UNIT 8 OBJECTIVES AND METHODS

Structure

8.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the meaning of price and its role and importance as an element of marketing;
- explain the objectives of pricing;
- describe the factors which affect the price determination; and
- identify the general methods of price determination and explain their comparative merits and limitations.

8.1 INTRODUCTION

After completing the product planning, the next step is to finalise the pricing policies and strategies; Pricing is a very important aspect in the marketing as it directly affect the sales and profits of the company. Hence, you should be very careful while deciding the price. The first task in pricing is to determine the base price for the product, including the decision on pricing objectives. This unit is mainly concerned with this aspect of pricing. In this unit we will discuss the meaning and importance of price, objectives of pricing, factors influencing the pricing decisions and basic methods of price determination.

8.2 ROLE AND IMPORTANCE OF PRICE

Every day we buy several things from the market. We pay some money for the product we buy. The money paid by us in exchange of the product is known as the price. **Thus, price is the exchange value of a product expressed in terms of rupees or any other monetary units.**

Anything of commercial value has a price. Generally, we think that only physical products have a price. But the services also have a price. However, the prices paid for different services are known by different names. For instance, ‘fare’ is the price we pay for transport service provided by a bus or railways or airways, ‘premium; is the price for the risk covered under insurance, 'interest' is the price charged on the bank loans, ‘tuition fee’ is the price of providing education, and 'rent' is the price of hiring a house or shop.

Adam Smith has aptly defined the concept of price: *"The price of ever everything what everything really costs, is the toil and trouble of acquiring it"*.

Price is an important element of marketing. Alter developing a product, the next thing a company has to decide is the price. If the price is not correctly determined it will adversely affect the sales of the product and the profit of the company. Buyer's decision to buy a product is largely influenced by its price. Through price the company may attempt to increase or reduce the demand for a product or the level of competition. Wrong pricing policies can also lead to legal complications apart from generating ill-will and resentment among the buyers.

The question as to what should be the reasonable price to charge from the buyer, is a perplexing problem for the marketing manager. While some people feel that the price can be as high as the customer can pay, others think that it should be low enough to enable the maximum number of persons to buy the product.

Price is an important consideration not only for business concerns, but also to other organisations which provide various types of services, such as transport insurance, advertising, banking, entertainment, electricity, etc. Moreover, organisation whose object is not to earn profit also find it useful to know the principles of pricing. For example, a university would like to know what would be the 'fair' or 'proper' tuition fee to be charged from students. Similarly, a doctor would like to know the principles of price setting for the consultation services, which he provides to the patients.

Often price is the major basis of competition in the market. It is one of the major aspects which the competitors watch very closely. The price of product will have a noticeable effect on its sales, on the firm's total revenues, and on its final profits.

Apart from the firm, price is important to the buyers and the society. Price represents the value of the market offering to the buyers. The demand of the product is greatly affected by its price. Price may often act as an indicator of quality. According to the law of demand, a decrease in price would lead to an increase in demand. However, in certain cases, increase in price may by perceived favourably by the buyers who might interpret it as a consequence of improvement of quality.

Price of a product influences wages, rent, interest, and profit, which are the prices paid to the factors of production-labour, land, capital and entrepreneurship respectively. Thus, price acts as a regulator of economy, since it influences the allocation of the factors of production.

Check Your Progress A

1) Fill up the blanks :
   i) Price is the................. of a product expressed in terms of rupees and paise or whatever the .... medium prevalent in the country where the exchange takes place.
   ii) Price facilitates the.......... of goods and services.
   iii) Wrong price policies may develop........... among buyers.
   iv) The number of units sold multiplied by the price per unit equals……………..
   v) Quite often consumers' perception of a product's quality varies……………… with price.
   vi) Price is important not only to the company selling a product but also to …………….. and ………….. organisations.

2) Who are the buyers and sellers in respect of the services whose prices are:

Type of price	Buyer	Seller
i) Insurance Premium		
ii) Interest		
iii) Rent		
iv) Income Tax		

v) GST
vi) Railway Fare
vii) Tuition Fee
viii) Salary

8.3 OBJECTIVES OF PRICING

The major objectives of pricing should be the same as those of the firm itself. Before fixing the price of its product, the firm must determine its pricing objectives. A firm may pursue more than one objective at the same time. While seeking to maximise profit in short run as well as long run, the firm may also seek to maintain good relations with the consumers and workers, and also comply with the legal requirements imposed by the government regarding pricing. It may seek to increase its sales and at the same time maintain good will. If the firm wants to pursue all these goals simultaneously, it has to strike a balance between all the objectives. The pricing objectives should be in conformity with the overall objectives of the firm.

