

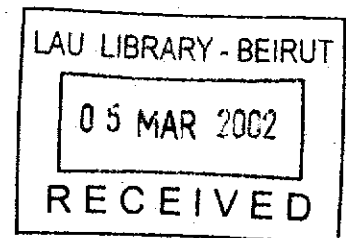
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CONSUMER PRICES AND PRICING POLICIES
IN THE MARKETING EFFORT

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Presented to Business Division
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of the Requirements for the Degree
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Chapter 1

Introduction

Pricing the product is a tricky problem in any market , because the price is a quantitative and clear figure . It is there to be compared and analyzed by competitors , distributors , and consumers alike which in many cases the mismanagement of a firm's pricing policy can lead to situations where the marketer's profit expectations can be undermined .

Since the world of consumer products is highly diverse-ranging from bread and butter to luxury cars and furniture it is reasonably hard to expect simple mechanical methods of pricing .

An adequate understanding of the vital role pricing plays in the marketing procedure is essential to the study of marketing . It is a complicated subject , and the reader must be familiar with the precise nature and behaviour of prices before he can comprehend prevailing methods .

This research will give a sequential representation to the reader about price which may be defined as the value of a commodity or a service expressed in terms of money . The general price level is reflected by wages , the standard of living , and profits-all of which are also commonly expressed in terms of dollars .

Statement of the Purpose

Historically , the development of marketing organizations can be seen as an adaptive process dealing with environmental change .

Business orientation thus , has changed from production ,

to sales , to consumers , and to the centrality of marketing in an integrated business system . Generally speaking , until about 1920 , the necessary marketing task was disposing of factory output , or selling . The organization was dominated by a production or financial orientation , with the sales department frequently placed under the manufacturing manager .

As competition intensified , sales were removed from the production manager and given more management attention . The sales department came into existence , and many supplementary selling functions like marketing research units , advertising department , ~~sales promotion functions developed which required~~ more coordination . Sales departments broadened into marketing organizations , and new attention was given to product planning , pricing as a tool of competitive strategy , advertising , distribution , and marketing research .

Marketing is now recognized as basic to the development of long-range company policy , or the basic motivating force for the entire corporation , which means that every activity of the corporation will be aimed at satisfying consumer needs and desires .

The view that an industry is a customer-satisfying process , not a goods-producing process , is vital for all businessmen to understand . An industry begins with the customer and his needs , not with a patent , a raw material , or a selling skill . So industries have to avoid endangering their futures by improperly defining their purposes .

Therefore , the customer-satisfying approach will be emphasized in this study , to clearly serve the purpose of all recent marketing conditions , and situations related to a business enterprise , whereby any efficient business organization has to survive in .

Statement of the Problem

Prices and pricing policies represent probably the most troublesome area of marketing management . Simply , it is said that people will buy anything if the price is right , but arriving at that exact price is an infinitely complex procedure .

So businessmen who are faced with an endless number of cases and problems specially in this field besides many others , use several ways to solve this kind of problems such as statistical decision theories , systems approach , experience , etc. .

To solve any problem , it is necessary first to know what the problem is , that is ; define the problem and then verify it . Very often a decision maker thinks his problem is to expand sales through a price cut to the level where the total number of buyers is maximized . This step probably will lead to a bankruptcy almost immediately because of a wrong price-cost relationship consideration even more complicating the problem . Therefore , a problem has to be formulated precisely enough to include the many factors related to price and pricing policies , to come up with final and satisfactory consequences for the business .

It is obvious that several major industries were once growth industries whereas at the present these same ones seem very much in the line of decline or already fully stopped growing mainly because of market saturations as declared by their inefficient managements . In every case the reason growth is threatened , slowed , or stopped is not because the market is saturated , it is because there has been a failure of management .

Opportunities for industries never lack . However , problems in the performance are likely to be solved only by the sound

approach and judgement of the top , that is , the executive responsible for the task should try his best to utilize any promising occasion , after putting aside all personal interests which might contradict to the common interests of the business .

Performance Objective

Pricing has many phases , and pricing objectives which are directly related to other company-level objectives , should be clearly specified to guide pricing policies and price determination .

Seeking a target return is a common objective . The target may be a certain percentage return on sales or on investment or a fixed dollar amount of profit being equal or slightly above last year's return , and being set for the short or long run depending on industry , market , competition , risk , profit , etc. .

In general , pricing objectives can be classified into three major groups : profitability objectives (profit maximization , and target return goals) , volume objectives (sales maximization or market share goals) , and status que objectives (social and ethical considerations) . These pricing objectives vary from firm to firm . However , multiple objectives are common among many of them , and very often once these objectives have been defined it becomes necessary in choosing among conflicting objectives , that is the need to adjust between long-run growth and short-run profitability , meaning that the initial goal may be market share and later change to profit .

The determination of the company's objectives should represent a careful weighing of the balance between the performance desired and the probability of its being accomplished . This balance is critical since too ambitious strategic objectives result in the

wasting of assets , the destruction of morale , and create the risk of losing past gains as well as future opportunities . On the other hand objectives which are not ambitious enough represent lost opportunities .

In any case , the pricing objectives chosen and followed by the executives should be consistent with the company's overall objectives .

So , this study will try more or less , to offer a complete and detailed description of many possible problems and solutions mentioned above , concerning the consumer pricing objectives , goals , strategies , etc. , in the marketing effort .

This research will be based on marketing philosophy , concept , and fact which altogether will provide the reader with interesting observation and explanation in this particular field , supplemented by tables and figures , making the material as easily understandable as possible .

The research undertaken has (a) examined the motivation with respect to determination of a specific price objective ; (b) described and analyzed the causes of price variation at a given period of time ; and (c) examined the desirability of setting up a price strategy .

Organization of the Study

Traditionally , the accounting function played the dominant role in pricing . Since the adoption of the market concept , however , business has seen a need to coordinate the different variables in the marketing mix . As a result , the responsibility for pricing decisions has shifted to marketing .

The organizational design of the marketing effort will determine the way in which the pricing strategy will be developed . Because pricing strategies are so closely related to basic policies , under normal competitive situations these strategies tend to be centralized , while a firm that operates in a highly competitive market may decentralize the pricing strategy all of the way through the organization to the salesperson .

This complete framework of pricing in the marketing process is introduced in the organization of this study .

The study is divided into three parts . Part 1 serves as a general introduction . Part 2 which covers the major topic , deals with several aspects of a company's consumer price structure and pricing strategies related to the other marketing mix strategies , in addition to the environmental , social , political and economical variables . Part 3 represents a conclusion and a summary for the study based on the philosophy of consumer prices and pricing policies in the marketing effort , considering the probable adjustments which might take place in the several , presently existing marketing factors related to the coming but unpredictable future .

Chapter 2

Presentation and Analysis of Results

I Company-Pricing Objectives

Pricing objectives are a critical part of a chain from overall company objectives to specific pricing policies and procedures¹. The goals of the firm and the marketing organization provide the basis for the development of pricing objectives, which must be clearly established before pricing policies and other procedures are implemented. However usually many firms simply take the market price, others use some mechanical cost-plus pricing procedures accepted in the industry and so on. Thus neglecting a complete understanding of price determination.

Pricing objectives may be classified under three major headings :

- 1 - Profitability objectives
- 2 - Volume objectives
- 3 - Other objectives

¹ A helpful discussion appears in A. R. Oxenfeldt, Pricing for Marketing Executives (Belmont, Calif. : Wadsworth Publishing Company, 1961).

1 - Profitability objectives - Under this heading lie (i) profit maximization as where the addition to total revenue is just balanced by an increase in total cost (through marginal analysis) , and (ii) target return objectives² which have become quite common among the larger firms ; may be either short-run or long-run goals and usually are stated as a percentage of sales or investment .

Goals of this nature also serve as useful guidelines in evaluating corporate activity , since firms that are making very low profits , the target rate can serve them as a standard for judging improvement³ .

2 - Volume objectives - This group includes (i) sales maximization where the company will continue to expand sales as long as its total profits do not drop below the minimum return acceptable to management , and (ii) market share objective , that is , the goal set as the control of a specific portion of the market for the firm's product .

² Target rate-of-return pricing is discussed in Douglas G. Brooks , "Cost-Oriented Pricing : A Realistic Solution to a Complicated Problem" , Journal of Marketing (April 1975) , pp. 72-74 .

³ Robert A. Lynn , Price Policies and Marketing Management (Homewood , Ill. : R. D. Irwin , 1967) , p. 99.

The company's specific goal can be to maintain or increase its share of a particular market⁴ . However , some firms with high market shares may prefer to reduce their share at times because the possibility of government action in the area of monopoly control has become extremely important in recent years .

Usually there are several reasons why firms adopt a type of market share objective .

- 1- Market share objectives are more readily measurable than other objectives .
- 2- High sales may mean more profit . (The extensive "Profit Impact of Market Strategies" project conducted by the Marketing Science Institute found a link between market share and profitability)⁵ .
- 3- Market share goals may also provide the firm a better competitive positioning within an industry .

To some extent , all of these reasons play a role in the wide acceptance of market share objectives in modern industry .

⁴ Various market share strategies are discussed in Paul N. Bloom and Philip Kotler , "Strategies for High Market Share Companies" , Harvard Business Review (Nov. - Dec. 1975) , pp. 63-72 .

⁵ R.D. Buzzell , B.T. Gale , and R.G.M. Sultan , "Market Share-A key to Profitability" , Harvard Business Review (Jan. -Feb. 1975) , pp. 97-106 .

3 - Other objectives - Some pricing objectives are not related to either profitability or sales volume . Yet , these other objectives are extremely important in the pricing behaviour of many firms . These include (i) social and ethical factors where certain organizations (medical institutions) use an ethical evaluation of one's ability to pay as an input into their pricing formula . (ii) status que objectives which are the basis of the pricing philosophy for many enterprises , simply reflect the desire to minimize competitive pricing action . Often this kind of an objective is held by a conservative management that wishes to minimize the risk of loss , preferring some assurance of profit . On the other hand , status que pricing objectives can be part of an extremely aggressive marketing strategy . The maintenance of stable prices allows the firm to concentrate its efforts in other areas of marketing , such as product improvement or promotion . This kind of objectives , in any case , remain a significant factor in contemporary pricing . And (iii) prestige goals which explain the pricing policies of some marketers setting relatively high prices so as to maintain a prestige and quality image with consumers . (Others may prefer to have a "low-price" image among their customers) .

Once the pricing objective is agreed upon , the executives try to develop an acceptable price determination procedure for the company (which differs from company to company) , by using either of several methods which will be studied in the next sections . However , before ending this section it will be helpful to give a brief explanation about the price-determination procedure .

