

Subject: Apparel Merchandising

Unit 6: Garment costing and pricing methods

Quadrant 1 – E-Text

Learning Objectives

The learning objectives of this unit are to:

- Outline the elements of a basic cost sheet of a garment.
- Describe cost plus method of pricing the garments.
- Describe marginal cost pricing method.
- Describe backward and target pricing method.

6.1 Garment Costing

According to ICMA London, Cost Accounting is that part of Management Accounting which establishes budgets and standard costs, and actual cost of operations, processes, departments or products and the analysis of variances, profitability and social use of funds.

Cost Accounting is the classifying, recording and appropriate allocation of expenditure for the determination of the costs of products or services and for the presentation of suitably arranged data for purposes of control and guidance of management.

Apparel costing is used for a number of reasons, including for: Classification and sub-divisions of Costs, Control of Materials, Labour and Overhead Costs, and for Business Policies. It helps the management to take decisions. It helps to create an expansion strategy. Ensures Optimum Profitability, and Helps the management to take suitable steps to meet seasonal variations in volume and costs. etc.

Apparel costing is useful for Budgeting and for setting standards for Measuring Efficiencies. It allows the best use of limited resources and is an instrument of Management Control. It helps in Cost Audit, and Price Determination. It ascertains the cost per unit of different products manufactured and provides a correct analysis of cost both by process and operations. It discloses sources of wastages and acts as a guide to price fixation of products manufactured. It ascertains the profitability of each product that is manufactured and exercises effective control of stocks of raw materials at various stages. Implements cost control systems. It guides the management in the formulation and implementation of incentive bonus plans and helps in preparation of budgets and also helps in implementation of budgetary control.

6.2 Elements of Costs

There are three main elements of costs. They are: Materials, Labour and other expenses. Materials can be either direct material or indirect material. Labour can be direct or indirect. Other expenses can be direct or indirect.

All Indirect Expenses give rise to Overhead expenses.

This includes: Production or Works overheads, administration overhead, selling overhead, distribution overhead, research and development overhead.

Direct Materials

Direct materials include: All raw materials, materials specifically purchased, parts or components purchased or produced, and primary packing materials.

Direct Labour

Direct labour includes: Labour engaged on the actual production, labour engaged in aiding the manufacture, and specially required for production. For example, Inspectors.

Overhead

Overhead is the aggregate cost of indirect materials, indirect materials.

Division of Costs

Here are some ways that costs can be divided.

1. Prime Cost = Direct Materials + Direct Labours + Direct Expenses.
2. Works or Factory Cost = Prime Cost + Works or Factory Overheads.
3. Cost of Production = Works Cost + Administration Overheads.
4. Total Cost / Cost of Sales = Cost of Production + Selling Overhead + Distribution Overhead.

Cost Classifications

Costs can be classified: By nature or elements or analytics, by functions, as direct or indirect cost, by variability, controllability, normality, time, according to planning and control and for managerial costs.

By Nature, Elements or Analytics

Costs can be classified by Nature, Elements or Analytical classification: This includes Material, labour and expenses.

By Functions

Cost can be classified by functions. Either by: Manufacturing and Production Cost, or by Commercial Cost. This includes: (1) Administrative Cost. (2) Selling and Distribution Cost and (3) Research and Development Cost.

As Direct or Indirect Cost

Costs can be classified as: Direct cost, and Indirect cost.

By Variability

Costs can be classified by variability, such as: Fixed or Period Cost, Variable or Product Cost and Semi-variability Cost.

By Controllability

Costs can be classified by controllability. These are: Controllable costs and Uncontrollable costs.

By Normality

Costs can be classified by normality. These are: Normal costs and Abnormal costs.

By Time

Costs can be classified on the basis of time. These are: *Historical costs* and *predetermined costs*.

According to Planning and Control

Costs can be classified according to planning and control. This includes: *Budgeted costs* and *Standard costs*.

For Managerial Costs

Costs can be classified for managerial purposes. This includes: Marginal costs, opportunity costs, replacement costs, avoidable and unavoidable cost.

