



MANAGERIAL ECONOMICS

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Lecture No - 39 : Product Pricing

Session Outline

Product Pricing

Product Life Cycle Based Pricing

- **Product Life**

- **Introduction – Growth _ Maturity - Decline**

Product faces different demand pattern and competition level under different stages

Charging uniform price – less optimum revenue

High price at the introduction stage – low price in decline phase

Product Life Cycle Based Pricing

- Price Skimming
- Under price skimming producer charges a very high price in the beginning to skim the market and earn super margin on sales.
- Mark up cost is normally high.
- First degree price discrimination.
- High price at the time of introduction – low price at the time of maturity.

Product Life Cycle Based Pricing

▪ **Product Bundling**

- Two or more products bundled together for a single price.
- Strategy is used to propagating new product as well as selling a product during decline phase.
- Packaged trip – hotel stay, sight seeing
- Travel package – bedding, food part of train fare
- Breakfast as part of room tariff

Product Life Cycle Based Pricing

- **Perceived Value Pricing**

- Value of goods for different consumers depends upon their perception of utility of the good.

- **Psychological pricing**

- Small sellers identify the perceived value on the basis of knowledge of market forces and charge a price which aims at taking away consumer surplus.

Product Life Cycle Based Pricing

▪ Perceived Value Pricing

- Consumer surplus – understanding of the perceived value of consumers.
- Sellers may try to influence perceived value through brand awareness and emphasis on quality.
- Example- Economy and premium segment
- Tanishq, Philips, Parker – creating hype of high quality.

Product Life Cycle Based Pricing

▪ Value Pricing

- Seller try to create a high value of the product but keep the price low.
- Seller allow some consumer surplus to buyers.
- Seller creates a high value of the product and charge a low price.

Product Life Cycle Based Pricing

▪ Loss Leader Pricing

- Multi product firm sell one product at a low price and compensate the loss by other products.
- HP – Printer is at low price, Cartridge is specific and highly priced.
- Success of this strategy largely depends on a combination of goods which are complementary in nature.

Cyclical Pricing

- The instability in economic condition, like expansion, contraction are referred as business cycle.
- Firms need to consider economic condition in formulating policies.
- Whether the firm should continue the same pricing strategies irrespective of phases of business cycle or they should adopt a different strategies across the phases?

Cyclical Pricing

▪ Rigid Pricing

Company should follow a stable pricing policy irrespective of the phase of economic cycle.

Whether it is a recession or expansion, if consumer can postpone their purchase they would not be affected by a fall or rise in price.

If a firm reduces its price to attract demand, consumer can wait for more decrease in price.

Cyclical Pricing

▪ Rigid Pricing

In the phase of expansion, if firms increase price, consumer may hasten to buy in fear of further increase in price.

Neither in recession nor in expansion, firm is getting benefit by changing price.

Cyclical Pricing

▪Flexible Pricing

Under this, firms keep their prices flexible to meet the challenges in demand.

FMCG and Agricultural products

Cyclical Pricing

▪Flexible Pricing

During recession prices should be reduced in view of declining income of consumers, where as when income rises prices can also be raised to take advantages of higher demand, especially where the supply is less elastic.

Multi Product Pricing

Firms who produce a large number of goods which have some kind of interdependence either in terms of production or demand.

Options for multi product firm :

1. produce and sell its final product to the end consumer.
2. produce and sell only which are used as intermediary goods.

Multi Product Pricing

A firm which produce intermediary products-

- Use these goods internally for final goods production
- Sell part of it to other firms
- Sell to other firms

Pricing strategies would be different in different cases.

Multi Product Pricing

Interdependence between the products:

- Demand Interdependence
- Supply Interdependence
- Input output Relationship

Multi Product Pricing

- **Demand Interdependence**

- **Substitutes**

- Optimal output of each good will be less than when there was no demand interdependence – as these goods compete with each other in the same market and sales of one product can not be enhanced at the expenses of others, hence firm cannot sell maximum of either of these products.

Multi Product Pricing

Demand Interdependence

▪ Substitutes

- If price of one commodity is increased it will push its customer to the substitute .
- Seller must treat its own product on the same pattern as those of competitors –
- charge the same price for both the goods or differentiate the products and take advantages of perceived value pricing.

Multi Product Pricing

- **Demand Interdependence**
- Substitutes – Going rate or combination of cost based pricing strategies

Multi Product Pricing

- **Demand Interdependence**

- **Complements**

- An increase in demand for the other as well, optimal output is greater than when there was no demand interdependence.

- increase in price of one good would result in decrease in demand for both the goods.

Multi Product Pricing

- Demand Interdependence
 - Complements
 - Pricing strategy should be either product bundling or loss leader – depending on company's objective and market condition.

Multi Product Pricing

▪ Supply Interdependence

- Firm has to first decide whether it would further process both products or
- Would dispose of the joint product and process and sell only the primary product.
- First option – Full costing of the primary product
- Second option – Marginal costing for the joint product

Multi Product Pricing

▪ **Input Output Relationship**

- Large firms producing multi products bearing input output relationship.
- Soft drink manufacture – bottling plant
- Tata sons – iron and steel, trucks and cars

▪ Pricing – Transfer Pricing

Ramsay Pricing

- Frank Ramsay – Model of Taxation
- Government should levy high tax on the goods which had low price elasticity and low tax for the goods which had high price elasticity

Ramsay Pricing

Firm should fix up the price close to marginal cost of the product which has highly elastic demand and should change substantial margin.

Price deviation from marginal cost should be inversely proportional to price elasticity of product.

Transfer Pricing

These are the charges made when a company supplies goods, services or financials to another company to which it is related as its subsidiary or sister concern.

When firm is vertically integrated, it encounters the problem of fixing price of product demanded for internal use.

Transfer Pricing

Use of these goods is part of total cost of final product but involve no cash outflow rather is only transfer of accounts from one subsidiary to another – transfer pricing

Used in large organization for transaction between various divisions, internal pricing as opposed to external market.

Transfer Pricing

It gained importance with the growth of MNCs.

It is often misused to evade taxes on net profit – government keeps strict check on transfer pricing so that corporate may not evade tax payments.

It helps related entities to reduce global incidence of tax by transferring high income to low tax jurisdiction or greater expenditure to those jurisdiction where tax is high.

Transfer Pricing

All regulatory authorities agree that transfer price should be at arm's length price – same price should be charged whether the product is transacted between related parties or with third party.

Transfer Pricing

Problem arise when the product is transacted only between related parties – there are various option for determining the arm's length price -

- Comparable uncontrolled price method
- Resale price method
- Cost plus method
- Transactional net margin method

Transfer Pricing

The transfer pricing law require that a company should submit details of its own transaction with others – major problem is non availability of comparable information in public domain.

Session References

Managerial Economics – Geetika, Ghosh and Choudhury