The pricing objectives can be classified into three major categories:
1) Profitability objectives
2) Sales volume objectives
3) Other objectives
Let us discuss these objectives in detail one by one.

8.3.1 Profit-oriented Objectives

Making profits is the major objective usually kept in mind in pricing decisions. Profit maximisation is the traditional pricing objective of business enterprises. Profit oriented objectives may take any of the following two forms: a) profit maximisation and b) achieve the desired rate of return on investment.

1) **Profit Maximisation:** Profit maximisation is the most common objective of business firms. The firm which aims at maximising profit will charge heavy margin of profit and, therefore, keep high prices. The major limitation of this objective is that the term profit maximisation often has an adverse connotation. It suggests profiteering, high prices and consumer exploitation

   If profit maximisation is the objective of the firm, it will estimate the demand .costs at different prices, and select the price which will bring maximum profits.

   The objective of profit maximisation is likely to be far more beneficial to a company and to the public if it is practiced over the long run. To maximise profits in long run, however, the firms sometimes have to accept short run losses. A Company entering a new market segment or introducing a new product often fix low prices to attract new buyers.

2 **To Achieve Desired Return on Investment**: A company may fix the price of its product at a level which helps in achieving a predetermined return on investment or on sales. Some companies first calculate their costs (including the manufacturing and distribution costs), and then add a margin of profit which gives it the desired return on the total investment. The target rate of return can serve as a kind of guidelines indicating improvements, especially in a new product line. The actual rate of return differs from industry to industry and from company to company. Many retailers and wholesalers use target return on net sales as pricing objective for short run periods. This pricing strategy (achieving a target return on investment) is generally opted by manufacturers who are leaders in their industry since they can get their pricing more independent of competitors.

8.3.2 Sales Volume-oriented Objectives

The pricing objective of some companies is to increase the sales volume or to maintain the sales volume or to increase the firm's market share.

1) **Maximisation of Sales Volume:** Many companies want to maximise their sales volume irrespective of the profit earned. In such a situation, the company will set a minimum or lowest acceptable profit level and then seek to maximise sales in the belief that the increased sales are more important in long run than immediate high profits. To increase sales volume may not be in accordance with the modern marketing concept which advocates profitable sales volume. The management may decide to increase its sales volume by resorting to price cuts or heavy discounts, which may result in actual loss to the company. Thus the management is willing to take a short run loss if the increased sales enable the company to get a foothold in its market. Increase in sales does not necessarily lead to higher profits. Certain products may be having goods sales, but may not earn enough profits for the firm.

2) **Maximisation of Market Share:** Market share may be a better indicator of corporate strength than the target return on investment, especially when the total market is growing. When sales volume is increasing and the firm's competitors are also increasing at a fast rate, a false sense of security may develop. To offset this danger, firms keep a close watch on their market share.

However, some firms with high market shares may even prefer to reduce their share at times to prevent action against concentration of economic power or monopolistic trade practice under the Companies Act, 2002.

8.3.3 Other Objectives

Sometimes pricing objectives are not related either to profit maximisation or to sales volume maximisation, but they may have some other important considerations in setting prices of their products. These objectives include: i) to stabilise price, ii) to survive in the market, iii) to prevent competitor's entry into the market, and iv) to maintain or improve company's image as a supplier of quality goods. Let us study these four objectives in more detail.

1) **To Stabilise Prices :** Certain companies seek to keep stable prices and avoid price war. This objective would be sought by the company when it is faced by a big competitor who acts as a price leader and where the product is a standardised one. In order to minimise competition, the company will follow the leader's prices.

2) **To Survive:** When a company is facing stiff competition or overcapacity or lack of demand for its product, its objective may be to survive in the business. In such circumstances, it will set low prices just to cover the variable costs and a part of fixed costs, so that it can stay in the business for the time being.

3) **To Prevent Competitors' Entry:** Sometimes, it is more important for the company to prevent the possible entry of a competitor than earning profit in the short run. In such a situation, it will fix price at the lowest possible level so that there is no attraction for any competitor to enter the market. With low prices the company can penetrate the entire market and establish its complete hold over it. This is also often referred to as market penetration objective since the approval pertains to penetrate into the market with lowest possible prices so that it is not attractive for the potential competitors to enter the market.

Apple

4) **To Improve Company Image as a Quality Goods Supplier:** For supplying high quality goods, the company may have to incur heavy expenditure for producing high quality goods. When higher expenditure is incurred, the prices will also high to be high.

In conclusion it can be said that if a firm is seeking a single objective of pricing policy, it must aim at maximising long term profit, since there are many cases when sellers do not maximise short run profit. Studies have revealed that the two most common objectives of pricing are profit maximisation and market share maximisation. Other objectives can more properly be viewed as pricing methods rather than as objectives. One factor that makes it difficult to arrive at the general principles and policies of pricing is the fact that different companies operate under different conditions. The principles and policies of pricing vary from industry to industry, company to company, and from time to time.