Cost is a measurement, in monetary terms, of the amount of resources used for some purpose. According to the American Accounting Association - Cost is the foregoing, in monetary terms, incurred or potentially to be incurred in the realisation of the objective of management which may be manufacturing of a product or rendering of services.

Fixed or period costs are those costs which remain fixed in total amount, with increase or decrease in the volume of output for a given point of time.

Fixed Cost per unit decreases as production increases, and increases as production declines.

Variable or product costs are those costs, which vary in total in direct proportion to the volume of output. These costs per unit remain relatively constant with changes in production.

Semi-Variable costs are the costs which are partly fixed and partly variable. *Marginal cost* is the total of variable costs that is prime cost plus variable overhead. Extra cost incurred to manufacture one extra unit of production.

Average Cost = Total Cost / Number of Units Produced

6.3 Methods of Costing

Let us now look at the methods of costing. These are: Job costing, contract costing, batch costing, process costing, unit costing, operating costing, operation costing, and multiple costing.

Job Costing:

Costs are collected and accumulated for each job, work order or project separately to analyse the cost according to each job.

Contract Costing:

When the job is big and spread over long periods of time a separate account is kept for each individual contract.

Batch Costing:

A Batch may represent a number of small orders passed through the factory in batch. Each batch is treated as an unit of cost and separately costed. It is an extension of job costing.

Process Costing:

A separate account is opened for each process to which all expenditures incurred thereon are charged so that cost per unit at each process can be ascertained.

Unit Costing:

Here the cost per unit of output and the cost of each item is ascertained. The manufacture is continuous and units are identical.

Operating Costing:

It is used to ascertain the cost of services rendered. **Example:** Transport undertakings.

Operation Costing:

This takes into consideration the rejections in each operations for calculating input units and cost. It refers to conversion cost from raw material to finished products.

Multiple Costing:

It represents the application of more than one method of costing in respect to the same product.

6.4 Techniques of Costing

These are: Uniform costing, Marginal costing, Standard costing, Historical costing, and Direct costing.

Uniform Costing:

It is the use of same costing principles and / or practices by several undertakings for common control or comparison of costs.

Marginal Costing:

It is the ascertainment of marginal cost by differentiating between fixed and variable cost. It is used to ascertain the effect of changes in volume or type of output on profit.

Standard Costing:

A comparison is made of the actual cost with a pre-arranged standard and the cost. The cost of any deviation (called variances) is analysed by causes.

Historical Costing:

It is ascertainment of costs after they have been incurred i.e. costs actually incurred on work done in the past.

Direct Costing:

It is the practice of charging all direct costs, variable and some fixed costs relating to operations leaving all other costs to be written off against profits in which they arise.

Cost Sheet / Statement of Cost

The particulars of the cost sheet includes, Direct materials, direct labour and direct expenses. The Prime costs are the work overheads. The work cost is the administrative overheads. The cost of production is the selling and distribution of overheads. The total cost as well as the cost per unit for each of these should be calculated. There is no prescribed format for a cost sheet. It may vary from industry to industry. Here is a specimen format of a cost sheet. Remember a cost sheet is a statement, which shows the various components of total cost of a particular product. A cost sheet is prepared on the basis of: Historical cost and Estimated cost.

Stock of Raw Material

The stock of raw material is calculated as:

Opening Stock of Raw Materials

Add: Purchase of raw material
Less: Closing Stock of Raw Material
= Raw Material Consumed

Stock of Work-in-Progress

Stock of work-in-progress is calculated as:

Prime Cost
Add: Opening Stock of WIP
Factory O/H Incurred
Less: Closing WIP
= Manufacturing Works cost

Stock of Finished Goods

Stock of finished goods is calculated as:

Cost of Production

Add: Opening Stock of Finished Goods

Less: Closing Stock of Finished Goods

= Cost of Goods sold.

Composition of Cost of Garment

In continuation of the other functions, a Production merchandiser is also required to do the costing of the product. The costing is done by keeping in mind the cost of the various raw materials, operating cost of the company, the competition and expected profit of the organization. At the same time, it is necessary to keep in mind the buyers costing expectations.

