

Pricing Strategy

Steps in Setting Price:

Following are the steps in setting price for a product:

1. Selecting the pricing objectives;
 2. Determining the consumers' demand;
 3. Estimating costs;
 4. Analysing the competitors' costs, prices and offers;
 5. Selecting a pricing method; and
 6. Selecting the final price.
1. **Selecting the pricing objectives:** Before selecting a suitable price for a product, the marketer is needed to review the company's objectives. The more clearer the company's objectives, the more easier to set a price. Following are the possible pricing objectives:
 1. survival,
 2. maximum current profit,
 3. maximum market share,
 4. maximum market skimming, and
 5. product quality leadership.

The decision whether to select high price or low price depends on various factors:

1. Price susceptibility of market,
2. Number of competitors in the market, and
3. Production cost per unit.

The price level also depends on the type of marketing strategy adopted for the product. The possible marketing strategies are listed below:

1. **Rapid Skimming:** It refers to launching a new product at a high level of price with high level of sales promotion. It refers to the product which is of high quality, but not known to the buyers. As soon as the

- product is known to the buyers, the buyers are willing to purchase them even at a higher price. It may also refer to the market where there are strong potential competitors.
2. **Slow Skimming:** It refers to launching a new product at a high price with low level of promotion. It also refers to the situation where the company's brand is known to the buyers and they are willing to purchase them even at a higher price. It may also refer to the market where there are few competitors.
 3. **Rapid Penetration:** It refers to launching a new product at a low price with high level of promotion. This marketing strategy is adopted where the company's brand is unknown in the market and where there are strong potential competitors.
 4. **Slow Penetration:** Under the slow penetration market strategy, the company launches a new product at a low level price with low level of promotion. The brand of the company is known and there are few competitors in the market.
2. **Determining the consumer's demand:** The next step is determining the consumer's demand. At this stage, marketer analyses the different level of demand at different prices. Therefore, it leads to the study of law of demand, elasticity of demand, demand curve, etc. In normal case, the demand and price are inversely related, i.e, the higher the price, the lower the demand, and vice versa. But some goods have 'elastic' or 'inelastic' demand. For example, demand for automobiles, perfumes, etc. are elastic; whereas the demand for rice, flour, eggs, etc. are inelastic.
 3. **Estimating costs:** Demand sets a ceiling on the price and the costs set the floor. The company wants to charge a suitable price covering the cost of production, selling and distribution, and administration. Costs taken into two forms, i.e, variable costs and fixed costs. Variable costs vary directly with the variation in production, but remain fixed per unit of production. However, the fixed cost does not vary with the change in production units, but it does not remain fixed per unit, as the production units varies. In other words, the fixed cost remain fixed in total and decreases in Rs. per unit with the increase in the production units or increases in Rs. per unit with the decrease in the production units.
 4. **Analysing the competitors' costs, prices and offers:** For a marketer, the next step in setting a price for a product is to analyse the costs and prices of the product and after-sales services and different other

services offered by the competitors of the company. A deep analysis may enable a marketer to discover the strengths and weaknesses of the competitor and the tastes or the purchasing trends of buyers.

5. **Selecting a pricing method:** The company has to select an appropriate method for pricing its products. Following are the suggested pricing methods:
 1. **Mark-up Pricing:** Under mark-up pricing, the price is equal to cost plus percentage mark-up on cost. For example, the cost of constructing one residential flat for a constructor / developer is Rs. 500,000 and the constructor / developer charges 25% above cost, the selling price of 1 residential flat will be equal to Rs. 625,000, i.e., $[500,000 + (500,000 \times 25\%)]$. This kind of pricing method is common among the contractors, lawyers, chartered accountants, different practitioners and manufacturing companies for pricing job orders, custom products, etc.
 2. **Target Return Pricing:** Under target return pricing, the price of a product is equal to cost plus required rate of return on investment. For example, the shareholders / owners of a product-selling company is expecting a return of 20% on net assets that amounts to, let say, Rs. 200,000, the marketer would select a price which would scratch a net profit of Rs. 200,000. This sort of pricing method is adopted in public investment companies, large-scale manufacturing companies, etc.
 3. **Perceived Value Pricing:** The market price of a product is calculated on the basis of customers' perceptions about a product. It is extensively used in non-durable consumer goods manufacturing companies. Non-durable or soft goods may be defined either as goods that are used up when used once, or that have a lifespan of less than 3 years. Examples of non-durable goods include cosmetics, food, cleaning products, fuel, office supplies, packaging and containers, paper and paper products, personal products, rubber, plastics, textiles, clothing and footwear, etc.
 4. **Value Pricing:** It refers to pricing high quality products at fairly level. This sort of pricing method is extensively used in personal computer manufacturing industry, electronic goods manufacturing industry, etc.
 5. **Going Rate Pricing:** Under this pricing method, the price of a product is based on prices of existing products in the market. The

going rate pricing method is used in pricing paper, cement, fertilizers, steel, petrol and chemical industries.

