Strategic Marketing-Contemporary Issues

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Lecture - 20

In the last session, we ended with this concept of predatory pricing or competition destroying pricing and as we mentioned that this strategy has been used by group of companies like the Japanese motorcycle manufactures, they use predatory pricing to penetrate deep into the European two wheeler market at the lower end the established manufacturers of Europe at that time abundant the lower end of the market, because the Japanese products where superior in performance and where offered at predatory pricing.

Once the established European companies exited from that market, vacated that space to the Japanese manufactures ‘Kawasaki and Yamaha’, and they then created, they are hegemony complete control over the lower segment. And then gradually they attacked and attacked and pushed out many of the old established motor cycle manufactures from the European market and created a command.

There are many similar instances and as a result of which once globalization and free flow of trade became and acceptable paradigm for most countries, it was easy to visualize this competition destroying situations, where a group of companies from one country could go and attack a particular market segment and if they were wealthy enough, they could take loses for a certain amount of time through predatory pricing they could destroy the manufacturing base of the target country in a certain segment. And then once the control of the invading group was established they could actually command higher and higher price.

So, as a result of this visualization, there are lot of rules and regulations that have been brought into practice which are devoted to price regulatory issues, and so price fixing or predatory pricing or deceptive pricing are now illegal, and there are competition counsels like in India we have the national manufacturing competitiveness council. And most countries now also have competition policy modeled after some good work that has been done in the by the European union and others which have been brought back some sanity and regularity in the pricing process.

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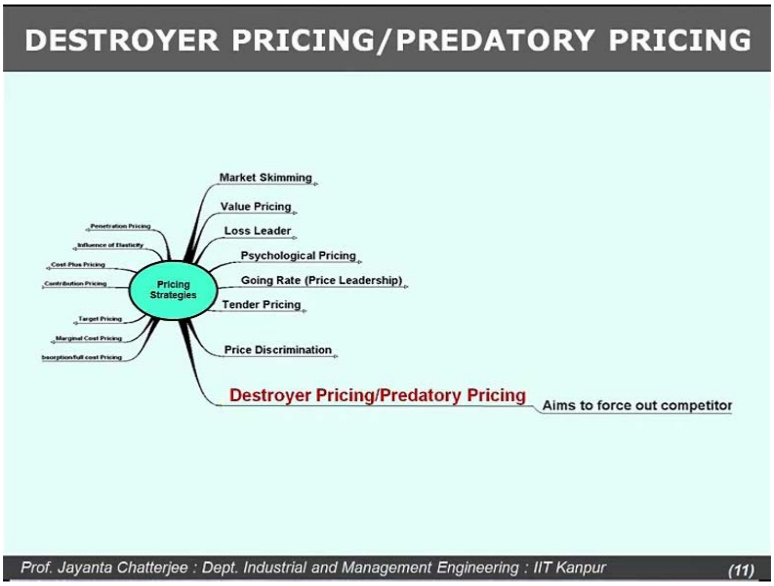

So, the valid marketing strategies with respect to pricing remain the methodologies that we discussed before like skimming or penetration pricing or value pricing or loss leader or physiological pricing. But to support all of this external part of the pricing strategy we also need to look at internal part of the pricing strategy. And that is our aim at this stage.

