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Pricing Policy and Strategy Determination for Companies Product

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ABSTRACT

This is a study based on pricing policy and strategy available for organizations for price determination of products. The essence is to inform producers who are new in the industry on the various methods of pricing strategies, and pricing mathematical formula to adopt in cost – oriented strategies. Five pricing strategies which have sub-strategies underneath such as competitive strategy, differential strategies, product line pricing strategies, distribution based pricing strategies and psychological and image pricing strategies, and pricing policy and objectives are highlighted.

INTRODUCTION

Pricing decisions are made to achieve certain objectives which are consistent with a company's overall mission and marketing strategy. Therefore, before setting price on a product, every business organization must decide on what it intends to achieve in the way of the business by taking cognizance of the fact that each possible price may have different implications for sales revenue, market share and profitability.

Pricing the product is one of the most complex components in the marketing mix, because it is the only component of the marketing mix that generate revenue for the business organization, while the other three (product, place, promotion) generate cost. Hence, if pricing policy and strategy are well factored, growth becomes apparent in organization.

From the traditional economics perspective, pricing is a reflection of economic sacrifice buyers must forgo towards acquiring a commodity. While from profit oriented companies' perspective, pricing is the return on a product for all efforts that are put into manufacturing and marketing the product.

PRICING POLICY

A pricing policy is a plan or course of action for achieving pricing objectives. Through pricing policies, management can determine the role of price in the marketing mix and guide itself generally in making pricing decisions over long periods. Pricing policies cover the areas of new product pricing, competitive & economic conditions or realization of pricing objectives.

OBJECTIVES OF PRICING

A pricing objective describes what a profit oriented company hopes to achieve via its pricing activities. A pricing objectives scheme is necessary on the ground that each possible price may have difference implications for profits, market share and sales revenue of the product which must be consistent with the company's overall mission and marketing strategies. Stated below are categories of pricing objectives:

Profit – Oriented Objectives: A firm's product price could be aimed at achieving a predetermined profit objective in order to attain a certain percentage return on sales or on its investment.

Market Survival Objectives: This is when a company set prices to meet short term survival due to intense competition and rapid changes in consumer needs & wants.

Sales – Oriented Objectives: Management & executives in large companies have the tendencies of focusing on sales volume when setting pricing objectives. Companies set prices to enhance sales growth since they know that price and sales volume are immensely related. Sales volume will lower unit production cost, increase total revenue and enhance profits. Penetration pricing policy is often used to achieve this objective product quality leadership: some companies often keep their product price at a product quality leadership such companies charges high prices that may cover all their costs in order to establish and maintain reputation for excellent service & product quality image in order to achieve this, the company may use prestige pricing policy.

Status Quo-Oriented Objectives: This type of pricing objective is described as "Don't-Rock-The-Boast" Objective. It is a situation where a company is satisfied with its current market position and sales and therefore adopts a status quo pricing objective. It is aimed at "stabilizing prices" or avoiding competition or meeting competition. The intention of status quo objective is to avoid price competition in favor of aggressive action on one or more of the other products, although the objective may be conservative.

PRICING COST POLICY

Setting price for a product can be done in three different methods by managers based on demand, cost and competition. Examined below are the methods:

Demand Oriented Pricing: This is use to determine price based on consumer perception, demand intensity and the value placed on the product. There are two variants of demand – oriented pricing namely;

Perceived – Value Pricing: In which case the firm focuses on the buyer's perception of value rather than seller's level of cost when pricing its product. On the other hand, demand – differential pricing is a price discrimination in which case products or services are sold at two or more prices that do not reflect a proportional difference in marginal cost.

Cost – Oriented Pricing: This involves setting price based on cost function associated with the product including arbitrary allocation of overhead. There are two variants of cost – oriented pricing namely;

Mark-up pricing: In which case some fixed percentage is added to the unite cost, while on the other hand.

Target pricing: is a case in which a company tries to determine the price that would yield the desired target market rate of return on investment.