The cost of a garment depends on these components: Fabric, trims, cut Make and Trim charges, value added services: printing, embroidery, washing, appliqué, testing of the garment, quality, transportation and logistics cost, profit of the manufacturing organization.

All these components of garment cost depend upon certain parameters which drastically affects above cost parameters. These parameters play a vital role when the production merchandiser does the costing of garment; as these parameters are very dynamic and keep fluctuating frequently. The parameters that affect the garment cost mostly are; Unit of Measurement, MOQ, Incoterm decided between raw material vendor and garment manufacturer, order quantity, etc.

Fabric

Fabric is generally the most significant factor in costing of garment. Fabric accounts for 60 to 70% of the total cost of basic-styled garments. In many cases, evaluating the quality and the quantity of fabric consumed in the garment indicates better than any other factor, the cost of producing it. The cost of fabric depends upon the type of fabric that is going to be utilised in the garment.

The types of fabrics are: Woven / knitted fabric, power loom /automatic loom fabric, fibre / yarn / fabric dyed fabric, fibre content of fabric, such as cotton, wool, polyester, silk, blended fabric etc., type of dyeing and finish used, gram per square meter / weight of fabric, type of yarn used, such as ring spun, open ended, or carded / combed etc.

Parameters that Affect the Fabric Cost

They are: Unit of measurement (UOM), fabric Minimum order quantity (MOQ), order quantity, Incoterm used.

The unit of Measurement (UOM) is a quantity used as a standard of measurement. The Unit of Measurement for woven fabric is normally in meters or yard, while knitted fabric measured in Kilograms or some time it is in yards also. The merchandiser should aware of unit of measurements while finding out the cost of fabric. Sometimes a buyer specifies the UOM of fabric.

Minimum Order Quantity

Fabric Minimum Order Quantity (MOQ) is nothing, but the smallest quantity of a product that a fabric manufacturer can supply. The MOQ depends on the type of fabric and on capacity of vendor. The MOQ plays an important role while ordering the fabric, as it directly affects the cost of garment.

If the order of fabric is below the estimated MOQ, then the vendor charges more cost as compared to regular charges. Merchandisers need to keep the MOQ in mind, while doing the costing of small quantity orders.

The cost of fabric may vary with the order quantity. The more the order quantity, the cost of fabric can be optimised till a certain level. But again, this depends on the type of fabric required, and fabric manufacturer capacity along with negotiations between fabric buyer and supplier.

Incoterm Used

Incoterm used is a factor that makes a huge difference in fabric cost. While importing the fabric from another country, a merchandiser needs to deal with the supplier for delivery of the fabric on the basis of incoterms like EXW, FOB, CIF, DDP etc., based on which it will be decided, as to who will bear the cost of transportation and risk.

No matter which incoterm is used, all the cost needs to be charged to buyer. If the fabric is purchased by using EXW incoterm, then the merchandiser needs to add the transportation cost along with the custom clearance charges and the price of fabric while calculating the garment cost.

Calculating the Cost of Fabric

The cost of fabric can be calculated by the following way:

Yarn cost + fabric manufacturing cost (knitting or woven) + dyeing cost + finishing cost = total fabric manufacturing cost

Dyeing cost indicates that if the fabric is yarn dyed or fibre dyed or piece dyed, the respective cost will be added depending upon the fabric type. The Finishing cost includes heat setting cost, normal finishing, compacting (knitted fabric) etc.,

Cost Calculation of Fabric in a Garment

Considering the knitted fabric and t-shirt as an end product, then fabric consumption can be calculated as:

Fabric consumption in kg

= (Body length + Sleeve length + allowance) x (Chest + allowance) X 2 X GSM

10000

Fabric Consumption for Woven Fabric

And for woven fabric and shirt as an end product, then the fabric consumption can be calculated as:

Fabric consumption in metres

$$= \frac{(\text{Full length} + \text{Sleeve length} + \text{allowance}) \times (\text{Chest} + \text{allowance}) \times 2 \times \text{Fabric width}}{100}$$

39.37

These methods are used to calculate the fabric consumption roughly at sampling stage by merchandiser. These formulas will give approximate calculation for pre costing stage of the garment. Sometimes fabric consumption is also done by forming the miniature marker by CAD department. These are the constraints of fabric consumption: Fabric cuttable width, repeat size, pattern type to be informed to the CAD along with buyer tech-pack in order to calculate exact width and consumption.

