Marketing Management II
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Lecture No. W5-L5
Different Methods of Pricing

Hello friends welcome to our fifth session of this module on pricing so we have discussed a lot of concept in the pricing in this module of pricing and we have started discussing about the role of pricing in the overall marketing strategy. We started looking into the blunders that market is make while pricing or designing the pricing program for the organization. So basically, what we have started in the beginning of this module was that understanding that pricing is a strategic tool and how it should be used.

Then, we have start looking into that part like how consumers evaluate that pricing so the consumer psychology and the evaluation of the pricing was also discussed in the uh second session of this module and then we have started looking into the process of setting the prices so setting the prices has six steps we have looked into each of those steps in a brief way and then we have started looking into the in depth manner into each of these steps so these six steps were for uh setting or understanding the pricing objectives and therein.

We have discussed five different types of pricing objectives and we have also seen that these pricing objective are essentially linked with the business objective or the marketing objective of the organization they have to in sync with those organizational objectives so that they can deliver what is exceptive from the pricing and that is where this the role of pricing as a strategic tool comes in and then we have discussed after the understanding or what is the pricing objective the next thing that need to do is understanding the demand.

The price sensitivity with respect to product so we have seen into the concepts of price elasticity of the demand that how the changes in the price where leads to change in the demand of a product and with that actually we have looked into this curve that or the assessment of how the price in the demand behavior is changing over the different price levels so that we can understand that demand function then we have looked into the cost function part then there.

We have looked into the lot of concept we have discussed in the costs like we have looked into the total cost which is the sum of fixed cost plus variable cost then we have talked about the nature of these two types of cost that fixed cost and variable cost fixed cost change does not change with the number of unit produced on the other side the variable cost changes with the every unit that you produce or that you distribute or further the matter that you sell.

So, your variable cost is changes with each one of four that is being offered are produced and with that we have looked into the average cost concepts also there in we have look looked into the fact that the fix cost has a behavior of economies of the scale that when you go on the higher number of units that you produce on the sell and then the fix cost reduces drastically.

I have given you an example to illustrate this fact and then with that we have also looked into this breakeven analysis which is very important from the perspective of pricing that we need to understand at what price at what number of units of sales the number the revenue will be equal to the total cost we need to understand this number very well because then we will understand that that many number of units one has to sell before making any profit for the organization so this was a brief recap of what we have discussed in the previous session.

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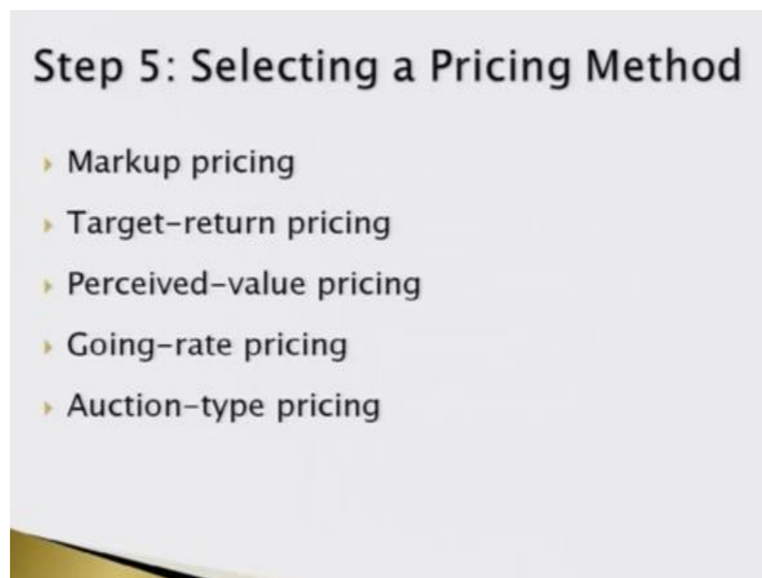

Today I am going talk about the fifth step in setting the price which is about selecting a pricing method so under the selection of pricing method you have a different type of pricing methods available the first one is markup available we will discuss about each one of again in depth about each one the pricing method the first one is mark up pricing then you have the

target return pricing then you have perceived value pricing which is very important these days from a marketers point of view understanding.

