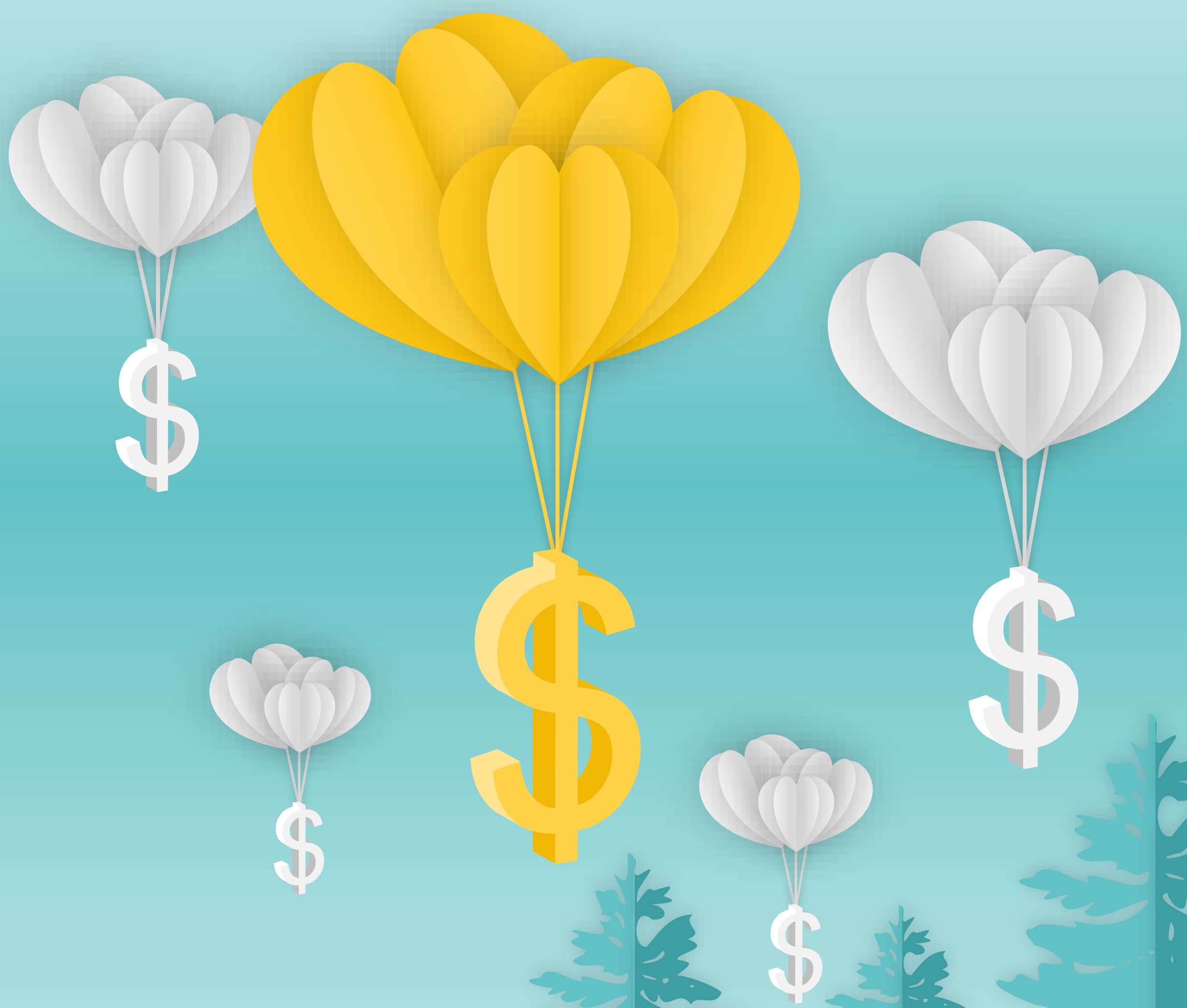
PRICING POLICIES



SYLLABUS -
OBJECTIVES OF PRICING POLICY
& PRICING METHODS

FACTORS GOVERNING PRICES

EXTERNAL FACTORS

- ELASTICITY OF DEMAND
- ELASTICITY OF SUPPLY
- GOODWILL OF THE COMPANY
- EXTENT OF COMPETITION IN THE MARKET

INTERNAL FACTORS

- COSTS
- MANGEMENT POLICY TOWARDS GROSS MARGIN & SALES TURNOVER
- STAGE OF THE PRODUCT ON PRODUCT LIFE CYCLE
- USE PATTERN & TURN AROUND RATE OF THE PRODUCT
- DISTINCTIVENESS OF THE PRODUCT
- EXTENT OF PRODUCT DIFFERENCTIATION PRACTISED BYNTHE FIRM

