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Apple's Pricing Strategy

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Introduction

Apple Inc., formerly Apple Computer Inc., established in Cupertino, California on April 1, 1976, has revolutionized personal computers and the electronics market. For a variety of reasons, Apple has engendered a unique reputation in the consumer electronics industry. This includes a customer base, particularly in the United States, that is unusually devoted to the company and its brand name.

According to surveys from J. D. Power[1], Apple has the highest brand name and repurchases loyalty of any computer manufacturer. While this brand loyalty is considered unusual for any product, it doesn't seem as though Apple has gone out of its way to create it. In 2006, more than 200,000 companies have signed on to create Apple-compatible products, a 26% increase from the previous year including software makers (Info Tech, 2007). A cottage industry of iPod accessories continues to blossom into something far more substantial. Apple's online iTunes Music Store has become the world's third-largest music retailer after Wal-Mart Stores Inc. and Best Buy Co.

Apple seems poised to extend its reach even further by launching its new Apple iPhone. But phonemakers such as Nokia and Motorola are quite nervous to see if Apple can remake the U.S. cellular business by determining what services consumers get and leaving the carriers out of the loop.

In this paper, we will analyze Apple's pricing strategies in the United States and Europe which include a combination of *skimming* and *versioning*, also called *price discrimination*.

[1] http://www.jdpower.com/corporate.

I. Apple's New Invention

1.1. Apple Product: iPhone

The Apple iPhone is an elegantly designed information communicator forged from steel and silicon that runs pioneering software under Apple's OS X in a Unix Kernel. The iPhone combines smart phone capabilities with a simple to use graphical interface projected on a large 'multi-touch' display. Apple has managed to create a Macintosh computer with mobile phone capabilities, bundled within an Internet enabled PDA and an iPod body. The iPhone's functionality is accessed through its 3.5-inch touch screen display and one "home" button. Using only finger commands, a user can navigate seamlessly through iPhone's features, conjuring up a keyboard when needed.

Some of its features include:

1) Smart iPhone: provides touch technology allowing users to make calls by simply pointing to a name or number in an address book or by dialing through a touch pad keyboard.

2) Wireless Internet Communication Device: serves as a Wi-Fi enabled Internet device that utilizes Apple's Safari browser to access: Internet email, web sites, online maps, and search engines.

3) IPod: offers a 3.5-inch widescreen iPod with touch screen controls.

4) PDA, Computer and Camera: includes PDA features (appoint calendars, contact lists, photos, emails and documents, literally with a touch of a 'virtual' button) ; enables users to take pictures at 2 MB resolution that can be stored in 4 GB or 8 GB flash memory cards or forward to others.

1.2. Apple's iPhone Strategy

1.2.1. Price

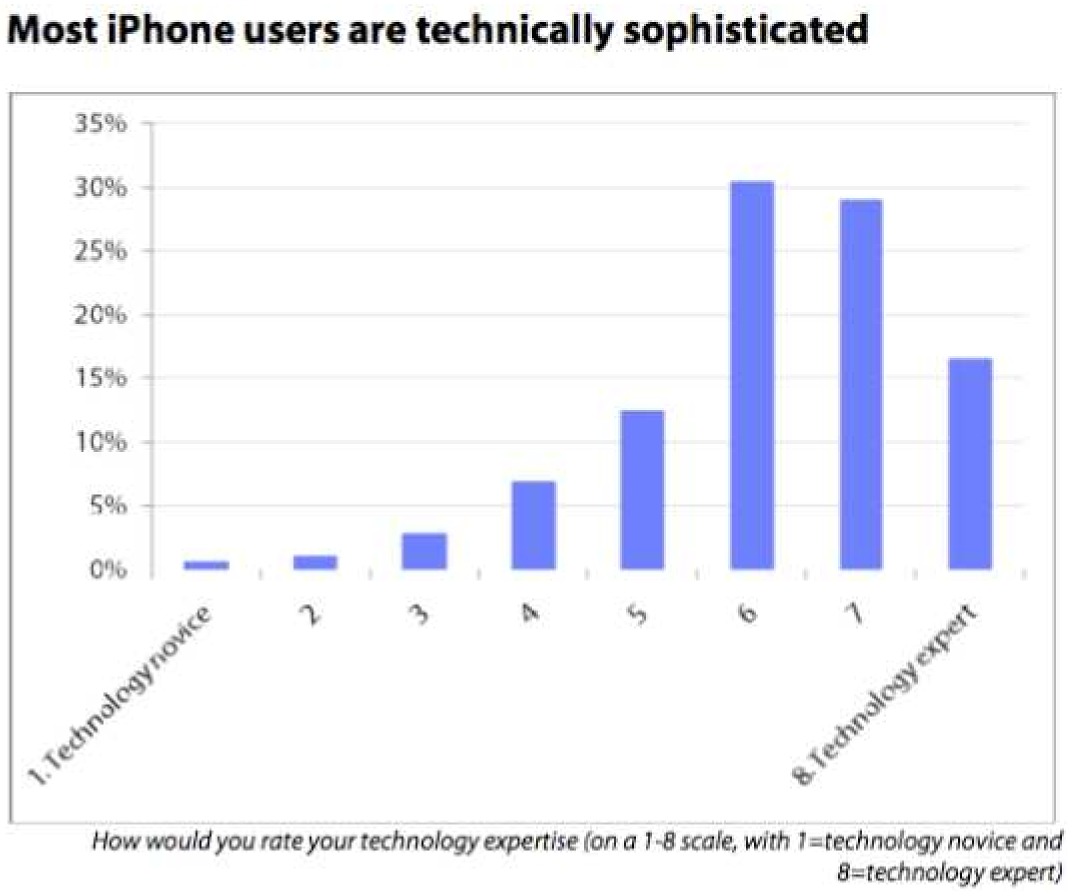
The initial price of the iPhone was set at:

