

Concept of price and pricing.
Importance of pricing for the firm and the economy.
Internal and external price factors.
Pricing approaches-cost-based, demand-based, value-based and competition based approaches.
New product pricing decisions.
Price lining and price adjustment decisions.
Initiating and responding to price changes.

Unit-7

Pricing Decisions



Price



- Price is the amount a customer pays in return for goods or service.
- It is defined as the value of product attributes expressed in monetary terms which a consumer pay or is expected to pay in exchange and anticipation of the expected or offered utility.
- Price is what customers pay for what they get.
- It is the amount of money that customers pay for the product.
- It is the value of what is exchanged.



Price



Price is expressed in different terms for different exchange:

Tuition- Education

Interest- Use of money/capital

Rent- Use of living quarters or a piece of equipment for a period of time.

Fare- Taxi or bus ride

Fee- Service of a physician or lawyer

Retainer- Lawyer's services over a period of time

Salary- Services of an executive or other staffs

Wage- Service of labour

Commission- Sales-person's services

Taxes- Paid for the privilege of making money

Price



William J. Stanton

“Price is the amount of money and/or other items with utility needed to acquire a product.”

Philip Kotler and Gary Armstrong

“Price is the amount of money charged for a product or service, or the sum of the values that customers exchange for the benefits of having or using the product or service.”



Price is usually expressed in terms of money.

It can also be a combination of money and other items of value.

Pricing



Pricing is concerned with determination of price for a product.

It is based on various pricing methods.

Pricing is done after consideration of following aspects:

Cost of production for the product.

Purchasing power of the customer.

Price of competing products.

Pricing policy of middlemen- wholesaler, retailer.

Pricing policy of the organization.

Current legal provisions related to pricing.

Elasticity of demand for the product.



Pricing



Price setting has become increasingly complicated and competent job these days due to pricing problem usually in for general type of situation:

1. When the company develops a new product and must set its price for the first time.
2. When circumstance such as inflation, shortages or excess inventories leads a firm to consider initiating a price change.
3. When the company produces several products that have interrelated demand and/or cost.
4. Pricing is a problem when competition initiates a price change.

Importance of Pricing



To the Economy

(Macro Perspective)

Factors of production

Supply and demand

Saving and investment

Economic management

To the Organization

(Micro Perspective)

Profitability

Market share

Non-price competition

To the Customer

Product choice

Quality of the product

Customer value

Objective of Pricing



Profit Oriented

- Target Return
- Satisfactory Profit

Sales Oriented

- Sales Volume
- Market Share

Status-quo Oriented

- Price Stability
- Meet Competition
- Survival

Quality Oriented

- Quality Leadership
- Quality Imitation

Factors affecting Price Determination



Internal Factor

- Price objectives
- Costs
- Elements of marketing mix
- Organizational structure

External Factor

- Market demand
- Competition
- Marketing intermediaries
- Government regulations
- Pressure groups



Pricing Approaches



Cost Based

- Cost Plus
- Target Return
- Break-Even

Demand/Value Based

- Perceived Value
- Customer Value

Competition Based

- Meet competition method/Going rate pricing
- Below completion method
- Above completion method
- Sealed-bid pricing method

Pricing Approaches



Cost Based

- Cost Plus
- Target Return
- Break-Even

Cost Plus/Marking Up Pricing

It is the traditional method of pricing where certain profit margin is added to the total cost. Such margin may be expressed either in terms of percentage or in value.

Suppose, the total cost of production of a particular product per unit is Rs.100. The seller will add certain percentage or flat value to the total cost as profit margin.

Formula:

Cost Plus Price = Unit Cost + Profit Margin

If, Unit Cost = Rs.100

Profit Margin = Rs.10

Cost Plus Price = Rs.110

Pricing Approaches



Cost Based

- Cost Plus
- Target Return
- Break-Even

Target Return

An average Rate of Return/Investment (ROI) is estimated on either total investment or total sales.

A firm tries to determine a price which will give a specified rate of return on its investment. -
A desired return on investment is added to the total cost to set price.

Formula:

$$\text{Target Return Price} = \text{Unit Cost} + \frac{\text{Desired Return} \times \text{Invested Capital}}{\text{Unit Sales}}$$

E.g. A manufacturer has Rs.4 million in the business and wants to set a price to earn a return on investment (ROI) of 25%. The manufacturer estimates unit cost to be Rs.275 and thinks that it can sell 40,000 units.

Answer: Rs.300 per unit.

Pricing Approaches



Cost Based

- Cost Plus
- Target Return
- Break-Even

Target Return

E.g.