Check Your Progress B

1) List various objectives of pricing.
2) Fill up the blanks:
   i) In an industry where there is an industry leader and where the product is standardised a firm would tend to have a ……………… ... pricing policy.
   ii) For preventing possible entry of competitors to the market…………………. pricing policy is suitable.
   iii) Profit maximisation objective is influenced by supply and……………………....conditions prevailing in a competitive market

3) State whether following statements are True or False.
   i) Profit maximisation policy is beneficial to the firm as well as to the general public if it is practiced over a long period of time since it results in desirable allocation of resources.
   ii) Price stabilisation policy seeks to prevent price wars.
   iii) Price objectives should determine the final price.
   iv) The target rate of return on capital employed may differ from industry to industry.
   v) In an industry having a price leader and a standardised product, follow-the-leader policy, is not advisable.

8.4 FACTORS AFFECTING PRICE DETERMINATION

The major factors affecting the price of product or service are as follows:

1) The value of the product to the buyer
2) Product costs
3) Competition
4) Legal considerations
5) Other elements of marketing.

Let us now discuss these factors in detail.

8.4.1 Value of the Product to the Buyer

A person buys a product only when it is of any value to him (i.e., it provides any utility to him) in relation to the price demanded. Since a man's wants are unlimited and purchasing power is limited, he would buy those products which will give him the maximum satisfaction in relation to the price paid. Each consumer, in a subjective manner, prepares priority schedule of goods and services that can be purchased with his entire income. This scheduling is usually done subconsciously and subjectively. Because of the subjectivity involved, it is difficult to measure the utility provided by a product to a consumer.

When we consider buyers and the price, we are usually concerned with how price affects their demand for a product. According to the **law of demand**, as you know more goods will be demanded at a lower price than at a higher price. This law holds good for most of the products. To a marketer demand means the desire for a product supported by the ability to purchase it.

In practice, a marketer must set a price that will attract enough buyers to achieve expected sales volume. The marketer must ascertain as to how price sensitive the buyers are to the change in price. This sensitivity is measured by price elasticity of *demand (simply referred to as elasticity of demand). Price elasticity is defined as the relative change in the quantity demanded caused by a relative change in refers to the inverse relationship that exists between the price and the quantity sold.* Price elasticity can be calculated by dividing the percentage change in the quantity demanded by the percentage change in the price charged. Symbolically it can expressed as follows:

$$\text{Price elasticity of demand (E)} = \frac{\dfrac{Q_1 - Q_2}{Q_1 + Q_2}}{\dfrac{P_1 - P_2}{P_1 + P_2}}$$

Where 'P' is price and 'Q' is quantity demanded.

If the demand for a product increases by 20% when the price is reduced by 5% the price elasticity demand is -4 and the demand is said to be elastic. The minus sign indicates that there is an inverse relationship between the demand and the price. If the demand falls by 5% when price is increased by 15%, then the elasticity of demand is 1/3. In this case, the demand for the product is inelastic.

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The demand for a product is said to be elastic if the percentage change in quantity is greater than the percentage change in price. *Conversely, the demand for a product is said to be price inelastic if a percentage change in price cause a smaller percentage change in demand*. For price elastic demand, a decrease in price would increase the total revenue (increase in quantity demanded would be more than the loss due to the price decrease). However, any increase in price would lead to a decrease in the total sales revenue. It is argued by others that the profit is the difference between market price and cost (cost include distribution cost, administrative cost and manufacturing cost). Actually, this approach may be more realistic because it emphasises profit as the final objective.

Cost is undoubtedly an important consideration in price determination. In order to survive and grew, a company must recover all the costs and earn some amount of profit. For a limited period, as in the case of introductory stage of a new product or while entering a new market, a company can afford to sell the product at a loss. However, in the long run all the costs must be recovered.

The proper function of cost is to set the lower limit on the initial price charged for a product, while value to the buyer indicates the upper limit of the price. The job of the marketing manager is to choose that price between these two limits which will help him better in achieving the overall objective of pricing.
If the demand for the product is inelastic, the company is in a better position to fix prices at a higher level. The demand for products which are purchased with discretionary income (such as luxury items, automobiles, etc.) is generally more elastic. The demand for necessities (such as salt, sugar, food grains, public transport services, etc.) is generally inelastic.

