Introduction to Marketing Essentials
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Lecture – 26
Pricing Products and Services – II

Welcome to Introduction to Marketing Essentials. Now, we will talk about module 26. Now, as you as shown in this slide, the module 25 and 26 are dedicated to understanding Pricing of Products and Services. We have talked about module 25, now let us see, what are the things that will be covered in module 26.

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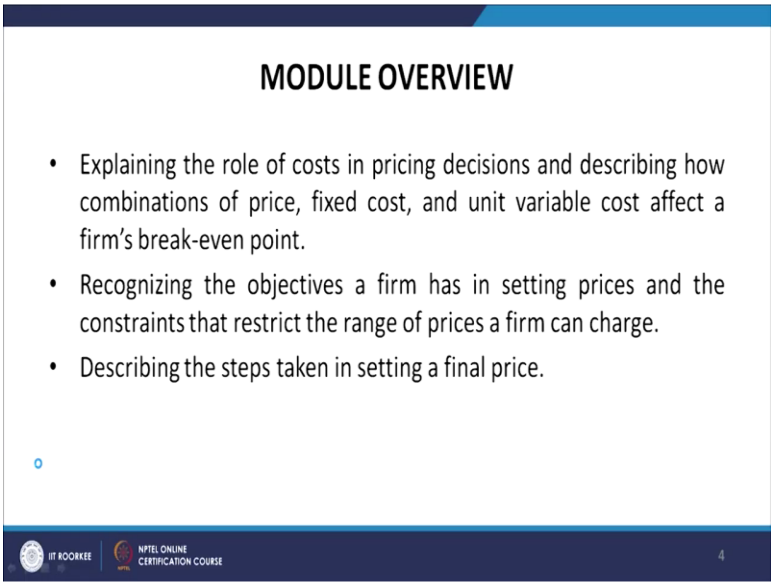

In this module, we will explain the role of cost in pricing decisions and describing how combination of price, fixed cost, and unit variable cost affect a firms breakeven point.

Then we will also try to recognize the objectives of a firm in setting prices and the constraints that restrict the range of prices a firm can charge. And then we will describe the steps taken in setting a final price.

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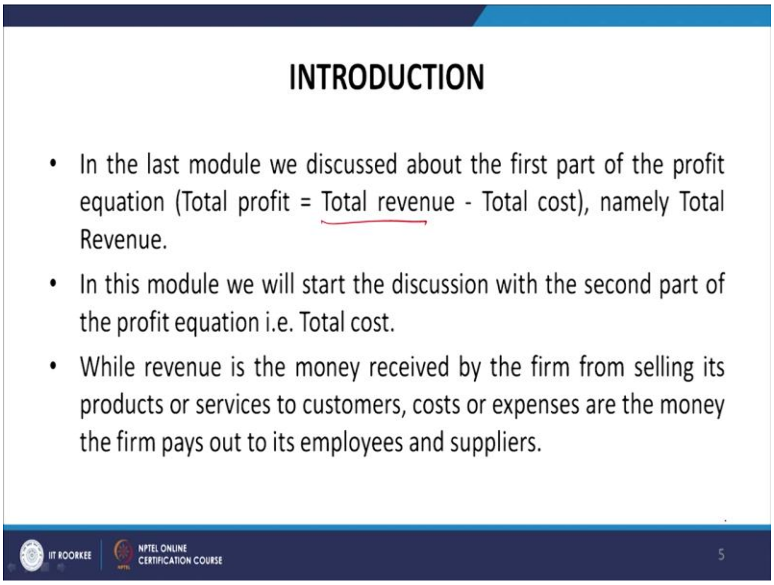

So, these are the three things that we will talk about in this module. So, to start with, in the last module we have discussed about the first part of profit equation; that is total profit is equal to total revenues minus total cost, so that is called as the total revenue.

In this module we will start the discussion with the second part of the profit equation that is the total cost. So, we will we have talked about total revenues, now we will talk about the total cost.

While revenue is the money received by the firm from selling its product or services to customers, costs or expenses are the money the firm pay out to its employees and suppliers and lots of other entities and people involved in production of these goods and services.

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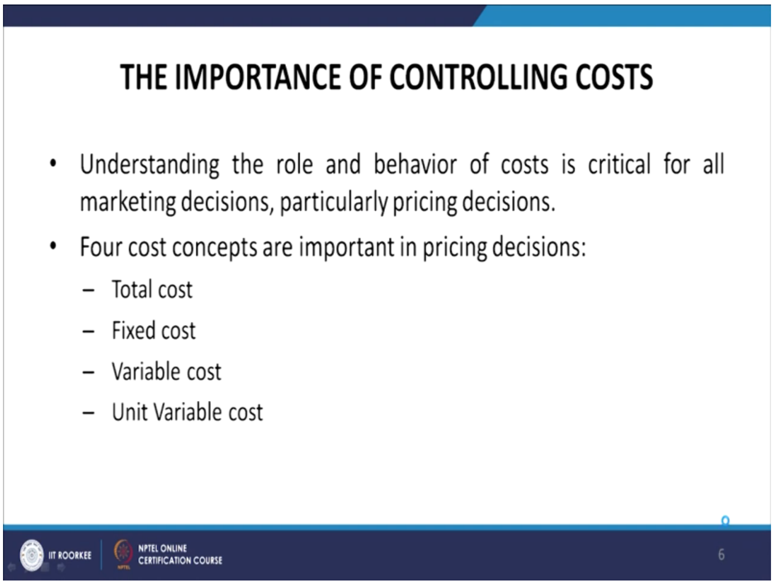

Now, it is very important to control the cost, because that is now when we have already fixed the total revenues, if that cost is not controlled then your profit decreases. So, it is important to control the cost.

Understanding the role and behavior of cost is critical for all marketing decisions, particularly the pricing decisions. Now, there are four cost concepts that are important in pricing decisions; one is the total cost, the second is fixed cost, the third is variable cost, and the fourth is unit variable cost.

Now, let us look at what is this total cost? So, the total cost is the total expense incurred by a firm in producing and marketing a product. The total cost is the sum of fixed cost and variable cost.

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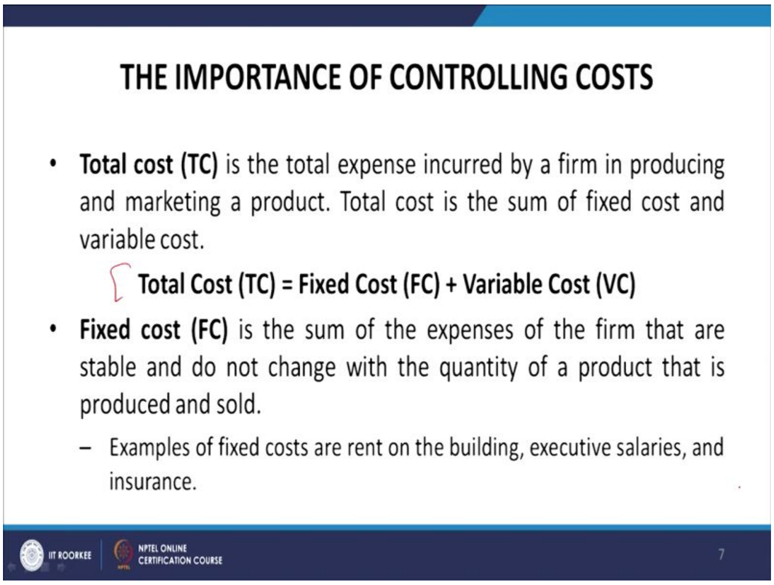

So, this is the equation that represents the total cost. So, the total cost that is TC is equal to the fixed cost that is FC plus variable cost that is VC. Now, let us look at what is this fixed cost?

So, fixed cost is the sum of the expenses of the firm that are stable and do not change with the quantity of a product that is produced and sold. For example, fixed cost are the rent of the building that you have taken for production; executive salaries; and insurance that goes.

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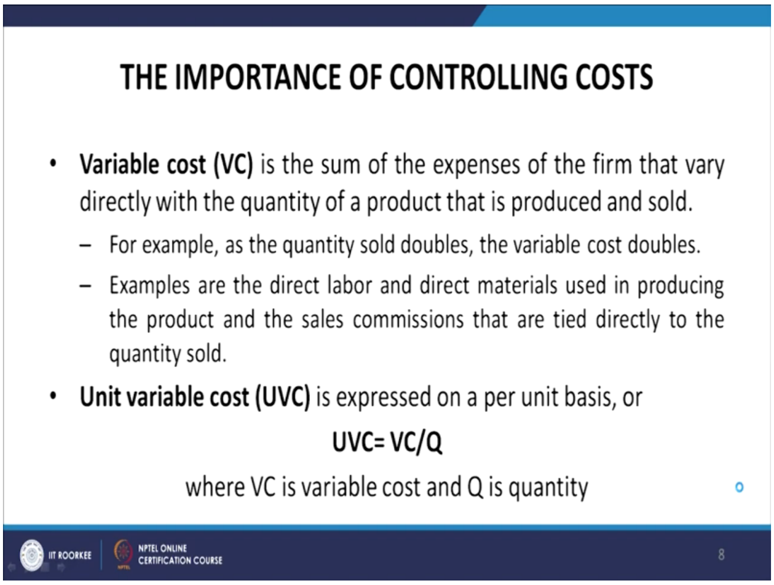

Next is the variable cost that is the VC; is the sum of the expenses of the firm that vary directly with the quantity of a product that is produced and sold. For example, as the quantity sold doubles, the variable cost will also double. Although, the fixed cost will remain the same.

So, examples are the direct label; the examples are the direct labor and the direct material used in producing the product and the sales commission that are tied directly to the unit sold. So, the sale sales commission per unit sold will remain the same, but when they sell more units, so that total sales commission goes up.

