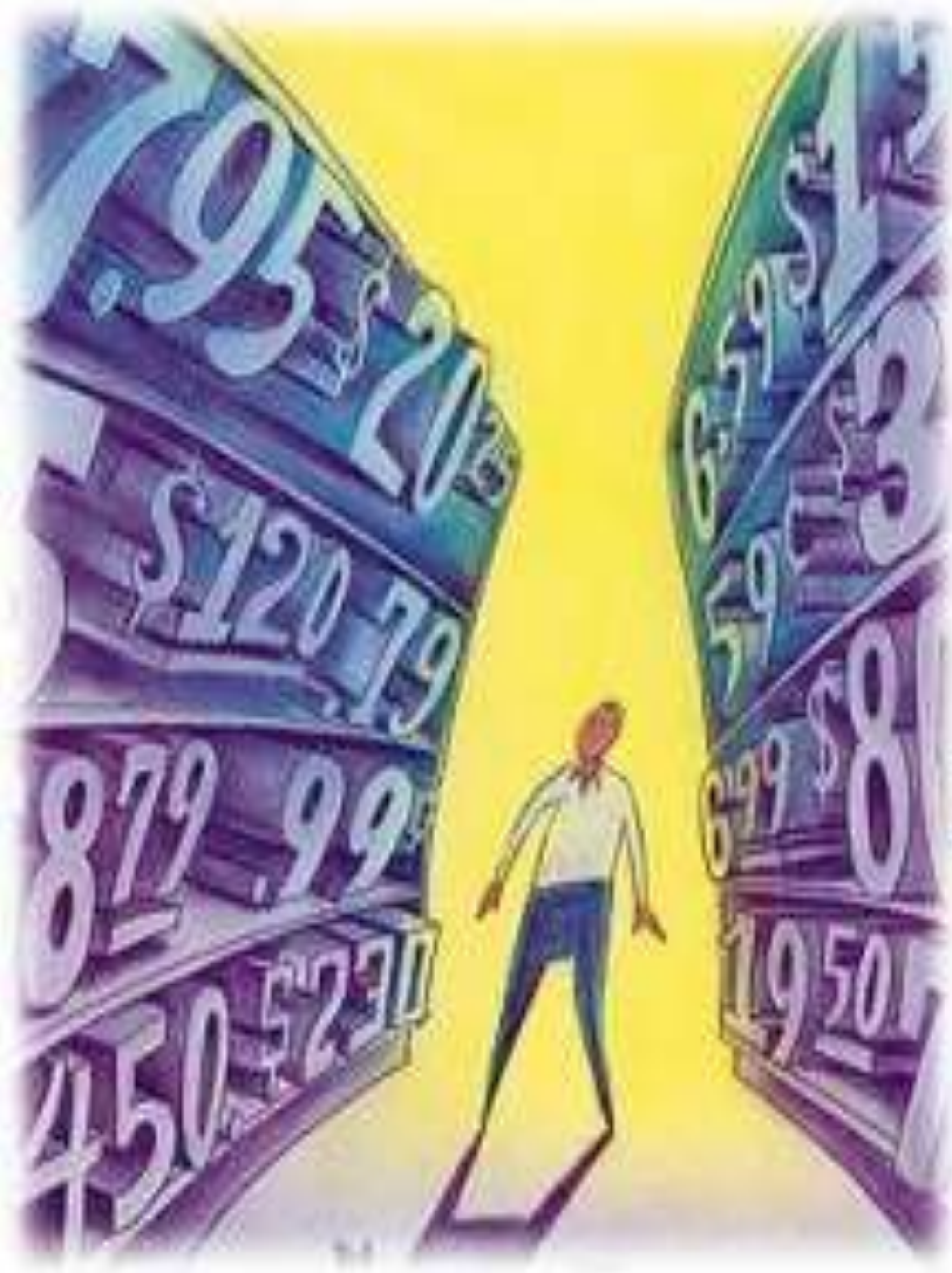

FACTORS AFFECTING PRICING DECISIONS

1. **Marketing objectives:** There are four major objectives on which prices are determined.
   They are survival, current profit maximization, market share leadership and product quality leadership.
   Survival strategy is adopted when company is facing stiff competition from the competitors and it wants quick reaction and recovery.

   Current profit maximization strategy is used to defend the market position. For example, assume a company is operating in the lubricants business. Its sales and market share are very high. It always tries to hold their current position. To do this, it increases the price of the product.

The next objective is market share leadership. Here, company strives to achieve the leadership position in the market. It reduces the price of the product so that more number of customers buy the product. Through volume generation, company gets the market leadership position.

Product quality leadership objective is used when company decides to come with high quality product and premium price. The intention of the company is to cater to the needs of the niche segment.

2. Costs: The cost of marketing and promoting the product will have direct impact on the price. For example, When airline fuel cost went up all airline companies increased the ticket prices Company will be incurring fixed cost (plant, machinery etc…) as well as variable cost (raw material, labor etc…) The fixed cost will go down if the number of products produced increases. The variable cost of the product decreases if the product is produced up to an optimal level and then once again it goes up.

3. 4Ps of marketing: The price of the product is determined by the other marketing mix elements also. Product influences the price level, i.e. if the product quality is very high company would like to price it high and vice versa. The new product requires aggressive promotion and results in higher promotion cost and higher price.

For example, Nokia when it introduced 1100 handset in Indian market priced it at Rs. 5200. It did so to get back its R&D and promotion cost. When the sales picked up, the price of the product has come down to Rs 3800.

