UNIT 9 CONCEPTS IN COST AND PRICE ANALYSIS

Structure

9.0 OBJECTIVES

After studying this unit, we should be able to:

- define the process of setting the price;
- explain the process of selecting the price objective;
- describe the methods of determining demand;
- explain cost estimation process;
- analyze the competitors offering and pricing;
- explain price/quality/value equation;
- explain various pricing methods;
- explain the process of selecting the final price; and
- explain response to market change.

9.1 INTRODUCTION

Price is set by all the companies for all the products. Price is there for everything. We pay fare for bus, taxi, airline, railway, auto rickshaw etc. We also pay rent for our house, electricity bill, telephone bill etc. Salary given to an employee is also a price. According to Kotler, "Price is the marketing-mix element that produces revenue; the other elements produce costs. Price is also one of the most flexible elements: It can be changed quickly, unlike product features and channel commitments or terms of business. Price is set independent of the rest of the marketing mix rather than as an intrinsic element of market positing strategy; and price is not varied enough for different product items, market segments, and purchase occasions."

9.2 SETTING THE PRICE

A company sets a price for its products :

- when a new product is introduced in the market

- when an earlier product is distributed in a different geographical location
- when a tender is quoted for a new contract for a product

Pricing Strategy

There are primarily nine pricing strategies which are adopted based on Price and Quality of the product. You need to decide whether you want to sell your product as a premium product or value for money or absolutely economy range with masses as your target market.

Table. 9.1 below shows nine price strategies in a grid form where Price is on X axis and Quality is on Y axis.

Table 9.1 : Price - Quality Matrix

	Price	High	Medium	Low
QUALITY	High	1. Premium Strategy	2. High-valuestrategy	3. Super-valuestrategy
	Medium	4. Overcharging trategy	5. Medium-value strategy	6. Good-valuestrategy
	Low	7. Rip-off strategy	8. False economy strategy	9. Economy strategy

1. The diagonal strategies 1, 5, 9 can coexist in the same market if the market consists of the following three kinds of buyers:
   a. Those who prefer quality
   b. Those who prefer low price
   c. Those who prefer both i.e. quality at a low price.
2. The strategies 2, 3, and 6 offer the most value to the customers amongst all types of pricing strategies. The objective is to offer the best possible product quality at the most affordable price to the customers.
3. The strategies 4, 7, and 8 amount to overpricing the product however the quality is not superior.

Let's take some examples to understand various pricing strategies.

In case of mineral water market pricing of Himalaya brand of natural mineral water is Premium pricing strategy over competition whereas Bisleri, Kinley or Aquafina are brands which are priced at Mid-Value pricing strategy.

In case of Ice-cream Amul followed a value for money strategy where as Baskin Robbins, through its parlours across India, has adopted Premium pricing strategy by pricing its products at a much higher price point compared to its competitors.

In case of apparel industry Peter England is an example of Economy strategy while Marks and Spencer or Color Plus adopt a Overcharging pricing strategy.

Price Setting Process

Usually, a company follows a six-step process for deciding on the pricing for its products. A step-by-step process is shown in Fig. 9.1.

Selecting the Pricing - Based on the product attributes, market conditions, and your vision about the product a pricing strategy is determined.

Determining demand - Determining pricing of a product also depends on the market demand supply conditions. The demand for a particular product is determined using market research tools.

Analysing Costs - It is the most critical point that needs to be considered before finalizing the price of your product. No one can sell product lower than its cost of production. A decent margin is a must to successfully sell a product and make money in the business.

Competitor's cost analysis - One can not price its product too high or too low than the competitors operating in that segment of the market. Either of the cases is not sustainable. If you sell at a very high price than competitors then your customer base will be very less and you will not be able to break-even. If you price your product very low then your margins would be under pressure.

Figure. 9.1

Selecting a Pricing method-Pricing method is selected depending on product's demand curve Product's cost structure and competitors price.

Selecting the final price-pricing methods help business to find final pricing. Other factors which help to set final price are psychological pricing influence of other marketing mix element company's pricing policies and impact on other parties.

Check Your Progress - 1

1. How many types of pricing strategies are there and what are the parameters on which they are developed?

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2. Write the six step procedure for setting the pricing policy.

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9.3 SELECTING THE PRICE OBJECTIVE

You have to decide how you want to position your product with respect to price-quality equation. You may want to offer:

- Best quality and ch rge a higher price or lower price.

