UNIT- III

LESSON 9 **PRICING POLICY**

STRUCTURE

9.1 INTRODUCTION

Pricing is a crucial managerial decision. Most companies do not encounter it in a major way on a day-to-day basis. But there is need to follow certain additional guidelines in the pricing of the new product. The marketing of a 'new product' poses a problem for any firm because new products have no past information. Here the firm is also not in a position to determine consumer reaction. The question is, what do we mean by a new product? New products for our purposes will include original products, improved products, modified products and new brands that the firm develops through its own R&D efforts. When fixing the first price, the decision is obviously a major one. When the company introduces its product for the first time, the whole future depends heavily on the soundness of initial pricing decision. Top management is accountable for the new product's success record and therefore establish specific criteria for acceptance of new product ideas especially in a large multidivisional company where all kinds of projects bubble up as favourites of various managers. There are always competitors who would also like to produce it at the earliest opportunity. Pricing decision assumes special importance when one or more competitors change their prices or products or both. Sometimes, the competitors may introduce a new brand without altering the price of an existing brand. If the new brand is perceived to compete with a given brand more effectively, then the firm in question may have to think on its pricing policy once again.

From a customer's point of view, value is the sole justification for price, Many times customers lack an understanding of the cost of materials and other costs that go into the making of a product. But those customers can understand what that product does for them in the way of providing value. It is on this basis that customers make decisions about the purchase of a product. Effective pricing meets the needs of consumers and facilitates the exchange process. It requires that marketers understand that not all buyers want to pay the same price for products, just as they do not all want the same product, the 3ame distribution outlets, or the same promotional messages. Therefore, in order to effectively price products, markets must distinguish among various market segments. The key to effective pricing is the same as the key to effective product, distribution, and promotion strategies. Marketers must understand buyers and price their products according to buyer needs if exchanges are to occur. However, one cannot overlook the fact that the price must be sufficient to support the plans of the organisation, including satisfying stockholders. Price charged remains the primary source of revenue for most businesses,

9.2 OBJECTIVES

The objectives of this lesson is:

- To understand the concept of pricing.
- To know about the factors affecting pricing decisions.

9.3 PRICE DEFINED

Although making the pricing decision is usually a marketing decision, making it correctly requires an understanding of both the customer and society's view of price as well. In some respects, price setting is the most important decision made by a business. A price set too low may result in a deficiency in revenues and the demise of the business. A price set too high may result in poor response from customers and, unsurprisingly, the demise of the business. The consequences of a poor pricing decision, therefore, can be dire.

9.3.1 The Customer's View of Price

As discussed in an earlier chapter, a customer can be either the ultimate user of the finished product or a business that purchases components of the finished product. It is the customer that seeks to satisfy a need or set of needs through the purchase of a particular product or set of products. Consequently, the customer uses several criteria to determine how much they are willing to expend in order to satisfy these needs. Ideally, the customer would like to pay as little as possible to satisfy these needs. Therefore, for the business to increase value (i.e., create the competitive advantage), it can either increase the perceived benefits or reduce the perceived costs, Both of these elements should be considered elements of price,

9.3.2 Price from a Societal Perspective

Price, at least in dollars and cents, has been the historical view of value. Derived from a bartering system-i.e., exchanging goods of equal value-the monetary system of each society provides a more convenient way to purchase goods and accumulate wealth. Price has also become a variable society employs to control its economic health. Price can be inclusive or exclusive. In many countries, such as Russia, China, and South Africa, high prices for products such as food, health care, housing, and automobiles, means that most of the population is excluded from purchase. In contrast, countries such as Denmark, Germany, and Great Britain charge little for health care and consequentlymake it available to all . There are two different ways to look at the role price plays in a society: rational man and irrational man. The former is the primary assumption underlying economic theory, and suggests that the results of price manipulation are predictable.

9.3.3 The Marketer's View of Price

Price is important to marketers, because it represents marketers' assessment of the value customers see in the product or service and are willing to pay for a product or service. A number of factors have changed the way marketers undertake the pricing of their products and services.

1. Foreign competition has put considerable pressure on U.S. firms ‘ pricing strategies. Many foreign-made products are high in quality and compete in U.S. markets on the basis of lower price for good value.

2. Competitors often try to gain market share by reducing their prices. The price reduction is intended to increase demand from customers *who* are judged to be sensitive to changes in price.

3. New products are far more prevalent today than in the past. Pricing a new product can represent a challenge, as there is often no historical basis for pricing new products. If a new product is priced incorrectly, the marketplace will react unfavourably and the “wrong” price can do long-term damage to a product’s chances for marketplace success.

4. Technology has led to existing products having shorter marketplace lives. New products are introduced to the market more frequently, reducing the “shelf life” of existing products.As a result, marketers face pressures to price products to recover costs more quickly. Prices must be set for early successes including fast sales growth, quick market penetration, and fast recovery of research and development costs.