The first stage in pricing a product is to estimate the total demand for it (easier to do for an old product than for a new one) . Two practical steps will complete this process ,

first , to determine whether there is a price which the market expects and , second , to estimate the sales volume at different prices (taking into consideration many variables in the market , plus the reactions of consumers , middlemen , etc. towards these estimates) . Thus by estimating the demand for the product at different prices , management , is determining the demand curve for the item . After doing this , management will look forward to competitive reaction . The next step (a critical one) in price determination is to decide what share of the market the company expects . Once this is done , the company will select its pricing strategy to reach the market target . This step will be followed by another major stage in the pricing procedure which is the consideration of the company's marketing policies with respect to the product itself , the distribution system , and the promotional program . And finally the specific base price will be selected .

The next section will cover some basic methods through which a price can be established in a number of ways .

II Price determinants (basic methods of setting price)

During the first part of this century most considerations of price determination emphasized the classical concepts of supply and demand . Since World War II the emphasis has shifted to a cost-oriented approach to pricing , besides the important role which custom , tradition , and environment have always played in the actual business practice to determine the price in the four types of market situations : Pure competition , monopolistic competition , oligopoly , and monopoly .

Over the years many different methods have been used by individual companies to accomplish the pricing procedure . Most of these approaches to price setting , however , are based on one or more , of the following major methods :

- 1 - Cost-oriented pricing
- 2 - Break-even analysis
- 3 - Demand-oriented pricing
- 4 - Competition-oriented pricing

1 - Cost-oriented pricing

Cost-oriented pricing⁶ is very commonly used because most accounting systems accumulate the costs of doing particular tasks , and profit-and-loss statements show very clearly that all costs must be covered . However , cost-oriented pricing is not as simple as it might seem at first look .

⁶For a systematic process that links marketing strategy with manufacturing cost-reduction plans see , C.D. Fogg and K.H. Kohnken , "Price-Cost Planning" , Journal of Marketing (April 1978), pp.97-106 .

The markup method

Most retail and wholesale prices are determined by a cost-oriented markup approach⁷, which is normally the trade or functional discount allowed by the previous channel members. Considering the large number of items the average retailer and wholesaler carry and the small sales volume of any one item, this cost-oriented markup approach to pricing seems both reasonable and practical.

Markups, unless otherwise specified, are related to selling price because the markup on selling price is roughly equivalent to the gross margin, which is computed in relation to total sales, and unless there is an adequate gross margin, there will not be any profits left at the end of the period. For this reason businessmen readily accept traditional markups that are close to their gross margins.

However, if a rigid customary markup over cost in pricing of products is followed, it will rarely make logical sense because any model that ignores current demand elasticity (see appendix A) in setting prices is not likely to lead (except by chance) to the achievement of maximum profit, either in the long run or short run. As the demand elasticity

⁷ Markup pricing is most commonly found in the retail trades (groceries, furniture, clothing, jewelry, and so forth).

changes (seasonally , cyclically , or over the product life cycle) , the optimum markup should also change⁸ .

Under special conditions , however , a rigid markup may lead to optimum profits such as if the average (unit) costs are constant over the range of likely outputs and price elasticity is constant for different points on the demand curve for long time . Both conditions make the use of rigid markups widespread in retailing .

Table 1 shows how a markup might be used at each level of a channel system

Table 1
The use of a markup at different levels
of a channel system

	Manufacturer %		Wholesaler %		Retailer %	
Selling price	\$ 240	100	\$ 300	100	\$ 500	100
Markup	24	10	60	20	200	40
Cost	216	90	240	80	300	60

⁸ In a study of the pricing policies of a sample of 88 small businesses , William Haynes found that most of the firms did not adhere strictly to rigid markups but modified them under different circumstances . Source : W.W. Haynes , Pricing Decisions in Small Businesses (Lexington : University of Kentucky Press , 1962) .

With a production cost (factory cost) of \$216 , the manufacturer is taking a 10% markup and sells the goods for \$240 which itself becomes the wholesaler's cost and with a 20% markup which is \$60 , the wholesaler's selling price becomes \$300 , which represents the retailer's cost . With an additional 40% markup , the retailer adds \$200 and the retail selling price becomes \$500 .

This illustrates more or less an acceptable situation⁹ , however , some retailers and wholesalers seek larger profits with higher markups such as 80 to 90 percent markups on selling prices , completely ignoring the concept of turnover (depending on the industry) where probably a 85 percent markup on selling price may not be nearly as profitable as a 10 percent markup on selling price . This is true because no units are sold at

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- ⁹ (i) Markups vary considerably among different goods . Some common markups on the retail price in department stores are about 20 percent for tobacco goods , 30 percent for cameras , 35 percent for books , 40 percent for dresses , 50 percent for jewelry . Source : Departmental Merchandising and Operating Results (N. Y. : National Retail Merchants Association) .
- (ii) Within the category of frozen foods , one study showed the markups on selling price to range from a low of 13 percent to a high of 53 percent . Source : L. E. Preston , Profits Competition , and Rules of Thumb in Retail Food Pricing (Barkeley , Calif. : University California Institute of Business and Economic Research , 1963) , p. 31 .

the high markup , but a very large number are sold at the low one , or because of a high markup , a slow turnover will increase cost by tying up working capital .

Nevertheless , many retailers and wholesalers seem more concerned with the size of their markup than with their total profit .

The cost-plus method -----

The simple and common cost-plus approach means that the selling price for a unit of a product is equal to the unit's total cost (assuming that all the inventory has been sold during a specific period) , plus an amount to cover the anticipated profit on the unit .

To fully understand the cost-plus method , it will be necessary to define the following cost concepts :

- Total fixed costs
- Total variable costs
- Total cost
- Average fixed costs
- Average variable costs
- Average total costs
- Marginal costs

Total fixed costs such as rent , executives' salaries , property taxes , insurance , etc. remain constant regardless of level of output . Even if production stops entirely , these costs continue , considering a fixed plant capacity and a short run period of time (over the long run , all costs tend to be variable) .

Total variable cost , on the other hand , which is the sum of many variable expenses that are closely related to output level-wages paid to workers , packaging materials , sales commissions , material costs , etc. will increase with each additional unit of output (at zero output , total variable cost is zero) .

Total cost is the sum of total fixed and total variable costs .

Costs per unit are average costs . Average cost per unit is obtained by dividing total cost by the total quantity produced which led to the total costs .

In a typical production operation , unit variable costs are relatively high for the first few units of output . Then , as total output increases , the average variable costs come down as the firm gains some economies of scale . But beyond some optimum point the average variable costs begin to rise again because of less efficient use of labour , materials , machines , space , overtime wage rates , etc. .

Marginal cost is the cost of producing and selling one more unit , that is , the cost of the last unit .

This brief discussion of cost concepts clearly states that not all costs behave the same as output changes , so , although costs furnish a good point from which to start computing price , but always after adjusting them according to demand factors .

When used by itself , cost-plus is a weak and unrealistic method of pricing because it completely ignores the different levels of output due to competition and market demand .

Table 2 illustrates the cost-plus approach .

		Table 2		The cost-plus method	
		Period I		Period II	
Sales (1000 units at \$1,5)		\$ 1500	(500 units at \$1,5)	\$ 750	
Expenses					
Variable	\$ 600		\$ 300		
Fixed	500	1100	500	800	
Net profit (Loss)		\$ 400		\$ (50)	
Unit cost		\$ 1,1		\$ 1,6	
Unit profit (Loss)		0,4		(0,1)	
Unit price		1,5		1,5	

During period I the income statement shows a profit of \$400 , while during period II it shows a loss of \$50 . So it is obvious that this cost-plus method although simple but it is a weak method because it does not adjust for cost variations at different levels of output . Since all costs do not behave the same way as sales expand or contract , the average cost per unit may change considerably as output rises or falls .

The average-cost method

This approach (mainly used in calculating bid prices for industrial goods and for government business) , often estimates the quantity to be sold by assuming that the firm will sell a quantity similar to past sales , and the price is found along the average cost curve at that previous quantity (after covering all fixed costs) .

So , as long as actual sales do not vary too much from the previous period , this cost-oriented approach will produce good results , however , losses may result if actual sales are much lower than in the previous period because the fixed costs will not be covered as completely as was expected .

The target return method

This method which has become popular in recent years defines a target percentage return on investment or a specific total dollar return which is added into total cost .

This method is very similar to the average-cost method , thus it suffers from the same deficiency . If the quantity that actually is sold in a given period is less than the quantity used in setting the price , then the target return is not achieved .

In some larger and more stable firms another kind of target return method is adopted which is the long run target return method in which case , according to R. F. Lanzilloti , the time factor instead of being one year for instance , it covers a period of five or more years based on a certain

percentage of capacity . Taking into account , that both higher and lower levels than the target return will be met during a five-year period , yet achieving the target return over the long run . Usually companies use this method to have more stable prices and long run profits .

The marginal cost method

The marginal cost-the change in total cost that results from producing an extra unit-is a useful method in some special pricing situations , such as during short-term price wars to achieve short-run objectives .

This method can be extremely important as well , to a marketing manager who is trying to find a way to keep operating in depressed times , or it might be useful when setting a price on a promotional item which will be used to attract business to other parts of the company 's line .

2 - Break-even analysis

Break-even analysis is specially useful for considering the relation of revenue and cost , where the total revenue curve can be related to the total cost curve to find the company 's break-even point . At this point , total revenue and total cost are equal ; beyond it , at a greater output level , the company will begin to make a profit on each unit ; below it , the company incurs a loss.

The break-even point may be computed in terms of units or dollar value of units stated as formula :

$$\text{BEP (in units)} = \frac{\text{total fixed costs}}{\text{selling price per unit} - \text{variable cost per unit}}$$

$$\text{BEP (in dollars)} = \frac{\text{total fixed costs}}{1 - \frac{\text{variable cost per unit}}{\text{selling price per unit}}}$$

It is important to note certain assumptions fundamental to the computations, like the assumption that the total fixed costs are constant (true, only over a short period of time and within a limited range of output). Also the assumption that the variable costs remain constant per unit of output (where variable costs in a firm usually fluctuate making the total cost line as a curved and sloped line rather than a straight line).

Generally, if a firm reaches the break-even point, it will cover exactly all its fixed and variable costs¹⁰. If even one more unit is sold, then it will begin to show a profit. Since once the fixed costs are covered, the portion of revenue formerly going to cover fixed costs now goes completely to profits. This is where the profit grows rapidly and why firms using this method are so anxious to get beyond the break-even point (see appendix B).

Although break-even analysis is extremely valuable, specially when used in combination with an analysis of total demand or when it is used in short run periods¹¹ so that many firms are

¹⁰ On the nature of costs, see, R. N. Anthony, "What Should Cost Mean?" Harvard Business Review, May-June 1970, pp. 121-131.