A lot of such choices depend on the product, alternatives available to the consumer, and your business objectives. For example, when mobile phones were introduced in the Indian market, the mobile operators used to charge very high price per minute of talk with poor voice quality. As the competition increased, per minute talk time has reduced considerably with significant improvement in voice quality. So, considering initial market response mobile service was a premium service and hence premium pricing strategy was accordingly adopted by the players.

For your business you have to decide the price objective before setting the price. There can be following possible price objectives:

- Sustenance
- Maximizing current profit
- Maximizing market leadership position
- Maximizing market leadership

i. Sustenance

In sustenance, a company aims to generate sufficient revenue so that the company can survive and necessarily make profit. The company sets the price such that, that it recovers the variable cost and some fixed cost. In situations where a company has installed a large capacity or is facing intense competition is more likely to set sustenance as price objective.

ii. Maximizing the Current Profit

In this objective, the company sets a price in a way which will maximize its profit. This objective assumes that company is confident about its demand curve and cost structure at different demand points. In case, the company keeps very high prices, it may catch attention of competitors, government, and alternative product companies. This may led to some kind of retaliation. For example, some years back milk powder traders had increased the prices resulting in government threatening to allow imports with liberal conditions. This threat from government led to softening of prices.

iii. Maximizing Revenue

In this objective, the company tries to actively manage the price in such a way that it is able to capture maximum share of demand at each price point. This approach assumes that the company knows the demand curve of its product and is able to alter its other marketing mix elements at each price point.

iv. Maximizing Market Leadership

In this approach, the company sets a lower price to capture largest market share of the product. Using this objective, the company targets long term profitability as it knows that cost per unit could reduce as the scale of production increases. This approach is more sited to companies which have a wide suit of products in the same need segment. For a single product company, following this approach might be difficult as it may require subsidizing losses from low prices in the beginning. For example, Amul could afford to keep low prices for ice-cream as it had profits from other products coming.

9.4 DETERMINING DEMAND

Besides using above mentioned methodologies to understand price-demand equation, it is important for marketers to understand what factors affect price sensitivity.

i. Factors Affecting Price Sensitivity

According to Tom Nagle, Author of "The Strategy and Tactics of Pricing", there could be nine product related factors that could affect price sensitivity:

a. **Substitution Effect:** A product having lesser substitutes is likely to be less price sensitive

b. **Inventory Effect:** A product that can not be stored is likely to be less price sensitive

c. **Shared-Cost Effect:** A product for which part of the cost is borne by a third party is likely to be less price sensitive

d. **Difficulty Comparison Effect:** A product which is not easy to compare is likely to be less price sensitive. For example, it is difficult to compare Naturals ice creams with other ice creams and hence buyers of Naturals are likely to be less price sensitive

e. **Unique Value Effect:** Buyers place high value on unique attributes of the product and are willing to pay higher price. For example, consumers place high value on the shelf life and quality of tetra pack milk and are willing to pay much higher price for that compared to other type of packed milk.

f. **Price-Quality Effect:** Buyers are less price sensitive to products where consequence of poor quality are very high i.e., products which are assumed to having high quality and hence exclusivity. This phenomenon is often observed in perfumes, high end watches, pens, and cars.

g. **The End-Benefit Effect:** Products which are likely to be price sensitive are likely to have price sensitive buyers also. For example, loose milk sold on local dairies is very price sensitive and its price fluctuates almost on a daily basis. Buyers of such milk are also likely to be more prices sensitive that say buyers of packed milk whose price is less fluctuating.

h. **The Sunk Investment Effect:** Products which are used along with assets in which investment has already been made are likely to be less price sensitive. For example, a retailer who has bought a refrigerator to store dairy products is likely to be less price sensitive for purchase of small spare parts of refrigeration unit.

i. **Total-Expenditure Effect:** Buyers are likely to be less price sensitive for products whose expenditure as a percentage of total income of the buyer is very low.

ii. Preparing Demand Schedule

According to Kotler, each price will lead to a different level of demand and therefore have a different impact on a company's marketing objectives. In the normal case, demand and price are inversely related: the higher the price, the lower the demand. However if price is charged very high, the level of demand falls.

Preparing demand schedule involves estimating demand curve and demand elasticity.

a. Estimating Demand Curve

In most of the products, a change in price would have impact on the demand. The relation between alternative prices and resulting demand is called demand curve. For some products a cut in prices would result in increase in demand while for some an increase in price may increase demand. Products having snob value may see an increase in demand with increase in price. A premium car maker may sell more units if price is increased as it may add to the image of exclusivity. However, in such cases also a steep increase in price may result in fall in demand.