Given,

Units = 1000

Variable cost = Rs.4,000

Fixed cost = Rs.6,000

Total Investment = Rs.3,000

Expected ROI = 10% or Rs.300

Soln.,

Total Fixed Cost (including target rate of return)
= Rs.6,000+Rs.300=Rs.6,300

Per Unit Fixed Cost=Rs.6,300/1000 =Rs.6.30

Per Unit Variable Cost = Rs.4000/1000 =Rs.4

Thus price that apparently should be set to bring a 10% return on investment is Rs.10.30 per unit

Pricing Approaches



Cost Based

- Cost Plus
- Target Return
- Break-Even

Break-Even

It is determining the quantity that has to be sold at a given price so that total revenue will equal total cost.

Every unit sold above the break-even point is a contribution to profit and every unit below that point represents a loss.

Formula:

$$1. \text{ Break Even Point in Units} = \frac{\text{Total Fixed Cost}}{\text{Selling Price} - \text{Variable Cost Per Unit}}$$

$$2. \text{ Break Even Point in Rupees} = \left\{ \frac{\text{Total Fixed Cost}}{1 - \frac{\text{Variable Cost Per Unit}}{\text{Selling Price}}} \right\}$$

Pricing Approaches



Cost Based

- Cost Plus
- Target Return
- Break-Even

Break-Even

Suppose: Total fixed cost is Rs.50,000, Variable cost is Rs.5/unit, Selling price is Rs.10/unit

$$\begin{aligned} 1. \text{ Break Even Point in Units} &= \frac{\text{Rs.50,000}}{\text{Rs.10}-\text{Rs.5}} \\ &= 10,000 \text{ units} \end{aligned}$$

$$\begin{aligned} 2. \text{ Break Even Point in Rupees} &= \frac{\text{Rs.50,000}}{1 - \frac{\text{Rs.5}}{\text{Rs.10}}} \\ &= \text{Rs.1,00,000} \end{aligned}$$

