Marketing Management II
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Lecture No. W5-L2
Considerations for Setting the Price

Hello and Welcome to our course Marketing Management part II and we are in Week 5. And this is second session of this on this pricing module. I am Shashi Sekhar Mishra jointly offering this course with Prof. Jayanta Chatterjee. I will just give a brief recap of what we have discussed in the previous session that was yesterday. And we discussed about price and overall the roll of the price in strategic marketing process and there we talked about the that pricing basically is in a strategic tool.

And we discussed about the lot of blenders that organization make in pricing a product. So, we talked about what happened to. In the case of TATA NANO unintentionally the product which was very good product got a tag of a cheap car kind of thing and that is called its sales over the period of time. Then we have also talked about that pricing has to be something which will reinforced the intended positioning of the product. This was one of the inference drawn from the case of at the launch of the TATA NANO.

That the pricing should reinforce this thing rather basically be conflict in conflict with the positioning intending position of the product. Then we also discuss about that pricing should be something which should be sync with the other three piece or the other marketing mix components. And then we talked about how consumer process this prices. So, we talked about the consumer psychology and their processing of the prices and there in what we have seen was we talked about the reference prices we talked about the pricing cues the product quality leadership.

So, some of these things we have discussed in the reference prices that we have seen that consumers generally have some kind of reference references in their mind like, whether it is a fair price, whether it is a typical price or this is that too much for a product to pay. So, there are upper bound prices they are lower bound prices. So, these kind of references are the exist in the minds of the consumers which they can think of from their past experience or the ingredients in the product.

That kind of effort that goes into production or creation are those kind of product that allows the customers to assess the value which is inherent in a product and based on those references. They try to understand whether the price that companies offering is something which they should pay or not pay with that. We also talked about the price cues that companies used that the use of this sale kind of or the big sale kind of banners or the symbols.

That organizations use for creation of the customer attract I mean for attracting the consumer attention towards those product or probably we talked about how the consumer a process the price point that is we talked about something which is can be priced at 299 or something which is priced at 300. So instead of starting from the right to left consumer tend to process the price information from 299. So, they will begin with 2 and then they will come to the two nines and instead of starting with 3 and then 0 starting with 00 or 99 they start with the first number that is 2 or 3.

So, when they see 2 they say that the price is closer towards 200 instead of having a look that the price is actually a 300 or closer to 300. And that creates a certain kind of perception that the pricing is on a lower side. So, with this, we have talked about a different things that goes into the minds of the consumer. What we are going to talk about today is that, how do we set prices? So, the setting prices has certain steps inside it.

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And it begins with basically the selecting the pricing objectives which is something very important as we quite often see that in fact which is something not present. So, it is like the head of the something and if it is not present you can understand it will not have any direction to go. So, the first thing in setting the price is you should understand what is objective of that pricing and that is where we thought discuss about that pricing is something as strategy tool.

It reinforce in the positioning, or it should reinforce, or it should help in achieving an organization is marketing objectives and in probably broad sense it should help the organization in attaining its organizational objectives. So, you will understand that as a one of the marketing mix one of the piece in the marketing mix. It has to sync with the organizational objectives a business objectives marketing objectives in an organization.

Then once we have understood what are the objectives we are going to discuss about each of the steps in much more detail in some of the next few sessions. But I am just summarizing this process and then in the second step you will see that once you have said objectives the second thing is that you have to understand what is the demand. Because you will see that demand and the price or something which have a close relationship. Many a times you will see that the two have a negative relationship.

But it is not a universal truth that in some cases you will find out that the price and the demand in such certain case we will follow a positive relationship or it could be an inverted U-shape relationship may be in some of the one of the sessions I will give you an example where this demand and the price follow a different kind of trajectories or the graph you understand. So, once you understand that differ corresponding to different price point there are different demands.

So, you can find out at which price pointer company should price a product. So that they can maximize a demand our intent they can max fulfill the objectives. So, whether you want to maximize your revenue or whether you want to maximize your profit looking at the different aspects of the organization and the looking at the different aspects of the other basically this surprise in the demand and the cost.

The next thing that comes into the picture is that once you have estimated the demand. Then you have to estimate the cost also and then they are in. We will talk about the different types of the cost the behavior of these different types of costs and depending on these costs are, how we price the product is also influenced? then once you have estimated your cost then talk about analyze the competitors price mix and you need to understand how competitors are pricing their product?

What method basically they are using for pricing the product and they are basically when we talk about competitor's price mix there we also look into the competitor's objectives. So, if competitor's objective is different from your objective they might be they might be pricing the product in a different way. So, these are some of the enhances probably as someone who is pricing a product you need to understand.

Then the second last thing is that you have to choose the pricing method, so there are different pricing method like, mark of pricing costs plus pricing and then you have competition based pricing you have perceived value pricing. These are some of the different methods we will talk about and finally you choose as a one of these most appropriate method of pricing the product depending on. And the different variables which are there which existed while operating in the market and then basically you choose the select the final price of the product.

So, with this method the whole process you arrive at a price point that that is the most suitable for pricing a product.

