Managing Services

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Lecture - 34
Pricing – Basic Concepts

Hello, we were discussing about strategy, now whatever maybe your strategy, whether it is differentiation based or it is focus based or low cost based. Ultimately in services business, you have to deliver to the customer consumer, more value than they expected. So, the post consumption, post consumption perception of value delivered to a consumer must be more than the pre consumption expectation created by the value positioning of the service.

So, value that you expected before you approach the service, if that is exceeded as per your perception after the service consumption, then you have a chance for delighting. Then, the service business will be in the zone, where they can cost delight and gain customer loyalty and advocacy. Now, ultimately the success in a services business is raised on this foundation of p minus e, perception exceeding expectation.

Now, whatever maybe your strategy, it is this value delivered will be the key measurement in customers mind. So, when a customer perceives the value received, in that there is a certain cognitive or logical part and there are number of other emotional or effective parts. Within that cognitive frame work for recognizing value received, price is a key, almost the core.

So, in some respect therefore, the price charged by the service business is a cost of acquisition to the cost of use for the consumer and that cost is compared in customers mind with respect to the value perceived. So, in service business, it is somewhat difficult and on the other hand, somewhat easier to create this value perception, which we will understand as we discuss during this session and in the following couple of sessions.

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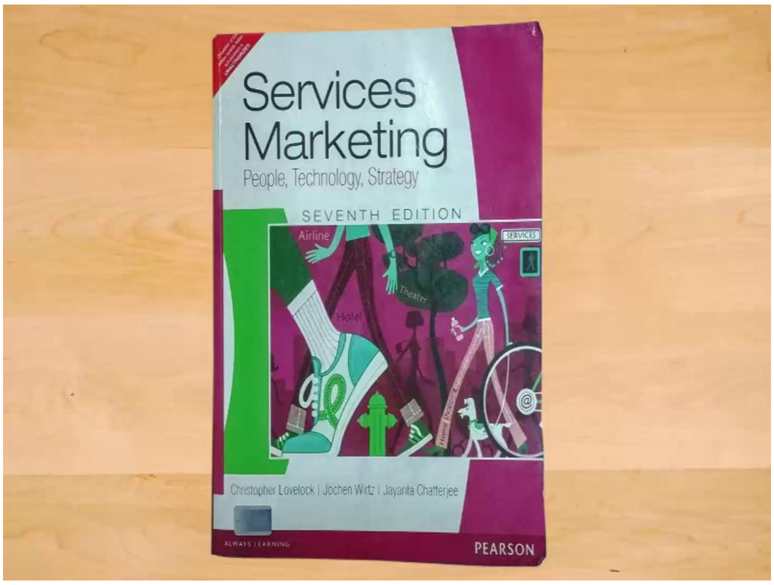

Different aspects as detailed in our text book in chapter number 6. So, chapter number 6 in this text book is titled as setting price and implementing revenue management. Revenue management is an advance concept, quite applicable or rather more applicable in the services business as oppose to in the goods business. But, before we get into those interesting areas of price setting in services business, let us review today some fundamentals about the art and science of pricing.

It is art and science, because a good part of the pricing consideration can be calculated, tabulated, figured out quantitatively. But, there are several still, which almost is intuitive art, deep understanding of the consumer psychology, deep understanding of the different occasions and situations in which service is short and delivered. And those basket of capabilities are in the realm of art, art of pricing. So, there is a science and there is an art of pricing.

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But, ultimately the role of pricing is to deliver current profit, deliver growth in market share. So, typically the pricing objective, here I have taken for an example, I have chosen an organization called 6 Ballygunge place. It is a service business for delivering traditional Bengali cuisine in different fusion mode, in a fusion with certain continental and European dishes and in very modern ambiance.

They have number of restaurants, which they run in Calcutta; they also have catering service to serve banquettes and parties and so on. And I think, they are now developing certain new other service businesses like home delivery of for smaller parties, etcetera. Now, for pricing strategy of such a business, one fundamental consideration will be growth and growth which will be measured in terms of current profit and growth in terms of market share, when 6 Ballygunge place competes with similar other restaurants like Bhojohori Manna or like Oh Calcutta or they compete with alternative food and beverage services like other restaurants, other catering services and so on.