Establishing a demand curve requires in depth understanding of product and likely response of consumers at different price points. A company can use methodology to draw demand curve. Some of the suggested methods are as follows:

- Use past data on change in price and resulting change in product shipment and draw a correlation. Effect of other factors like competitors' response, change in other marketing mix elements has to be reduced from price-demand equation.
- Use consumer survey to ask them how many units of product they would buy at alternative price points. Using this approach requires an expert agency which can carefully design the questionnaire, method of administering it, and use of analysis tool to analyze the data.
- Change price in different geographies and measure the product off take in these markets.

b. Demand Elasticity

Demand elasticity is defined as responsiveness of demand for small change in price. In case of a small change in price, there is hardly any change in demand and said to be inelastic demand and if price changes sharply, the demand is said to be elastic. For example, in a particular geography, current price of packed milk is Rs 10 per litre and it is increased to Rs 10.5 per litre and there is hardly any drop in demand, the demand of packed milk in that area would be called inelastic. The elasticity of demand depends on few factors:

- Long run Vs short run: Generally demand is inelastic in short run and elastic in long run. In short run buyers do not notice the change in price and also it is difficult for them to find a good substitute
- Magnitude of price change: Demand is in elastic for small change in price and very elastic for a large change in price
- Direction of price change: For certain products, an increase in price may result in increase in demand. However, a very large increase may again result in decrease in demand.

The higher the demand elasticity of a particular market, the more difficult it is to price a product. In these types of markets any change in pricing would lead to huge flux. The lower the demand elasticity the easier to price a product and make price changes as and when necessary.

Your answer should include the following points:

Check Your Progress - 2

1. An MNC cheese brand was lured by large Indian market. It decided to put up a large cheese manufacturing unit in India. In first few years they realised sales is not going as per the expectation but the company is hopeful of the same in future. Which price objective will the company use?

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2. For a small change in price, if the change in demand is large. Would the demand be called elastic or inelastic?

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9.5 ESTIMATING COSTS

For any company, planning is important, and budgeting is one of the important aspects of planning. Estimating a cost of product properly is essential for any company. Cost of any product increases if the demand of the product is more. Cost of any product includes:

- Production cost
- Distribution and selling cost
- Risk cost.

i. Types of Cost:

Cost is how much a company spends on a product to make it available to the end-user. There are two types of costs: fixed cost and variable cost.

i) **Fixed Cost:** Fixed cost does not change with production or profits, which means a cost which is fixed for any company to occur. It includes payment of bills for rent, electricity, salaries of the employees; interest etc. all this is must for a company to pay regardless of the output.

ii) **Variable Cost**: Variable cost varies with the number of unit produced by a company. For one unit the cost is fixed but the cost for a company varies as the number of unit varies. For e.g. for a milk pouch the cost of milk and packaging cost is fixed however depending on the number of milk pouches the cost changes.

The other costs are Total cost and Average cost. Total cost is the sum of fixed and variable cost for any specified level of production.

Total cost = Fixed cost + Variable cost

Average cost is the cost per unit at the specified level of production. Average cost is equal to the total cost divided by the production cost.

Average cost = Total cost / Production

ii. Correlation Between Costs and Production Cycle

Cost of any product is correlated with its scale of production. As the scale of production increases, the fixed costs are allocated over more units of the product and also the production learning is embedded into the process thereby reducing variable cost per unit of the product. For example, Amul and Nestle launched packed curd in the market. In the initial stages itself Amul captured higher market share i.e., started selling more units of packed curd. This led to reduced cost of packaging per unit of curd and also reduced transportation cost per unit. While for Nestle the profitability of packed curd was reducing as the cost of production was high and the sales was declining. This led to Amul further increasing its market share.

iii. Target Costing

Target costing is a method by which a company determines the ways to achieve the success by planning the services provide, designing the products, processes and related cost structures that provide value to the customer. Cost of a product changes with the production, which can further be reduced by careful planning of the managers, engineers, and agents. The steps involved in Target costing method are shown in fig.9.2.

