Chapter 7

Pricing Policies and Strategies

Pricing represents the exchange value of goods and services in terms of money. It is an important component of marketing mix of a firm. Determining the prices of different products of a firm is a very difficult task of the marketing manager. Simply stated, the new product has never had a price before. The marketing manager has to do a lot of exercise to determine its price. He may pull a price out of the air because it sounds right. But this approach may lead to the failure of the firm because low pricing would lead to huge loss and high pricing may .turn the firm out of the market. The marketing manager may also decide to follow the competition or may decide simply to charge as much as he can get. Both these approaches are also not sound and they may threaten to undermine the long-run survival of the firm. An innovative marketing manager determines the prices in such a way that the firm is able to sell its products successfully and achieve its overall objectives. He tries to maintain optimum relation between pricing and other components of the marketing mix, viz., product, promotion and distribution.

7.1 CONCEPT AND SIGNIFICANCE OF PRICING

Definition of Price

The term 'price' denotes money value of a product. It represents the amount of money for which a product can be exchanged. In other words, price represents the money which the buyer pays to the seller for a product. In actual business situations, it is very difficult to define the price of a product. When a person is buying a product, he may buy certain services also alongwith the product. The more the number of services he wants to get, the more price he will have to pay. Thus, in pricing we must consider more than the physical product alone. A seller prices a combination of the physical product plus several other services and benefits alongwith the product including warranty promise, repair facilities, package, free home delivery service and credit facilities. The price a buyer has to pay will depend upon the number of services he requires along with the product.

Some sellers quote a price that includes various services while others price these individual services separately. This point must be taken into consideration while comparing the prices charged by different sellers. It is obvious that there are many possible combinations of a product and the various services which may accompany it. In the light of this discussion, we may define price *as the amount of money which is charged by a seller from a buyer for combined assortment of a product and its accompanying services.*

Significance of Pricing

Pricing is an important element of marketing mix of a firm. All other Ps of marketing mix *i.e.*, product, promotion, physical distribution and packaging are highly dependent on the price at which the firm can sell its product to the customers. Pricing decisions and policies have direct influence on the nature and type of product and its packaging, promotion policies, and channels or distribution policies of the firm. For instance, a firm may decide to improve the quality of its product, increase the number of accompanying services and spend more on promotion, packaging, and distribution if it is confident to sell its product at the price good enough to cover the cost of additional services and promotion: There is also no doubt that nature and type of product, promotion and distribution policies of the firm influence the pricing policy of the firm.

Pricing policy of a firm is a major determinant of its success. If prices are too high, the business is lost; if prices are too low, the firm may be lost. Price structure affects the firm's competitive position and its share of the market. It has an important bearing on the firm's revenue and net profit. With the help of the price, the firm can make an estimate of expected revenue and profit. Profit is equal to revenue minus cost. Price also helps in determining the quantum of production which should be carried on by the firm. The management of a firm can make estimates of profits at various levels of production and at different prices and can choose the best possible combination of production volume and price.

Pricing decisions affect the competitive strength of the firm in the market. In a free market economy, *price mechanism has considerable impact upon the competitive strength of different firms*. Obviously, more consumers will be attracted to the seller charging lesser price for a given product. Each firm would try to outsell others through price reduction resulting in competitive conditions in the market. In this way price also helps in maximising social welfare.

Pricing of different goods is also important from the point of view of the consumer. They determine the purchasing power and the standard of living of the consumer. Goods and services offered by various producers at different prices help the consumer to take buying decisions and satisfy his wants in a better way. For instance, a person may decide to buy a small colour T.V. and a study table instead of purchasing a big colour T.V. only, In his decision-making, the person is guided by his purchasing power based on prevailing prices.

Pricing is the key activity in the economy of a country which permits the system of free enterprise. Pricing influences wages, interest, rent and profit. It regulates production and allocates resources in a better way. High wages attract labour, high interest rates attract capital and so on. The firms which are not able to market their products at good prices cannot survive in the long-run since they are not able to pay for the various factors of production. Thus pricing weeds out the inefficient firms. It compels the existing firms to make better utilisation of economic resources if they want to survive in the long-run.