8.4.2 Product Costs

It seems more logical to start the process of fixing price with costs. While fixing the price, the questions like: What is the cost? What profit should be earned on the sale of products? They seem easier to answer than the question: What can people pay for the product? Yet the third question (i.e., what people pay for the product) is the most important of the three. Nevertheless, many **marketers think in terms of total costs (manufacturing cost + distribution cost + administering cost) plus a reasonable profit as the proper procedure for fixing the price.**

Price = Total Cost + Profit

Types of Costs

For pricing purposes costs can be classified as: 1) fixed costs, and 2) variable costs.

Fixed Costs are those costs which do not vary with the volume of production or sale, whether the manufacturer produces 2,000 units or 100 units or completely stop the production he will have to incur certain expenses, such as the rent (or property tax) for the building, interest on the borrowed capital, electricity charges for lights and fans (used in office), etc. These costs are also known as *'overhead costs'.* *These are called 'fixed costs' since they do not change in the short run.*

Variable Costs are those costs which vary with the level of production: Costs of raw material, labour, power, etc., are directly proportional to the quantity of goods produced and are, therefore, called variable costs. These can be controlled by changing the level of production.

The sum of the fixed and variable costs is called **total costs**. Average total cost is the total costs divided by the number of units produced.

8.4.3 Competition

While the upper and lower limits of the price of a product is set by keeping in view the value of the product to the buyer and the cost of the product to the seller, the actual price to be fixed is influenced greatly by the degree of competition in the relevant market. If there is no competition or negligible competition in the market, the price will tend to be on the higher side. On the other hand, a free and healthy competition may result in reduction of the price.

The price and features of the products offered by the competitors will greatly affect the price charged by the company. Moreover, even the prices of substitute products should also be taken into consideration while fixing the price of the product.

Before a company decides the price of its product, it must also analyse the market, of competing products and also the behaviour of present competitors in the industry. The company also must examine the possibility of new competitors mining the industry and their reaction towards the company. The likelihood of the entry of new competitors must be taken into account while fixing the price of the product.

8.4.4 Legal Considerations

Pricing is a very sensitive and important decision in marketing. An increase in price often attracts public criticism and may also attract legal restraint. Suppose an essential commodity, like medicine, costs Rs. 10 per unit, whereas the buyer is prepared to pay any amount in case of an emergency. In the absence of any competition, the seller will be tempted to charge a very high price, say Rs. 100 per unit. However, the law can restrain the unscrupulous seller from charging 'what the traffic will bear'. This can be done by the Government by declaring the said medicine as an 'essential commodity' under the Essential Commodities Act, 1955. Then, the seller does not have the freedom to charge above the price level fixed by the government in accordance with the guidelines laid down in the law. A number of legislations seek to regulate excessive discriminatory and unreasonable prices. The marketing manager must keep in view the legal restraints in matters of price fixation. These restraints are explained in detail in Unit 10.

8.4.5 Other Elements of Marketing

The elements of the company's (or the marketing methods) also have a Significant effect on the pricing decision of a product. The channel of distribution, quality and amount of advertising, efficiency of sales personnel, the type of product differentiation, credit facility, after sales service, etc. affect the final price charged from the buyer. If the company is in a strong position in these respects, it gives the company a freedom to charge relatively higher prices. If the company is lacking or deficient on any of these counts, it may have to keep lower prices. For example, if a company is providing home delivery or 'money back' guarantee or is selling through expensive outlets (like air conditioned showrooms) the selling prices of its product can be on a higher side.

The company must follow all the marketing policies including the price policy consistently. If a product is significantly differentiated from competitor product the company has more discretion in fixing the price of the product.

Check Your Progress C

1) List the factors that influence the price of a product.
2) Fill up the blanks:
   i) The mechanism for measuring the relative intensity of demand for a product is referred to as the...................
   ii) The demand for a product is elastic if an increase in the price of the results in............ of the total revenue.
   iii) The formula for computing the price elasticity of demand of a produce of price is…………………....
   iv) Healthy price competition will result in the ………of price.

3) Give two examples for each of the following:
   i) Products having elastic demand.
   ii) Products having inelastic demand.

4) The demand for a product increases by 25% when its price is reduced by 10%. Calculate the price elasticity of demand of the product. Will the demand be called the price elastic or inelastic?

5) Differentiate between fixed costs and variable costs.

8.5 BASIC METHODS OF PRICE DETERMINATION

From the point of view of sound business principles, prices should be determined after taking into consideration the costs, demand, competition, elements of marketing mix, and legal considerations. However, in practice, marketers often rely on one of the three major determinants of prices-costs, demand and competition.

Based on the relative emphasis given to these factors, there are three practical approaches to the setting of the price of a product or service:

1) Cost-oriented pricing
2) Demand-oriented pricing
3) Competition-oriented pricing

Study Figure 8.1 carefully for the classification of various methods of pricing. Let us study these methods in detail.