Now, let us look at what is this unit variable cost that is UVC? It is expressed on a per unit basis, or UVC is equal to variable cost upon quantity. So, where VC is the variable cost and Q is quantity, so that is VC upon Q.

Now, many firms, they go bankrupt because their costs get out of control causing their total cost to exceed their total revenues over an extended period of time. So, that leads to wiping out all the profits that the firm may have earned earlier.

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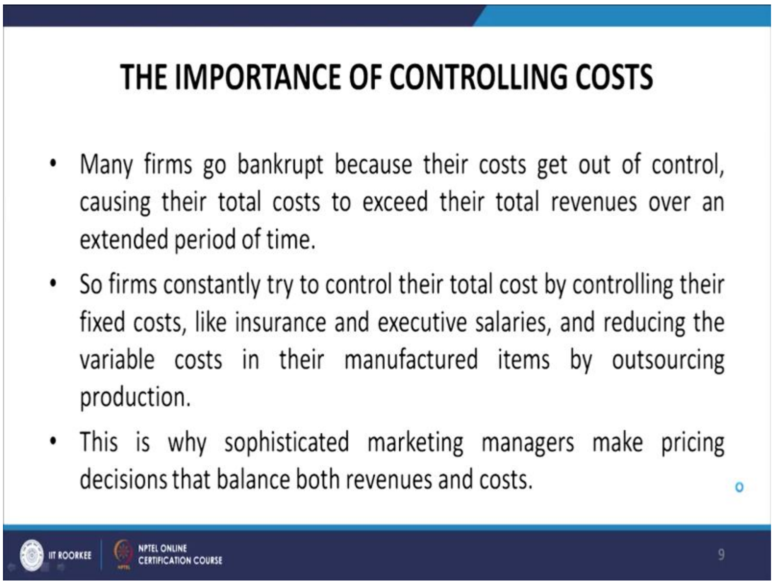

So, firms constantly try to control their total cost by controlling their fixed cost, like insurance and executive salaries, and reducing the variable cost in their manufactured items by outsourcing production. This is why sophisticated marketing managers make pricing decisions that balance both revenues and costs.

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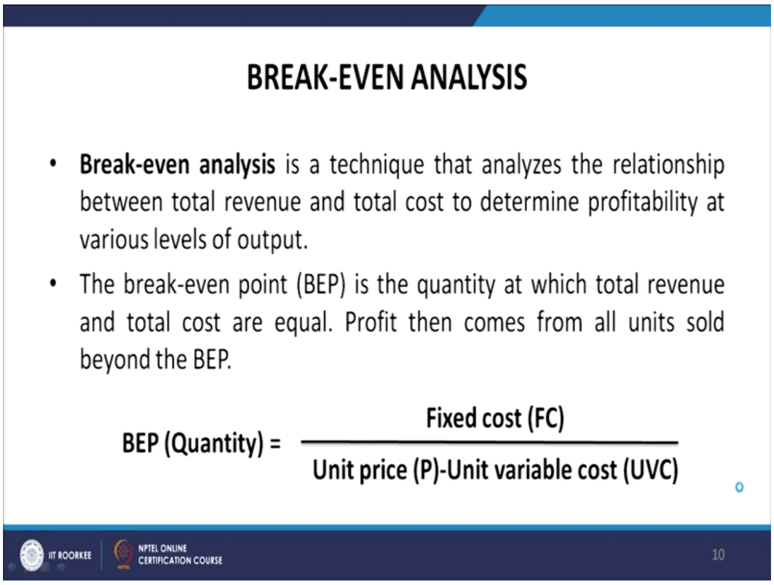

Now, let us look at this; what is this break even analysis? This break even analysis is a technique that analyzes the relationship between total revenues and total cost to determine profitability at various levels of output.

This BE, this breakeven point is also called as BEP, is the quantity at which total revenues and total cost are equal. Profit then comes from all unit sold beyond the BEP. So, at this breakeven points, the profits the costs are equal to the earnings and we earn that then the company starts earning profits.

So, BEQ that is the quantity at which this breakeven happens is equal to the fixed cost upon unit prices minus unit variable cost.

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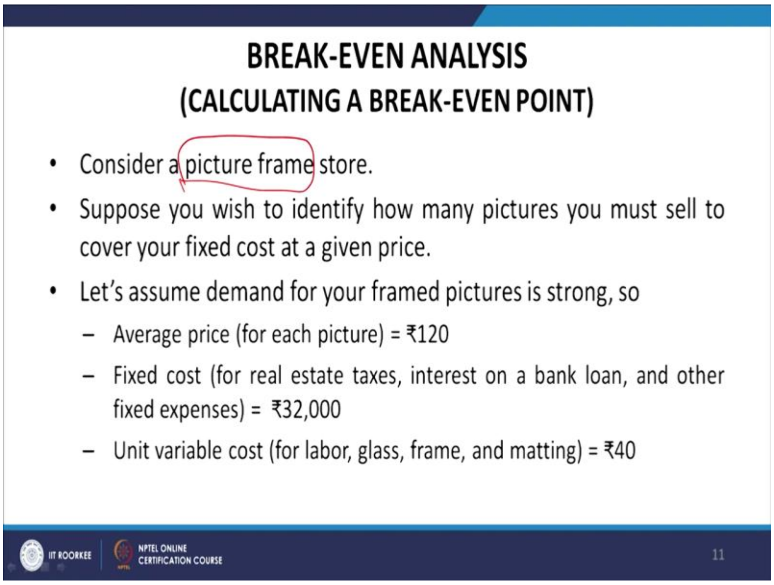

How do we go about calculating a breakeven point? So, consider a picture frame store. So, we are talking of a store that makes picture frames and fixes picture frames. Suppose you wish to identify how many pictures you must sell to cover your fixed cost at a given price.

Let us assume, demand for your framed pictures is strong, so average price for each picture is rupees 120. The fixed cost that is for real estate taxes, interest on the bank loan, and other fixed expenses is equal to rupees 32,000. Now unit variable cost for labor, glass, frame, and matting is rupees 40.

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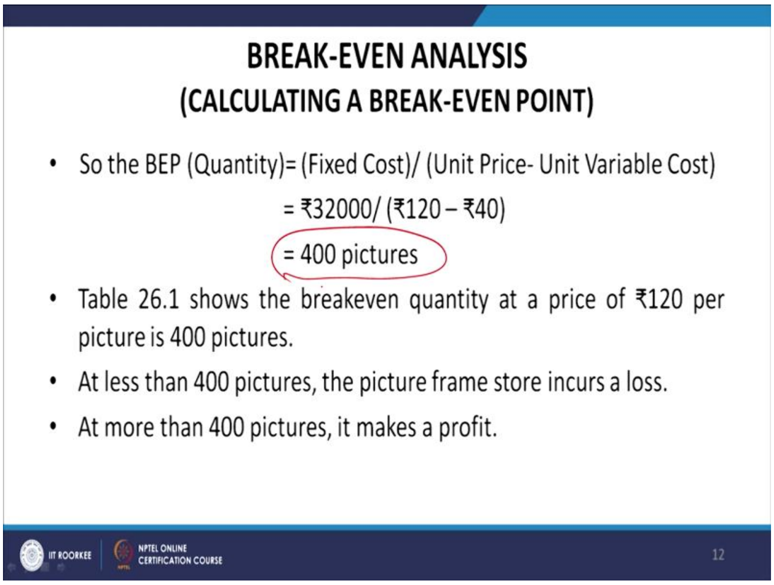

So, now, let us look at this BEQ, that it is equal that is equal to the fixed cost upon unit price minus unit variable cost. So, that is rupees 32,000 upon rupees 120 minus rupees 40. So, that is that comes to 400.

This table 26.1, shows the breakeven quantity at the price of rupees 120 picture is rupees is 400 pictures. Less than 400 pictures, the picture frame store incurs a loss. More than 400 pictures, it makes a profit. So now, then on in this table it shows the breakeven point.

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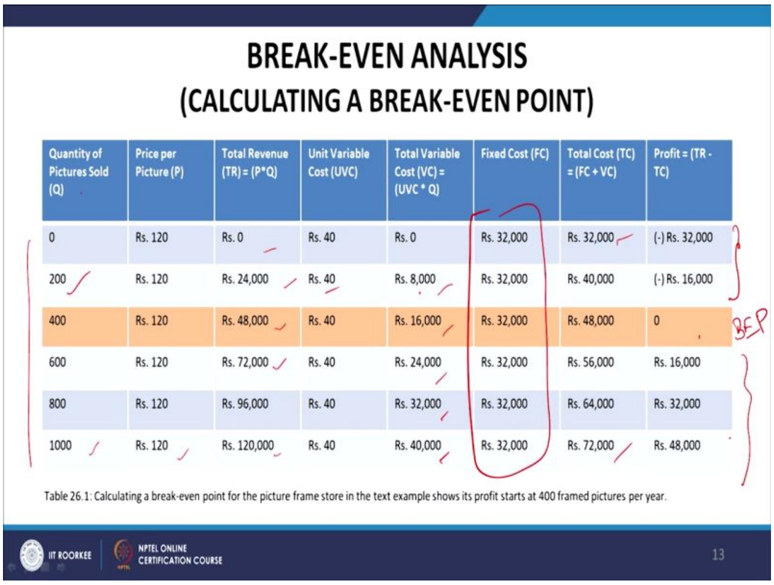

Quantity of Pictures Sold (Q)	Price per Picture (P)	Total Revenue (TR) = (P*Q)	Unit Variable Cost (UVC)	Total Variable Cost (VC) = (UVC * Q)	Fixed Cost (FC)	Total Cost (TC) = (FC + VC)	Profit = (TR - TC)
0	Rs. 120	Rs. 0	Rs. 40	Rs. 0	Rs. 32,000	Rs. 32,000	(-) Rs. 32,000
200	Rs. 120	Rs. 24,000	Rs. 40	Rs. 8,000	Rs. 32,000	Rs. 40,000	(-) Rs. 16,000
400	Rs. 120	Rs. 48,000	Rs. 40	Rs. 16,000	Rs. 32,000	Rs. 48,000	0
600	Rs. 120	Rs. 72,000	Rs. 40	Rs. 24,000	Rs. 32,000	Rs. 56,000	Rs. 16,000
800	Rs. 120	Rs. 96,000	Rs. 40	Rs. 32,000	Rs. 32,000	Rs. 64,000	Rs. 32,000
1000	Rs. 120	Rs. 120,000	Rs. 40	Rs. 40,000	Rs. 32,000	Rs. 72,000	Rs. 48,000

Table 26.1: Calculating a break-even point for the picture frame store in the text example shows its profit starts at 400 framed pictures per year.

