www.idosr.org Hoch and Rao
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International Digital Organization for Scientific Research ISSN: 2550-7931
IDOSR JOURNAL OF APPLIED SCIENCES 5(2) 42-48, 2020.

Review on Impact of Pricing Policy in an Organization

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ABSTRACT

Pricing is the process whereby a business sets the price at which it will sell its products and services, and may be part of the business's marketing plan. In setting prices, the business will take into account the price at which it could acquire the goods, the manufacturing cost, the marketplace, competition, market condition, brand, and quality of product. A systematic approach to pricing requires the decision that an individual pricing situation be generalised and codified into a policy cover-age of all the principal pricing problems. Policies can and should be tailored to various competitive situations. A policy approach which is becoming normal for sales activities is comparatively rare in pricing. Therefore this review work will detail all the procedures required in price policy used in managing customers in an organization.

Keywords: Pricing Policy, organization, marketing and approach.

INTRODUCTION

Price is one of the most flexible elements of the marketing mix, which interferes directly and in a short term over the profitability and cost effectiveness of a company [1]. Despite the importance a price has on the performance of businesses, it seems that such element has not received the proper attention by many academics and marketing professionals [2]. Typically, in marketing, the main focus is placed on the development of new products, distribution channels and communication strategies, and according to [3] this could lead to precipitated pricing decisions without properly evaluating market and cost factors. Thus, pricing is treated as the simplest strategy within marketing, perhaps because many companies determine their prices based on intuition and the manager's market experience [4]. In addition, only few managers strategically think about pricing while proactively administrating their prices in order to create favorable conditions that lead to profits [5]. Considering this, [6] highlight the need for more research regarding the pricing preferences and practices because, according to the authors, less than 2% of all published articles in marketing journals are focused on pricing.

A pricing policy is a standing answer to recurring question. A systematic approach to pricing requires the decision that an individual pricing situation be generalised and codified into policy cover-age of all the principal pricing problems [7]. Policies can and should be tailored to various competitive situations. A policy approach which is becoming normal for sales activities is comparatively rare in pricing. Most well managed manufacturing enterprises have a clear cut advertising policy, product customer policy and distribution-channel policy. But pricing decision remains a patchwork of ad hoc decisions. In many, otherwise a well managed firm, price policy has been dealt with on a crisis basis [8]. This kind of price management by catastrophe discourages the kind of systematic analysis needed for clear cut pricing policies.

Pricing Policy Considerations in an Organisation

The following considerations involve in formulating the pricing policy are as below [9]:

(i) Competitive Situation:

Pricing policy is to be set in the light of competitive situation in the market. We have to know whether the firm is facing perfect competition or imperfect competition. In perfect competition, the producers have no control over the price. Pricing policy has special signifi-cance only under imperfect competition.

(ii) Goal of Profit and Sales:

The businessmen use the pricing device for the purpose of maximizing profits. They should also stimulate profitable combination sales. In any case, the sales should bring more profit to the firm [10].

(iii) Long Range Welfare of the Firm:

Generally, businessmen are reluctant to charge a high price for the product because this might result in bringing more producers into the industry. In real life, firms want to prevent the entry of rivals. Pricing should take care of the long run welfare of the company.

(iv) Flexibility:

Pricing policies should be flexible enough to meet changes in economic conditions of various customer industries. If a firm is selling its product in a highly competitive market, it will have little scope for pricing discretion. Prices should also be flexible to take care of cyclical variations.

(v) Government Policy:

The government may prevent the firms in forming combinations to set a high price. Often the government prefers to control the prices of essential commodities with a view to prevent the exploitation of the consumers. The entry of the government into the pricing process tends to inject politics into price fixation.

(vi) Overall Goals of Business:

Pricing is not an end in itself but a means to an end. The fundamental guides to pricing, therefore, are the firms overall goals. The broadest of them is survival. On a more specific level, objectives relate to rate of growth, market share, maintenance of control and finally profit. The various objectives may not always be compatible [11]. A pricing policy should never be established without consideration as to its impact on the other policies and practices.