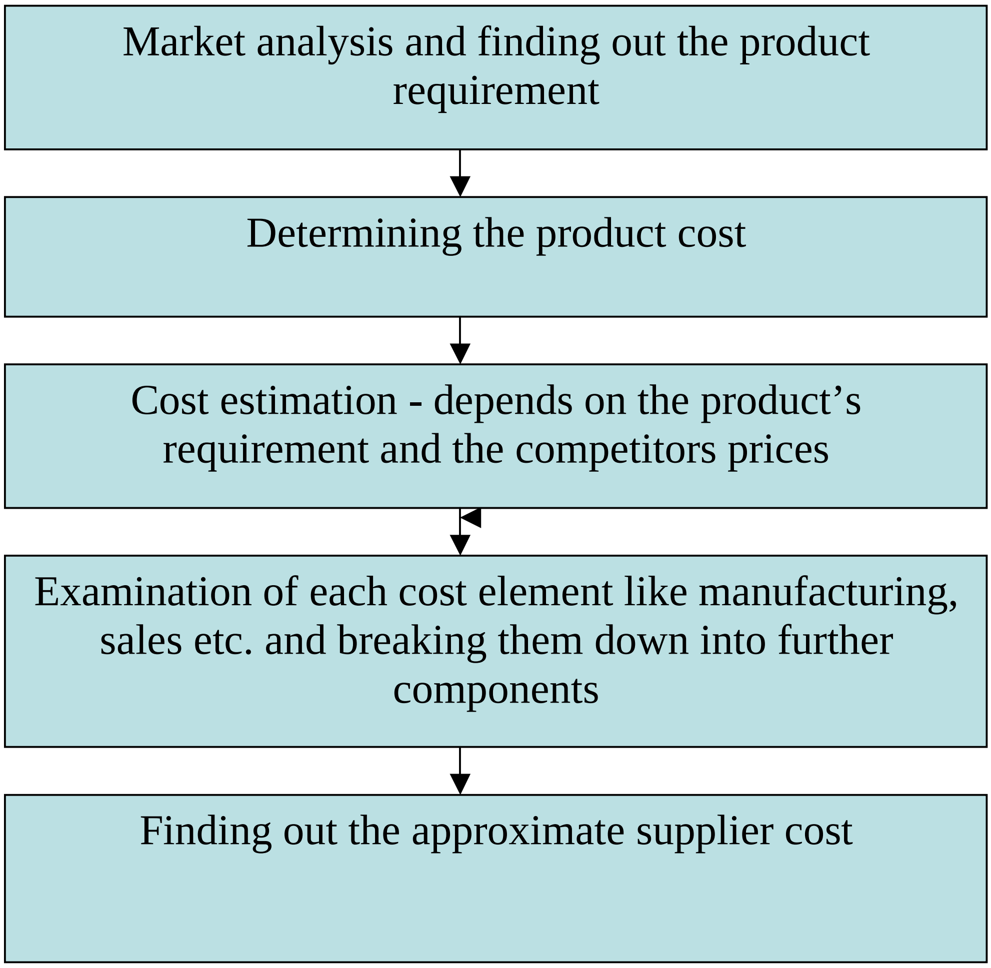

Figure. 9.2

The objective behind performing these steps is to find out whether the final cost comes in the target costing range. If it does not in that case a company may take the decision of not entering into that product market as the company will not earn profit in that case.

9.6 ANALYZING COMPETITOR'S PRICES AND OFFERS

Price of any product is determined by the demand of the market and the company's cost. A company should consider competitor's pricing, cost and possible reaction of the consumers to the price before pricing the product. A company should keep a track on the competitor's prices and the offers. There can be any of the three possibilities a company has to be taken care of i.e.

- If a company's offer is similar to the competitor's offer, then the pricing should also be almost similar to the competitor's pricing.
- If a company's offer is not up to the competitor's offer, then the company should keep the product pricing low.
- If a company's offer is better than the competitor's offer the company can keep a price higher than the competitor's price.

9.7 SETTING THE PRICE/QUALITY/VALUE EQUATION

Value of a product or service in the mind of consumer is a function of perceived quality of the product, perceived positioning of the product, perceived quality and positioning of competing products, and the difference in price of competing products.

i. Differentiate Between Price and Value

Consumers may compare price of a company's product and the competing product and also compare the perceived difference in product quality to decide which products offers a better value to them. In products, where consumer has much alternative choice, the winning companies are striving hard to offer best value to the consumer. In the new products, the companies can charge high price until the consumers have enough choices to derive price-quality equation. For example - in ice-creams, Amul is perceived to be offering better value to consumer as it is perceived to be of better quality and lower price as compared to Walls or Mother Dairy etc. In Mumbai, an ice-cream brand called Naturals is able to charge a higher price and consumers are willing to pay the price. This is because the brand offers ice-creams with flavors of seasonal fruits and there is no competing brand with that positioning.

