Chapter 5

Product Pricing Decisions

5.1 MEANING AND CONCEPT OF PRICE AND PRICING

WHAT IS PRICE ?

Superficially it is easy to define the term 'price'. A price is the amount we pay for a good or a service or an idea. When a customer asks the dealer "what is the price of this product" ? the ready answer is "Rs 150/- all inclusive". Price is the amount for which a product, a service or an idea is exchanged, or offered for sale regardless of its worth or value, to the potential purchaser. Thus, rent for an apartment, tuition fees for education, consultancy fees to a physician—surgeon or a dentist, fare to an air-line—taxi—railway, honorarium for a guest lecturer, salary to an executive, wages to workers, is the price in various forms. A more contemplative person may say that price is the sum-total of all the errors and skills which have gone into the creation of buyer satisfaction.

DEFINITIONS

❑ **"Price is the amount of money and/or other items with utility needed of acquire a product."** —*W.J. Stanton, M.J. Etzel and B.J. Walker*

❑ **"Price is equal to the total product offering."** —*Mr. J. Walker*

However, the real meaning of the word 'price' is not that simple. There are several reasons for this. First, the buyer and seller have different views of the meaning of 'price'. Secondly, it is virtually impossible to specify a single prevailing price for any one product or a unit of service because of geographical dispersion of customers—proliferation of products—and services—market segmentation—variety of transactions and the like. Thirdly, the factor of conflict that may arise within a firm, within a channel system or between a firm and its environment in connection with pricing. Forthly, the problem that price is only one of the several competitive weapons that can be used by the seller. The problem of setting right price is made more difficult by the need to coordinate competitive pricing with indirect and non-price competitive strategies.

A consumer oriented marketing approach to pricing requires that the market planners should understand the meaning of price to the ultimate user and the seller. To the 'ultimate user', the price for a product or a unit of service represents a sacrifice of purchasing power. The money spent on one product is not available for something else. Though the affluence of the average individual in a country is rising almost every one finds it necessary to choose among the alternative ways of spending. This is applicable to all—big or small purchasers equally. For a 'seller' may be a manufacturer or a reseller, price can mean something quite different, than what it means to the buyer. The seller knows that the price is a source of revenue and a prime determinant of profit. Cost plus profit is equal to price. In the eyes of a marketing manager, price refers to not only cost plus profit but a product feature. That is, it stands for quality and quantity of the product.

Thus, the term 'price' is not absolute but relative in terms of variables in the entire marketing programme. It is equal to product expectations namely, physical product, other attributes of making it available such as delivery, installation, credit, return privileges and other after-sales services. In short,

WHAT IS PRICING ?

The term 'price' need not be confused with the term 'pricing'. Pricing is the art of translating into quantitative terms (rupees and paise) the value of the product or a unit of a service to customers at a point in time.

DEFINITIONS

❑ **"Pricing is a managerial task that involves establishing pricing objectives, identifying the factors governing the price, ascertaining their relevance and significance, determining the product value in monetary terms and formulation of price policies and the strategies, implementing them and controlling them for the best results."** ***—Prof. K.C. Kite***

❑ **"Pricing begins with an understanding of the corporate mission, target markets and the marketing objectives; then pricing objectives are developed; next management estimates as to extent of flexibility in establishing prices by studying costs and profits internally and demand and competition externally; prices are, then set between these two extreme ends by deciding price strategies in the light of objectives so set; specific methods are used to set prices; final aspects is implementation and control that includes effective monitoring to get feed-back on consumer response and competitive reactions."** ***—Mr. M.J. Jones and S.W. Jetty***

Thus, pricing is the function of determining the product or service or idea value in monetary terms by the marketing manager before it is offered to the target consumers for sale. Precisely, pricing is the process of setting objectives, determining the available flexibility, developing strategies, setting prices and engaging in implementation and control.

5.2 ROLE OF PRICING IN MARKETING STRATEGY

Price is a complex variable because, manufacturers, wholesalers, retailers, consumers, public policy makers—all influence and are influenced by the price and pricing of a product, service or an idea.

Pricing programmes are fundamental in whole scheme of marketing because :

1. All products, services and ideas have a price, even if they are free. That is, marketing managers must fix their price.
2. Price decisions can be made more frequently than other decisions which can be implemented immediately.
3. From budgeting stand point, price is fundamental for price decisions impact the percentage contribution or margin.
4. Pricing decisions have important implications for advertising, sales, distribution and sales-promotion programmes. Pricing as a marketing function has vital role to play at micro and macro levels of the economy of any country.

Its importance is spelled out by the following points.

1. Price is the Pivot of an Economy : In the economic system, price is the mechanism for allocating resources and reflecting the degrees of both risk and competition. In an economy particularly free market economy and to a less extent in controlled economy, the resources can be allocated and reallocated by the process of price reduction and price increase. Price policy is a weapon to realise the goals of planned economy where resources can be allocated as per planned priorities. Price is the prime mover of the wheels of the economy namely, production, consumption, distribution and exchange. As price is a sacrifice of purchasing power, it affects the living standards of the society; it regulates business profits and, hence, allocates the resources for the optimum output and distribution. Thus, it acts as powerful agent of sustained economic development.

2. Price regulates demand : The power of price to produce results in the market place is not equalled by any other component in the product-mix. It is the greatest and the strongest 'P' of the four 'Ps' of the mix. Marketing manager can regulate the product demand through this powerful instrument.

price increases or decreases the demand for the products. To increase the demand, reduce the price and increase the price to reduce the demand. Price has a special role to play in developing countries where the marginal value of money is high than those of advanced nations. Demarketing strategy can be easily implemented to meet the rising demand for goods and services. As an instrument, it is a big gun and it should be triggered exclusively by those who are familiar with its possibilities and the dangers involved. It is so because, the damage done by improper pricing may completely sap the effectiveness of the well-conceived marketing programme. It may defame even a good product and fame well a bad product too.

3. Price is competitive weapon : Price as a competitive weapon is of paramount importance. Any company whether it is selling high or medium or low priced merchandise will have to decide as to whether its prices will be above or equal to or below its competitors. This is a basic policy issue that affects the entire marketing planning process. Secondly, price does not stand alone as a device for achieving a competitive advantage. In fact, indirect and non-price competitive techniques often are more desirable because, they are more difficult for the competitors to copy. Better results are the outcome of a fine blend of price and non-price strategies. Thirdly, there is close relationship between the product life-cycle and such pricing for competition. There are notable differences in the kinds of pricing strategies that should be used in different stages. Since the product life span is directly related to the product's competitiveness, pricing at any point in the life-cycle should reflect prevailing competitive conditions.

4. Price is the determinant of profitability : Price of a product or products determines the profitability of a firm, in the final analysis by influencing the sales revenue. In the firm, price is the basis for generating profits. Price reflects corporate objectives and policies and it is an important ingredient of marketing mix. Price is often used to off-set the weaknesses in other elements of the marketing-mix. Price changes can be made more quickly than any other changes in the product, channel, personal selling and sales-promotion including advertising. It is because, price change is easily understood and communicating to the buyer in a precise way. That is why, price changes are used frequently for defensive and offensive strategies. The impact of price rise or fall is reflected instantly in the rise or fall of the product profitability, thinking that other variables are unaffected.

5. Price is a decision input : In the areas of marketing management, countless and crucial decisions are to be made. Comparatively marketing decisions are more crucial because, they have bearing on the other branches of business and more difficult as the decision-maker is to shoot the flying game in the changing marketing environment. Normally, profit or contribution is taken as a base for pay-off conditions. Price can be a better criterion for arriving at cut-off point because, price is the determinant of profit or contribution. As pointed earlier, price as an indicator has a special role in the decision-making process in developing countries because, consumer response to price changes will be more quick and tangible as people have higher marginal value of money at their disposal. For instance, if it is a decision regarding selecting product improvement possibilities, select that possibility which gives the highest price as compared to the cost.

These five points make product pricing an important and major function of marketing manager. However, until recently, it has been one of the most neglected areas of marketing management. In fact, we must have a specialist in pricing as we do have in other functions of marketing. This negligence is quite evident from the fact that even the well-known companies in the world price their products on simple concepts of costs—market position—competition and desired profit. Scientific pricing is much more than this easy exercise.

5.3 THE PRICING OBJECTIVES :

Like other areas of marketing planning, pricing of products begins with the setting of pricing objectives. Pricing objectives are the foundations for the price policies and strategies to be framed and implemented in due course. The process of establishing objectives is structured by the firm's internal environment. In fact, a very large number of price objectives are available. The point lies in that these price objectives must be consistent with the organisation's internal thrust and compatible with the external environment. It is because, price objectives are to serve as the basic standards for measuring managerial performance for effective monitoring, coordinating and planning.