9.4 PRICING OBJECTIVES

Firms rely on price to cover the cost of production, to pay expenses, and to provide the profit incentive necessary to continue to operate the business. We might think of these factors as helping organisations to: (1) survive, (2) earn a profit, (3) generate sales, (4) secure an adequate share of the market, and (5) gain an appropriate image.

1. ***Survival:*** It is apparent that most managers wish to pursue strategies that enable their organisations to continue in operation for the long term. So survival is one major objective pursued by most executives. For a commercial firm, the price paid by the buyer generates the firn1’s revenue. If revenue falls below cost for a long period of time, the firm cannot survive.

2. ***Profit:*** Survival is closely linked to profitability. Making a $500,000 profit during the next year might be a pricing objective for a firm. Anything less will ensure failure. All business enterprises must earn a long-term profit. For many businesses, long-term profitability also allows the business to satisfy their most important constituents-stockholders. Lower-than-expected or no profits will drive down stock prices and may prove disastrous for the company.

3. ***Sales:*** Just as survival requires a long-term profit for a business enterprise, profit requires sales. As you will recall from earlier in the text, the task of marketing management relates to managing demand. Demand must be managed in order to regulate exchanges or sales. Thus marketing management's aim is to alter sales patterns in some desirable way.

4. ***Market Share:*** If the sales of Safeway Supermarkets in the Dallas-Fort Worth metropolitan area account for 30% of all food sales in that area, we say that Safeway has a 30% market share. Management of all firms, large and small, are concerned with maintaining an adequate share of the market so that their sales volume will enable the firm to survive and prosper. Again, pricing strategy is one of the tools that is significant in creating and sustaining market share. Prices must be set to attract the appropriate market segment in significant numbers.

5. ***Image:*** Price policies play an important role in affecting a firm's position of respect and esteem in its community. Price is a highly visible communicator. It must convey the message to the community that the firm offers good value, that it is fair in its dealings with the public, that it is a reliable place to patronise, and that it stands behind its products and services.

9.5 FACTORS DETERMINING PRICING POLICY

The pricing decisions for a product are affected by internal and external factors.

A. Internal Factors:

1. Cost

While fixing the prices of a product, the firm should consider the cost involved in producing the product. This cost includes both the variable and fixed costs. Thus, while fixing the prices, the firm must be able to recover both the variable and fixed costs.

2. The predetermined objectives

While fixing the prices of the product, the marketer should con-sider the objectives of the firm. For instance, if the objective of a firm is to increase return on investment, then it may charge a higher price, and if the objective is to capture a large market share, then it may charge a lower price.

3. Image of the firm

The price of the product may also be determined on the basis of the image of the firm in the market. For instance, HUL and Procter & Gamble can demand a higher price for their brands, as they enjoy goodwill in the market.

4. Product life cycle

The stage at which the product is in its product life cycle also affects its price. For instance, during the introductory stage the firm may charge lower price to attract the customers, and during the growth stage, a firm may increase the price.

5. Credit period offered

The pricing of the product is also affected by the credit period offered by the company. Longer the credit period, higher may be the price, and shorter the credit period, lower may be the price of the product.

6. Promotional activity

The promotional activity undertaken by the firm also determines the price. If the firm incurs heavy advertising and sales promotion costs, then the pricing of the product shall be kept high in order to recover the cost.

B. External Factors:

1. Competition

While fixing the price of the product, the firm needs to study the degree of competi-tion in the market. If there is high competition, the prices may be kept low to effectively face the competition, and if competition is low, the prices may be kept high.

2. **Consumers**

The marketer should consider various consumer factors while fixing the prices. The consumer factors that must be considered includes the price sensitivity of the buyer, purchasing power, and so on.

3. **Government control**

Government rules and regulation must be considered while fixing the prices. In certain products, government may announce administered prices, and therefore the mar-keter has to consider such regulation while fixing the prices.

4. **Economic conditions**

The marketer may also have to consider the economic condition prevail-ing in the market while fixing the prices. At the time of recession, the consumer may have less money to spend, so the marketer may reduce the prices in order to influence the buying decision of the consumers.

5. **Channel intermediaries**

The marketer must consider a number of channel intermediaries and their expectations. The longer the chain of intermediaries, the higher would be the prices of the goods.

Some other factors need to be consider while fixing price for a product are:

- ***Determine primary and secondary market segments.*** This helps you better understand the offering's value to consumers. Segments are important for positioning and merchandising the offering to ensure maximized sales at the established price point.
- **Assess the product's availability and near substitutes.** Underpricing hurts your product as much as overpricing does. If the price is too low, potential customers will think it can't be that good. This is particularly true for high-end, prestige brands. One client underpriced its subscription product, yielding depressed

response and lower sales. The firm underestimated the uniqueness of its offering, the number of close substitutes, and the strength of the consumer's bond with the product. As a result, the client could increase the price with only limited risk to its customer base. In fact, the initial increase resulted in more subscribers as the new price was more in line with its consumer-perceived value.