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So, in pricing policy therefore to remembering that it is to give us current profit, give us growth in market share, give us revenue growth as well as profitability growth. The policy setting can be described by this particular diagram which is in front of you, where you select the pricing objective and we compare that with respect to or rather that is derived or sort of interactive with the determining demand and we have to estimate cost.

We also have to analyze the competitors costs, competitors prices and the entire range of offering from the competitors. So, when 6 Ballygunge places trying to determine their pricing strategy, they have to look at the pricing strategy of Bhojohori Manna or of Oh Calcutta, they have to also look at the comparable, other restaurants at park street and other places in Calcutta and their pricing policies. They have to compare, they have to understand the five star hotel and the restaurants and their pricing policies.

So, they have to therefore determine the pricing of competitor, so at the horizontal level; that means they appears, pricing of competitors who are positioning themselves at a higher price level and pricing strategy of restaurants, who are actually positioning themselves a little down on the scale and then, one has to select a pricing method and selected final price. We cannot have a discussion on pricing without having any discussion on costs.

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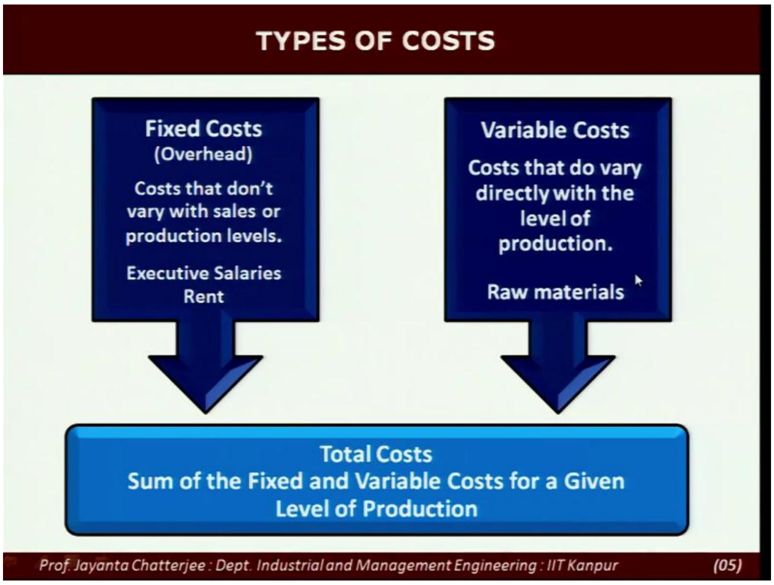

And as you know, there are two types of costs, some are fixed cost, we often call them sunk costs, because these are costs on which as a manager you may not have much of control. That means, the infrastructure or the place that has been rented or the salaries of a long term employees, fixed salaries which are not or at least the fixed component of all salaries and electricity bill, average and other stuff. So, these are costs, which are fixed with respect to the volume of sales.

So, whether you run your restaurant 5 days in a week or you run your restaurant 3 days in a week or 7 days in a week, there are certain costs, which will remain unaltered like rent. There will be some of the costs are semi variable like the electricity cost, to some extent it will be variable with respect to your hours of operation and so on. But, it will not vary with respect to your volume of sales for example, because that has many other variables embedded in that.

So, there are therefore, some fixed cost which are quite fixed like the rental of the place, some costs are, fixed costs are somewhat fixed somewhat variable like the electricity bill or your generated fuel bill and so on. Then of course, there are costs which are totally variable; that means, they are quite tightly tied to the number of units sold or number of dishes delivered or number of parties served or number of customer served and so on.

So, they are therefore, these costs are directly related to the level of production and these costs are costs of raw material, cost of different ingredients in the case of a food and beverage restaurant or it could be certain types of ancillary stuff supply like napkins and so on, etcetera. So, these costs are linked to the number of units delivered or number of units produced.

Together they cross the total cost, now if we have a revenue line and so the unit cost minus the variable cost, which is linked that unit production gives us the margin per unit and the total fixed cost divided by that margin per unit gives us the break even volume or the break even sales. That means, the level beyond which up to which it is cost recovery and beyond which we are contributing to the bottom line.

