MARKETING MANAGEMENT

UNIT-2

PART-XII

OBJECTIVES OF PRICING

Pricing – Main Objectives of Pricing Followed by Different Firms

Pricing is not an end in itself but a means to achieve marketing objectives of the firm. Therefore, the pricing strategy of a firm should be designed to achieve specific objectives. Like other operating objectives, the objectives of pricing are derived from the overall objectives of the firm. The basic objectives of a firm are survival and growth.

The objectives of pricing should be clearly defined because without clear cut objectives a sound price structure cannot be developed. In practice very few firms define their pricing objectives in unambiguous terms. The specific objectives of pricing may vary from firm to firm and even for the same firm at different points of time. Most firms have multiple pricing objectives.

The main objectives of pricing followed by different firms are as follows:

1. To achieve target rate of return on investment;

2. To stabilize prices;

3. To maintain or improve share of the market;

4. To meet or prevent competition;

5. To maximize profits; and

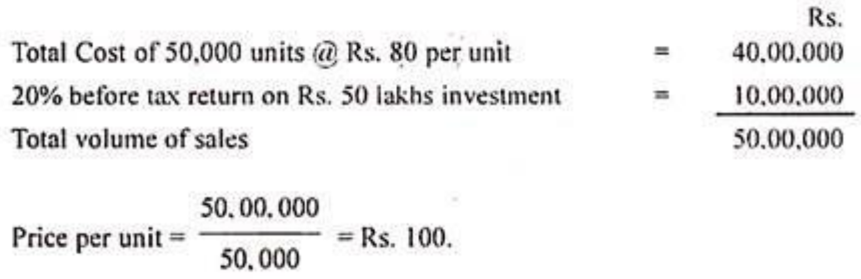
6. To improve public image.

Objective # 1. Target Rate of Return:

Firms following this objective design their pricing strategy in such a way that will yield desired return on total investment (ROI). Rate of return refers to the amount of net profits divided by investment or capital employed. This goal often leads to cost plus pricing. The price of a product or service is determined by adding the expected margin of profit to the cost of production and distribution.

In order to fix the price, the firm estimates the amount of total profit required to earn the expected rate of return. The figure of total profit divided by the average sales volume gives profit margin per unit. Suppose, for instance, that a company wants to earn a return of 20 per cent (before taxes) on its total investment of Rs.50 lakhs. The annual sales volume on an average is anticipated to be 50,000 units and the total cost per unit is Rs.80.

The company can calculate the price as under:



		Rs.
Total Cost of 50,000 units @ Rs. 80 per unit	=	40,00,000
20% before tax return on Rs. 50 lakhs investment	=	10,00,000
Total volume of sales		50,00,000

$$\text{Price per unit} = \frac{50,00,000}{50,000} = \text{Rs. } 100.$$

Target rate of return is an important pricing objective and an increasing number of firms follow this goal due to several reasons. Firstly, it ensures a reasonable return to the investors. Secondly, it does not lead to public criticism. Thirdly, the rate of return can be used to evaluate and compare the performance of different products of the firm. Fourthly, it provides a measure of restraint and a guideline for judging improvement in a new product line.

However, target return pricing may not be feasible in all conditions. This goal can be achieved by firms which are industry leaders or which sell in protected markets. Some firms may attempt to achieve target return on sales during the short run. They set a percentage markup on sales which is sufficient to cover operating costs and the desired profit.

In such cases, the rate of profit would remain the same, but the amount of profits would vary with the number of units sold. The target rate of return differs from firm to firm depending upon the cost of capital and the actual market conditions in the industry.

Objective # 2. Price Stabilization:

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This goal is adopted in industries having a few firms. In an oligopolistic situation where one firm is very big and all others are small, the big firm acts as the price leader and other firms follow it. All the firms try to avoid price wars. No firm is willing to cut its prices for fear of retaliation by other firms.

In order to avoid fluctuations in prices, they may even forgo maximizing profits during the period of scarce supply or prosperity. This objective is followed in case of products which are vulnerable to price wars or which are advertised at the national level. Price stability helps in planned and regular production in the long run. However, it may create rigidity in pricing.

Objective # 3. Target Share of the Market:

In an expanding market, market share is a better indicator of a firm's success than the target rate of return. When the market has a potential for growth, a firm earning the target rate of return may, in fact, be decaying if its share of the market is decreasing. Therefore, maintenance or improvement in the market share is a more worthwhile objective in growing markets. Market share measures a firm's sales vis-a-vis the sales of its competitors.

Objective # 4. Facing Competition:

Under conditions of intense competition, a firm may seek to meet or prevent competition. It may fix prices at a very low level (even below cost) to eliminate its competitors or to prevent the entry of new firms in the market. Some firms follow this practice while introducing a new product. This goal is not very popular and cannot be adopted on a regular basis. In the long run, a firm cannot survive if it continues to charge less than the cost of the product or service.

Objective # 5. Profit Maximization:

Traditionally, profit maximization is considered to be the objective of pricing. The classical economic theory suggests the fixation of prices in such a way that the marginal cost is equal to marginal revenue where profits are maximized. Even today some firms are not very conscious of social responsibilities and try to maximize profits. But in recent years there has been a change in the philosophy of business and profit maximization is not considered rational business behaviour. In practice, no firm states explicitly that profit maximization is its pricing objective due to the fear of public criticism and government regulation.

Objective # 6. Improving Public Image:

Another objective of pricing may be to enhance the firm's public image. The firm may launch a premium product at a high price for this purpose. Alternatively, it may offer the new product at a low price to appeal to the common buyer. The pricing policy should be consistent with the established reputation of the firm.

In addition to the foregoing, business firms may design their pricing policy to achieve the goals of full capacity utilization, market exploration, diversification, etc.

Pricing objectives may be classified into three categories:

(i) Sales volume objectives including sales maximization and improvement in market share.

(ii) Profitability objectives consisting of profit maximization and target rate of return.

(iii) Status quo objectives comprising price stabilization, maintaining market share, facing competition and covering costs.

Typical Pricing Objectives:

1. Growth in Sales:

A low price can achieve the objective of increase in sales volume. A low price is not always necessary. Competitive price, if used wisely, can secure faster increase in sales than any other marketing weapon.

2. Market Share:

Price is typically one of those factors that carry the heaviest responsibility for improving or maintaining market share — a sensitive indicator of customer and trade acceptance.

3. Pre-Determined Profit Level:

Return on Investment, say 20 to 25 per cent is a common decision in marketing. Pricing for profit is the most logical of all pricing objectives.

4. Counter Competition:

Many firms follow a flexible pricing policy to counter competition. Prices are to be varied depending upon market condition.

5. Control Cash-flow:

A principal pricing objective is to return cash as much as possible (the funds invested) within a given period. Investment in research and development, market development, promotion, etc., should pay back within a specified period. Capital expenditure on any project must be recovered within 5 to 10 years. Pay-back or cash-flow objectives fit in easily with other corporate objectives.

While determining objectives of a pricing policy, marketers must take into account reactions of number parties such as customers, competition, resellers or dealers, Government, public opinion, and so on. For instance, there may be a conflict between sales maximisation objective and a return on investment or profit objective. However, it should be noted that maximum market penetration in the short-run (in the early phase of the product life-cycle) is the key to maximum ROI in the long run.

6. To Penetrate the Market:

Many firms enter the market by charging a very low price for the product. Example- Low-price Chinese toys have flooded the market.

7. Meet or Follow Competition:

Many firms desire the stabilisation of price levels and operating margins as more important than the maintenance of a certain level of short-run profits. The price leader maintains stable prices in the industry. Follow the leader