PRICING

Price goes by various names -freight, fare, license fee, tuition fee, professional charge, rent, interest, etc. But price in an enterprise/business system is seldom so simple.

By definition," **price is the money that customers must pay for a product or service**". In other words, price is an offer to sell for a certain amount of currency.

Here, the word, offer indicates that price is subject to change if there are found insufficient number of customers at the original price of the product. That is why prices are always on trial. If they are found to be wrong, either they must be immediately changed or the product itself must be withdrawn from the market.

Pricing of the product is something different from its price. In simple words, pricing is the art of translating into quantitative terms the value of a product to customers at a point of time. Someone has opined that, "The key to pricing is to build value into the product and price it accordingly."

Pricing is one of the key elements of marketing mix.

The salient ingredients of pricing are:

(i) Pricing covers all marketing aspects like the item-goods or services-mode of payment, methods of distribution, currency used, etc.

(ii) Pricing may carry with it certain benefits to the customers like guarantee, free delivery, installation, free after-sale servicing and so on.

(iii) Pricing refers to different prices of a product for different customers and different prices for the same customer at different times.

Pricing – Buyers' and Sellers' View

In general terms price is a component of an exchange or transaction that takes place between two parties and refers to what must be given up by one party (i.e., buyer) in order to obtain something offered by another party (i.e., seller).

Yet this view of price provides a somewhat limited explanation of what price means to participants in the transaction.

In fact, price means different things to different participants in an exchange:

1. **Buyers' View**

For those making a purchase, such as final customers, price refers to what must be given up to obtain benefits. In most cases what is given up is financial consideration (e.g., money) in exchange for acquiring access to a good or service. But financial consideration is not always what the buyer gives up.

Sometimes in a barter situation a buyer may acquire a product by giving up their own product. For instance – two farmers may exchange cattle for crops. Also, as we will discuss below, buyers may also give up other things to acquire the benefits of a product that are not direct financial payments (e.g., time to learn to use the product).

2. **Sellers' View**

To sellers in a transaction, price reflects the revenue generated for each product sold and, thus, is an important factor in determining profit. For marketing organizations price also serves as a marketing tool and is a key element in marketing promotions. For example – most retailers highlight product pricing in their advertising campaigns.

PRICING OBJECTIVES

Pricing can be defined as the process of determining an appropriate price for the product, or it is an act of setting price for the product. Pricing involves a number of decisions related to setting price of product. Pricing policies are aimed at achieving various objectives. Company has several objectives to be achieved by the sound pricing policies and strategies. Pricing decisions are based on the objectives to be achieved. Objectives are related to sales volume, profitability, market shares, or competition. Objectives of pricing can be classified in five groups as shown in figure 1.

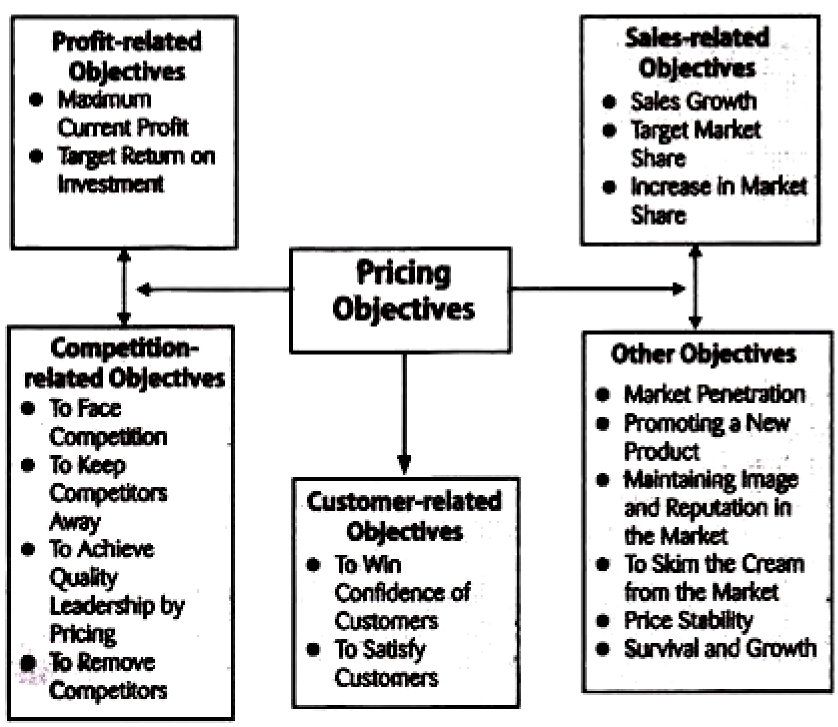

Figure 1: Pricing Objectives

1. PROFITS-RELATED OBJECTIVES

Profit has remained a dominant objective of business activities.

Company's pricing policies and strategies are aimed at following profits-related objectives:

(a) Maximum Current Profit

One of the objectives of pricing is to maximize current profits. This objective is aimed at making as much money as possible. Company tries to set its price in a way that more current profits can be earned. However, company cannot set its price beyond the limit. But, it concentrates on maximum profits.

(b) Target Return on Investment

Most companies want to earn reasonable rate of return on investment.

Target return may be:

- Fixed percentage of sales
- Return on investment
- A fixed rupee amount

Company sets its pricing policies and strategies in a way that sales revenue ultimately yields average return on total investment. For example, company decides to earn 20% return on total investment of 3 crore rupees. It must set price of product in a way that it can earn 60 lakh rupees.