So, here it is the quantity of picture sold. It varies from 0 to 1,000. The price per picture remain the same, that is rupees 120 and the total revenues that is TR is equal to P into Q. So, because 0 0 quantity of picture were sold into 120, so the total revenue is 0. Then 20 into 120 it is 24,000; 40 into 120 it is 48,000; 600 into 120 is 72,000; 1,000 into 120 is 1,20,000. The unit variable cost remains the same that is rupees 40 all through.

The total variable cost that is UVC into quantity is again 8,000; 16,000; 24,000; and 22,000; 32,000 and 40,000. The fixed cost is the same that is 32,000.

So, this total variable cost is 200 into 40, that is 8,000. The total cost, that is fixed cost and the variable cost is 32,000 to and it goes up to 72,000, and then the total profit in these two cases it is negative.

Here, it is the breakeven point; this yellow line. And then these are the profits that the store will earn for different quantity of pictures sold.

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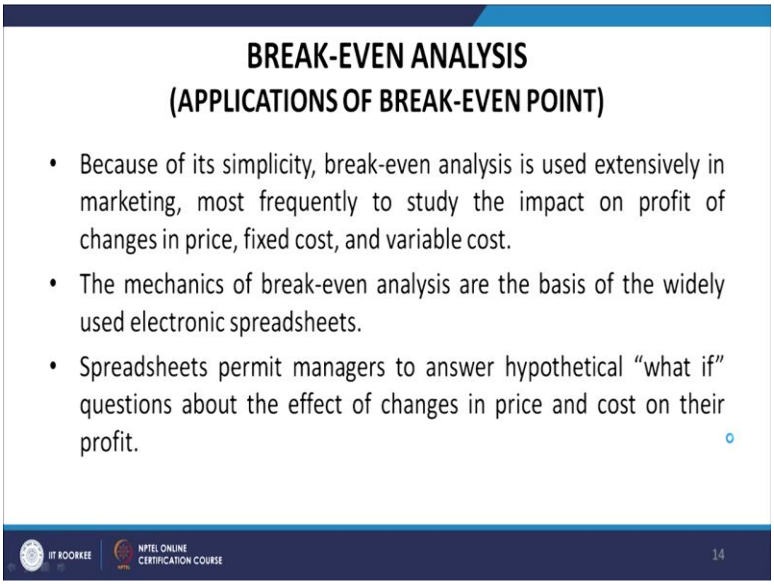

Now, how to understand? Now, we will understand the applications of breakeven point. Because of its simplicity, breakeven analysis is used extensively in marketing, most frequently to understand the impact on profit of changes in price, fixed cost, and variable cost.

The mechanism or the mechanics of breakeven analysis are the basis of a widely used electronic spreadsheets.

Spreadsheets permit managers to answer hypothetical what if questions about the effect of changes in price and cost on their profits.

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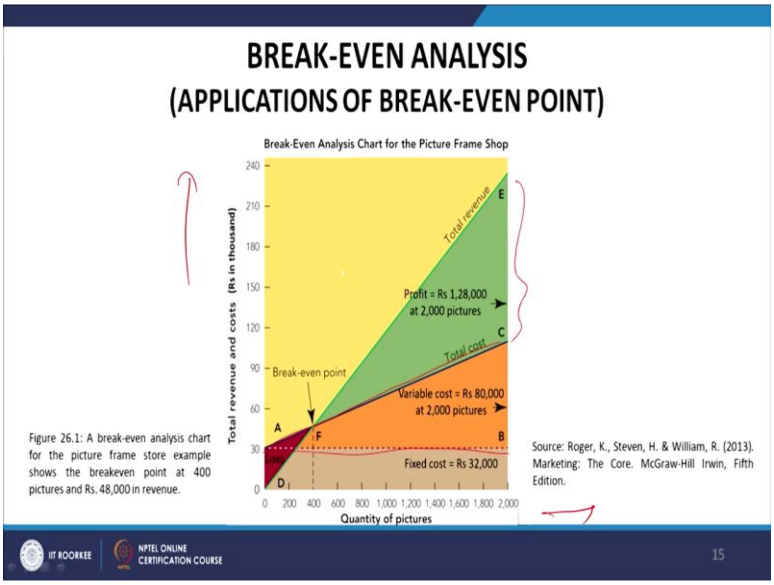

Now, this is the graph that shows the application of breakeven point. So, the breakeven even analysis chart for the picture frame store, example shows the breakeven point at rupee at 400 pictures and a rupees 48,000 revenues. So, now, you see that on this axis, we have the quantity of pictures and on the y axis we have the total revenues and the cost.

So, the quantity of picture will sold will be will depend upon the demand, while the total revenue cost will depend upon the number of pictures sold. Now, if it is this line, that is a fixed cost is rupees 32,000. Then again here, it is in this yellow line that is the total cost. This F is the breakeven point and here, it is the total revenues and here this is the profit is equal to 1,28,000 at 2,000 pictures. So, that this is the maximum profit.

Now, let us look at the pricing objectives and the various constraints related to pricing. With such a variety of alternative pricing strategies available, a marketing manager must consider the pricing objectives and constraints that will narrow the range of choices. While pricing objectives frequently reflect corporate goals. Pricing constraints often relate to conditions existing in the market place.

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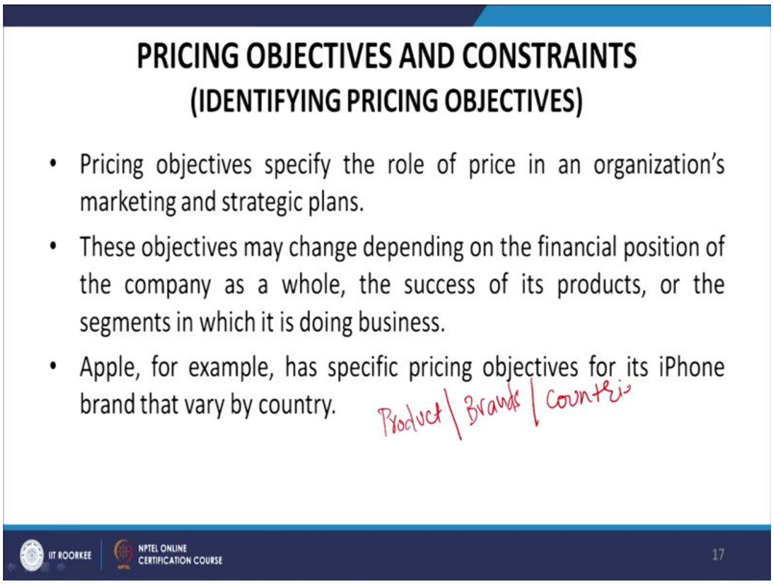

So, let us first start with identifying the pricing objectives. So, pricing objectives specify the role of price in an organization's marketing and strategic plans. These objectives may change depending on the financial position of the company as a whole, the success of its products, or the segments in which it is doing business.

Apple, for example, has a specific pricing objectives for its iPhone brand that vary by country. So, the company may have different pricing objectives for the different products, for the different brands, and for different countries.

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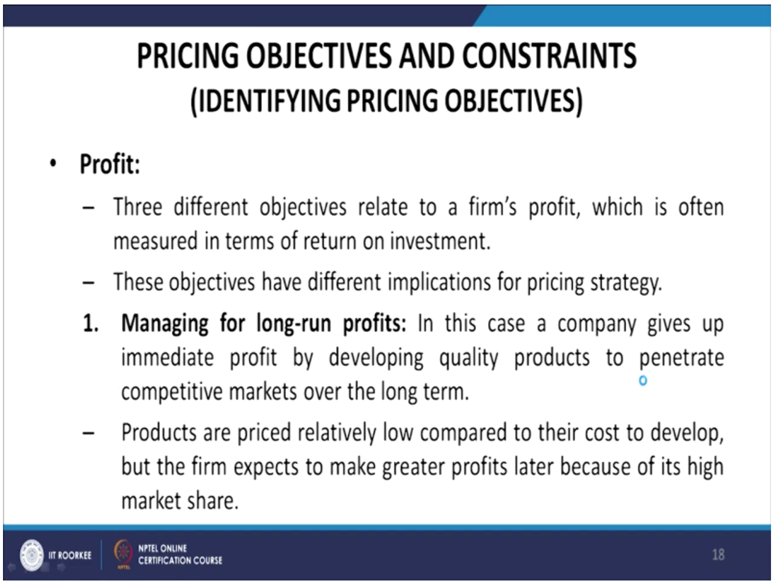

Now, let us look at the profits. Three different objective relates to a firm's profit, which is often measured in terms of return on investments. These objectives have different implication for pricing strategy.