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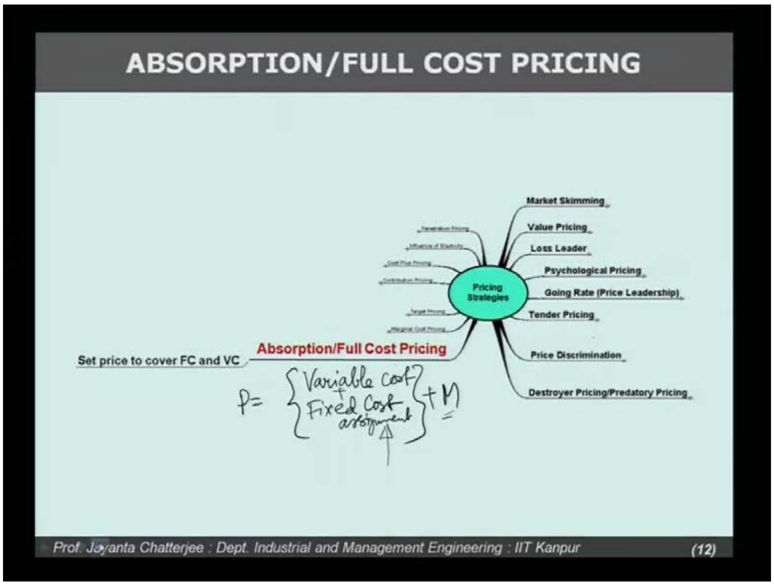

So, the internal part means how these external approaches to pricing that we have skimming value loss leaders physiological going rate tender pricing or yield pricing or price discrimination or variable pricing. Now, the left hand side the mind map actually shows that how we are going to manage the cost side of the outside pricing thrust.

So, absorption or full cost is quite easy to understand that this is where we want to observe the full variable cost and fixed cost. So, we have to. So, the p should be covering both of this plus some margin. And that is how we will arrive at the price. So, this is what we call absorption or full cost pricing.

That means, we cover the full cost and in absorption we actually also try to see that certain normally this is a fixed cost assignment. There is a per unit assignment of the fixed cost. But if we want to recover or absorb a certain part of the fixed cost in to the margin itself; that means, we want to make add a higher level of margin. So, that over a period of time the fixed cost.

That means a new machine that has been put to produce a certain type of shoes. We would like to recover the full absorb the full cost the fixed cost of producing that kind of product into the margin. So, that then it becomes absorption pricing on top of the full cost pricing.

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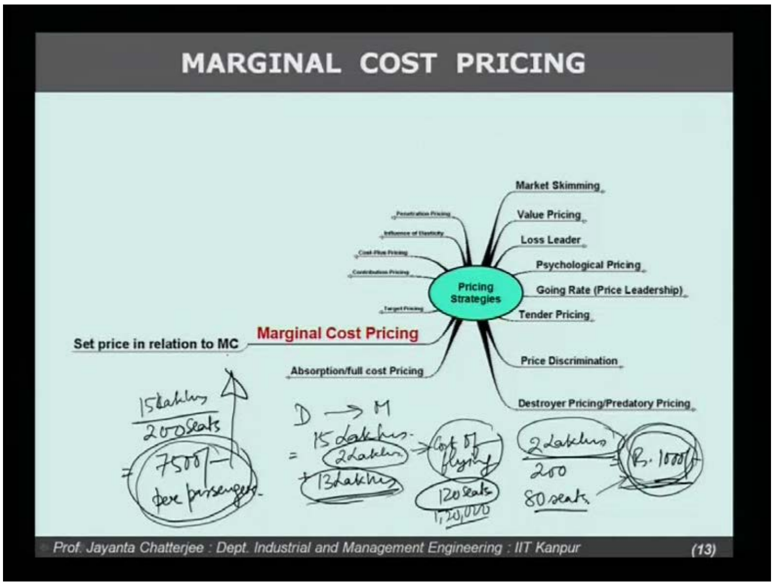

The next one is actually a little more interesting which is the marginal cost of pricing or marginal cost pricing. This you will see often happens that you hear somebody was able to fly to Bombay for 500 rupees. Whereas, the normal price of the ticket will be 5000 rupees advance purchase price, might be 4000 rupees, late purchase price might be 7000 rupees.