Competition- oriented pricing: This method is employed to evaluate competitor's operational price and this may influence the company to decide whether to charge the same rate with competitors or to keep its prices lower or higher than its competitors by a certain percentage. There are two variants of competition –oriented pricing, namely;

Going Rate Pricing: in which the company attempts to keep its prices at the average level being charged by the industry. This is done where costs are difficult to measure or where buyers and competitors response is certain. While;

Sealed – Bid Pricing: is adopted by companies when they compete for jobs or contracts on the basis of bids; whereby a company bases its price on how competitors will price rather than basing it on its own cost or demand. Hence, in attempt to win the contract or job, the company must price lower than other companies but at the same time, it cannot set price below its cost even if it is desperate to win the job.

PRICING STRATEGY.

There are several strategies that are available to marketing managers which he may use to arrive at a price that reflects market realities, costs, consumer perceptions and other considerations .Zikmund and Amico(2002) ,opined a five pricing strategies categories for product pricing under five headings below:

a. Competitive Pricing Strategies

b. Differential Pricing Strategies

d. Distribution based pricing Strategies

e. Psychological & Image Pricing strategies

Competitive Pricing Strategies:

These strategies are used by firms that have competitive pricing objectives whereby dominant organizations use pricing to exploit their position in the industry while weak organizations may opt for the role of follower.

The followings are approaches under competitive pricing strategy:

Price Leadership & Followers Supply: This strategy implemented by firms that have large shares of the market and of the production capacity in their industries such firm have enough market information and enough control over their distribution systems to determine a price level that other s will follow.

Inflationary Pricing approach: This pricing approach is employed during inflationary period in which firms change the size or amount of the product sold to meet the buying power of consumers as they become more conscious and sensitive to price change.

Penetration pricing approach: This pricing strategy is implemented when a competitive situation is well established and a low price in the introductory stage of the product life cycle will be necessary to break into the market. A penetration price is a low introductory price which in the short run may result in a loss. The aim of this strategy is to enable a new product to become established and survive in the long run. The firm utilizes low prices to capture the mass market and generate a larger unit sales volume for a product or service.

Undercutting the competitive approach: This approach emphasizes offering the lowest price among available choices. Here, price is used as the focal point of the entire market strategy.

Traditional Pricing approach: This is a situation whereby certain prices are set largely by tradition rather than by individual marketers. It is known as customary prices, and it may remain unchanged for long periods.

Differential Pricing Strategies: This strategy is used by a firm that sells the same product to different buyers at different prices. The following are differential pricing approaches:

SKIMMING: This is a pricing strategy of setting the highest possible price that buyers will pay. It is intended to "skim the cream off the market". The strategy is aimed at attracting the market segment that is more concerned with product quality, uniqueness or status than price. The skimming approach raises the price high and then systematically reduce price over time.

One – Price versus Variable pricing approach: Holding the price the same for all buyers is termed a one price strategy. It provides the advantages of simplicity of administration which in turn leads to lower personnel expenses. Variable pricing on the other hand is a differential pricing approach whereby marketers allow customers to negotiate in an attempt to secure a favorable price.

Periodic discounting approach: This approach uses price reductions that are predictable over time. The price changes associated with periodic discounting take place over shorter time periods than those associated with skimming. Further prices may be expected to rise in subsequent periods.

Random discounting approach: This approach involves lowering the price of a product occasionally and randomly to entice new customers. This strategy ensures that consumers cannot predict the timing of discounts. It is designed in such a way that regular and high –income customers routinely buy at the normal (high) price and price –conscious shoppers purchase at the sale price.

Second market Discounting Approach: This differential pricing strategy is designed to sell a brand at one price in core target market and at a reduced price in a secondary market segment.

Product – Line Pricing Strategies

This Pricing approach is designed to maximize profits for the total product line rather than to obtain the greatest profits for any individual item in the line. i.e. marketers focus on total – profit pricing rather than on item pricing. The following are product line pricing approaches:

Captive pricing approach: In a captive pricing strategy, the basic product is priced low, often below cost, but the high markup on supplies required to operate the basic product makes up for that low price.