So, the first is, managing for long run profits. So, that is the first objective of pricing. In this case, a company gives up immediate profits by developing quality products to penetrate competitive markets over the long term. Products are priced relatively low compared to their cost to develop, but the firms expects to make greater profits later, because of its high market share.

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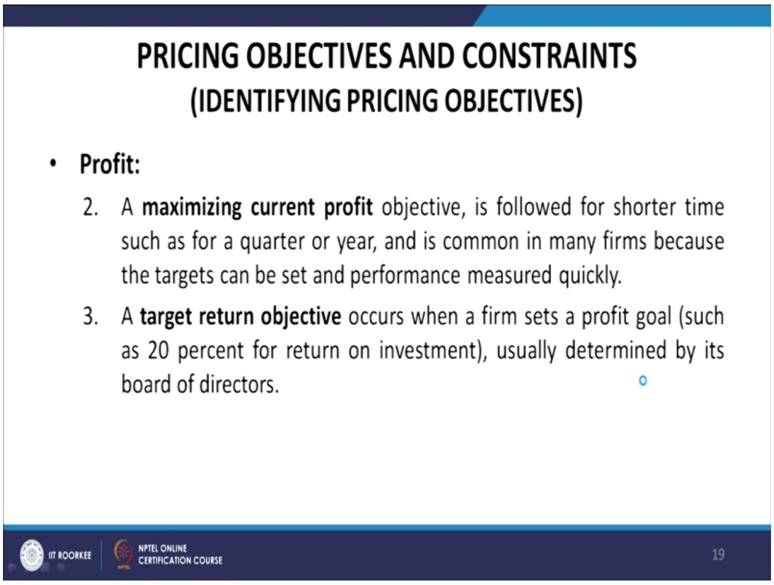

The second is, a maximizing current profit objective, is followed for shorter time, such as for a quarter or year, and is common in many firms because the targets can be set and performed and performance measured quickly.

The third is the target return objectives that occurs when a firm sets a profit goal, such as 20 percent of return on investment, usually determined by its board of directors. Now, these three profit objectives have different implications for a firm pricing decisions.

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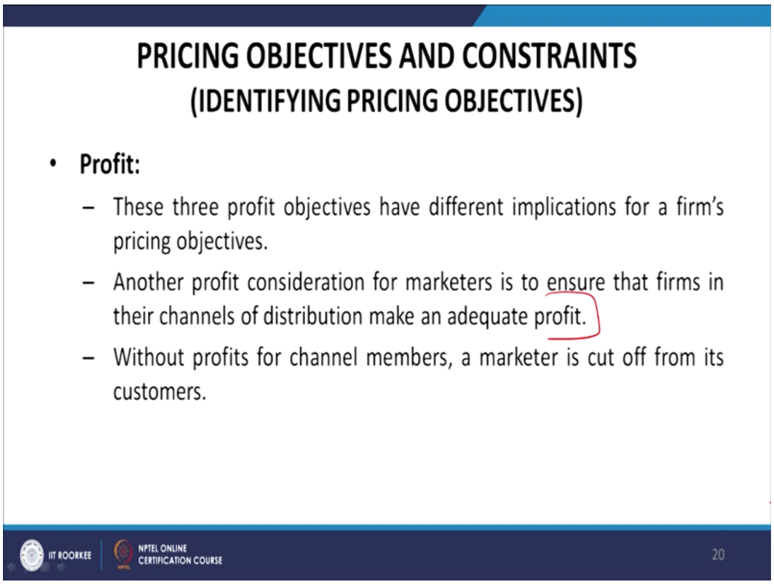

Another profit consideration for marketer is to ensure that firms in their channels of distribution make an adequate profits. So, that is also important, that their channel partners they are also making sufficient profit, otherwise they will stop carrying your product and brands and shift to other products or brands.

Without profit for channel members, a marketer is cut off from its customers, because these channel members are the link between the manufacturer and the customer.

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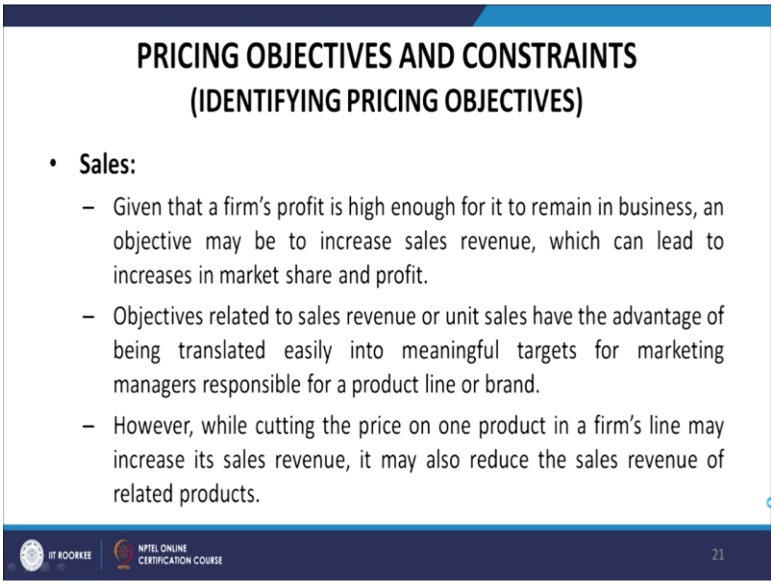

Now, let us look at the sales. Given that a firm's profit is high enough for its, given that the firm's profit is high enough for it to remain in business, an objective may be to increase sales revenues, which can lead to increase in market share and profits.

Objectives related to sales revenues or unit sales have the advantage of being translated easily into meaningful targets for marketing managers responsible for a product line or brand.

However, while cutting the price of one product in a firm's product line may increase the sales revenues. It may also reduce the sales revenues of related products. Another important thing to look at, here is the market share.

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So, market share is the ratio of the firm's sales revenues or unit sales to those of the industry, that is competitors plus the firms itself. Firms often pursue a market share objective when industry sales are relatively flat or declining.

Although increased market share is a primary goal of some firms, others sees it as a means to other ends; increasing sales and profits.

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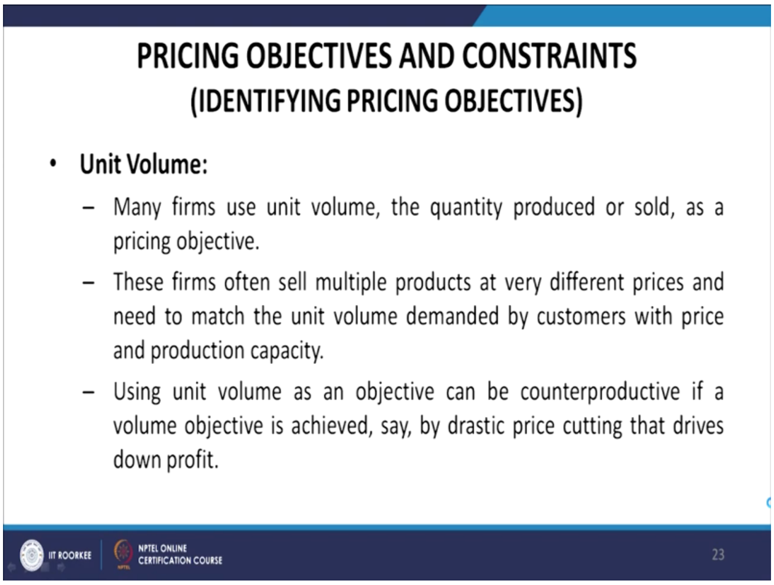

Now, now we will look at this unit volume. Many firms use unit volume, that is the quantity produced or sold, as a pricing objective. These firms often sell multiple products at very different prices and need to match the unit volume demanded by customers with price and production capacity.

Using unit volume as an objective can be counterproductive if a volume objective is achieved, say, by drastic price cutting that drives down profits.

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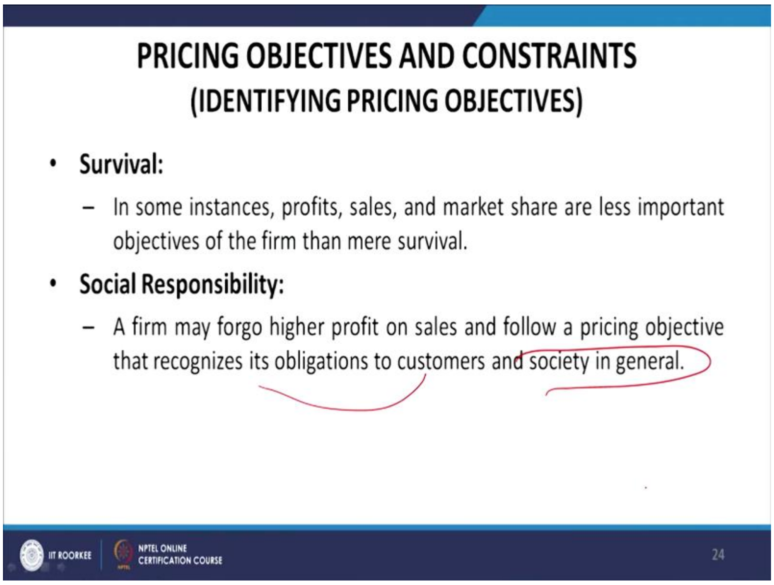

Another pricing objective can be survival. In some instances, profits, sales, and market share are less important objective for the firm then mere survival. Another pricing objective can be that of social responsibility.

A firm may forgo higher profits on sales and follow a pricing objective that recognizes its obligation to customers and society in general. So, here the firm is more worried about their obligation to the customer and society and not and they are not just concerned about the sales and the profits.