The most widely accepted price objectives are outlined below :

1. Survival : Survival is the most fundamental objective in most cases. Organisations tolerate almost any kind of deficiency say, short-run losses, internal organisation, reduction in the size of operations and the like in order to continue in existence. Therefore, at least in the short-run, some organisations price products with objective of obtaining working capital for uninterrupted operations. However, survival price objective is a short-run or a temporary goal and is insisted only when the firm faces a survival crisis. Once, it turns the corner, it shifts to other price objectives.

2. Target return on investment : Pricing for profit is the most logical price objective. Pricing to attain predetermined profit involves the establishment of specific profit goals either as a percentage of sales or a R.O.I. or R.O.A.M. (Return of Assets Managed). Price decisions based on investment return are becoming very common both in private and public sector undertakings, these days. This objective expects a certain predetermined rate of return on capital employed over a period of time. That is, the sales revenue arrived at the end of financial year is enough to cover all the costs and leave desired margin equal to the rate of return. Most target return on investment price objectives are achieved by intuition or trial and error rather than by the use of predictable models to generate profit level.

3. Market share : Market share is really a meaningful measure of the success of a firms marketing strategy. A market share price objective can be either to maintain the market share, to increase it or some times to decrease it. The company uses the price as an input to enjoy a target market share. Target market share means that portion of the industry sale which a company aspires to attain. This market share is normally expressed as a percentage of the total industry sales. Price is typically one of the most important variables in improving or maintaining market share. However, if the market share objective is pursued without regard to other objectives, it may not achieve the organisational goals. Price flexibility and, often, profits are linked to firm's market share position. In all developing countries, they prefer market share price objective to rate of return objective. This price objective helps to maintain and meet the restrictions laid down by the laws of the land. Thus, MRTP Act of 1969 says that no company is to develop to such an extent as to call it 'dominant'. The solution lies reducing the market share.

4. Cash-flow Management : Product pricing decisions are extremely important to the financial manager. In the past, marketing plans did not, as a rule, make any major claim on a company's cash reserves. Today, the marketing world has changed drastically. The rapid expansion of new product research and decentralised distribution net-works and the explosions of aggressive selling have made it necessary to commit sums of money to marketing. Since, there are many other demands within the firm, it is quite imperative that the price objective is to retain as much cash possible within a given period of time. This is of particular importance in case of those firms that spend a lot on product research and development like chemicals; electronics, pharmaceuticals and so on. Even the consumer packaged goods marketers incur heavy product introduction costs in the form of advertising. These sunk costs are to be covered early at a faster rate.

5. Price and profit stabilisation : Stabilising prices and profits can be a long-term objective of a firm. Fluctuating prices having fluctuating profits bringing into play unwanted forces affecting the firm's economic health and status in market place. Stabilisation of prices and margins is more in critical industries where oligopoly prevails. For example, in marketing of most basic metals, it is an accepted practice of the majority of the firms to follow the price-leader. The role of a price leader is generally that of maintaining stable prices in an industry in which erratic and irresponsible pricing moves would result in undesirable changes in market share and profits. Stable prices help in preventing price wars amongst the competitors. This stable price and profits objective can be set in motion by keeping the prices between the safe limits—not allowing them to fall below a norm during slump and not allowing them to rise above norm during boom.

6. Resource mobilisation : Mobilising the resources for either self-development or reinvestment else where can be another price objective. Prices are deliberately set high in certain cases so as to make not more profits but to generate more surplus for the purpose of reinvestment in the same firm or other firms. Thus, State Trading Corporation of India has been following this objective on all the imported stuff sold in Indian market. One such example is imported cars. Similarly, petrol rates are kept very high as it yields a good easy surplus because, gasoline automobiles depend fully on petrol. As a governmental exercise, it works well and to that extent the general public escapes tax axe on their backs. This price objective is most commonly found in developing countries where it adds to the revenue ex-chequer for reallocation.

7. Meeting killer competition : Price can be used as a weapon to meet the competition or eliminate it. Matching or marring the competitors is the simplest strategy in case of those companies that are more interested in non-price strategies. Meeting of competition implies keeping more or less same prices as fixed by the competitors. Here, quality and cost considerations are to be taken more or less identical. In case of such price policy, consumers are at a loss to decide only by price. They go by other points such as weight, colour, dimensions, package, feel appearance etc. This can be called as maintenance pricing. As opposed to this, a firm is to follow destroyer policy followed in order to war off possible entrants or to compel the competitors to leave the line. In latter case, such a policy is more successful if the competitor has the higher costs, so that he cannot afford lower prices.

8. Profit maximisation : Profit maximisation is the age-old objective of pricing. Here, price policy followed by the management helps the firm to maximise its earnings under given market conditions. Maximisation of profits is of the overall activities of the firm and not in case of each product item because, it means exploitation and goes against the concept of social responsibility of charging reasonable profit. Profit maximisation can be a long-term objective because, at the early stages of product life-cycle, there is need for building up minimum market share, sales volume which is possible with lower prices and lower margins. Many a times, a firm may wish to sacrifice some short-run profits by pricing lower than pricing higher so that it keeps out competitors, thereby maximising the profits in the long-run. However, long-run profit maximisation is very difficult to estimate because, the environment is hard to predict beyond the short-run.

9. Maintaining the image : Every company has an identity from the moment it opens its doors. It is an identity representing what it has done to convey the public. It is the sum-total of the impression that the people have about the firm. It is about its products—packages—trade marks—brand names—employees—graphics the marketing programme and the like. This image is deeply influenced by how the company handles the delicate and sharp weapon of pricing. For instance, a firm known for high quality and high priced products will lose its current clientele if it goes in for low quality and low priced products. As a result the high quality and high priced products are likely to lose their original image so far enjoyed. It is true conversely also. However, a company image well established will favour price policies of its choice because, the customers have accepted the company. Thus, in India, if Phillips, Hindustan Lever, Tatas and the like follow the price policy that is supported in the light of their long- standing reputation. Thus, pricing policy can build an image, make it or mar it, though image insulates the changes in price policies.

5.4 FACTORS INFLUENCING THE PRODUCT PRICING DECISIONS

The marketing executives set the product prices between an upper and the lower limits. Upper limit is the highest value that the customer is likely to put on the product or services at a given point of time. However, the lower limit is the cost of producing, promoting, distributing and includes reasonable margin. Within these extreme limits, the actual price is influenced by internal and external factors. It is crystal clear that the marketeer can exert deeper control over internal factors while the external factors control him, his line of thinking and action. The total and clear picture of these internal and external factors is clearly depicted by the chart on the next page (Fig. 5.1).

It is but essential to consider these internal and external factors.

A. Internal Factors :

Internal and controllable factors affecting the price decisions are—organisational factors, marketing mix, product differentiation, costs, product life-cycle and the objectives.

We can add one more point namely, the functional position :

1. Organisational factors : Organisational factors refer to the internal arrangement or mechanism for decision making and its implementation. These arrangements differ widely from concern to concern at the different times in an organisation. Normally, pricing decisions occur at two levels. Overall price strategy is the prerogative of the top executives who determine the basic price range for the product range with reference to market segments. However, the actual pricing is dealt at lower levels. Price decision is the outcome of production and marketing specialists. Again, the mechanism has been greatly assisted by computers. Pricing can be a centralised or decentralised decision. Thus, it is the nature and the make-up of organisational relations that have impact on pricing decisions.

2. Marketing mix : Though price is an important component of marketing mix, other components cannot be niggarded. Any shift or change in any one of the elements has an immediate effect on the other three elements. Therefore, pricing decisions must be seen not in isolation but as a part of total marketing strategy and should avoid conflict with other elements namely, product, promotion and place. Price as a marketing technique is a big gun in the armoury of marketing manager that can make, maintain or mar the situation. However, price change in either way will, not bring expected results unless such price changes are combined well with other components that make a total marketing strategy. In many cases, mere price changes have brought in disastrous doom.