¹¹ R. E. Frank and W. F. Massy, "Short Term Price and Dealing Effects in Selected Market Segments", Journal of Marketing Research, May 1965, pp. 171-185.

faced with reasonably stable costs and demand structures , but it has a very limited value as a pricing tool in firms whose costs fluctuate frequently and widely and whose product mixes vary considerably .

3 - Demand-oriented pricing

The traditional supply and demand analysis in addition to flexible break-even analysis provide tools that enable a marketing manager to develop the most profitable price per unit .

The concepts of marginal revenue and marginal cost play a significant role in reaching the most profitable quantity which is found graphically at the intersection of these two curves .

Theoretically , when a firm operates in a market of perfect competition , its demand curve is horizontal at the market price , meaning that , the single seller has no control over the price , and he can sell his entire output at the market price . However , even in a perfectly competitive market , the industry as a whole has a downward sloping curve (more units can be sold at lower prices than at higher prices) .

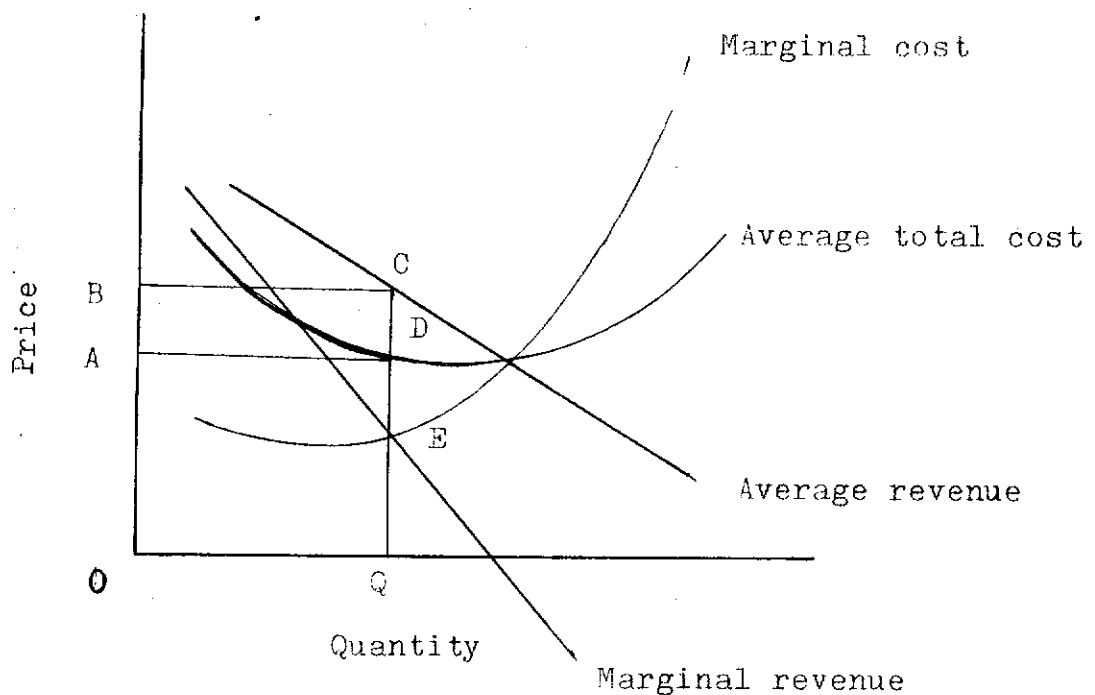
Nowadays , monopolistic competition which constitutes a considerable number of business firms has a downward sloping demand curve . It is characterized by product differentiation , which will attract some buyers at a high price , but to broaden its market , it must lower the price .

In the following section , a practical procedure of price setting and profit maximization through the application of marginal analysis will make the idea simpler and clearer to the reader .

Price setting and profit maximization through marginal analysis-
 To set a price , based on demand and supply analysis , the concepts of average and marginal revenue , in addition to those of average and marginal cost should be well understood by the price setter . Marginal revenue is the change in total revenue which results from the sale of one additional unit of product . Average revenue is the unit price at a given level of unit sales (total revenue divided by the number of units sold) . Marginal cost , as mentioned previously , is the change in total cost that results from producing an extra unit . Average cost is the average for all units .

Figure 1 illustrates graphically the firm's average and marginal curves .

Figure 1
 The firm's average and marginal curves



The firm will continue to sell as long as the revenue from the last unit sold equals or exceeds the cost of producing this last unit ($MR \geq MC$). Thus the volume of output is where marginal costs equal marginal revenue. This is the quantity OQ . The price is determined by OB with a unit profit of AB . Total profit is OQ times AB (quantity times unit profit). This is the area bounded by $ABCD$.

In general, since the firm's demand curve is downsloping, an extra unit can be sold only by reducing the price. In such a case, the total revenue that would be obtained if price were cut might still be positive, but the marginal revenue might be negative. The relationship between price¹², quantity, total revenue, and marginal revenue in a hypothetical situation with roughly a straight-line downsloping demand curve is summarized in table 3.

¹² For more discussion on the relation between price and quantity, see D. S. Tull, R. A. Boring, and H. M. Gonsior, "A Note on the Relationship of Price and Imputed Quality," *Journal of Business*, April, 1964, pp. 186-91.

Table 3

The relationship between price , quantity ,
total revenue , marginal revenue

Quantity	Price	TR	MR	TC	Profit
0	\$ 14	\$ 0		\$ 13	\$ -13
1	13	13	\$ 13	16	- 3
2	12	24	11	18	6
3	11	33	9	20	13
* 4	9	36	3	22	14
5	7	35	-1	25	10
6	5	30	-5	30	0

The above table shows that negative marginal revenues may occur at lower price levels (total revenue curve is declining) . It also shows that the most profitable price is \$9 and a quantity of four will be sold . Beyond a quantity of four , the total profit curve declines .

Marginal analysis is useful in helping the marketing manager to determine the best price to charge for all that he will sell . Depending on the complete and detailed information and experience of management , firms can do almost an accurate job of estimating marginal and average costs and revenue and then determine the demand curve with a selected price related to a selling quantity .

On the other hand , this marginal approach to determining the most profitable output also will determine that output which will be least unprofitable when market conditions are so poor that the firm must operate at a loss , or even suspend operation (when it cannot recover marginal costs unless stronger demand is expected soon) . But if marginal costs can be covered in the short run , even though fixed costs are not , the firm should remain in operation until fixed facilities (machinery) wear out , earning at least some contribution to fixed costs .

In spite of effectiveness of demand-oriented pricing , besides marginal analysis by firms that are interested in profits , yet relatively few firms use this approach simply because a demand curve represents the summation of a considerable number of variables (either controllable or not) and its estimation is not a simple task . However , businessmen do estimate demand curves through available methods including quantitative models such as using equal profit curves (not necessarily to maximize profits but to improve them) , the experience-curve approach¹³ (probable price shifts) , experimental methods (surveys) , and many types of market tests¹⁴ .

¹³ R. J. Dolan and A. P. Jeuland "Experience Curves and Dynamic Demand Models : Implications for Optimal Pricing Strategies" , Journal of Marketing (Winter 1981) , pp. 52-62 .

¹⁴ R. Schlaifer , Probability and Statistics for Business Decisions (New York : McGraw-Hill Book Co. , 1959) .

4 - Competition-oriented pricing

A firm is most likely to use this pricing method when the market is highly competitive and the product is not differentiated significantly from the competitors' .

Under perfect competition many firms in the textile industry , small firms producing standardized products , manufacturers of plastic type products , etc. , all ordinarily use this method of pricing .

This market-based method of pricing is also used when customary price level exists . This is applied on products such as soft drinks , chewing gum , candy bars , etc. . When rising costs place pressure on the customary price , sellers often react by a cut on their costs by reducing the quantity or the quality¹⁵ of the product (however , over the years in most markets , rising costs bring up customary prices to new levels) .

In certain cases a price is set at some point below that which is considered the competitive level (typically used by discount retailers) . Under such conditions stores offer fewer services , and they operate on the principle of low markup and high volume . Some restaurants and gas stations are recent examples of this market .

¹⁵ J. E. Stafford and B. M. Enis. "The Price-Quality Relationship : An Extension" , Journal of Marketing Research , Nov. , 1969 , pp. 456-58 .

On the other hand , with distinctive products , prestige product manufacturers or jewelry store retailers sometimes set their prices above the market level¹⁶ so that they can effectively segment the market on an income basis .

¹⁶ F. E. Brown , "Price Image Versus Price Reality" , Journal of Marketing Research , May , 1969 , pp. 185-191 .

III Price policies and strategies

Price policies and strategies are the basis on which pricing decisions are made . They are an important element in the firm's total image , and provide the overall framework and consistency needed in pricing decisions . Pricing policies must deal with varied competitive situations . The type of policy is dependent upon the environment within which the pricing decision must be made , and the development of a pricing strategy requires a clear understanding of the values , objectives , and policies of the organization .

One-price versus variable-price policy

Under a one-price policy the company charges the same price to all similar types of customers who buy similar quantities of the product under the same terms of sales . When a variable-price policy¹⁷ is used , the company will sell similar quantities to similar buyers at different prices (under this policy the price is usually set as a result of bargaining) .

The one-price policy is more common , specially at the retail level , since it facilitates mass selling efforts . A majority of U. S. producers adopt this type of policy , mainly for administrative convenience and to maintain goodwill among customers .

¹⁷ For more details see , "Flexible Pricing" Business Week , December 12 , 1977 , pp. 78-88 .

Flexible prices , on the other hand , are used in direct sales of industrial goods , and at retail for more expensive items and homogeneous shopping goods . Also flexible prices can enable a marketing manager to adjust more readily to the different jobs required in various channels of distribution or in different territories¹⁸ .

Although if properly handled the use of flexible-pricing can be profitable and acceptable in many cases , but its main disadvantages are that middlemen may be competing with each other in the same markets which might make the firm's flexible prices illegal , and it will generate dissatisfaction among the customers when some of them find that others have obtained lower prices .

Price lining

Price lining is the practice of marketing merchandise at a limited number of prices¹⁹ , frequently used in retail department stores (widely used in the retailing of all types of apparel) , where they identify the market segment to which the firm is interested in .

18 M. R. Warshaw , "Pricing to Gain Wholesalers' Selling Support.," Journal of Marketing . July , 1962 , pp. 50-54 .

19 See A. R. Oxenfeldt , "Product Line Pricing ," Harvard Business Review (July-August 1966) , pp. 137-144 .

For the consumer , the main benefit of price lining is that it simplifies buying decisions . From the retailer's point of view , the policy is advantageous because it helps store owners plan their purchases .

Failure to maintain the price ranges in a price-lining situation can result in a firm's cannibalizing other products in its line²⁰ .

Another problem confronting a price-line decision is that once it is made , retailers and manufacturers have difficulty in adjusting it in the case of rising costs . Under such circumstances the seller either will change the price lines resulting confusion or he will reduce costs by reducing product's size or quality so that holding prices at existing levels .