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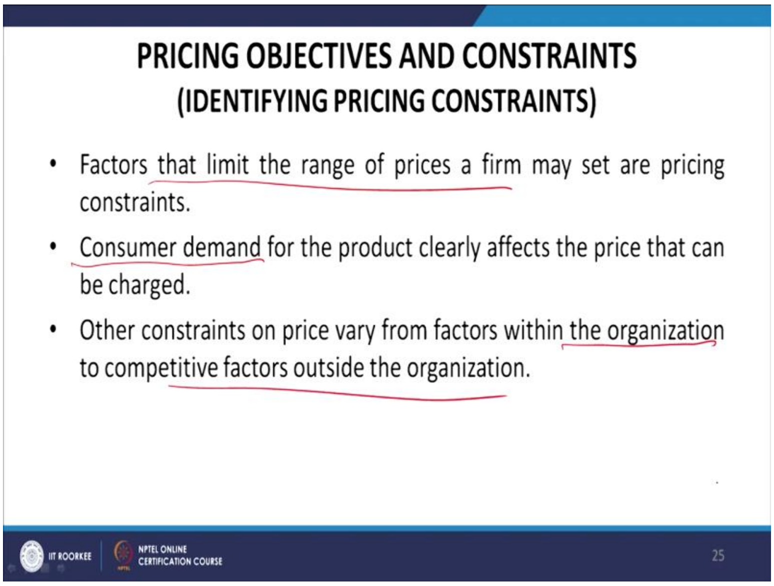

Now, let us try to identify some pricing constraints. So, factors that limit the range of prices a firm may set are called as pricing constraints. So, these are the factors that will affect whether the firm or the range of prices that a firm can set, so set, so these are called as the pricing constraints. Consumer demand for the product clearly affects the prices that can be charged.

So, one such constraint is the consumer demand, because if there is no demand then the company or the demand is very very less then the company will have to reduce the prices that we have seen in price quantity graph. Other constraints on prices vary from factors within the organization to competitive factors outside the organization.

So, there are several constraint that are from within the organizations and there are several constraint that are outside the organization.

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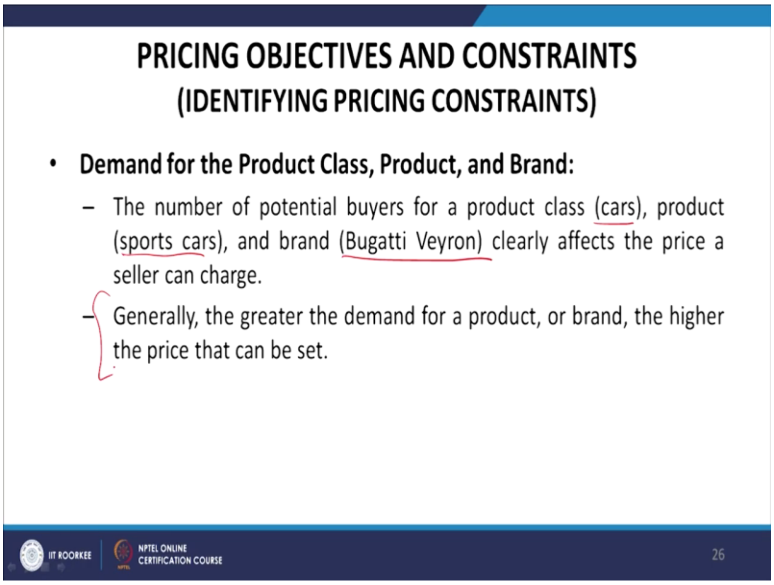

Now, demand for the product class, product and brand. The number of potential buyers for a product class, that is let us say cars;- products is, sports cars, and brand Bugatti Veyron, clearly affect the price a seller can charge. Generally, the greater the demand for a product, or brand, the higher prices that can be set.

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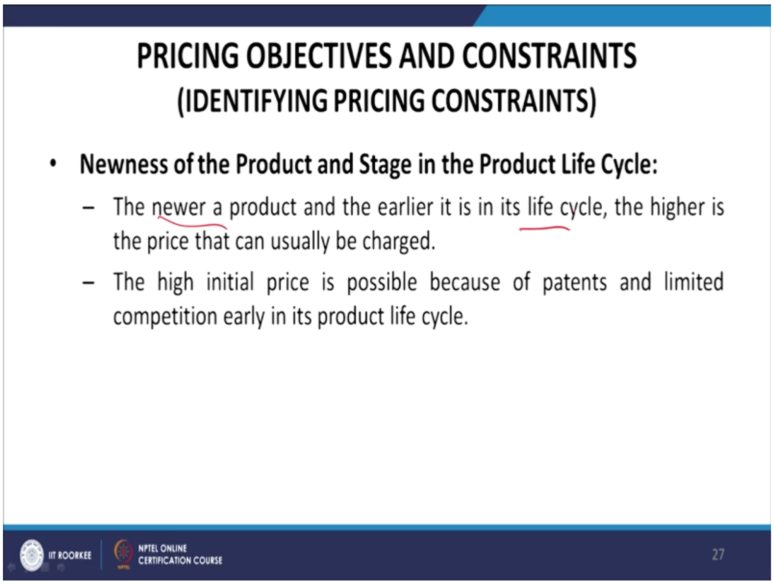

So, that is a rule of thumb. The more demand, the more prices. Another consideration is the newness of the product and stage in the product life cycle.

The newer a product and the earlier it is in its lifecycle, the higher is the price that can usually be charged. So, if it is a new product and in the introduction or the growth stage of the life cycle, then it is easier to charge the higher price.

The initial higher price is possible because of patents and limited competition early in its product life cycle. Later on as it move on to maturity and decline there are lots of competitors and therefore, the profits come down, and so the company has to reduce the prices also.

Now, cost of producing and marketing the product is another constraint. In the long run a firms price must cover all the costs of producing and marketing a product.

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If the price does not cover these costs, the firm will fail. So, in the long run a firm's cost set a floor under its prices. However, manufacturers have adopted aggressive pricing tactics, thus decreasing profit margins.

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Another constraint on pricing is the competitor's price. When apple introduced its iPad in 2010, it was not only unique, and in the introductory stage of its product life cycle, but also the first commercially successful tablet device sold. As a result, Apple had great latitude in setting a price.

Now, with a wide range of competition in tablets from Samsung Galaxy tab, and others, Apple's pricing latitude is less broad.

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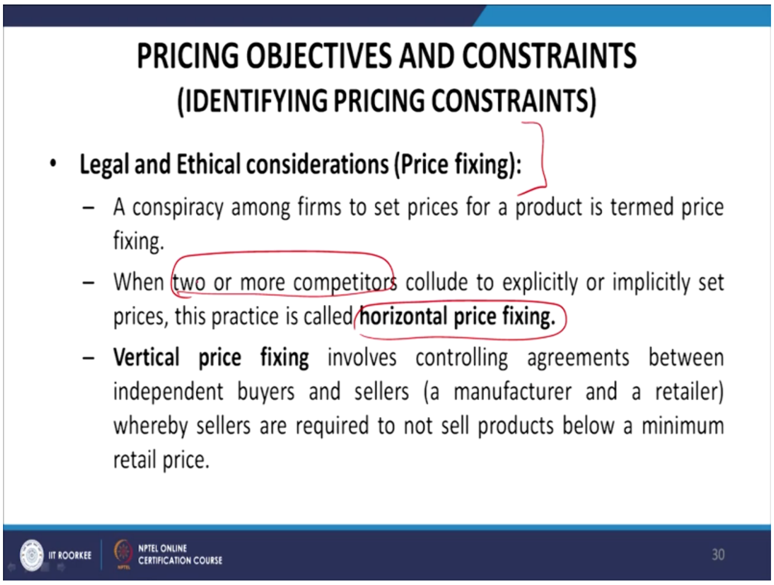

Then there are some legal and ethical consideration, related to pricing which are also called as price fixing. A conspiracy among firms to set price for a product is termed as price fixing. When two or more competitors collude to explicitly or implicitly set prices this practice is called as horizontal price fixing.

When there are two or more competitors they come together. Vertical price fixing involves controlling agreements between independent buyers and sellers, a manufacturer and a retailer, whereby sellers are required to not to not sell product below a minimum retail price.

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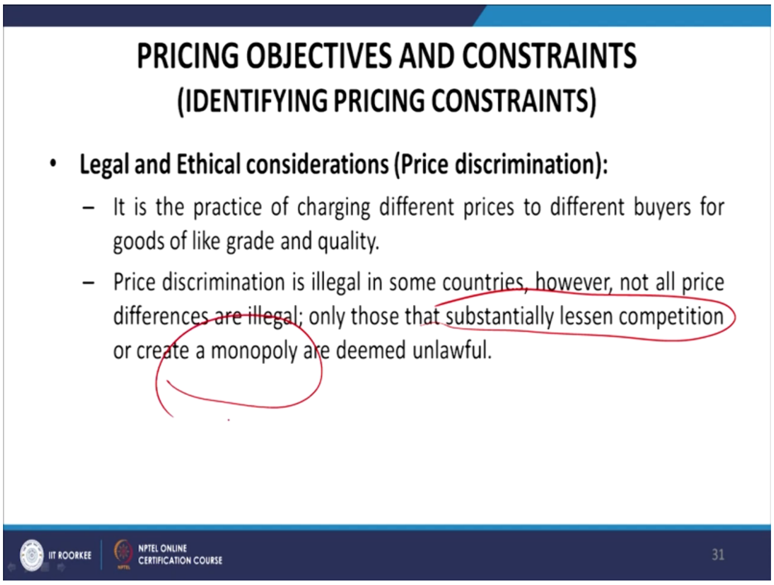

It is the practice of charging different prices to different buyers for goods of like grade and quality. Price discrimination is illegal in some countries; however, not all price differences are illegal; only those that substantially less in competition or create a monopoly are deemed to be unlawful.

