DESIGNING PRICING STRATEGIES AND PROGRAMS

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Pricing is one of the most complex and sensitive areas for the marketing executive. It is very difficult to set price, particularly when the product is launched in the market for the first time. The complexities of pricing can be seen in the way consumers perceive the price of the product. Consumers may view a price as high or low, denoting superior or inferior quality, or reflecting prestige or low status. As a result, a variety of factors go into developing a finite price. The price set today by a company is not, however, static. It may have to change the price with the elapse of time to meet varying circumstances and opportunities. No price, how carefully established-will be appropriate throughout the product's life. Competitors may engage in price war with the company. Company should, therefore, respond to the price changes of the competitors and this move should be a well-thought one.

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Lesson-1: Setting the Price

Objectives of this lesson

After reading this lesson, you will be able to:

- Understand the meaning and role of price
- Identify different pricing objectives
- Assess target market's evaluation of price and its ability to purchase
- Determine demand
- Analyze and estimate costs
- Evaluate competitors' costs, prices, and offers
- Select a pricing method
- Determine a specific price.

Introduction

Price is the sacrifice made by the consumers to get an item. They are very sensitive to what they sacrifice for a product. In price setting, marketers should consider consumers' ability to pay, demand of the product that exists, cost involved in producing the item, as well as the costs, prices, and offers of their competitors.

The Meaning and Role of Price

The price is what the consumer must give up in order to get the product. It is a representation of value placed on the product for purposes of exchange. Partially, this value is established by the marketing executive. Marketers incur certain costs in making, handling, storing, and selling the product. These costs are usually covered in the selling price except certain expectations. Marketers seek some extra compensation over the actual costs so some profits are made by them. Costs and profit expectations, then, become the value the marketing executive places on the product.

The price is what the consumer must give up in order to get the product.

The value of the product is not always set by the marketer. Buyers as well help determine value through their purchasing patterns. Buyers allocate their funds to the goods and services that maximize their short and/or long-run benefits. Buyers thus, place a trade-off value on the company's product by weighing the benefits of having the item against the cost of foregoing the purchase of other products or retaining their money.

The price of the product, then, will be balanced between the seller's value and the buyer's trade-off value. Where these two are similar, the price will be appropriate. If they do not match, some change in values must occur or the product will fail in the marketplace, i.e. it will not sell well.

The nature of the value of the product determines the price related problems. In addition to the costs, the seller's expectations of profit and the buyer's trade-off values are variables. Not all sellers have the same profit expectations and not all buyers have the same perception of the benefits of having the product versus holding money or purchasing another product.

A product's price reflects the personal values of the seller and buyer.

Generally speaking, a product's price reflects the personal values of the seller and buyer. Specically, price has a somewhat different role, acting as a technical mechanisms for negotiations between individuals and groups of individuals who have goods, services, or money to trade. Truly speaking, price is the common denominator allowing sellers and buyers to make evaluations and complete their exchanges.

Price is a means for allocating the nation's scarce resources.

You as a marketer should be in mind that, price is a means for allocating the nation's scarce resources. Raw materials, products, and services in relatively short supply tend to be more highly valued than those readily available. Through the pricing system, sellers and buyers can better arrange their priorities and better utilize the resources of the economy.

Price is a highly significant marketing variable directly affecting company's sales and profits. Price also has considerable symbolic value, conveying information about the company to potential buyers.

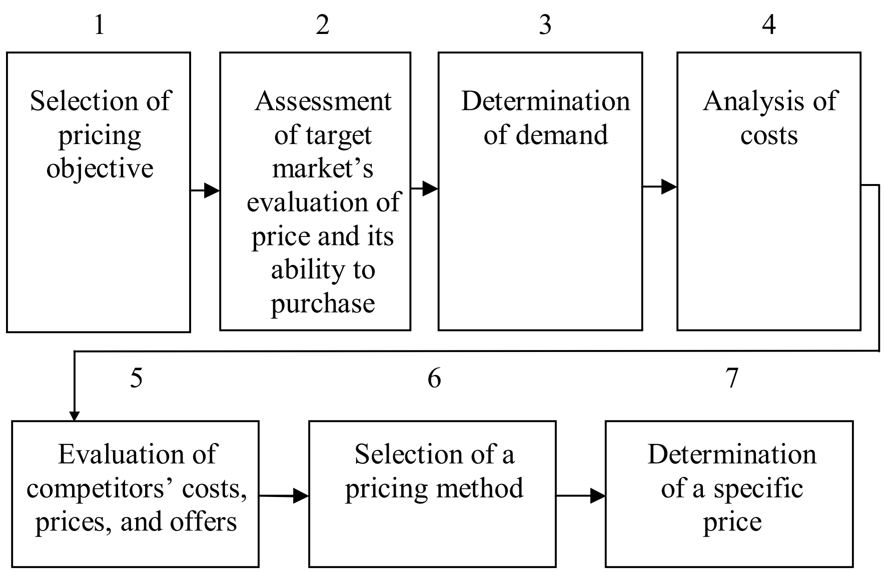
A marketer should realize that his sales and profits are heavily influenced by the prices of his products. An increase or decrease in price can mean higher or lower revenues. This assumption is not always realistic since price changes alter buyer's cost-benefit trade-off. Generally, when the price increases, consumer demand falls and vice versa. But total taka sales can increase even though demand declines. Similarly, total taka sales can rise when prices decline and consumer demand greatly increases. Though consumers are sensitive to price changes, but the degree of sensitivity depends on many factors such as consumer's financial status, availability of new products and so on.

The price set by marketing executive is also important as consumers relate a product's price to such factors as quality, progressiveness, and social status, psychological satisfaction and so on. They usually equate higher prices with better quality, modern, and more fashionable products. This image carries over to a company's other products as well as to the company itself affecting the future of the company.

Stages for Establishing Prices

We have already examined the nature and importance of price. It is now time to move on to the stages followed in price setting. Setting price for the first time is a real challenge to a firm and it faces this situation when it plans to launch a new product, or introduce an existing one into a new distribution channel, or area, or participates in a bid. In setting its pricing policy, a firm has to consider quite a number of factors and proceed following a logical process consisting of seven steps. They are: selection of pricing objective; assessment of target market's evaluation of price and its ability to purchase; determination of demand; analysis of costs; analysis of competitors' costs, prices, and offers; selection of a pricing method; and, determination of a specific price. Following figure shows the stages involved in price setting.