Price	
Model	Price
4gb model	$499
8gb model	$599

Introduced in June 2007 at a top price of $599 in the United States, the iPhone was one of the most anticipated electronic devices of the decade. Despite its high price, consumers across the country stood in long lines to buy the iPhone on the first day of sales. Just two months later, Apple discontinued the less-expensive $499 model and cut the price of the premium version from $599 to $399.

1.2.2. Target Group

A study conducted by Rubicon (2008) on iPhone users indicates that 50% of the surveyed users are age 30 or younger. Most of the users described themselves as technologically sophisticated. In general, iPhone users were over represented in the occupations that are usually early adopters of technology: professional and scientific users, arts and entertainment, and the information industry.



(Source : Rubicon consulting, 2008)

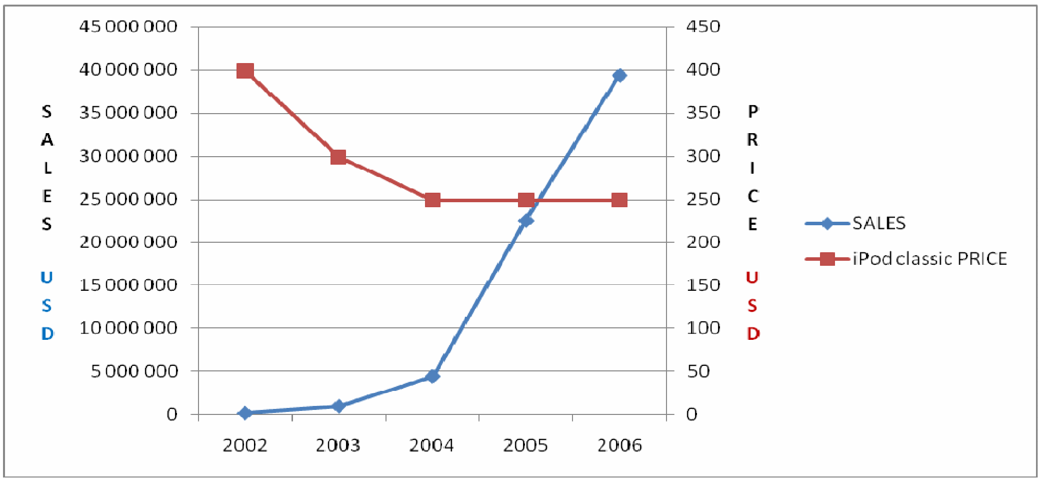
Moreover, the iPhone user base consists mainly of young early adopters: about 75% of whom are previous Apple customers. Now, the challenge for Apple is to get their product beyond the youthful technophiles and into the hands of mainstream users in order to maintain sustained growth. While the early adopters are a great group for launching a product, without mainstream use, the early success would not be lasting. This is why Apple has decided to use different pricing strategies such as the skimming and versioning.

II. Skimming

Skimming is referred to as selling a product at a high price; basically companies sacrificing sales to gain high profits. This is employed by companies in order to reimburse their cost of investment put into the original research of the product. This strategy is often used to target early users of a product/service because they are relatively less price sensitive than others. Early users are targeted either because their need for the product is more than others or they understand the value of the product better than others. In any case, this strategy is employed only for a limited period of time as a way to recover most of the investment of a product.