6. **Sealed Bid Pricing:** It also refers to 'competitive-oriented pricing'. It is common where firms submit sealed bids for jobs / contracts. For example, pricing for scraps, wastages of factory, etc.
6. **Selecting a final price:** The final and the last step in setting prices is, of course, selecting a final price from a number of alternative prices, which would match the company's short term and long term objectives.

Price Adaptation Strategies:

Following are the price adaptation strategies:

1. **Geographical Pricing:** Geographical pricing refers to the product pricing for the customers in different locations, cities and countries. It also accounts for various tariffs, taxes and shipping costs. In foreign trade, another term is extensively used, i.e, counter-trade. It has taken 15-25% of the total world trade and may have the following forms:
 1. **Barter:** Exchange of goods with no money and third party.
 2. **Compensation deal:** The seller receives partial cash payment and the rest in products by the buyer.
 3. **Buyback arrangement:** The seller receives cash, as partial payment for the plant or machinery or any other technology being sold. And the rest of payment is made in the products manufactured on that machinery.
 4. **Offset:** The seller receives the full amount, but he will have to spent a part of it in the country or the location of buyer.
2. **Price Discounts and Allowances:** To promote the sales, the seller has to allow price discounts and allowances. Following are the forms of price discounts and allowances:
 1. **Cash Discounts:** Cash discounts are allowed by suppliers on early payments within the stipulated time, e.g, 2/10, net 30, 3/7 EOM, 2/15, net 40 ROG, etc. which are extensively used in trading and merchandising. 2/10, net 30 means the buyer must pay within 30 days of the invoice date, but will receive a 2% discount if they pay within 10 days of the invoice date.. 3/7 EOM - this means the buyer

will receive a cash discount of 3% if the bill is paid within 7 days after the end of the month indicated on the invoice date. It should be noted that if an invoice is received on or before the 25th day of the month, payment is due on the 7th day of the next calendar month. If a proper invoice is received after the 25th day of the month, payment is due on the 7th day of the second calendar month. 2/15 net 40 ROG - this means the buyer must pay within 40 days of receipt of goods, but will receive a 2% discount if paid in 15 days of the receipt of goods by the purchaser. (ROG is short for "Receipt of goods.").

2. **Quantity Discounts:** Quantity discounts are the price reductions generally allowed on bulk purchases, for example, 1% on less than 1000 units, 2% on 1000 units or more than 1000 units. The rationale behind them is to obtain economies of scale and pass some (or all) of these savings on to the customer. In some industries, buyer groups and co-ops have formed to take advantage of these discounts. Quantity discounts are, generally, of two types, i.e, cumulative quantity discounts and non-cumulative quantity discounts.
 1. **Cumulative quantity discounts:** also known as accumulation discounts. These are price reductions based on the quantity purchased over a set period of time. The expectation is that they will impose an implied switching cost and thereby bond the purchaser to the seller.
 2. **Non-cumulative quantity discounts:** are price reductions based on the quantity of a single order. The expectation is that they will encourage larger orders, thus reducing billing, order filling, shipping, and sales personal expenses.
3. **Functional Discounts:** Functional discounts are allowed to channel members if they perform various functions like distribution, storing, shelf-stocking and record keeping. Also known as 'trade discounts'. Trade discounts are often combined to include a series of functions, for example 20/12/5 could indicate a 20% discount for warehousing the product, an additional 12% discount for shipping the product, and an additional 5% discount for keeping the shelves stocked. Trade discounts are most frequent in industries where retailers hold the majority of the power in the distribution channel.
4. **Seasonal Discounts:** Seasonal Discounts are allowed on off-seasoned buyings. For example, warm-wear in June-July, cold drinks in December-January, etc.

