# Managerial Economics

**M.Com. IV Sem.**
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# PRICING POLICIES AND PRACTICES

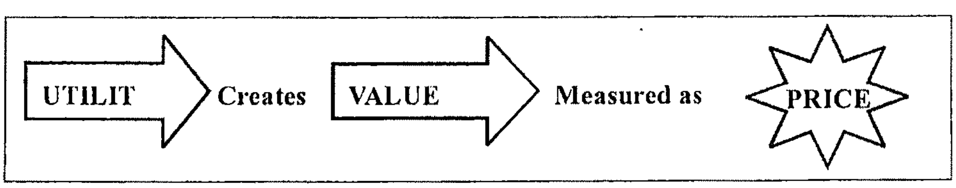
In the preceding chapter, product policies & practices of small scale units located in Varanasi have been examined which include nature of product and various areas of product policies and practices which, in turn cover product item, product line, product mix, product diversification, product standardization, materials used, colour, design, quality, branding, packaging, labeling etc.

The present chapter purports to examine different aspects of pricing policies and practices of small-scale industries. Thus this chapter deals with the concept & significance, pricing objectives, factors influencing pricing decisions, elements of price setting, methods of price determinations, pricing policies and strategies, prices changes etc.

**5.1 Introduction:**

Pricing is one of the vital constituents of marketing mix. After the burial of barter system, price has acquired a central position in the exchange process. Price is viewed differently for different marketable objects. For a physical product it is invariaby called as a price. In the matters of various services it has different names, such as rent, fare, commissions, premium, interest, salary, taxes, etc. A price is a unit value of an object expressed in terms of money. In a more formal way, a price represents the value of the product or service for both the seller and the buyer.

Pricing has a significant role in overall marketing functions. It is the only element of marketing mix which creates revenue for the enterprise, all other elements like product, marketing channels and promotion are cost items. It is true to say that without prices there can be no marketing. Revenues earned by the way of price reflect the success of performance marketing activities. It is equally important for all types of enterprises involved in the exchange of either physical products or services. The rise in the relative importance of price is attributable to rapid cost increases, more foreign competitions for many products and services, greater price awareness on the part of consumers, and shortages leading to high prices in some product categories. Further, suitable prices assist an enterprise in maximizing profits and maximizing sales. Price is also the only objective criterion for customers for assessing quality of different items. Viewing its performance and making a final choice in the process of buying decisions. Price also helps the channel members to compensate themselves suitably for their functions. Similarly, it also helps in deciding promotional policies regarding budget determination. However price is not synonymous. Utility is a qualitative measure of a product, to satisfy human events. Value on the other hand, is a quantitative measure of the exchange power of product relating to other product. Both utility and value are interconnected with the price which can be expressed as under.



It may also be noted that price is not equally important for all the products and for all the consumers. At times price acts as a determining factor and, at times, as an influencing factor depending upon customers perceptions about the product. Specifically for general customers (belonging to lower and middle income groups) price may act as a determining factor while fore customers belonging to higher income group price may act as an influencing factor.

In the course of survey, the researcher gathered the perception of the small-scale industrial units located in Varanasi regarding the role of price in their business activities. All the entrepreneurs interviewed pay more emphasis on price. However, they are also of the view that rich customers do not hesitate to pay more if they find something new, something better and something improved in the product, but their ratio is very much small.