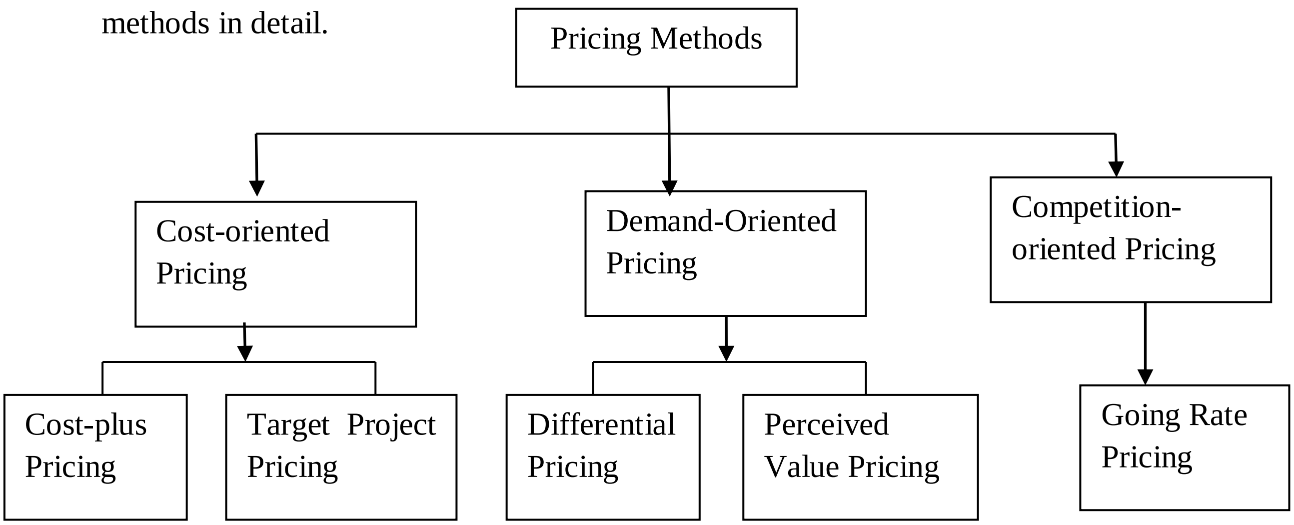

Figure 8.1 Methods of Price Determination

8.5.1 Cost-oriented Pricing

When the selling price is determined based on the total product cost and a specified margin of profit, the approach is known as the *cost-oriented approach to pricing or the cost-based pricing.* There are two methods of price setting which stem from the cost-oriented pricing: 1) cost-plus' pricing, and 2) target-profit pricing or break-even analysis. Let us study these two methods in detail.

1) Cost-plus Pricing

Some firms set the selling price of their products by aggregating all the costs of the product (including the manufacturing cost, distribution and marketing costs) plus a predetermined margin of profit. The cost-plus pricing method has been explained in the following illustration:

	Rs. Per unit
Total manufacturing costs	30.00
Selling and promotional costs	4.00

Distribution and administration costs	6.00
Total costs	40.00
Margin of profit	10.00
Selling price	50.00

In this method the product cost include both variable cost and fixed overhead costs.
This approach can be simply stated as: Selling Price = Variable Costs + Overhead Costs (Fixed Cost) + Profit Margin.

To make this method of cost-plus pricing more realistic, the company must consider the changes that are expected to occur in these costs as a result of change in the volume of production.

The pricing method enables the firm in covering all the costs and, in addition, to earn the desired margin of profit. Thus, the method is quite justifiable on grounds of fairness to both the sellers and the buyer. The method is also easy to understand and implement as there is generally less uncertainty about cost than the demand for the product. The margin of profit to be added to the cost has to be determined by the company. It can vary from industry to industry and from situation to situation. Retailers using the cost-plus method of pricing do not necessarily apply the same percentage of mark-up to every item.

This may also be a safe method in an uncertain market. It can safely be used pricing the jobs like government contracts that are difficult to estimate in advance. For fixing prices for services, often cost-plus pricing method is adopted.

2) Break-even Analysis and Target-profit Pricing

This pricing method is slightly different from the cost-plus pricing method. Here, the firm wants to determine a price that will enable it to earn the desired profit. For the purpose, the break-even analysis is used by the firm and the break-even point is determined.