5. **Allowances:** Allowances are extra-payments designed to gain reseller participation in special programmes, e.g, trade allowances, promotional allowances, brokerage allowances, etc.
3. **Promotional Pricing:** The promotional pricing strategies are:
 1. **Loss-Leader Pricing:** Super markets and departmental stores often drop prices on branded products to promote their stores' sales. But it dilutes the company's brand image and may lead to complaints from other retailers who charge the normal list price.
 2. **Special Event Pricing:** Special event pricing are for special events, e.g, Eid sale, Christmas sale, back-to-school sale, Eid Mela, etc.
 3. **Cash Rebates:** Cash rebates allowed by auto manufacturers and some consumer goods manufacturers within a specified time period.
 4. **Low Interest Financing:** Low interest financing is provided on certain consumer goods like automobile, motorcycle, television, refrigerators, air conditioners, etc.
 5. **Longer Payment Terms:** Sellers, especially mortgage banks and auto companies, stretch loans to their customers over longer periods and thus lower the monthly payments.
 6. **Warranties and Service Contracts:** Warranties and service contracts are provided on, especially, the consumer goods like television, refrigerators, air conditioners, personal computers, etc.
 7. **Psychological Discounting:** Psychological discounting involves in setting an artificially high price and then offering the same product at substantial savings.
4. **Discriminatory Pricing:** Price discrimination exists when sales of identical goods or services are transacted at different prices from the same supplier. Different prices are charged on the basis of different consumer groups, locations, product forms, etc. Discriminatory pricing may take the following forms:
 1. **Consumer-Segment Pricing:** Discriminatory pricing based on consumer segments, e.g, museum often charge low admission fee for students and senior citizens.
 2. **Product-Form Pricing:** Different versions of the same product are priced differently but not proportionately to the increase in costs. For

example, Microsoft sold different versions of its operating software Windows XP at different price level. 'Windows Vista Home Basic Version' is sold at \$200 and with some variations the same operating software 'Windows Vista Ultimate Version' is sold at \$320.

3. **Image Pricing:** Image pricing refers to pricing the same product on the basis of different images, e.g, a perfume manufacturer may put a perfume in a bottle, name it and give it an image and may price it at \$10 per ounce; he may put the same perfume in a different bottle, give it another name and image and may price it at \$18 per ounce.
4. **Location Pricing:** Discriminatory pricing based on different locations, even though the cost of offerings at each location is identical, e.g, theatre charges different prices for different audience preferences for different locations.
5. **Time Pricing:** Prices are varied by seasons, day or hours. Time pricing is usually applicable in public utilities like electricity, telephone bills, hotels and airlines, and also for internet hours.

Predatory Pricing: There is another type of pricing of discriminatory pricing known as 'predatory pricing'. It refers to setting a price of a product below its cost, just to beat the competitors in the market. This has been prohibited by law. There was a strong legal allegation against the Microsoft that it has been perceived from its pricing tactics that it is involved in predatory pricing. Thus, the US Government's anti-trust lawsuits against Microsoft, bring it to a big trouble. It even led the court to think to bifurcate the company into two companies. Actually, in 1996, the company started giving away its product 'Internet Explorer' below its cost and in some cases absolutely free. This Microsoft's pricing tactics wrest the market dominance from Netscape Communication Corporation. Netscape constantly revised its pricing structure but failed to appeal the customers. This cause rivals to label Microsoft as a predator, which was further tendentious for raising prices as it gains the lion's share of the market.

5. **Product Mix Pricing:** In pricing a product, the marketer must also accounts for profitability of product mix. Product mix pricing is a difficult task because each product has different demand, cost and competition. Product mix pricing may take several forms:
 1. **Product-Line Pricing:** Companies normally develop product lines rather than single products and develop different price levels, for e.g,

three price levels \$200, \$350 and \$500 for men's suits, the customers will associate low, average and high quality with the three price levels.

2. **Optional Features Pricing:** It refers to the pricing of additional features with the main products, e.g, pricing of air conditioners, personal computers, automobiles, etc.
3. **Captive-Product Pricing:** For example, manufacturers of razors and cameras often price them low and set high mark-ups on razor blades and camera film rolls.
4. **Two-Part Pricing:** It consists of a fixed charge and a variable charge based on consumption, e.g, pricing in telephone billings, electricity, etc.
5. **By-Product Pricing:** It refers to pricing of by-products for the consumers seeking to purchase the by-products.
6. **Product-Bundling Pricing:** Sellers often bundle their products and features at a set price.