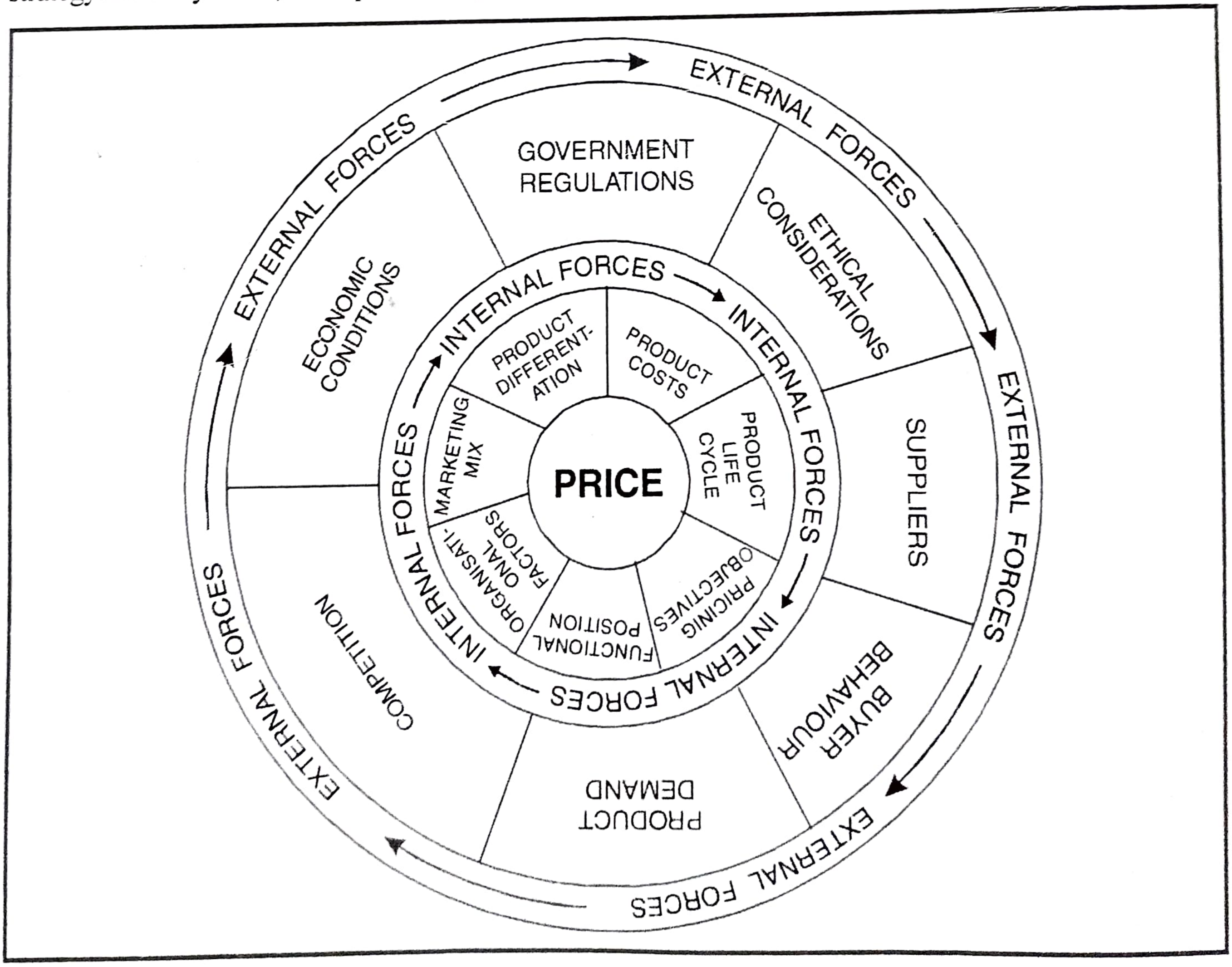

Fig. 5.1. Factors determining product pricing.

3. Product differentiation : The technique of product differentiation gives much lee-way to the firm in setting prices for the products if done better than the competitors. Product differentiation is the ability of a manufacturer to make his product distinctive from others in the market. This differentiation is relevant to consumer and may be real or imaginary but is meaningful. In case of consumer goods, product differentiation is seen to the maximum possible extent. This can be by means of package design, smell, colour, shape, advertising theme, or the brand name that the product can be differentiated. Thus, toilet soap cakes are same but different in colours that can be capitalised; the fragrance also can be a point for differentiated pricing. Simply adding the phrase "Export Quality" may make a world of difference with national and international packaging. Again, the firm's reputation can be the base for price differentiation.

4. Product Costs : It is but natural that most of us think that price of a product or a service is determined by costs solely. That is, price is cost plus plan. Costs have relevance if market demand and competition are taken into account. That is, production costs merely determine the business existence and it is the demand and the competition that determine the price. Precisely, it is the market that sets the price and not product costs. There is nothing wrong if it is said that it is price that determines the costs. However, there is close relationship between costs and price. It is the effort of the every concern to cover all the costs so that the firm has the fair chances of making surplus. Though profit earning and maximisation are the goals of pricing, it may be always possible to do so.

5. Product life-cycle : The pricing policy followed is to be commensurate with the age of the product. That is, in what stage of the life-cycle the product is, that is going to decide the pricing policy to be followed. In the product introduction stage, the policy followed is one of market penetration. That is, the prices are to be the lowest possible. This builds goodwill. In the growth stage, prices can be raised to the extent tolerated by the consumers. However, abnormal rise is dangerous. In the third stage—the stage of product maturity—prices can be raised by following the policy of market skimming. However, it should be done with utmost care as competitors are in action. In the decline stage, the prices are to be reduced to maintain the demand. Thus, it is the stage of the product life-cycle in which the product is treading through that determines the exact nature of price policy in a given concern.

6. Pricing objectives : A price policy is the means to achieve the price goals so set. Therefore, the nature of pricing policy is dictated by the obejctive or set of objectives to be attained as set by the top management authorities. It is these pricing objectives that provide the focus for framing policies and strategies. As noted earlier, there are as many as nine objectives. These objectives, though nine in number are closely related to, one another and the attainment of one leads to another or others. Though a firm has a basic pricing objective or set of objectives for its product lines, each product is likely to have a specific pricing objective. Therefore, a firm is expected to define its price goals in clear-cut terms so that they are accepted and acted upon.

7. Functional position : Functional position of the manufacturer, wholesaler and retailer has its own impact on firm's pricing policy. If the firm has a longer channel of distribution, the product price for the consumer is bound to be higher than in case fo a smaller channel. From this, one should not jump to the conclusion that such a channel should be kept quite limited to reduce the costs so that the consumers get the products at minimum price. However, a sound channel management can bring about considerable slicing down in costs. Cutting the product pipe-line is to be done on the merit of individual cases. Again, there is need for coordinated functioning of these manufacturers and middlemen so that control over the internal operations, selling advertising and administrative costs can be possible.

B. External Factors :

As against the internal controllable factors affecting the pricing policies, there are equal number of external uncontrollable factors which are to be carefully analysed, interpreted correctly which control the firm.

These factors are—demand, competition—economic conditions—governmental regulations —ethical considerations—suppliers and buyer behaviour, which are outlined below :

1. Product demand : Demand is the single most imported factor having tremendous impact on price, pricing policy and strategy followed by the firm. It is the nature and the magnitude of the demand that are more relevant to product pricing. The demand may be elastic or inelastic or perfectly elastic or perfectly inelastic. The pricing decision will vary depending on the exact nature and the extent of elasticity. A perfect elastic condition brings about more than proportionate increase in demand with a slight fall in the market price. Thus, 5 per cent fall in price brings about say 30 per cent increase in demand. In case of elastic demand—normally called as unit elasticity—a 10 per cent fall in price would bring 10 per cent rise in demand. In case the situation is that of perfect inelasticity, even the substantial fall in price would not pull up the demand. Say, 25 per cent fall in price brings 1 per cent rise in demand. In case of inelasticity, the severity is reduced. Say, 20 per cent fall in price would bring 5 per cent rise in demand. The demand conditions or magnitudes are not absolute but relative. It is the thread-bare study of actual demand condition that paves the way for price decisions and policies.

2. Competition : Knowing one's competitors is critical to successful marketing planning. The firm should constantly compare its products, prices, channels and promotion with those of competitors. The company is supposed to know as to who are its competitors ? What are their objectives ? What are their strategies ? What are their strengths and weaknesses ? And what are their reaction patterns ? A company's competitors include those who are seeking the same customers and customer needs and making similar offers to them. A competitor's objectives and strengths and weaknesses go a long way towards elucidating its possible moves and reactions to the company moves such as say, a price hike or a price cut or a promotion set-up or introduction of new product or grant of liberal credit facilities. Competitor reactions or proactions are hinged on his philosophy of doing the business, his internal culture and certain guiding beliefs. Pricing policy of the firm, therefore, depends on competitors pricing and substituting policies, among other things, in case each firm is facing a unique situation.