Pricing Approaches



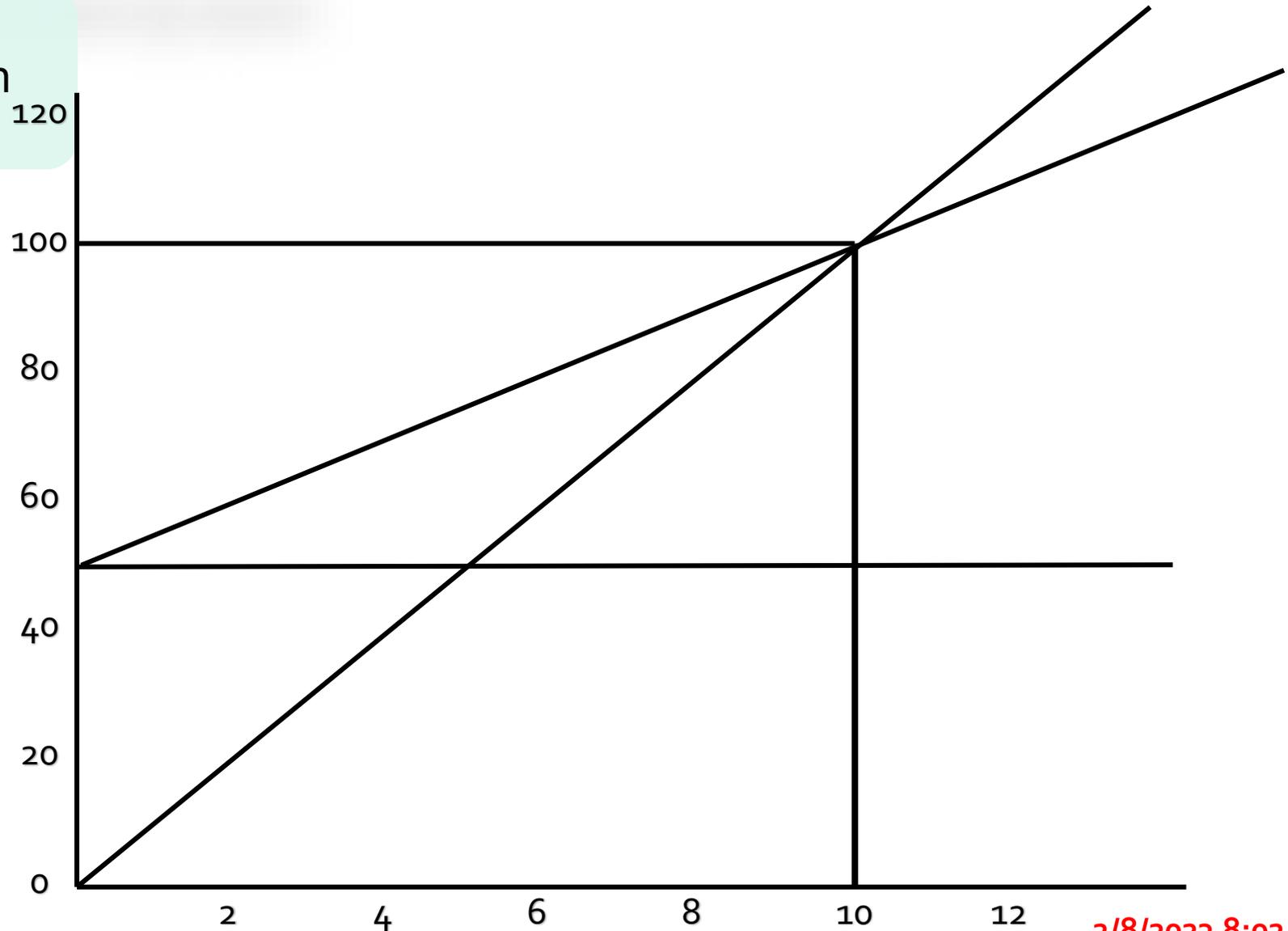
Cost Based

- Cost Plus
- Target Return
- Break-Even

Break-Even

1. 10,000 units

2. Rs.1,00,000



Pricing Approaches



Demand/
Value
Based

- Perceived Value
- Customer Value

Pricing Approaches



Demand/
Value
Based

- Perceived Value
- Customer Value

Perceived Value

It is the method of price determination which focuses on customer's perceived value.

Perceived value is made up of several elements, such as customer's image of the product performance, the channel deliverables, the warranty quality, customer support and softer attributes such as the suppliers' reputation, trustworthiness and esteem.

Under perceived value pricing, a firm sets its target price based on customer perceptions of the product value.

The firm can use other marketing mix elements, such as advertising and sales force to communicate and enhance perceived value in buyers' minds.

