CHAPTER 8

PRICING

LEARNING OBJECTIVES

After completing this chapter, the student will be able to:

- **Understand the concept of 'price' and 'pricing'**
- **Explain various pricing objectives**
- **Identify the factors that affect pricing**
- **Understand the various methods of pricing**
- **Comprehend various pricing strategies followed in practice by business enterprises**

8.1 INTRODUCTION

Pricing is an element of the marketing mix and plays a significant role in the development of the marketing strategy of a firm. Pricing is important because it is the only element in the marketing mix that brings revenue to a firm whereas all other elements represent costs. Besides, pricing is an element that provides a great deal of flexibility to a marketer. Unlike product features and channel commitments, prices can be changed quickly. Yet, despite its importance, many marketers do not handle pricing well. In this chapter, we will focus on those aspects of pricing that enable a firm to develop an effective marketing strategy. Some such major aspects include: the concept of price and pricing; pricing objectives; the factors that affect pricing decisions; general pricing methods/approaches and pricing strategies.

8.2 CONCEPTS OF PRICE AND PRICING

Concepts of price and pricing are discussed in the following lines:

8.2.1 Price Defined

In the ordinary sense, *price refers to the amount of money charged for a product or service.* This means that a price is the cost paid by a customer to acquire a product or use a service. In marketing, however, price is defined in a broader sense and *represents the value that is exchanged in a marketing transaction.* Value reflects the relationship between the product's benefits and the consumer's costs. It means price is something that is given up (i.e., what is sacrificed) in an exchange to gain the benefits of having or using a product or service. On the part of a customer, the sacrifice is usually monetary (product cost), but it can be other things as well, such as the time spent waiting to acquire the product or service. The benefits can be in the form of getting a need-satisfying product or service, and additional services, such as warranty or guarantee, after-sales services, etc.

It is only after comparing the benefits against the sacrifices that customers arrive at a final judgment about product prices and make buying decisions. Likewise, sellers also take into account these considerations and decide about product prices. In most marketing transactions, price is important and buyers and sellers are aware of the value that each must part with in order to complete the exchange.

8.2.2 Pricing Defined

Pricing can be defined as the art of translating into quantitative terms (rupees, etc.) the value of the product to customers at a point in time. The notion of value here is flexible, subjective and determined by the customer. Value may be concrete, such as the cost savings of replacing worn-out shoes with a new pair. It may be intangible, such as the owner's pride in having a new car. The same product may have a different value for two different customers, or it may have a different value for the same customer over time. Having a sports car may seem important to a 19-year-old, but by the time the driver is 25, economy or safety may be overriding concerns.

A few important points about pricing are worth noting:

1. Pricing covers the 'total marketing offering'. In this sense, pricing takes into account the product cost, a reasonable profit margin and the cost borne by the firm on account of all the facilities and benefits extended to buyers. These may include: the time of payment (immediate cash payment or payment through instalments); discount offered; guarantee or warranty assurances; timely and authentic information transmitted through advertising, personal selling, and other communication channels; convenient distribution methods chosen and so forth.
2. We generally think only of consumer and industrial goods as having a 'price'. But, pricing is equally important for services. However, for services, prices are expressed in different terms. For example, insurance companies charge a premium, educational institutions charge a tuition fee, a lawyer or physician charges a fee, taxis charge a fare, banks charge interest for a loan, a toll is charged for some bridges, etc.
3. Pricing is an important concern for both non-profit and profit-making organizations. The non-profit group may wish to set a 'fair' price for its services. For example, a hospital may charge a heavy price if it wants to recover the total cost involved in providing services to its customers, or it may charge a small price if it wishes to become self-sufficient through large gifts from donors.

8.2.3 Importance of Pricing

Pricing is important because it acts as a powerful instrument to produce significant results in the market place. Its power is not equaled by any other element of the marketing mix. Pricing has the power to change the market dynamics and help a company in gaining a position of competitive advantage. We explain how pricing plays such an important role and brings about beneficial effects.