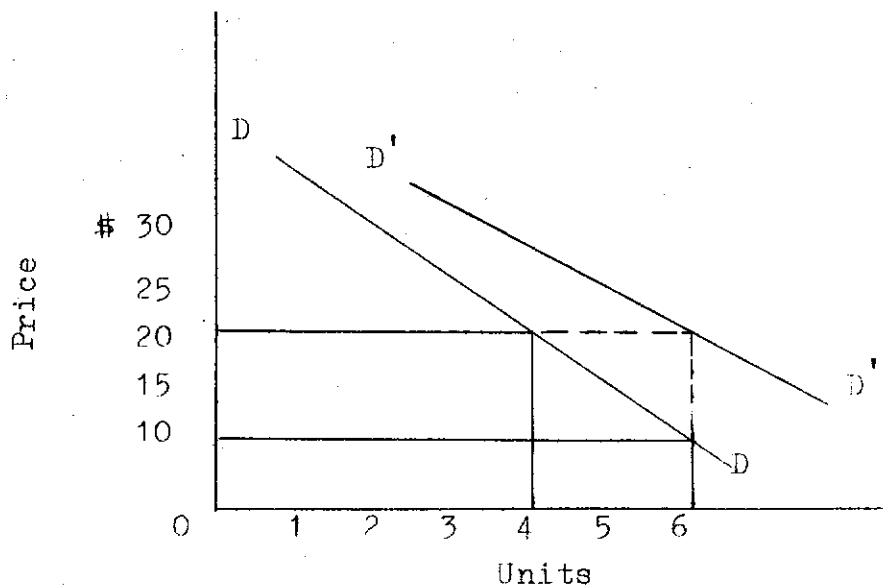
²⁰ According to analysts' different opinions , one reason the Ford Motor Company's Edsel automobile failed in the mid-1950s , was the fact that it was originally positioned between the Ford and Mercury brands which had already extended their product lines , thereby cannibalizing the market in which Edsel was to be positioned . The experience cost Ford \$500 million . Source : J. N. Brooks , The Fate of the Edsel and Other Business Adventures (New York : Harper and Row , 1963) .

Price versus nonprice competition

In price competition sellers try to move up or down their demand curves by changing prices . In nonprice competition sellers try to shift their demand curves to the right by means of product differentiation , promotional activities , variety of services , etc. .

Figure 2 (shift in demand curve) gives a simple illustration where a nonprice competition can shift the demand curve for a product .

Figure 2
Shift in demand curve



In a given period of time , the producer can sell 4 units at \$20 . On the basis of price competition alone , sales can be increased to 6 units if the price is reduced to \$10 (the demand curve is still DD , and total revenue is going down) . However , if the seller is interested in additional sales without any decrease in selling price (and total revenue) , he engages in a promotional program (a form of nonprice competition) . In this case , the seller is able to persuade enough new customers to buy at the original \$20 price so that his unit sales increase to 6 units . In effect , his entire demand curve has shifted to position DD' .

Nowadays , there is an increasing use of nonprice competition in marketing because many firms prefer to use promotion , product differentiation , and other forms of nonprice activity rather than to rely regularly only on price as a sales stimulant ²¹ .

²¹ See, P. W. Farris and M. S. Albion , "The Impact of Advertising on the Price of Consumer Products" , Journal of Marketing (Summer , 1980) , pp. 17-35 .

Pricing new products

The pricing of new products presents a peculiar problem to marketers²² .

Basically , there are two alternative policies , skimming and penetration , associated with the product life cycle , that a company might follow in pricing a new product .

A skimming pricing policy chooses a relatively high entry price . One purpose of this strategy is to allow the firm to recover its sunk costs quickly .

During the late growth and early maturity stages of the product life cycle the price is reduced for two reasons : (i) the pressure of competition and (ii) the desire to expand the product's market .

The assumption is that competition will eventually drive the price to a lower level . A skimming policy , therefore ,

²² See (i) G. C. Thompson and M. B. Macdonald , Jr. , "Pricing New Products ," The Conference Board Record (Jan. 1964) , pp. 7-9 .

(ii) Buell "Techniques for Pricing New Products and Services ," Handbook of Modern Marketing , McGraw Hill , Inc. 1970 .

(iii) D. F. Mulvihill and S. Paranka , Price Policies and Practices : A Source Book in Readings , Wiley , New York , 1967 .

(iv) J. Dean , "Pricing Policies for New Products" , Harvard Business Review (Nov. - Dec. 1976) , pp. 141-153 .

tries to maximize the revenue received from the sale of a new product before the entry of competition , considering that , it is easier to lower the price than it is to raise it . . Examples of products that have been introduced using a skimming policy include ballpoint pens , electric toothbrushes , television sets , Polaroid cameras , etc.²³ .

A major disadvantage which a skimming policy has : it attracts competition , that is , potential competitors , who see the innovating firms make large returns , also enter the market . This forces the price even lower than what it might be under a sequential skimming procedure . (See appendix C) .

Penetration pricing is the opposite policy in new-product pricing . It is an entry price for a product lower than what is finally believed to be the long-term price (soaps , toothpastes , etc.) . The reason is that an initially lower price will help secure market acceptance .

One advantage of such a policy is that it discourages competition from entering since the existing low price does not suggest the attractive return associated with a skimming policy . However , the important part is when to move the price to its intended level . Ofcourse consumers will resist any price increase , but correct timing which is absolutely necessary and brand popularity and loyalty will overcome any disproportionate decrease in customers due to any increase in prices .

²³ R. A. Lynn , Price Policies and Marketing Management

(Homewood , III . : R. D. Irwin , 1967) , p. 137 .

Pricing in periods of inflation

Nowadays , many economies (American and foreign) suffer from higher moving prices which represent some real problems to executives in their management of a marketing program , specially in the area of pricing²⁴ .

In short , inflation (see appendix D) , refers to a rising price level resulting in reduced purchasing power for the consumer (a person's money is devalued in terms of what it can buy) . So management must develop creative pricing strategies to meet the going on challenge of inflation such as : (i) to charge extra for certain services (ii) to reduce the percentage of cash or quantity discounts (iii) to find ways to control (and even to reduce) some costs , thus reducing the upward pressure on prices²⁵ (iv) to conduct an analysis of a company's marketing costs to identify high-cost customers , sales territories , and products .

In short , sound evaluation , executive judgement past experience , etc. will enable the marketing manager to take favourable steps in pricing strategy under inevitable circumstances of inflation .

²⁴ See, "Pricing Strategy in an Inflation Economy" , Business Week (April 6 , 1974) .

²⁵ One such cost control strategy is to eliminate low-profit products from a company's product mix . However , care must be taken not to drop products that customers expect the seller to carry as a normal part of the product mix . Also , the remaining products must absorb the share of fixed costs formerly carried by the eliminated products .

Geographic price policies

Geographical considerations are important in pricing when the shipment of heavy , bulky , low unit-cost materials is involved . Prices may be quoted where either the buyer or seller pays all transportation charges or there is some type of expense sharing .

F. O. B. (Free on Board) pricing , where the seller quotes the selling price at the factory or other point of production and the buyer pays the entire cost of transportation . This pricing method tends to establish a geographic monopoly for a given seller because freight rates prevent distant competitors from entering the market . The seller in turn is increasingly priced out of distant markets .

So F. O. B. pricing may limit the potential buyer's market . It is one reason why so many producers operate plants near their basic raw material suppliers . In U.S. , for example , industries which use large quantities of steel , are concentrated in Milwaukee , Chicago , Detroit , Philadelphia , etc. near the biggest steel mills . A location close to his basic material suppliers enables a manufacturer of a final product to compete over a wider area .

Under freight absorption pricing policy the seller permits the buyer to subtract transportation expenses from the bill . This method is commonly used by firms with high fixed-costs and low variable costs because it permits a considerable expansion of their market since the same price is quoted regardless of shipping . Actually , a company can absorb freight costs until its net return is simply above variable cost .

Uniform delivered price (the same price including transportation expenses quoted to all buyers) is another pricing policy . The price that is quoted includes an average transportation charge per customer , which means that distant customers are actually paying a lesser share of selling costs while customers near the supply source pay a charge which exceeds the actual cost of shipping .

This policy is most often used when transportation costs are relatively low and the seller wishes to sell his product in all geographic areas at one price .

Zone pricing , is simply a modification of a uniform delivered pricing system , the market is divided into different zones and a price is established within each . The primary advantage of this pricing policy is that it allows the seller to compete better in distant markets .

The zone approach often is used by manufacturers of hardware and food items , both to minimize the possibility of price competition in the channels and to simplify the computation of transportation charges they would have to make for the thousands of wholesalers and retailers they serve .

Basing-point pricing policies were basically used during the early days of the steel industry and later in cement , and building materials - characterized by oligopoly . However , the net result was the discontinuance of these systems as a basis for pricing due to action taken by legal authorities against them .

Discounts and allowances

Discounts and allowances result in a deduction from the list price offered by sellers in order to encourage customers to buy in larger amounts .

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Quantity discounts are price reductions given because of large purchases . These discounts are justified on the grounds that large volume purchases reduce selling expenses and may shift a part of the storing , transporting , and financing functions to the buyer .

Quantity discounts may be either cumulative or noncumulative .

A cumulative discount is based on the total volume purchased over a period of time , and it is specially applicable to the sale of perishable products . These discounts are an advantage to a seller because they tie customers more closely to him . Whereas a noncumulative discount is based upon an individual order of one or more products , and it is expected to encourage large orders .

Cash discounts are those reductions in price that are given for quick payment of a bill . They are probably the most commonly used variety . Cash discounts usually specify an exact time period , such as 2/10 , n/30 . This would mean that the bill is due within thirty days , but if it is paid in ten days , the customer may subtract 2 percent from the amount due .

²⁶ Ashok Rao , "Quantity Discounts in Today's Markets" , Journal of Marketing (Fall 1980), pp. 44-51 .

Cash discounts have become a traditional pricing practice in many industries . Such discounts are set up to improve the liquidity position of sellers , lower bad-debt losses , and reduce the expenses associated with the collection of bills .

Trade discounts (functional discounts) , are payments to channel members or buyers for performing some marketing function normally required of the manufacturer . An example of a trade discount would be when a wholesaler passes a 40 percent discount on to his customers (retailers) and keeps a 10 percent discount as payment for activities such as storing and transporting . So if the list price is 100 with trade discounts of 40 percent and 10 percent . The retailer pays 60 (100 less 40 percent) , and the wholesaler pays the manufacturer 54 (60 less 10 percent) . It should be noted that the 40 and 10 percent do not form a total discount of 50 percent off the list price . This series of discounts is known as a chain discount .