This posse value pricing is extremely important to understand and exploit the full value of your offering or the seize the opportunity that that exist in any particular product or the offering and then we will look into this going rate pricing processing and then we will also talk in little bit of brief about this auction type pricing so these are the five broad or mint method of pricing in the in the industry if you go back if you go in the industry you will see that different industry sector different method.

May be popular and it is also possible that within the same industry you will see that one seller might be using markup pricing other might be using for this perceived value pricing so it depends on lot of contingent factors which are present at a particular time of when you are designing a pricing program and once we will discuss each one of them you can understand which one is the most suitable for you to set up your prices so i am going to talk about the first one which is markup pricing.

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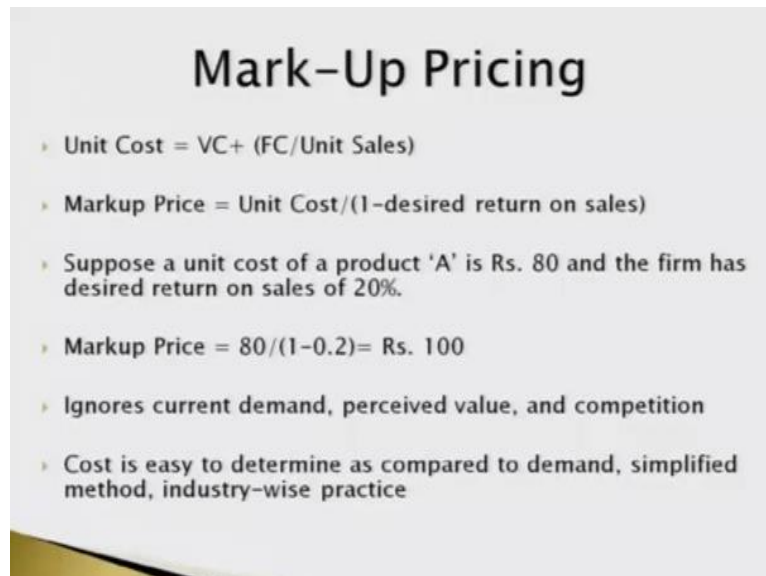

Now markup pricing is the formula is for market pricing is that unit cost equals two variable claw a cost plus a fixed cost upon unit call so that was the unit cost in markup prising the markup rises unit cost divided by 1 minus desired return on sales so for the example suppose you have a product a for which your cost of production or whatever the cost is the cost of sales is actually 80 rupees if you say and then if your desired rate of return is 20 percent.

In that case the markup price will be unit cost is 80 and the at the denominator you have 1 minus 0.2. So, 0.2 is the fraction or the desired return on sales that is 1 minus 0.2 which is equal to 0.8 so the formula gives you the market price equals to 100 rupees now you can understand this a pretty straightforward simple method of determining what should be the price but you have to understand in this pricing method is that it ignores some of the important or critical factors which are which might be very important from the marketing perspective.

So, it ignores the current demand you will see that the price has been set in this method irrespective or the level of the demand and how the demand various is that case the price should be adopted but here what happens is the this the demand function has not been probably included in this pricing method the second thing is perceived value so how much benefit.

That customer derives how much how much he or she thinks of what is the value of that product that is also is not present and that the third thing which is which is not taken care of in this pricing method is the competition so that so that it ignores the you can understand that mark markup pricing actually ignores three vital parameters to be included in the pricing is that current demand perceived value and the competition so it might not be very suitable way of pricing in many places particularly the situation

Where your product is you the cost and the value that is delivered by the product is very different. So, but I would still say that you have to understand here that in this method this method is very easy to adopt or this method is very easy to basically practice because the cases where you will understand that cost is easy to determine as compared to demand various with the time and the very various other factors present in the market so you will see that cost is easy to determine so this formula is pretty simple.

If you understand your costs then you can find out what is what should be the markup pricing on the other side this method is also very simplified you will see that many companies or many forms at opting this method because wherever there is a industry wise practice to mode to have this markup pricing the mode to have this markup pricing the companies will find it easier sometimes I will also tell you from my own experience talking to the lot of marketing managers.