Offering best value on sustainable basis requires companies to reengineer their processes and build capabilities that can reduce the cost and increase value for the consumer. Companies resorting to sales and promotion activities are the only means to offer value to the consumer, but may not be able to do it on long-term basis. In USA, a retail chain called Wal-Mart pioneered the concept of Every Day Low Prices (EDLP). Under this approach, the chain sells most of the brands at fairly low price on everyday basis. To offer such a value to consumer, Wal-Mart had to invest heavily in redesigning its logistics management, renegotiate prices with suppliers, and cut down on inventory. In a similar example - in India, Amul has developed a highly efficient milk procurement system wherein Amul provides technical assistance of milk producers and buys milk from them. These milk producers are also the owners of Amul and the profit of Amul is distributed amongst them in form of higher milk prices.

ii. Relation Between Price and Value

Price of a product is determined by its value to the consumer. The phrase "you get what you pay for" is very common, but it's not always true. Sometimes you get much less than what you pay for, sometimes you get more than what you pay for, and sometimes you exactly what you pay for. Relation between price, quality and value can be defined as:

Value = Quality / Price

If the value comes to more than 1 then the product is good, if the value is less than 1 product is not at the satisfactory level, and when the value is equals to 1 the product is satisfactory.

9.8 SELECTING A PRICING METHOD

According to Kotler, a company should consider following factors before setting the final price or selecting the pricing method:

- Product's demand curve
- Product's cost structure
- Competitor's price

Companies select a pricing method based on one or more of these considerations. Given below are different price-setting methods.

i. Cost Plus Pricing

This is the most elementary method of setting up a price. Under this method, the company adds a profit margin to the cost of production and decides the price. The cost of production includes variable and fixed cost per unit of the product. Profit margin is generally higher in: seasonal products, products with inelastic demand and products which are slow moving (to cover risk of not selling). For example, the expected profit margin on ice-cream is higher than on loose milk as ice-cream is seasonal and there is risk of not selling it enough during off-season.

Other example is, the dairy unit procures milk from farmers, does some elementary processing in its processing unit, and transports it to market for final sales. Therefore, cost is added on actual and marginal profit is taken on the basic cost.

Variable cost: Procurement price paid to the farmer (Rs 10/ liter)

Fixed cost: Rent of the processing unit, transportation cost, manpower cost etc (Rs 15000/ month)

The dairy unit is expecting to sell 15000 liter per month. In such case, the fixed cost per liter is Rs 1 and variable cost is Rs 10. Therefore, the total cost of production is Rs 11. Suppose the unit wants to retain a profit margin of 27%. The final price would be:

Cost of production / (1-desired profit margin) = 11 / 0.73 =Rs 14

Thus, the final price would be Rs 14/ liter.

As we can notice, with increase in sale of milk the fixed cost per liter decreased and the unit could earn higher profit margin or could reduce the price and maintain the same profit margin.

ii. Target Return Pricing

According to Kotler, in target return pricing a company decides the targeted return on capital invested in the business and then sets the price which would yield targeted return. For example, a diary units producing packed milk has invested Rs 10 lacs in the business and is targeting 20% return. The dairy unit estimates to sell about 50,000 units of milk packs in a year and the cost of production (fixed and variable both) per unit is Rs 15. Therefore to target a return of 20%, the unit would set the price as follows:

$$\text{Targeted price} = \frac{\text{Cost of production} + (\text{Capital invested} \times \text{Targeted return}}{\text{Estimatesd sales per year}}$$

$$= 15 + (10,\ 000,\ 00 \times 0.2)\ /\ 50{,}000$$

$$= 15 + 4 = 19$$

Thus the dairy unit would set the price at Rs. 17 per unit of milk.

In case the actual sale is lower than the estimated, the actual return on investment would be lower and vice-versa. In products where competition is high and a company is using target return pricing, the company has to focus on reducing the capital invested in the business so that it is able to achieve targeted return despite reduction in price.

iii. Value Based Pricing

In value based pricing, the company offers a low price for a high quality product. To use this method, the company has to reengineer its production processes to reduce the cost of production such that it is able to pass the saving in cost of production to consumers on a sustainable basis. This approach creates a long-term competitive advantage for the company.

iv. Perceived Value Pricing

In this approach, the company tries to estimate the price the buyers would be willing to pay for the perceived value of the product. A company builds up the perceived value of the product through innovative use of advertising and sales promotion. This approach is most commonly used in high end products like perfumes, cars, designer clothes, jewelry, and watches etc.