Figure - 10.1 : Stages Involved in Price Setting



We shall discuss each of them in turn:

- **Pricing objectives**

Pricing of goods and services is often a critical factor in the successful operation of business organizations. Although the basic pricing ingredients (costs, competition, demand, and profit) are the same for all firms, the optimum mix of these factors varies according to the nature of products, markets, and corporate objectives. The manager's job is to develop and implement a pricing strategy that meets the needs of a particular company at a certain point in time.

Many different ways of handing prices are observed. Prices are often set by top management rather than by marketing or salespeople in smaller companies, while, division and product-line managers handle prices in larger companies following the general pricing policies and objectives set by the top management. Selecting the pricing objective means deciding in advance what the company wants to achieve through offering its product. The marketing mix strategy of a firm including price becomes easier if the company is able to select its target market and position the product correctly. A firm can easily set price of its product if it can clearly set its objectives. ***Pricing objectives*** are overall goals that describe the role of price in an organization's long-range plans. Pricing objectives will influence decisions in most functional areas. The objectives must be consistent with the organization's overall objectives. Because of the many areas involved, a marketer often uses multiple pricing objectives. Here we shall look at some of the typical pricing objectives pursued by the marketing executives. One of the six major objectives can be pursued by a firm through its pricing, such as survival, maximum current profit, maximum sales growth, product quality leadership, maximize current revenue, or maximum market skimming. We shall now discuss in turn each of these objectives:

Pricing objectives will influence decisions in most functional areas.

A fundamental pricing objective is to survive.

- ***Survival:*** A fundamental pricing objective is to survive. Most organizations will not tolerate short-run losses, internal upheaval, and almost any other difficulties if they are necessary for survival. Since price is such a flexible and convenient variable to adjust, it sometimes is used to increase sales volume to levels that match the organization's expenses. If a company is plagued with over-capacity, intense competition, or changing consumer wants, it can pursue the survival objective. It is a short run objective pursued by different companies to ensure survival. Companies here cut prices without considering profit margin in such a way that covers variable costs and some fixed costs in order to sustain.

- ***Maximum Current Profit:*** It is another pricing objective being pursued by many companies; and they set a price that guarantees maximum current profit. This objective does not always guarantee maximum profit particularly in the long run because the company overlooks the effects of other marketing mix variables, legal restraints on price, and competitors' reactions. The other problem associated with it is that a company set price here taking into account the demand and cost functions which can hardly be estimated accurately.

- ***Maximum Sales Growth:*** Pursuing this objective means setting price at the lowest level to ensure maximum sales in order to lower unit cost thus maximizing long-run profit. This can also be termed as market-penetration pricing, and consumers are here thought of as highly sensitive to prices. In order to pursue this strategy three conditions must prevail. They are: the market is price sensitive, and market growth is stimulated by low price; accumulated production experience reduces production and distribution costs; actual and potential competitions are discouraged by low price.

- ***Product-Quality Leadership:*** A company might have the objective of product quality leadership in the market. If a company aims to be the product-quality leader in the market it can pursue this pricing objective. Here the company sets prices at a higher level (compared to competitors) to give the market an idea that its product is superior in terms of quality, durability, functional performance and so on (it obviously produces a high quality product). The price is also charged high here to cover high product quality and the high cost of research and development.

- ***Maximise Current Revenue:*** Here the price is set based on demand function with the aim of maximizing sales revenue. It is hoped that market share growth and profit maximization will be achieved in the long-run if this objective is pursued.

- ***Maximum Market Skimming:*** In this objective, price is set at a high level . This objective is pursued particularly in case of new or innovative product with the hope that some segments will buy the product because of the newness even paying a higher price. When these segments become sour, the company will lower price to attract new segments and continues to follow the same method as long as the product is sold and thus skims the market.

Under the following conditions, market skimming strategy works:

- If a sufficient number of buyers have a high current demand
- If the unit costs of producing a small volume are not so high that they cancel the advantage of charging what the traffic will bear
- If the high initial price does not attract more competitors to the market
- If the high price communicates the image of a superior product.

Other Pricing Objectives

There are some other pricing objectives some of which are followed by business organizations, and others by nonprofit, social, or public organizations. They are: achieve a target market share, achieve a target return on investment, maximize cash flow, meet or prevent competition, stabilize prices, support other products, partial cost recovery (may be pursued by an educational institution), full cost recovery (may be pursued by a non profit maternity clinic), and social price geared to the varying income situations of different clients (may be pursued by a nonprofit theatre company). Let us now have a short discussion on them:

- ***Achieve a Target Market Share:*** Here, the marketing executive will estimate the total market potential and determine what share the product should obtain given the competition. The executive will then estimate how high (or low) the price should be set to achieve that market share.

- ***Achieve a Target Return on Investment:*** A more realistic pricing objective is achieving a target return on investment. Here, the marketer first determines the total costs of making and selling a certain number of units, including both the variable costs and the fixed costs. Thereafter, he decides on desired return on that investment. From that point, the executive will calculate a price that will yield that level of profitability. For example:

Total cost to produce and sell 1,000,000 units	=	Tk.1,000,000
Desired return on investment	=	15%
Target profits	=	Tk.1,50,000
Selling price per unit (for 1,000,000 units)	=	Tk.1.15

- ***Maximize Cash Flow:*** Under this objective, the marketing executive may decide to price the product in a manner that maximizes the cash flow. It is assumed that sales are synonymous with cash. But in many instances, purchases are made on credit. If a company must pay its supplier before its customers pay, cash inflows will be slower than outflows of cash. In order to get rid of this problem, the marketing executive may have to induce consumers to either pay in cash or pay sooner than they would otherwise. Here, a marketer can make the cash price more attractive to buyer than a credit price or what is available from other sellers.

- ***Meet or Prevent Competition:*** There are situation where a marketer may be more concerned about the competition in the marketplace than with the actual performance of the product. In such situations he may simply price the product in a manner that nullifies price as a marketing variable, or discourages potential competition from entering the marketplace.

- ***Stabilize Prices:*** Here a marketer tries to create a consistent price for the product so that both the executive and potential buyers will know what price to expect and plan for. To stabilize prices, the marketing executive will generally meet competitive price changes as they occur, reducing the benefits to price modification, and resulting in a more stabilized price, which may help him to retain his customers.