Price lining approach: This approach prices the product in a product line according to a number of "price points". Price points are simply specific prices. Price lining is the selecting of prices for an assortment of merchandize being carried in the store. Price lining simplifies customers buying decisions and retailers decisions.

Leader Pricing and Bait Pricing Approach: Leader pricing is a common pricing strategy that sacrifices items profit for total profit. The leader items are sold not at a loss but at the seller's cost (the cost leader) or at a very small profit (the low profit leader)

Bait pricing involves attracting customers by advertising low price models. Although the bait item is available for sale in sufficient quantity, the marketer's expectation is to trade the customers up to a higher – margin model that is also available for sale.

When the merchant has no intention of selling the bait merchandize, but only intend to convince the customer to buy more expensive goods is termed as bait and switch.

Distribution – Based Pricing Strategies: This strategy stresses on the consideration for prices based on the geographic distance separating the buyer from the point of sale or the point of production. Geographic pricing policies reflect management's attempt to recover some or all of the costs involved in shipping products long distance.

F.O.B approach:

This is a common form of geographic pricing which stands for "freight on board" or "free on board" which is always followed by the name of a specific place; which tells the buyer the point to which the seller will ship the goods. At that point, the buyer takes title to the goods and becomes responsible for shipping charges.

Basing – point pricing approach: This distribution based pricing strategy involves the selection of one or more locations to serve as a basing points. Customers are charged prices.

Psychological and Image Pricing Strategies: This strategy stimulates the customer to think that the item's price has been marked down. When customers choose brands because their prices send message, they are responding to a psychological or image pricing strategy.

Reference Pricing Approach: This strategy is based on isolation effect which suggests that a choice looks more attractive next to a high priced alternative than it does something about a brand in isolation. This approach is used by retailers to choose a moderate price for a version of a product that will be displayed next to a higher priced model of the same brand or competitive brand.

Odd versus even pricing approach: Odd prices produce psychological effects on consumers. Consumers tend to believe that prices which are odd are reduced to barest minimum and are usually attracted to such prices.

Even prices are used to good effect by the marketers of services and high quality merchandise. Even prices are said to be most effective when the is to create an image of high quality to appeal to upscale consumers.

Prestige Pricing Approach: Many customers judge the quality of a product by its price. Prestige price is used to determine the prices of luxury goods where the seller is successful in creating a prestige for his product.

PRICING MATHEMATICAL FORMULA

Target – Return Pricing: This is adopted by manufacturing who fix a target on the total cost.

Formula:

$P = AVC + \frac{F}{X} + \frac{rk}{X}$ } $P = AVC + \frac{F}{X} + \frac{rk}{X}$

Where P is the selling price to be determined.

AVC is the average Unit Variable Cost.

F is the Cost.

X is the standard Volume to be Produced.

K is the capital employed or invested costs.

Markup: The difference what goods are sold and retailers in selling the selling price.

Formula:

Markup = Selling Price – Cost.

Markup Percentage: This is move useful to the middlemen in their decision making.

Markup Percentage on retail = $\frac{\$Markup}{\$Selling\ Price}$

Markup Percentage on Cost = $\frac{\$Markup}{\$Selling\ Price}$

Application of the formula to Pricing

Formula:

$R = \frac{C}{100\ Percent - MU\ Percent}$

Where: R is Retail Selling Price

C is Cost

Mu is the markup or gross margin

Determination of cost that will yield a desired markup percentage at a particular selling price:

Formula:

C = R x (100 % - Mu%)

Break – Even Pricing:

This pricing analysis is used to determine cost plus pricing and help manufactured to determine at what level of output the revenue will equal the costs assuming a certain selling price.

Formula

Break-even point $= \frac{Total\ fixed\ cost}{margin\ of\ contribution}$

Margin of Contribution = Unit Selling Price – Unit Variable Cost

CONCLUSION

A common mistake in marketing is setting a product pricing independently of the rest of the marking mix rather than an intrinsic part of market positioning strategy price should not be set in isolation; it should be blended with the other three components in order to form a coherent mix that provides superior customer value. Therefore, adequate consideration must be given to pricing policy and strategy of every business organ since pricing has direct effect on wages, investment, interest and profits.

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