1. **Pricing is the source of a firm's revenue generation and profit:** Price is the only element in the marketing mix that produces revenue; all other elements represent cost. Through the creative use of pricing, it can stimulate demand and motivate customers to buy a firm's products. This brings in revenue. Besides, a price makes a direct impact on a company's profits. When a firm is able to sell enough of its products to cover its costs, it earns profits. This can be best understood with the following equation, which is significantly important for the entire company:

   $$\text{Profits} = (\text{Prices} \times \text{Quantities Sold}) - \text{Total Costs}$$

   Prices multiplied by quantities sold, generate revenues; when a firm is able to sell enough of its products to recover its costs, it gets profits.
2. **Pricing is the most flexible element of the marketing mix:** Price is often the only marketing mix element that can be changed quickly to respond to changes in demand or competitive moves. For example, a marketer can agree to a field salesperson's request to lower price for a potential customer during a phone conversation. But, such quick changes are not possible with other elements of the marketing mix. For instance, it may be necessary to introduce quick modifications in the product features to meet the requirements of customers or competition, but it is not possible, because modifying product features takes time. Similarly, it takes time to introduce any changes in the promotional programme or the distribution system.
3. **Pricing is the index of product quality and user status:** Price has a psychological impact on customers and can reflect product quality and user status. A company can highlight the product quality and user status by keeping the price high. This is especially true for ego-intensive products, such as specific brands of clothes, jewellery, cars and music and photographic equipment.
4. **Pricing is a powerful tool of offering and meeting the challenges of competition:** Regardless of the types of products marketed, a firm can offer a tough competition to its rivals as well as face challenges thrown by them, with the appropriate pricing policy. Sometimes, a marketer may decide to follow price-cutting as a strategy to build or maintain market share. When a firm's costs are lower than those of the competitors, it has the advantage of following a low-price strategy to win over customers.
5. **Pricing is the determiner of value:** Pricing is the most authentic and widely-used way to attach value to a product. Through pricing, a firm can express the value of the product in monetary terms. Also, consumers can weigh their satisfaction in terms of the price they pay for the product.

8.2.4 Pricing Objectives

Pricing objectives are goals that describe what a firm wants to achieve through pricing. Pricing objectives may vary from firm to firm. Marketers must ensure that pricing objectives are consistent with marketing objectives and the overall objectives of an organization. The various pricing objectives that companies might set for themselves can be classified into the following three major groups:

1. Profit-oriented pricing objectives
2. Sales-oriented pricing objectives
3. Status-quo pricing objectives

These three categories of pricing objectives are shown in Figure 8.1 and explained below.

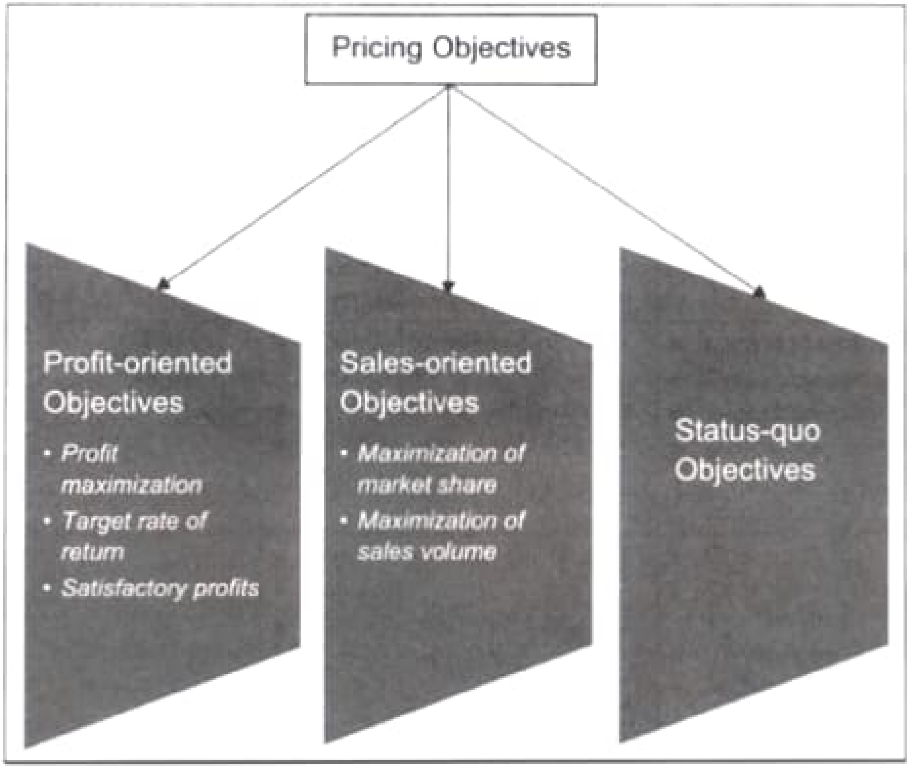

Figure 8.1 Three Types of Pricing Objectives

8.2.5 Profit-oriented Pricing Objectives

The important profit-oriented objectives are as follows:

- **Profit maximization:** Profit maximization means setting prices so that total revenue (i.e., receipts from sales) is as large as possible relative to total cost. In attempting to maximize profits, managers may try to expand revenue by increasing customer satisfaction, or they can attempt to reduce costs by operating more efficiently.
- **Target return on investment:** Many firms strive for a specific level of profit, generally known as the target rate of return on investment (ROI). Target ROI is calculated by adding a percentage amount to the cost of the product (called mark-up) that is sufficient to cover the anticipated operating expenses and a desired profit margin. The actual market conditions in each industry determine the target rate - it may be 8 percent, 10 per cent, or some other percentage.
- **Satisfactory profits:** Satisfactory profits are reasonable profits. Rather than maximizing profits or achieving a target rate of return on investment, some firms seek a level of profit that satisfies the shareholders and management. The definition of 'satisfactory', however, will be decided keeping in view the level of risk that an organization faces.

8.2.6 Sales-oriented Pricing Objectives

Firms pursue a variety of volume-oriented objectives. These objectives are explained below:

- **Maximization of market share:** Market share is a company's product sales as a percentage of the total sales of that industry. The pricing policy of some firms is geared towards maximizing the firm's market share. In growing fields, especially technology-based products, companies want a large market share to gain added clout with vendors, reduce production costs and project a dominant appearance to customers. Besides, when sales are increasing but the firm's competitors are multiplying at an ever faster rate, a false sense of security may develop. To face this danger, firms keep a close watch on their percentage of the market share.

- **Maximization of sales volume:** Rather than strive for market share, sometimes firms try to maximize sales. This pricing objective is typically adopted to achieve rapid growth or to discourage other firms from entering a market. A business firm may elect to offer an unusually low price in order to increase dramatically the number of customers using its product. This is known as the rapid-penetration objective. The firm hopes to increase its share of the market through this strategy. Retail chains, such as Big Bazaar, aim at this objective.

8.2.7 Status-quo Pricing Objectives

Some pricing objectives are not related to either profitability or sales volume, yet they are important in the pricing. One such pricing objective is status-quo objective. This is explained here.

- **Status-quo objectives:** Status-quo pricing seeks to maintain the firm's existing position. When a favourable situation exists, any change represents a threat, whether from customers, competitors or the government. To protect its position, a firm may pursue status-quo-oriented objectives. These may include such objectives as: the maintenance of market share; meeting (and not beating) the competition; the maintenance of an image; the maintenance of stable prices; the achievement of certain mark-ups and the recovery of costs.

It is obvious from the above description that, generally, a firm will pursue more than one objective at the same time. While it may aim at maximum profits, it may also wish to maintain good relations with the consumers and build a prestigious company name (even if this means reducing immediate profits). The firm's pricing decisions will reflect all of these objectives. One goal may be dominant at a particular time, but often pricing decisions will represent a balancing of different objectives.

8.2.8 Factors Affecting Prices and Pricing

Two general sets of factors, internal and external, affect the prices of goods and services. The nature of internal pricing considerations (corporate and marketing objectives, marketing mix, etc.) is that they can be controlled by the firm. On the other hand, external factors (demand, competition, economic conditions, government regulations and ethical considerations, etc.) cannot be controlled by the firm. These internal and external factors put pressures on a firm while making its final pricing decision. These factors are shown in Figure 8.2 and explained below:

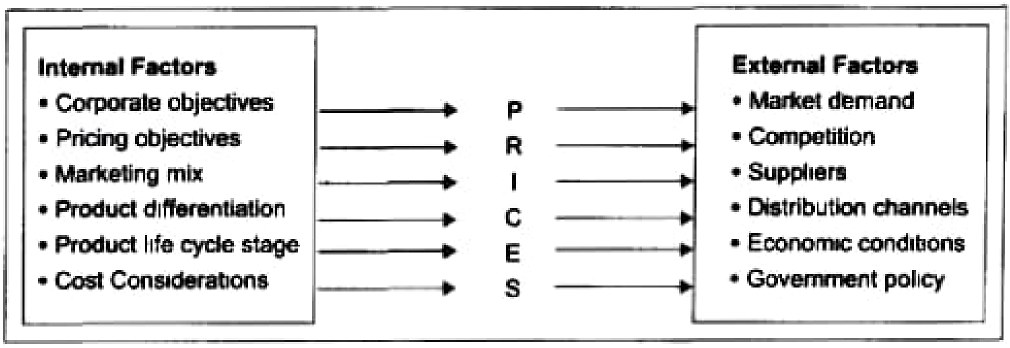

Figure 8.2 Factors Affecting Prices/Pricing

8.2.9 Internal Factors

The impact of major internal factors on pricing is discussed below:

1. **Corporate objectives:** Corporate objectives reflect the philosophy of the owners and also their perception of the external environment. Marketers should set prices that are consistent with their corporate objectives. For example, if the corporate objective is to achieve very high sales growth, the marketer will set prices very low to generate new sales and take sales away from competitors, even if profits suffer. On the other hand, if the objective is to emerge as a quality leader, the marketer will set prices relatively high (i.e., premium pricing).
2. **Pricing objectives:** There are many types of pricing objectives, and the type of pricing objective a marketer uses has a considerable effect on pricing decisions. For example, a marketer who uses pricing to increase its market share would set its brand's prices below competing brands of similar quality to attract the competitor's customers.
3. **Marketing mix:** All marketing mix variables are highly interrelated. Pricing decisions are considerably influenced by other elements and activities associated with the product, distribution and promotion variables of a firm's marketing mix. For example, superior product quality and features, efficient channels of distribution and effective media of communication, enable a firm to set higher prices for its market offerings.
4. **Product differentiation:** Generally, the more a firm's product is differentiated from competitive offerings, the more flexibility it has in setting higher prices for its products. For example, if customers see few differences between competing products, they will buy whatever product costs the least.
5. **Product life cycle stage:** The various stages, through which a product passes during its life time, have a considerable bearing on its prices. During the introductory stage, a firm usually adopts a cost-plus pricing strategy as the product is new and strives for market acceptance. During the growth and maturity stages, a firm uses a competition-oriented pricing strategy because the product has already gained market acceptance and competes against existing brands. During the decline stage, a firm uses price-cut strategy because the product's sales and profits have declined.
6. **Cost considerations:** Clearly, costs have a direct bearing on the levels of prices. A firm may temporarily sell products below cost to match competition, to generate cash flow or even to increase market share, but in the long run it cannot survive by selling its products below cost. To maintain market share and revenue in an increasingly price-sensitive market, firms must constantly concentrate on reducing costs.

8.2.10 External Factors

The effect of major external factors on pricing is explained below.

1. **Market demand:** The market demand for a product or service has an important impact on pricing. Many factors shape demand, including the price of the product and offers from other firms, the income and preferences of buyers and the number and size of competitors. In settling upon a price, marketers must study the character of demand in the industry and must gauge the effects of price changes on demand.
2. **Competition:** The dynamics of competition is a key factor in pricing strategy. For example, low or no competition in the market has an effect of pushing up product prices.

8.3.1 Cost-oriented Pricing

One of the methods of pricing a product is on the basis of its cost. There are three different ways or methods in which a company can use cost as the basis of setting prices. These are explained here.

1. **Full cost or mark-up pricing:** Under this method, the marketer estimates the total cost (fixed cost + variable cost) of producing a product and then adds a mark-up or the margin (i.e., something extra for profits) that the firm wants. This is the simplest pricing method and is commonly used by construction companies, lawyers, accountants, software consultants, and other professionals. This approach has one advantage in that it allows recovery of all costs plus the amount added as a profit margin. This method, however, suffers from certain limitations. It ignores the fact that the firm may not sell its all products at a price that the firm has calculated. Besides, there may also be technical problems in allocating fixed costs in multi-product firms.
2. **Direct cost or contribution pricing:** Under this method, the marketer uses only those costs that are directly attributable to a specific output in setting prices. In simple words, the marketer works on the premise of recovering the direct (variable) cost of the product and getting a contribution towards its overheads (fixed cost). The direct cost method is used when the market is dominated by big firms and the objective of the firm is to get a foothold in the market. In such a situation, the marketer will feel satisfied if the firm is able to recover its direct cost immediately, and as it gains market acceptance, it can raise the product price above the variable cost and recover a part of the fixed cost. This method also works well when there is idle capacity and the margin covers some part of the fixed cost.
3. **Break-even pricing:** Under this cost-oriented pricing method, the marketer examines the relationship among cost, price, revenue and profit over different levels of production and sales. Central to this analysis is the determination of the break-even point. At the break-even point, the sales volume generates just enough revenue to equal the total cost. Here the firm has neither a profit nor a loss; that is, it just breaks even. The break-even point is important because a firm begins to make a profit only with a sales volume beyond that point. Break-even volume is calculated using the following formula:

   Break-even Volume = Total Fixed Cost/Price-Variable Cost per Unit

   Or

   (Per unit contribution to fixed cost)

   For example, consider a toy animal produced by a company in Delhi. The product has a fixed cost of ₹50,000 a year, a variable cost of ₹6 per unit and sells at a price of ₹10. The number of units necessary to break even for the year would be:

   Break-even Volume = ₹50,000/₹(10-6)

   = 12,500 units.

If the company wants to make a profit, it must sell more than 12,500 units.

8.3.2 Value-oriented Pricing

The value-oriented method of pricing is based on the value that a product has for the customer, and not on the cost for the seller or any other factor. A customer values a product in terms of his needs, desires, preferences, and psychological satisfaction which he is likely to derive by using it. The customer's perception of the product is also influenced by his comparison of prices charged by competitors. Therefore, a company using value-based pricing must also find out what value customers attach to the competitors' products. Essentially, marketers should be able to capture the value of the product as perceived in the mind of the customer.

Value-oriented pricing is of two types, as shown in Figure 8.4 and explained below:

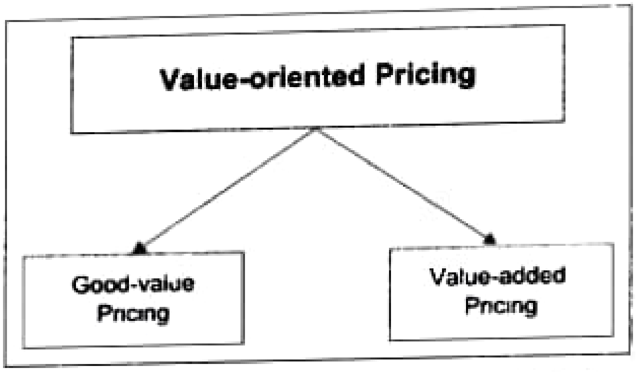

Figure 8.4 Types of Value-oriented Pricing

- **Good-value pricing:** When a company offers just a fair amount of quality and good service at a reasonable price, it is called good-value pricing. Consumers' attitudes towards price and quality have undergone a fundamental shift, and to cater to this, the marketers are adopting this approach. For example, the introduction of less expensive versions of an established brand name: Levi's Strauss introducing Levi's Signature and McDonald's offering 'value meals.' Another approach is to sell products at low prices as followed by chains like Reliance Fresh, Big Apple, Fair Price, etc.
- **Value-added pricing:** When a company attaches value-added features and services to differentiate their products and justify their higher prices, it is called value-added pricing. Thus, instead of reducing prices (as is done under good-value pricing), the value-added pricing strategy focuses on superior product features and services, and through this price power is built. This helps in avoiding price competition and justifying higher product prices. For example, Dove soap is priced higher as compared to other soaps as it is the soap that claims to have moisturizer in it which justifies its higher price.

8.3.3 Comparison between Cost-oriented Pricing and Value-oriented Pricing

Figure 8.5 compares the cost-oriented pricing method with the value-oriented pricing method. This comparison clearly shows that cost-oriented pricing is product-driven whereas value-oriented pricing is customer-driven.