v. Competitive or Going Rate Pricing

In this approach, the company sets the price very close to the price charged by the competitor. This approach is used in mature products where creating differentiation is difficult. This is quite a popular method of pricing which assumes that the price charged by competitor is a fair price and could leave some profit for the company. For example, when Mother Dairy launched packed milk in Mumbai, it set the price at the same level as that charged by Amul.

vi. Promotional Pricing

Companies use promotional pricing to drive various sales objectives. Some of these are given below:

- **Buy One Get One Free:** Companies offers the same product or some other product of the company to consumers if they buy their product. The objective here could be to induce trial of other product of the company, clear inventories and prevent consumer trying product of competing companies. For example, Amul uses this technique often with ice-creams. It gives a 500 gms pack of the same flavour or any other flavour free on purchase of one 500 gm pack.

- **Cash Rebates:** Companies use this technique to induce purchase during a specific period of time. Rebates can also help clear inventories without reducing the stated list price of the product.

- **Special Event Pricing:** Companies offer low prices, extended warranties etc. during a specific period of the year. The objective here is to cash on the preparedness of the consumer to spend during that period. Companies use this technique during festive season like Diwali by offering low prices or some promotional offers etc.

vii. Discriminatory Pricing

Companies can charge different price for the same product for different customer segments. Companies use positioning, packaging, and product information about the competitive landscape to differentiate the pricing. According to Kotler, Discriminatory pricing occurs when a company sell same product at two or more prices. They do not reflect a proportional difference in cost.

Differential pricing can be offered in several forms:

- **Image pricing:** Companies can position the same product differently to charge different pricing. Companies making perfumes use this technique very often.

- **Product form:** Different versions of the same product are priced differently but not in proportion to the definite cost structure. For example, Amul sells packed milk at Rs. 17 per litre and flavoured milk at 45-50 Rs. per litre.

- **Location pricing:** Companies sell same product differently at different locations even though the cost of offering the product is same at different locations. For example, Consumer durable companies use this technique very often while pricing the same products in different countries.

Check Your Progress - 3

1. Write down the steps involved in target costing.

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2. Write the formula for Target return pricing and show with numbers an example of Target return pricing.

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9.9 SELECTING THE FINAL PRICE

Pricing methods help business to find out the final price. Other factors that help to set the final price are:

- Psychological pricing
- The influence of other Marketing-Mix elements
- Company pricing policies
- Impact of price on other parties.

Let us discuss each of them one by one.

i. Psychological Pricing

Many consumers feel high priced product offers high quality. If a consumer knows about the quality features of a product, price plays a less significant role in comparison to quality. When a consumer thinks of buying a product they keep some budget in the mind which is decided by the past prices, current prices, or the buying situation. Mostly high priced product is thought of to have a high quality. So at times increasing the rates of a product increases the sales also.

ii. The influence of other Marketing Mix Elements

The final price of a product depends on the other marketing mix elements also like the advertising, brand name etc.

iii. Company Pricing Policies

The price of any product set should be decided according to the company's pricing policies. In many companies a pricing department is set up to make sure that product price should be reasonable for the customers, and that should give profit to the company also.

iv. Impact of Prices on Other Parties

According to Kotler, Management must also consider the reactions of other parties to the contemplated price.

- How will distributors and dealers feel about it?
- Will the sales force be willing to sell at that price?

- How will competitors react?
- Will suppliers raise their prices when they see the company's price?
- Will the government intervene and prevent this price from being charged? - In this case the marketers should know the laws regulating prices.

9.10 RESPONDING TO MARKET CHANGES

There are situations in which a company may need to decrease or increase the price.

i. Initiating Price Cut

There can be following circumstances when a company can cut the price:

- Excess plant capacity: A company needs more business and the business is not generating even after increased sales efforts, product improvement, and other measures.
- Declining market share: A company can cut the price if the market share is falling.
- Dominating the market through lower cost: A company either introduces a product keeping the prices low comparative to other competitors or starts cutting the prices to gain the market share.

But a price cutting strategy can lead to traps like:

- Low quality trap: A customer assumes that a lower priced product have lower quality.
- Fragile-market share trap: A customer can shift to other company if offered a low priced product.
- Shallow pockets trap: A higher priced competitor can cut the price and stay in the market because of having a good financial status.

ii. Initiating Price Increases

Profits may increase if the increase in price is successful. Circumstances that can lead to price increase are:

- **Cost Inflation:** If the increase in cost doesn't match with the productivity, a company may have fewer profits which can lead to increase in price.
- **Overdemand:** As the demand increases it may become difficult to supply all the customers which can lead to increased pricing, rationing supplies to customers, or both. According to Kotler, companies can also respond to higher costs or overdemand without raising prices. The following possibilities can be included:
- Shrinking the amount of product instead of raising the price.
- Substituting less expensive materials or ingredients.
- Reducing or removing product features to reduce cost.

