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strategy while launching fast moving consumer products. The policy results in high sales volume during the initial stages of a product's life cycle. Some retailers use this strategy by operating on the principle of low mark-up and higher volume. Penetrating pricing is an aggressive pricing strategy and it may be used to restrict the entry of new firms in the industry.

Penetrating pricing is desirable under the following conditions :

(*a*) Demand for the product is highly elastic, *i.e.*, the quantity sold is highly sensitive to price.

(*b*) Substantial economies in unit cost can be achieved by operating at large volumes of production and sales.

(*c*) There is strong potential competition in the market.

(*d*) High income market is inadequate, *i.e.*, very few consumers are willing to pay a high price.

(*e*) The public is likely to accept the new product as a part of its daily life.

'Nirma' detergent powder quickly penetrated into the mass market by providing value for money and displaced the higher-priced 'Surf' in India.

Sometimes, a product can be rescued from a premature death by adopting penetrating pricing after the cream of the market has been skimmed. For a product having big market potential, a policy of low initial price makes sense. However, very low price may bring in demand which the firm is unable to meet. Some consumers may think that the low priced product is of poor quality. In case costs are underestimated, it may be difficult to raise prices later on to cover the unforeseen costs. The choice between skimming and penetrating pricing will depend largely on the ease and speed with which competitors can bring out substitute products.

3. Cost Plus Pricing : The basic idea underlying this approach is that the selling price of a product must cover its full cost and yield a reasonable margin of profit. The margin may be a fixed amount per unit or a percentage of cost. The margin is known as 'mark up' and, therefore, cost plus pricing is also known as 'mark up pricing'. The following formula is generally used to fix prices under this approach :

> Selling price = Total cost per unit + Desired profit per unit.

The actual formula used for cost plus pricing may vary widely between industries and even between firms within an industry. The variation arises due to differences in the composition of cost and different accounting practices, or methods of cost determination.

The term 'total unit cost' may be defined in several ways. Actual, expected and standard costs are the usual concepts of cost. Actual cost implies historical cost or current cost. It reflects the cost for the latest available period at the current rate of output. Expected cost is a forecast or estimated cost calculated on the basis of expected rate of output, efficiency and expected unit prices. Standard cost is the cost that should be at some normal rate of output and at the standard level of efficiency. In actual practice, cost is determined on the basis of estimates and cost experience. Actual cost appears to be the most relevant concept as expected and standard costs are conjectures.

The profit margin or mark-up that is added to cost differs from firm-to-firm. The amount of the margin depends upon the distinctiveness of the product, degree of competition, industry practice and some vague notion of a reasonable profit. Rate of return on investment is a useful method of deciding the mark up, particularly for large well-established firms. Under this approach, the firm first of all determines the target rate of return. Then the normal volume of production and its standard cost is determined. The amount of capital investment divided by the standard cost of normal output gives the figure

4. Quality and Service : An article may be sold at a price much above the cost if the customers consider that the article is of exceptional quality or value services rendered in its sale. On the other hand, the article may not sell even at a low price if the quality or service is considered to be very poor.

5. Buying Motives : A customer may pay a high price to satisfy his vanity. This happens when the article is purchased for status or prestige. Price must be consistent with the desired public image of the product.

6. Promotional Strategy : Firms using intensive techniques of sales promotion may price their products above the market price. They attempt to differentiate the product from competitive products and satisfy the customers that the product is high priced due to its special advantage.

Similarly, policies relating to channels of distribution, after-sales services, etc., influence prices.

7. Risks : Some seasonal goods and fashion articles are sold at prices out of line with costs to cover unusual risks undertaken by the seller. Goods which are sold on liberal terms of credit may also be high priced to cover loss of interest and risk of bad debts.

8. Government Control : Prices of certain products are regulated by the government. In India, maximum prices of edible oils, automobiles, sugar, cement, etc., are fixed by the government. Public policy, therefore, influences prices.

2.6.1. Pricing Strategies

Individual pricing decisions should be taken on the basis of a systematic approach. Pricing strategies provide a framework within which pricing decisions can be taken systematically to achieve the pricing objectives. These strategies provide guidelines for deciding and implementing prices for different products and markets. A sound pricing strategy facilitates a balanced and rational approach to pricing decisions. Some of the pricing **strategies** available to marketers are given below.

1. Skimming (Skim the Cream) Pricing : In this strategy, a very high price is set so that in the initial stages the cream of demand may be skimmed and the investment made in the product is quickly realised. The aim is to 'sell to classes' who don't care how much they pay for a novel product. Later on, the price may be reduced to tap other segments of the market. This strategy is appropriate in case of a highly distinctive product which is aggressively promoted in the early stages of its life cycle. Skimming pricing is effective for new and distinctive products due to the following reasons :

(*a*) In the early stages the product is distinctive and imitation has not taken effect. Therefore, price is less likely to affect the sales volume, *i.e.*, the demand is inelastic.