The fact is that a lot of people do not understand about the other pricing method so this kind of markup pricing is very useful for them in the in the sense it is simple it is intuitive and from their past experience they use markup pricing to price their product in a quite an effective manner also however you are one i would also like to basically point out thing here is that in markup pricing you have to understand.

Whenever there are certain kind of product you will see that markup prices are very high in the sense where the seller has a higher financial risk whether that the product that does not sell very fast or it will have a lot of damages and all those things so understanding those kind of things the basically that seller will have higher level of desired return on sales now you will understand once you basically plot this.

Market price versus unit cost minus one minus desired return on sales as the desired return on in scale increases the markup price will increase in a much sharper way so in that case wherever, you will see that markup pricing is happening and the seller believe that that certain kind of higher returns should be taken in a should be targeted because there will be some kind of risk or some kind of seasonal effects which will come so you will see that market price is quite it might be on a much higher side in those cases.

Now this is one example basically how the markup pricing moves from the different stages of the value chain so here shown you in this example that manufacture of a product so you can call it a product so you can call it a product for this product a you will see that manufacturers cost of manufacturing this product is 60 rupees and they have this markup this desired return on sales of 16.67 percent so in that case the absolute value of markup will come out to be equal to 12 rupees so the manufacturer the manufacturer.

Though the cost is 60 so with their 16.67 percent of markup they will be selling it at a 72 rupees price to the wholesaler now for the wholesaler the cost is 72 groupies and the wholesaler is targeting 20 percent in return on sale in that case the sellers this wholesaler so basically markup will come out to be 80 new piece and the when the other product will reaches to the next stage which is retailer the cost to the retailer will be 90 rupees now retailer here will add 40 percent of his desired return on sale.

You will see that since they are selling the he is manufacturing in larger quantity selling in a larger quantity so despite their markups are much less than retailer they their revenues might be overall all the profits might be higher since this is a basically the number of units that they sell is less and so the markup might be higher so here the markup is 40 percent and when you will calculate you can go back and you can have a calculation so if you have a 40 percent markup here you will get.

The absolute mark of value comes out to be 60 rupees now what happens is by the time the product reaches it becomes 150 rupees so a product which has started from 60 rupees from manufacture by the time it reaches to consumer the cost is (100) 150 rupees with this kind of mark of pricing because the three levels of markup has been added the next method of pricing here is target return pricing and the target return pricing you can understand it is like a unit cost plus desired return and desired return on invested.

Capital divided unit cells now in this case you will understand you pre-access how many units you are going to sell and depending on how many units you will sell you can calculate a target return price so I have given you in one example here a unit cost is rupees 100 and your desired return again is 20 percent now when your target desired return in 20 percent with invested capital of 1Lakh rupees and units sales is projected to be a 1000 units will be sold.

You will find out that your target return comes out to be one hundred and twenty rupees now one big one important thing that you need to understand in this target return pricing is that if the number of units that you are projecting to be sold is 100 rupees if you do not sell those many units that is thousand units if you do not sell in this case supposedly you sell basically 800 units so in that case the loss of the sales of 200 units that will be probably a huge loss to you.

In terms of the revenue loss and ultimately it may cause you to on profit no loss kind of situation also so that the dynamic nature of the demand or the and the dynamic of market is not captured here so that point is a another very important thing that you have to understand because you if you assume too many.

I mean if you overestimate the sales then also you will be in a trouble situation that you may not realize that much amount of sale and you may lose revenue from the number of units that

you have not sold which you have targeted or in otherwise case if you assume that that very few units will be sold in that case you will reach to a target return price which will be very high and in those situation.

What will happens is that your plan the final price that you will set up for the product might be very high and with those prices you will find it different to sell the number of units or your product might not do well in the market so that is a another disadvantage of this target return pricing.

