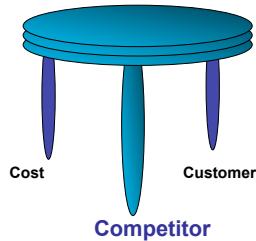


## Competitor Based Pricing



## The Goal

- Setting a Price that is Competitive  
That is to say
- Choosing a Selling Price that is based on the prices chosen by the competition in our industry seeking to serve our market

## Three Approaches to Pricing

1. Cost Based
- 2. Competitive Based**
3. Customer Based

## Classic Competitive Topics

- **Relative to Competitor's Prices**
- Relative to Relative Product Quality
- Bidding Models

## Relative to Competitor's Prices aka Going-rate pricing

- **Relative Price Ratio**

## Relative Price Ratio aka Going-rate pricing

- Your price per unit as a percentage of
  - the average industry price
  - the closest competitor's price
- Your price = \$85
- Average industry price = \$90
- Relative Price Ratio =  $\$85/\$90 = 94\%$

### Relative Price Ratio

- Classic Application is Using the Relative Price Ratio in a Pricing Policy for Price Setting
- Our Policy is to have a Price that is always **5% less** than the industry's average price
- If our \$85 Price is currently at **94%** of average
- We must raise our price to a new level
- New price =  $95\%(\$90) = \mathbf{\$85.50}$

### Classic Competitive Topics

- Relative to Competitor's Prices
- **Relative to Relative Product Quality**
- Bidding Models

### Value-Pricing Policy

- "Value-pricing is not simply a matter of setting lower prices than the competitor... it is a commitment to having one's operations designed to be the cost leader."

### Relative Product Quality

- Measuring Product Quality
  - Horse power, Speed, Reliability, etc.
  - Government, Industrial and Consumer Testing (performance index or 5 star rating system)
  - Product Version # (our simulation)
- Average Product Quality is the sum of the individual ratings divided by the number of competitors
- Relative product quality is your quality rating divided by the average quality rating

### Basic Price/Quality Theorem

- The maximum price you can set is the point where your relative price,  $P_r$ , is equal to your product's relative quality,  $U_r$ .
- $P_r = U_r$
- $P/P_a = U/U_a$   
where  $P$  = your price,  $P_a$  = average price, your quality =  $U$ ,  $U_a$  = average product quality

### Basic Theorem Implies

- 1) If you have a product with average quality, then the most you can charge is the average price.
- 2) If you have a product that is 10% higher than the average quality, then you can charge up to 10% more than the average price.

$$P/P_a = U/U_a$$

- P = your price, P<sub>a</sub> = average Price  
U = your product quality, U<sub>a</sub> = average quality  
Pr = P/P<sub>a</sub> = relative price, Ur = U/U<sub>a</sub> = relative quality
- In a perfectly equal world  
Relative Price = Relative Quality  
P/P<sub>a</sub> = U/U<sub>a</sub>
- To set the Upper Limit or Maximum Price
- $P = (U/U_a) \times P_a$

## Example

- In the simulation your product has achieved version 2 quality and the average product version is 1.8 quality and the average price is \$80. No new product versions will be reached next period. What is the maximum price you can charge?
- **Relative Quality =  $U/U_a = 2/1.8 = 111\%$**
- **Maximum Price to set =  $P^* = (U/U_a)P_a$**
- **$P^* = 111\%(\$80) = \$88.89$**

## Upper and Lower Limits

- Calculating your price on a cost plus basis to cover cost and achieve a target Return on Sales (Profit) for the lower limit.
- Calculating your Pricing to Relative Product Quality is a popular benchmark for the upper limit on the price selection