So, how come how what is the rational of this 500 rupees? So, this is simply like this that suppose an a flight from Delhi to Mumbai cost say 15 lakhs. Of this 15 lakhs, maybe it is only 2 lakhs which is the cost. If it flies the rest of it; that means, 13 lakhs is almost you can say like the that will be that cost will be there. You will be incurring that cost which could be the parking fee at the airport which could be the interest and the appreciation cost of the aircraft and so on and so forth. So, in there is high investment based operations like an airline service or like a hotel this part is very large.

So, suppose the aircraft has 200 seats. So, what you would normally like to get is 15 lakhs divided by 200 seats. So, you would like to get an average price of 7500 rupees per passenger. But as you can see if you are flying; then this 13 lakhs you have incurred anyway if the flight takes places. The only additional cost to you is 2 lakhs. Now, if I divide 2 lakhs by that same 200 seats, then as you can see here I get about 1000 rupees. So, which means that suppose the plain is flying an about 120 seats have been filled up. 80 seats are vacant.

Now, if I can actually get at least 1000 rupees recovered per seat; it recovers my marginal cost. And therefore, if I sell 80 seats at thousand rupees then that 80,000 will be a mitigation of a loss which would have otherwise happen which is not to be calculated with this rate but should be calculated at this rate. So, if I sell 80 seats at 1000 rupees that 80,000 takes care of my, because earlier I have already sold 120 seats.

That means, that I have already recovered in fact that I might have sold at higher price. But, at least if I take thousand that is already recovered and now this 80 seats my 2 2 lakhs is get recovered. So, the balance then goes whatever I have got from the previous set of purchases. So, this marginal costing is often used at the last moment when an opportunity is getting perished. Or you often do it when refusing in industrial market if it is come to a bidding process.

That comes to a stage that where the customers says that look I can give you 2000 order for 2000 a pieces of packets of tea. For this Air India’s long term rate contract, but I will only pay you 10 rupees. Even though you know we have agreed to 30 rupees per packet, but for this additional amount I am now going to pay 10 rupees. Or it could even be that you have an excess stock you could go and say I have a stock clearance offer to you.

So, these things happen in consumer market particularly in the service market where variable pricing because this last moment seats been sold at 1000 rupees. Or every month there is a lottery and certain number of seats are sold at 1000 rupees where normally people will be paying 7500 and higher will be excepted in the service market. But, even in the industrial market this is possible to implement.

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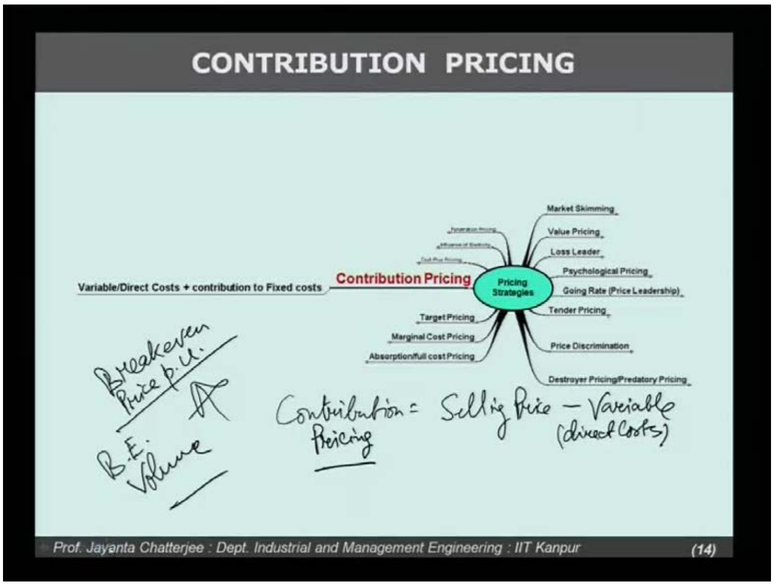

Contribution pricing we have already discussed. Contribution if you remember from our previous discussion that contribution is equal to selling price minus the variable direct costs. So, if you use this formula then you can actually you can see your selling price is equal to the contribution. That you aim targeting plus the variable cost will give you: this definitely is related to the break even concept. That we have breakeven price per unit, break even volume and other concepts that we have already discussed.

