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Chapter 7 - External Pricing / Pricing Policy

Concepts

1. AIM is "What should be the price for the product / Service".
2. It should be Value for Money. The value will mean different for different people.
3. Based on company cost, we have a base price i.e. price below which the company will not sell
   a. Total Cost +
   b. Marginal Cost +

4. What are external factors that will affect the selling prices

a. Types of market and competition:

(i) **Perfect Competition:** Many Buyers and Many Sellers producing homogeneous products: Accept Going Rate Pricing.

(ii) **Monopolistic Competition**: Many Buyers and Many Sellers NOT producing homogeneous products. The seller with new features will be able to raise the price for some temporary period. Others will catch on soon and the advantage will be lost.

(iii) **Oligopoly:** Few Sellers & Many Buyers. If they join hands, they can be Price setters. If not, the seller with the best quality and service will be able to charge higher.

(iv) **Monopoly**: Sellers & Many Buyers. Seller will set the price

(v) **Monopsony:** 1 buyer & Many Sellers. Accept the price set by the buyer.

b. Competition Based Pricing

(i) **Going Rate Pricing:** Price going on in the market

(ii) **Sealed Bid Pricing:** Tenders by the government. Try to quote the least so that company has the maximum chance of getting the contract.

c. Product life cycle (can be an internal factor also)

(i) **Introduction:** If an innovative product, then SP will be high. If mass product, it will be lowered.

(ii) **Growth**: If an innovative product, then SP will be lowered in this stage. If mass product, it will be raised to some extent as the market would be established.

(iii) **Maturity**: If an innovative product, then SP may be further lowered in this stage. If mass

product, it may be raised further to some extent as the market would be established.

(iv) **Decline**: It is usually reduced to sell

d. Type of product

(i) **Mass / Necessity:** SP is less

(ii) **Class / Luxury:** SP is high

e. Type of strategy

(i) **Skimming**: Charge very high price in the launch i.e. Total Cost PLUS huge Profit

(ii) **Penetration**: Charge very low in the launch i.e. Marginal Cost PLUS

(iii) **Predatory Pricing**: Sell below Marginal Cost to wipe out the competition.

OR

(i) **Product Differentiation:** Concentrate on quality, branding, service and Charge high.

(ii) **Low-Cost advantage:** Concentrate on mass production and sell at least prices

f. Type of economy

(i) **Developed**: SP is usually higher as paying capacity of customers is higher

(ii) **Developing & Underdeveloped**: SP is usually lower.

g. Pricing of a New product

(i) **Revolutionary Product:** Highest Price as the product is innovative.

(ii) **Evolutionary Product**: SP will depend on the success of the evolutionary product

(iii) **Me Too Product**: SP will depend on the value addition of the product.

i. Porter's five forces / five force model to assess the competitive environment of an industry

(i) Bargaining power of buyers

(ii) Bargaining power of suppliers.

(iii) Threat of substitute products or services.

(iv) Threat of New Entrants.

(v) Intensity of competition/rivalry amongst firms.

5. Situation of Skipping, NormaL, Penetration

a. Established Product

(i) Normal Situations: Follow Total Cost PLUS. For-profit, either use ROI, % of Cost or SP or AD-HOC

(ii) Special Situation: Follow Marginal Cost PLUS

b. New Product

(i) New Product for the Market or New product for the company with huge positive factors: Skimming, Normal or Penetration

(ii) New product for the company with NO positive factors: Marginal Cost Plus.

Q1 / Category - Classwork / Star Rating - ⭐

1. In this problem, we are a company called Videocon. We want to make a TV in India.
2. It will import 40% of parts from Sansui japan. Balance 60% will be made in India or purchased from India.
3. Apart from the above cost of the parts, we have Assembling costs, Technical know-how and royalty.
4. We add all the costs and let SP be X. Finally Cost + Profit = SP. We solve the equation and get the answer.

Q2 / Category - Classwork / Star Rating - ⭐

1. It is the simplest Question.
2. That SP is best where Profit is highest

Q3 / Category - Classwork / Star Rating - ⭐

1. Returns mean Returns after tax is tax rate is given in the problem.
2. List Selling Price means MRP price. Do remember what we get is the Sales after trade discount.
3. If SP is to be found and profit is given, you can always use “Sales - Total Cost = Profit”

Q4 / Category - Classwork / Star Rating - ⭐⭐

1,. In the first part, we have contribution. Hence,m we add variable costs to arrive at SP.
2. For the variable cost, we add DM, DL, Variable Factory Overheads and Variable S & D.
3. For Contribution, use the ROI formula. Find Investment for ROI. For investment Take FA and WC.
4. For FA, do remember, we also make other products. Hence take proportionate.
5. For part (ii), it is a regular product which is known, we follow TOTAL COST PLUS
6. For part (iii), it is a new product with no special features. Hence, we follow Marginal Cost plus.