2. SALES-RELATED OBJECTIVES

The main sales-related objectives of pricing may include:

(a) Sales Growth

Company's objective is to increase sales volume. It sets its price in such a way that more and more sales can be achieved. It is assumed that sales growth has direct positive impact on the profits. So, pricing decisions are taken in way that sales volume can be raised. Setting price, altering in price, and modifying pricing policies are targeted to improve sales.

(b) Target Market Share

A company aims its pricing policies at achieving or maintaining the target market share. Pricing decisions are taken in such a manner that enables the company to achieve targeted market share. Market share is a specific volume of sales determined in light of total sales in an industry. For example, company may try to achieve 25% market shares in the relevant industry.

(c) Increase in Market Share

Sometimes, price and pricing are taken as the tool to increase its market share. When company assumes that its market share is below than expected, it can raise it by appropriate pricing; pricing is aimed at improving market share.

3. COMPETITION-RELATED OBJECTIVES

Competition is a powerful factor affecting marketing performance. Every company tries to react to the competitors by appropriate business strategies.

With reference to price, following competition-related objectives may be priorized:

(a) To Face Competition

Pricing is primarily concerns with facing competition. Today's market is characterized by the severe competition. Company sets and modifies its pricing policies so as to respond the competitors strongly. Many companies use price as a powerful means to react to level and intensity of competition.

(b) To Keep Competitors Away

To prevent the entry of competitors can be one of the main objectives of pricing. The phase 'prevention is better than cure' is equally applicable here. If competitors are kept away, no need to fight with them. To achieve the objective, a company keeps its price as low as possible to minimize profit attractiveness of products. In some cases, a company reacts offensively to prevent entry of competitors by selling product even at a loss.

(c) To Achieve Quality Leadership by Pricing

Pricing is also aimed at achieving the quality leadership. The quality leadership is the image in mind of buyers that high price is related to high quality product. In order to create a positive image that company's product is standard or superior than offered by the close competitors; the company designs its pricing policies accordingly.

(d) To Remove Competitors from the Market

The pricing policies and practices are directed to remove the competitors away from the market. This can be done by forgoing the current profits by keeping price as low as possible in order to maximize the future profits by charging a high price after removing competitors from the market. Price competition can remove weak competitors.

4. CUSTOMER-RELATED OBJECTIVES

Customers are in center of every marketing decision.

Company wants to achieve following objectives by the suitable pricing policies and practices:

(a) To Win Confidence of Customers

Customers are the target to serve. Company sets and practices its pricing policies to win the confidence of the target market. Company, by appropriate pricing policies, can establish, maintain or even strengthen the confidence of customers that price charged for the product is reasonable one. Customers are made feel that they are not being cheated.

(b) To Satisfy Customers

To satisfy customers is the prime objective of the entire range of marketing efforts. And, pricing is no exception. Company sets, adjusts, and readjusts its pricing to satisfy its target customers. In short, a company should design pricing in such a way that results into maximum consumer satisfaction.

5. OTHER OBJECTIVES

Over and above the objectives discussed so far, there are certain objectives that company wants to achieve by pricing.

They are as under:

(a) Market Penetration

This objective concerns with entering the deep into the market to attract maximum number of customers. This objective calls for charging the lowest possible price to win price-sensitive buyers.

(b) Promoting a New Product

To promote a new product successfully, the company sets low price for its products in the initial stage to encourage for trial and repeat buying. The sound pricing can help the company introduce a new product successfully.

(c) Maintaining Image and Reputation in the Market

Company's effective pricing policies have positive impact on its image and reputation in the market. Company, by charging reasonable price, stabilizing price, or keeping fixed price can create a good image and reputation in the mind of the target customers.

(d) To Skim the Cream from the Market

This objective concerns with skimming maximum profit in initial stage of product life cycle. Because a product is new, offering new and superior advantages, the company can charge relatively high price. Some segments will buy product even at a premium price.

(e) Price Stability

Company with stable price is ranked high in the market. Company formulates pricing policies and strategies to eliminate seasonal and cyclical fluctuations. Stability in price has a good impression on the buyers. Frequent changes in pricing affect adversely the prestige of company.

(f) Survival and Growth

Finally, pricing is aimed at survival and growth of company's business activities and operations. It is a fundamental pricing objective. Pricing policies are set in a way that company's existence is not threatened.

Pricing decisions

Pricing of a product or service refers to the fixation of a selling price to a product or service provided by the firm. Selling price is the amount for which customers are charged for some product manufactured or for a service provided by the firm. The pricing decisions are influenced by both internal and external factors.

Needles, Anderson and Caldwell have suggested external factors and internal factors to be considered for setting a price by a business firm.

Factors to Consider When Setting a Price:

External Factors:

1. Total demand for product or service and its elasticity
2. Number of competing products or services
3. Quality of competing products or services
4. Current prices of competing products or services
5. Customer's preferences for quality versus price
6. Sole source versus heavy competition (Number of suppliers in the market)
7. Economic and political climate and trends and likely changes in them in future.
8. Type of industry to which the product belongs and future outlook of the industry.
9. Governmental guidelines, if any.