- Removing or reducing product services, like installation and free delivery.
- Using less expensive packaging material or larger package sizes.
- Reducing the number of sizes and models offered.
- Creating new economy brands.

iii. Customer's Reaction

Change in price arises many questions in the consumer's mind. A consumer can take a price decrease in several ways:

- Is the new model of a product coming in the market?
- Is the product quality is not good because of which the product is not selling leading to reduced price?
- Will the price come down further?
- Is the company compromising with the product quality while decreasing the rate?
- Is the company facing any financial crisis?

Increase in price normally decrease the sales but can have positive impact also. For example a consumer may think that the new item is in fashion, or provides better quality. Mostly the customers are concerned about the prices if the product cost a lot or is bought frequently. Infrequently bought items price are not necessarily noticed by the customers.

iv. Competitor's reaction

Change in price of a company's product is a cause of worry because the competitor's reaction is unpredictable. Competitors mostly react:

- If the number of companies are less
- Buyers have much information about the companies
- The product is identical.

The two assumptions that can be made to predict the competitor's reaction are:

- the competitor reacts in a set way to price change
- Or the price change is taken as a challenge to the competitor

According to Kotler, different interpretations that can be taken by the competitors on a price cut are:

- The company is trying to steal the market.
- The company is doing poorly and trying to boost its sales
- The company wants the whole industry to reduce prices to stimulate total demand.

v. Response to Competitor's Price Changes

When the competitor initiates a price cut, a company should consider the following points:

- What is the reason behind price change by the competitor?
- Is the price change permanent or temporary?
- What will happen to the company if the change in price will not take effect? Are other companies will respond to price change?
- What will be the reaction of other competitors and firms?

A price reaction program is used if a competitor cuts the prices. According to Kotler, reaction programs for meeting price changes find their greatest application in industries where price changes occur with some frequency and where it is important to react quickly. Fig. 9.3 shows a price reaction program.

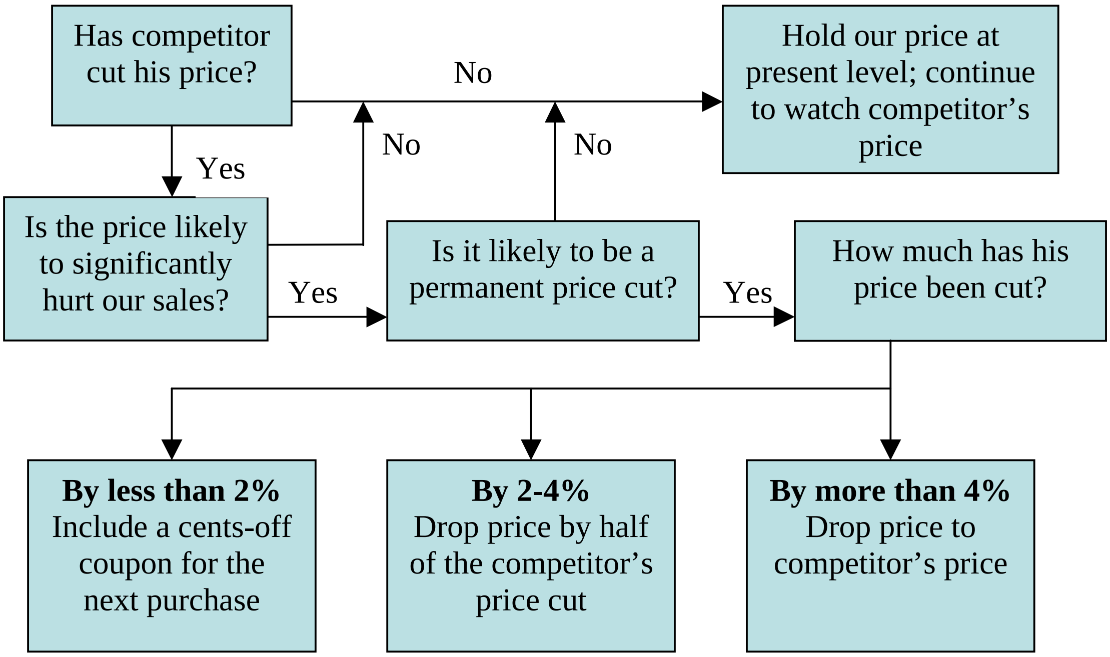

Figure. 9.3

Note: *Adapted from Kotler*

Check Your Progress - 4

1. What is psychological pricing?

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2. What are the assumptions that can be made to predict the competitor's reaction?