7.2 OBJECTIVES OF PRICING

As an element of the marketing mix, pricing strategy should be directed towards the accomplishment of specific marketing objectives which lead to overall organisational objectives. Pricing is not an end in itself, but a means to achieve certain objectives of the marketing department of a firm. Before determining the price itself, an explicit formulation of the firm's pricing objectives is essential. In actual practice, very few firms cautiously establish pricing objectives. Non-formulation of the clear-cut pricing objectives and policies leads to inconsistency and non-uniformity of pricing in the long-run.

The fundamental guides to pricing are the firm's overall goals. Normally, the broadest of these is survival. But to be more specific, firm's objectives relate to the rate of growth, market share, independence of operations and earning of sufficient profits. The pricing objectives should aim at achieving the firm's objectives. Pricing objectives vary from firm to firm. Generally, the firms have multiple pricing objectives. The important pricing objectives followed by various firms are as under :

1. Profitability objectives :

(*i*) Target rate of return on investment

(*ii*) Maximisation of profits.

2. Market related objectives :

(*iii*) Meeting or preventing competition in the market.

(*iv*) Maintaining or improving market share.

(*v*) Price stabilisation.

3. Public relations objective :

(*vi*) Enhancing public image of the firm.

These objectives are discussed below :

(*i*) **Target Rate of Return on Investment or Net Sales.** This is an important goal of pricing policy of many firms. A firm following this goal tries to build a price structure to provide sufficient return on capital employed. Generally, an estimate is made of return expected over the long-run, and the prices are fixed to achieve the expected rate of return. This leads to *cost plus pricing*. In other words, the price represents the cost of production and distribution and a margin of profit.

(*ii*) **Profit Maximisation.** In practice, no firm states explicitly that its pricing objective is to maximise profits because of fear of public criticism. However, in economic theory, there is nothing wrong with the objective of profit maximisation because if profits become unduly high, new entrepreneurs will be attracted into the field. Thus, there will be an automatic balance of demand and supply of the product. But in the recent years, the business philosophy has changed. Most of the businessmen do not attempt to maximise their profits because they realise that they operate in the society and they have certain social obligations.

(*iii*) **Meet or Prevent Competition.** Some firms adopt the pricing policy to meet or prevent competition. They are ready to fix their prices to meet competition in the market. Sometimes they are prepared to follow 'below cost pricing' in order to fight competition. They charge less than the cost because they feel that it will prevent the new firms to enter the market. It may be mentioned that this practice is not publicly admitted by the firms even though they follow it while introducing a new product. Sometimes, this practice turns out to be unsuccessful because new firms are attracted into the field once the new product becomes popular. It is not possible for a firm to charge less than the cost of a product for a long-term period.

(*iv*) **Maintain or Improve Share of Market.** This pricing objective is followed by the firm operating in the expanding markets. When the market has a potential for growth, market share is a better indicator of a firm's effectiveness than the target return on investment. A firm might be earning a reasonable rate of return but its share of market may be decreasing. Therefore, a worthwhile pricing objective in times of increasing market should be to maintain or to improve share of the market.

(*v*) **Price Stabilisation.** Many firms have the objective of price stabilisation in the long run. The objective is often found in industries that have a price leader. In oligopolistic situation where there are only a few sellers, each seller will try to maintain stability in his pricing. In such a situation, one seller acts as the price leader and others follow him. Thus, a relationship exists between the leader's price and those charged by other firms. No firm is willing to engage itself in price wars. They may even forego maximising profits in times of prosperity or short supply in order to stabilise the prices. Price stability helps in planned and regular production in the long-run. In order to stabilise prices, many manufacturers follow the policy of resale price maintenance by their dealers. In some degree, this goal is collateral to that of a target return on investment.