3. Economic conditions : The economic conditions prevailing in the country or a region are having decisive impact on firm's pricing policy. If the economic climate is good, and invigorating, generally the demand for and sales of a product or products increases. A period of prosperity and happiness brings monetary satisfaction to the people. However, boom period encourages competitors to enter the line to take advantage of profit margin. This leads to keen competition. Generally, the established competitors are having greater flexibility as they chewed the prosperity. However, when high inflationary trends prevail, there will be repositioning with further hike in prices. However, this boom period is not bestowed permanently. Any hike in these will shoot up the cost of manufacturers. Again, the manufacturer passes it on to the consumers through price hike. It is equally true in case of other inputs particularly the parts that are used in the making of final products. Thus, the price of an automobile may move if parts like batteries, belts, spark plugs, rings, wind-screens, mud-guards move up. It is equally true that when the suppliers smell that the manufacturers or users are making higher profits and their input is significant and cannot be substituted, they attempt to capitalise on that issue and raise the prices. The other factors that have considerable influence on the final pricing decisions are the scarcity and value characteristics of the suppliers.

4. The buyer behaviour : Buyers, here, we mean both business buyers and final users. The composition of these buyers and their behaviour have definite impact on the pricing decisions of the firm. Generally, if the buyers are more in number and smaller in strength, lesser will be the impact on the company pricing as they are too small to influence unless they are well organised. On the other hand, a few buyers but large users have profound influence on the pricing decisions. Again, the pricing policy to be followed would be different in case of industrial users and the final users. The firm cannot have the same or identical price policy for both the classes of consumers. The study of buyer behaviour both individual and organisational is also of much relevance that provides focus for the price fixation as it highlights the buyer reactions.

In short, the decision-makers are to be aware of both controllable and uncontrollable factors that have far reaching impact on the price decisions of the firm. It is worth pondering here that pricing is but one component of marketing strategy and to attain the best results, all the components are to be carefully coordinated in the process of formulation and implementation.

5.5 APPROPRIATE APPROACH TO PRICING

As price is one of the marketing-mix variable, it warrants a precise and logical method for price setting. Firms should be systematic in setting the prices. Optimal prices cannot be established and pricing remains an art with a host of factors to be evaluated for which there are no precise measures and weights. Though, price setting is more an art, than a science, certain logical steps are involved in the appropriate approach to pricing. The most widely used pricing methods begin with costs. This cost-plus as a reasonable profit explanation of pricing is understandable. However, pricing strategy must be based on consumer, just as product, promotion and place strategies are. The ultimate goal of the price fixing process is to set a price that is compatible with the rest of the marketing-mix. This is not an easy task that makes possible proper placement of costs which can hardly be ignored and meeting other considerations than profit.

A systematic approach to pricing involves eight steps. These eight logical steps are narrated below :

1. Identify the potential customers : The ultimate purchasers are those who pay the price for a product or a service. They are therefore, focal point in pricing strategy. It is extremely short-sighted to select a pricing policy or strategy without first identifying those people whom the pricing plan is supposed to affect. Of course, the identification of such market components is not a new step in the market planning. The users, purchasers and the purchase influencers who are important in pricing are exactly the same individuals whose needs and attitudes were explored in the development of the rest of marketing-mix. The novelty of identifying these individuals for pricing purposes lies not in the task of doing it but rather the role they play.

2. Estimate the demand : Prices are seldom set for each user or a buyer. Rather, users are grouped together into market segments may be regional, economic, demographic or psychographic— whose members are reasonably similar. For each market segment, it is necessary to determine the relationship of alternative prices to potential demand. The discovery of these relationships may require a deep penetration by the market planner into the nature of the demand for the product and the factors that influence it. This demand analysis is the part of the research activity as the starting stage of planning empirical studies of demand to produce demand schedules for each market segment. This permits the planner to judge fairly and accurately the range of prices that might be charged and price elasticity of demand within that range. In absence of statistical analysis or controlled experimentation, subjective assessment of market is the only way-out.

3. Determine competitors' prices : The importance of pricing in relation to competition, makes it mandatory for the market planner to know exactly what competitors are charging. It is not that easy to get such competitive pricing information as it is usually a closely guarded secret. Though it is easier to get price-lists of competitors, the challenging task is that of actual pricing policy. In spite of this, there are several ways in which these obstacles to obtain the information can be overcome. Most sellers establish excellent rapport with a few key customers. These customers find it useful to provide selected manufacturers with information about the prices quoted by the competitors. It is also possible to get information by comparative shopping. This type of shopping involves the observation of prices actually charged by the competitors.

4. Identify alternative basic prices : After pin-pointing the market, estimating demand and discovering competitors' prices, it is usually possible to identify the basic pricing alternatives. The basic price is the reference price. It is price from which actual prices can be determined by adding extras and deducting intras. Actual prices deviate from the basic prices because of two reasons namely,

1. Product-line pricing requires price differentials with different products in a multiple line and 2. Differences caused by market structures, geographical location, competitive conditions and terms and conditions of individual dealings. The number of pricing alternatives will depend on the range of prices within which the company chooses to compete and price elasticity that exists. The wider the range and greater the cross-elasticity of demand, the more will be the number of pricing alteratives that must be considered. If the range is narrow and the cross-elasticity is low, there should be only two or three distinct pricing alternatives.

5. Calculate manufacturer's net price : Assuming that the manufacturers use some middlemen, it is essential to calculate the amount of the basic price that will be paid to the manufacturer and the amount that will be retained by the channel member or the members. If the manufacturer sells direct to the final buyers, the basic price and the manufacturer's net price will be the same. If the basic price is ₹ 500.00 and 20 per cent is given to the middlemen, then the manufacturer's net price will be ₹ 400.00. From this it follows that if the company wants to make profit, all other costs—fixed and variable—must be less than this net price of ₹ 400.00, taking the above example.

6. Estimate costs : Other costs to be incurred may be fixed or variable. Fixed costs are those that do not vary in total with the changes in the sales. These are depreciation, rent interest and other general and administrative expenses. Although these costs do not vary in total, they do decline per unit as the sales expand. On the other hand, variable costs are those that vary in total with output though they are constant per unit of output or sale. These are the items of direct material, direct labour, direct expenses and variable overheads. Since there are some expenses which are neither hundred per cent fixed nor hundred per cent variable, we must account for such semi-variable or semi- fixed costs too.

7. Calculate expected profit : The expected profit is obtained by multiplying the costs per unit by expected volume and subtracting this amount from the total revenue anticipated by the manufacturer. The most convenient way of doing this is to use break even analysis because, the break even chart shows the relationship between the total costs and the total revenue at alternative price—levels and volume of output and sales. Much depends on the managerial philosophy and the minimum rate of return on capital employed or sales.

8. Repeat the analysis for each major segment : It might be necessary to develop separate pricing strategies for each segment, if the marketer has more than one major segment. It is common for markets that are homogeneous in all other respects to be segmented on a price basis. Segmentation does not necessarily mean that the manufacturer must attempt to serve all, the segments. However, this is of particular significance as market price elasticity varies greatly from segment to segment in case of each individual firm.

5.6 THE METHODS OF PRICE DETERMINATION

The companies resolve pricing issue by selecting a pricing method that incorporates costs, competition and demand factors. The choice of a particular method, however, depends on the pricing needs and the decision input barriers encountered by the management. The most important pricing methods are based on cost, competition and demand.

A. COST BASED PRICING METHODS :

Costs establish the floor for the possible price range and there are two commonly used cost oriented pricing methods to set the product prices. These are :

(1) Cost plus pricing and

(2) Target return pricing.

1. COST PLUS PRICING METHOD :

Cost plus or target or mark-up pricing involves simply adding a percentage of the cost to arrive at the price. There is slight difference between cost plus and mark-up pricing. Mark-up pricing is an addition of profit calculated as a percentage of sales rather than as a percentage of cost. In the final analysis, the amount of profit will be the same though the percentage of profit differs on cost and on sales.

This is clarified by the following example.