A break-even analysis relates total cost to total revenue. *A break-even point is that level of production at which the total sales revenue (TR) equals the total cost (TC). In other words, a break-even point is the level of production or supply where firms neither earns any profit nor suffers any loss*. It is represented by the intersection of TC and TR. There are different break-even points for different selling prices. Any amount of sale above the break-even point gives profits to the firm. If the amount of sale is below the break-even point the firm will incur loss. The break even point can be calculated in the following way:

$$\boxed{\text{Break even Point (In Unit)} = \frac{\text{Total Fixed Costs}}{\text{Per unit Contribution}}}$$

$$= \frac{\text{Total Fixed Costs (F)}}{\text{Selling price per unit(P)} - \text{ Average variable costs per unit (V)}}$$

$$\text{or B.E.P.} = \frac{\text{F}}{\text{P} - \text{ V}}$$

Look at Figure 8.2 for a graphical presentation of break-even analysis. The figure

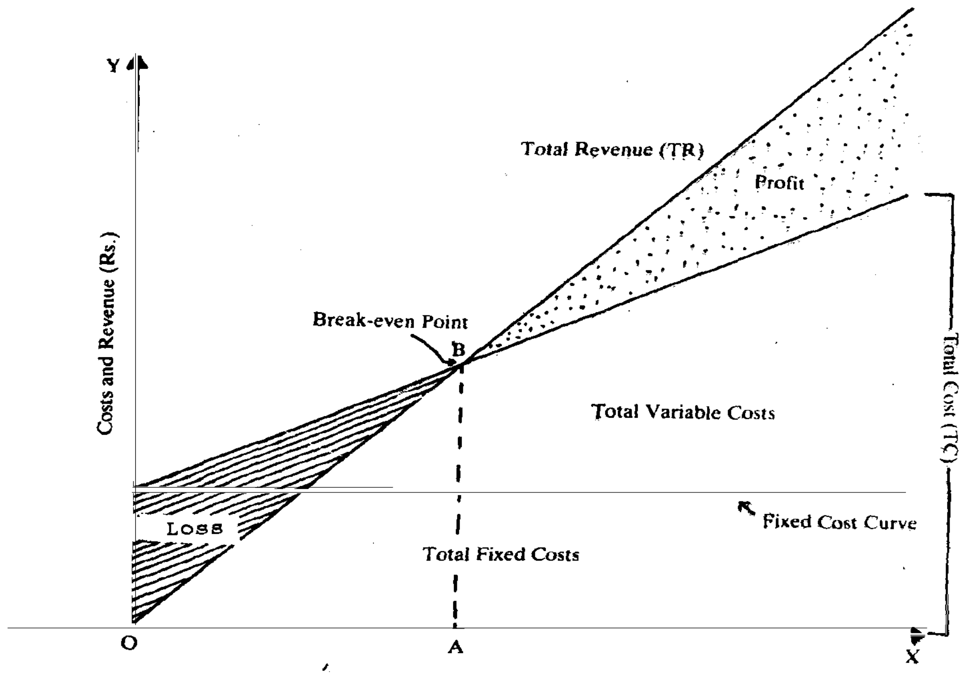

Figure 8.2 : Break even Chart

shows the relative profit/loss at each level of quantity sold. A loss may be expected until the quantity of units sold reaches point A on the quantity line. The break-even point is represented by B, where the TR line intersects the TC line. After that, a profit may be expected. The fixed-cost curve does not change with the quantity whereas the variable cost increase with the increase in quantity of production. The total of fixed costs and variable costs. The total cost curve shows the total revenue curve shows the amount of the sales volume, i.e., the number of units sold multiplied by the selling price per unit.

Let us understand the technique with the help of an illustration. Consider the case of Bharat Leather Works which manufactures foam leather bags. Suppose the total fixed costs for manufacturing and finishing the bags are Rs. 80,000 (irrespective of the amount of sales volume), the average variable cost per bag is Rs.8, and the selling price is Rs. 12 per bag. Then,

$$\text{Break} - \text{even Point (BEP)} = \frac{80{,}000}{12 - 8} = 20{,}000 \text{ bags}$$

Thus, if the selling price is to be set at Rs.12 per bag, the firm must sell at least 20,000 bag to break-even. i.e., for the total revenue to cover the total costs. If the firm wants to earn profit of

Rs. 50,000, it must sell at least 32,500 bags at a price of Rs. 12 per bag. The break-even point, in rupees, can be found by multiplying the number of bags the selling price per bag. In this example, the break-even point in rupees will be Rs. 2.40,000 (20,000 bags x Rs. 12 per bag).

The break-even analysis is a very useful technique for financial analysis and pricing decision-making. With the help of this technique, a marketing manager can ascertain the financial implications of pricing decisions, before they are actually implemented. For example if the price is increased from Rs. 12 per bag to Rs. 13 per bag, the break even point will come down to 16,000 bags. Similarly, if the price is reduced by Re. 1 per bag, the break-even point will go upto 26,667 bags. It is a simple device which is pretty accurate in the short run where costs, prices and demand estimates are relatively stable.