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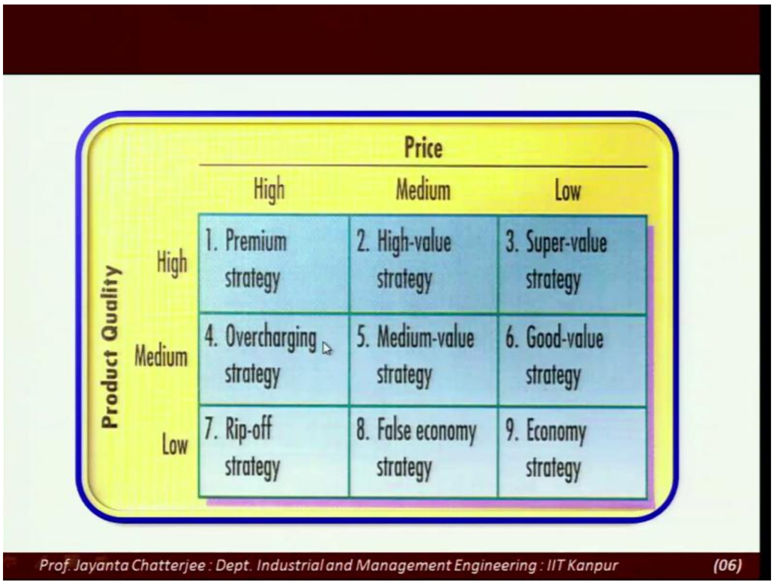

Obviously, this is almost a common sense that if we create a matrix, which on one side; that is on the y axis we have quality, low medium high and price, we have high medium low. Then; obviously, if the, at high qualities delivered at low price that we can call the supper values strategy, a medium level pricing with high qualities, high value strategy and high price with high quality could be the premium strategy.

Now, price is often also a signal for quality, we know now as we discussed I think in the previous session that if you invest well in quality and if your quality is really good, then in many ways you will be reducing waste of different kinds, which means you will reduce costs of different kind. So, if you have a low cost capability and low cost strategy, it is possible that why your product quality will be pretty high, your price your cost will be quite low.

But, you need did not therefore position yourself at a low price end, but you put actually position yourself at a high value strategy; that means, medium price and excellent quality delivered. In many types of services this is the position that organizations try to achieve; obviously, if your delivering low quality at high price; that is a rip of strategy practically not possible in services business today, unless you have some kind of monopolistic position.

So, certain types of state monopoly like the electricity supply, sometimes has this rip off strategy. But, really speaking today with the kind of active consumerism and interns competition and continues pressure and policy from competitors coming from all over the world, it is very difficult today to be in this low quality high price. So, this is even this over charging, these quadrants we can actually forget and really speaking organizations are now trying to remain within these four quadrants.

Because, these low quality low price also is not like if we take that again back to that example of 6 Ballygunge place, this low quality, low price maybe possible in some road side snack bars and so on. But, even there you know people will not tolerate low quality for long. So, this quadrant is out and a these 7, 8, 9 these quadrants of out, really speaking the most interesting quadrants for us to understand pricing will be this 2, 3, 5 and 6.

Over charging, rip off, false economy; these strategies are really gone not very possible here. Now, premium strategy in services is sometimes feasible, there could be you know like the first class service on Air India or on Singapore Airlines or this kind of positioning as possible, but mostly we have to look at these four quadrants.

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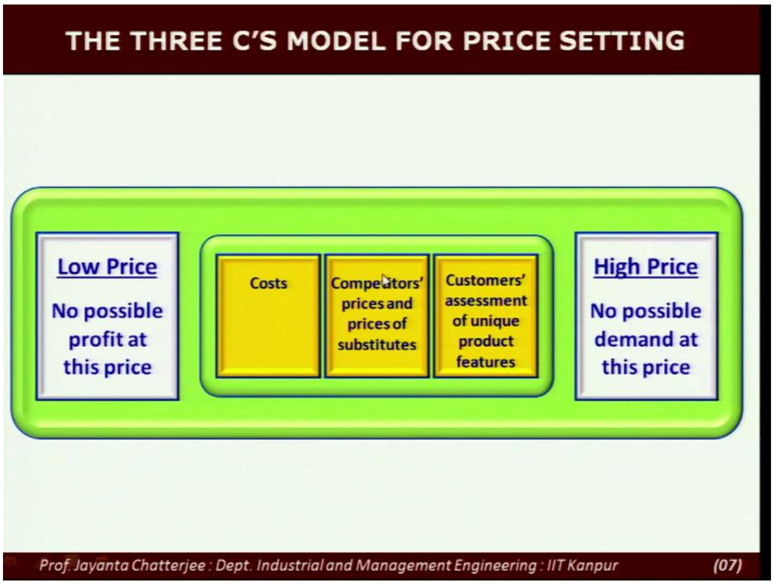

Obviously, this is the range of pricing, this is the low price beyond which you are in at a loss. So, it is not possible to profit beyond this price level, this is where a maybe the zero profit level and this is the high price, actually this is you can say a price beyond, which there is no demand, because a price is so high that even the premium positioning is no longer possible.