THE PRODUCTS SOLD BY THE FIRM

	Radio Mono	Two-in-one	Stereo-deck
	₹	₹	₹
Prime cost	500.00	800.00	1,700.00
Manufacturing overheads	300.00	400.00	600.00
Administrative burden	100.00	200.00	400.00
Selling & distribution burden	50.00	100.00	300.00
Cost of sales	950.00	1,500.00	3,000.00
Profit (25% on cost) or (20% on sales)	237.50	375.00	750.00
SELLING PRICE	1,187,00	1,875.00	3,750.00

The easy formula to set price under mark-up pricing method will be:

$$\text{Selling price} = \frac{\text{Average unit cost}}{1\text{–Desired mark-up percentage}}$$

$$\therefore \quad ₹\,1{,}000 = \frac{₹\,700}{1-30\%} \qquad \therefore \quad ₹\,1{,}000 = \frac{₹\,700}{1-0.30}$$

$$\therefore \quad ₹\,1{,}000 = \frac{₹\,700}{0.70}$$

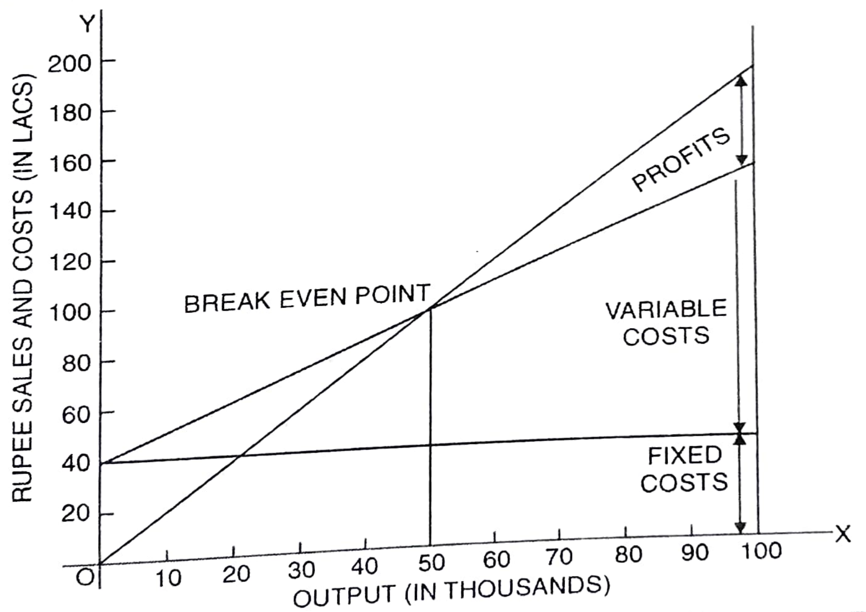

Fig. 5.2. Cost based pricing.

2. Target return pricing :

It is another very popular cost oriented method followed by good many manufacturers. It is based on the break even analysis. It sets the prices at a desired percentage return over and above the break even point. Thus, the costs of producing and offering the goods for sale are determined and a target percentage return is then added to these costs at a given standard output level. Since, total revenue to be generated includes costs and profits, it is easier to find unit selling price by dividing the total sales revenue by total output or input level. If Kemp and Company has a standard output level of say, 80,000 tricycles and the total cost works out to be ₹ 1,27,50,000 consisting of ₹ 42,50,000 fixed costs and ₹ 85,00,000 variables costs and it wants to make 20 per cent on costs, the total revenue generated will be of ₹ 1,53,00,000. Therefore, the unit selling price will be of ₹ 180 each. This data can be presented in the form of a graph showing the cost, volume and profit relationship as given in Fig. 2.

Merits and Demerits of Cost Based Methods

The cost based methods covered above have their own merits and demerits. The worth emphasising one are narrated below :

The Merits :

1. Simplicity : Unlike demand approach, cost ascertainment is much easier as estimation would not pose any problem. Moreover, it is internal to the firm.

2. Harmonious Competition : There are lesser changes of price wars between the competitors as industry-wide costs mark-ups are uniform. Costplus pricing thus provides competitive stability.

3. Socially Justifiable : Relative to demand oriented and competition oriented approaches, cost-plus pricing is socially fair. It is because, the rate or return remains the same even if the demand rises or falls.

4. It is Safer : Cost based methods guarantee recovery of costs of production and distribution and do not allow the management to play with seasonal and cyclical shifts in the business.

5. It Moves with New technology : It is quite reasonable and dependable method to opt for cost based pricing whenever a company is welcoming a new technology where the production problems and long-term cost conditions can hardly be predicted with ease and certainty.

The Demerits :

1. Ignores Demand and Competition : Perhaps, the greatest short-coming of the cost oriented methods is that they ignore the impact of demand and competition. Any pricing method that ignores these two strong external factors has hardly any practical utility.

2. Arbitrary Cost Allocation : The methods used for joint costs allocation are far from being precise and perfect as large degree of arbitrariness prevails. Therefore, the prices based on such costs tend to be imperfect. This is a specific problem of company with multiple product port-folio where joint cost allocation is a headache.

3. Cost Irrelevance : Very often prices which are based on costs are not always relevant to the pricing situation. For instance, there are situations where opportunity or incremental costs are more relevant than full costs; during inflation future costs are more fitting than historic costs.

4. New Products : Pricing new products is a problem as the firm is not having any past cost experience. Accurate unit cost can be arrived at only if market is tested and sales volume is known.

5. No Penalty for Inefficiency : Cost based pricing does not penalise the inefficiency that is creeping in. On the contrary, it gives a good hideout. Say, if the product costs have shot-up by work stoppages, material wastage reduced output, all are covered as a part of total cost.

B. COMPETITION BASED METHODS :

Good many firms set prices largely in relation to the pricing of their competitors. Though, no firm can afford to disregard cost and demand factors in pricing, it gives major attention to positioning its prices just relative to the prices of its competitors.

There are two such commonly used competition based pricing. These are outlined below :

1. GOING RATE PRICING :

Going rate pricing is the method of setting the prices in relation to the prices of competitors. The firm bases its prices largely on the competitors' prices with less attention paid to its own costs or demand. Therefore, the firm may charge the same, more or less than the major competitor or competitors. Generally, in industries where oligopoly prevails such as steel, paper, fertilisers, aluminium, copper and the like, the firms charge the same price as their competitors. It is natural that the firm charges the prices when the competitor or competitors change not bothering about their costs and demand changes. Some firms may charge not higher or lower prices than their competitors.

The following exhibit makes this concept very clear :

GOING RATE PRICE FIXING

Price per ton

Costs and mark-up	Competitor	The pricing firm The possible price alternatives		
		Alternative I	Alternative II	Alternative II
Cost of sales	₹ 5,000	₹ 5,100	₹ 5,100	₹ 5,100
Profit margin	₹ 1,000	₹ 900	₹ 1,000	₹ 800
Final price	₹ 6,000	₹ 6,000	₹ 6,100	₹ 5,900

Whether this method is appropriate or not, this depends on good many factors such as firm's pricing objectives, the structure of the industry, existence of spare capacity, costs of production—administration and selling of competitors and the customers' perceptions of the products of the firm as compared to those of competitors. This going rate pricing is popular where the costs are difficult to measure and competitive response is uncertain. It reflects industry's collective wisdom to the pricing that guarantees industrial harmony and fair return.

2. SEALED BID PRICING :

In all those business lines where the firms bid for jobs, competition based pricing is followed rather than its costs and demand. The firm fixes its prices on how the competitors price their products. It means that if the firm is to win a contract or a job, it should quote less than the competitors. With all this, the firm cannot set its price below a certain level. This is, it cannot price below the cost. One the other hand, higher price above its costs reduces the chances of winning the job. The net effect of the two opposite pulls can be well described in terms of "expected profit" of a particular bid.

This can be explained with reference to the following exhibit.

EFFECT OF DIFFERENT BIDS ON EXPECTED PROFIT

Case	Firm's bid	Firm's profit	Probability of getting this bid (A guess)	Expected profit
1.	₹ 6,500	₹ 100	85 per cent	₹ 85
2.	₹ 7,000	₹ 500	36 per cent	₹ 180
3.	₹ 7,500	₹ 1,000	9 per cent	₹ 90
4.	₹ 8,000	₹ 1,50	3 per cent	₹ 45
5.	₹ 8,600	₹ 2,100	1 per cent	₹ 21

In the exhibit, case one gives the lowest profit but the highest chances of getting the bid. With all that, profit is rupees 85. On the contrary, case No. 5 gives the highest profit with least chance of getting the bid with a profit of only rupees 21. Under these circumstance, the best bid would be one that gives maximum expected profit and that is case No. 2, with a profit of rupees 180.

These competition based pricing methods are generally followed by the managers when :

1. They believe that strong competitors are better and able to select appropriate prices so they "follow the leader."
2. Retaliatory price changes are likely beyond given range, and price changes by competitors have a substantial effect on company sales.
3. Costs, demand and other factors that affect sales and profit are stable enough to make it possible to rely on following general industry pricing trends.

C. DEMAND BASED PRICING METHODS :

All those firms that set product prices based on costs or competition can not afford to forget the relationship between traditional mark-ups or competitors' prices and market demand considerations.

Demand for products has its impact and, hence, demand schedules can be purposively incorporated into price setting through different methods.

There are two important demand based methods namely,

(1) Demand modified break even analysis pricing and

(2) Perceived value pricing.