Q5 / Category - Homework / Star Rating - ⭐

Exactly same as the previous one

Q6 / Category - Classwork / Star Rating - ⭐⭐

1. It is one of the best questions that are all about if a company has two similar products with some feature difference, what should be the pricing.
2. In part 1, we have to make a statement to find selling prices based on apportionment being done based on machine hours and labour hours.
3. In Part 2, we discuss how SP should not be based on accounting apportionment and how the difference between products should be reflected in the difference between the SP so that each product gets sold in the market.

Q7 / Category - Classwork / Star Rating - ⭐⭐⭐

1. In usual cases, that option (in this problem the selling price) is best where Profit is highest.
2. Probability is a concept used to determine 1 single outcome (average outcome), instead of many. If we want average profit, find all cases for-profit and then apply probability to them to find average profit.
3. Very good adjustments for material and labour which will also require slab rates. Once that is done, we find the average profit for three selling prices.
4. Second part of this question brings to us the disadvantage of the probability technique getting exposed and that is the final outcome is not possible.
5. In comments, we do say, use probability to assess risk and not compute the final outcome as that is not possible. Risk has three components: Perception, Inclination and Capability.

Q8 / Category - Classwork / Star Rating - ⭐⭐

1. It is a problem with Joint Probability which is P(1) x P(2).
2. In usual cases, that option (in this problem the selling price) is best where Profit is highest.
3. Fixed cost remains the same only, hence we go for that SP where we get the highest contribution.
4. Problem is on probability. that option is best where there is the highest average contribution.

Q9 / Category - Classwork / Star Rating - ⭐⭐

1. In this problem, we follow cost-plus markup pricing of 25%. Based on our estimate of 200,000 units, we get SP as Rs. 50
2. Market research tells us that at Rs. 50, only 140,000 units will be sold. Therefore, what we want is not possible.
3. We evaluate the options which are possible. We select the option with the highest profit. That SP was Rs. 56. It satisfied one other criterion that it gave the company a 25% mark up also.

Q10 / Category - Homework / Star Rating - ⭐

1. It is **May 2019** ICAI exam question.
2. Same as the previous question

Q11 / Category - Classwork / Star Rating - ⭐⭐

1. It is a case scenario.
2. A product is about to be launched. We have to think to launch it at a high price (skimming) or low price (penetration).
3. We are a car manufacturing company. IN past, we have launched cars which are excellent but at less prices. Due to that demand is high. Supply was a problem, and hence second-hand car market had started. All this was because of low prices.
4. We recommend skimming now to remove the problems.
5. One extra thing that I told is that company can think of launching a new brand of premium cars so that

increasing the price is not a problem.

Q12 / Category - Classwork / Star Rating - ⭐⭐

1. The company has got an order and has quoted the customer based on Total Cost plus
2. Customers will pay less. We have to evaluate whether to accept or reject the offer.
3. We argue as the fixed cost will be recovered from normal sales, let's evaluate this order based on marginal cost plus. Moreover, Sales commission will not be payable as the customer has approached the company.
4. In the end, we do discuss that offering lower prices may lead to dissatisfaction among regular clients and they may start the ask for discounts also.

Q13 / Category - Classwork / Star Rating - ⭐⭐

1. The company runs a planetarium. They are about to organise a show for school kids.
2. It wants a minimum price to be quoted. The minimum price will be the cost of organising one show i.e. Rs. 10,000. Moreover, there is no opportunity cost.
3. Among other financial factors, we say that:
    a. Any other cost which will be incurred should also be considered.
    b. Students of the school will eat and drink at the cafeteria which will bring extra income and hence will reduce the cost i.e. minimum price.
4. Among other factors, we say that
    a. Such programs will add to the goodwill of the planetarium.
    b. More schools will start to approach the planetarium for such shows and might become a second line of the business.

Q14 / Category - Classwork / Star Rating - ⭐⭐

1. Similar to the previous two questions. We want the relevant cost of the order.
2. Everything is simple. We follow marginal cost-plus and ignore fixed cost.
3. Be Careful about labour and labour has idle time and hence there will be no extra labour cost.
4. Last part is about the perfect competition market. What should be the pricing strategy? The seller is a price taker. The main aim is cost minimisation and operating at a higher level.

Q15 / Category - Concept Builder Question / Star Rating - ⭐

1. TEV / objective value = Cost of the Next Best Alternative ± Value of Performance Differential
2. Do not set a price higher than TEV. Perceived value is usually lower than TEV. The final price should be below perceived value but above the cost.