OBJECTIVES OF PRICING POLICY

Maximisation of profits for the entire product line

Promotion of long range welfare of the firm

Adaptation of prices to fit the diverse competitive situations faced by different products

Flexibility to vary prices to meet changes in economic situation

Stabilisation prices and margin

Kotler's Additional Objectives:

Market penetration

Market Skimming

Early cash recovery

Satisficing

PRICING METHODS

COST ORIENTED

1. COST PLUS PRICING
2. PRICING FOR A RATE OF RETURN
3. MARGINAL COST PRICING

COMPETITION ORIENTED

1. GOING RATE PRICING
2. CUSTOMARY PRICES
3. SEALED BID PRICING

COST PLUS PRICING

- •Most commonly used method
- •Price is set to cover costs (Material, Labour & Overhead) and a pre determined percentage for profit
- •The percentage for profit differs among industries, firms and products.
- •Profit percentage reflects compeititve intensity, cost base and risk.

Drawbacks / Inadequacies

- •Ignores demand
- •Fails to reflect forces of competition
- •Method of allocating overheads is arbitrary. Cost may be unrealistic.
- •Ignores incremental cost & marginal cost. Uses average cost only.

COST PLUS PRICING

Reason for its popularity

- **Fair and plausible**
- **Factual & Precise**
- **Firms preferring stability uses full cost pricing**
- **Firms uncertain about the shape of their demand curve uses this pricing**
- **Specially used in –**
  - **Public utility pricing**
  - **Product tailor made to customer requirement**
  - **Monopsony buying – where the customer knows about the suppliers cost**

PRICING FOR A RATE OF RETURN

Variant of full cost pricing

Problem faced is adjusting the prices for change in cost. Popular policies followed are –

1. Revise prices to maintain a constant percentage mark up over costs

2. Revise prices to maintain profits as a constant percentage of total sales

3. Revise prices to maintain a constant return on invested capital

Inadequacies are the same as full cost pricing.

MARGINAL COST PRICING

Prices are determined on the basis of marginal cost & fixed costs are ignored.

Price is fixed to maximise its total contribution to fixed cost and profits.

Advantages

Prices are highly competitive

Marginal costs more accurately reflect future costs

Permits aggressive pricing policy

Useful for pricing over the life cycle of a product

Suitable in the case of multi product, muti process & multi market concerns

Innovation combined with constant scientific & technological development, difficult to predict long term

Most suitable method of short run pricing.

GOING RATE PRICING

Emphasis is on the market instead of the cost.

Firms adjust its price to the price set by the market.

Suitable when cost are difficult to measure

Safe policy when price leadership is established

In an oligopolistic market it is a simple way to escape price rivalry

Easy & less troublesome

CUSTOMARY PRICING

Prices of certain goods become more or less fixed, not by deliberate action on the seller's part but as a result of having prevailed for a considerable period of time.

Changes in costs are reflected in changes in quality or quantity

Prices will change only when costs change significantly

Customary prices are maintained even when products are changed.

Even in the face of lower costs same price is maintained

To make an upward revision of prices, test the new price in limited market to determine the customer reaction.

SEALED BID PRICING

Popular in Construction activites & used goods disposal

Prospective buyers (or sellers) are asked to quote their prices in sealed covers

All offers are opened at a pre determined time in the presence of all the bidders.

The buyer who quotes the highest or the seller who quotes the lowest is awarded the contract.

This method is totally competition based.

There is a risk of collusion among the bidders.

If sellers collude, buyer has to pay an exhorbitantly higher price.