(*vi*) **Public Image.** A company's image is important to its success. This is largely influenced by the company's practice/pricing strategy. A firm with an established reputation based on existing price lines may introduce a new product at either higher or lower prices to appeal to a different market segment. If this segment has not tried any of the company's product but is aware of its prestige, it might desire to purchase its products because price is no larger a deterrent factor.

7.3 FACTORS AFFECTING PRICE DETERMINATION

Numerous factors affect the pricing policies and decisions of a firm. Such factors could be studied under two groups : (1) ***Internal Factors*** ; and (2) ***External Factors.*** *Internal factors* are the forces which can be controlled by a firm to a certain extent such as company objectives, marketing mix, costs, etc. But *external factors* are the forces outside the firm over which a business has not control. They include demand, competition, buyers, suppliers, economic conditions and government.

(1) Internal Factors

(*i*) **Objectives of the Firm.** A firm may have various objectives and pricing contributes in achieving them. Firms may persue a variety of objectives, such as maximising sales revenue, maximising market share, maximising customer delight, maintaining a particular image, maintaining stable price, etc. Pricing policy should be established only after proper considerations of the objectives of the firm.

(ii) **Role of Top Management (Organisational Factors).** It is the top management which generally has full authority over pricing. The marketing manager's role is to assist the top management in price determination and administer the pricing within policies laid down by top management. Pricing activities have such direct effect on sales volume and profit that the marketing manager cannot keep himself aloof pricing policy marking. However, in many companies, some authority is also granted to lower level executives for setting prices, especially where pricing varies in different markets, or where there are numerous product and frequent pricing decisions are required.

(iii) **Cost of the Product.** Cost and price of a product are closely related. The most important factor is the cost of production. In deciding to market a product, a firm should also try to decide what prices are realistic, considering current demand and competition in the market.

(iv) **Product Differentiation.** The price of the product depends upon the characteristics of the product. In order to attract the customers, different characteristics and benefits are added to the product, such as quality, size, colour, attractive package, alternative uses, etc/ Generally, customers pay more price for the product which is of the new style, design, better package, etc.

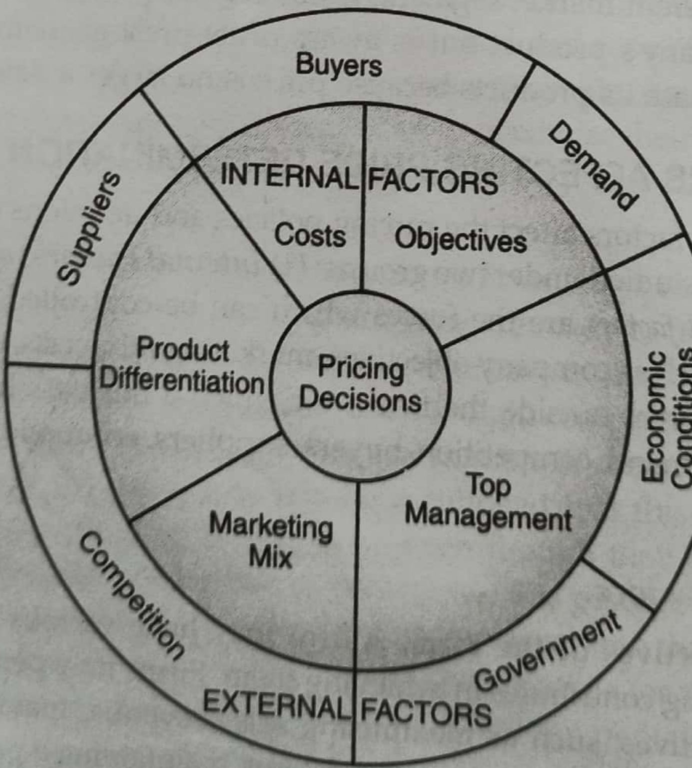

Fig. 7.1. Internal and External Factors in Pricing.