For fixing of price through the break-even analysis, the company must consider different prices, their impact on the sales volume required to pass the break-even point and earn the desired profit. Possibility of achieving the break-even sales level at different price levels also must be examined. The break-even analysis is particularly useful for fixing the price of a new product.

The major limitation of break-even analysis for price fixation is that the variable cost for each additional unit are assumed to be the same and the total fixed costs are assumed to remain constant at all levels of production. These assumptions may be true for certain products, but not for all. The assumption of uniform selling price, irrespective of the quantity purchased, is also not always true. In order to encourage bulk buying, sellers. offer quantity discounts which have the effect of lowering the selling price for the higher slab of the purchases. In that case, the sales revenue may not increase proportionately and the revenue curve may not be linear.

Through the break-even analysis, one can ascertain the number of units to be sold in order to break even. However, through this technique we may not be able to ascertain whether the firm can actually sell that number of units at that particular price. Break-even analysis, thus, is only partially helpful in price determination. It shows the comparative effect of alternative prices, costs and quantities on the break even point.

8.5.2 Demand-oriented Pricing

Demand-oriented pricing is based on an estimate of how much sales volume can be expected at various prices which can be paid by different types of buyers. Instead of fixing the price on the basis of costs or competitors price, some firms often fix the selling price of their products on the basis of the demand. In other words, irrespective of the cost of the product or what the competitors are charging, a higher price is charged for a product or service when its demand is more and a lower price is charged when the demand is less, even though the costs are the same in both cases.

The two methods of pricing under this approach are :

1) Differential pricing
2) Perceived-value pricing

1) Differential Pricing

Generally different groups of buyers have different wants and desires. Consequently, the intensity of their demand for the product would also be different. In such situations, for the same product sellers would be tempted to charge higher price for those having less elastic demand and lower price for those having more elastic demand. **Differential pricing is normally based on one of the four factors: the customer, place (location of the customer), time of purchase, and the product version.**

Different prices may be fixed for different customers, persons or groups of persons. This may be possible due to the difference in the capacity of bargaining ability to pay, level of knowledge about the product features or the availability of product. For example, in a cinema hall tickets for different classes of seats are priced at different rates whereas there is no significant difference in the cinema shown to these classes.

If the prices are different for the same or similar product sold at different places, it is a case of location or place differential. In terms of time, the demand for a product frequently varies by season, day, or even by the hour of the day. The prices may be fixed to take advantage of the demand intensity at a particular season or point of time. For example, telephone rates are different on working days and holidays. Telephone rates are also different for day calls, night calls and evening/morning calls. Similarly, hotels often charge different rates for the same accommodation during different seasons.

Under product based differential pricing, the seller charges substantially different prices from the buyers of slightly different versions of the same products, so that the difference in prices is more than proportionate to the cost of different product forms or versions. The hard-bound American edition of William J Stanton's book on Fundamentals of Marketing is priced at Rs.900, whereas the international student edition of the same book is priced at Rs. 150 only. The only difference in the two editions is in respect of the quality of the paper used and the use of colour pictures and diagrams in the hard-bound edition. The price difference is much more than the difference in the actual cots of two editions.

Discriminatory, prices are likely to generate customer ill-will and may also attract legal action. Hence, the seller has to consider the consequences well before deciding upon the discriminatory prices.

2) Perceived-value Pricing

Different buyers often have different perceptions of the same product on the basis of its value to them. A cup of tea is priced differently by hotels and restaurants of different categories, because buyers will assign different value to the same item. When you follow this perceived-value' method of pricing, you have to ascertain how different buyers perceive the product in terms of its quality, features and attributes (like colour, size, durability, softness etc.), and how they perceive the value of the product in terms of such product differences.

8.5.3 Competition-oriented Pricing

When the price is determined with reference to the price of a similar product charged by the competitor, and not on the basis of the costs of the product or the different perceptions of the product by different buyers, the pricing approach is referred to as competition-oriented pricing.

Going Rate Pricing

This is the important method under competition-oriented pricing approach. In this case the firm does not maintain an elaborate record of various product costs. The firm also does not try to ascertain the difference in the intensity of demand or the perceptions of the value of the product in the minds of the buyers. The firm decides the price of its products on the 'going-rate prices' in the market. The price is not necessarily the same as that charged by the competitors or by the industry leader, it can be lower or higher. Whenever the industry leader or the trade association increases / decreases the price, the firm follows them. The practice of fixing the going rate price is quite popular among traders, especially among the retailers.