- ***Support Other Products:*** There are situations where a marketer will use a product as a loss leader in which a loss is taken on the product in order to enhance sales and profits of other products within the mix of the company's products. He may do this with the hope of maximizing total company profits rather than profits for individual items. This objective is found to be effective when great consistency exists within the product mix.

- **Assessment of Target Market's Evaluation of Price and Its Ability to Purchase**

Although it is assumed that price is a significant issue for customers, the importance of price depends on the type of product and the type of market the company targets. By assessing the target market's evaluation of price, a marketer is in a better position to know how much emphasis to place on price. Information about target market's price evaluation may also aid a marketer in determining how far above the competition a firm can set its prices. Understanding the purchasing power of buyers and knowing how important a product is to them in comparison with other products help marketers to assess the target market's evaluation of price accurately.

- **Determination of Demand**

Level of demand of a product is dependent on the levels of price set

Level of demand of a product is dependent on the levels of price set, thus, having different impacts on the marketing objectives of the concerned firm. We can understand the relationships between price and demand through demand schedule. Demand schedule tells us how much quantity of a product will be demanded (sold) at various prices. It is known that price quantity relationship is inverse except few exceptions. That is less will be demanded if price is charged high and more will be demanded if price is charged less which means that buyers are price sensitive. In case of specialty or prestige goods, price increase may increase demand because buyers draw a price quality relationship: they take the higher price to signify a better or more exclusive item. We shall now discuss the factors affecting price sensitivity of buyers.

Factors Affecting Price Sensitivity: There are nine factors that affect price sensitivity as identified by Nagle. They are:

1. ***Unique value effect:*** When the product is considered more unique by the buyers they will usually be less price sensitive.

2. ***Substitute awareness effect:*** When buyers are less aware of substitutes then they are found to be less price sensitive.

3. ***Difficult comparison effect:*** When buyers cannot easily compare the quality of substitutes then they are usually less price sensitive.

4. ***Total expenditure effect:*** If the expenditure on the product is less as to the ratio to buyers' income then they are found to be less price sensitive.

5. ***End-benefit effect:*** The less the expenditure is to the total cost of the end product the less price sensitive buyers are.

6. ***Shared cost effect:*** When part of the cost is borne by another party, then buyers are less price sensitive.

7. ***Sunk investment effect:*** If the product is used in conjunction with assets previously bought buyers will be less price sensitive.

8. ***Price-quality effect:*** When the product is assumed to have more quality, prestige, or exclusiveness then buyers are less price sensitive.

9. ***Inventory effect:*** When buyers cannot store the product then they are less price sensitive.

Methods of Estimating Demand Curves: Several methods can be used to measure the demand curve of a company's product. They are discussed below:

First, existing data on past prices, quantities sold, and other factors can be analyzed statistically. ***Second,*** price experiments may be conducted either by estimating demand curve based on in-store sales data of a product at various prices or selling product at various prices in various territories and see their affect on sales. ***Third,*** buyers may be asked how much they will buy a product at various prices

Price elasticity should be taken into consideration in setting price.

Price Elasticity of Demand: It is the relative responsiveness of changes in quantity demanded to changes in price. Price elasticity should be taken into consideration in setting price. If the change in price does not affect the demand position we can call it inelastic demand situation, and, elastic demand situation is that where slight change in price considerably affects demand position. A product, demand of which is elastic, marketers can ensure increased sales by lowering the prices. Elasticity of demand depends on number of conditions, and demand of a commodity is likely to be less elastic if following conditions are present: (a). where number of substitutes or competitors are few in number; (b). where buyers do not readily notice the change (increase) in price; (c). where buyers are relatively brand loyals; and, (d). where buyers consider price increase as logical.

- ### Analysis of Cost

In setting price, a company considers its costs of production, distribution, and other costs as of the elasticity of demand. To stay in business, a company has to set prices that cover all its costs. Here we shall discuss (i). types of costs, (ii). cost behavior at different levels of production per period, (iii). cost behavior as a function of accumulated production, (iv).

cost behavior as a function of differentiated marketing offer, and, (v). target costing, in understanding how costs are estimated.

- ***Types of Costs:*** Costs are associated with the production of any good or service. Determining costs of production necessitates distinguishing fixed costs from variable costs. Cost that does not vary with the quantity of production can be termed as fixed cost such as house rent, executives' salary and so on. The cost of renting a factory, for example, does not change because production increases from one shift to two shifts a day. Variable costs, on the otherhand, are directly related to the quantity of production. They increase with the increase of production, and, decrease with the fall of production such as raw material's cost. These costs are usually constant per unit. Average variable cost is the variable cost per unit produced. It is calculated by dividing the variable costs by the number of units produced. Total costs are the sum of fixed and variable costs. In price fixation a company normally charges a price that covers at least its total cost.

- ***Cost Behavior at Different Levels of Production Per Period:*** Costs of production vary with different levels of production because the rate of utilization of machinery varies and fixed costs per unit also vary. Management should find the optimum level of production to keep the fixed cost per unit at a minimum level.

- ***Cost Behavior as a Function of Accumulated Production:*** A company's per unit production costs keep reducing as it increases its production up to a certain level, because it accumulates experience as it progresses. For example, if the company produces 50,000 units, per unit production cost may be Tk.15; if it produces 100,000 units, per unit production cost may come down to Tk.12 and so on. An experienced company may exploit this experience by reducing its price compared to competitors' prices in order to drive few of the competitors out of the race and thus can increase its market share significantly.

- ***Cost Behavior as a Function of Differentiated Marketing Offers:*** Since this is the era of extreme competition, companies try to satisfy their customers by fulfilling their requirements. It leads to the idea of offering different terms to different customers since they vary in their requirements and as a result marketer's costs will differ with different customers. Since marketers' costs vary here marketers should fix different prices for different customers and in fixing prices here they should rely on activity based cost (ABC) instead of standard costing.

- ***Target Costing:*** Here a company first determines the price of a product at which it must sell and from there on it deducts the desired profit margin to arrive at the target cost. Efforts are taken thereafter to keep the production cost and other costs limited to the target cost.

Target cost for this purpose is broken down to all of the costs that are involved with the production and marketing of the commodity so that measures can be taken to keep the cost of every item limited within the target cost.