So, till the time they are they are they do not reduce the competition or they do not create a monopoly, these price fixing they are not illegal. Then another legal and ethical consideration is deceptive pricing.

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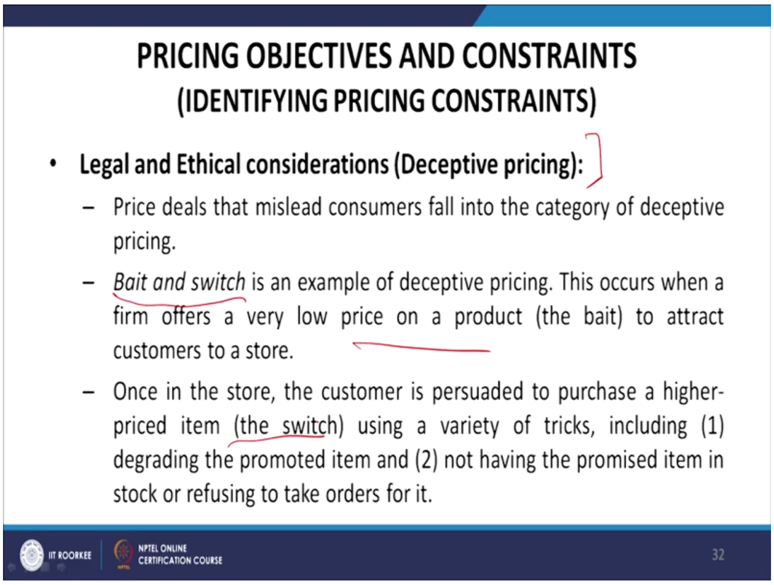

Price deals that mislead consumers fall into the category of deceptive pricing. Bait and switch is an example of deceptive pricing. This occurs when a firm offers a low price on a product that is the bait to attract customers to a store. So, this is another important constraint on pricing that is the deceptive price and this is bait and switch.

Once in the store, the customer is persuaded to purchase a higher priced item. So, he was shown a low price product so that he comes inside the store. Now, he is persuaded to purchase a higher priced item, that is called as the switch, using a variety of tricks including.

One degrading the promoted item, so the customer is told that that product with low prices is not good; it is not suitable for him. The second is not having the promised item in stock or refusing to take orders for it.

So, one is that you tell customers that this is not a good product and the second is that you tell the customers that they do not have that item in stock or you or the company just refuses to take orders for it. So, that is deceptive pricing.

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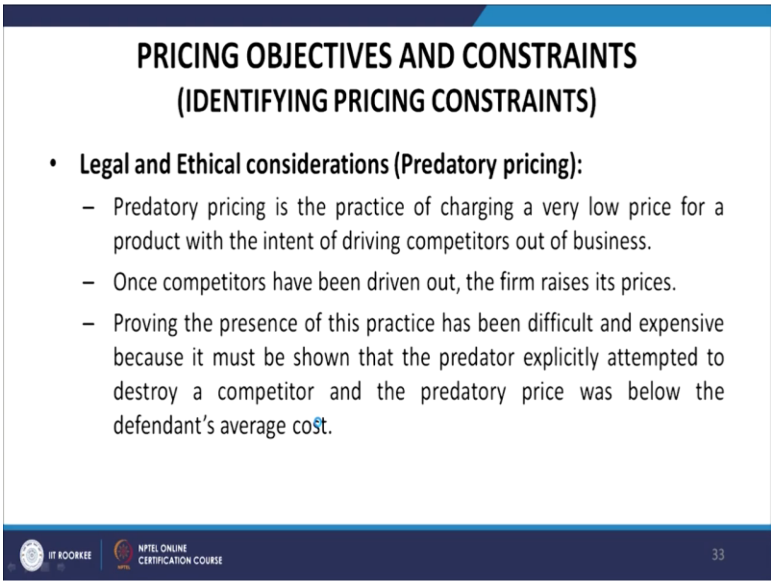

Another problem with pricing is that of predatory pricing. Predatory pricing is the practice of charging a very low price for a product with the intent of driving competition out of business. So, that is predatory pricing. So, the company charges so low prices that the competition is not able to sustain with those compete on those kinds of prices and they are wiped out.

Once, competitors have been driven out, the firm then start raising its prices. So, proving the presence of this practice has been difficult and expensive because it must be shown that the predator explicitly attempted to destroy a competitor and the predatory price was below the defendants average cost. So, now, how to go about proving that the predatory pricing is done?

So, that is slightly difficult, because now you have to show that the intent of company was to wipe out the competitor; one. Second, you have to also have to determine whether that price was below the average cost of producing that product for that company. So, in that case it becomes a predatory pricing.

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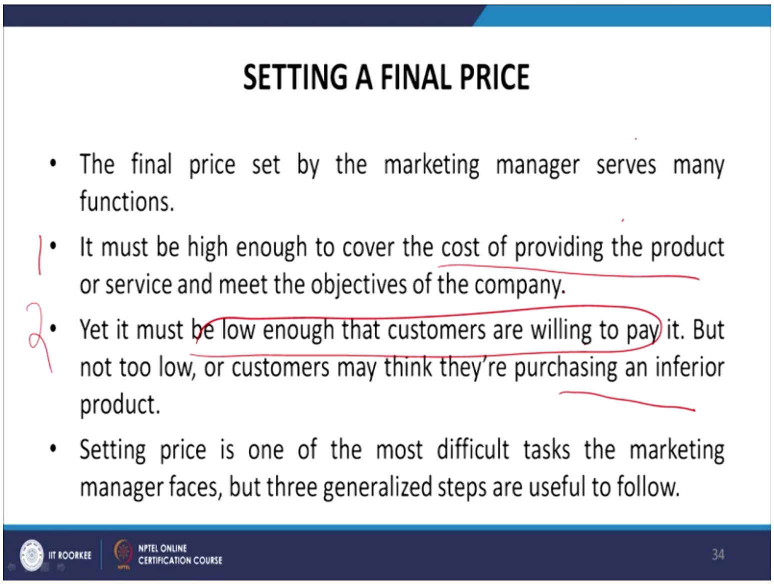

The next important thing that we will talk about, that how to go about setting a final price? The final price set by the marketing managers serves many functions. First is that it must be high enough to cover the cost of providing the product or service and meet the objective of the company.

So, that is the first important thing in setting a final price by the marketer that it should be high enough to cover the cost; one, but not only cost and also meet the objective of the company. Second is, it must be low enough that customers are willing to pay for it.

If it is not low enough, or the customers are not willing to pay the price then; obviously, your pricing is wrong. But not too low, or customers may think they are purchasing an inferior product.

So, one thing is that, the price should cover the cost. One, it should meet the objective of the company; two, it should be, so that customers are willing to pay for it. And it should also be, so that the customers do not think that they are buying a inferior product or service. Setting price is one of the most difficult tasks, the marketing managers faces.

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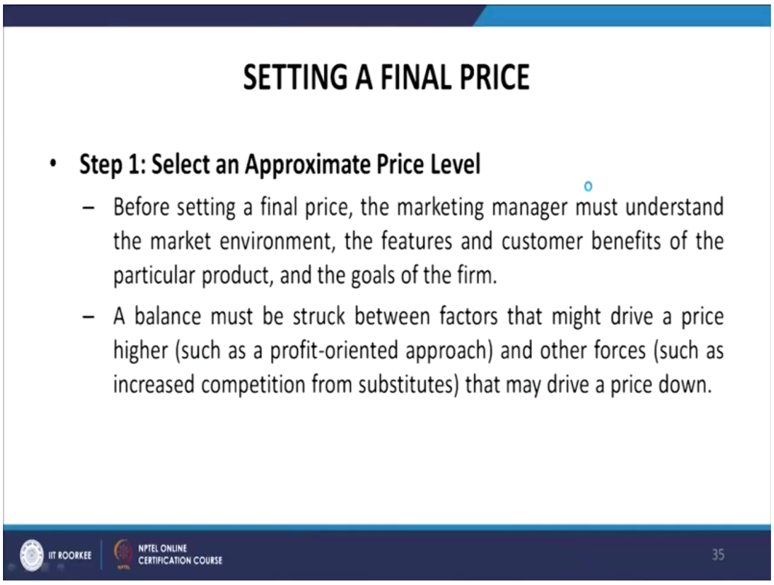

But, three generalized steps are useful to follow;- the first is select an approximate price level not a price point, but we are talking of approximate price level. Before setting a final price, the marketing managers must understand the marketing environment, the features and customer benefits of the particular product, and the goals of the firm.

The balance must be stuck between factors that might drive a price higher. Such as, the profit oriented approach, and other factors such as, increased competition from substitutes that may drive a price down.

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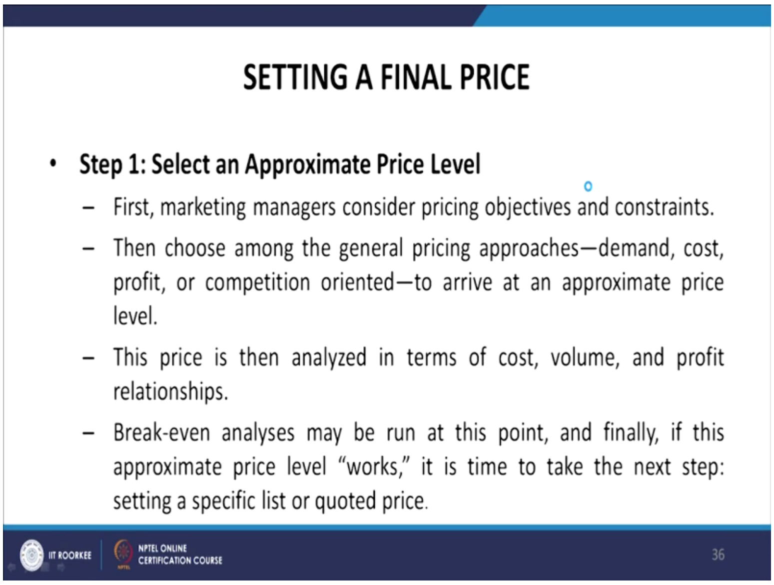

First, marketing managers consider pricing objectives and constraints. Then they choose amongst the general pricing approaches that is demand, cost, profit, or competition oriented- to arrive at an approximate price level.