According to Köehler (1996), the skimming price strategy is a high price strategy which provides a healthy margin but risks a depressed sales volume. Since high prices also attract piracy, protection costs against piracy basically eat up margins. In the case of Apple, the buyers are not attracted by pirated versions of products because of the image of the brand linked to the snobbism of the "members of the Apple family".

In the graph below, we compared iPod sales with the price of iPod classic from 2002 to 2006. According to the data, the iPod classic model seemed to have either reduced its price or maintained the same price from one year to the next. In 2002, iPod classic price was the highest; as a result, it was also shown as the year with the lowest sales. For example, the Apple iPod classic costs over the years include: 399$ (2002), 299$ (2003), 299$ (2004) and 249$ (2005).



Foremost, while issuing new generation model of a classic iPod, the company was still selling the previous version at the reduced price.

The skimming pricing strategy is presented at two levels. First, the price of the same model is diminishing with time, especially when Apple is issuing the newest version of the iPod. Second, the price of every next generation model launched on the market is less expensive than its predecessor, which is illustrated by the above graph.

Here, we took the prices of the iPod classic but the same results can be seen with the iPod mini (the launching price in 2004 was 249$ while the newest version launched in 2005 cost 199$) and the iPod nano.

To gain market share, a seller cannot solemnly rely on skimming strategies but must also use other pricing tactics such as pricing discrimination, which has been the case of Apple.

III. Versioning (Pricing discrimination)

Pricing discrimination is a pricing strategy that charges customers difference prices for the same product or service. In pure price discrimination, the seller will charge each customer the maximum price that he or she is willing to pay. Most often the seller places customers in groups based on certain attributes and charges each groups a different price.

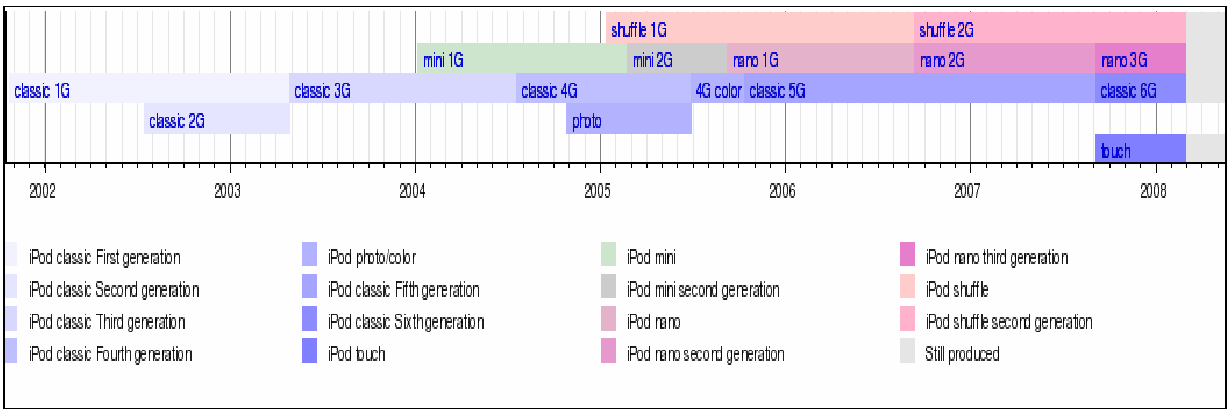
Apparently, price discrimination is only feasible under certain conditions: 1) companies have short run market power; 2) consumers can be segmented either directly or indirectly, 3) arbitrage across differently priced goods is infeasible (Stole, 2003). Given the fact that these conditions are fulfilled, companies typically have an incentive to practice price discrimination. However, the form of the price discrimination may also depend on the nature of the market power.

Jagmohagn Raju (2007) highlights that Apple's price cut is an example of a strategy known as "temporal price discrimination" where it charges people different prices depending on the their desire or ability to pay. Companies such as Apple may practice this strategy for two reasons. First, they gain wide profit margins from those willing to pay a premium price. Second, they benefit from high volume by building a wider customer base for the product later. It's important to note that price discrimination can also be structured across geographies, seasons and by adding or eliminating features.

As for the "temporal price discrimination," Apple reduced $200 from the original price of the iPhone just two months after its release. After a flood of complaints by its customers, Apple attempt to rectify complaints by offering $100 store credit to early iPhone customers. In addition to temporal price discrimination, Apple practices price discrimination via versioning where it proposes many versions of products according to the needs and prices of their customers'. The "wealthy" clients can buy a latest version of iPod classic, iPod nano or iPod touch while those who are less "wealthy" can always pay the price of a previous generation iPod (classic or nano) or an iPod Shuffle (49$).

The current iPod line consists of (from left to right): the iPod shuffle, iPod nano, iPod classic and iPod touch.