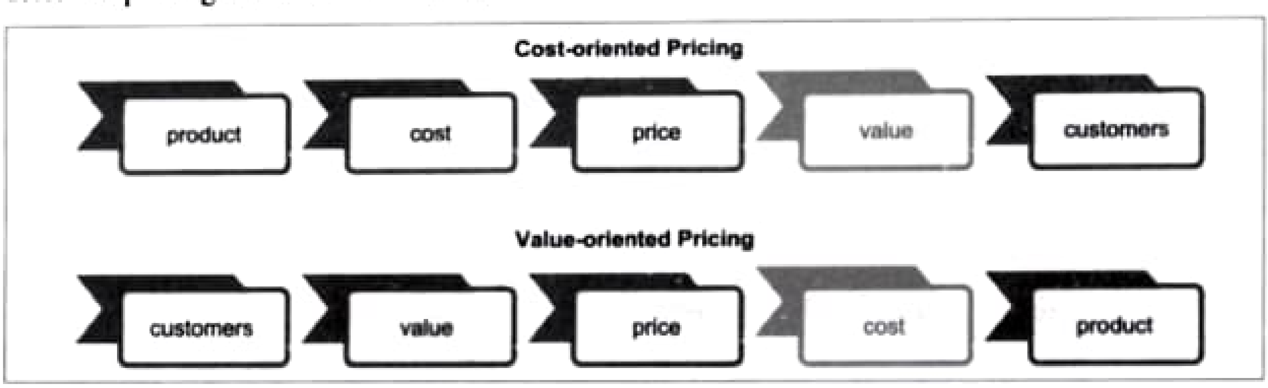

Figure 8.5 Reverse Sequential Arrangement between Cost-oriented and Value-oriented Methods

Table 8.1 presents a detailed comparison between cost-oriented and value-oriented pricing methods.

Table 8.1 Cost-oriented vs Value-oriented Pricing

Basis	Cost-oriented Pricing	Value-oriented Pricing
Basis of calculation	Prices are calculated on the basis of costs of producing a product	Prices are calculated on the basis of the buyer's perceived evaluation of a product
Profit earned	A certain amount of profit (margin) is added to the cost	A high amount of profit can be earned as prices so charged might be higher based on the value attached to the product by the customer
Types of products	This approach is generally followed by non-branded products	This approach is generally followed by branded products
Process of price calculation	In this case, the product is produced first and the cost is calculated and then the price is attached	In this case, the perceived value that will be attached by the customers is measured and then the product is produced and priced so as to deliver that value to the customers
Complexity involved	It is comparatively easier to calculate cost; hence, there is not much difficulty in setting product prices	It is very difficult to accurately assess buyer's perception of value; hence, very difficult to set product prices
Basis of market research	In this method, the market research might focus on the competitors' prices of products	This approach commands a lot of market research to assess consumers' perceptions about the product and their capacity to pay

8.3.4 Demand-oriented Pricing

Under this approach, the price is determined on the basis of the demand for the product. The company analyses the pattern of demand of the product to finalise the price of a product. In case the demand for the product is strong, customers pay a higher price. On the other hand, when the demand is weak, a lower price is charged. For example, hotels that otherwise attract numerous tourists in season often offer reduced tariff during lower-demand (off-season) periods. Obviously, the effectiveness of demand-based pricing depends on the marketer's ability to make a correct assessment of the demand.

8.3.5 Competition-oriented Pricing

Competition-oriented pricing, as the name indicates, is done to face the competitors in the market. Whenever a firm has to decide about its prices, it has to take into account the prices charged by its competitors. It is of the following two types:

1. **Going-rate pricing or 'follow the crowd' pricing:** Under this method, prices are fixed at the same level as that of the competitors. Smaller firms 'follow the leader'. If the leading firm changes its prices, the firms following also change their prices, irrespective of any change in their firms' own demand or costs. This type of pricing acquires significance where the products are homogeneous and price is the major variable in the marketing strategy, such as cement or steel. This method of pricing helps to prevent price wars in the industry. However, its biggest limitation is that it assumes that all firms or the leading firm is operating efficiently. In case it is not, it means that the firm following the leader will also adopt a price level which reflects the leader's inefficiency, rather than its own efficiency.

2. **Sealed-bid pricing:** Under this method, bids (quotations) are invited from different suppliers, and the one who quotes the lowest rate gets the order, subject to satisfying the product specifications. The rates quoted by the potential suppliers are kept confidential and known only to themselves and the buyer (sealed bids). A major focus for suppliers is the likely bid prices of competitors. This method is generally adopted by business buyers and government agencies.

Figure 8.6 Showing Competitive Pricing can Sometimes Lead to Price-wars

8.4 MAJOR PRICING STRATEGIES

A pricing strategy is a course of action designed to achieve pricing and marketing objectives. Generally, pricing strategies help marketers solve the practical problems of establishing prices. Some of the major pricing strategies available to marketers are shown in Table 8.2 and discussed in this section.

Table 8.2 Major Pricing Strategies

New-product pricing strategies	Market-skimming pricing Market-penetration pricing
Product-line pricing strategies	Captive pricing Bait pricing Premium pricing Two-part pricing
Psychological pricing strategies	Odd pricing Bundle pricing Reference pricing Prestige pricing
Promotional pricing strategies	Loss leader pricing Special event pricing
Differential pricing strategies	Geographic pricing Negotiated pricing
Price-adjustment strategies	Discount and allowance pricing Dynamic pricing

8.4.1 New-Product Pricing Strategies

New-product pricing strategies aim at developing prices for new products. Companies bringing out a new product face the challenge of setting prices for the first time. Depending on the product and marketing context, companies can choose between two broad strategies: market-skimming pricing or market-penetration pricing.