- ***Survey the market for competitive and similar products.*** Consider whether new products, new uses for existing products or new technologies can compete with or, worse, leapfrog your offering. Examine all possible ways consumers can acquire your product. I've worked with companies that only take into account direct competitors selling through identical channels. Don't limit your analysis to online distribution channels.

  Competitors may define your price range. In this case, you can price higher if consumers perceive your product and/or brand is significantly better; price on parity if your product has better features; or price lower if your product has relatively similar features to existing products. An information client faced this situation with a premium product. Its direct competitors established the price for a similar offering. As the third player in this segment, its choices were price parity with an enhanced offering or a lower price with similar features.

- ***Examine market pricing and economics.*** A paid, ad-free site should generate more revenue than a free ad-supported one, for example. In considering this option, remember to incorporate the cost of forgone revenue, especially as advertisers find paying customers more attractive.

  To gain additional insight from this analysis, observe consumers interacting with your product to better understand their connection to it. This can yield insights into how to package and promote the offering that can affect on pricing, features, and incentives.

- **Calculate the internal cost structure and understand how pricing interacts with the offering.** A content client promote its advertising-supported free e-zines to incent readers to register. The client believed the e-zines had no value as the content was repurposed from another product, so it didn't advertise them. Yet the repurposed content was exactly what readers viewed as a benefit. By undervaluing its offering, the client missed an opportunity to increase registrations and, hence, advertising revenues with a product that effectively had no development costs**.**

- ***Test different price points if possible.*** This is important if you enter a new or untapped market, or enhance an offering with consumer-oriented benefits. To determine price, MarketingExperiments.com tested three different price points for a book. It found the highest price yielded the greatest product revenue. Interestingly, the middle price yielded greater revenue over time, as it generated more customers to whom other related products could be marketed.
- ***Monitor the market and your competition continually to reassess pricing.*** Market dynamics and new products can influence and change consumerneeds. Determine price based on a number of factors. Most important is what potential customers are willing to pay and their value to your company over time.

9.6 PRACTICALASPECT OF PRICING DECISION

Practical aspect of pricing decision explained here with the help of a case study.

CASE STUDY: PRICING IN THE PACKAGE HOLIDAY MARKET

UK holidaymakers take some 36 million overseas holidays each year. Of these, almost half are "packaged holidays" - where the consumer buys a complete package of accommodation, flight and other extras - all bundled into one price. This is a highly competitive market with a small number of large tour operators (including Thomson Holidays, Air tours, First Choice, JMC) battling hard for market share. Package holidays were devised partly as a way of achieving high sales volumes and reducing unit costs by allowing tour operators to purchase the different elements (flight, catering, accommodation, etc.) in bulk, passing some of the savings on to consumers.

Low margins require high asset utilisation

Estimates of tour operating margins vary, but fairly low average figures - of the order of 5% (or around £22 on the typical holiday price of around £450) are widely assumed in the mainstream segment of the market. It should however be noted that vertically integrated holiday operators (where the tour operator also owns an airline and a travel agency) will normally also generate profit from consumers. Accordingly, the gross margins on the total operations of the integrated operators may be larger than those on their tour operation activities alone. Tour operators need to operate at high levels of capacity utilisation (figures of the order of 95% or more in terms of holidays sold) in order to maintain profitability. Matching capacity and demand is therefore critical to profitability, especially since package holidays are perishable goods - a given package loses all its value unless it is sold before its departure date. Perishable goods markets require highly flexible production and distribution systems so that supply and demand can be closely matched and 'waste' production minimised. But suppliers of package holidays are severely hampered in precisely aligning capacity and demand. They need to 'produce' (i.e. contract for the necessary flights, accommodation, etc.) virtually the whole of what they expect to sell a long time before it is 'consumed' (i.e. when the consumer departs for the holiday destination, or at the earliest, when the consumer pays the bulk of the price - usually around 8 weeks before departure).

Long-term management of capacity

Tour operators' capacity plans, and the associated contracts with hoteliers and airlines, are typically fixed 12-18 months ahead of the holiday season. Some adjustments are possible after this date. However, within about 12 months of departure date, once the booking season has begun (i.e. from about the summer of 2002 for departures in summer 2003) the scope for changes is severely limited. This is due to the inflexibility of many commitments with suppliers and the problems associated with changing dates, flights, hotels, etc., of customers who have already booked. Only by contracting for their expected needs well ahead of time, enabling suppliers to plan ahead, can tour operators obtain a sufficiently low price to attract an adequate volume of profitable sales. Tour operators therefore need to encourage early bookings. These improve cash flow - a substantial deposit (usually around £100 per person, equivalent to around 25% of a typical short-haul holiday price) is paid by consumers on booking; the balance is payable two months in advance of departure (except, naturally, for 'late' bookings). Tour operators also reduce the risk of unsold holidays, and the consequent need for discounting, later on. Adding capacity is easier than reducing it during a season, although in some instances, e.g. where a particular resort is proving especially popular, all suitable accommodation (and/or flights to the relevant airport) will already have been reserved, at least for the peak period. But it