This pricing method is used for a new product.

Pricing Approaches



Demand/
Value
Based

- Perceived Value
- Customer Value

Customer Value

It is the method of price determination which focuses on customer value.

Here, the customer value is the ratio between benefits and the costs.

Benefits are that the customer may receive such as product value, service value, personal value and image value by purchasing goods and services.

On the other hand, costs are those that the customers have to pay such as money, time, energy and psychological efforts.

Customers want maximum value from the product purchased.

In this regard a firm may use customer value pricing method.

It is the method in which the firm wins loyal customers by charging a fairly low price for a high quality offering. It provides high customer value.

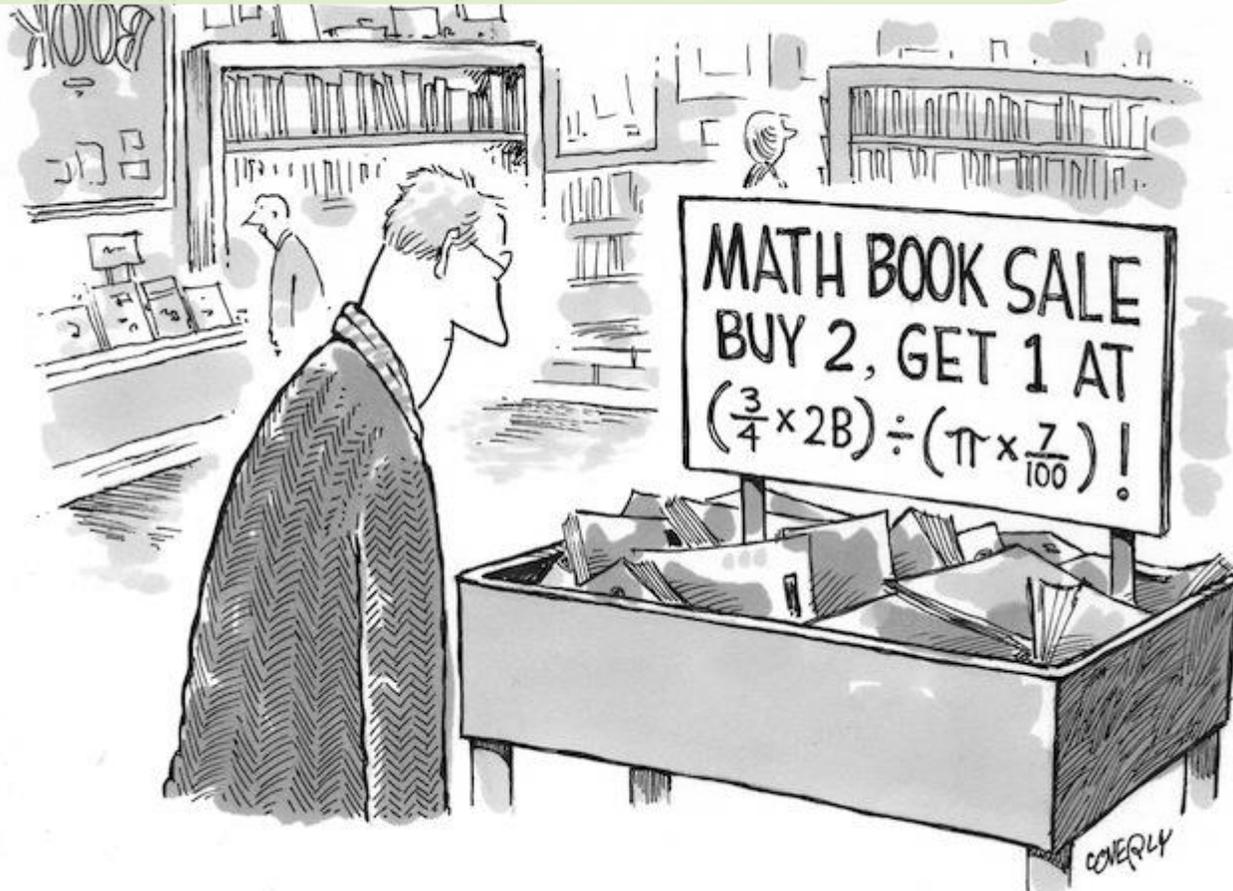
This pricing method is appropriate for the existing products.