The marker efficiency considered 80-85% depending upon the fabric type i.e. solid dyed, stripe, checks fabric. Efficiency can be changed depending upon the fabric parameters, matching parameters of the buyer, type of style.

The buffer in the consumption should be added to the fabric by merchandiser, generally it is 0.03-0.08% of total fabric consumption. In case of trim fabric i.e. interlining the 10-20% more buffers is kept while ordering the interlining, in order to maintain the inventory and to avoid the shortage during the production and fabric wastage percentages, to be added also, while calculating the fabric consumption. Considerable wastage depends on factory practices, type of fabric and type of garment.

Trims

Trims include all materials other than fabric used in the garment. For example most garments have accessories such as threads, buttons, zippers, labels, elastics and miscellaneous items. Quality and quantity of trim and labour required to apply it on garment are directly related to cost of garment. The different trims have different UOM; even same trim can have 2-3 different UOMs that can be summarised as:

UOM of Trims Used in Garments

Trims	UOM
Thread	1000 meter tube, 2000/5000 Meter Cone
Labels	Unit
Zippers	Unit

Buttons	Gross (144 Units)
Polybag	Unit , thickness is measured in mm. or gauge
Carton	Unit
Hand tags	Unit
Shanks	Gross
Rivets	Unit
Lace	50 Meter
Hanger	Unit
Tapes / Velcro	50 Meter or Kg.
Elastics	50 Meter

Other factors that need to be considered while calculating the trims cost is MOQ, order quantity, lead time and quality of raw material used to make the trims.

Thread

After fabric, thread is another component which needs to be considered for calculating the cost of garments most. The consumption of thread is calculated by IE department. It is dependent upon the type of seam and SPI. While ordering the thread the operation break down and number of sewing M/c for that particular style should be taken in account.

Accordingly, number of cones of thread needs to order. In order to calculate thread consumption special software's are also available which gives the accurate thread consumption.

Sometimes, the thread can be computed as while preparing the sample. Initial weight of the thread cone is measured and after preparation of sample again weight measured. The difference of weight gives how much thread is consumed, and converting it into meters will give actual thread consumption for that particular garment. While ordering thread it's important to consider the wastage, normally which is 10-15%.

Labels

Several labels are used in garment such as, main label, care label, and content label. The cost of label depends upon make of label, that is, fibre content, printed, jacquard label, size of labels, colours used in label, etc., A unit garment label cost may not play a significant role, but in case of mass production it plays vital role. The other factors that are important while ordering the labels are MOQ, and order quantity.

Zipper

Zippers also has several types like metallic zipper, nylon zipper etc. which plays the drastic role in cost of zipper. Merchandiser should be aware of the parameters of zipper for accurate costing and negotiation. MOQ is the parameter which affects the cost of zipper considerably; at certain MOQ only zipper will get at desired price.

Buttons

Buttons can be made up of different types, nylon buttons, plastic buttons, acrylic based buttons, wood, shell, or metal. Every type of button has its own MOQ decided by manufacturer of button. Buttons are purchased on gross with the line specified.

1 gross = 1 packet = 144 buttons = 12 dozens

Polybags

The cost of poly bag is highly dependent on thickness, dimension and raw material used. The poly bag ordered in terms of number of pieces. The cost of poly bag is equally important as it give significant difference when we consider the whole order quantity.

Cartons

Just like poly bags, the cost of cartons are highly dependent on material used and dimensions. Depending upon these factors cost of cartons is decided, the UOM of cartons generally is number of pieces while cost varies with MOQ.