(*b*) High price in the initial stages will provide funds for expansion into the big volume segments of the market.

(*c*) Skimming pricing takes the cream of the market before attempting to penetrate the more price sensitive sections of the market.

(*d*) The strategy can be used to feel out the market. It is easier to start out with a high initial price and reduce it later than to set a low price initially and then raise the price to cover unforeseen costs.

(*e*) By setting initial price at a high level the manufacturer can restrict demand to the level which he can meet.

Skimming the cream strategy is likely to attract competitors and as new firms enter to reap good profits, price may have to be lowered.

2. Penetrating Pricing : This strategy involves setting a low price in the initial stage so as to make the brand quickly popular and to maximise the market share. The manufacturer seeks to sell to the masses. Many firms use this increasingly popular due to increasing competition, need for control over distribution costs, wide product lines, technical nature of products, availability of public warehouses and desire to reduce dependence on middlemen.

Direct Selling

Direct sale means the producer directly sells goods to ultimate consumers and there is no middleman or intermediary. A manufacturer can sell directly to consumers through the following methods :

(a) **Door-to-Door Salespersons :** The producer employs sales force who approach customers at their residences/ offices, book orders and deliver the goods. For example, Eureka Forbes Ltd. has been selling its 'Aquaguard' brand of water purifiers and vacuum cleaners through this method. Sales call is the original and the oldest form of direct marketing. Many companies such as Avon, Amway and Tupperwave are also using this method

(b) **Retail Outlets :** A big company opens its own chain of retail stores in different parts of the country. It may also franchise a number of retailers to sell its products. Bata India Ltd. and Raymonds have adopted this method.

(c) **Catalogue Selling :** In this method the seller mails one or more product catalogues to selected persons who are likely to place an order. For example, Avon sells cosmetics through this method. Also known as direct mail selling, it involves preparing a highly selective mailing list and sending catalogues, letters, folders, audio tapes and video tapes to prospective customers in the list. The prospective customers read these and send orders. Direct mail is a popular medium because it permits high degree of selectivity, is flexible and allows early testing and measurement. In this method, customers place orders by mail, telephone or fax. The producer delivers the product through V.P.P. (Value Payable Post) or courier.

(d) **Telemarketing :** The product is heavily advertised on TV. The customers who watch the advertisements and feel interested can place their orders by telephone, mail or fax. The product is delivered to customers through courier, V.P.P. or the producer's own vehicles. Asian Sky Shop is using this method in India.

Telemarketing has become a major direct marketing tool. Some telemarketing systems are fully automated. For example, automatic dialing and recorded message prayers (ADRMPs) can dial numbers, play a recorded advertising message and take orders from. interested customers, on an answering machine device or by forwarding the call to an operator.

(e) **On Line Marketing OR Internet Marketing :** This is the latest method of direct selling. It is a very convenient and hasslefree method. Customers can order products 24 hours a day wherever they are. They need not visit the store and face salespersons. They can access information on the Internet about competing brands. This method is less expensive for the seller. He can quickly add products and change prices and descriptions. It also helps the seller in building relationship with customers.

Direct distribution is useful when aggressive selling is required to push up a new product or when the benefits of the product need to be effectively demonstrated or when specific target customers (*e.g.*, housewives) are to be reached. Direct of capital turnover. When multiplied by target rate of return, capital turnover provides the percentage mark-up. For example, if capital turnover is 1.2 and the target rate of return is 15 per cent, the mark-up standard cost will be 18 per cent.

Advantages : Cost plus pricing is the most widely used technique of pricing. It is a safe approach to pricing. It ensures full coverage of costs and helps in achieving a reasonable return on capital employed. The method is logical and can be defended on moral grounds. It discourages cut-throat competition in the market.

Disadvantages : Cost plus pricing suffers from following limitations :

(*a*) It is very often difficult to determine accurately the cost per unit due to common overheads and joint products. The method involves arbitrary allocation of costs in such cases.

(*b*) The method ignores the nature and level of demand. The resulting price may, therefore, be out of line with market conditions.

(*c*) It fails to reflect competition in the market.

(*d*) The mark-up on the cost of the product is not fixed but may change with changes in demand. In practice, the rule of thumb methods are used to determine the mark-up.

(*e*) The method makes for rigidity in pricing and may restrict the size of the firm below the optimum level.

