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# PRICING AND ITS MODELS

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## Introduction

Pricing is the most vital and highly demanded component within the theory of marketing mix. Pricing is also a key variable in micro economic price allocation theory. The firms decision on the price of the product and the pricing strategy impact the consumer's decision on whether or not to purchase the products. The technology of internet usage has increased and developed dramatically therefore, price comparisons can be done by customers through online access.

## Concept of Pricing

Pricing is a fundamental aspect of financial modelling and is one of the four Ps of the marketing mix, the other three aspects are Product, Promotion and Place. Price is the only revenue generating element amongst the four Ps, the rest being cost centers. However the Ps of marketing will contribute to decreasing price elasticity and so enable price increases to drive greater revenue and profits.

## Objectives of Pricing

- To achieve the financial goals of the company ( ie, profitability )
- To fit the relatives of the market place
- To support a product's market positioning and be consistent with other variables in the marketing mix
  - Price is influenced by the type of distribution channel used, the type of promotions used and the quality of the product
  - Price will usually need to be relatively high if manufacturing is expensive , distribution is exclusive , and the product is supported by extensive advertising and promotional campaigns
  - A low cost price can be a viable substitute for product quality, effective promotions, or an energetic selling effort by distributors

## Nine Laws of Price Sensitivity and Consumer Psychology

In their book, "The Strategy and Tactics of Pricing" Thomal Nangle and Reed Holden outline nine laws or factors that influence how a consumer perceives a given price and how price sensitive she/he is likely to be with respect to different purchase decisions.

### 1. Reference Price Effect

Buyer's price sensitivity for a given product increases the higher the product's price relative to perceived alternatives. Perceived alternatives can vary by buyer segment, by occasion and other factors.

**2. Difficult Comparison Effect**

Buyers are less sensitive to the price of a known / more reputable product when they have difficulty comparing it to potential alternatives.

**3. Switching Costs Effect**

The higher the product – specific investment a buyer must make to switch suppliers, the less price sensitive that buyer is when choosing between alternatives.

**4. Price – Quality Effect**

Buyers are less sensitive to price the more that higher prices signal higher quality. Products for which this effect is particularly relevant include: image products, exclusive products and products with minimal cues for quality.

**5. Expenditure Effect**

Buyers are more price sensitive when the expense accounts for a large percentage of buyers available income or budget.

**6. End – Benefit Effect**

The effect refers to the relationship a given purchase has to a larger overall benefit, and is divided into two parts:

**Derived demand:** The more sensitive buyers are to the price of the end benefit, the more sensitive they will be to the prices of those products that contribute to that benefit.

**Price proportion cost:** The price proportion cost refers to the percent of the total cost of the end benefit accounted for by a given component that helps to produce the end benefit (e.g think CPU and PCs ). The smaller the given components share of the total cost of the end benefit, the less sensitive buyers will be to the component's price.

**7. Shared – Cost Effect**

The smaller the portion of the purchase price buyers must pay for themselves, the fewer prices sensitive will be.

**8. Fairness Effect**

Buyers are more sensitive to the price of a product when the price is outside the range they perceive as "fair" or "reasonable" given the purchase context.

**9. Framing Effect**

Buyers are more price sensitive when they perceive the price as a loss rather than a foregone gain, and they have greater price sensitivity when the price is paid separately rather than as part of a bundle.

**Pricing Models**

**1. Absorption Pricing**

In this model, method of pricing, in which all costs are recovered. The price of the product includes the variable cost of each item plus a proportionate amount of the fixed costs.

**2. Contribution – Margin Based Pricing**

Maximises the profit derives from an individual product, based on the difference between the product's price and number of units that can be sold at that price.

**3. Creaming or Skimming**

In most skimming, goods are higher prices so that fewer sales are needed to break even. Selling a product at higher price, sacrificing high sales to gain a high profits therefore "Skimming" the market. Skimming is usually employed to reimburse the cost of investment of the original research into the product, commonly used in electronic markets, when a new range, such as DVD Players, are firstly dismarket at a high price.

**4. Decoy Pricing**

This method of pricing where the seller offers at least three products and where two of them have a similar or equal price. The two products with the similar prices should be the most expensive ones and one of the two should be less attractive than others. This strategy will make people compare the options with similar prices , and as a result sales of the more attractive high priced item will increase.

**5. Freemium Pricing**

The word "Freemium" is a portmanteau combining the two aspects if the business model "free" and "premium". Freemium is a revenue model that works by offering a product or service free of charge (typically digital offerings such as software, content, games and web services etc ) while charging a premium for advanced features . It has become a highly popular model with notable success.

**6. High – low Pricing**

In this model methods of services offered by the organisation are regularly priced higher than competitors but through promotions, advertisements and or coupons, lower prices are offered by on key items.

**7. Limit Pricing**

A limit price is the price set by monopolist to discourage economic entry into a market, and is illegal in many countries. The limit price is often lower than the average cost of production or just low enough to make entering not profitable.