- **Evaluation of Competitors' Costs, Prices, and Offers**

In order to set prices appropriately, a company should have clear picture about competitors' cost, prices, and their reactions against the possible range of prices determined by market demand and cost. It is also imperative to know in detail about competitors' offer in terms of quality, price and other variables. If the company finds that its offer is more or less similar to competitors' offers, it should price close so that it does not lose sales. If it finds that it is in a superior position, it can charge high price, and should charge lower price compared to competitors if its offer is found inferior to competitors' offers. Becoming aware of competitors' prices, particularly, is not always an easy task, especially in producer and reseller markets. Competitors' price lists are often closely guarded. Even if a marketer has access to competitive price lists, these lists may not reflect the actual prices at which competitive products are sold. The actual prices may be established through negotiation. It is, therefore, important for marketers to be very careful in utilizing competitive price information while reaching price decisions.

- **Selection of a Pricing Method**

When a company has three Cs in hand it is ready to select price. The three Cs are: customers' demand schedule, cost function, and, competitors' prices. In selecting price, a company has to select a particular pricing method which includes cost considerations; competitors' prices and prices of substitutes; and, customers' assessment of unique product features. We shall now discuss different pricing methods any of which may be selected by a company:

- ***Markup Pricing:*** This is the easiest pricing method. Here marketers first find out various costs and add a standard percentage with it as profit. For example, a particular item's fixed and variable costs are in total Tk.20 and marketer decides to make a profit of 20%, than the product's price will be Tk.24/= (Tk.20+4).
- ***Target-Return Pricing:*** Here the price is set at that level which will yield target rate of return on investment made by the company. For example, a company has invested Tk.10,00,000/- in its business, and expects a sale of 100,000 units, and per unit cost is Tk.10/-. The company wants to achieve 20% rate of return on investment. In this case its target return price will be Tk.12/-. The formula used to calculate target return pricing is as follows:

$$\text{Target Return Price} = \text{Unit Cost} + \frac{\text{Desired Return} \times \text{Invested Capital}}{\text{Unit Sales}}$$

- ***Perceived-Value Pricing:*** This is one of the contemporary pricing method under which marketers in setting their prices do not take into account their costs as key consideration, rather they see the buyers' perception of value. To build up perceived value in the buyers' mind, marketers use non price variables such as durability, reliability, service etc. in their marketing mix, and perceived value is captured to set price accordingly.

- ***Value Pricing:*** This is also a modern method of pricing where high quality products are priced significantly low i.e. high-value is offered to customers. Value pricing is not a matter of simply setting lower prices compared to competitors, rather it is a matter of re-engineering the company's operations to truly become the low-cost producer without sacrificing quality, and lowering one's prices significantly so that large number of value conscious customers are attracted.

- ***Going-Rate Pricing:*** It is a popular pricing method and used when costs and competitors' responses are difficult to measure. Firms here do not take into account their costs and demand positions in setting prices rather determine prices based on their competitors' prices. They can charge similar, lower, or higher prices than their competitors.

- ***Sealed-Bid Pricing:*** This type of pricing method is followed when a firm wishes to win a contract or job. Pricing here is done keeping in mind the probability of winning the contract and expected profit, not the cost of the firm and its demand position. If a firm wants to increase the probability of winning it has to set lower price.

- **Determination of a Specific Price**

Final price may be selected easily based on the pricing methods discussed earlier. In order to select the final price, few additional factors to be taken into consideration by a company. These are: psychological pricing, influences of other marketing mix elements on price, company pricing policies, and the impact of price on other parties. We shall now discuss them in turn:

- ***Psychological Pricing:*** Price sometimes denotes psychological meanings such as high price means high quality or odd price means lower price range or may convey the notion of discount or bargain. For example, a particular product priced at Tk.200/- per unit may contain Tk.150/- worth of that product but consumer will not mind paying Tk.200/- for the product because it may communicate an image of Tk.200/- worth. In case of ego-sensitive products, higher prices may be charged. Another example could be a product charged Tk.199/- instead of Tk.200/-. Customers may see this as a price in Tk.100/- range rather than Tk.200/- range.

In case of ego-sensitive products, higher prices may be charged.

- ***The Influences of Other Marketing Mix Elements on Price:*** In selecting the final price, a company should take into account the influence of other marketing mix elements such as the quality of the product, the advertising budget and so on. A particular brand could be priced high if its relative quality is average but the advertising budgets are high. Brands that are of high average quality and advertising budgets are high may also be priced high. If a product is in the later stage of its life cycle and occupies a major portion of market share may also be priced high.

- ***Company Pricing Policies:*** Final price is also the outcome of the pricing policy being pursued by a company. For example, if a company emphasizes on the price recommendations of its sales force it may select the final price based on the price quotes made by the sales people.
- ***Impact of Price on Other Parties:*** Final price is also selected considering the impact of it on other parties such as distributors' reactions, sales people's objections, government reactions, competitors' policies, and the effect of legislation on prices.

Questions for Review

1. Price is a representation of value placed on the product –
   a. For purpose of exchange
   b. For purpose of selling it
   c. For purpose of utilizing it
   d. None of the above.

2. In a narrow sense, a product's price reflects the –
   a. Values of the seller and middlemen
   b. Personal values of the seller and buyer
   c. Values of the government and buyer
   d. All of the above.

3. An increase or decrease in price can mean higher or lower revenues –
   a. Assuming the quantity demanded changes
   b. Assuming the per unit profit does not change
   c. Assuming the quantity demanded does not change
   d. None of the above.

4. Consumers usually equate higher prices –
   a. With better quality
   b. With modern and more fashionable products
   c. Both a & b
   d. None of the above

5. Which of the following is a stage involved in price setting?
   a. Selection of pricing objective
   b. Determination of demand
   c. Selection of a pricing method
   d. All of the above.

6. The optimum mix of basic price ingredients varies according to –
   a. The nature of products
   b. The nature of markets
   c. The nature of corporate objectives
   d. All of the above.

7. Pricing objectives are overall goals that describe the role of price in –
   a. An organization's long-range profitability
   b. An organization's long-range plans
   c. An organization's long-run existence
   d. None of the above.

8. Which of the following situation necessitates a firm to pursue a survival objective?
   a. If a company is plagued with over-capacity
   b. If a company is plagued with intense competition
   c. If a company is plagued with changing consumer wants
   d. All of the above.