(vii) Price Sensitivity:

The various factors which may generate insensitivity to price changes are variability in consumer behaviour, variation in the effectiveness of marketing effort, nature of the prod-uct, importance of service after sales, etc [12]. Businessmen often tend to exaggerate the importance of price sensitivity and ignore many identifiable factors which tend to minimize it.

(viii) Routinisation of Pricing:

A firm may have to take many pricing decisions. If the data on demand and cost are highly conjectural, the firm has to rely on some mechanical formula [13]. If a firm is selling its product in a highly competitive market, it will have little scope for price discretion. This will have the way for routinised pricing.

Objectives of Pricing Policy

The pricing policy of the firm may vary from firm to firm depending on its objective. In practice, we find many prices for a product of a firm such as wholesale price, retail price, published price, quoted price, actual price and so on [14]. Special discounts, special offers, methods of payment, amounts bought and transportation charges, trade-in values, etc., are some sources of variations in the price of the product. For pricing decision, one has to define the price of the product very carefully.

Pricing decision of a firm in general will have considerable repercussions on its marketing strategies. This implies that when the firm makes a decision about the price, it has to consider its entire marketing efforts [15]. Pricing decisions are usually considered a part of the general strategy for achieving a broadly defined goal. While setting the price, the firm may aim at the following objectives [16]:

(i) Price-Profit Satisfaction:

The firms are interested in keeping their prices stable within certain period of time irrespective of changes in demand and costs, so that they may get the expected profit.

(ii) Sales Maximisation and Growth:

A firm has to set a price which assures maximum sales of the product. Firms set

a price which would enhance the sale of the entire product line. It is only then, it can achieve growth.
(iii) Making Money:
Some firms want to use their special position in the industry by selling product at a premium and make quick profit as much as possible [10].
(iv) Preventing Competition:
Unrestricted competition and lack of planning can result in waste-ful duplication of resources. The price system in a competitive economy might not reflect societies real needs. By adopting a suitable price policy the firm can restrict the entry of rivals.
(v) Market Share:
The firm wants to secure a large share in the market by following a suitable price policy. It wants to acquire a dominating leadership position in the market [11]. Many managers believe that revenue maximisation will lead to long run profit maximisation and market share growth.
(vi) Survival:
In these days of severe competition and business uncertainties, the firm must set a price which would safeguard the welfare of the firm [12]. A firm is always in its survival stage. For the sake of its continued existence, it must tolerate all kinds of obstacles and challenges from the rivals.
(vii) Market Penetration:
Some companies want to maximise unit sales. They believe that a higher sales volume will lead to lower unit costs and higher long run profit [13]. They set the lowest price, assuming the market is price sensitive. This is called market penetration pricing.
(viii) Marketing Skimming:
Many companies favour setting high prices to 'skim' the market. Dupont is a prime practitioner of market skimming pricing. With each innovation, it estimates the highest price it can charge given the comparative benefits of its new product versus the available substitutes.
(ix) Early Cash Recovery:
Some firms set a price which will create a mad rush for the product and recover cash early. They may also set a low price as a caution against uncertainty of the future.
(x) Satisfactory Rate of Return:
Many companies try to set the price that will maximise current profits [14]. To estimate the demand and costs associated with alternative prices, they choose the price that produces maximum current profit, cash flow or rate of return on investment.

Factors Involved in Pricing Policy

The pricing of the products involves consideration of the following factors [15]:
(i) Cost Data.
(ii) Demand Factor.
(iii) Consumer Psychology.
(iv) Competition.
(v) Profit.
(vi) Government Policy.

(i) Cost Data in Pricing:

Cost data occupy an important place in the price setting processes. There are different types of costs incurred in the production and marketing of the product. There are production costs, promotional expenses like advertising or personal selling as well as taxation, etc. They may necessitate an upward fixing of price [16]. For example, the prices of petrol and gas are rising due to rise in the cost of raw materials, such as crude transportation, refining, etc. If costs go up, price rise can be quite justified. However, their relevance to the pricing decision must neither be underestimated nor exaggerated [17]. For setting prices apart from costs, a number of other factors have to be taken into consideration. They are demand and competition.