(v) **Marketing-Mix.** Price is one of the important elements of the marketing mix and, therefore, must be coordinated with the other elements : production, promotion and distribution. In some industries, a firm may use price reduction as a marketing technique; others may raise prices as a deliberate strategy to build a high-prestige product line. In either case, the effect will fail if the price change is not commensurate with the total marketing strategy that it supports.

(2) *External Factors*

(*i*) **Demand.** The market demand for a product or service has a big impact on it pricing. Since demand is affected by the prospective buyers, their capacity and willingness to pay, their preference etc. are taken into account while fixing the price. A firm can determine the expected price in a few test-markets by trying different prices in different markets and comparing the results with a controlled market in which price is not altered. If the demand of the product is inelastic, high prices may be fixed. On the other hand, if demand is elastic, the firm should not fix higher prices, rather it should fix flexible (lower) prices than that of the competitors.

(*ii*) **Competition.** Competition in the market is a crucial factor in price determination. The prevailing information about what price the competitors are charging for similar products and what possibilities lie ahead for raising or lowering prices also affect pricing.

(*iii*) **Buyers.** The nature and behaviour of the consumers and users, for the purchase of a particular product or service, do affect pricing, particularly if their number is large or if they perceive a product of better quality and a symbol of status and prestige.

(*iv*) **Input Suppliers.** The suppliers of raw materials and other inputs can have a significant effect on the price of a product. For example, if the price of cotton goes up, the increase is passed on by suppliers to manufacturers. Manufacturers, in turn, pass it on to consumers. Sometimes, however, when a manufacturer appears to be making large profits on a particular product, supplies will attempt to cash in on the profits by charging more for their supplies. In such a case, the manufacturer may decide to absorb the additional costs and not increase the prices.

(*v*) **Government Regulations.** The regulatory pressures, anti-price rise and control measures by the Government effectively discourage companies from cornering too large a share of the market and controlling prices. Table 1 lists the factors that influence prices in practice :

TABLE 1 Force Influencing Pricing in Practice

Forces that Push Up Price	*Forces that Pull Down Price*
1. There is more demand but less supply.	There is more supply but less demand.
2. An increases in wages not matched by an increase in productivity	Stable wages as productivity rises.
3. Weak competition and non-price competition	Strong competition and competition on the basis of price.
4. Lack of efficiency in the use of land, labour, and capital by business.	Efficient use of land labour and capital by business.
5. Buyers eager to acquire ownership (bullish attitude).	Buyers resistance to purchasing for any reason (bearish attitude).
6. Sellers hold goods for higher prices (bullish attitude).	Sellers eager to sell stock (bearish attitude).
7. The supply of money increases.	The supply of money decreases.
8. Goods are non-perishable by nature.	Goods are perishable by nature.

Source : Based on Schwartz, David, J., *Marketing Today : A Basic Approach*, 1977 p 528.

7.4 PRICING POLICIES

Pricing policies constitute the general framework within which pricing decisions should be made in order to achieve the pricing objectives. They provide guidelines within which pricing strategy is formulated and implemented. The following statements will clarify the meaning of pricing policy :

(*i*) Pricing should aim at maximising profits for the entire product line.

(*ii*) Prices should be set to promote the long-term welfare of the enterprise, *e.g.*, to discourage competition in the market.

(*iii*) A predetermined and systematic method of pricing new products should be provided.

(*iv*) Prices should be adopted and individualised to fit the diverse competitive situations encountered by different products.

A systematic approach to pricing the products of a firm requires that decision of individual pricing situations be generalised and codified into policies covering all the principal pricing policies. Pricing policies should be tailored to meet the various competitive situations. This implies that a firm can follow different pricing policies with regard to different markets or different customers. For instance, full cost pricing may be followed to sell the products to a big buyer like Government, particularly when the plant capacity is lying idle.

Types of Pricing Policies and Decisions

We can classify various pricing policies into the following categories :

(*i*) Demand-oriented pricing.