Those who adopt the going rate method of pricing argue that the prevailing rates represent the collective wisdom of the industry. Furthermore, it is often difficult to ascertain the customer's reaction to price differentials and their perception of the different product features. Moreover, this method is easy to adopt as there is no need to estimate the price elasticity of demand or various product costs. It is also felt that the adoption of the going rate pricing method prevents price wars among competitors. This method is practiced mainly in the case of homogeneous products, under conditions of pure competition and oligopoly. The firm selling any undifferentiated product is a purely competitive market actually has very little choice in setting its prices.

Check Your Progress D

1) List the three major methods of setting price.
2) What are the factors taken into account in cost-plus pricing?

3) State the formula for computing break-even point.

4) If the fixed costs for manufacturing and selling a product amounts to Rs. 1 lakh, variable costs per unit is Rs. 25, the selling price per unit is Rs. 40, calculate the break-even point.

5) Differentiate between perceived value pricing and going-rate pricing.

6) State whether the following statements are **True** or **False.**

   i) Break-even analysis is particularly useful in setting the price of a new product.

   ii) People in the same income brackets do not have different perceptions of the same product.

   iii) In the going-rate pricing, the firm ignores its costs and the demand intensities for its product.

   iv) The going-rate pricing method is appropriate in a market which is highly competitive and where the product is homogeneous.

8.6 LET US SUM UP

Price is the exchange value of a product or service. It is an important marketing function since it determines the company's sales revenue and profit and also regulates the economic activity.

Pricing objectives must be decided in accordance with the company's overall marketing objectives. Pricing objectives may be broadly classified under three heads
1) Profitability objectives (including profit maximisation and target return on investment). 2) sales volume objectives (including sales maximisation and 3) other objectives (including price stabilisation, survival, market penetration for prevention of competitor's entry into the market, and building image as a supplier of quality goods).

While deciding selling prices of goods and services, business enterprises may adopt any one of the following three approaches 1) cost-oriented approach. 2) demand oriented approach, and 3) competition-oriented approach.

In cost- oriented approach, cost is the major basis of fixing price. In this approach are two methods: 1) 'costs –plus' pricing 2) target profit pricing. Cost plus price is arrived at by aggregating the relevant costs and adding to it a margin of profit. Target profit pricing - based on the break-even analysis.

Major consideration in price welling under demand-oriented approach is the buyer's demand intensity and perception of the product's value and utility, rather than the product costs. There are two distinctive methods under this approach 1) differential or discriminatory pricing, and 2) perceived-value pricing.

The decisions and actions of competitors, rather than the company's product costs or demand level, form the basis for setting the price under competition-oriented approach. The firm neither maintain its own cost records nor seeks to measure the demand intensity nor buyer's perceptions towards the product, Going rate price comes under this approach

8.7 KEY WORDS

Break-Even Point: That quantity of output at which the sales revenue equals total costs, assuming a certain selling price.

Cost-Plus Pricing: A method of price determination where the price of a unit of a product is set at a level equal to the units total cost plus a desired profit on the unit.

Going-rate Pricing: A pricing objective that involves setting prices basing on competitor's price rates than on company costs or demand.

Target Profit Pricing: A pricing objective that involves setting prices so as to achieve a certain percentage return on investment on or net sales.

8.8 ANSWERS TO CHECK YOUR PROGRESS

A 1) i) exchange value; monetary ii) exchange is) ill-will iv) sales revenue v) directly vi) the firm providing service; non-profit

B 2) D) price stabilisation ii) penetration pricing iii) demand

3) i) True ii) True ii) True iv) True v) False

C 2) i) elasticity of demand ii) decrease in iii) $\frac{Q_1 - Q_2}{Q_1 + Q_2} \div \frac{P_1 - P_2}{P_1 + P_2}$ iv) reduction

4) 2.5, elastic

D) 6) i) True ii) False iii) True iv) True

8.9 TERMINAL QUESTIONS

1) Explain the role and importance of price.

2) Explain the major pricing objectives.

3) What factors affect the basic price of product or service? Briefly explain each of them.

4) Explain the major methods of setting the price in actual practice.

5) Write brief notes on the following:

   i) Break-even analysis

   ii) Cost-plus pricing

   iii) Going-rate pricing

   iv) Profit-maximisation objective

   v) Survival objective

   vi) Perceived-value pricing

6) Explain the major merits and limitations of the cost-plus pricing method.

7) Distinguish between the profit maximisation pricing and the sales-volume maximisation pricing.

8) Explain the reasons for the popularity of the going rate method of price setting. What are its inherent weaknesses?

9) A small manufacturer sells a toy to the retailer at the rate of Rs.8.40 per dozen. The manufacturing cost was 50 paise per toy. The selling and administration Costs amounted to Rs.19,200. How many dozens of the toys must he sell to over these expenses and to pay for an advertising campaign costing Rs.6,000?

Note: These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University for assessment. These are for your practice only.