9. Pursuing Maximum Sales Growth objective means setting price –
   a. At the lowest level to ensure maximum sales
   b. At the highest level to ensure maximum profit
   c. At the lowest level to wipe out competitors
   d. At the moderate level to ensure long-run existence.

10. Under which the following conditions, market skimming strategy works?
    a. If a sufficient number of buyers have a high current demand
    b. If the high price communicates the image of a superior product
    c. Both a & b
    d. None of the above.

11. Demand schedule tells us how much quantity of a product will be demanded (sold) –
    a. At various places
    b. At various prices
    c. During different periods
    d. All of the above.

12. Which of the following is a factors affecting price sensitivity?
    a. Unique value effect
    b. Substitute awareness effect
    c. Difficult comparison effect
    d. All of the above.

13. Cost that does not vary with the quantity of production can be termed as -
    a. Fixed cost
    b. Semi-fixed cost
    c. Variable cost
    d. Marginal cost.

14. Define the meaning of price and explain its role. Summarize different pricing objectives.

15. How would you analyze and estimate costs? Explain alternative pricing methods available to a marketing executive.

Answers

1. a, 2. b, 3. c, 4. c, 5. d, 6. d, 7. b, 8. d, 9. a, 10. c, 11. b, 12. d, 13. a.

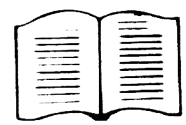
Lesson - 2: Adapting the Price

Objectives of this lesson

After reading this lesson, you will be able to:

- Trace the goals of price adaptation
- Know the concept of geographical pricing
- Identify different price discounts and allowances offered by companies to reward customers
- Understand different promotional pricing methods followed by companies
- Know how prices can be discriminated
- Describe product-mix pricing

Introduction



Prices set by a company do not always remain same . Over time, the original price established for almost any product will have to be adjusted. The marketing executive will find it necessary to change the product's price several times during the course of its life cycle. They are changed or adapted depending on the needs or situations. A company needs to adapt its prices to different situations i.e. it may charge different prices depending on geographic variation, variations in segments, purchase timing, order levels, delivery frequency, guarantees, service contracts, and some other factors.

Goals of Price Adaptation

Price adaptations are made to pursue number of goals.

Price adaptations are made to pursue number of goals. They are: change of purchase patterns; market segmentation; market expansion; utilization of excess capacity; implementation of channel strategy; and, to meet competition. We shall now discuss in brief these goals in the following paragraph :

- ***Change of Purchase Patterns:*** Marketers may adapt their prices to influence or change patterns of purchase. Lower prices may be granted to induce customers to buy in larger quantities, to buy in anticipation of future needs, or to concentrate their purchases among fewer sources of supply. Higher prices may be charged from certain customers to discourage them from carrying the line, thus reducing the intensity of competition in certain markets.

- ***Market Segmentation:*** Marketers can also adapt their prices to tap segments of a market which differ in price elasticity of demand. These differences in sensitivity to price may come about because of differing values in use among various classes of buyers and/or differing competitive situations facing the seller.

- ***Market Expansion:*** By offering lower prices to customers who have lower values in use, the market for a given product or service may be expanded. Such expansion may also be accomplished by offering lower prices to present customers to gain new applications of the product or service where prior price levels made such applications uneconomic.

- ***Utilization of Excess Capacity:*** Price adaptations can also be made to utilize excess production or marketing capacity. If such capacity exists, adaptation makes a sale possible which covers direct costs and will contribute to the total profits of the firm.

- ***Implementation of Channel Strategy:*** Price adaptation is a major device by which a firm attempts to implement its marketing strategy with regard to channels of distribution. Price variations may reflect differences in marketing tasks performed by various types of resellers or differences in the competitive environments in which they operate. Adaptation may encourage certain channels to engage in various promotion of the line, or they may be used to gain representation of the line in diverse channels.

Adaptation in price is also a device which can be used to meet competition.

- ***To Meet Competition:*** Adaptation in price is also a device which can be used to meet competition. The price ceiling for a given product or service is set by the value in use or utility offered to the buyer as well as by the alternatives open to the buyer with respect to other sources of supply. Where the seller is disadvantaged because production facilities are located far from the potential buyer, a price adaptation may be made to make the delivered price attractive compared to competition.

Price-Adaptation Strategies

Price of a company may be adapted following a number of adaptation strategies. A company may choose one or more of these strategies depending on the policies it decides to pursue. Different price-adaptation strategies to be discussed here are: geographical pricing; price discounts, allowances, and promotional pricing; discriminatory pricing; and product-mix pricing.

- **Geographical Pricing:**

A marketer, in addition to deciding what price to set for the product, may also have to decide whether to charge different prices in different geographic areas. The basic issue confronting the executive here is recognizing that market conditions and consumer sensitivities to price vary by geographic area. Difference in price occurs not only on wide territorial bases, but also between districts and even in different parts of the same district. Though such an exercise is very costly, the executive could segment the overall market into very small geographic areas and set unique prices in each. In geographic pricing a company may charge variable price depending on the customers living at different locations or countries. A company may charge a higher price to distant customers to cover higher shipping and other costs or it may even charge a lower price to increase sales. A company may follow different techniques with regard to realize the money. They are: barter, compensation deal (receives some percentage in cash and rest in products), buyback arrangement (accepting partial payments through products manufactured by the buyer), and offset (receives full payments in cash but agrees to spend a substantial portion in that country or region in buying products produced there).

- **Price Discounts, Allowances, and Promotional Pricing:**

The standard price established for the product by a marketer is ***list price.*** But it is not always the actual price charged the customer. Basic prices are here modified to reward customers for such acts as early payments, volume purchases, and off-season buying and called together discounts and allowances.

Marketers sometimes offer a discount or allowance to the buyers, effectively reducing the product's list price, making it more competitive in the marketplace, stimulating short-term demand, or creating product awareness. In order to attain any of these objectives, a marketer can choose from a variety of discount and allowance methods. Some of the most commonly used strategies are:

- Quantity discounts
- Cash discounts
- Trade discounts
- Seasonal discounts
- Promotional allowances - loss-leader pricing, special-event pricing, cash rebates, low-interest financing, longer payment terms, warranties and service contracts, psychological discounting
- Forward dating
- Other allowances

- ***Quantity Discounts:*** Here a marketer reduces the list price based on the number of units purchased. It can be very effective at both consumer and middleman levels. This type of discount is allowed to buyers who buy in bulk volume. This discount again may vary with the quantity purchase. A marketer can use two forms of quantity discounts, viz. noncumulative and cumulative. A noncumulative quantity discount applies to the number of units purchased in a single transaction at a single point in time. For example, a "3 for Tk.1.00" price is actually a quantity discount since the buyer will pay Tk.0.50 for one unit, but Tk.1.00 for three, a savings of Tk.0.50. At the middleman level, the marketing executive will use a noncumulative

Two forms of quantity discounts can be used: noncumulative and cumulative.

discount. Usually, larger purchases allow for economies of scale in both processing the orders, and in transporting them to the middleman.