Allowances are similar to discounts in that they are deductions from the price the purchaser must pay . The major categories of allowances are trade-ins which are often used in the sale of durable goods (automobiles) . They permit a reduction without changing the basic list price by deducting from the item's price an amount for the customer's old item that is being replaced . Promotional allowances are price reductions given by sellers in payment for promotional services performed by the buyer . (An equitable promotional discount must be given to all retailers , not just to the large retail chains which exert market power) .

Transfer pricing

One pricing problem peculiar to large-scale enterprises is that of determining an internal transfer price—that is, the price for sending goods from one company profit center to another²⁷. As companies expand, there is need to decentralize management. Profit centers (any part of the organization to which revenue and controllable costs can be assigned, such as a department) are then set up as a control device in the new decentralized operation. Such centers in large companies can secure many of their resource requirements from within the corporate structure. The pricing problem becomes what rate should profit center A (maintenance dept.) charge profit center B (sales dept.) for a certain service. The answer to similar questions depends upon the philosophy of the firm involved taking into consideration that when the external market for the intermediate product is perfectly competitive, the firm should use the market-determined price on intracompany sales. In other cases, an appropriate profit-maximizing transfer price is a function of the marginal costs and revenues of the several divisions.

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- ²⁷ See (i) P. E. Dascher, "Some Transfer Pricing Standards", Pittsburgh Business Review (Nov.- Dec. 1971), pp. 14-21.
- (ii) David Granick, "National Differences in the Use of Internal Transfer Prices", Calif. Management Review (Summer 1975), pp. 28-40.
- (iii) Peter Mailandt, "An Alternative to Transfer Pricing", Business Horizons (Oct. 1975), pp. 81-86.

Unit pricing

Unit pricing is a retail price-information reporting policy employed largely by supermarket or grocery store chains .

Under a policy of unit pricing., for each separate product and package size there is a shelf label which states (i) the price of the package and (ii) this price expressed in monetary terms per some standard quantity measure .

Many questions arise whether this pricing policy is an effective tool for store chains upon which to base extensive advertising or does it improve consumer decisions²⁸ , or it is simply a policy which increases retail operating costs .

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- 28 Several studies have been made to measure the consumers' response to unit pricing , and so far the research results generally have been inconclusive . For more details see,
- (i) J. E. Russo , G. Drieser , and S. Miyashita , "An Effective Display of Unit Price Information" , Journal of Marketing , April 1975 , pp. 11-19 .
 - (ii) K. B. Monroe and P. J. Laplaca , "What are the Benefits of Unit Pricing ?" Journal of Marketing , July 1972 , pp. 16-22 .
 - (iii) M. J. Houston , "The Effect of Unit-Pricing on Choices of Brand and Size in Economic Shopping" , Journal of Marketing , July 1972 , pp. 51-69 .

Promotional (leader) pricing

Most promotional pricing is done at the retail level²⁹, with a price cut on items in order to attract customers .

Under this method certain goods are priced very low for the only purpose of getting customers into the store who hopefully will buy other regularly priced merchandise³⁰, resulting in a net increase in total volume and total profits .

Leader pricing usually is limited to well-known, widely used, branded items, and to goods that customers don't stock heavily—butter, coffee, cigarettes, etc. . The idea is to attract customers, not sell large quantities of the leaders. And to avoid hurting the firm's own profits, it may be desirable to use items that are not directly competitive with major lines, as in the sale of bargain-priced cigarettes at a gasoline station .

²⁹ For an interesting study of consumer response to promotion prices see, N. D. French and R. A. Lynn, "Consumer Income and Response to Price Changes: A Shopping Simulation", *Journal of Retailing* (Winter 1971-72), pp. 21-23 .

³⁰ B. Faust, W. Gorman, E. Oesteral, and L. Buchta, "Effective Retail Pricing Policy", Purdue Retailer (Lafayette, Indiana: Department of Agricultural Economics), p. 2 .

Leader items usually are sold above cost but below the normal price level . For consumers , leader pricing is desirable , since money that might have been spent on promotion is used to cut prices . Whereas , most retail stores that regularly use leader pricing³¹ switch continually from one item to another . This is because a continuous use of an artificially low rate for long periods on certain items may result in it being accepted as customary for the product³² .

Bait advertising , is another promotional tool where the seller attracts buyers' interest on false claims (prohibited under the Federal Trade Commission) . The seller offers or advertises an exceptionally good buy and then finds some excuse for not selling the advertised item but selling something else . He may refuse to sell the product , discredit its features , show a defective one , or impose unreasonable delivery dates or service terms . Having tempted the buyer , he tries to sell a substitute product that is more profitable to him .

³¹ Many laws regulate leader pricing , which seem to disregard the basic idea that the purpose of a business is to make a profit on the total operation , and not necessarily on each sale of each product .

³² Poultry , which was originally used as a leader during the 1930s and 1940s , has suffered from such a phenomenon .

Psychological pricing

Generally , so-called psychological pricing has no real basis in psychological research . Some businessmen simply feel that certain prices or price ranges for certain products are more appealing to buyers than others . There , however , is no consistent research foundation for such thinking³³ .

A similar pricing approach is prestige pricing . For some target customers , relatively high prices seem to mean high quality or high status , where , if the prices begin to appear cheap , they start worrying about quality and may stop buying³⁴ .

³³ See , (i) Z. V. Lambert , "Perceived Prices as Related to Odd and Even Price Findings " , Journal of Retailing (Fall 1975) , pp. 13-22 .
(ii) B. P. Shapiro , "The Psychology of Pricing" , Harvard Business Review (July-August 1968), pp. 14-25 .

³⁴ Price (in the absence of other factors) is an important indication of the way that the consumer perceives the product's quality . The higher the price , the better the buyer perceives the quality of the product . One study asked 500 people about their understanding of the word expensive . More than two-thirds of the answers dealt with high quality such as "best" or "superior" . The end result of all this research is that the relationship between price and perceived quality is a well-supported fact in contemporary marketing . For more details see , (i) D.M. Gardner , "An Experimental Investigation of the Price-Quality Relationship" , Journal of Retailing (Fall 1970) , pp. 25-41 . (ii) J.D. McConnell , "An Experimental Examination of the Price-Quality Relationship" , Journal of Business (Oct. 1968) , pp. 439-444 .

Another commonly used psychological pricing policy is odd pricing (often avoided in prestige stores) . Under this method prices are set at odd amounts , such as 29 cents , 49 cents , \$19.95 , etc. . A refrigerator is priced at \$995 rather than \$1000 . In general , retailers believe that pricing items at odd amounts will result in larger sales . Thus 49 cents will bring greater revenue than 50 cents . Marketing men using this approach seem to assume that they have a rather zigzag shaped demand curve .

In any case , nowadays , this kind of pricing is questionable whether it is effective because various studies have not reported conclusive results .

IV Restraints on pricing decisions

Generally , laws tend to focus on prices simply because they are tangible and highly visible-they are what customers must pay for the whole marketing mix (price can be changed more quickly than any of the other variables in the marketing mix) .

Usually every country has its own legislative constraints on business , but more or less they seem to be based on similar ideas and perceptions resulting from the orderly arrangement of principles and facts . To be more specific , the stress will be on U. S. legislation and its constraints on pricing policies .

Management taking pricing decisions must avoid price fixing , price disctimation , charging less than the minimum legal price , raising prices unjustly , advertising deceptive prices , or in anyway harming the environment .

Price fixing

Pricing agreements among competitors (horizontal price fixing) are generally prohibited under the Sherman Act and more specifically under the Federal Trade Commission Act . There are special cases , however , in which price fixing is specifically permitted by law , where price agreements are carried out under the supervision of a government agency , as is the case in many vegetable cooperatives or in the regulated transportation industries .

Laws known as fair trade (or resale price maintenance) which permit price fixing , has been used effectively for well-differentiated products with relatively inelastic

demands and with manufacturing costs that represent a small percentage of the price . For drug items such as aspirin for example , there is relatively little relationship between production cost and retail price . Yet significant price reductions would create little expansion in demand and would therefore decrease total revenue . Retail druggists have found fair trade an effective managerial device to maximize profits on inelastic demand curves ; since the consumers have not been too concerned because each fair-traded item represents only a relatively small part of their total expenditure .

~~After 1975s fair trading has declined in importance~~³⁵ .
Modern marketing men are finding much positive approaches to improving the effectiveness of their marketing mixes .
Now they adopt offensive rather than defensive tactics , generating competition on all four P's , not just price .

Price discrimination

One of the most important federal laws affecting a company's marketing program is the Robinson-Patman Act , under which price discrimination (price differentials) is prohibited .

Price discrimination (except under certain situations) between different purchasers of commodities of like grade and quality which may tend to injure competition is unlawful .

³⁵ In 1975 a federal law (Consumer Goods Pricing Act) was passed , which , in effect , canceled the earlier federal laws (Miller-Tydings Act 1937 and McGuire Act 1952) .

The law does permit some price differentials , but they must be based on cost differences (a difficult task due to the perhaps arbitrary allocation of fixed costs to several products) , or the need to meet competition . Both buyers and sellers are liable to conducting to a lawsuit if they knowingly enter into discriminatory arrangements .

Any price differential for products could be justified by offering a different "something" which makes the customers feel this "something" , and are willing to pay for it .

A major objective of antitrust legislation is to protect competition , not competitors , and "meeting competition" in "good faith" seems to be acceptable if it can be shown that the price discrimination occurred as a defensive rather than an offensive action .

The law also stresses that equal functional (promotional) discounts given to a large supermarket chain must be given as well to the small independent grocery store or any quantity discount must be given to all buyers .

To avoid discriminating (price differentials) business executives probably will find it wise to deemphasize price³⁶

³⁶ The three basic ways of de-emphasizing price in a marketing mix are : (1) nonprice competition (through the use of the other three variables - Product , Place , and Promotion) , (2) price control via legal or administrative devices (through fair trade , exclusive or selective distribution , careful planning of functional discount structures , leasing rather than selling , consignment selling , price fixing , mergers to reduce competition , etc.) , (3) price leadership .

as a marketing variable and to offer few quantity discounts , or to offer the same cost-based prices to all customers . In short , marketing managers will try to avoid active price competition (shifting competition to other areas of marketing mix) , instead , they will become more interested in seeking alternative methods for controlling price .

Price decreases

This pricing decision is based on low prices to drive competitors from the market so that the resulting monopolist can then raise prices . Unfair Trade Practices Acts is designed to protect smaller merchants from larger merchants who might otherwise sell certain items at or below cost (minimum price) for a while to attract customers . Without this protection , larger competitors could damage their smaller competitors³⁷ .