These are procured based on the number of plies, dimensions of the carton and GSM of the paper used to make the carton. Generally, the number of plies used in carton box is 3, 7 and 9 ply. For example: 9 ply, 60 X 40 X40, 4 side calico, 1 side print and 180 GSM.

Hand Tags

Hand tags or price tags are used as packing material, the cost of hand tags are dependent upon material used, printing on it and MOQ.

Shanks and Rivets

Generally, shanks and rivets are trims that are made up of metallic. The UOM of rivets and shanks is gross and No. of pieces respectively. The cost of shanks and rivets is dependent upon the MOQ and material used.

Hangers

Hangers are usually made up of hard plastics or sometimes wood. The cost of a hanger depends on the material used, size, print and colour on it. Generally, transparent hangers are costlier than coloured ones.

Tags and Velcro

Tapes are purchased based on the width and mobil on tapes are purchased in kg. Thus, increase in width by 100% increases the cost by 80%. For satin tapes increase in width by 150% increases the cost by 250%. Another factor that affects cost is MOQ.

Calculation of Trim Charges

Trims charges are generally calculated as for the different type of sourcing and mode of transportation. If shipment is by air then the trim cost + 15-25% more cost is quoted to buyer, depending on the freight charges. If shipment is by sea then trim cost + 10-15% more cost is quoted to buyer depending upon freight charges. If there is domestic sourcing then there are

local taxes. Transportation charges is bound to add in the total trim cost. These additions are done by the merchandiser, depending upon the business outlook.

Other charges included during the costing by merchandiser. Rejection and wastage charges is 2 to 5%, depending on the order quantity. Commission on foreign exchange is 2 to 3%. Commission of buying house, (if applicable) is 1 to 1.5%. Internal transportation charges is 1 to 2 dollars per garment. Margin, decided by marketing department by looking at the business scenario is 10 to 15%. Testing inspection charges is 1 to 2%.

CMT (Cost of Making) Cost

The cost of making done "in house" is based on the total cost per hour multiplied by the number of hours it takes to make the style and divided by the number of units produced if the making is done by a contractor; the contractor adds profit on to this amount.

Labour cost per minute = (Monthly salary of an operators / Total minutes available in the month) at 100% efficiency.

CM cost = (SAM of the garment * Minute cost of the labour)/Line efficiency (%).

6.5 Value Added Services

Value added services is cost added to of special process like embroidery, printing, washing used to impart the type of look buyers wants.

These are associated cost of garment manufacturing are wet processing chemicals, washing and contracted operations. Wet processing chemicals include bleaches, detergents, softeners, neutralizers, wetting agents and resins.

Complicated wet process finishes contribute a significant amount to the price of a product. Merchandiser must know in detail about each of these operations, sourcing, contracting requirement and time involved. Cost of these varies depending on different styles. For example, Embroidery costing requires derivation of thread consumption, additional cost of hand embroidery is involved etc. printing cost is dependent on no. of colours for printing, MOQ, and type of print.

The example of garment cost is given by assuming the following dimensions for polo neck T-shirt, no. of pieces = 4000, salary of the operator = 6000 Rs./month=120\$/month no. of working days = 26, line efficiency considered= 50%, sewing SAM= 15 min., Cutting SAM= 7 min.
1\$=50INR

Chest = 60 cm, Length (HSP to waist) = 75 cm, Sleeve length = 25 cm.

Fabric used is 2/60s 100% cotton S/J fabric. GSM is 180

Calculating the Fabric Consumption

Fabric consumption in kg

$$= (\text{Body length} + \text{Sleeve length} + \text{allowance}) \times (\text{Chest} + \text{allowance}) \times 2 \times \text{GSM}$$

10000

$$= (75 + 25 + 2) \times (60 + 1) \times 2 \times 180 / 10000$$
$$= 0.224\text{kg} + 0.08(\text{weight of cuff and collar})$$

Calculation of CMT Charges

CMT charges are calculated as: Total available capacity per month (in minute) = 26
working days X 8 hours per day X 60 = 12,480 minutes.

