



# MANAGERIAL ECONOMICS

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Lecture No - 38 : Product Pricing

**Session Outline**

**Product Pricing**

## Third Degree Price Discrimination

This is most common type

It separates markets on the basis of the price elasticity of demand

Segmentation is based on geographic separation of markets, nature of use, personal characteristics of consumer.

## International Price Discrimination and Dumping

Prices are different in international market, depending on paying capacity and price elasticity of demand.

**Dumping** – strategy adopted by a country where a product is exported in bulk to a foreign country at a price which is either below the domestic market price or below the marginal cost of production.

## Indian Railway and Price Discrimination

Indian railway is the largest monopoly in the country and charges different fare under various heads.

**On the basis of consumer categories** – Doctors, Senior Citizen, patients, students, unemployed youth etc.

25% concession for 10 categories of passenger

50% concession for 27 categories

75% concession for 26 categories

100% concession for 2 categories

## Indian Railway and Price Discrimination

**On the basis of class of travel**

Seven classes – Different fare

## Indian Railway and Price Discrimination

### **On the basis of category of train**

Discrimination is on the basis of time covered in travel.

Rajdhani, Shatabdi, superfast, mail/express, Garib Rath, Jan Shatabdi, passenger and shuttle

## International Price Discrimination and Dumping

It is a kind of predatory pricing which is aimed at gaining monopoly in a foreign country or at disposing of excess inventory in order to avoid reduction in home price and thereby help in reduction in producer's income.

Dumping is a pricing which is below the fair value of the product.



## International Price Discrimination and Dumping

WTO has a provision of imposing special duties to counteract such a policy if the affected country can prove that dumping has taken place and is harming its industry.

India in several instances investigated against imports of consumer goods and anti dumping duties have been imposed.

## Types of Product Pricing

Cost based Pricing

Pricing based on Firm's objectives

Competition based pricing

Product life cycle based pricing

Perceived value pricing

## Cost based Pricing

The natural basis of determination of price should be the cost of production with some margin.

- Cost plus Pricing
- Price of product is the sum of cost plus a profit margin.

## Cost based Pricing

Which cost to be included in price?

Total cost including fixed cost or only variable cost?

**Total Cost – Cost plus pricing**  
**Variable cost based pricing – Marginal costing**

## Cost based Pricing

### Cost plus or Mark up Pricing :

A firm will consider total cost per unit or average cost ( $AFC + AVC$ ) and determine a mark up, depending upon various considerations such as target rate of return, degree of competition, price elasticity and availability of substitutes.

## Cost based Pricing

## Cost plus or Mark up Pricing :

$$\text{Price} = \text{AC} + m$$

Where  $m$  is the percentage of mark up.

## Cost based Pricing

### Marginal Cost Pricing :

When demand is slack and market is highly competitive, full cost pricing may not be the right choice.

Variable cost to be added in price.

Here is Price of the product is the sum of variable cost plus a profit margin.

## Cost based Pricing

### Marginal Cost Pricing :

Incremental cost pricing

Base price (Cost) is less than in case of full cost pricing hence price would be highly competitive.

This method is used to beat competitors.

Useful in public utility (social justice) where profitability is not the objective.



## Cost based Pricing

### Target Return Pricing

Mark up is decided by producer rationally not arbitrarily.  
Price is determined as marginal cost , however margin is decided on the basis of target rate of return.

Target rate of return determined by Company's experience, consumer's paying capacity and risk involved.

## Pricing based on Firm's Objectives

- Profit maximization – Mark up Pricing
- Sales maximization - Sales Maximisation

## Competition based Pricing

### ▪ Penetration Pricing

- When a firm plans to enter a new market which is dominated by existing players, its only option is to charge a low price, even lower than the ongoing price.
- Penetration pricing – marginal cost pricing
- Success largely depends on price elasticity of demand.

## Competition based Pricing

### ▪ Entry Detering Pricing

#### ▪ Limit pricing

▪ Success of this strategy depends on the fact that the firm earns economies of scale and hence cannot afford to charge low price.

▪ The electricity rates are charged by public sector units in India are subsidized, hence private players find it difficult to enter the market.

## Competition based Pricing

### ▪ Going rate Pricing

- This rate is adopted when most of the players do not indulge in separate pricing but prefer to follow the prevailing market price.
- Normally price fixed by dominant firm and other firms accept its leadership and follow that price.

## Competition based Pricing

### ▪ Going rate Pricing

Success of this strategy is dependent on the fact that

1. Most of the firms do not want to enter into price war kind of situation
2. Small or new firms may not be sure to shift in demand by charging a different than prevailing market price.
3. Product sold by the players are very close substitute , hence cross elasticity very high.

## Competition based Pricing

### ▪ Going rate Pricing

Popular in oligopoly and monopolistic market where product differentiation is minimal or cosmetic and switching cost is negligible

Adopted for the product that has reached maturity and has become generic.

## Competition based Pricing

### ▪ Going rate Pricing

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## **Session References**

**Micro Economics :ICFAI University Press**

**Managerial Economics – Geetika, Ghosh and Choudhury**

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