Costs are of two types

Fixed costs and variable costs. In the short period, that is, the period in which a firm wants to establish itself, the firm may not cover the fixed costs but it must cover the variable cost. But in the long run, all costs must be covered. If the entire costs are not covered, the producer stops production. Subsequently, the supply is reduced which, in turn, may lead to higher prices [18]. If costs are not covered, the producer stops production. Subsequently, the supply is reduced which, in turn, may lead to higher prices.

If costs were to determine prices why do so many companies report losses?
There are marked differences in costs as between one producer and another. Yet the fact remains that the prices are very close for a somewhat similar product. This is the very best evidence of the fact that costs are not the determining factors in pricing [19]. In fact, pricing is like a tripod. It has three legs. In addition to costs, there are two other legs of market demand and competition. It is no more possible to say that one or another of these factors determines price than it is to assert that one leg rather than either of the other two supports a tripod. Price decisions cannot be based merely on cost accounting data which only contribute to history while prices have to work in the future. Again it is very difficult to measure costs accurately. Costs are affected by volume, and volume is affected by price. The management has to assume some desired price-volume relationship for determining costs. That is why, costs play even a less important role in connection with new products than with the older ones [20]. Until the market is decided and some idea is obtained about volume, it is not possible to determine costs. Regarding the role of costs in pricing, Nickerson observes that the cost may be regarded only as an indicator of demand and price. He further says that the cost at any given time represents a resistance point to the lowering of price [21]. Again, costs determine profit margins at various levels of output. Cost calculation may also help in determining whether the product whose price is determined by its demand, is to be included in the product line or not. What costs determine is not the price, but whether the production can be profitably produced or not is very important.

Relevant Costs

The question naturally arises: "What then are the relevant costs for pricing decision? Though in the long run, all costs have to be covered, for managerial decisions in the short run, direct costs are relevant [22]. In a single product firm, the management would try to cover all the costs." In a multi-product firm, problems are more complex. For pricing decision, relevant costs are those costs that are directly traceable to an individual product. Ordinarily, the selling price must cover all direct costs that are attributable to a product. In addition, it must contribute to the common cost and to the realisation of profit. If the price, in the short run, is lower than the cost, the question arises, whether this price covers the variable cost [17]. If it covers the variable cost, the low price can be accepted. But in the long run, the firm cannot sell at a price lower than the cost. Product pricing decision should be lower than the cost. Product pricing decision should, therefore, be made with a view to maximise company's profits in the long run.

(ii) Demand Factor in Pricing

In pricing of a product, demand occupies a very important place. In fact, demand is more impor-tant for effective sales. The elasticity of demand is to be recognised in determining the price of the product. If the demand for the product is inelastic, the firm can fix a high price. On the other hand, if the demand is elastic, it has to fix a lower price [18]. In the very short term, the chief influence on price is normally demand. Manufacturers of durable goods always set a high price, even though sales are affected. If the price is too high, it may also affect the demand for the product. They wait for arrival of a rival product with competitive price. Therefore, demand for product is very sensitive to price changes.

(iii) Consumer Psychology in Pricing

Demand for the product depends upon the psychology of the consumers. Sensitivity to price change will vary from consumer to consumer. In a particular situation, the behaviour of one individual may not be the same as that of the other. In fact, the pricing decision ought to rest on a more incisive rationale than simple elasticity. There are consumers who buy a product provided its quality is high. Generally, product quality, product image, customer service and promotion activity influence many consumers more than the price [18]. These factors are qualitative and ambiguous. From the point of view of consumers, prices are quantitative and unambiguous. Price constitutes a barrier to demand when it is too low, just as much as where it is too high. Above a particular price, the product is regarded as too expensive and below another price, as constituting a risk of not giving adequate value. If the price is too low, consumers will tend to think that a product of inferior quality is being offered. With an improvement in incomes, the average consumer becomes quality conscious [6]. This may lead to an increase in the demand for durable goods. People of high incomes buy products even though their prices are high. In the affluent societies, price is the indicator of quality. Advertisement and sales promotion also contribute very much in increasing the demand for advertised products. Because the consumer thinks that the advertised products are of good quality. The income of the consumer, the standard of living and the price factor influence the demand for various products in the society.