So, between these two ends, we have this three elements or three C'S as we often call them; that is cost competitors prices and price substitutes and customers assessment of the uniqueness of your service or in some way, they also these C'S stands for the companies objectives and so on. So, between this one end of low price, another end of high price, we have this considerations of the three C'S, which will guide our pricing policy.

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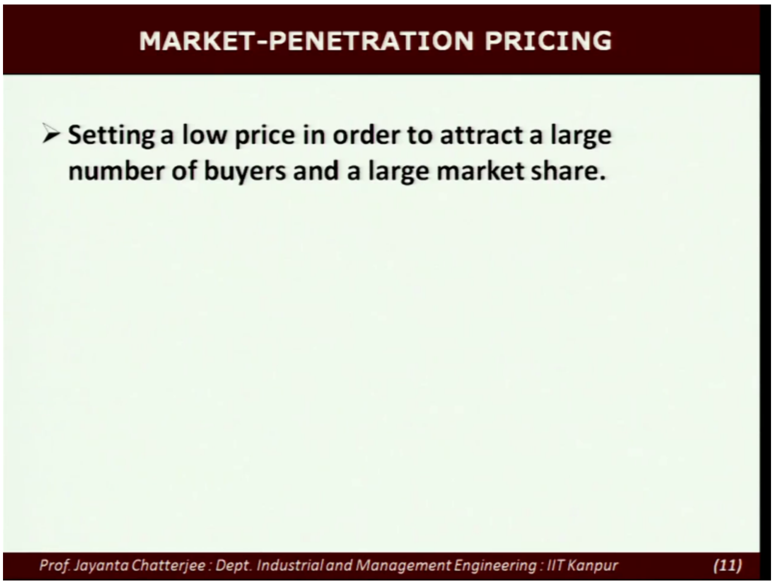

There can be price policy, which is for market penetration, in market penetration prose where we sort of set a low price, deliver good quality; we have to one to attract a large number of buyers, a large market share. So, most entrepreneur service organizations, adopt this type of pricing strategy and as you can see the interns competition; that is going on now in the field of e-commerce and e-retailing.

So, fashion retailing on the web a books and periodicals and music retailing on the web, different types of house old stuff retailing on the web, mobile phone, a telephone, tablet retailing on the web, interns price competition. And this because, their all trying to grab market share, there all trying to grab attention of the consumer and trying to persuade the consumer at least comes once an experience their website and their transactional platform.

With the hope that they will be able to create other hopes and policies by which the customer will continue to play with them. So, market when iteration pricing often the starting point for entrepreneur service businesses.

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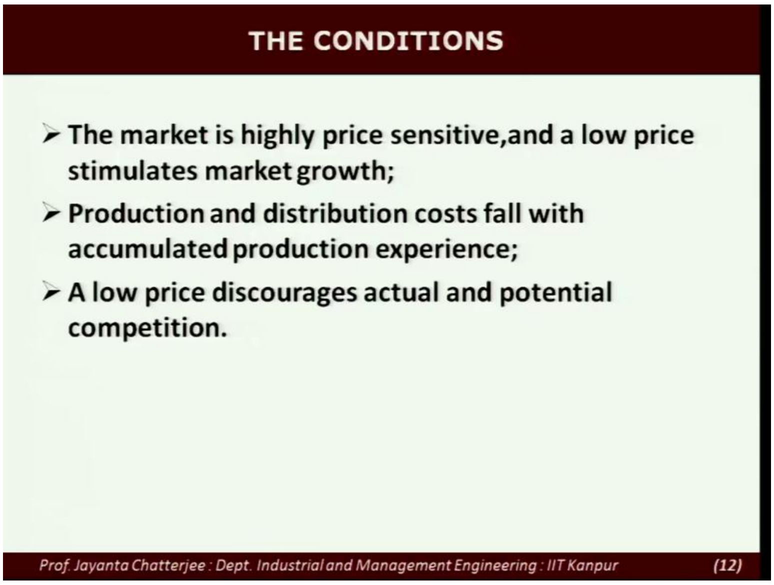