1. Demand Modified Break Even Analysis :

Demand modified break even pricing is that method which sets the prices to achieve highest profit (over the break even point) in consideration of the amount demanded at alternative prices. In other words, this method requires estimates of market demand at each feasible price break even points and expected profit levels of total sales revenue can then be calculated.

The following exhibit and graph Fig. 3 elucidate this concept very clearly.

COST VOLUME PROFIT RELATIONSHIP

Unit price ₹	Market demand (units)	Total revenue ₹	Total point (units)	Break even point (units)	Expected profit Rs
At 5	65,000	3,25,00	3,62,500	80,000	37,500
At 10	55,000	5,50,000	3,37,500	26,667	2,12,500
At 15	45,000	6,75,000	3,12,500	16,000	3,62,500
At 20	30,000	6,00,000	2,75,000	11,429	3,25,000

Note. Total costs include fixed costs to the tune of ₹ 2,00,000.

As per the exhibit, the fixed costs are of ₹ 2,00,000, unit variable cost ₹ 2.50 and the demand forecasts at prices ₹ 5, ₹ 10, ₹ 15 and ₹ 20 are given correspondingly. It is quite evident that the price of ₹ 15 gives the highest profit amongst all the alternatives figuring ₹ 3,62,500. Hence, ₹ 15 is the price accepted.

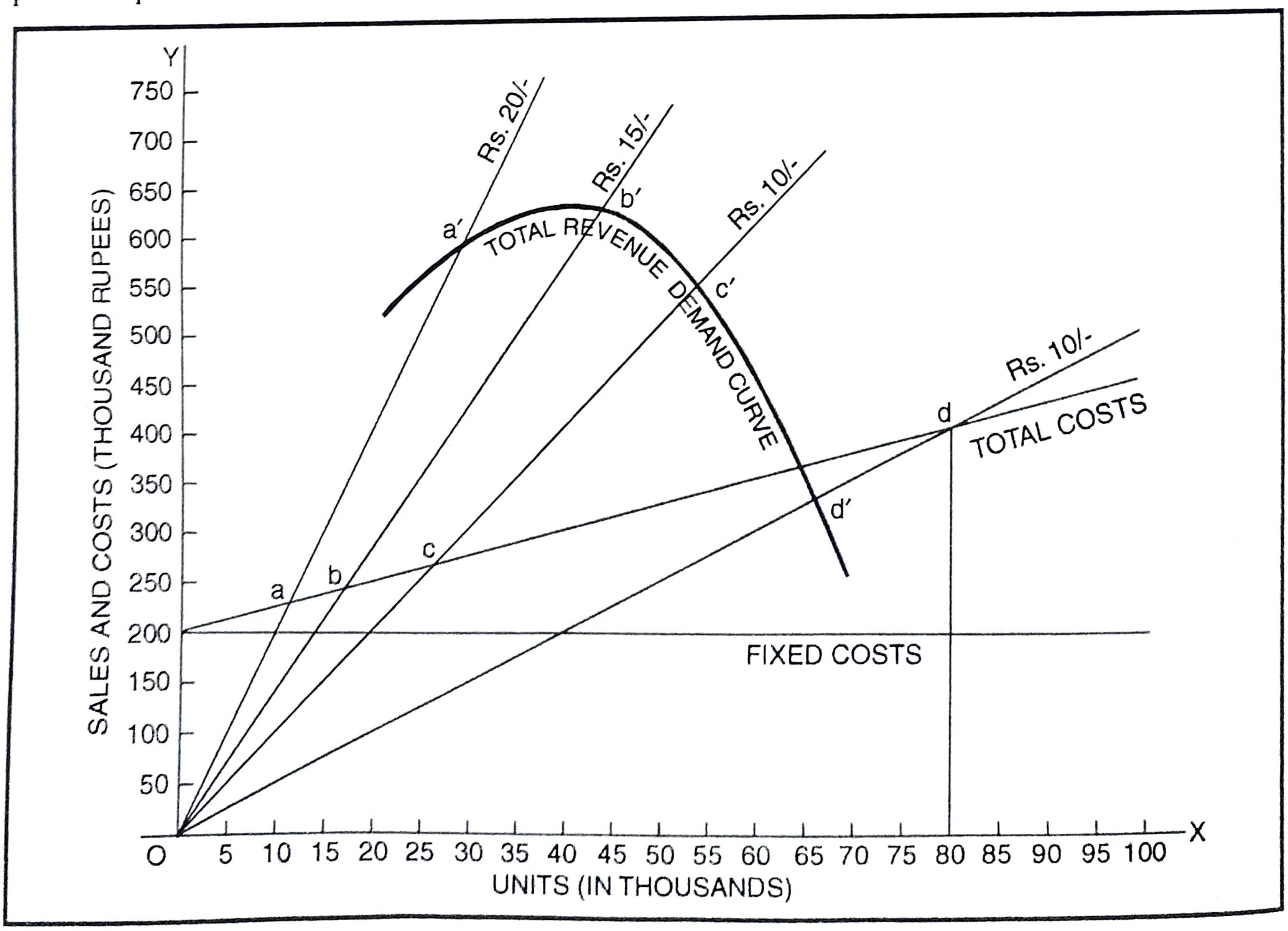

Fig. 5.3. Demand based pricing.

Though this method gives the clear way, the basic challenge is one of getting accurate estimates of the price and the quantity demanded relations.

In case of established products, the firm may employ time series analysis. Alternatively, the firm may conduct direct customer interviews rating the likely response at different price levels. Here, much depends on how the consumers actually respond. Instead, another approach is to use controlled store experiments. This approach can be used both in case of existing and the new products and it guarantees greater validity than time series analysis.

2. Perceived Value Pricing :

Of late, good many firms are setting their product prices on the basis of perceived value of a product. It is the buyer's perception of value and not the seller's cost which is the key to the product pricing. The prices setter use non-price variables in marketing-mix to build up perceived value in the buyer's minds and price is set to capture the perceived value. This approach fits well within the thinking of product positioning. For instance, people have their own perception value for say Zodiac ties, Double bull shirts, Leo toys, Bata shoes, Fiat car, Vespa scooter, HMT tractors, Tata trucks, Bajaj tempos and so on. This pricing strategy is though psychological, underscores the behavioural foundation underlying price elasticity. The people are readily willing to pay a premium price. The willingness of customers to pay a higher price depends on their perception of the fairness of the price, of the quality they get for the price they pay. If a competitor is selling his tractors at ₹ say ₹ 80,000 and you are selling at ₹ 90,000 you must convince your customer as to why he should pay more to the extent of ₹ 10,000.

For this, your answer may be :

	₹	80,000	only if equivalent to the competitor.
Plus	₹	6,000	price premium for extra durability.
Plus	₹	5,000	price premium for reliability.
Plus	₹	4,000	price premium for superior service.
Plus	₹	5,000	price premium for longer warranty on parts.
	₹	1,00,000	The package value.
Minus	₹	10,000	Discount.
	₹	90,000	Final price.

Thus, the customer may be convinced as to why he is to pay more by ₹ 10,000 and gain getting a discount of ₹ 10,000 failing which he would have paid ₹ 20,000 extra. The key to preceived value pricing is the most accurate determination of the market's perception of the offer's value. Inflated or deflated perception value calculated by the price setters are likely to go wrong. That is why, market research is needed to establish the market's perception of value as a guide to effective pricing.

5.7 PRICING POLICIES AND STRATEGIES

It is essential to establish policies for pricing of its products or services or ideas just as it is for all the aspects of business decision-making. Without definite price policies, each price decision is a time-consuming, tedious and a pell-mell affair. A policy frame-work should lead to pricing that is consistent with the company objectives, costs, competition and demand for the product. A set of price policies and strategies will not only make price setting easier but also make possible as series of prices at various levels of distribution that are rational and justifiable. It is all possible because, pricing policies are the guidelines providing a focus within which the company management administers the policies to match to the market needs.

Following are some of the pricing policies and strategies which are in vogue.

A. Price Variation Policies :

Price variation policies are those where in the firm attempts to vary the prices of its products with a view to match them with the differing market needs. There can be three variations of such price variation policies.

These options open to the firm are :

(1) Variable price policy. (2) Non-variable price policy and (3) Single price policy.

1. Variable Price Policy :

It is that policy in which the company charges different prices for sale of its like goods at a given time to similar buyers purchasing in comparable quantities under similar conditions of sale. This is, prices charged differ from buyer to buyer. This variable price policy is more apt in small business and where products are not standardised. It works well where the individual sale transactions of large sums and the bargaining power of individual purchasers is differing with the size of the transaction. The greatest advantage of this variable price policy is that it has the highest degree of flexibility as a promotional tool. But it creates friction and dissatisfaction among the consumers who feel that they are discriminated. Further, it is a time consuming affair.