Market-skimming pricing

A market-skimming pricing strategy involves setting a relatively high initial price for a new (innovative/novelty) product in order to get maximum advantage from early adopters. It taps the opportunity for the selling product at high prices to those segments of the market that want to possess new products first and do not bother much about the price. By charging a higher price in the initial stages of the product, the firm intends to skim the cream (i.e., reap maximum profits). It is for this reason, this is also known as 'skimming the cream off the top' strategy. This strategy was used by Maggie noodles when it entered the Indian market and had no competitor.

Conditions under which skimming pricing is particularly appropriate:

- The new product is perceived to be unique, having distinctive features strongly desired by consumers, e.g., offering new benefits to consumers currently not available in alternative products.
- Some consumers are willing to pay the higher initial price to have the innovation first.
- Demand for the product is fairly inelastic, especially during the early stages of a product's life cycle.
- Competitors are not able to enter the market easily and undercut the high price. This, for example, is possible through patent protections; or making it difficult for competitors to copy the innovation easily (because the product is complex to manufacture, its raw materials are hard to get or the product relies on one's own invented technology), or the high costs of entry.

Market-penetration pricing

A market-penetration pricing strategy involves setting a relatively low initial price for a new product to tap a substantial segment of a large and growing market. The low price established for the new product helps a firm to penetrate deep into the market easily, capture a large share of a substantial market and earn profits quickly. Besides, low prices discourage competitors from entering the market because the profit margin is relatively small. The penetration pricing strategy has been successfully used by well-known companies. For example, Micromax entered the washing powder market by using penetration pricing; McDonald's success is primarily because it offers a wide range of food at low prices; and Dell is typically associated with penetration pricing.

Conditions under which penetration pricing is particularly appropriate:

- A large market exists for the product and the market has the potential for further growth.
- Few consumers are willing to pay a high initial price.
- The market is highly sensitive to the price level even in the introductory stage and the low initial product price builds heavy sales.

- The market is so characterized by competition that soon after its introduction, the product may encounter stiff price competition from other brands/substitutes.
- High production volume is required to offer the product at a reasonably low price.

Table 8.3 presents the basic differences between skimming and penetration pricing strategies.

Table 8.3 Skimming vs Penetration Pricing

Basis	Skimming Pricing	Penetration Pricing
Price level	Relatively high initial prices are kept when the product is introduced	Relatively low prices are kept when the product is introduced
Aim	To reap maximum profits (i.e., skim the cream) before the competitors enter the market.	To reach the mass market and capture a large share in the market
Competition	No competition exists when the product is introduced	Competition already exists in the market.
Price-quality association	Price-quality association is strong and the product is a novelty	Price-quality association is weak and the product may not be a novelty.
Usefulness	Useful for products with a shorter product life cycle	Useful for products with a longer product life cycle

8.4.2 Product-Line Pricing Strategies

Product-line pricing strategies aim at organising a set of prices that are used to establish and adjust the prices of multiple products within a product line. The purpose of product-line pricing is to maximize profits for the entire product line, rather than focusing on the profitability of individual items. The major product-line pricing strategies are discussed here.

(i) **Captive pricing:** A captive pricing strategy involves setting a price for the basic product along with other products (items) that are required to operate the basic product. For example, printers need ink and razors need blades. With captive pricing, the basic product is priced low while the items required to operate the basic product are priced high, e.g., Gillette razors are normally priced low but the blades are priced high. Similarly, printers are reasonably priced while ink is highly priced.

(ii) **Bait pricing:** A bait pricing strategy involves putting a low price on one item (product) in the product line with the intention of selling a higher-priced item in the product line. For example, a TV retailer might advertise its lowest-priced TV model, in the hope that when customers visit his store they will purchase a higher-priced TV model.

(iii) **Premium pricing:** A premium pricing strategy involves setting higher prices for higher-quality or more versatile products in comparison to other models in the product line. This strategy is employed by marketers when they have multiple versions/models of the same product, along a product line, and each version is targeted at a separate customer segment. For example, a TV-selling firm may have different models with different features, like the one with a remote control and TV-programme-recording facility, the other with a remote control but without TV-programme-recording facility, and yet simple model without a remote control and programme-recording facility attached to it. The firm may set a premium (highest) price for the TV with remote control and programme-recording facility and put it at the top of the product line, followed by other models.