Internal Factors:

1. Cost of product or service
2. Variable costs
3. Full absorption costs
4. Total costs
5. Replacements, Standard or any other cost base
6. Price geared toward return on investment
7. Loss leader or main product
8. Quality of materials and labour inputs
9. Labour intensive or automated process

10. Markup percentage updated
11. Usage of scarce resources
12. Firm's profit and other objectives
13. Pricing decision as a long-run decision or short term decision or a onetime spare capacity decision

Factors Influencing Pricing Decisions:

Among the many factors influencing the pricing decisions, the three major influences are customers, competitors and costs.

Customers:

Managers examine pricing problems through the eyes of their customers. Increasing prices may cause the loss of a customer to a competitor or it may cause a customer to choose a less expensive substitute product.

Competitors:

No business operates in a vacuum. Competitors' reactions also influence pricing decisions. A competitor's aggressive pricing may force a business to lower its prices to be competitive. On the other hand, a business without a competitor can set higher prices. A business with knowledge of its competitor's technology, plant capacity and operating policies is able to estimate its competitors' cost, which is valuable information in setting prices. Managers consider both their domestic and international competition in making pricing decisions. Firms with excess capacity because demand is low in domestic markets may price aggressively in their export markets.

Costs:

Costs influence prices because they affect supply. The lower the cost relative to the price, the greater the quantity of product the company is willing to supply. A product that is consistently priced below its cost can drain large amounts of resources from an organisation.

In making pricing decisions, all above three factors are important. However, when setting prices, companies weigh customers, competitors and costs differently. Companies selling homogeneous products in highly competitive markets must accept the market price. In less competitive markets, products are differentiated and managers have some discretion in setting prices.

As competition further decreases, the key factor affecting pricing decisions is the customers' willingness to pay, not costs or competitors. Pricing strategy is now being accepted as a tool for providing customer satisfaction and continuous improvement of the product as well.

DIFFERENT METHODS OF PRICING:

The different methods of pricing are generally the following:

1. Total Cost Plus or Full Cost Plus Pricing:

Total cost plus or full cost plus pricing involves all costs plus a profit margin. It includes not only the product's direct costs but also the indirect costs incurred by the overall company which have to be allocated to different products. An obvious problem in this method is the determination of total costs. If multiple products are manufactured, the cost determination process is complex. In this situation, indirect or non-manufacturing costs have to be distributed among the different products in order to determine finally the full cost of different products.

Advantages:

Full cost plus method has the following advantages:

(1) It is simple to operate if cost structures of products are known.

(2) The pricing decision under full cost approach becomes standardised and such decisions can easily be delegated to lower management.

(3) It ensures recovery of total costs and also provides a reasonable rate of return to the firm.

(4) It helps a business firm to predict the selling prices of other competitive firms, specially of those firms who are having similar cost structures.

(5) This pricing method is important in contracting industries where price of the contracts needs to be determined considering fixed costs also.

(6) This method does not require estimating demand of products before fixing the selling prices. Instead, a standard profit margin on total cost can be used.

(7) This brings stability in the pricing policy and selling price can be justified to customers. On the other hand, prices based on less than total cost such as marginal cost may prompt the customers to believe that the low price will prevail, in absence of which consumers will be dissatisfied and the firm can face serious problem.

(8) Full cost pricing is consistent with absorption costing system.

(9) If similar technologies and techniques are employed within an industry, such that there is likely to be broad comparability of cost structures between different firms operating in the industry, then widespread use of cost-plus methods can lead to a high degree of price stability.

Disadvantages:

Full cost method has the following disadvantages too:

(1) It ignores demand and competition and may result into under-pricing or over-pricing of products.

(2) Fixed costs are likely to be distributed on some arbitrary basis as there are different methods of apportionment and thus total costs of different products will be different depending on which apportionment method is used.

(3) In full cost pricing, the choice of volume or capacity base is very important. There are different concepts of capacity starting from maximum to normal or lower, or expected and different unit product costs will emerge under these concepts. It means selling prices will be subject to wider fluctuations.

(4) This method does not distinguish between relevant costs (e.g., variable costs and incremental fixed costs) and irrelevant costs (fixed costs).

(5) The proper treatment of fixed cost presents a problem in full costs pricing. As volume increases, the fixed cost and full cost per unit decreases. If price follows cost, price goes down and further spurs demand. Unfortunately, the opposite is more distressing. As volume decreases, full cost increases. As price goes up, demand falls and volume declines again a downward spiral. Hence, any attempt to consider the demand situation in establishing the full cost of the product involves circular reasoning.

(6) This method cannot always shield the firm from a loss. When the product is priced higher the unit cost (considering the fixed costs as well) and sales demand falls below the volume level used to calculate the fixed cost per unit, the total sales revenue will be inadequate to cover the total fixed costs. In other words, full cost pricing will ensure recovery of total costs and earning of target profit when sales volume is equal to or more than the volume or capacity level which has been used to estimate total unit costs.

Within full cost plus method, some other cost bases can be used for determining the selling price such as manufacturing cost plus or conversion cost plus.

Manufacturing Cost plus Pricing:

Manufacturing cost (or product cost) plus pricing includes cost incurred specifically for manufacturing the product plus a profit margin. The profit margin added to this cost must cover all operating expenses and generate a satisfactory level of profit. Using the information given in the earlier example, a cost of? 500 will be used. To this cost, a higher profit margin needs to be added to cover non-manufacturing overheads as well as to provide a satisfactory level of profit to the firm.