This price is then analyzed in terms of cost, volume, and profit relationships. Break-even analysis may be run on this point, and finally, if this approximate price level works, it is time to take the next step; that is setting a specific list or quoted price.

So, this is the second step in this process of setting a final price, so and that is set the list or quoted price.

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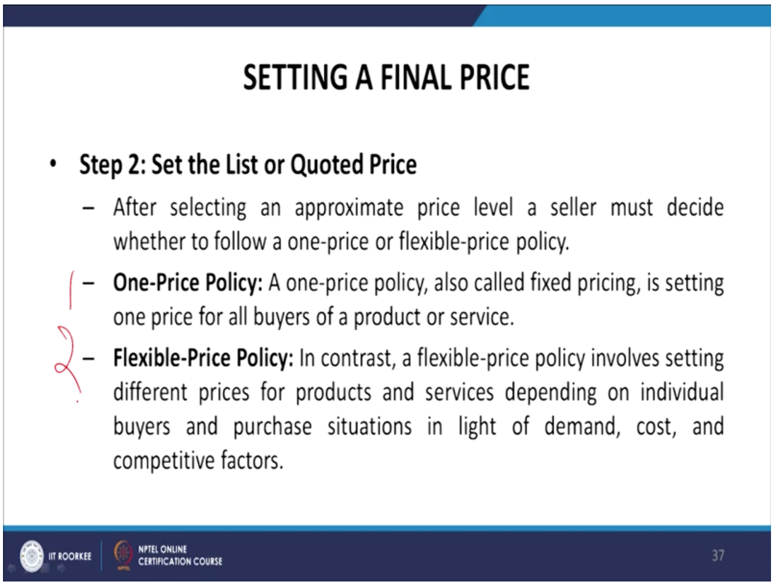

After selecting an approximate price level a seller must decide whether to follow a one price or flexible price policy. What are the different between these two? So, the first one is the one price policy; a one price policy also called as fixed price, is setting one price for all buyers of a product or service.

The second is flexible price policy. In contrast, a flexible price policy involves setting different prices for products and services depending on individual buyers and purchase situations in the light of demand, cost, and competitive factors.

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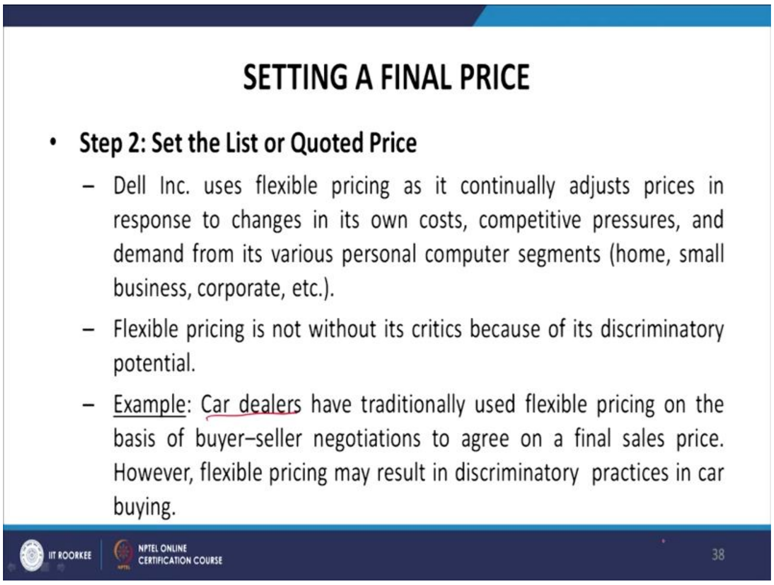

Dell incorporated, it uses flexible pricing as it is continually adjust prices in response to changes in its own costs, competitive pressures, and demand from its various personal computer segments and the various segments, that it sends to are home, a small businesses, and corporates. Flexible pricing is not without its critics because of its discriminatory potential.

For example; car dealers have traditionally used flexible pricing on the basis of buyer seller negotiations to agree on a final sales price. However, flexible pricing may result in discriminatory practices in car buying. So, now they have the car dealers, can charge higher from someone and lower from other.

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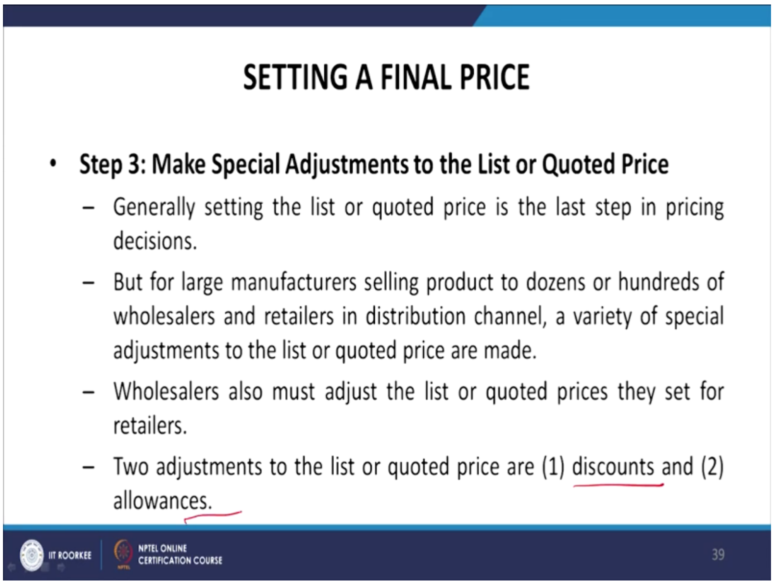

The third step in this process of setting a final price is to make a special adjustments to the list or quoted price. Generally setting the list or quoted price is the last step in pricing decisions.

But for large manufacturers selling products to dozens or hundreds of wholesalers and retailers in distribution channels, a variety of special adjustments to the list or quoted prices are made. Wholesalers also must adjust the list or quoted prices they set for retailers. Two adjustment to the list or quoted prices are; the first is the discounts, and the second are the allowances.

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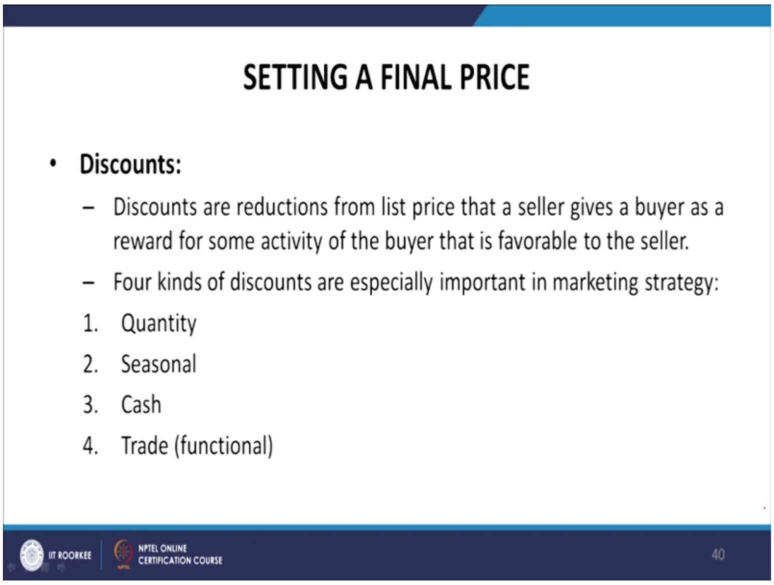

What are these discounts? Discounts are reduction from list price that a seller gives a buyer as a reward for some activity of the buyer that is favorable to the seller.

And there are four kinds of discounts that are important in marketing strategy; and they are quantity discounts; when you buy huge quantity, so some amount of discount is given. Seasonal discount; off season summer, winter. Cash discounts; so if you are making payment in cash then you get a discount.

And, trade functional, because you are the, because the trade member the channel member is carrying out some function, so he get some kind of discount.

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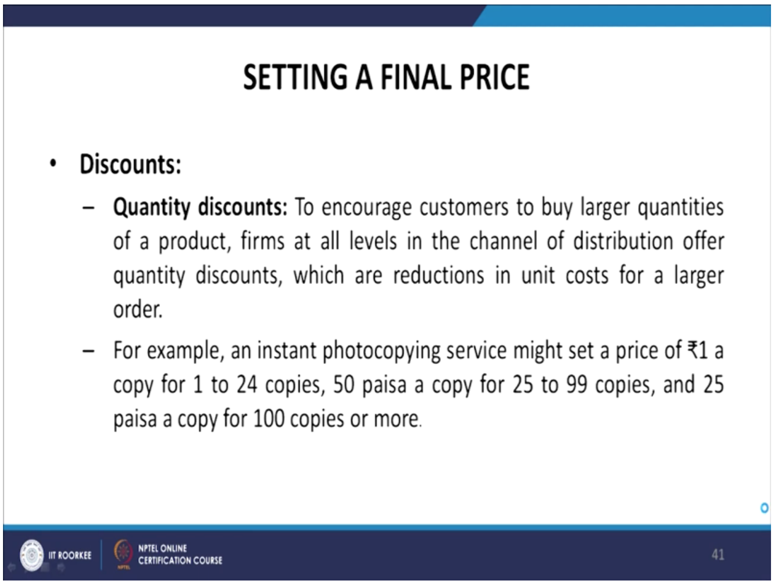

So, now, in detail this quantity discount is to encourage customers to buy large quantities of a product, firms at all levels in the channel or distribution offer quantity discounts, which are reduction in unit cost for a larger order.