(*f*) The strict adherence to cost plus pricing may result in loss of business as the firm does not know how much a customer is willing to pay.

(*g*) It presumes a fixed margin of profit. But in practice, businessmen increase the margin of profit when they expect good demand.

(*h*) Cost plus pricing may not always be feasible. When there is idle capacity, cost plus pricing will not be useful.

4. Parity Pricing : Under this pricing strategy a business firm adjusts its own price policy to the general pricing structure in the industry. It involves charging according to what competitors are charging. Many companies in an industry follow the price level set by the market leader. It is also known as going rate pricing' or competition based pricing.

Parity pricing is an appropriate strategy in the following situations :

(*a*) When it is very difficult to measure costs, parity pricing may be the logical first step in a rational pricing strategy.

(*b*) When price leadership is well established, charging according to what competitors are charging may be the only safe policy. In an oligopolistic market, charging lower than the leader may lead to price war.

(*c*) Where competition is very severe and competitive products are homogeneous.

(*d*) It may be less troublesome and less costly than an individualistic pricing strategy.

2.7. PLACE — DISTRIBUTION CHANNELS

Distribution of products is an important element of marketing mix. Distribution element involves two broad functions, namely : (*a*) the choice of distribution channel through which the product shall flow from the manufacturer to ultimate users, and (*b*) physical distribution comprising transportation and storage of goods. So far as the choice of channel is concerned, the firm may distribute its product directly to customers without any intermediaries. Alternatively, it may distribute through one or more middlemen such as wholesaler, retailer, selling agent, etc. Whatever channel is used, the selling has become popular due to increasing costs of distribution, scattered-markets, cut-throat competition, desire to maintain control over distribution, modern means of communication, etc.

2. Manufacturer-Retailer-Consumer : Under this channel, the manufacturer sells to one or more retailers who in turn sell to the ultimate consumers. Various marketing functions are performed by the producer and the retailers. This channel is popular when the retailers are big and buy in large quantities, *e.g.*, departmental stores, chain stores and supermarkets. This channel is often used for the distribution of consumer durables and products of high value. Automobiles, home appliances, readymade garments, shoes and perishable products are often sold through this channel. This channel relieves the manufacturer from much burden of selling and at the same time provides him control over distribution.

3. Manufacturer-Wholesaler-Retailer-Consumer : This is the 'traditional' or normal channel for the distribution of consumer goods. This channel is suitable where the producer has limited finance and a narrow product line or where the wholesalers are specialised and provided strong promotional support. Small producers and small retailers find this channel most convenient especially in case of products with widely scattered markets. This channel is also used in case of consumer durables which are not subject to frequent changes in fashion. Producers of industrial goods may use an industrial distributor who serves as a wholesaler as well as a retailer.

4. Manufacturer-Agent-Retailer-Consumer : When the retailers are few or geographically concentrated, distribution through agents may be more economical than through wholesalers. For instance, a manufacturer may employ selling agents and brokers to sell his products to retailers. Sometimes, even the retailer is bypassed and the agent sells directly to institutional buyers like consumer cooperatives, business firms, educational institutions and government agencies or departments. This channel is commonly used to sell textiles, agricultural products, machinery and equipment, etc. In case of industrial goods, an agent may be used in place of industrial distributor to reach industrial users.

5. Manufacturer-Agent-Wholesaler-Retailer-Consumer : This is the longest channel of distribution. It is used when the manufacturer wants to be fully relieved of the problem of distribution. The producer hands over his entire output to the selling agent who distributes it among a few wholesalers. Each wholesaler sells to a number of retailers who in turn sell to ultimate consumers. In case of cloth this channel is widely used. For the sale of many industrial products an industrial distributor is employed due to the storage facilities provided by him. This channel results in wider distribution of the product.

2.8. FACTORS DETERMINING CHOICE OF CHANNEL OF DISTRIBUTION

While choosing a channel of distribution, the following factors should be taken into consideration.

1. Product Considerations : The nature and type of the product have an important bearing on the choice of distribution channels. The main characteristics of the product in this respect are given below :

(a) **Unit Value :** Products of low unit value and common use are generally sold through middlemen as they cannot bear the costs of direct selling. Low priced and high turnover articles like cosmetics, hosiery goods, stationery and small accessory equipment usually flow through a long channel. On the other hand, expensive consumer goods and industrial products, *e.g.*, jewellery, machines are sold directly by the producers.

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Questions:

Q.1. Write short notes on the following
a) Skimming Pricing
b) Penetrating Pricing
c) Cost Plus Pricing
d) Parity Pricing

Q2 - Discuss the various methods of Direct selling.

Q3 - Discuss the advantages and disadvantages of Cost Plus Pricing.