Conversion Cost plus Pricing:

Conversion cost plus pricing uses conversion cost for determining the selling price and to this cost a profit margin is added. This pricing methods is generally followed when the customer provides the materials. This method depends on the assumption that greater profits can be realised if efforts are directed to products requiring less labour and overhead because more units can be produced and sold.

Situations under which Full Cost plus Pricing can be used:

Most companies rely on full cost information reports when setting prices.

There is economic justification for reliance on full costs for pricing decisions in three types of circumstances:

1. Many contracts for the development and production of customised products and many contracts with government agencies specify that prices should equal full costs plus a markup. Prices set in regulated industries such as electric utilities also are based on full costs.

2. When a firm enters into a long term contractual relationship with a customer to supply a product, most activity costs are likely to emerge and full costs become relevant for the long term pricing decisions.

3. The third situation is representative of many industries. When demand is low, firms adjust the prices downward to acquire additional business based on the lower incremental costs when surplus capacity is available. Conversely, when demand for products is high, firms adjust the prices upward based on the higher incremental costs when capacity is fully utilised.

Because demand conditions fluctuate overtime, prices also fluctuate overtime with demand conditions. Although the fluctuating short-term prices are based on the appropriate incremental costs, over the long run, their average tends to equal the price based on the full costs that will be recovered in a long term contract. In other words, the price determined by adding on a markup to the full costs of a product serves as a bench mark or target price from which the firm can adjust prices up or down depending on demand conditions.

On the strengths and weaknesses of full cost-based prices, Decoster et al. observe the following:

(i) Although the cost-based pricing formula is simple, it does not agree with economic theory, because it ignores the relationships between demand and price and between price and volume. The price determined by full cost plus a markup may be so high that there are no customers. If so, some of the volume potential of the firm will be idle. There is a circularity problem. Volume is used to determine price in the full cost based pricing formula, yet the number of units the company sells and therefore the firm's volume may depend on price.

(ii) A principal reason (for the wider use of pricing policies based on full cost) is the inability of the decision maker to quantify the demand curve. This inability to apply economic theory leads the business manager to apply intuitive judgment coupled with trial-and-error methods. Many decision-makers begin with a full cost approach and then, on the basis of buyer's reaction, adjust the price. In this way, the full cost based price represents a first approximation a target price whose markup must be adjusted to meet the actual market place.

(iii) Another reason for the adoption of full costs-based prices is the belief that theory represent a "floor" or "safe" price that will prevent losses. This safety factor is more illusory than real.

Although the per-unit sales price will cover the per-unit full cost, losses may still be incurred if the sales volume is not achieved.

(iv) Perhaps the most convincing reason for the use of cost-based prices is that the costs of a particular firm are comparable with costs of other firms in the industry. One firm's costs are reasonable estimates of its competitors' costs, and hence its prices are likely to be comparable to those of its competitors. If most companies use similar facilities to perform similar activities, they will have similar full costs, and thus, similar prices if they produce at about the same volume level.

2. Marginal Cost Plus Pricing:

This method, also known as contribution approach, uses only variable costs as the basis for pricing. Fixed costs are not added to the product, service or contract. This pricing method emphasises the relationship between prices and costs that vary directly with sales. It ignores fixed costs altogether. However, fixed cost should be taken into account in determining the profit margin to be added to variable costs to arrive at the selling price.

Marginal cost approach helps a business firm to enter into new markets easily, to increase its competitive position in the existing markets, to survive during trade depressions, to utilise spare available capacity, to dispose off surplus or obsolete stock, to make profitable special order decisions.

Marginal cost-plus pricing brings some disadvantages to the firm as well. For instance, recovery of fixed costs may be doubted. There is likely to be undesirable competition for cutting prices to a lower level. In case management decides to increase lower marginal cost pricing, it may face dissatisfaction from the consumers.

Using the information given in the earlier example, marginal costs of Rs 350 can be used to set the selling price. Obviously, it indicates the cost below which the price should not fall; otherwise the company would have losses. Also, a higher profit margin can be added to marginal cost which may work as a long term selling price even for normal sales. For instance, if the profit margin of 100% is added to marginal costs of Rs 350, the selling price will be Rs 700.

Marginal cost plus method is useful in those situations where a firm has recovered its total fixed costs from sales in the normal market but is unable to increase its further sales in that market. If still spare capacity is available, the firm may attempt to sell to some other customers or markets at lower (marginal cost-plus) price which will provide some contribution towards fixed cost and thus profit will increase. For a long-term pricing policy, it is necessary that a higher profit margin should be added to marginal cost to recover both variable and fixed costs in the long run. A smaller profit margin will lead to low sales revenue which will not be sufficient to recover fixed costs.

3. Differential Cost Plus Pricing:

This method involves adding a markup on differential cost which is the increase in total cost resulting from the production of additional units. Differential cost pricing differs from variable cost pricing in which a mark up on variable cost is added, whereas both variable costs and fixed costs are included in the differential costs on which a markup is determined. This method can be applied where some revenue above differential cost may be received rather than no revenue at all. Such additional revenue makes some contribution towards the recovery of fixed costs which are already incurred.