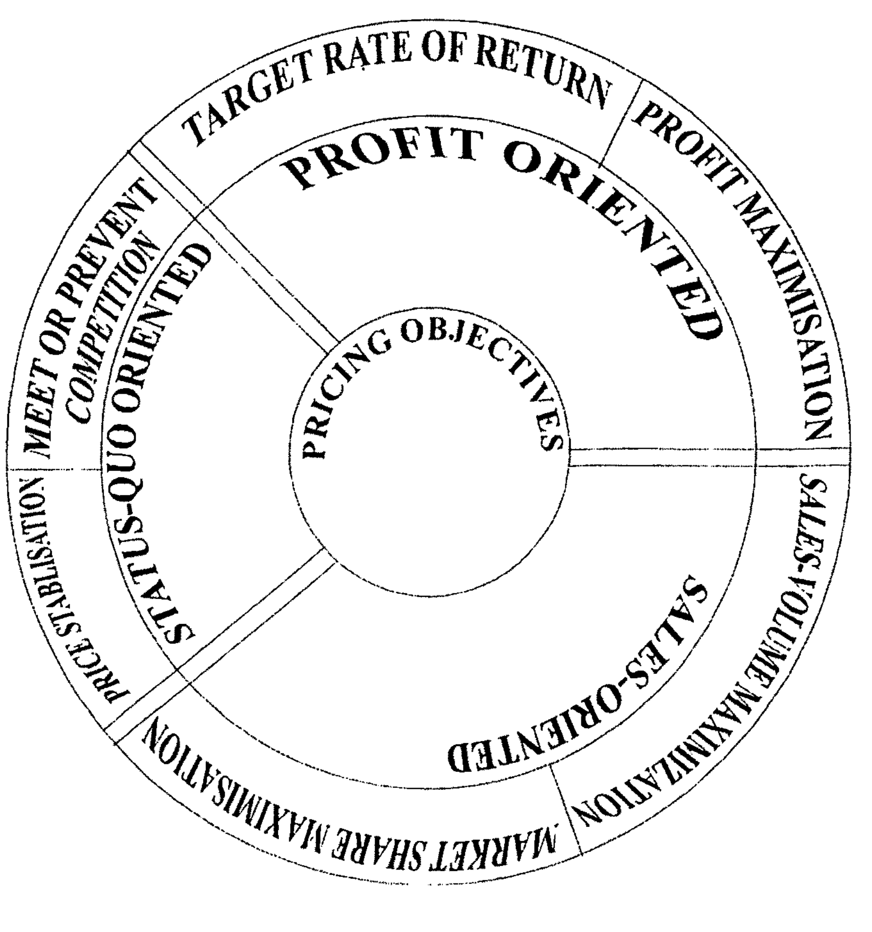
**5.2 Pricing Objectives:**

Pricing decisions are taken to achieve marketing objectives which, in turn, help in achieving the overall organizational goals. More importantly, pricing objective act as a guide in price determination & information of pricing policies and strategies. It is therefore, imperative that prior to price determination and strategy formulation pricing objectives are set. As pricing decisions are much more flexible and dynamic in nature in comparison to decisions regarding product, marketing channels and promotion pricing objectives may also follow the same path. Pricing objectives may vary from one enterprises to another within an industry, from one industry to another within an industry and from one time period to another within a given market and a competitive setting. Broadly, pricing objectives are divided into three parts. First, profit oriented pricing objectives, second sales oriented pricing objectives and third status-quo oriented pricing objectives. Achieving a target rate of return and maximizing profit come under profit oriented objectives of pricing objectives. On the other hand, increasing sales Volumes and maintaining or increasing market share are the sales oriented pricing objectives. Further, stabilizing prices and meeting competition fall within the category of status-quo oriented pricing objectives. These pricing objectives may change depending upon the change in marketing objectives and overall organisational goals. Similarly, the emphasis on any one of these objectives may also change accordingly. This is the reason that every pricing objective has its due significant for an enterprises and therefore these objectives can be depicted in the form of a circle (Figure 5.1).

Though setting pricing objectives is a critical decision making area in marketing, rarely firms consciously establish or explicitly state, a pricing objective. With a view to ascertaining the pricing objectives of the small scale industrial units located in Varanasi, the reasearcher has conducted an opinion survey the results of which are summarized in Table 5.1. An analysis of the table reveals that target rate of return on investiment sales growth and maximizing profit are the major pricing objectives of all the sample small-scale industries. However a large section of industrial units operating under different small-scale industries also set their pricing. Objectives for meeting or prenenting competition. Apart from these price stabilization does not form any place on the list of major pricing objectives, simply because the raw materials and labour cost are not within the control of the small-scale entrepreneurs. It may be noted that at the time of fixing price the units also consider customers positive reactions towards prices. Individually, units operating in wood crafts set their pricing objectives keeping in view competitive conditions. Price stabilization is out of the ambit of pricing objectives for all the industrial units engaged in different industries. Only a few engineering and chemicals as also hosiery units keep in mind price stabilisation for setting prices of their products. It is significant to note that the sample small-scale units belonging to different industries do not have a conscious and clearly stated pricing objectives.

**Figure 5.1**

**Pricing Objectives.**



## (5.5) Factors Influencing Price Determination:

Price Determination is the heart of overall pricing policy and strategy. Pricing objectives act as a foundation stone for price determination. Though theoretically an enterprise is free to set any price for its different product items practically it is not so because it is the customer who has ultimately to pay the price and for this a customers cannot be compelled. A customer pays a price on his own individual considerations and calculations which are beyond the influence of an enterprise. Besides there are other factors also which restrict an enterprise to fix any price. It this obvious that determining a price in the result of the inter-lay of several forces. These forces obviously are of two broad categories internal or controllable forces and enternal or uncontrollable forces. The major internal forces are marketing objectives, cost of product, stages of product life cycle length of channels of distribution and promotional policies and strategies. On the other hand, level of demand, nature of competition, legal considerations, consumer behaviour, socio-economic considerations and ethical considerations come under the category of external forces.

The Small-scale industries located in Varanasi are also very much concious about the internal and external environment in which they work. Their prices settings are not a simple job. They are fully aware that they have to face hectic competition with modern industries whose operations are carried out and guided by modern tools and techniques of production, of finance, of marketing and of human resources. Consequently, they have to beat huge burden not only of the competitors but also of the modern well informed and choosey customers. The researcher has conducted an opinion survey in order to ascertain the factors which are taken into consideration in price determination by the small scale industries located in Varanasi district.