And the conditions under which this strategies good, this policies good is, when the market is highly price sensitive and there low price stimulates market growth, which is one of the strategies being adopted by almost all e-commerce, e-retailing players. Because, they feel that compare to the physical stores, if customers really find lower prices than more and more will shift from physical purchasing, physical shopping behavior to electronic shopping behavior.

And also the scalar production are if there is a economy of scale; that means, more volume; obviously you are fixed cost per unit will down, it more units are sold so. But, there are other issues like learning curve and so on, where that means, more you sale the more you customers, you get you find tune your operations, you learn how to delight the customers more and more. And therefore, those are benefits, which you can develop later, once you have by using a penetration pricing the customers with you.

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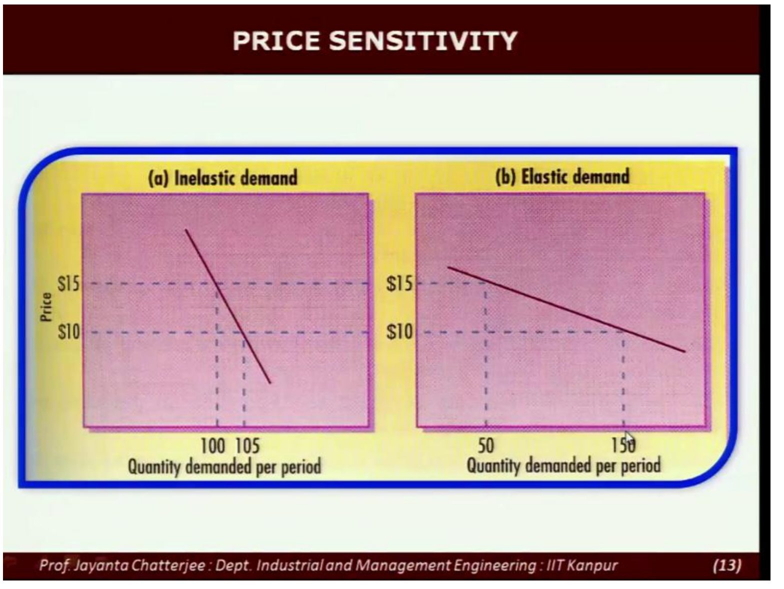

One thing, we have to remember from fundamental economies lesson than that in some case, a reduction in prices will actually cross very little change in the demand, this is called the inelastic demand. So, depending on this price verses demand graph, if this graph is actually of this shape this is means that it is the demand is inelastic. If the graph is of this shape; that means, a little change in price can make that means, is 10 dollars to 15 dollars change in price, can change the demand from 50 to 150.

So, this is a 50 person change in price creates 3 times more demand. This is this understanding that whether the market in which you are operating for your services, how sensitivities to this elasticity is very important before you actually either reduce or increase your prices.

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Price often actually a prices set and price is not normally reduced, but there can be seasonal discounts, you can give different times of pricing incentives, bundle pricing, repeat purchase pricing, coupon based attraction to the customer to come back and a purchase that sort of price adjustment strategies can be there. So, ultimately there can be two approaches to at any point of time, when we look at price management.

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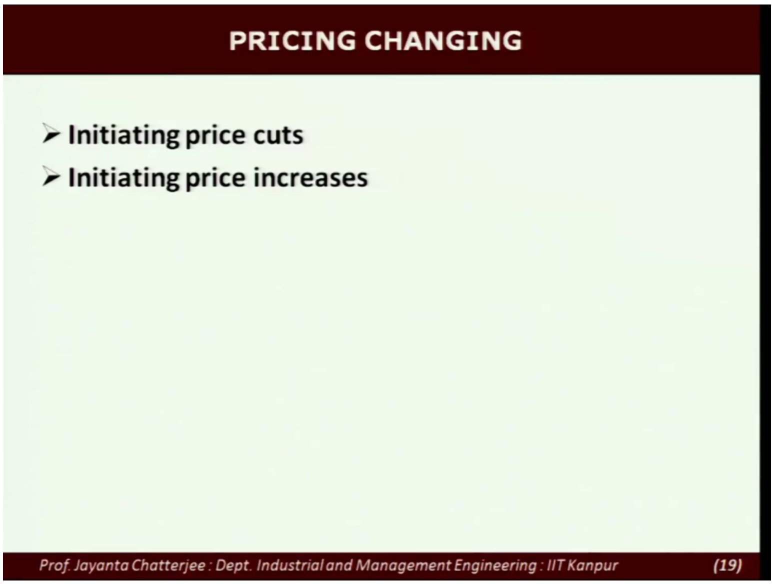