4. Standard Costs:

Standard costs represent the costs that should be attained under efficient operating conditions at a normal capacity. The cost-based methods have some adverse implications and include costs due to inefficient manufacturing, wasteful operations etc. That is, it is likely that unnecessary costs may be assigned to the product. On the other hand, standard costs use costs from efficient operations plus the agreed profit. Also, pricing can be done more quickly.

However, before standards are used as a basis for pricing decisions, care should be taken to see that the standards established reflect current conditions. While using standard costs, variances must be controlled carefully to ensure that prices reflect realistic production costs. If standard costs differ from actual costs significantly, the standard costs should be modified to conform to real operating situations.

PRICING STRATEGIES

A business can use a variety of pricing strategies when selling a product or service. The price can be set to maximize profitability for each unit sold or from the market overall. It can be used to defend an existing market from new entrants, to increase market share within a market or to enter a new market.

Types of Pricing Strategies:

1. **Penetration Pricing**

The price charged for products and services is set artificially low in order to gain market share. Once this is achieved, the price is increased. This approach was used by France Telecom and Sky TV. These companies need to land grab large numbers of consumers to make it worth their while, so they offer free telephones or satellite dishes at discounted rates in order to get people to sign up for their services. Once there is a large number of subscribers prices gradually creep up. Taking Sky TV for example, or any cable or satellite company, when there is a premium movie or sporting event prices are at their highest so they move from a penetration approach to more of a skimming/premium pricing approach.

2. Skimming Pricing

Price skimming sees a company charge a higher price because it has a substantial competitive advantage. However, the advantage tends not to be sustainable. The high price attracts new competitors into the market, and the price inevitably falls due to increased supply.

Manufacturers of digital watches used a skimming approach in the 1970s. Once other manufacturers were tempted into the market and the watches were produced at a lower unit cost, other marketing strategies and pricing approaches are implemented. New products were developed and the market for watches gained a reputation for innovation.

3. Competition Pricing

Competitive pricing consists of setting the price at the same level as one's competitors. This method relies on the idea that competitors have already thoroughly worked on their pricing. In any market, many firms sell the same or very similar products, and according to classical economics, the price for these products should, in theory, already be at an equilibrium (or at least at a local equilibrium). Therefore, by setting the same price as its competitors, a newly-launched firm can avoid the trial and error costs of the price-setting process. However, every company is different and so are its costs. Considering this, the main limit of the competitive pricing method is that it fails to account for the differences in costs (production, purchasing, sales force, etc.) of individual companies. As a result, this pricing method can potentially be inefficient and lead to reduced profits.

For example, a firm needs to price a new coffee maker. The firm's competitors sell it at $25, and the company considers that the best price for the new coffee maker is $25. It decides to set this very price on their own product. Moreover, this pricing method can also be used in combination with other methods such as penetration pricing for example, which consists of setting the price below that of its competition (for instance, in this example, setting the price of the coffee maker at $23).

4. Product Line Pricing

Where there is a range of products or services the pricing reflects the benefits of parts of the range. For example car washes; a basic wash could be $2, a wash and wax $4 and the whole package for $6. Product line pricing seldom reflects the cost of making the product since it delivers a range of prices that a consumer perceives as being fair incrementally – over the range.

If you buy chocolate bars or potato chips (crisps) you expect to pay X for a single packet, although if you buy a family pack which is 5 times bigger, you expect to pay less than 5X the price. The cost of making and distributing large family packs of chocolate/chips could be far more expensive. It might benefit the manufacturer to sell them singly in terms of profit margin, although they price over the whole line. Profit is made on the range rather than single items.

5. **Psychological Pricing**

This approach is used when the marketer wants the consumer to respond on an emotional, rather than rational basis. For example Price Point Perspective (PPP) 0.99 Cents not 1 US Dollar. It’s strange how consumers use price as an indicator of all sorts of factors, especially when they are in unfamiliar markets. Consumers might practice a decision avoidance approach when buying products in an unfamiliar setting, an example being when buying ice cream. What would you like, an ice cream at $0.75, $1.25 or $2.00? The choice is yours. Maybe you’re entering an entirely new market. Let’s say that you’re buying a lawnmower for the first time and know nothing about garden equipment. Would you automatically by the cheapest? Would you buy the most expensive? Or, would you go for a lawnmower somewhere in the middle? Price therefore may be an indication of quality or benefits in unfamiliar markets.

6. **Cost Plus Pricing**

Your company has been developing a new printer that will streamline many processes for your small business customers. Your job is to determine the price of the printer. After doing some research, you determine that the best method for pricing the printer is the cost-plus method.

Cost-plus pricing is a straightforward and simple way to arrive at a sales price by adding a markup to the cost of a product. In our example of the printer, you first have to determine the break-even price, which is the sum of all of the expenses involved in creating a product, including expenses like supplies, production costs, and marketing costs. When you pull all of the expenses together to determine the cost of each printer, you determine that each one will cost $78 to produce. If you sold the printer at $78 your company would break even, meaning there would be no profit or loss.

7. **Cost-based Pricing**

Cost-based pricing involves setting prices based on the costs for producing, distributing and selling the product. Also, the company normally adds a fair rate of return to compensate for its efforts and risks. To begin with, let’s look at some famous examples of companies using cost-based pricing. Firms such as Ryanair and Walmart work to become the low-cost producers in their industries. By constantly reducing costs wherever possible, these companies are able to set lower prices. Certainly, that leads to smaller margins, but greater sales and profits on the other hand. But even companies with higher prices may rely on cost-based pricing. However, these companies usually intentionally generate higher costs so that they can claim higher prices and margins.