(iv) **Two-part pricing:** A two-part pricing strategy involves establishing two separate charges (prices) to consume a single good or service. This pricing strategy is very common with and cars. A bottle of perfume priced at ₹5,000, for example, might contain scent worth only ₹500 only, but some customers still buy it for ₹5,000 in the belief that it is of superior quality because of its high price.

8.4.4 Promotional Pricing Strategies

Promotional pricing strategies aim at promoting the sale of products for a short term. Companies using promotional pricing temporarily price their products below the list price, and sometimes even below cost, to stimulate early purchases. Two major forms of promotional pricing strategies are discussed below:

(i) **Loss leader pricing:** A loss leader pricing strategy involves dropping the price on a product (near or even below cost) to generate demand or traffic at the retail outlet. Big retail stores often use loss leader pricing to attract customers by giving them especially low prices on a few items. Backed by heavy promotion, these items are used to bring customers into the store in the hope that they will buy other items to offset losses from the loss leaders. The only problem with this strategy is that the firms whose brands are chosen as loss leaders oppose this strategy as it dilutes their image.

(ii) **Special event pricing:** A special event pricing strategy involves establishing special prices and coordinating them with a particular day, season, or event. For example, Big Bazaar offers its lowest prices on Wednesdays; retailers offer huge discounts during festivals such as Diwali; and amusement companies like EsselWorld offer special attractions on New Year's Eve.

8.4.5 Differential Pricing Strategies

Differential pricing strategies are designed to charge different prices across different market segments for the same quality and quantity of product. The main purpose of differential pricing is to attract potential customers from various market segments who cannot afford a single price that is too high. In simple words, heterogeneity in the market motivates a firm to adopt differential pricing strategies. Some major types of such strategies are explained below:

(i) **Geographic pricing:** A geographic pricing strategy involves charging different prices for the same product in different markets—say, charging a premium price in the primary target market, and a discounted price in another (secondary) market. Often, the price charged in the secondary market is lower, where a firm either dumps or sells at a discounted price to utilize its surplus capacity. For example, some textbooks and pharmaceutical products are sold for considerably lower prices in foreign countries than in the domestic country.

(ii) **Negotiated pricing:** A negotiated pricing strategy involves establishment of final price through bargaining between the buyer and the seller. For example, wholesalers negotiate prices with manufacturers even when there is a predetermined stated price. Like business intermediaries, ordinary consumers are also seen negotiating prices for houses, cars, etc.

8.4.6 Price-Adjustment Strategies

Price-adjustment strategies are designed to accommodate customer and situational requirements by adjusting product prices. The most commonly used price-adjustment strategy are discount and allowance pricing and dynamic pricing, which are discussed below:

(i) Discount and allowance pricing

A discount and allowance pricing strategy involves adjustment in the basic product prices to reward customers for showing certain favourable payment and buying behaviours. To encourage customers to do what they would not ordinarily do, companies offer various forms of discounts (price reduction). The most common ones include: cash discount (for making prompt payment), quantity discount (for buying in large quantities), functional discount (to trade channels for performing certain functions like storage and transportation), and seasonal discount (for making off-season purchases). Apart from discounts, companies also offer allowances (reduction in prices) to reward dealers or distributors for promoting the company's products through sales support programmes. For example, if a retailer runs an ad for a company's product, the company may pay, say, half the bill.

(ii) Dynamic pricing

A dynamic pricing strategy involves adjusting prices continuously to meet the characteristics and needs of individual customers and situations. A dynamic pricing strategy is mainly used by Web (Internet) sellers who are required to instantly and constantly adjust prices to meet the requirements of demand dynamics. Online auctions through eBay, for example, are a powerful method of dynamic pricing in which consumers negotiate the final prices they pay.

EXERCISES

Review Questions

1. What is meant by price? Explain the objectives of the pricing policy of a business firm.
2. What important factors should a marketer consider before setting product prices?
3. Using examples, discuss the advantages and disadvantages of cost-plus pricing.
4. What is price skimming? Under what conditions are price skimming and price penetration advisable?
5. Discuss psychological pricing strategy. Illustrate the application of psychological pricing strategy with examples.
6. Compare cost-based and demand-based pricing methods, with examples.
7. What is promotional pricing? What are its advantages or disadvantages?

University Examination Questions