Labour Cost per Minute

Labour cost per minute = (Monthly salary of an operators / Total minutes available in the month)
at 100% efficiency
= 6000 / 12480 = 0.480 Rs.

Sewing Cost

Sewing cost = (SAM of the garment X Minute cost of the labour) / Line efficiency (percent)

$$= 15 * 0.480 / 50$$
$$= 0.288 \text{ dollars}$$

Cutting Cost

Cutting cost = (SAM of cutting * Minute cost of the labour) / cutting efficiency (percent)

$$= 7 * 0.480 / 50$$
$$= 0.134 \text{ dollars.}$$

Trimming cost is considered as 0.06 dollars, as it depends upon how many operators are there for trimming.

Production Cost of Garment (CMT)

Production cost of garment (CMT) = sewing cost + cutting cost + trimming cost
 = 0.288+0.134+0.06
 = 0.482 dollars.

FOB Cost of Garment

Fabric cost + 7% duty	1.97\$
Trim cost + 7% duty	0.3\$
Fabric and trims transportation charges	0.06\$
Testing + inspection charges	0.2\$
Commission on foreign exchange	0.08\$
Buying house commission	0.16\$
Rejection 5%	0.16\$
Value addition services	0.2\$
CMT	0.482\$
Margin	0.5\$
Total FOB cost of garment	4.11\$

6.6 Pricing Policies of Garments

Of course, one objective of pricing is to make a profit, but this may not be a firm's primary objective. Other objectives include: survival, profit maximization, target return on investment, market share goals and status quo pricing.

Survival

A firm may have to price its products to survive, either as an organization or as a factor in a particular market. This usually means that the firm will cut its price to attract customers. Such a goal can't be pursued on a long-term basis. Consistent losses would cause the business to fail.

Profit Maximization

Many firms may state that their goal is to maximize profit, but this goal is impossible to define (and thus impossible to achieve).

What, exactly, is the "maximum" profit?

Target Return on Investment

Target Return on Investment is the return on an investment (ROI) is the amount earned as a result of that investment.

Market Share Goals

Market Share Goals is a firm's market share is its proportion of total industry sales. Some firms attempt, through pricing, to maintain or increase their share of the market.

Status Quo Pricing

In pricing their products, some firms are guided by a desire to avoid "making waves"—that is, to maintain the status quo. This is especially true in industries where price stability is important. If a firm can maintain its profit or market share simply by meeting the competition, charging about the same price as competitors for similar products, then it will do so.

Selecting a Pricing Method

There are three pricing methods that can be employed by a firm:

1. Cost Oriented Pricing
2. Competition Based Pricing
3. Marketing Oriented Pricing

1. Cost Oriented Pricing

In cost oriented pricing, companies often use cost oriented pricing methods when setting prices. Two methods are normally used for cost-oriented pricing: *Full cost pricing* and *direct or marginal cost pricing*.

Full Cost Pricing

Here the firm determines the direct and fixed costs for each unit of product. The first problem with Full-cost pricing is that it leads to an increase in price as sales fall.

Direct or Marginal Cost Pricing

Direct or marginal cost pricing involves the calculation of only those costs, which are likely to increase as output increases. Indirect or fixed costs (plant, machinery etc) will remain unaffected whether one unit or one thousand units are produced. Like full cost pricing, this method will include a profit margin in the final price. Direct cost approach is useful when pricing services for example, Competition based approach, Competitive bidding, Market oriented pricing.

2. Competition Based Pricing (Going-Rate Approach)

In going-rate pricing, the firm bases its price largely on competitors' prices, with less attention paid to its own costs or to demand. The firm might charge the same, more, or less than its major competitors. Where the products offered by firms in a certain industry are very similar the public often finds difficulty in perceiving which firm meets their needs best. In cases like this (for example in financial services and delivery services) the firm may attempt to differentiate on delivery or service quality in an attempt to justify a higher selling price.