## 5.4 Pricing Methods Decision:

After taking decision on the front of pricing policies, a marketer takes decision on pricing method for determination of price. Pricing methods refers to those ways and means, and techniques and devices which are employed to price determination in accordance with pricing objectives. In fact, "pricing method is simply the technique that is appropriate for achieving the desired pricing objectives". There are three basic methods of price determination, namely,

(i) Cost based pricing.

(ii) Demand based pricing, and

### 5.4.1 Cost based pricing:

Cost based pricing means setting the price of one unit of a product equal to the units total cost plus the desired profit on the unit. In technical terms, cost based pricing include both variable cost and fixed or overhead costs plus a reasonable mark-up, i.e.

Selling Price = Variable Cost + Fixed Cost + Profit Margin.

The mark-ups vary depending on the number of factors, such as, nature of products, markets channel members, stock turn rate etc. "Usually, the higher the value of product (unit cost of the product) the larger the mark-up and vice-versa". To make more effective the cost based pricing, a firm may use break-even analysis. It is especially useful for analyzing the relation of total cost and total revenues at different levels of volume and consequently profitability at different levels of prices. In fact, some firms use break-even analysis in an attempt to bring prospective revenue (and perhaps demand) into a cost-based pricing.

Break-even analysis determines the level of output at which the revenue will be equal to cost, assuming a certain selling price. The point where total cost (TC) is equal to total revenue (TR) is known as the break-even point. At this point, a firm neither earns any profit not suffers any loss. It is represented by the intersection of TC and TR. There are different break-even points for different selling prices. Any amount of sale above the break even point gives profit to the firm. If the amount of sale is below the break-even point the firm will incur loss. The break-even point can be calculated in the following way.

$$\text{Break-even point (In units)} = \frac{\text{Total Fixed Costs}}{\text{Per Unit Contribution of Fixed Costs}}$$

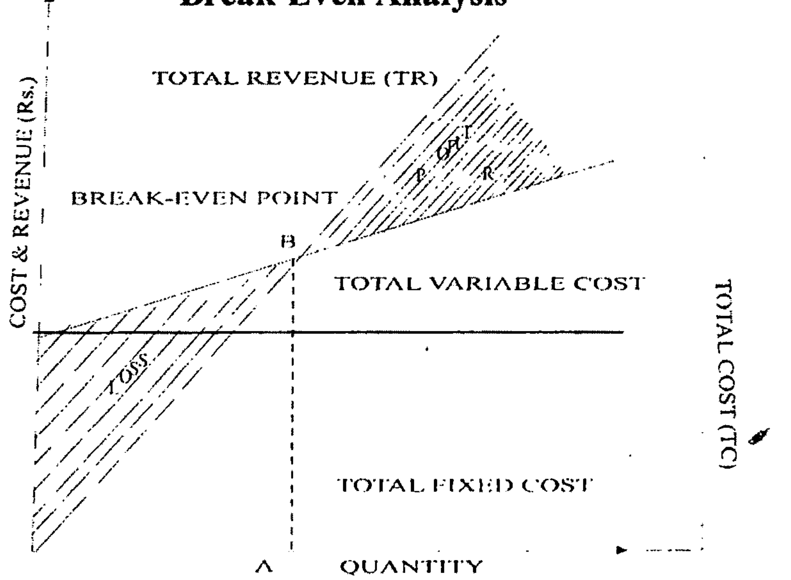
$$= \frac{\text{Total Fixed Cost (F)}}{\text{Selling Price per Units (s) - Variable Cost per Unit (v)}}$$

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

Graphical Presentation of Break-even analysis depicted in Figure 5.2

**Figure 5.2**

**Break-Even Analysis**




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

On the whole cost based pricing is "simple, safe, socially fair and can maintain competitive harmony". But it completely ignores the influences, of competition & market demand at the various prices. Thus, cost based pricing is only partially helpful in price determination.

**(5.4.2) Demand based pricing :**

Demand based pricing means setting the price as per buyer's demand intensity and perception of the products value or utility (i.e., perceived value), rather than the product costs or competitors prices. In other words irrespective of the cost of product or what the competitors are charging, a higher price is charged for a product when its demand is more and a lower price is charged when the demand is less, even though the costs are the same in both cases.

In order to determine the basic price, marketer may use test marketing or forecasting technique. Under test marketing technique, a marketer may "test market different prices in different market segments under relatively controlled conditions and develop demand schedule indicating demand as reflected in volume/revenue at different prices". A market may select the price which ensures maximum revenue/ profit. On the other hand, in forecasting technique a marketer may forecast price on the basis of historical demand available in company records or elsewhere. The demand schedules so prepared may indicate the price the company may charge.

On the whole, demand based pricing takes into account consumer's price elasticity and preferences. It penalise in efficiency optimise product mix and facilitates and new product pricing. But it completely ignores two major elements of pricing considerations i.e. product costs and competitors prices. Thus, it is also partially helpful in price determination.