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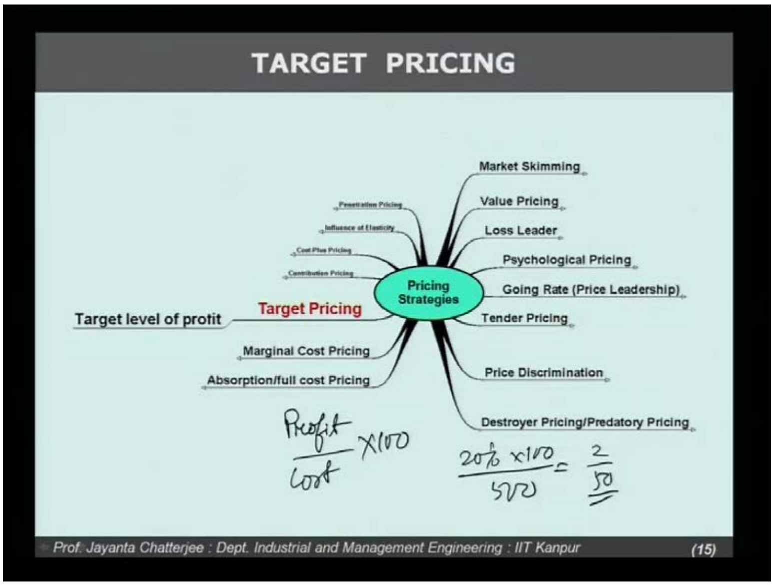

The next item is almost similar which is called target pricing. That means that we target a certain profit level and that will give us the mark up that we need to do to achieve that. So, if you are. So, it is basically normally taken that our target profit divided by cost multiplied by hundred. So, if our cost is 500 and we want to have a 20 percent. So, 20 percent into 100 divided by 500. That gives us say something like 2 by 50. And that is the kind of mark up that we would like to keep if we want to achieve this target pricing level.

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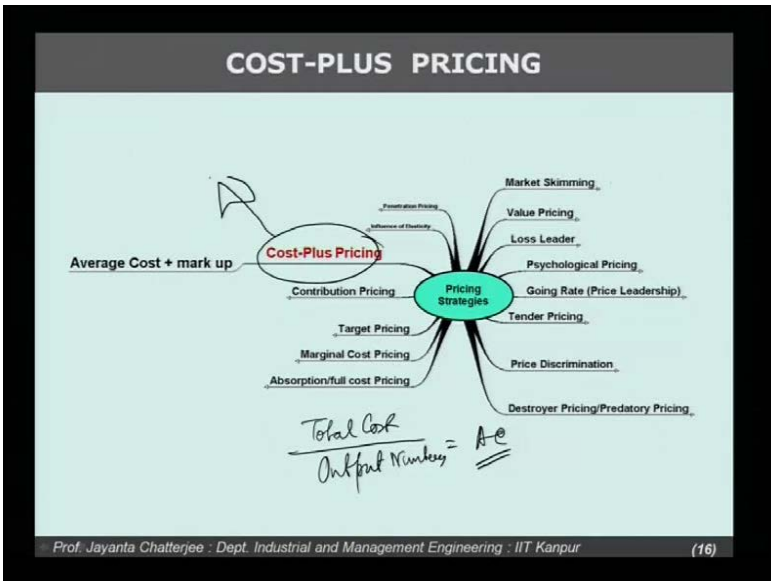

The total cost pricing is if you take the average cost. That means, we take total cost which is obviously all costs variable and fixed and divided by total number of output numbers. And that will give us an average cost. Then we can add certain margin to it and that is we called cost plus pricing.