On the otherhand, the cumulative discount reduces the price based on the number of units purchased within some time period. Whether used at the consumer or middleman levels, its purpose is to encourage buyer loyalty to the seller, rather than gain large purchase orders from them.

Cash discount is a reduction in the list price based on the buyer's early payment in cash.

- ***Cash Discounts:*** Cash discount is a reduction in the list price based on the buyer's early payment in cash. Though it is not used extensively at the consumer level, but is a widely adopted practice at the middleman level. Its basic purpose is to stimulate rapid payment and draw in precious cash to the company. It is paid to customers who pay their bills promptly. For example "5/15, net 30," means a customer has to pay his bill within 30 days but will get a discount of 5% if he pays within 15 days. The biggest problems in offering cash discounts center on the administrative burdens and potential for abuse. Some of the buyers may take the facility of discount but not pay within the stipulated time causing financial trouble for the company.

- ***Trade Discounts:*** Reducing the product's list price to a middleman is called a trade or functional discount. It is basically offered to the channel members by the manufacturers if they (channel members) perform certain functions such as selling, storing, and record keeping. It may vary from channel member to channel member depending on the type and magnitude of functions performed by them.

- ***Seasonal Discounts:*** Here the product's list price is reduced in order to stimulate sales during a particular time period. Such discount may be given to the buyer to induce earlier than necessary purchases of seasonally used products, or to build sales during traditionally off-peak periods. If a buyer buys a manufacturer's product in off-season he may be offered seasonal discount by the manufacturer. This type of discount allows the seller roll his product round the year as a result of which he can keep his production going on throughout the year.

- ***Promotional Allowances:*** To encourage middlemen to promote or otherwise display a product, a marketer can offer a promotional allowance. If the buyer allows a reduction on the list price to the seller it can be termed as allowance. To ensure dealers' participation in advertising and sales support programs, sellers normally offer allowances. In practice, this allowance can take one of several forms. Some of the commonly practiced ones are discussed below.

i. Loss-Leader Pricing: More legitimate pricing techniques are known as loss-leader selling whereby the price is set below invoice cost in order to reduce inventory size. To stimulate additional traffic to store, supermarkets and department stores normally drop the price on well-known brands. Leader pricing, on the otherhand, is merely a reduction from the going price, also intended to reduce inventory.

ii. Special-Event Pricing: Special-event pricing involves advertised sales or price cutting to increase revenue or lower costs. To attract more customers, sellers establish special prices in certain season such as beginning of the month or beginning of the year. Special event pricing entails coordination of production, scheduling, storage and physical distribution. Whenever there is a sales lag, a special sales event may be launched.

iii. Cash Rebates: To clear their inventories, manufacturers normally offer cash rebates if products are purchased within a specified time period.

iv. Low-Interest Financing: A company can offer low interest financing to customers instead of cutting price of its product and thus can increase sales.

v. Longer Payment Terms: Here, buyers are offered the opportunity to buy the product in installments by charging a higher price of the product.

vi. Warranties and Service Contracts: By offering free or a reduced price warranty or service, a company can promote its sales.

- **Forward Dating:** Such discount are offered to middlemen. The marketing executive will offer the products to the buyer and not charge for the goods until a later date. For example, the product may be shipped to a buyer in December, but he won't be billed until April. The advantage to buyers of this type of price offer is that they can have the products and possibly sell them before having to make the payment. Thus, they do not tie up their funds in inventory. For the company, sales are guaranteed, and production can be scheduled more effectively.

- **Other Allowances:** In addition to the above, marketers can also offer some other discounts to their customers. Some of them are discused here. ***Rebates*** are cash refunds for buying the product. They have been very popular at the consumer level. ***Trade-ins*** can also be used by the marketing executive to discount the product's list price. It is a price reduction given for used goods when similar new goods are bought. By giving fair market value, or even more on a trade-in, the executive can effectively change the actual price charged to the buyer. Push money (PM) can sometimes be used by the marketer to support the sales of particular products. Push money is funds passed down to retail sales clerks to encourage them to emphasize the company's product instead of his competitors' ones.

Rebates are cash refunds for buying the product.

Discriminatory Pricing

To accommodate differences in customers, products, locations, and so on, a company often modifies its basic price. Price can be discriminated in many ways which we shall discuss in the following paragraphs:

- ***Customer-Segment Pricing:*** A same product may be sold at different prices to different customer groups though the production costs are same. For example, students and freedom fighters may be charged half fare by transport companies.

- ***Product-Form Pricing:*** Product of a company may have different versions or sizes. In such a situation it may charge different prices for different versions or sizes but not proportionately with respect to the cost of the product.

- ***Image Pricing:*** Based on image differences, price of the same product may be fixed at different levels. For example, a particular brand of one liter soybean oil in tetra pack may be charge Tk.45/-, and same quantity of same brand in glass bottle may be charged Tk.70/- thus the company is trying to develop two different images of the same product.

- ***Location Pricing:*** Different prices may be charged for the same product sold in different location (geographic or other) though the cost of offering the product is same. A cinema hall, for example, charges different prices for front stall, rear stall or other types of seats.

- ***Time Pricing:*** If prices are varied by season, day, or hour, it may be termed as time pricing. Hotels, airlines, public utility companies such as DESA, T&T etc. normally practice time pricing.

Product-Mix Pricing

The logic of setting or charging a price on an individual product has to be modified when the product is a member of a product mix. Six situations may be distinguished involving product-mix pricing. They are: product-line pricing, optional-feature pricing, captive-product pricing, two-part pricing, byproduct pricing, and product-bundling pricing which we shall discuss in turn:

- ***Product-Line Pricing:*** If a company maintains a product line instead of a single product it may set various prices for a single product in the line to develop different images in the minds of the buyer. For example, an electronics company may carry 21 inches color television at three price levels. Customers will thus associate three price levels with three types of quality.