2. Non-Variable Price Policy :

It is also called as 'one price' policy because, the company charges similar price for sale of like goods at a given time to a class of buyers purchasing in comparable quantities under similar conditions of sale. Here, the price charged varies from class to class say, wholesalers, subwholesalers, retailers and distributors. This non-variable price policy is less discriminatory as prices differ from class to class than customer to customer. It is a popular price policy followed by all those firms which have indirect marketing arrangements. There will be no question of price bargaining as the rates are applicable to the class of buyers as a whole. The greatest satisfaction is that there is no cause for friction and heart-burning among the buyers.

3. Single Price Policy :

It is that price policy wherein all the buyers irrespective of their class, size, or the conditions of purchases are charged similar purchase price under similar conditions of sale. This is the price policy that has no touch of discrimination and it is constructive in the sense that it helps in building goodwill. It is equally easy to administer as there is no scope for bargaining. Instead of speaking on price of the product, the sales army can utilise its time on product quality, service and outstandability. However, this price policy does not find favour with quantity buyers who feel that they should have been charged much lower prices than the small-lot purchasers. As a result, such buyers may be lost to competitors unless the product is really known by its brand. This feeling is easily accommodated by product differentiation and market segmentation.

B. Geographic Price Policies :

Geographical price policies are fully reflective of the practical problems of consumers and producers or the sellers locating geographically and the emergent transportation costs of linking them. Take our own country where production centres are highly concentrated while the consumption centres are widely dispersed. Thus, the cities like Mumbai, Chennai, Calcutta, Delhi, Ahmedabad, Bangalore. Hyderabad where we have industrial conglomeration while the demand for the products produced in these comes from far off places. Taking transport costs as major thrust, pricing policies are designed.

The major geographical pricing policies are :

(1) Point of origin price policy (2) Freight absorption price policy.

1. Point of Origin Price Policy :

It is that type of geographic pricing policy in which a firm quotes ex-factory price and makes no allowance for the transportation costs necessary to move the goods to the point of destination. There can be two variations in this policy namely, 'ex-factory' and 'free on rail' (F.O.R). Price under ex-factory pricing holds buyer responsible for all the transportation costs both freight and cartage from the factory point. On the other hand, F.O.R. price is the one in which the company bears cartage or carriage till the transport agency or the railway station. That is, the buyers are to meet freight from the tranport agency or the railway station to the point of destination.

Point of origin price policy leads to the establishment of the geographical monopoly for the firm because, the transportation costs separate those firms located in distant areas from competing with the local producers. It guarantees better price realisation in local markets wherever the products enjoy relatively inelastic demand. Further, price quotations and price administration are simplified. However, a firm cannot enter national market unless its products are distinctive enjoying inelastic demand and strong brand loyalty and where competitors find it difficult to enter.

2. Freight Absorption Price Policy :

Freight absorption price policy is one that absorbs the transportation costs fully or partly. That is, the price quoted is inclusive of transportation costs. In other words, the buyers do not bear directly freight and other transportation charges though the price includes such charges.

There can be three variations of this freight absorption price policy namely,

(1) Unform delivered price policy. (2) Zonal price policy and (3) Base point price policy.

(1) 'Uniform Delivered Price Policy' is popularly known as 'postage stamp' price or 'F.O.R. Destination' price. It is one in which the firm absorbs full transportation costs and delivers the goods to all the buyers at their ends at a uniform price irrespective of location and distance. Thus, buyers from Goa, Mumbai, Kolkata, Chennai, Delhi and so on all are to pay a uniform price that includes full freight absorption by the firm. Under actual business conditions, the firm averages the total freight charges for all customers and adds in full or part to the basic price so as to arrive at the final price to be quoted. It implies that the firm's net return differs from location to location of the buyers. This policy is fully used to expand market as a non- price competitive measure. This is of special significance in catching distant markets.

(2) 'Zonal Price Policy' is one under which the firm divides its markets into zones and quotes uniform prices to all the buyers located in the identified zone. That is, the prices quoted will differ from zone to zone rather than a single price all over the country. The price arrived at is the addition of average transportation costs to the basic price. As a result, buyers located in close zones are penalised and those located at distances are subsidised. Thus, there is a partial absorption of the transport costs in real sense. This, policy, therefore, stabilises the prices within a zone and simplifies calculation of transport charges.

(3) 'Base Point Price Policy' like zonal pricing policy it implies partial absorption of the transport costs by the firm. However, the price is quoted by adding transport costs computed up to the buyers' location by reference to one geographic location, not necessarily the factory and that location is called as 'base- point'. In other words, the buyers pay ex-factory price plus freight computed from the nearest base point irrespective of the actual freight incurred by the firm. In such a deal, it is quite possible that the actual freight paid by the company may be less than what is charged to the buyer. This difference enjoyed by the pricing firm is known as 'phantom freight'. Depending on the number of base points, such policy can be single base-point price policy or multiple-base point price policy.

This price policy is normally the collective decision of all the firms that believe in base-point pricing. However, this price policy encourages price rigidities and discriminates against local buyers who are forced to pay 'phantom freight' for no fault of theirs. That is why, it is controversial price policy with collusive overtones.

C. Price Differential Price Policies :

The price policies that involve price differentials are those the pricing firm accepts the gap between the price 'quoted to the consumers or dealers and the actual price charged. Thus, price differential represents the differences between the price quoted and the price charged to the buyer. Such price differentials have been accepted as part of pricing strategies to encourage buyers, to meet competitive pressure, to attain financial objective and finally to compensate the buyers for the loss of value satisfaction. By 'price differential' we mean that the final price will be less than the quoted price. It is not always true because, it may mean price hike too. Thus, discounts and rebates reduce the basic price quoted while warranty charges might increase it that is they are the subtractions and additions to the price quoted.

Therefore, the forms of price differentials are discount—rebates and premiums.

Discounts :

Discount is the price differential that reduces the quoted price so that the buyer pays much less than the quoted price. Discount is an allowance made to the buyers in consideration on marketing services rendered. Discount can be of three types namely, trade—quantity and cash.

'Trade discount' or functional discount is the deduction allowed of the quoted price with reference to specific position enjoyed by the buyers in the channel of distribution. The aim is to compensate the intermediaries of the distribution channel for their valuable service rendered. It is a percentage deduction of the quoted price. Say, it the firm quotes a price of ₹ 3,000 per ton and allows a trade discount of 10 per cent to the wholesalers and retailers, then the actual price payable by the wholesalers and retailers will be ₹ 2,700. If the retailers are given 20 per cent off, then the price to the retailers will be ₹ 2,400 per tonne. In other words, the manufacturer may allow 30 per cent to the wholesaler and wholesalers may allow back 20 per cent to the retailers so that they retain 10 per cent. Trade discount varies from industry to industry, company to company and product to product in a company. It depends on the length of the channel and the nature of functions performed by intermediaries.

The merits of granting trade discount to the company are :

1. An attractive discount lures the intermediaries to operate in the channel.
2. Price can be differentiated without varying it so as to match it with customer demand elasticity.
3. Large discounts help in increasing the sales as the benefit of discount may be passed on to them also. The only difficult aspect is how to asses the functions and the performance of intermediaries for fixing a standard rate of discount.

'Quantity discount' is the deduction allowed off the quoted price to the buyers on the basis of quantities bought. It is generally allowed on the aggregate of all or specific classes of product purchases measured in rupee value or physical units or in terms of purchases at time or purchases over a period of time or beyond a specific floor volume.

For instance, the following schedule may operate in case of a firm.

SCHEDULE OF QUANTITY DISCOUNT

Quantity ordered	Rate	Rate of discount
0001 to 50 units	₹ 50 per unit	Nil
0051 to 250 units	₹ 50 per unit	02 per cent
0251 to 550 units	₹ 49 per unit	03 per cent
0551 to 1000 units	₹ 48 per unit	04 per cent
For more than 1000 units	₹ 47 per unit	05 per cent

Thus, if a buyer purchases 1,001 units, the rate actually applicable will be 47.5 per cent (effective) and the rate per unit will be ₹ 44.65. Hence the total amount of discount enjoyed by him on 1,001 units will be of the order of ₹ 2,352.35. Now this discount may be on a single purchase or the cumulative purchases made over a period. Again, the slab rates make it clear that prices quoted are reduced with the increase in the quantity purchased and increase in the rate of discount.