Very regularly often used by startup companies because particularly in the professional market or in the industrial market. If you are a young company, then the buyer will say show me your cost and prepare to give you a twenty percent on top of your cost. But, lay down all the figures and not only for the startup companies or the new entrant for regular suppliers to automotive companies.

For example, there are called TR 1 suppliers. That means, most automotives companies have 2 or maximum 3 suppliers for critical parts. So, their entire year's requirement they will be saying that I am going to give all my business to you two companies. And let's negotiate a long term price and that kind of negotiation is often based on sharing true information about cost and arriving at the margin that you want to get.

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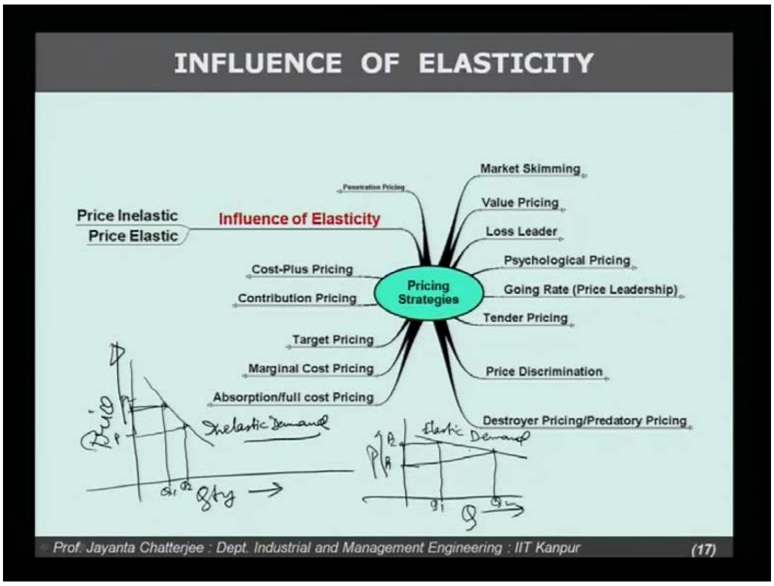

The last part is about understanding the influence of elasticity on pricing. So, as we know from our we have already learnt it from that if your quantity verses price graph looks like this then for a. So, the gap between Q 1 and Q 2 will be far smaller than this gap between P 1 and P 2.

So, this kind of what we call inelastic demand. So, change in price does not make that kind of change in quantity where as this is the kind of demand pattern. What is elastic demand? So, quantity price. So, as you can see if this is P 1 and this is P 2 then the difference can be this difference P 1 and P 2 can create a much bigger difference between Q 1 and Q 2.

So, this is another sometimes you may it is not always true. Therefore, that if you offer a price reduction in the market you will have a volume increase. So, when you use the principles of penetrating pricing or skimming oriented pricing. These are some important considerations for you that whether your market is has the characteristics of inelastic demand or elastic demand. So for example: in perfumes offering a big price discount.

That means, in the high end or in the more in the discretionary purchase end. There are many products which exhibit inelastic demand where as in staples to a certain extent; the this elastic demand is production. So, that is why often you will see soaps are being sold. You know buy two get one free sort of thing because there we will that sort of price reduction costumer will say, ‘oh this is a good deal’ and the demand will increase. So, instead of buying two soaps or might be the person actually came with a demand of one soap, but will now go with three soaps.

So, you have been able to actually with that enticement you have been able to increase your cue with this change in price. So, you will be able to the demand is more elastic there up to a certain limit. Of course, I mean if you go beyond that; if you say can I persuade you to buy ten soaps then this key might not operate. So within certain limitations.

So, elasticity is often little contextual depends on the kind of product the demand pattern. So, in industrial market often certain low cost consumables in the production process can be to some extend can have a elastic demand. Can by price reduction one can push the volume? But for many other parts if it is like a high value pairs. Then just by the price reduction makes no sense because it will be purchased based on the usage and based on the depreciation in the machine and the requirement of the parts.