- ***Optional Feature Pricing:*** If a company offers optional products or features along with its main products it can go for optional-feature pricing. For example, a hotel can charge low price for accommodation and charge high for car rental service being offered by it since guests require transport service in addition to accommodation facilities.

- ***Captive-Product Pricing:*** There are some products which require ancillary or captive products to be used properly, such as battery for battery operated toys or films for cameras. Producers of main products may charge high prices for the captive products and warning customers not to use ancillary products manufactured by other companies for guaranteed performance.

- ***Two-Part Pricing:*** This type of pricing is practiced most by the service firms. They charge a fixed price for the basic service and variable usage fee for other services. For example, a museum may charge a fixed entry fee and variable fees for seeing different objects or events. Normally fixed fee is charged low to encourage purchase of the basic fee which in turn induce buyers to purchase other services.

- ***Byproduct Pricing:*** Byproducts are sometimes an automatic outcome of the production of certain items such as petroleum from a paint manufacturing plant. A company can price byproducts low to increase its revenue and support its main operation.

- ***Product-Bundling Pricing:*** A seller may offer its bundle of products at a reduced price than the individual prices added together. For example, a tool manufacturer may combine a number of tools together and price the bundle low compared to the total price of the individual gadgets. It will induce buyers to by the bundle instead of buying a particular one or two items and thus saving money.

Questions for Review

1. Which of the following is a goal of price adaptation?
   a. Market segmentation
   b. Market expansion
   c. Utilization of excess capacity
   d. All of the above.

2. The price ceiling for a given product or service is set by –
   a. The value in use or utility offered to the buyer
   b. The alternatives open to the buyer with respect to other sources of supply
   c. Both a & b
   d. Values of the government and buyer.

3. Which of the following is a price-adaptation strategy?
   a. Geographical pricing
   b. Price discounts, allowances, and promotional pricing
   c. Both a & b
   d. None of the above.

4. In geographic pricing a company may charge variable price depending on –
   a. The customers living at different locations or countries
   b. The customers living at different types of houses
   c. Both a & b
   d. None of the above.

5. Compensation deal means –
   a. Accepting partial payments through products manufactured by the buyer
   b. Receiving some percentage in cash and rest in products
   c. Receiving full payments in cash but agrees to spend a substantial portion in that country or region in buying products produced there
   d. All of the above.

6. Basic prices are modified to reward customers for such acts as –
   a. Early payments
   b. Volume purchases
   c. Off-season buying
   d. All of the above.

7. Cash discount is a reduction in the list price based on –
   a. The buyer's early booking of the product
   b. The buyer's timely payment cash
   c. The buyer's early payment in cash
   d. None of the above.

8. Seasonal discount may be given to the buyer –
    a. To induce earlier than necessary purchases of seasonally used products
    b. To build sales during traditionally slow periods
    c. Both a & b
    d. None of the above.

9. Promotional allowances are given to middlemen –
    a. To ensure their participation in advertising
    b. To ensure their participation in sales support programs
    c. Both a & b
    d. None of the above.

10. Leader pricing is –
    a. Merely a reduction from the going price
    b. A reduction from the list price
    c. A reduction from the competitors' prices
    d. None of the above.

11. Special event pricing entails –
    a. Coordination of production
    b. Coordination of production, scheduling, storage and physical distribution
    c. Coordination of production, storage and physical distribution
    d. All of the above.

12. Discuss why price adaptations are necessary. Identify and explain different price discounts and allowances offered by companies to reward customers.

13. What do you understand by promotional pricing? Explain critically the important promotional pricing methods followed by companies.

14. How prices can be discriminated? Describe the product-mix pricing.

Answers

1. d, 2. c, 3. c, 4. a, 5. b, 6. d, 7 . c, 8. c, 9. c, 10. a, 11. b.

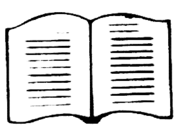
Lesson - 3: Initiating and Responding to Price Changes

Objectives of this lesson

After reading this lesson, you will be able to:

- Understand the circumstances that lead a company to cut prices
- Identify the circumstances that lead a company to initiate price increases
- Understand the common price adjustments made by a company
- Know how price change affects customers, competitors, distributors, suppliers, and government
- Understand how a company respond to competitors' price changes.

Introduction



In a dynamic business world, price administration cannot end with the setting of an initial price. Changing marketplace conditions often require the organization to cut or increase prices to stop making changes. Companies very often face situations where they may need to reduce or increase their prices even after the development of pricing strategies and structures. In the following few paragraphs we shall discuss circumstances leading a firm to cut or increase price; how customers, competitors, distributors, suppliers, and government react to price changes; and, how to respond to competitors' price changes.

Initiating Price Cuts

Tradition holds that any competitor can lead prices down, but only dominant competitors can lead prices up. Prices may be cut temporarily either to introduce a new product, or to sell excess inventory.

If a company's market share is declining, the marketing executive can decide to cut price to revive sales. A small competitor may institute price cuts to gain market share; however, a large competitor will follow price reductions only if a greater amount of profit will be lost by not doing so.

Price reduction or cut occasionally occurs even in oligopoly. The reason is that no mechanism can control all of the companies operating in the marketplace.

In the growth stage of the product, the marketing executive may cut the price on an incremental basis, because competition becomes greater and supply of competing items grow. The executive may also wish to tap a larger share of the target market - those who cannot or will not pay the higher price. To successfully compete during the maturity stage, the marketing executive will have to cut the price significantly since the intensity of competition peaks and the target market becomes an extremely price sensitive group at this stage.

Price cut may also be initiated to achieve more widespread distribution of the product, or for special promotional efforts, or to move out excess inventory. A company, then, cuts price under several circumstances of which excess plant capacity, declining market share and drive to dominate the market through lower costs are important.

Initiating Price Increases

You know that changing marketplace conditions often require the organization to increase prices. You should note that only dominant competitors can lead prices up. This rule of thumb holds true some of the time. Only companies with relatively large market shares are likely to be successful in leading price increases. One of the most frequent causes of initiating price increases is a change (rise) in the cost of producing or selling the item.

The impetus for a price change, thus, first comes from increased costs. Price increases may also be initiated anticipating increased future labor costs, basic supplies, and many of the fix expenses.