The merits of granting quantity discount are :

1. They encourage bulk purchase or orders that will be economical to handle.
2. Slow moving items or 'self-warmers' can be moved faster with this bait of quantity discount.
3. They stabilise orders booked irrespective of changes in seasons and thus production can be kept in balance. As against these merits, there are some problems too. Those buyers who do not qualify marginally are likely to oppose this idea as they are disappointed and demoralised. Again, it is difficult to design anti-discriminatory, anti-competitive discount schedule. Violation of these conditions is a legal offence under the MRTP Act.

'**Cash discount**' is the deduction from the invoice price granted to all those who clear their bills within the desired dead-line. It is a reward to the buyer for timely or prompt payment of the amount due. The cash discount rates are based on the prevailing rates in the market at a given point of time.

For instance, if a buyer has bought goods worth ₹ 1,000 and is eligible for 20 per cent trade discount and 5 per cent cash discount for clearing the bill within a fortnight, he enjoys the discounts on quoted price of ₹ 1,000 as under :

Quoted price :	₹	1,000.00
Less trade discount @ 20%		200.00
Net invoice price	₹	800.00
Less cash discount @ 5%		40.00
Net amount due	₹	760.00

The advantages of granting cash discount are :

1. It encourages prompt or timely payment.
2. Liquidity of the company can be improved, particularly when the money market is tight. However, this cash discount should be used carefully because, indiscriminate use at all the times only increases the costs.

Rebates :

'**Rebate**' is a deduction of the quoted price. Many a times, the buyers suffer loss of value satisfaction caused by certain factors. The causes of such dissatisfaction may be defective goods delivered, delays caused in delivery, goods damaged in transit, possible deterioration in quality on the shelves. In order to accommodate these genuine claims, concessions are given in the form of rebate. One cannot think of standard rates of rebate. Only the merit of the individual case in respect of which rate can be decided. For instance, in case of 'second hands' may be in case of cloth, suit-cases, ready garments, soap cakes, and the like any thing between 25 per cent to 45 per cent of the 'firsts' quoted prices. It is worth remembering that the rebates are calculated before calculating the discounts.

For instance, if VIP Luggage Company quotes a price of ₹ 550 for the 'first' quality 20" suitcases, and the buyer is allowed 30 per cent rebate, 20 per cent trade discount and 5 per cent cash discount, the actual amount payable will be :

Quoted price for first quality suit case	₹	550.00
Less 30 per cent rebate being 'seconds'	₹	165.00
	₹	385.00
Less 20 per cent trade discount	₹	77.00
	₹	308.00
Less cash discount 5 per cent	₹	15.40
Net amount payable	₹	292.60

The Merits of Granting Rebate to Buyers are :

1. It acts as an instrument of wiping off the tears by compensating the value dissatisfaction suffered.
2. It has psychological elevation of granting at times too many concessions thus boosting the sales of the defective. However, as there cannot be one standard rate of rebate, buyers have the feeling of partial satisfaction and resentment which affect the firm's goodwill.

Premiums :

All the earlier four points were those that reduced the net price payable by the buyer. However, at times, opposite is also true. There are occasions where the actual price paid will be higher than the quoted price. Thus, consumer durable manufacturing units can add premium to the price quoted for one reason or the other. It does not mean that discounts are not given. Even after enjoying discounts, the prices paid might be higher. It is not that all companies resort to this premium adding. Thus, a tractor or fridge, oil engine, or generator units are likely to add extras for say warrantees, special after-sale services, extra durability and so on.

Let us take the case of television manufacturing company.

SPECIFICATION FOR COLOUR TELEVISION 66 cm.

1.	Original price	₹	20,000.00
2.	Add warrantee on picture tube	₹	1,000.00
3.	Add extra after-sale services	₹	500.00
	Total	₹	21,500.00
	Less 5 per cent discount	₹	1,075.00
	Net price	₹	20,425.00

D. Leader Price Policy :

Leader pricing is one where the firm in the industry initiates the price changes and these price changes are so effective that other firms follow suit. It is the one of price approximation by followers to that of initiator in the industry. In marketing jargon the former is called as "price follower" and the latter as "price leader". This pricing policy works on the principle that there is some truth and wisdom in following the established and giant units. This normally occurs in all those industries where the products are highly standardised and produced on mass scale. It may be a cigarette, sugar, cement, fertiliser, steel, tea, soaps, paints, type-writers and so on. A company can afford to a price leader only when it enjoys lion's share of market; is well informed about its demand, supply and cost conditions; has the reputation for sound pricing policies over the years, and above all the management has all the drive and initiative. Many times, it pays to be the price follower than the price leader. The price leader has several options of effecting changes such as maintaining the price, raising relative perceived quality, reduce price, increase and price improve quality or launch low price fighter line.

E. Psychological Pricing :

Psychological pricing is to do with creating a typical consumer perception so that the consumer is made to buy the product. That is, the prices fixed influence the psyche of customer and spur him to action. It is mostly the price policy followed by consumer durables. Thus, shoes companies in India have played with the consumer psychology by pricing say, Mocasin pair at ₹ 399.95 instead of pricing at ₹ 400.00 straight. It means two things; for the customer : one that things are cheaper and that the manufacturers are not exploiting the consumers because, they are true to the last paisa. It is an advantage to the seller as it multiplies the sales.

F. New Product Pricing Policies :

Basically, price determination process involved in case of new products need not be very much different from those of existing products. However, there are distinct price objectives involved in case of new products. Larger latitude of pricing objectives is possible in case of new products; pricing flexibility is also greater. There is growing competition and limited accepted prices when the new product is in the growth, maturity and decline stage. Further, as product is yet to see light of the day, much depends on external factors.

In case of new products, there can be two possible price policies namely,

1. Skimming price policy and 2. Penetration price policy.

1. Skimming Price Policy :

Skimming price policy sets high initial price to first profit from price inelastic customers, and then successively lowering the prices, often under increasing competitive conditions, to the levels that more price sensitive customers are willing to pay. It sets introductory prices at high levels relative to costs to "skim the cream" off the market. As there is no immediate competition and there are price inelastic customers, the firm finds it easier and safer to set initial new product prices as high as possible relative to costs and to lower the prices gradually as the market conditions dictate. It is essentially a slow risk strategy and allows the sellers to recover their investment rapidly though the higher returns that tempts the competitors to enter the arena.

This skimming pricing policy is going to be very successful under the following conditions :

1. Where the demand is relatively inelastic because, the customers know little about the product and close rivals are few.
2. Where the market can be broken down into segments with different price elasticities of demand.
3. Where little is known about the cost or price elasticity of the product.
4. Where it is essential to minimise the risk as one can move down then move up in the prices. The companies with high price tags ride the storms of depression easier than the cut-price merchants as their high margins support them.
5. Where the firm is efforting to 'up-market' its product so as to improve further on quality, service and expenditure on marketing costs and so capitalise on its efforts.

2. Penetration Price Policy :

As opposed to the concept of skimming price strategy, it is an attempt to set new product prices low relative to the costs. It involves setting low initial price to establish market share, pre-empt the competitors and/or to capitalise production economies. By setting low initial prices, the competitors are kept away and this makes possible for the firm to enlarge its share by generating larger sales volume.

The conditions which favour penetration pricing policy are :

1. Where there is high price elasticity of demand. That is, the firm is depending on low prices to attract more customers to new product.
2. Where large scale economies are possible, it is because, large sales volume means lower unit cost.
3. Where there is a strong threat of competition; here only a low price can ward off potential entrants to the market.
4. Where there is unutilised capacity; it is because, the price policy that increases the demand has no meaning unless the firm is in a position to meet the demand created.
5. Where market segments are not there so that high price may be accepted.

5.8 RESALE PRICE MAINTENANCE

The discussion on pricing would be incomplete without reference to the relevant concept of "resale price maintenance". It is so important today that it is though as a policy of a marketing organisation. Resale price maintenance is that marketing policy whereby the manufacturers known for their branded products, place restrictions on the prices at which the products shall be sold by the buyers and the sub-buyers from them. It is the policy of establishing the minimum resale price below which a wholesaler or retailer may not sell the manufacturer's products.

Resale price maintenance is designed to prevent excessive price cutting by wholesalers and retailers and consequent reductions in their profit margins. It discourages product substitution by merchants and maintains the prestige of an advertised brand. The co-operation and merchandising support of the retailers is gained. The consumers are protected against over-charges by the retailers. If these are the arguments in favour of resale price maintenance policy, the opponents contend to say that it creates higher prices, protects inefficient retailers, removes incentives for lower prices, increases the cost of living and above all retards the much warranted free competition.

The importance of resale price maintenance cannot be estimated precisely as there is little objective evidence on the agruments for and against the practice, so far as its effects on the general