Q16 / Category - Classwork / Star Rating - ⭐

1. In this problem, we have to find the TEV of X2. X is its competitor.
2. X2 has an advantage in that the probability of a system crash is less. Hence, we add this.
3. X2 has the disadvantage and that is its operating cost is higher. Hence, we reduce this.

Q17 / Category - Concept Builder Question / Star Rating - ⭐

1. It is a theory that uses Demand / Price elasticity. It means when prices fall, demand rises. Its equation is P = a - bQ.
2. This is not used for products that have inelastic demand.
3. Company gets the highest profit when MR = MC
4. MR = a - 2bQ. Use this equation to find out Q i.e. quantity where profit will be highest.
5. Put the value of Q in P = a - bQ and find the SP at that level.
6. Symbols used

   P = Price, b = Slope of the Demand Curve, Calculated as b = Change in Price / Change in Quantity

   Q = Quantity Demanded, a = Price at Which Demand is Zero

Q18 / Category - Concept Builder Question / Star Rating - ⭐

1. Find Marginal Cost i.e. VC
2. Use MR = MC and find Q
3. Put Q in P - a - bQ and find P.
4. Find the total highest contribution by calculating sales and variable costs at that level.

Q19 / Category - Classwork / Star Rating - ⭐⭐⭐

1. The transferor division is BD. The transferee division is WD.
2. In part 1, we have to think about the company. Hence ignore the transfer price. Do remember that we have to find SP of Wagon and 4 units of Bogie are required for 1 unit of Wagon. Hence, when we find the variable cost of the wagon for the company, do take the cost of 4 bogies and the variable cost of 1 wagon.
3. In part 2, we think about departments and hence transfer price is relevant. We compute the SP of BD first. Incorporate it in the cost of WD and then find the best price.
4. In each of the parts, use the THEORY OF PROFIT MAXIMATION.
5. In the last part, we discuss how skimming for new class bogies for which we have a patent. It is a capital intensive product and for them skimming should be a better option.

Q20 / Category - Classwork / Star Rating - ⭐⭐⭐

1. It is **RTP - May 2021** question
2. The first STEP is to find the variable cost of RIFMN. For that add material, labour and machine cost.

3. It is a normal question of THEORY OF PROFIT MAXIMATION, but "a" is not given. Instead of that, a line is given and that is **The market research for Rifmn indicates that for every ₹4 decreases in price, demand would be expected to increase by 8,000 batches, with maximum demand for Rifmn being one million batches.** Here, if P is kept ZERO, the quantity will be 1 million.
4. Then, it is a normal problem. Find out Q first and then the best P.
5. In the last part, the company has launched some new Drugs that will help to cure a disease like COVID. It is patented. Hence we recommend skimming but with a few ethical factors also.

Q21 / Category - Homework / Star Rating - ⭐⭐⭐

1. It is **May 2019** examination paper
2. It is a long question but do it after the chapter on PRODUCT LIFE CYCLE.

Q22 / Category - Classwork / Star Rating - ⭐⭐⭐

A. It is RTP - **Nov 2020** question

B. To get a competitive advantage and superior performance we have three options:

1. Relative low-Cost advantage
    a. selling seats via the internet rather than through a travel agent
    b. trimming overhead costs by using lower-cost out-of-town airports
    c. no printed tickets
    d. fixed seat allocations
    e. No free meals and drinks
    f. efficient operations i.e. fast turnaround times for aircraft to improve utilization
    g. no exceptions policies to reduce the cost of handling exceptions (e.g. no flexibility for passengers who arrive late).
    h. Cost economies can also be realized from large scale operations.
2. Differentiation advantage
    a. Prime landing slots can be obtained at major airports around the world
    b. Using superior and advanced technology
    c. well-maintained, clean, and comfortable aircraft
    d. Training in customer care
    e. recruitment of high-quality staff; providing complementary services such as in-flight entertainment, high-quality food, and drink.
3. Focus strategy: Michael Porter enlightens focus as attaining low cost or product differentiation for a particular buyer group, a segment of product line, or geographic market rather than for the industry as a whole. The firms need to optimize the strategy on two variants: cost focus and differentiation focus.

C. Ideas for reducing cost

1. BA should attempt to increase the number of internal domestic flights to offset currency

fluctuations.

2. ATF costs can also be lowered by investment in fuel-saving modern Airbuses, however, the reduction in operating costs may outweigh the capital equipment costs.

Q23 / Category - Classwork / Star Rating - ⭐⭐⭐

1. Where PV Ratio is higher, it follows a differentiation strategy. Here the FC is also relatively higher, which further confirms that it follows this strategy.
2. Where PV Ratio is lower, it follows a low-cost advantage model. Here the FC is relatively **lower.**