So, in a way that is an inelastic sort of demand. So, this is kind of a background discussion that will be useful particularly if you are starting a new venture or you have this a new product pricing challenge. In the beginning of the last session I was talking to you about two hypothetical examples. But, borrowed from almost real life situation one related to an industrial product which is a modular new design bullet casting machine developed by a company electro thermo.

And what should be the pricing strategy for such a product verses a new karaoke machine meant for a home use? And how what should be the pricing policy now? In both of this cases it is like a new product pricing challenge and we will discuss this in the context of the overall situation with respect to a very important part of marketing which is entrepreneurial marketing for a new company or for a startup company or marketing strategy. For a new product entrepreneurial marketing is important for a small company as startup.

As I mentioned it can also be an important investigation area for large companies getting into a new type of product. Like for example, goggle has been hugely successful as a software and as a service provider of almost virtual service. But, as you know Google has now acquired the mobile phone business of Motorola. And they want to now create a whole set of products and bring it to the market which will truly leverage the entire range of potential of the android operating system platform of the mobile phone.

Now, the pricing strategy here is quite an intricate challenge because on one hand Google has been extremely successful with their android platform because companies like HTC or Samsung they use the android platform. And they have brought the android platform to this stage by spooning by encouraging a large number of developers of free source software or software that are downloadable from the android market website.

And all this have happened because those companies like HTC or Samsung never felt threatened by goggle because they consider goggle as a facilitator or as a technology platform supplier. Now, the same technology platform supplier if they now start making phones which will compete in the market place with HTC or with Samsungs smart phones then they might feel the pressure and may want to therefore, create an alternative scenario. So, they might now move in to Microsoft court with the new Microsoft operating system for which actually only Nokia may be the real big buyer. So, it can change the market.

So, how should Google handle this new hardware business? What should be the pricing strategy for the Google Motorola new range of phones? How they should create a nonthreatening situation for the big buyers of the other side of Google's business which is their core business of software and services will be an interesting challenge? So, this is a new product price setting challenge new product marketing strategy problems. So, we will see that how we can take our some of our concepts that we discussed. So, far and apply it to the entrepreneurial marketing situation.

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So, the entrepreneurial marketing plan is the same as a normal marketing plan. That means, it has to explain the process of creating and delivering the needed desired goods and services to customers. That solves their problems. But, in entrepreneurial marketing we have to focus strongly on this problem solving part.

This we have discussed before that if you understand deeply the customer pain points the dimension of the problem. And you then create your bundle of value proposition then your chance is better rather than focusing on the all the new features that are being offered by your new product So, instead of future based marketing strategy your whole focus should be on how efficiently how effectively you solve the costumer problem.

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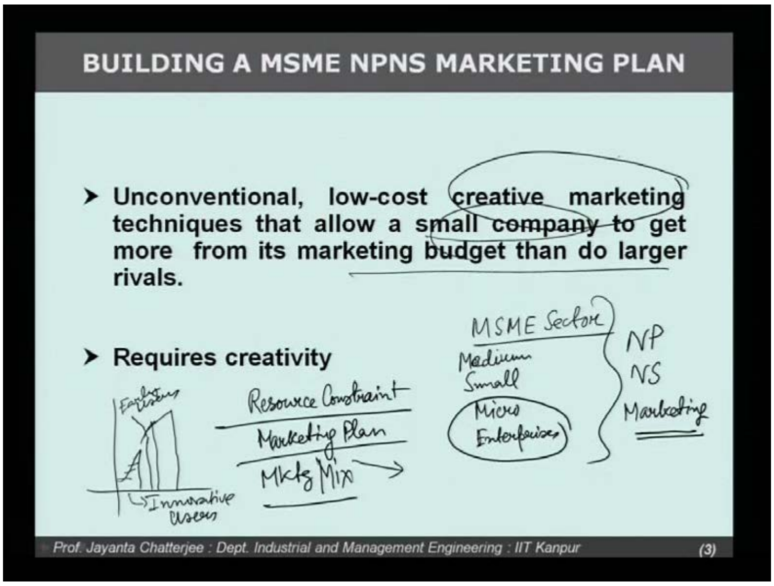

Now in case of this what we call the M S M E sector that is medium small and micro enterprises for this sector. A new product or a new service marketing plan offer some special challenges usually such companies have resource constrain. So, the marketing plan has to look at the marketing mix and understand that there will be a significant investment in the cost of directly approaching the customer.