4. Nature of the market and demand:

The price determination depends on the nature of the market also. The nature of the market is classified into following categories.

a. Perfect competition

b. Monopolistic competition

c. Oligopolistic competition

d. Monopoly

a. Perfect competition: The nature of the market where many buyers and sellers exist. Both the buyers and sellers exhibit the switching habit. If the seller charges more for the product, then buyer will shift to another seller. Usually in these types of markets, companies set their prices according to the competition. For example, in a stock market, prices of shares are frequently affected due to the large number of buyers and sellers.

b. Monopolistic competition: The nature of the market where many buyers and sellers exist but no particular buyer or seller has total control over the market. In case of monopolistic competition, prices are fixed by the gap in the product line of all competitors and on the level of differentiation. For example, food suppliers, footwear manufacturers and various service providers exist in monopolistic competitive market.

c. **Oligopolistic competition:** The market consists of few suppliers who dominate a large portion of the market. They do not allow new players to enter the market. They are price sensitive to each other and so are dependent on each other For example, automobile manufacturers, pharmaceutical companies do business in oligopolistic market.

d. Monopoly: In a monopolistic market there is only one seller due to regulatory, technical or economic entry barriers. Indian Railways has monopoly over the railway industry in India. It is able to sell its products and services at the determined rates. Prices are economical in the monopoly markets that are usually controlled by the government.

5. **Competition:** Price is also determined by how intense the competition is in the particular industry. Cellular industry and airline industry in India are involved in such type of price wars. The price war between Reliance Jio and Airtel is exemplary.

6. **Environmental Factors.** These external factors are very crucial for the company's price decisions. We discussed the impact of macro and micro environment on the company's strategies. For example, in the union budget, tax on cigarette is increased. Hence company that manufactures cigarette should increase the price. The increase in the price is determined by the government environment which the company cannot control.

Pricing Policies and Strategies

Cost based pricing

I. Cost plus pricing: The method of adding markup to the total cost of the product.

Problem: Company X would like to sell 75,000 units in the year 2008. The fixed cost of the company is Rs 2 lakhs and variable cost is Rs 5 per unit. Company wants 30 % profit after sales. Calculate the price of the product to achieve desired sales and profit.

Solution:

Unit cost = VC+ (FC/ unit sales)

= 5+ (200,000/75000)

= 7.67

Price = Unit cost/ (1- desired return on sale)

= 7.67/ (1-0.3)

= 10.85

Approx Rs 11/unit.

Pricing Policies and Strategies

Cost based pricing

II. Break even pricing:

The firm determines the price at which it will make the target profit.

Procedure to calculate the break even volume:

1. Find out the total fixed cost of the company.
2. Determine the price at which company would like to sell
3. Calculate the variable cost per unit.
4. Determine the break even volume by the following formula

Break even volume= Fixed cost/ (Price- variable cost)

Pricing Policies and Strategies

Competition Based pricing:

In this method a seller uses prices of competing products as a benchmark instead of considering own costs or the customer demand. Some techniques of competition based pricing are as follows -

a) Destroyer Pricing

This strategy is used as an attempt to eliminate competition. It involves lowering the prices of the company's products to an extent where competition cannot compete and consequently they go out of business.

b) Price Matching or Going Rate Pricing

Many businesses feel that lowering prices to become more competitive can be disastrous for them (and often very true!) and so instead, they settle for a price that is close to their competitors. Any price movements made by competition is then mirrored by the organization so long that one can compensate for any reductions if they lower their price.

c) Price Bidding or Close Bid Pricing

Price bidding is a strategy most common with manufacturing, building and construction services. In this strategy, companies submit the quotation according to the tender stipulations

Competition has forced companies to adjust their base prices according to the situations. There are basically five different types of pricing strategies that companies adopt. They are

1. Discounts and allowances
2. Location pricing
3. Psychological pricing
4. Geographical pricing
5. International pricing

1. Discounts and allowances

Companies offer price reduction for the customers on the following basis:

a. **Cash discount** is given when the customer makes early payment before the due date. To explain, a manufacturer gave 21 days credit to a grocery store person. If the customer pays the bill within 7 days, company may ask him to pay 2% less than the actual amount.

b. **Quantity discount** is a price reduction to buyers who buy the products in large quantities. Suppose a manufacture sells submersible pumps for Rs 20,000, and if customer buys three motors at one go, then he will reduce the price of the product to Rs 18,000.

c. **Functional discount** is offered when customer carries the promotion or other marketing activities. To illustrate, a chemist will be paid a nominal amount for displaying the company products or promoting the company products.

d. **Seasonal discount** is usually offered when customer purchases the product in the off season. For example, if customers purchase the winter cloth in rainy season, then he/she will get discount on the total products produced.

2. Location pricing is the method of setting the price of the product according to the locations. Here company changes the price from one location to another location though other cost remains the same. To make it more clearer, company X is having two stores, one in a market area and another in suburban area. It charges more in the market area and less in the suburban area.

3. Psychological pricing: It is 'a pricing approach that considers the psychology of prices and not simply the economics; the price is used to say something about the product. For example, a company sets Rs 299 and Rs 399 for their leather product which in turn creates the impression that the price is in the range of 200 rather than 300.

4. Geographical pricing: setting the price on the basis of geographies they are selling and freight charges. In this strategy, different options exist for the company.

5. International pricing: Organizations should consider the different external factors and customer profiles in different countries before arriving at a pricing strategy. It should adopt their products and their prices according to that. For example, CIPLA sells some medicines in Africa and America with different prices.