**8. Loss Leader**

A loss leader is a product, sold at a low price (ie sold at below the cost price) to stimulate other profitable sales. This would help the companies to expand its market share as a whole when a "featured brand" is priced to be sold at a lower cost, relatives tend not to sell large quantities of the loss leader products and also they tend to purchase fewer quantities from the suppliers as well to prevent loss for the firm. Super markets and restaurants are an excellent example of retail firms that apply the strategy of loss leader.

**9. Marginal Cost Pricing**

In business, the practice of selling the price of a product is equal to the extra cost of producing an extra unit of output. By this policy, a producer charges for each product unit sold, only addition to total cost resulting from materials and direct labour. Business often set prices close to marginal cost during periods of poor sales.

**10. Cost plus Pricing**

Setting a price based upon analysis and research compiled from the target market. This means that marketers will set prices depending on the results from the research. For instance, the competitors are pricing the products at a lower price, then it is upto them to either price their goods at an above price or below, depending on what the company wants to achieve.

**11. Odd Pricing**

In this type of pricing, the seller tends to fix a price whose last digits are just below a round number. This is done so as to give the buyers/ consumers no place for bargaining as the prices seems to be less and yet in an actual sense are too high, and takes advantage of human psychology. A good example of this can be noticed in BATA Showrooms where instead of Rs.100, it would be written as Rs.99.99.

**12. Pay What You Want**

Pay what you want is pricing system where buyer pay any desired amount for a given commodity, sometimes including zero. In some cases, a minimum price (floor) may be set, and /or a suggested price may be indicated as guidance for the buyer. The buyer can also select an amount higher than the standard price for the commodity.

**13. Penetration Pricing**

Penetration pricing includes setting the price low with the goals of attracting customers and gaining market share. The price will be raised later once this market share is gained. Penetration pricing strategy is usually used by firms or businesses who are just entering the market. This strategy can sometimes discourage new competitors from entering a market position if they incorrectly observe the penetration price as a long range price.

**14. Predatory Pricing**

Predatory pricing also known as aggressive pricing (also known as “under cutting”), intended to drive out competitors from a market. It is illegal in some countries. This strategy is dangerous to be practiced as it could impact firms to face major destructions and even cause the business to shut down completely.

**15. Premium Decoy Pricing**

Method of pricing where an organization artificially sets one product price high, in order to boost sales of a lower price product.

**16. Premium Pricing**

Premium pricing is the practice of keeping the price of a product or service artificially high in order to encourage favourable perceptions among buyers, based solely on the price. The practice is intended to exploit the tendency for buyers to assume that expensive items enjoy an exceptional reputation, are more reliable or desirable, or represent exceptional quality and distinction. Consumers are willing to pay more for trends, which is a key motive for premium pricing. Ethical consumption , Fair traders and Voluntarism are the examples of premium pricing.

**17. Price Discrimination**

Price discrimination is the practice of setting a different price for the same product in different segments to the market. For example, this can be for different classes, such as ages, or for different opening times. There are three types of price discrimination which revolve around the same strategy and same goal – maximise profit by segmenting the market, and extracting additional consumer surplus. The following are the types

a. First degree price discrimination
b. Second degree price discrimination
c. Third degree price discrimination

**18. Psychology Pricing**

Pricing designed to have a positive psychological impact. For example, selling a product at Rs.3.95 or Rs.3.99 rather than Rs.4.00. There are certain price points where people are willing to buy a product. If the price of the product is Rs.100 and the company price it as Rs.99, then it is called psychological pricing. In most of the consumers mind Rs.99 is psychologically 'less' than Rs.100. A minor distinction in pricing can make a big difference in sales.

**19. Target Pricing Business**

Pricing method where by the selling price of a product is calculated to produce a particular rate of return on investment for a specific volume of production. The target pricing method is used most often by public utilities, like electric and gas companies, and companies whose capital investment is high, like automobile manufacturers. Target pricing is not useful for companies whose capital investment is low because, according to this formula, the selling price will be understated.

**20. Value Based Pricing**

Pricing a product based on the value the product has for the customer and not on its costs of production or any other factor. This pricing strategy is frequently used where the value to the customer is many times the cost of producing the item or service. For instance, the cost of producing a software CD is about the same independent of the software on it , but the prices vary with the perceived value the customers are expected to have. In order to employ value based pricing we have to know your customer's business, his business cost, and his perceived alternatives. Value based pricing have many effects on the business and consumer of the product. Value based pricing is a fundamental business activity and is the process of developing product strategies and pricing them properly to establish the product within the market.

## Conclusion

Price is perhaps the most important of the four Ps ( Product, Promotion, and Place being others) of marketing since it is the only one that generates revenue for a company.

Price is mostly described as the value exchange that occurs for a product or service. Broadly, price is the total of all values exchange for a product or service. Price is dynamic, when establishing a price or for a product or service , a company first assess several factors regarding its potential impact.