The decision to initiate price increases is also influenced by general sensitivity of demand to price and by the possible reactions of competitors. For a firm with highly differentiated product, a move to a higher level of price may reflect product superiority. Such upward moves are, of course, easier to sustain when non price promotional efforts have created a strong selective demand for the product. With the increase in costs, marketing executive may decide to increase price rather than to maintain it.

Overdemand is another variable which may motivate the marketing executive to initiate a price increase. There may be a situation when a firm may not be able to meet the demand of all who desire the product. To discourage certain segment of buyers in order to cope up with the overdemand situation, firm may initiate the price increase. Number of circumstances then, may lead a firm to increase its price, of which cost inflation, general sensitivity of demand to price, and overdemand are notable.

A company can also deal with the above two situations without raising price. One of the following techniques may be adopted by a company to face cost inflation and overdemand without price increase:

- It may shrink the amount of product.
- Less expensive materials and ingredients may be used.
- It may reduce or remove some of the product features.
- It may also remove or reduce product services such as warranty, free delivery, and free installation.
- Less expensive packaging materials may be used or larger sized package may be promoted.

- Number of sizes and models may be reduced.
- New economy brands may be developed.

Reactions To Price Changes

Price change of a company's product may affect many parties such as customers, competitors, suppliers, distributors, and government. We shall now discuss reactions of different parties to price change in the following sections:

Reactions of Customers

Customers may react differently to price cuts such as: the item may be abandoned; it is faulty or not selling well; the firm may quit from this business; the quality of the item has been reduced; or price may come down further.

Customers may equally react to the price increase of an item. Price increase, though, normally reduce sales, may carry some positive meaning as well. Customers may consider the item as "hot" and may rush to buy it anticipating that it may not be available in future, or they may consider the item worth even if the price is raised. Customers are normally price sensitive to costly items or items frequently bought compared to less costly and less frequently bought items.

Reactions of Competitors

Marketing executives must have a clear idea of the competitive environment in which they operate so that they can estimate the extent of pricing flexibility available to them.

Same as the customers, competitors also react to price change of a company's product, and this reaction is inevitable if there are few competitors, if buyers are highly informed, and if product is homogeneous.

Like customers and competitors, the distributors, suppliers, as well as government may also react to price changes brought by a company. Distributors may find it less profitable dealing with a product the price of which is raised, or they may find it less prestigious selling a product whose price is cut. The suppliers may ask for higher price if the product's price is increased. In addition to knowing about customers', competitors', distributors', and suppliers' reactions, one needs to recognize the legal restraints that limit freedom of pricing action.

Responding to Competitors' Price Changes

Following price changes is usually less risky than leading. If a dominant firm increases its prices, smaller competitors can hold steady and hope to gain market share. If they follow the leader's increases, they are likely to at least hold their current shares. They may even improve their profits with little risk.

What if relative market shares are fairly even among number of competitors? In this case, the firm that leads with price increases takes the greatest risk. Customers obviously favor price cuts, but they have to be educated about increases. It is, therefore, always safer to follow, but this is not always an option. A firm's survival may hinge on leading with a price increase at the right moment.

In case of homogeneous product, a company can either cut its price as soon as the competitors cut their prices or it may augment product to compete. If the price is increased by the competitors in case of homogeneous product, a company can match its price accordingly if it thinks that price increase will benefit the industry as a whole.

In case of non-homogeneous product, a company can react to competitors price in many ways such as maintaining price, raise perceived quality, reduce price, increase price and improve quality, and launch low-price fighter line.

Competitors' pricing actions are sometimes impossible to predict, but they can have devastating effects. Marketers face difficult pricing decisions and must make them quickly. What the marketing executive should exactly do depends on the situation. Like so much else in marketing, price administration is only part science; much depends on intuition, preparedness, and art.

Questions for Review

1. Changing marketplace conditions often require the organization –
   a. To cut prices to stop making changes
   b. To increase prices to stop making changes
   c. Both a & b
   d. None of the above.

2. Prices may be cut temporarily –
   a. To introduce a new product
   b. To sell excess inventory
   c. Both a & b
   d. To increase values of the government and buyer.

3. A large competitor will follow price reductions only –
   a. If a greater amount of profit will be lost by not doing so
   b. To offer price discounts and allowances
   c. Both a & b
   d. None of the above.

4. In the growth stage of the product, the marketing executive may cut the price on an incremental basis –
   a. Because competition becomes greater
   b. Supply of competing items grow
   c. Both a & b
   d. None of the above.

5. To successfully compete during the maturity stage, the marketing executive will have to cut the price significantly –
   a. Since the intensity of competition peaks
   b. Since the target market becomes an extremely price sensitive group at this stage
   c. To receive full payments in cash
   d. Both a & b.

6. Price cut may also be initiated –
   a. To achieve more widespread distribution of the product
   b. For special promotional efforts
   c. To move out excess inventory
   d. All of the above.

7. One of the most frequent causes of initiating price increases is –
   a. A change (rise) in the cost of producing or selling the item
   b. A change (rise) in the market share
   c. A change in government policy
   d. None of the above.

8. The decision to initiate price increases is also influenced by –
    a. General sensitivity of demand to price
    b. The possible reactions of competitors
    c. Both a & b
    d. None of the above.

9. Which of the following is a technique that may be adopted by a company to face cost inflation and overdemand without price increase?
    a. Shrink the amount of product
    b. Use of less expensive materials and ingredients
    c. Reduce or remove some of the product features
    d. All of the above.

10. Which of the following could be a reaction of customers toward the price change brought by a company?
    a. The item may be abandoned
    b. The firm may quit from this business
    c. Price may come down further
    d. All of the above.

11. Customers are normally price sensitive –
    a. To costly items
    b. To item frequently bought
    c. Both a & b
    d. None of the above

12. In case of homogeneous product –
    a. A company can cut its price as soon as the competitors cut their prices
    b. The company may augment product to compete
    c. Both a & b
    d. None of the above.

13. Narrate the circumstances that lead a company to cut as well as increase prices.

14. Explain how price change affects customers, competitors, distributors, suppliers, and government. Discuss how a company respond to competitors' price changes.

Answers

1. c, 2. c, 3. a, 4. c, 5. d, 6. d , 7. a, 8. c, 9. d, 10. d, 11. c, 12. c.