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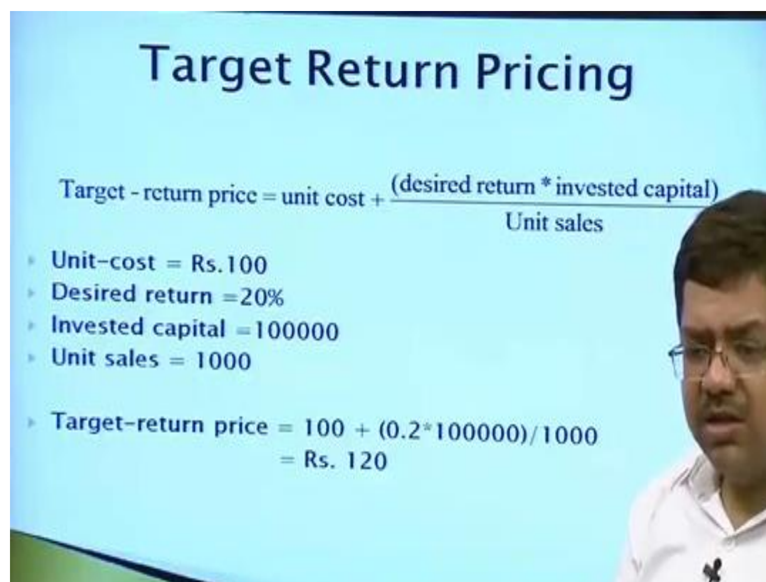

The third method in the this setting the price method is or the methodology is that which is actually a very popular among market is this percy value pricing the smart mark market here will always try to price their product from percy value pricing perspective in the sense and what is we need to understand. what is the perceived value if you can recall our initial session on marketing management.

One you will understand we have always talked about perceived value so percy value is basically your benefit minus cost perceived benefit minus perceive cause now here whatever what is what is being done in this to understand the value of a product is you need to basically some all the benefits which are delivered by a product so supposedly in this case I have talked about us take the case of a car now what kind of benefit.

It provides to you so I have said like there are three benefits its provides a the car will provide you the benefit of transportation the car will provide you the second benefit would be the

safety and the third benefit could be the time that you save over other transportation method or the convenience so you see the as you build on the different benefits the this stakes will go higher the benefits will go higher and the perceive the value that is being delivered by the product will be higher now.

The logic here is that the more the benefits you cater the more the value that you create and accordingly the product should be priced now what happens the product costs might be very low on the other side you will find out that that the value that is being delivered by the product might be very high so in those cases the value and the perceived value and the cost of the product might not be very much in sync or they might there be who is different between the value that is being delivered by a product and the cost and in those cases it is advisable that the pricing should be more towards.

The perceived value or the value delivered by the products so far example you see there are four different types of automobiles four different brands of the automobiles here the product a product b product c and product d you will see that they provide different levels of the three different benefits top speed Malaysian comfort now you see that each one of them in terms of the value.

That they catering is different and since their value that they are catering is different depending on the value that they are catering to the customer the pricing should be according to that value that is being delivered another way or probably that through the number. This example that been explained that if you want to assess the value of the car be in this case with respect to car a you will understand that though the initial price of the car b is hired 50000 rupees and the maintenance costs over the life cycle of that car b is 100000.

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Perceived Value Pricing

	CAR -A	CAR-B	Difference
Initial Price	200000	250000	50
Maintenance Cost over Life-cycle	150000	100000	5
Fuel Cost over Life-cycle	300000	275000	25
Perceived value of CAR-B	= 20000 (A)+ 50000 (Savings in Maintenance)+ 25000 (Saving in fuel expenses) = $275000		

Compared to car a so it saves on the maintenance cost over the life of the cause for 10 years so in next 10 years the car will say 50000 rupees for you and if we talk about the fuel costs over life cycle for another 10 years again compared to 3lakhs it costs you true like 275000 so it against a few 25000 so now you will see that if you want to understand the percy value with respect to car is so the car should come at 2lakhs but you will see that you will see that you will say that the saving on the maintenance.

Over the life cycle is 50000 and saving in terms of the fuel is to 275000 so the actual perceived value with respect to car is a 275000 rupees so this is a one good example to explain you what is perceive value percy value pricing is something which is very important from the market is point of view in the sense that one is supposed to look into the benefits that his or her offering is creating to the customer and once you assess what Is the value that is being created to the customer your pricing should reflect.

The value that is being created by the by the product that is being created by the your product or the services that you are marketing now I will stop here when we will meet in the next session we will start talking about the remaining methods of the pricing and then we will conclude this pricing module through the last session of this course or this module on pricing. Thank you very much!