³⁷ In 1976 the H. J. Heinz Company charged the Campbell Soup Company with minimum-price marketing practices which threatened to eliminate Heinz from the canned soup market . Heinz asked for \$315 million in damages . The complaint declared that Campbell maintained its 80 percent market share by using new brand reproduction to gain shelf space and that it used minimum pricing , advertising , and promotional practices . According to Heinz , Campbell maintained competitive prices where it faced competition , but it raised prices where it did not have competition . Campbell was also charged with "saturation advertising" in markets selected by competitors . See , "Heinz is Boiling ..." , Advertising Age , December 6 , 1976 , p. 2 .

Price increases

Strictly speaking , there is no legislative rule against price increases . The seller is generally free to increase the price of his goods to any level , the only difficulty being economic . The major exception under this method occurs in the case of public-regulated utilities , which have monopoly power in their respective areas ; their price schedules are regulated and approved in the public's interest . Under such situations the government plays a significant role by using its influence to discourage major industry price increases because of inflationary concerns .

Deceptive pricing

The Federal Trade Commission has sought to control deceptive pricing under the Wheeler-Lea Amendment of 1938 , which prohibits "unfair or deceptive acts in commerce" . In the late 1950s deceptive pricing was commonly used as a competitive device by many major retailers³⁸ . The situation worsened as regular retailers tried to compete with discounters . In 1958 , the Federal Trade Commission issued its "Guides Against Deceptive Pricing" , which were clarified in 1964 to protect the national advertisers and consumers (deceptive pricing is a more common problem in the sale of consumer goods than industrial goods , because consumers typically have less information and more quickness of mind in buying commodities) , by clearly advertising a list

³⁸ Television sets advertised at \$309.95 would be placed "on sale" for \$249.95 , but might be available elsewhere for a nonadvertised price of \$215 .

price so as not to create a false impression of the value being offered³⁹ .

Consumer protection from deceptive pricing does not come from antitrust legislation , but rather from legislation that deals with truth in advertising⁴⁰ .

Recently , the consumer movement has led to the use of unit pricing in retail grocery stores . The prices of all brands are reduced to a common price per unit , such as one ounce , so that the consumer may make direct price comparisons easily .

To preserve the environment

Public policies toward the conservation of resource and the preservation of the environment are just beginning to have

39 "Guides Against Deceptive Pricing" , Federal Trade Commission , October 10, 1958 , and January 8 , 1964 .

40 The A & P supermarket chain lost to the Federal Trade Commission in 1975 because it failed to have products on the shelf as advertised , which set up deceptive advertising .

their impact on pricing strategies⁴¹ .

Antipollution devices on automobiles have raised automobile prices and led to the development of engines that do not require these devices . Whereas , conservation of resources enters pricing decisions as states require soft drink and beer bottlers to use returnable bottlers . Several other factors come to confirm that a relationship exists between nature and technology which through marketing effort and public policy may be cured , that is, sound pricing decisions will rebalance the development of the pricing strategy for the environment in which the firm is operating .

41 Companies are required to add devices to their production systems (increase production costs) that will reduce the pollution of air and water .

An example of water pollution is illustrated in the following case . In the chemical industry in the U. S. , caustic soda is produced as a by-product in the production of more profitable chlorine . At one time , the supply of caustic soda was so great that it was being dumped as waste into the Gulf of Mexico . Obviously , this had a depressing influence on the environment , and consequently , on the behaviour of the companies in the industry which had neglected any feelings towards a better preservation-plan of the nature , but only accumulating dollars on the account of the too expensive universe . (Other examples are the modern nuclear firms in several industries which seriously threaten both animal and plant life all over the world) . New no-waste technologies in use around the world can help companies meet their goals of profit , growth , and survival . See , M. G. Royston , "Making Pollution Prevention Pay" , Harvard Business Review (Nov. - Dec. 1980) , pp. 6-14 .

Chapter 3

Conclusions , Recommendations and Summary

Conclusions

In spite of the increased role of nonprice factors in the modern marketing process , price remains an important element and specially challenging in certain situations , offering an active marketing manager many possibilities and opportunities for changing marketing mixes .

The study of this research is focused on consumer prices and pricing policies in the marketing effort , which starts with discussion of pricing decisions in the organization . Traditionally , accountants played a dominant role in pricing decisions of the organization ; but since the arrival of the marketing concept , this responsibility has shifted to the marketing function . Business has recognized the need to coordinate the various variables in the marketing mix (product , distribution , promotion , and pricing strategies) . Most businessmen now feel that marketing is better situated to handle the pricing responsibility.

The first section of chapter 2 considers the proper choice of an objective (or objectives) among the major pricing objectives (profitability , volume , other objectives) , that is , pricing objectives should be consistent with the company's overall objectives .

Section II illustrates basic methods of setting a price . In practice , companies , tend to orient their pricing toward either cost , demand , or competition . A company , for instance ,

to maximize profit , sets the price so that marginal revenue equals marginal cost . This ideal model can serve only as a guide in the real world , for reasons like ; there are many strategic pricing goals other than profit , the problem of joint costs and joint revenues makes it impossible to estimate the marginal revenue and marginal costs for a single product , and the model does not include competitive effects , public policy , channel reactions , uncertainties surrounding the estimates of demand and cost , etc. .

Section III deals with the several price policies (price lining , promotional prices , new product pricing , price flexibility , etc.) and strategies (price-quality relationships , competitive bidding , transfer pricing , etc.) .

All the above mentioned policies and strategies in addition to others are discussed carefully considering customers' and competitors' reactions . (The probable reaction of customers is summarized in the concept of price elasticity of demand) . Further considerations concerning price policies include also the probable reactions of suppliers , middlemen , and governments . Finally prices are often adjusted to meet psychological objectives .

The last part discusses the restraints on pricing decisions . Legislation and legal cases often focus on pricing matters , because prices are more tangible (for everybody) than other factors . It is good to mention that most legislation and legal acts are designed to protect competition (not competitors) and consumers . Although the guidelines laid down by legislation and court cases are something dim and uncertain , there are good reasons for the marketing manager to pay close attention to them . In short , a good marketing man should understand

the legal environment and know how to work within it .

A final supplementary (appendix) part of the research includes some topics which are related to price and pricing policies either directly or indirectly . These are classified under headings (demand , break-even , competition , inflation , and mass production) and are explained in more detail .

Recommendations

Marketing in its micro-level definition is the performance of business activities which direct the flow of goods and services from producer to consumer in order to satisfy customers and accomplish the firm's objectives .

The importance of the customer in planning marketing strategies is always emphasized because we have assumed that the basic objective of our economic system is meeting consumer's needs as they , the consumers , see them . Thus , the consumer is the focal point in our definition of marketing . (It is sufficient here to note that different economies have different objectives) .

Since consumer satisfaction is our marketing goal , the efficiency of the marketing effort must be measured by the extent of this satisfaction . The individual buyer seeks to spend his income on those goods that will deliver the most utility (satisfaction) according to his tastes and relative prices . Unfortunately , however , we can not measure this satisfaction quantitatively and , therefore , provide a precise measure of marketing effectiveness . While there are a number of approaches to such measurement (using the relative cost or profitability of alternative ways of doing specific things

or to accomplish the same specific objective , etc.) , none of which is fully satisfactory .

Price besides promotion , product and distribution (elements of marketing mix) altogether form the mean to reach acceptable levels of performance in the total process of the marketing effort .

As a result of World War II , business which was product oriented became customer oriented . The marketing man was in change and his prime preference was marketing research .

Today , to be successful , a company must continuously adapt itself to both internally and externally changing conditions which are taking place almost instantly⁴² . And so it should try to take aggressive rather passive action to be able to overcome the endless chain of barriers in a most favourable manner .

IBM , for example , did not invent the computer . Sperry Rand did . But IBM owns the computer position because they built their computer fortress before competition arrived . So establishing a leadership position depends not only on luck and timing , but also upon a willingness to take the advantage when others stand back and wait .

⁴² Know the right markets for your company , the right marketing tasks , and how to achieve consistency . See B. P. Shapiro , "Making Money through Marketing" , Harvard Business Review (July-August 1979) , pp. 135-142 .

Today every company has become marketing oriented .
However , knowing merely what the customer wants is not too helpful if a dozen other companies are already serving his wants .

To be successful today , a company must be "competitor" oriented (in all four Ps of marketing mix and not just in price) . It must look for weak points in the positions of its competitors and then start marketing attacks against those weak points⁴³ . For example , in 1973s , while others were losing millions in the computer business , DEC was making millions by exploiting IBM's weakness in small computers . Similarly Savin established a successful position in small , inexpensive copiers . A weak point in the Xerox lineup .

The future marketing plan therefore , seems to look like a competitive plan which will develop a list of competitive strengths and weaknesses as well as a plan of action to either exploit or defend against them .

In the coming periods , the strategic planning will become more and more important . Companies will have to learn how to attack , defend and flank their competition . They will need better intelligence on how to anticipate competitive moves⁴⁴ .

43 Awareness of competitive forces can help a company stake out a position in its industry that is less vulnerable to attack . See M. E. Porter , "How Competitive Forces Shape Strategy" , Harvard Business Review (March-April 1979) , pp. 137-145 .

44 Consumer concerns need not be threats to business . Viewed imaginatively and analytically , consumer issues can become part of a firms marketing strategy to obtain competitive advantage . See B.W. Becker , "Using Consumer Issues for Competitive Advantage" , Business Horizons (May-June 1981) , pp. 43-47 .

Nevertheless , even if a marketing effort is consumer oriented it may result in favourable outputs greatly increasing the efficiency of business and marketing in case that business managers understand and accept the correct marketing concept-that the primary purpose of the whole business operation is to satisfy the customer . Acceptance of this philosophy forces an integration of all the activities of a business into a total system of action . This integration and the direction of all activities toward a specific goal can only lead to more effective business management which in turn , will learn to think of itself not as producing goods or services but as buying customers .

As a final analysis , every company uses slightly different marketing strategies , and it is up to each customer to decide how effectively individual firms satisfy his needs . Generally speaking , customers are willing to pay higher prices or buy more of those goods which best satisfy them . Thus , efficient marketing plans can increase the profits needed to attract investment , provide jobs , and pay for research to develop new or better products . Profits are not only the goal of most businesses , but they can be used as a rough measure of a firm s efficiency in satisfying customers .

To conclude , although in the past years price played a very significant role in many marketing or business decisions in the almost absence of the other three Ps in the marketing mix , however , nowadays regarding to the very complicated environment , complex consumer-behaviour , economic factors , laws , and other uncontrollable variables , any similar approach , that is , considering price alone as a main tool in performing marketing activities of any kind , certainly will be disastrous , leading the whole company to a critical situation or even to bankruptcy .

Ofcourse , the point should be clear . Undoubtedly price which is in an everyday practice by a vast majority of businessmen , money-market professionals and the public is still a very practical and preferable tool due to its easiness to handle , flexibility and rapid-reaction outcomes in comparison with the other marketing mix tools . However , continuous changes in environmental , economical , political , cultural , and psychological⁴⁵ variables now strictly require the exact use of any one , or a combination of marketing mix Ps in the right place and in the right time .