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9.11 LET US SUM UP

- Price is the marketing-mix element that produces revenue, the other produce costs.
- A company sets a price for any product under three circumstances -.
  - when a new product is introduced in the market,
  - or an earlier product is distributed in a different geographical situation,
  - or when a tender is quoted for a new contract
- A company has to decide its price objective before setting the price. The possible price objectives are: sustenance, maximizing current profit, maximizing market leadership position, maximizing market leadership.
- The nine factors that affect price sensitivity are: Substitution effect, Inventory effect, Shared-cost effect, Difficulty comparison effect, Unique value effect, Price-quality effect, End-benefit effect, Sunk investment effect, Total-expenditure effect.
- Normally demand and price are inversely related: the higher the price, the lower the demand. However, if price is charged very high, the level of demand falls.
- There are two types of costs: fixed and variable.
- Cost of any product is correlated to its scale of production.
- Value of a product or service in the mind of consumer is a function of perceived quality of the product, perceived positioning of the product, perceived quality and positioning of competing products, and the difference in price of competing products.
- Different price setting methods are: Cost plus, Target return pricing, Value based pricing, Perceived value pricing, Competitive or going rate pricing, Promotional pricing, Discriminatory pricing.
- In addition to defined price setting methods other factors that help to set the final price are: Psychological pricing, the influence of other Marketing-Mix elements, business pricing policies, impact of price on other parties.
- A price reaction program is used if a competitor cuts the prices. According to Kotler, reaction programs for meeting price changes find their greatest application in industries where price changes occur with some frequency and where it is important to react quickly.

9.12 KEY WORDS

Sustenance **:** Process of generating revenue.

Demand curve : Relation between alternative prices and resulting demand.

Demand elasticity : Responsiveness of demand for small change in price.

Cost plus pricing : Adding a profit margin to the production cost and deciding a price.

Value based pricing : Offering a lower price for a high quality product.

Discriminatory pricing: Charging different price for the same product from different customer segments.

Excess plant capacity : required more business and the business is not generating even after putting efforts.

9.13 SOME USEFUL BOOKS

Kotler, P. (2000), Marketing Management, millennium ed., Prentice-Hall, Englewood Cliffs, NJ.

Kotler, P., Ang, S.H., Leong, S.M. and Tan, C.T. (1999), Marketing Management - An Asian Perspective, 2nd Ed., Prentice Hall.

Steven Schnaars (1991), Marketing strategy, Customers & Competition.

Donald Lehmann and Russell Winer(1997), Analysis for Market Planning.

Palmer, A. (2004), Introduction to Marketing: Theory and Practice, Oxford University Press.

9.14 ANSWERS TO CHECK YOUR PROGRESS

Your answer should include the following points:

Check Your Progress - 1

1) i. There are primarily nine types of pricing strategies. They are developed on the basis of price and quality.

2) i. The six step procedure for setting the pricing policy is:

   a. Selecting the pricing objective

   b. Determining demand

   c. Estimating costs

   d. Analyzing competitor's cost, prices and offers

   e. Selecting a pricing method

   f. Selecting a final price

Check Your Progress - 2

2) i. The company may use the Sustenance price objective.

ii. The demand would be called the elastic demand.

Check Your Progress - 3

3) i. The steps involved in target costing method are:

a. Market analysis and finding out the product's requirement

b. Determining the product cost

c. Cost estimation

d. Examination of each cost element

e. Finding out the supplier cost

ii The formula for target return pricing is:

$$\text{Targeted price} = \frac{\text{Cost of production} + (\text{Capital invested} \times \text{Targeted return})}{\text{Estimated sales per year}}$$

Check Your Progress - 4

4) i. Psychological pricing: Many consumers feel high priced product offers high quality. If a consumer knows about the quality features of a product, price plays a less significant role in comparison to quality. When a consumer thinks of buying a product they keep some budget in the mind which is decided by the past prices, current prices, or the buying situation. Mostly high priced product is thought of to have a high quality. So at times increasing the rates of a product increases the sales also.

ii. The two assumptions that can be made to predict the competitor's reaction are:

- the competitor reacts in a set way to price change
- Or the price change is taken as a challenge to the competitor