8. **Optional Product Pricing**

Companies will attempt to increase the amount customers spend once they start to buy. Optional ‘extras’ increase the overall price of the product or service. For example airlines will charge for optional extras such as guaranteeing a window seat or reserving a row of seats next to each other. Again budget airlines are prime users of this approach when they charge you extra for additional luggage or extra legroom.

9. **Premium Pricing**

Use a high price where there is a unique brand. This approach is used where a substantial competitive advantage exists and the marketer is safe in the knowledge that they can charge a relatively higher price. Such high prices are charged for luxuries such as Cunard Cruises, Savoy Hotel rooms, and first class air travel.

10. **Bundle Pricing**

The act of placing several products or services together in a single package and selling for a lower price than would be charged if the items were sold separately. The package usually includes one big ticket product and at least one complementary good. Bundled pricing is a marketing method used by retailers to sell products in high supply.

GEOGRAPHICAL PRICING

What Is Geographical Pricing?

Geographical pricing is the practice of adjusting an item's sale price based on the location of the buyer. Sometimes the difference in the sale price is based on the cost to ship the item to that location. But the difference may also be based on what amount the people in that location are willing to pay. Companies will try to maximize revenue in the markets in which they operate, and geographical pricing contributes to that goal.

Key Takeaways

- Geographical pricing is a practice in which the same goods and services are priced differently based on the buyer's geographic location.
- The difference in price might be based on the shipping cost, the taxes each location charges, or the amount people in the location are willing to pay.
- Prices are also varied based on demand, such as a product that is competing with many rivals in a market versus a product that is exclusive to a market.

Understanding Geographical Pricing

Most typically, geographical pricing is practiced by companies in order to reflect the different shipping costs accrued when transporting goods to different markets. If a market is closer to where the goods originate, the pricing may be lower than in a faraway market, where the expense to transport the goods is higher. Prices may be lower if the goods compete in a crowded market where consumers have a number of other quality options.

Charging higher prices to account for higher shipping charges to faraway locations can make a seller more competitive, as their products will be available to a larger number of customers. But higher shipping costs may make local customers avoid buying the product that is shipped from far away in favor of cheaper, local products.

Prices are also impacted by whether the manufacturer is a price taker instead of a price maker. A price taker is a company or individual that has to settle for whatever price the market has determined for the product, as they lack the market share or influence to determine the price. A price maker has the market share to set the price.

Geographical Pricing Strategy

It is always up to the seller of the goods to determine how they will price their product and based on that decision, the outcome will vary. For example, the seller may decide to sell their product in a location far away and absorb the cost of shipping, thereby pricing the product competitively in a foreign market. This may result in lower profit margins or no profits at all but may increase brand awareness in the new location for some benefit down the line.

Conversely, the seller may pass the cost of shipping onto the consumer via high prices for the product, which may have many different effects. The product may sell poorly as it sold at a higher price compared to competitors, or the seller could run a marketing campaign positioning the product as a higher quality luxury item, thereby justifying the higher price. In this case, it might only be bought by a small part of the population, but that might be profitable enough.

Five geographical pricing types

Geographical pricing is a more general phrase that encompasses a range of more concise strategies.

1 – Zone pricing

This is the strategy most associated with geographical pricing. Customers within designated regions are charged the same price for goods and services, with more distant customers charged a higher price.

Zones are typically represented on a map using concentric circles or other boundaries which reflect population density, geography, or transportation infrastructure.

Gasoline prices in the United States are based on a complex mixture of factors including the number of competing stations, transportation corridors, average traffic flow, and the number of vehicles.

2 – Free on Board (FOB) origin pricing

Here, the buyer pays for variable shipping costs from the production facility or warehouse.

Ownership of the item transfers to the buyer once the item has left the facility, with the seller or buyer able to arrange the transportation itself.

3 – Basing point pricing

In basing point pricing, certain cities are designed as basing points. Shipping costs from these cities are the same, regardless of whether the buyer lives near the city.

Basing point pricing is common practice in the steel and automotive industries.

4 – Uniform delivered pricing

Similar to basing point pricing is uniform delivered pricing, where buyers pay the same freight costs regardless of their distance from the dispatch location.

The exact freight cost is determined by an average and is typically incorporated into the price of the product.

5 – Freight-absorption pricing

Freight-absorption pricing is a strategy where the seller absorbs all or part of the delivery cost to a given region.

This strategy, which is often reserved for when a product is on sale, is essentially a buyer discount because the freight cost is not built into the price.

Other geographical pricing considerations

While geographical pricing is mostly driven by shipping cost, there are a couple of other factors that may influence product prices:

- **Taxation laws** – a business may adjust its product pricing based on different sales tax percentages. If Region A has a sales tax of 15% and Region B has a sales tax of 25%, the business will sell its products for a higher price in Region B to offset the extra sales tax.
- **Supply and demand** – product pricing may also reflect a supply and demand imbalance in the market. When supply is low in a particular region, prices increase.
- **Consumer purchasing power** – those living in rural areas tend to have lower purchasing power than their city counterparts. Purchasing power across different cities also fluctuates, with residents of Zurich and Sydney enjoying more purchasing power than those residing in Manila or Nairobi.