Competitive Bidding

Many contracts are won or lost on the basis of competitive bidding. The most usual process is the drawing up of detailed specifications for a product and putting the contract out for tender. Potential suppliers quote a price, which is confidential to themselves and the buyer. In sealed-bid pricing, that is, only known to client and not to the other parties tendering for the service), firms bid for jobs, with the firms basing the price on what it thinks other firms will be bidding rather than on its own costs or demand.

3. Market Oriented Pricing

The price of a product should be set in line with the marketing strategy. The danger is that price is viewed in isolation (as would be the case with full cost pricing), with no reference to other marketing decisions, such as positioning, strategic objectives, and promotion, distribution and product benefits.

Pricing Strategies

These are some of the pricing strategies that are commonly adopted by companies. They are Geographical pricing, price discounts and allowances, promotional pricing, discriminatory pricing and product-mix pricing.

Geographical Pricing (Cash, Counter Trade, Barter)

Geographical pricing involves the company in deciding how to price its products to different customers in different locations and countries.

Counter trade may account for 15 to 25% of world trade and takes several forms:

Barter is the direct exchange of goods with no money and third party involved.

In a *Compensation deal*, the seller receives some percentage of the payment in cash and the rest in products.

In a *Buyback arrangement*, the seller sells a plant, equipment, or technology to another country and agrees to accept as partial payment products manufactured with the supplied equipment.

In an *Offset deal*, the seller receives full payment in cash, but agrees to spend a substantial amount of the money in that country within a stated time period.

Price Discounts and Allowances

The role of offering discounts can be a useful tactic in response to aggressive competition by a competitor. However, discounting can be dangerous unless carefully controlled and conceived as part of your overall marketing strategy. The main types of discounts common today are *Cash and settlement discounts*, *quality discounts* and *promotional discounts*.

Cash and Settlement Discounts

Cash and settlement discounts are intended to bring payments in faster. This is paid during cash payment and final settlement.

Quality Discounts

The trouble with quality discounts is that when formalized on a published price list, they become an established part of your pricing structure and as a result their impact can be lost.

Promotional Discounts

Promotional discounts are the best kind of discounts, because they enable you to retain the power to be flexible. There may be times, when you want to give an extra boost to sales - to shift an old product before launching an updated one for example.

Promotional Pricing

Companies can use several pricing techniques to stimulate early purchase.

These techniques include: Loss-leader pricing, Special event pricing, Cash rebates, low-interest financing, longer payment terms, warranties and service contracts, and psychological discounting.

Loss-leader Pricing

Supermarkets and department stores often drop the price on well-known brands to stimulate additional store traffic. This pays if the revenue on the additional sales compensates for the lower margins on the loss-leader items.

Manufacturers of loss-leader brands typically, object because this practice can dilute the brand image and bring complaints from retailers who charge the list price.

Special-Event Pricing

Another technique is special-event pricing. Sellers will establish special prices in certain seasons to draw in more customers.

Cash Rebates

Auto companies and other consumer-goods companies offer cash rebates to encourage purchase of the manufacturers' products within a specified time period. Rebates can help clear inventories without cutting the stated list price.

Low Interest Financing

In this technique, instead of cutting its price, a company can offer customers low-interest financing. A typical example is where automakers have even announced no-interest financing to attract Customers.

Longer Payment Terms

Sellers, especially mortgage banks and auto companies, stretch loans over longer periods, and thus, lower the monthly payments. Consumers often worry less about the cost (such as the interest rate) of a loan, and instead worry more about whether they can afford the monthly payment.

Warranties and Service Contracts

Another popular technique is for companies to promote sales by adding a free or low-cost warranty or service contract.

Psychological Discounting

Psychological discounting is a strategy that involves setting an artificially high price, and then offering the product at substantial savings. Promotional-pricing strategies are often a zero-sum game. If they work, competitors copy them and they lose their effectiveness. If they do not work, then the money is wasted, which could have been put into other marketing tools.

Discriminatory Pricing

Companies often adjust their basic price to accommodate differences in customers, products, locations, and so on. Price discrimination occurs when a company sells a product or service at two or more prices that do not reflect a proportional difference in costs.