(iv) Competition Factor in Pricing:

Market situation plays an effective role in pricing. Pricing policy has some managerial discretion where there is a considerable degree of imperfection in competition. In perfect competition, the individual producers have no discretion in pricing. They have to accept the price fixed by demand and supply. In monopoly, the producer fixes a high price for his product [19]. In other market situations like oligopoly and monopolistic competition, the individual producers take the prices of the rival products in determining their price. If the primary determinant of price changes in the competitive condition is the market place, the pricing policy can least be categorised as competition based pricing.

(v) Profit Factor in Pricing:

In fixing the price for products, the producers consider mainly the profit aspect. Each producer has his aim of profit maximisation. If the objective is profit maximisation, the critical rule is to select the price at which MR = MC. Generally, the pricing policy is based on the goal of obtaining a reasonable profit. Most of the businessmen want to hold the price at constant level. They do not desire frequent price fluctuation [19]. The profit maximisation approach to price setting is logical because it forces decision makers to focus their attention on the changes in production, cost, revenue and profit associated with any contemplated change in price. The price rigidity is the practice of many producers. Rigidity does not mean inflexibility. It means that prices are stable over a given period.

(vi) Government Policy in Pricing:

In market economy, the government generally does not interfere in the economic decisions of the economy. It is only in planned economies, the government's interference is very much. According to conventional economic theory, the buyers and sellers only determine the price. In reality, certain other parties are also involved in the pricing process [4]. They are the competition and the government. The government's practical regulatory price techniques are ceiling on prices, minimum prices and dual pricing. In a mixed economy like India, the government resorts to price control. The business establish-ments have to adopt the government's price policies to control relative prices to achieve certain targets, to prevent inflationary price rise and to prevent abnormal increase in prices.

Factors Affecting the Pricing Decisions

Price is the only element of marketing mix that helps in generating income. Therefore, a marketer should adopt a well-planned approach for pricing decisions. The marketer should know the factors that influence the pricing decisions before setting the price of a product. The following are the factors below [20]:

I. Organizational Objectives:

Affect the pricing decisions to a great extent. The marketers should set the prices as per the organizational goals. For instance, an organization has set a goal to produce quality products, thus, the prices will be set according to the quality of products. Similarly, if the organization has a goal to increase sales by 18% every year, then the reasonable prices have to be set to increase the demand of the product.

II. Costs:
Influence the price setting decisions of an organization. The organization may sell products at prices less than that of the competitors even if it is incurring high costs. By following this strategy, the organization can increase sales volumes in the short run but cannot survive in the long run [20]. Thus, the marketers analyze the costs before setting the prices to minimize losses. Costs include cost of raw materials, selling and distribution overheads, cost of advertisement and sales promotion and office and administration overheads.

III. Legal and Regulatory Issues:
Persuade marketers to change price decisions. The legal and regulatory laws set prices on various products, such as insurance and dairy items. These laws may lead to the fixing, freezing, or controlling of prices at minimum or maximum levels [20].

IV. Product Characteristics:
Include the nature of the product, substitutes of the product, stage of life-cycle of the product, and product diversification.

V. Competition:
Affects prices significantly. The organization matches the prices with the competitors and adjusts the prices more or less than the competitors. The organization also assesses that how the competitors respond to changes in the prices.

VI. Pricing Objectives:
Help an organization in determining price decisions. For instance, an organization has a pricing objective to increase the market share through low pricing [21]. Therefore, it needs to set the prices less than the competitor prices to gain the market share. Giving rebates and discounts on products is also a price objective that influences the customer’s decisions to buy a product.

CONCLUSION

In order to have a better performance than their competitors, companies should establish a set of superior resources, such as, abilities, skills and knowledge, because the role of the price fixing capacity as a way of effectively improving the company's performance is vital. Therefore, a more strategic approach to the companies' pricing process excels as a relevant element for the companies' better performance and for the construction of a possible source of competitive advantage. The profitability and cost effectiveness of the companies are highly attached to a pricing strategy that visualizes their internal capacities, skills and corporate advantages against their competitors while also considering their customer's needs or how much they are willing to pay. Setting lower prices could sacrifice profits because a greater sales volume may not compensate for a lower profit margin. Higher prices could also sacrifice profits because greater margins per unit may not compensate for a smaller sales volume.

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