Key takeaways:

- Geographical pricing is the process of adjusting the sale price of a product or service according to the location of the buyer.
- Geographical pricing types include zone pricing, FOB pricing, basing point pricing, uniform delivered pricing, and freight-absorption pricing.
- Geographical pricing is mostly driven by consideration for shipping costs. However, region-specific taxation laws, supply and demand, and consumer purchasing power are also key factors.

Product Line Pricing: Definition, Strategies and Examples

Companies regularly use product line pricing to boost sales and expand their market reach. It's a common tactic that marketers use to increase sales traffic and increase profits. If you're interested in pricing and advertising strategies or work in the marketing or sales fields, you can benefit from learning about product line pricing.

What is product line pricing?

Product line pricing is a multi-tier design system for selling the goods or services that a company produces. Product line pricing is a tool that businesses use to create the perception of different quality levels for products in the minds of the consumers they target. Companies often have completely unique marketing campaigns for their various product tiers, and many organizations seek to establish a sense of elitism with their brand or higher-tier products using product line pricing.

Why organizations use product line pricing

Here are two primary reasons companies use product line pricing:

1. Create a price differential

A price differential is a difference in the cost of two or more products or product types. Using a product line price model creates varied price differentials, and companies use the psychology of these price gaps to cultivate a sense of financial achievement in buyers who can afford the product at the higher end of the differential. Buyers at the lower end of the price differential also feel a sense of accomplishment in being able to purchase an item with the same brand name or level of recognition as the product at the higher end of the differential.

2. Expand market reach

Using product line pricing allows companies to target customers with low-end, mid-range and high-end budgets. By offering two, three or more product tiers, a company can reach a much larger range of customers. This grants companies the potential to attain more sales and greater brand recognition.

5 PRODUCT LINE PRICING STRATEGIES

Here are five pricing strategies that companies or stores often use in conjunction with product line pricing:

1. Domino effect pricing

Domino effect pricing is a strategy within product line pricing in which the dollar amount for an item, or the price attributed to the baseline model, affects the potential pricing of products and upgrades for higher tier purchases.

If a company wants to make more money on its high-end products, then it can make slight increases in the cost associated with its lower-tier products. Customers or potential buyers within the higher-tier market are likely to expect a certain price difference between the two product lines. Therefore, companies can raise the price of higher-tier items without losing customers or other negative consequences.

Related: 7 Common Pricing Models

2. Captive pricing

Captive pricing is a product line pricing strategy that involves attracting and securing customers using an enticing baseline product. The baseline usually has an attractive low price, and it encourages current customers to buy add-ons or additional complimentary items. The additional items should relate to the functionality or improvement of the original product and may make the customer feel good about their buying decision.

Related: What Is Captive Product Pricing? Definition and Examples

3. Bundle pricing

Bundle pricing is a strategy of product line pricing in which a company or retailer bundles or packages multiple related items together. The items in the bundle or package usually have a lower total price than if they were all sold separately. This system encourages customers to buy more items than they normally would. This simultaneously raises the total sale price for each transaction and encourages a buyer to feel as if they have spent less money than they might have if the company didn't offer them the package or bundle.

4. Leader pricing

Leader pricing is an element within product line pricing in which a company claims to be the leading supplier of an item for the lowest dollar amount. Sometimes, this claim is a part of the overall business model, or a company may offer this low price as a part of a sale or temporary discount. This strategy can generate high levels of in-store or online traffic, in which the expectation is the company makes more profits when customers make additional, unplanned or impulse purchases.

5. Bait pricing

Bait pricing is a strategy that's similar to leader pricing, in that a retailer offers a significant price reduction on an item to drive traffic to retail stores. This strategy differs in the length of availability and buying intention. Companies offer bait pricing for a limited time, and there's usually a limited supply of the advertised item.

Also, while leader pricing relies heavily on the hope of a consumer purchasing additional items, bait pricing relies on a salesperson's ability to entice a customer to purchase a different item than the one they originally intended. This item is usually similar to the advertised item, but costs more and has more features or represents a significant upgrade from the original product.

Examples of product line pricing

<u>Here are some product line pricing examples:</u>

Mobile phones

Most mobile phone companies take advantage of product line pricing, in that they offer baseline models with an additional two or three higher-tier models with each mobile phone that the company releases. For example, baseline models may have basic storage capabilities and features. Whereas higher-priced or elite models may have double the storage, more advanced cameras and features like wireless charging or high-speed gaming or streaming capabilities.

Additionally, as the mobile phone industry is heavily reliant on ever-changing technology, these models typically upgrade every year or every two years, which adds to the product line pricing model. These companies also take advantage of accessories and additional items that promote ease in captive pricing and bundle pricing.

Related: 13 Examples of Penetration Pricing In Different Industries

Automobiles

The automotive industry regularly uses product line pricing in that they develop a minimum of three product tiers with unique style, functionality and technological upgrades for each. For example, a baseline model of a car may have fabric seats, manual transmissions and other manual features, whereas higher-tier models may include luxury textiles, heated seats, voice navigation and other upgraded features.

More expensive products often feature larger cargo space and automated features like parking assistance, backup cameras and anti-lock brakes. By offering a multi-tier product line, automobile makers can sell their products to a wide variety of buyers in different markets.