In first-degree price discrimination, the seller charges a separate price to each customer depending on the intensity of his or her demand.

In second-degree price discrimination, the seller charges less to buyers who buy a larger volume.

In third-degree price discrimination, the seller charges different amounts to different classes of buyers, as in the following cases: Customer-Segment pricing, Product-form pricing, Image pricing, Channel pricing, Location pricing and Time pricing.

Customer-Segment Pricing

In customer-segment pricing, different customer groups are charged different prices for the same product or service. For example, museums often charge a lower admission fee to students and senior citizens.

Product-Form Pricing

In product-form pricing, different versions of the product 'are priced differently but not proportionately to their respective costs.

Image Pricing

Some companies price the same product two different levels based on image differences at. A perfume manufacturer can put the perfume in one bottle, give it a name and image, and price it at Rs.50. It can put the same perfume in another bottle with a different name and image and price it at Rs.200.

Channel Pricing

A typical example of channel pricing is Coca-Cola, which carries a different price depending on whether it is purchased in a fine restaurant, a fast-food restaurant, or a vending machine.

Location Pricing

In location pricing the same product is priced differently at different locations even though the cost of offering at each location is the same. A theater varies its seat prices according to audience preferences for different locations.

Time Pricing

In time pricing, prices are varied by season, day, or hour. Public utilities vary energy rates to commercial users by time of day and weekend versus weekday. For price discrimination to work, certain conditions must exist.

- I. First, the market must be segment able and the segments must show different intensities of demand.
- II. Second, members in the lower price segment must not be able to resell the product to the higher-price segment.

- III. Third, competitors must not be able to undersell the firm in the higher-price segment.
- IV. Fourth, the cost of segmenting and policing the market must not exceed the extra revenue derived from price discrimination.
- V. Fifth, the practice must not breed customer resentment and ill will.
- VI. Sixth, the particular form of price discrimination must not be illegal.

6.7 Product-Mix Pricing

Price-setting logic must be modified when; the product is part of a product mix. In this case, the firm searches for a set of prices that maximizes profits on the total mix.

Pricing is difficult because the various products have demand and cost interrelationships and are subject to different degrees of competition. We can distinguish six situations involving product-mix pricing. They are: product-line pricing, optional-feature pricing, captive-product pricing, two-part pricing, by-product pricing, and product-bundling pricing.

6.8 Product Line Pricing

Companies normally develop product lines rather than single products and introduce price steps. In many lines of trade, sellers use well-established price points for the products in their line. The seller's task is to establish perceived-quality differences that justify the price differences.

Optional-Feature Pricing

Optional-feature pricing is offered by many companies. This is usually done by offering optional products, features, and services along with their main product.

Captive-Product Pricing

Some products require the use of ancillary, or captive, products. For example, manufacturers of razors and cameras often price them low and set high markups on razor blades and film, respectively. Another example is, when a cellular service operator gives a cellular phone free, if the person commits to buying two years of phone service.

Two-Part Pricing

Service firms often engage in two-part pricing, consisting of a fixed fee plus a variable usage fee. The fixed fee should be low enough to induce purchase of the service. The profit can then be made on the usage fees.

By-Product Pricing

The production of certain goods such as, meats, petroleum products, and other chemicals, often results in by-products. If the by-products have value to a customer group, they should then be priced on their value. Any income earned on by-products will make it easier for the company to charge a lower price on its main product, if competition forces it to do so.

Product-Bundling Pricing

Sellers often bundle products and features. Pure bundling occurs when a firm only offers its products as a bundle. In mixed bundling, the seller offers goods both individually and in bundles. When offering a mixed bundle, the seller normally charges less for the bundle than if the items were purchased separately. The savings on the price bundle must be substantial enough to induce them to buy the bundle.

6.9 Conclusion

To summarize, in this unit, you have learnt about the elements of a basic cost sheet of a garment, and the importance, methods of costing and classification of cost. You have also reviewed the objectives of pricing, and the pricing methods adopted by the garment industry.