Pricing Approaches

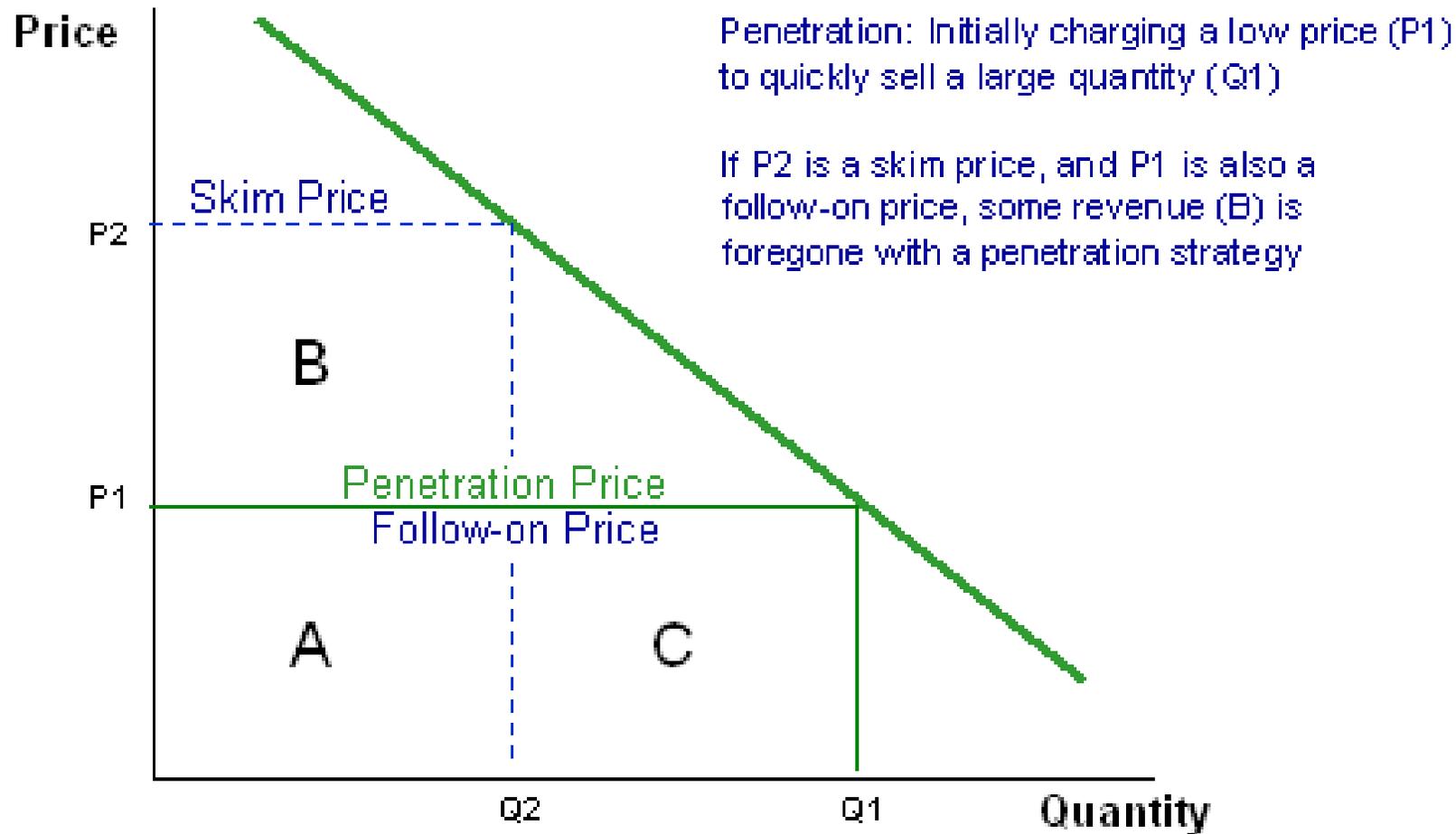


Competition Based

- Meet competition method/Going rate pricing
- Below competition method
- Above competition method
- Sealed-bid pricing method



New Product Pricing Decision



Market-Skimming Price

Market-Penetration Price

Competition Price

New Product Pricing Decision-Introduction Stage



Market Skimming may be suitable in the following situation:

If the company is going to launch a new product for the market.

If the new product has distinct feature strongly desired by the customer.

If the demand for the product is fairly inelastic.

If the new product is protected by patent right or other rights or the market is more protective for the product.

Market Penetration may be suitable in the following situation:

When a mass market exists for the product.

When the demand for the product is highly elastic.

When economies of scale are possible (i.e. substantial reduction per unit cost can be achieved through large-scale operation)

When fierce competition already exists in the market for the product.

Market-Skimming Price

Market-Penetration Price

Competition Price

Product Pricing Decision



In the growth stage of a product life cycle when the product has been accepted in the market, the pricing strategy is always to keep the price in tune with competitors' prices so as to hold and expand the market share. If the initial product price has been high, company now reduces it in order to meet competition on the other hand and expand the market on the other. If the price was fixed at lower level, the company would hold on to it.

Maturity stage is a stage of high competition. So, in this stage price range narrows down and tends to be uniform; non-price competition is preferred to maintain and enlarge the market share.

In this stage, the company follows a 'run-out' strategy which involves cutting back all support costs on a product to that minimum level that will optimize product's profitability over its limited foreseeable life.

Pricing strategy in
Growth Stage

Pricing strategy in
Maturity Stage

Pricing strategy in
Decline Stage

Price Lining & Price Adjustment Decisions



Price Lining

Price Lining refers to selecting a limited number of prices at which a business will sell related products.

It helps customers in simplifying buying decisions; while for the retailers, price lining helps planning purchases of required goods.

Price Adjustment Decisions

There are several strategies to adjust price of the product to the changed market situations.

- Geographical Pricing
- Price Discounts & Allowances
- Promotional Pricing
- Discriminator Pricing
- Product-Mix Pricing
- Psychological or Odd Pricing Strategy
- Resale Price Maintenance

Price Lining & Price Adjustment Decisions



Product-Mix Pricing

Product mix is a set of product-line and other items.

In each product-line different pricing strategies may be required.

These prices are to be modified time to time to maintain or maximize profit on the company's total product mix.

Pricing may be difficult because of the existence of interrelated demand and cost.

- Product-line Pricing: Color TV & B/W TV
- Optional-feature Pricing: Food with Cold/Hot drinks
- Captive-product Pricing: Razor Machine & Blade
- Two-part Pricing: Telephone Bill
- By-product Pricing: Wastages
- Product-bundling Pricing: Spoon set, Dinner set etc.

Geographical Pricing

Price Discounts & Allowances

Promotional Pricing

Discriminator Pricing

Product-Mix Pricing

Psychological or Odd Pricing Strategy

Resale Price

Maintenance

Initiating to price change



Pricing is a challenge not only when a firm sets a price for the first time; but also when it is about to initiate a price cut or increase.

Initiating Price Cuts:

- Excess capacity
- Vigorous price competition triggering a price war
 - Drive for dominance through lower costs
 - Demand for product is price-elastic
 - Consumers assume low quality of product
 - Reduction in service level

Initiating Price Increase:

- Costs inflation
- Over demand of the product
- Adding free service delivery or installation facility to the consumer
- Reduction in discounts
- Scarcity of the product



Responding to price change

When the key competitors of the company make changes in their products, the company should adopt price response strategies. The major price response strategies may be:

Competitive Price Strategy



Do Nothing Strategy



Non-Price Competition Strategy

