price policy, the firm charges different prices to different buyers for the same product. It is common among expensive consumer goods (e.g., autos) and industrial products. This policy permits the salesperson to make immediate price adjustments. But, it also increases the time required to close a sales, which raises selling costs and reduces profit margins.

- **Price level across product's sales cycle:** When entering a new market, the firm's initial price will impact the product's long-run sales and profitability.

One pricing approach is to initially sell the firm's new product at a high price, and then reduce price over time. This skimming price policy is appropriate when: the threat of potential competition is low (e.g., industry has high entry barriers, such as the auto business); customers are not very price sensitive; technology is changing rapidly (e.g., Intel example in last column); economies of scale are low; few product substitutes exist; protection is high (e.g., patents); and not much is known about the shape of the product's demand curve. This strategy has been used for numerous products (e.g., PCs, CDs, etc.).

In a second approach, labeled penetration pricing policy, the firm prices its new product relatively low. The firm's goal is to grab as much market share as it can and as quickly as possible. This pricing policy is recommended when the above-mentioned conditions for skimming are reversed. Texas Instruments adopted the penetration pricing policy when it entered the calculator market in the 1970s.

In the next column, we will discuss the last two pricing policies: discounts and allowances, and geographical pricing.

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