Finally , all the above mentioned aspects which contribute to the success of a business enterprise , are closely paralleled with the individual behaviour of the marketing manager , thus constituting the complete frame of the organization . Certainly , the marketing manager should exercise neither any conservations nor priorities in the favour of his personal satisfaction vis a vis a profitable decision for the whole company . Instead he should put all his sound judgement , past experience and flexibility into action to acheive both the company target and the customer satisfaction at the same time .

45

Identifying the decision makers and their purchasing motives often requires a psychologist's eye . See , T. V. Bonoma , "Major Sales: Who really does the buying?" , Harvard Business Review (May-June 1982) , pp. 111-119 .

As a complimenting step to the success of a company besides the mentioned ones , it is advisable to plan one's pricing policies with great care . No effort should be spared in assembling all the relevant data which may affect the development of such policies . Mistakes usually occur through inadequate understanding of market attitudes and conditions . The cost of mistakes often outweighs the cost of research⁴⁶ .

46 A motocar manufacturer launched a new model at \$6500 . Unfortunately inadequate research was conducted on the price elasticity of that particular model . In fact the price was more or less determined by the production cost per unit at a given level of output and to which a predetermined margin was added . Once the car was launched , it was soon discovered that demand surpassed supply and that a "black market" developed to such an extent that the consumer was prepared to pay \$1500 above the list price . In terms of consumer satisfaction , he seemed quite happy to pay \$8000 ; surely creative research should have highlighted what the consumer was actually prepared to pay for the car in question . However in terms of lost profit the price selected cost the firm vast sums of money .

Summary

Pricing is the area where exact decision tools and executive judgement meet . It remains a complex variable however , because it is at the same time both objective and subjective .

Price cannot be managed in isolation but is one part of an integrated mix of proceedings put together by the marketer to win the support of his target customers . Improperly handled price moves can destroy the effectiveness of other marketing efforts mainly by undermining their basic logic and credibility . Relationships among price moves and other elements of marketing strategy must be an overriding concern of the marketer .

In short , the marketer is confronted with internal and external factors as he faces his price decisions . The first are subject to his control , while the second form the framework within which his product with all of its attributes , including price , must fit . The external environment has become more important as productive capacity has increased , labour costs have become a higher proportion of total costs (because of union bargaining) , due to instabilities created in the international economy (political , financial , etc.) , the balance of exports vis a vis imports in many countries has taken a different way of direction (more imported goods have entered the American market⁴⁷) , and most recently , automation and better production controls have been available .

⁴⁷ The dollar's rise has made the products of U.S. firms more expensive abroad at the same time that they have to compete with lower prices for foreign goods at home . Between

As should be apparent from the discussion of this research , any acceptable approach must include certain essential elements . First , businessmen must recognize that there are many parties to the pricing process (consumers , competitors , suppliers , government , etc.) . Second , price must be related to a broad structure of objectives . Third , a long-range policy , must be established covering such issues as the number of different price offerings to be included in the product line , the frequency of price changes to be made , and the relationship that the firm's prices bear to the average price prevailing in the industry .

~~After all , the marketing specialist will define the constraints~~ that prescribe the area within which price should be set . And within that area the executive will try to select a price that guarantees consumer's satisfaction and yields maximum profits simultaneously .

Today , price still serves as a means of regulating economic activity . The employment of any or all of the four factors of production (land , labour , capital and entrepreneurship) is dependent upon the prices received by each .

1981 and 1984 , exports fell 7% while imports rose 25% . For example , a major danger besides many others from the dollar's climb is that it will destroy America's edge in the production of high-technology goods . A study by Stephen Roach , a senior economist at the Morgan Stanley investment-banking firm , showed that during 1983-84 period , imports of such high-tech equipment , computers , etc. rose by 218% . Meanwhile other countries are able to export more goods to the U.S. stimulating their economies . For instance , between the period 1982-84 , West Germany's exports to the U.S. rose 42% , France's climbed 47% , and Italy's were up 52% .

Appendix A

The demand schedule , the demand curve and its elasticity :

The demand schedule is the simplest form of the demand relationship . It is a list of prices and corresponding quantities of a good that would be demanded by anyone at those prices .

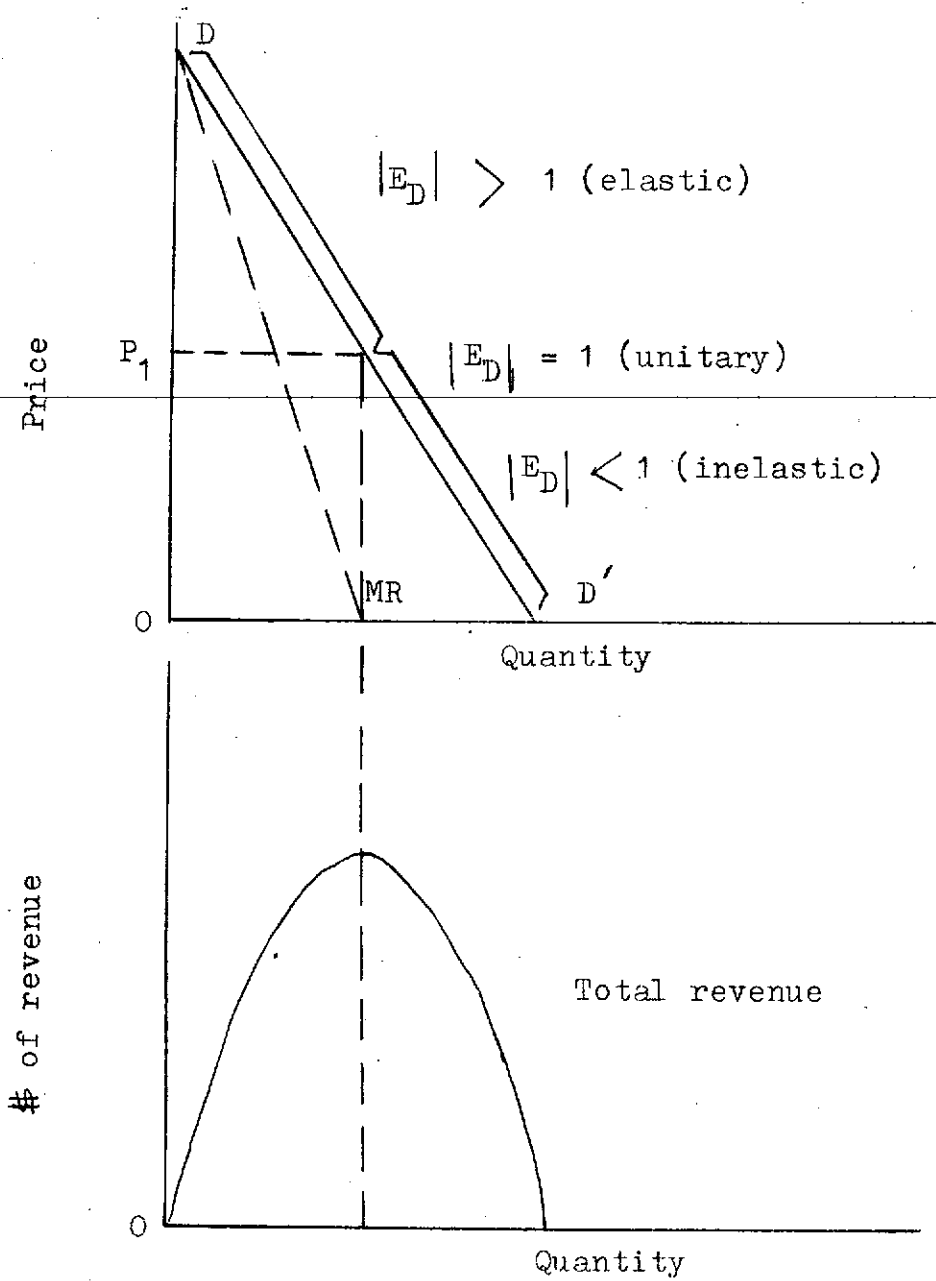
Changes in price result in movement along the demand curve , whereas changes in any of the other variables (consumer level , income , substitute goods , complementary goods , consumer desire , promotion by competitors , future price expectations) in the demand function may be expected to result in shifts of the entire curve .

The relationship among price P , quantity Q , elasticity measures⁴⁸ , marginal revenue MR , and total revenue TR is illustrated in Figure A .

When TR is maximized , $MR = 0$ and demand is unit elastic $|E_D| = 1$ which means that a percentage change in price is exactly offset by the same percentage change in quantity demanded , the net result being a constant TR . At any price higher than P_1 (unit elasticity) , the demand function is elastic $|E_D| > 1$ which means that a percentage change in price is exceeded by

⁴⁸ Price elasticity of demand E_D is the ratio of a percentage change in quantity demanded to a percentage change in price .

Fig. A - Price elasticity over the demand function



a percentage change in quantity demanded , the net result being a reduction in TR . For inelastic demand (at lower prices) $|E_D| < 1$, a percentage change in price results in a smaller percentage change in quantity demanded , the net result being an increase in TR .

It is extremely important for decision makers to be aware of the relationship between price , elasticity , and total revenue , since any attempt to charging higher prices to increase revenues not necessarily leads to a successful situation such as in a case where the current demand structure is elastic , because under this situation the total revenues are already being maximized by present price level , instead , any further increases will lead to a reduction in total revenues .