Either, we want to initiate price cut or we want to initiate price increase.

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Price cut can be initiated due to excess capacity or competition or your pricing policy for penetrative pricing.

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Price increase can be done due to a cost inflation or over demand, these days of course, price increase can be very seldom deployed, because the competition intensity almost a negates the possibility. Of course, you have continuously monitor the reactions of customers as well as competitors to price change, you have to be very sure that you are not going to cost a price war unless that is what we want.

And if you want to win in the price war, you have to have a very strong handle on your low costs strategy. The low cost strategy that we discussed earlier or low cost and focus combination, where you will be able to create a bundle of values for a certain segment of customers by virtual of which you will be able to shield your pricing from different types of other pressures.

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So, competitors price change, you can just like they will have these responses, you can have the similar responses to a price change scenario, maintain price or reduce price and increase price and improve quality, etcetera. Some of these like increase price and improve quality, these are very traditional thinking in today's world, they may not be very valid.

But, this launching a low price fighter line is often a good strategy in response to an aggressive predatory pricing from a challenger. So, this is how at one time, when a Nirma came with a good product at a very low price, the response from the traditional manufacturers as are the organize players of those days, now Nirma itself is a big organize player.

But, in those days, people like a Unileaver or Proctor and Gamble, they responded with by launching a low price fighter line. The same think happens in service business as well.

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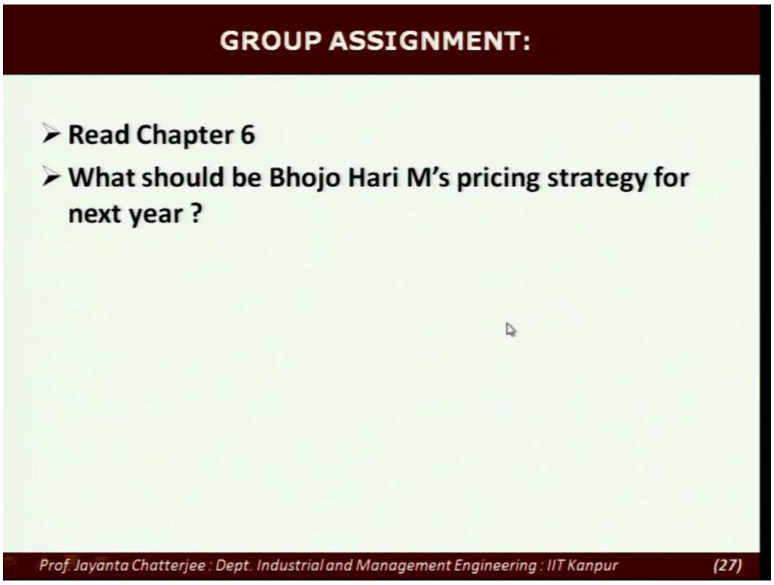

So, I will conclude today's session by requesting you to read chapter number 6 from the book, which is the chapter title setting prices and implementing revenue management. The initial part of that chapter you are requested to be read and I would like it think about that an organization like Bhojohari Manna, I introduce that, they have number of restaurants in Calcutta, in Bombay, Bangalore.

And other places with serve Bengali cuisine, traditional Bengali cuisine in some exact Bengali cuisine in a modern ambiance. Now, this organization is in competition with 6 Ballygunge place in competition with Calcutta, some of them are regional players, some of them are the national players and think about go to the website Bhojohori Manna, read a little bit about them, read about their competition. And think that, what should be their pricing policy for next year.

We will continue this discussion with a deeper understanding for your deeper understanding over the next two sessions.

Thank you.