Retail shopping

Product line pricing is also common in other retail shopping scenarios. This pricing strategy is particularly popular in retail clothing stores. Companies sometimes offer multi-level products within one store, and other times they create multiple brands or stores to market and sell their varied item types.

Within each tier, the textiles, intended durability and design features regularly vary. Product line pricing in retail clothing stores expands the market reach and is particularly successful in expanding a customer base and increasing brand recognition. Additionally, product line pricing in this industry often benefits from domino effect pricing and leader pricing.

DISCOUNT AND REBATE

Discount and rebate are commonly used terms in today's dynamic markets, especially in the e-commerce world. Rebates and discounts are distinct forms of price cuts that directly or indirectly promote the overall sales of a business. Both the terms may sound similar, however, there is some difference between discount and rebate. applied.

Rebate – It is provided by a seller to the buyer for reasons such as; **inferior quality of goods, inaccurate quantity, missing buyer-specific features in the final product, delayed supply, etc.** Unlike, a **trade discount** that is provided mainly for high quantity buying, a rebate is for reasons which help a supplier to provide healing touch in a situation that is unfavourable during the process of selling.

Example of Rebate – Goods worth 10,000 were sold by Unreal Corp. to ABC Corp. but some of the goods were of poor quality, therefore, after a mutual agreement Unreal Corp. allowed a rebate of 1,000 i.e. 10%.

Discount – A seller grants it to the buyer in two distinct forms; trade discount and **cash discount**. It may be **allowed out of the selling price** (also known as maximum retail price or catalogue price) or **as a reduction from the net amount** payable.

Trade Discount – It encourages large quantity buying and is mostly provided to resellers.

Cash Discount – it is provided to encourage early payment. This helps the seller to maintain cash flow and healthy **working capital**.

Example of Discount – Goods worth 10,000 were sold by Unreal Corp. to ABC Corp. @10% discount each. Cash discount allowed @5% if payment is made within 15 days. This means a trade discount of 10% and an additional 5% discount if the payment is made within 15 days of the sale.

Type of Reduction	Main Reasons
Discount	It is given to encourage high volume buying, prompt payment, etc.
Rebate	It is offered for reasons such as inferior quality, delayed delivery, etc.

Difference Between Discount and Rebate (Table Format)

	Discount	**Rebate**
Definition	Discount is the reduction offered by a seller to the buyer from the purchase price of goods or services.	Rebate is refund or return of currency value that a seller of goods provides to the buyer for various different reasons.
Reasons	To promote high quantity purchases, receive timely payments, and increased sales.	For various reasons which are unfavourable during the purchase cycle, such as; poor quality, delay in delivery, etc.
Type of Transaction	Trade discount is offered both on cash and credit sale, however, cash discount is only offered on a prompt payment.	Rebate is allowed on both cash and credit sales.
Impact on Invoice	Trade discount is reduced from the original value even before the invoice is generated. Cash discount, on the other hand, is reduced from the final invoice value.	The amount of rebate does not affect the original invoice as the adjustment is made post-sale. The effect is shown in trading account & the income statement.
Recording in book of accounts	In case of a trade discount, it is not shown in the books of accounts whereas a cash discount is recorded in the income statement as an expense.	It is shown separately in the financial statements as it is provided after the sale has already been recorded.
Timing	It is applied at the time of occurrence of an event i.e. before the sale or purchase has been completed.	It is used after an event has been recorded i.e. post the sale or purchase has been completed.

	Discount	Rebate
Consideration	Trade discount is provided considering the quantity bought. Cash discount is provided considering the time of payment.	Rebate is provided considering all the reasons for which a trade discount or cash discount is not offered.

Refund Vs Rebate: The terms 'refund' and 'rebate' are sometimes used synonymously. However, one important thing to keep in mind is the fact that where a refund is usually provided in full, a rebate is generally provided in part.

Examples of Rebate and Discount

Rebate

ABC brand has been in the mobile business for a few years. The company has come up with a new marketing strategy for a particular model X that is already popular in the market.

Reason for Rebate	Delayed deliveries of mobile sets of the X model
Price of 1 set	10,000
Refund offered	10% of the phone price
Eligible Customers	Each customer that has received the phone later than 1 month after ordering it
Required Steps	Register themselves on the company website, fill out a survey, and verify their purchase of the X model.
Additional offer	These customers can also qualify for 10% off on ABC earphones which are not that successful in the market.
Actual Cost to customers	9,000

The above strategy will be termed a rebate. This is a well-known sales promotion strategy and hits the demand side of any product. It is identifiable with characteristics like a refund of some amount, the transaction taking place after some time of the actual sale, and the customers required to do something extra in order to claim the rebate.

Discount :

XYZ is a supermarket. It is facing low demand for breakfast items due to the pandemic situation. It comes up with a simple marketing strategy.

Discount Offers	10% off on all ready-to-eat breakfast items , 5% off on all breakfast cereals
Eligible Customers	All customers who buy the qualifying items and the required quantity
Actual Cost to customers	The discount will be a reduction in the total bill amount and the buyer will have to pay less at the check-out
Example	A customer will pay 900 for an item worth 1,000 and 950 for a breakfast cereal priced at 1,000

The above strategy is a simple trade discount strategy. It is still better to clear the inventory at lower prices than to risk the quality of perishable goods. The identifiable features of a discount can be easily seen such as all customers equally qualify for it, benefits are received at the time of purchase, and the discount is reducing the bill amount.