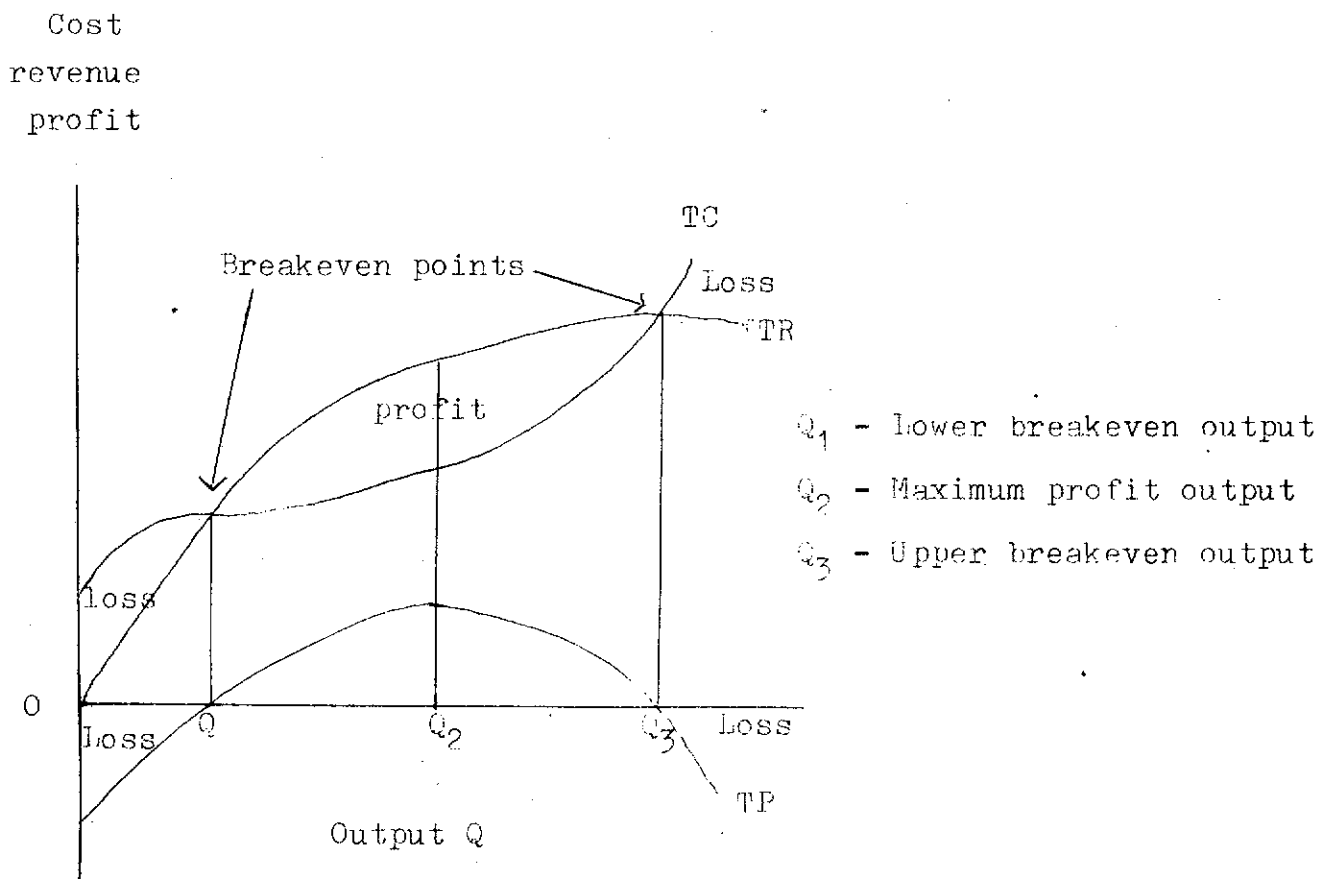
Appendix B

Breakeven analysis

The study of the interrelationships among a firm's sales, costs, and operating profit (EBIT) at various output levels is known as breakeven analysis.

Breakeven analysis is based on the revenue-output and cost-output functions of microeconomic theory. These functions are shown together in Figure B.

Fig. B - Generalized breakeven analysis



Total revenue is equal to the number of units of output sold multiplied by the price per unit . Assuming that the firm can sell additional units of output only by lowering the price , the total revenue curve TR will be U - shaped (inverted) . The total cost curve TC , (short run cost function , which consists of fixed cost and variable cost components) indicates the relationship between costs and output for a given production process in which one or more of the factors of production (plant , production capacity) are fixed .

The difference between total revenue and total cost at any level of output represents the total profit that will be obtained . In figure B , total profit TP at any output level is given by the vertical distance between the TR and TC curves . A breakeven situation (zero profit) occurs whenever $TR = TC$. In figure B , a breakeven condition occurs at two different output levels Q_1 and Q_3 . Below Q_1 , losses will be incurred since $TR < TC$. Between Q_1 and Q_3 , profits will be obtained , since $TR > TC$. Above Q_3 , losses will occur again , since $TR < TC$. Total profits are maximized within the range Q_1 to Q_3 , where the vertical distance between the TR and TC curves is greatest which is Q_2 .

In the application of economic breakeven analysis to practical decision-making problems , the nonlinear revenue and cost relationships of economic theory are often replaced by linear functions which can be developed either graphically or algebraically or as a combination of the two .

Appendix C

Competition - price relationship

Universal constraints impose limitations on organizations at all levels . These may be grouped under headings such as competition , demand , government , technology , environment , etc. .

These almost uncontrollable variables affect marketing management , and its future strategies both in the short and long runs .

Beginning in 1890 , a series of laws were passed that were basically antimonopoly or procompetition . However , years of 1930's convinced many businessmen that too much competition had disadvantages . After 1950's in a way or another , laws appeared to focus mainly on the consumer protection .

From the standpoint of the consumer , an increase in competition usually means lower prices , better quality , better services , etc. . From the standpoint of the seller , more competition means that he is forced to be more effective in his planning , coordination , and control . Competition may express itself as a price war , the invention of new substitute products , an offer of more services , etc.

The period between 1970 and 1980 became as a complement of previous ones . Foreign competition has become so powerful , that the U.S. auto companies , for example , found it harder than ever to price arbitrarily . That is , these companies did not make their price . Instead , they had to take a price

that was set by their competitors , and then the only way to make a profit was to bring their costs down . Furthermore , the 40 percent annual growth rate in minicomputers during 1972 attracted many competitors (capital needs were low and technology was simple) . But by 1975 at least 25 percent of the companies that had entered the market had dropped out (only a dozen competitors remained , with the top four accounting for 70 percent of the market)⁴⁹ . The industry strategy was one of sharp price cutting (the chief means of competition was pricing , some units were cut more than 50 percent in one year) , thus , to get rid of the marginal firms which could not cover all their costs .

The minicomputer industry illustrates that easy entry leads to excess capacity , which leads to price cutting , which eliminates the marginal firms from the field . As a general interpretation , market share is lost by many businesses because of intensified competition , declining prices , rising costs , or other changes which hurt both their profitability and their competitive positions .

⁴⁹ RCA and General Electric apparently concluded that they were much below the minimum market share in the computer business and incurring losses , they pulled out . Similarly, Motorola , with an estimated 6% to 7% share of U.S. TV-set sales , and an approximate loss of \$20 million in the period from 1970 to 1973 , announced its intention early in 1974 to sell the business to Matsushita .

See also "Bowling over the Minis" , Forbes , May 1 , 1975 , p. 42 .

Appendix D

Inflation

Inflation is a major factor in many economies , and the marketing manager has a big job keeping up with it , specially with respect to pricing .

In contrast to the legal and cultural environments , economic conditions change continiously ; they can move rapidly up or down , requiring tactical and even strategic responses .

There are two basic approaches by which the government may deal with inflation - fiscal policy and monetary policy . Fiscal policy concerns the receipts and expenditures of government where in such periods of inflation an economy could either reduce government expenditures , or raise its revenue (principally taxes) or a combination of both . Monetary policy refers to the manipulation of the money supply and market rates of interest . In periods of rising prices monetary policy may impose that the government take actions to decrease the money supply and raise interest rates , thus restraining purchasing power .

The marketing implications of both fiscal and monetary policy are numerous . Higher taxes mean less consumer purchasing power , which usually results in sales declines for nonessential goods and services . Lower federal expenditure levels make the government a less attractive customer for many industries . A lowered money supply means less liquidity is available for potential conversion to purchasing power . High interest rates lead to a significant fall in the construction and housing industry .

After all, inflation affects marketing by modifying consumer behaviour⁵⁰ . As purchasing power continues to decline , customers become more price conscious , which may lead to three possibilities - all important to marketers . Consumers can either elect to buy now in the belief that prices will be higher later or decide to reallocate their purchasing plans or postpone a certain purchase .

It is also good to mention a more particular , recent situation of inflation which is stagflation⁵¹ .

~~This peculiar brand refers to a situation when an economy has high unemployment and rising price level at the same time . This is true for many developed countries all over the world where day to day information proves the very serious reality which a marketing executive is faced with .~~

⁵⁰ Bob Gatty , "Coming - Focus on Food Prices" , Nation's Business , Dec. 1980 , pp. 58-61 .

⁵¹ F. W. Kniffen , "Stagflation Pricing - Seven Ways You Might Improve Your Decisions" , Marketing News (Nov. 15 , 1974) .

In an inflationary environment , the elasticity of price expectations , which is the percentage change in future prices expected as a result of current percentage price changes , may provide helpful insights . For example a positive coefficient of price expectations (greater than unity) suggests that current price increases may shift the demand function to the right . This may result in the same or greater sales at the higher prices as consumers try to overcome future price increases by stockpiling the commodity . The sugar price rise of 1975 party illustrates this process , where the large inventory of the product in the consumers' hands due to a high elasticity of price expectations , eventually led to lower the price expectation elasticity , (perhaps turning it negative) , and finally resulted in shift to the left in the demand function .

Appendix E

Profit versus mass production

Mass production mainly generates great pressure to put the product into motion (all effort focused on production) . But what usually gets emphasized is selling which focuses on the needs of the seller , not marketing which focuses on the needs of the buyer . Marketing , in spite of being a more complex process , gets ignored .

For instance , the automobile industry in U.S. makes the point clear . During 1970s the auto companies annually spent millions of dollars on consumer research . But the fact that the new competitor (foreign) compact cars were selling so well in that years compared to the American ones indicated that U.S. car industry researches had for a long time failed to show what the customer really wanted until the companies lost millions of customers to foreign small car manufacturers .

The answer is that the American car industry was not able to really satisfy the customer's wants (in this case , producing compact cars) . Because the companies were mainly product-oriented , not customer-oriented . That is , the areas of the greatest unsatisfied needs were ignored either partly or entirely . Such areas of customer needs focus on fuel efficiency , repair , maintenance and other services which were viewed by the industry as being of secondary importance .

On the other hand , Henry Ford was able to cut his selling price and therefore sell millions of 500 cars because his invention of the assembly line had reduced the costs . Mass production

was the result , not the cause , of his low prices . Parts of his operating philosophy as he expressed was as the following :

"Our policy is to reduce the price , extend the operations , and improve the article . You will notice that the reduction of price comes first . We have never considered any costs as fixed . Therefore we first reduce the price to the point where we believe more sales will result . Then we go ahead and try to make the price . The new price forces the costs down ... although one may calculate what a cost is , and of course all of our costs are carefully calculated , no one knows what a cost ought to be . One of the ways of discovering ... is to name a price so low as to force everybody in the place to the highest point of efficiency . The low price makes everybody dig for profits⁵²..."

Ford , was one of the production pioneers , but in fact , his real genius was marketing since he did fashion a production system designed to fit market needs .

In real life , the marketing effort is still viewed as a necessary consequence of the product , not vice versa , as it should be . That is the legacy of mass production , with its limited view that profit exists essentially in low-cost full production , however , nowadays , any profit even under mass production may be realized only by a hard thinking about the customer .

⁵² Henry Ford , My Life and Work (New York , Doubleday ,

Page and Company , 1923) , pp. 146-147 .

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