The variety of Apple music players are well illustrated by the graph below:



This large offer is constantly renewed which allows the company to practice the skimming and reassure the snobbish members of the Apple family.

IV. Apple's Strategy: United States and Europe

Apple's high-tech inventions may be in direct conflict with the high end products made by Nokia, Motorola, Sony Ericsson and Samsung. However, these companies will not give up that category without fighting for the end. They are used to cramming their phones with more technology than their competitors as in the case with Nokia's N series, Sony's P series, and Motorola's range of smart phones. They have high resolution cameras and video recorders, MP3 players, software and dozens of gameslso; not to mention the fact that they already have large market shares. For instance, the number of Symbian-based phones increased 44% to 34.6 million in the first six months of 2007 from 24 million in 1H 2006, with a quarter of those sales coming from Japan. The success of Nokia N95 and E-Series phones has also helped Symbian boost its revenues to about $172 million (Malik, 2007).

The North-American market is very different from the rest of the world, with strong segments for Microsoft, Palm (Access), and RIM. In Europe (EMEA) the market is dominated by Symbian (Nokia), with a small Microsoft pocket and an even smaller RIM market share. It's also interesting to see the large Linux share in Japan and China (PRC).

In Europe, Britain's O2 and Germany's T-Mobile have signed exclusive deals with Apple to offer the iPhone to their domestic customers. In Britain, subscribers will have to pay between $74 and $115 per month for an 18-month contract, while in Germany, customers must fork over $72 to $130 per month for a two-year contract (Scott, 2007). It appears that Apple is going against the grain of the European mobile business by charging £269 ($538) for the phone in Britain, and locking customers into 18-month contracts at monthly rates of £35 to £55 ($70 to $110). Typically, carriers discount even high-end cell phones in Europe. Such figures are in addition to the cost of the iPhone handset—which is itself a radical departure for the European market, where most phones are heavily subsidized by operators. British and German customers had to pay $565 and $439, respectively, for the iPhone, compared with $399 for U.S. consumers.

In France, Apple has chosen Orange as an exclusive carrier for its iPhone, which is sold in Orange's online and direct retail stores. The iPhone is available in an 8GB model for €399 ($592.78) and customers need to sign up for one of the special "Orange for iPhone" plans, which range in prices from €49 to €119 per month depending on the usage. Customers can also buy the iPhone for €549 if they wish to use one of Orange's other rate plans. If not, they have the option to buy an iPhone for €649 ($964.20) without a plan.

The European market is pretty much dominated by "pay-as-you-go customers" who have no contractual obligations to phone carriers and they make up 60% of the phone users (O'Brian, 2007). As a result, the iPhone may be insufficient to induce people to sign up for one or two year service contracts.

Currently, the iPhone is available (March, 2008) at 99€ in Germany and in United Kingdom whereas it cost more than 400€ in November 2007. On the one hand, the price cut can be explained by the arrival of a new iPhone in June 2008 compatible with 3G networks. On the other hand, it may be due to the disappointing sales in Europe: 100 000 iPhones sold in France, 70 000 in Germany and 200 000 in the UK while Apple's objective was to sell 10 000 000 globally by the end of 2008[2].

[2] http://tempsreel.nouvelobs.com/depeches/medias/multimedia/20080419.ZDN5194/apple_en_passe_de_devenir_un_fabricant_de_telephones_co.html

Conclusion

The challenge for Apple is to keep coming up with proprietary products that fuel its business model, which is based on innovation and R&D for both hardware and software. Apple's pricing strategies include setting the price high at the start of launching a new product. After gaining some profits from its early customers who are often fascinated with new technology, Apple seems to reduce its prices in order to make it affordable and popular among other competitive products. Not to mention the fact that Apple's iPhone and iPod prices change according to its customers as well as geographical locations. Basically, the company adapts prices according to the customers' ability to pay in different countries.

In addition to applying versioning and skimming pricing strategies, Apple also practices vertical bundling, linking the use of an iPod to the use of its iTunes stores. The company argues that protecting iTunes codes is in fact encouraging innovation. However, it also allows the company to control a large part of: portable digital media player market, online music market and online video market. At the same time, it maintains sufficient economic power in these markets in order to control consumer pricing, which ends up having its consumers pay higher prices.

With its iPhone, Apple has tried to bind users to AT&T in the US, Orange in France, T-Mobile in Germany and O2 in the UK. However, low sales rates in European countries have shown that iPhone prices were in fact too in comparison to similar smartphones issued by its competitors on the phone market. In order to respond to this challenge, Apple has used its best arm - innovation and will soon issue a new version of the iPhone, which is expected to relaunch iPhone sales.

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