For example, an instant photocopying service might set a price of rupee 1 a copy for 1 to 24 copies, 50 paisa for a copy for 25 to 99 copies, and 25 paisa a copy for 100 copies or more. The seasonal discount are to encourage buyers to stock inventory, earlier than their normal demand would require. Manufacturers often use seasonal discounts.

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And the third types of discounts are cash discounts; to encourage retailers to pay their bills quickly, manufacturers offer them cash discounts. Cash discounts are typically expressed as a percentage of the list price.

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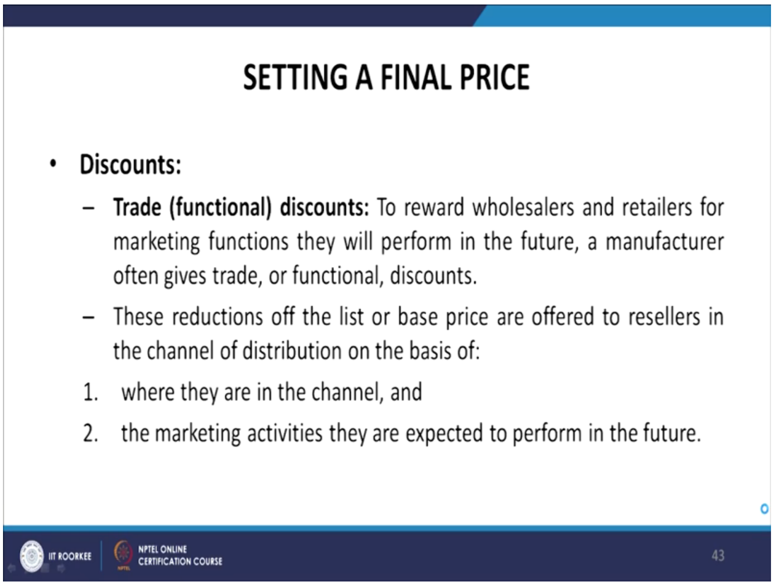

Then there are these trade or functional discounts to reward wholesalers and retailers for marketing functions they will perform in the future, a manufacturer often gives trade, or functional, discounts.

These reductions off the list or the base price are offered to resellers in the channel of distribution on the basis of where they are in the channel; one, and the second is the marketing activity they are expected to perform in the future.

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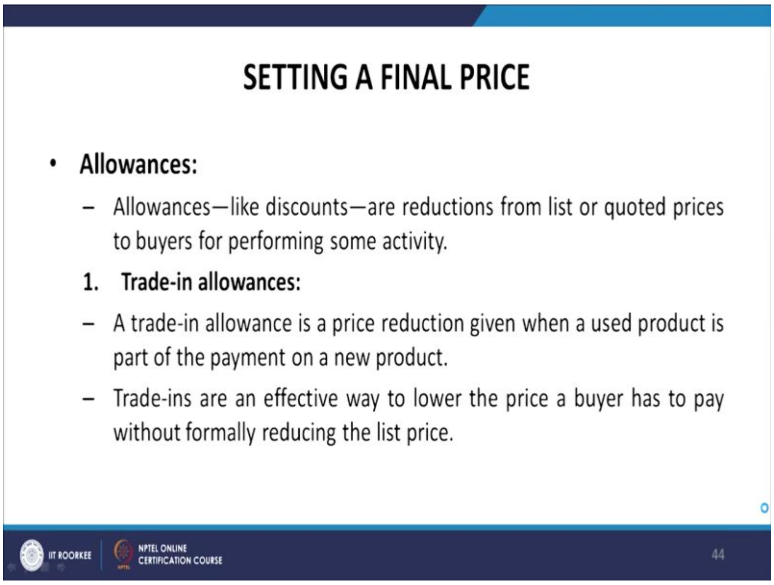

Allowances are; like discounts;- are reductions from the list or quoted prices to buyers for performing some activity. So, there are trade in allowances; a trade in allowance is a price reduction given when a used product is part of the payment on a new product.

So, trade-ins are an effective way to lower the price a buyer has to pay without formally reducing the list price.

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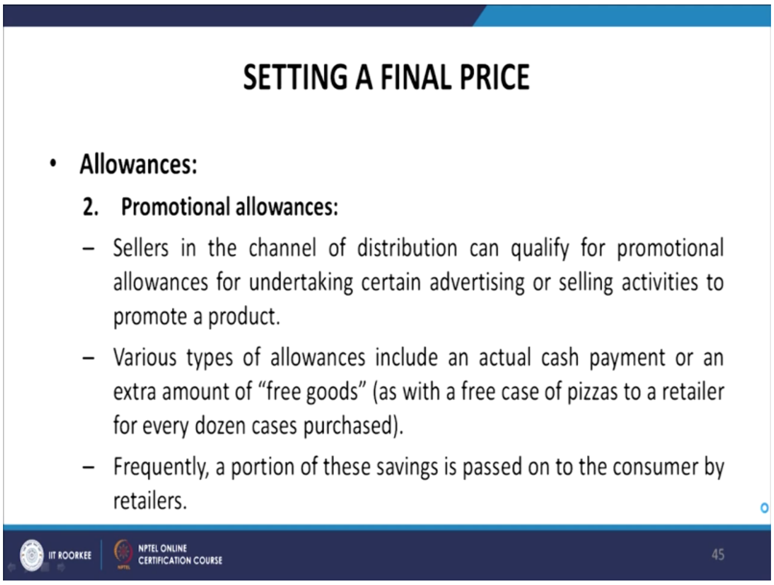

Then there are some promotional allowances; sellers in the channel of distribution can qualify for promotional allowances for undertaking certain advertising or selling activities to promote a product.

Various types of allowances include an actual cash payment or an extra amount of free good as with a free case of pizza to a retailer for every dozen cases purchased. Frequently, a portion of these savings is passed on to the consumer by the retailer. Now, some companies, such as Procter and Gamble, have chosen to reduce promotional allowances for retailers by using everyday low pricing.

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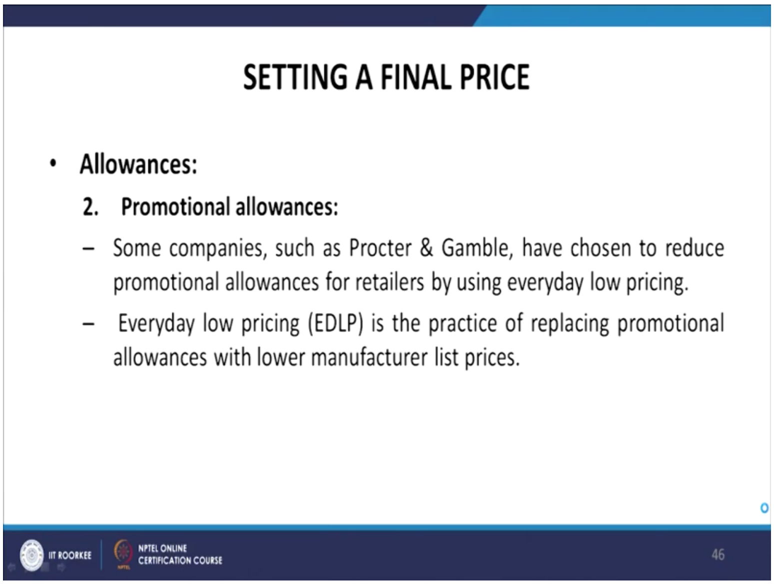

So, this everyday low pricing that is called as EDLP is the practice of replacing promotional allowances with lower manufacturer list prices.

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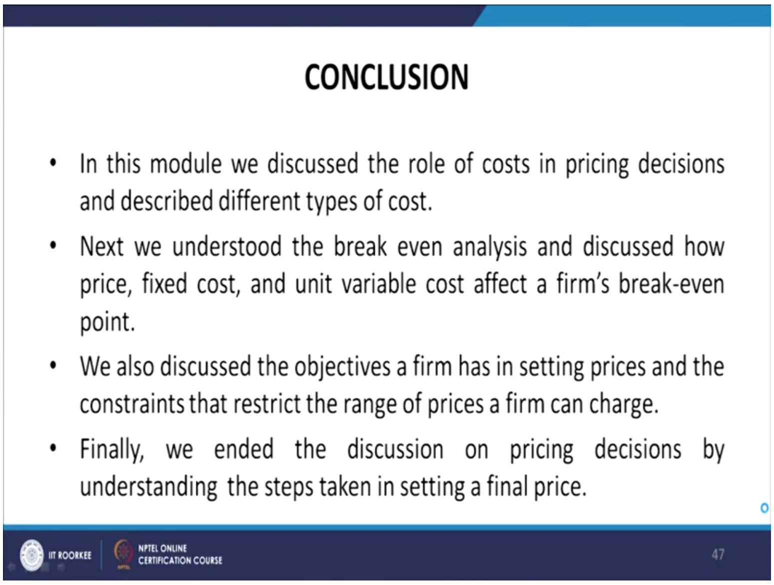

To conclude in this module, we have discussed the role of cost and pricing decisions and described different types of cost.

Next we have understood the breakeven analysis and described how prices, fixed cost, and unit variable cost affect a firm's breakeven point. Then, we have also discussed the objective a firm has, in setting prices and the constraints that restrict the range of prices a firm can charge.

Finally, we ended the discussion on pricing decisions by understanding the steps taken in setting as final price. These are the three books from which the material for this module was taken.

Thank you.