That means, person to person selling in many cases you may need to have lot of explanatory investment either in directly meeting one to one on one with the customer or making presentations at conferences, at exhibitions, participating in industry workshops and so on. As a result you may not be having much left to do lot of make big bang advertising. And in many of these cases advertising will make no sense because these can we are talking about a new to the world. So, even there will be a limited number of. So, you're really interested in getting a good share of this what we call the innovative users. And the next segment the early user in this case it is this big bang promotion is not of much use. So, one actually likes to focus on a marketing budget that is suitable for a small company and therefore, the focus is on creative marketing.

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We will have to take up some examples to understand that how you can do this low cost entrepreneur marketing by choosing some specific target market, creating a crisp costumer need statement. Remember that this has to focus on pain and problem resolution and build a marketing mix around the advantages solution that you offer to fulfill the need.

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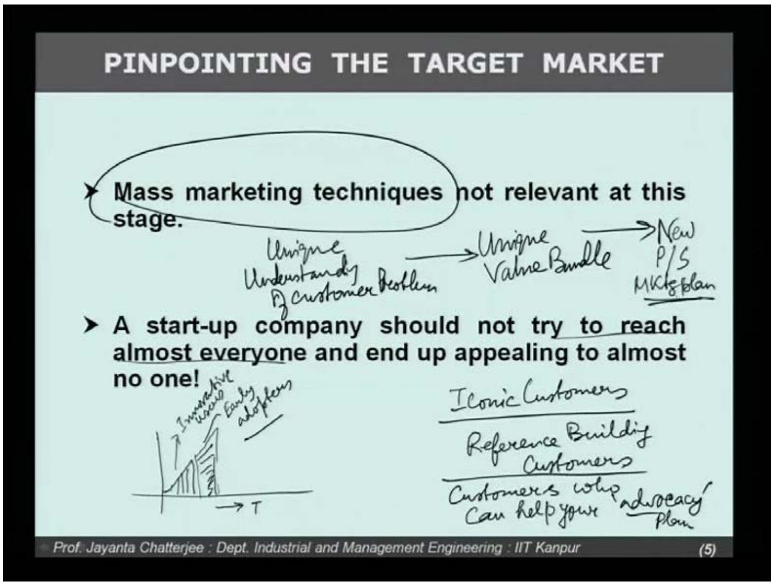

Because you are looking into this part and this part of the market if I draw it a little bigger than we are looking at there is this chasm. So, we are looking at the innovative users and the early adopters. So, here your whole focus will be to create some what we call Markey customers or iconic customers or reference building customers. Customers who can help your advocacy plan. So, mass marketing techniques are not very reverent at this stage. So, trying to be reach everyone is not a good strategy at this stage. Obviously, so, based on your unique value bundle which is derived from a unique understanding of customer problem you have to create the new product or service marketing plan.

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You can do all of these based on this you will have to create a marketing plan for the karaoke machine for domestic party use or for classroom or for institutional use that we talked about. So, that is your task and when we come back then we will discuss that issue as well as some of the other examples.

So, important for you at that stage at this stage is to understand that how to get these first two segments the innovative user IU. So, we are talking about the home karaoke machine. So, first task is to how to get the innovative users and the early adopters. And how to go from there to win this key target which is the early majority how to go and reach the early majority focus on pricing strategy. And your distribution is the place usually and your promotion.