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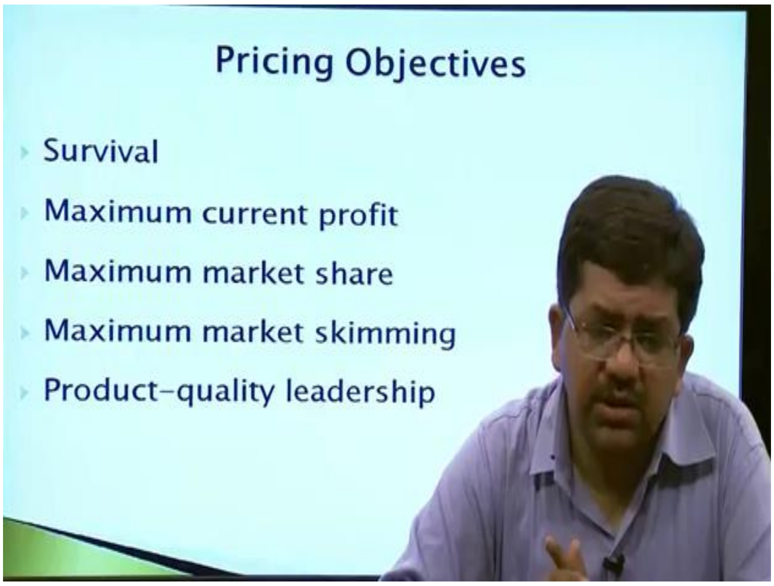

So, Today I am going to talk about the different pricing objectives broadly. If I see there are five types of objective that exist among the different players in the market. You will see that this pricing objective the first one is a survival the second is a Maximum current profit where you try to maximize your profit. The third is a Maximum market share. The fourth is a market Skimming.

The some of these things we have talk talked or reference in the earlier session or the previous model or the previous course that is Marketing Management Part I. But in this model of the pricing we will talk about these ones in much more detail. And if possible if we have the time we will also talk about some of the examples of this kind of pricing. So, the last one in this pricing objective is this Product-Quality Leadership.

So, these are the five different types of objectives and here you will see that the first one the survival is something that exists. When in a company which is operating in the market they are coping up with a situation where they have over capacity

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So, the supply is on higher side then the what exists in then the demand that exists in the market. So, when they supply is on a higher side then demand you will see that there will be a very intense competition in the market among the players and survival also could be a problem. When the consumer needs are changing very fast as an organizations you might not be able to cope up with those kind of changing needs or you are unable to bring the product that are in sync with the changing consumer trends.

So, in those cases basically your survival is at the stake and your organizations future is at the stake and what you should do is an organization is that we often see that in this situation what the companies try to do is that they price a product that is variable cost plus some additional margin or some plus variable cost plus something so to cover some part of their fixed costs and in that way they are able to ensure that they can survive for sometime or some significant time.

So, in that case you will see in this survival method of pricing the prices should cover variable cost plus some fixed cost and you will see that survival is the short term strategy where in the pricing is not done basically keeping in mind the long run future of the organization.

It is just to say that you just to say that you can exist in sometime you are able to have to retain your customer or you are able to hold the ground in the market for some time and then you have to eventually in that time period that you buy through this kind of pricing you are able to learn some kind of differentiation or you are able to add value in your product and in the long run you have to come out with the products or the offering which are clearly differentiate differentiated. And in that case, you will be able to probably survive for the long run.

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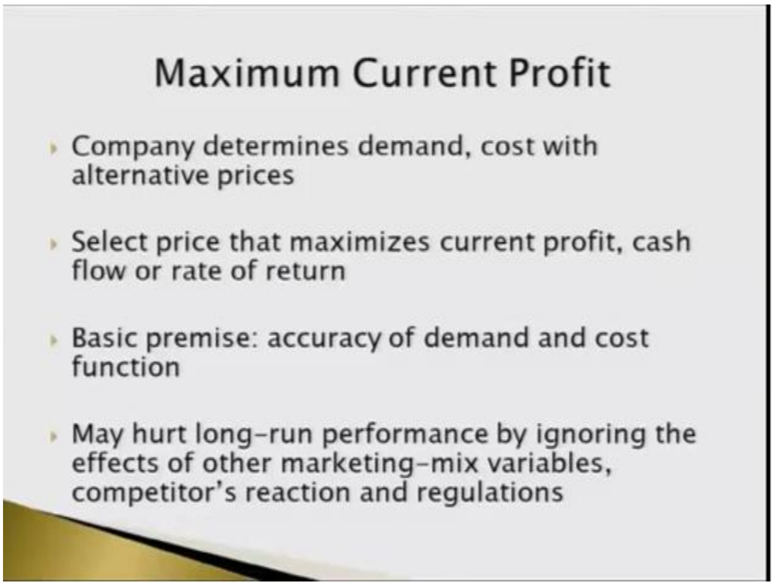

So after survival, I am going to talk about the next method the next objective which is commonly seen in the pricing objective is this maximum current profit you will see that the maximum current profit is something where this company has to first determine what kind of demand or what kind of cost exist with respective to the alternative prices. So one should have a very good knowledge about its demand and the cost functions.

But you will see that when we theoretically talking about it good knowledge of the demand and cost functions, it may not be very true because when we when will talk about the kniticality of demand in the cost. You will see that there are something in demand in the cost that cannot be very accurately measured, or they cannot be very easily assess. And that way probably our accuracy of demand in the cost function is not a very good assumption or something which does not hold very easily.

So, but if we assume that we understand the demand in the cost very well with respect to different price alternative prices then that what we try to do is that, we choose the demand in the cost and a pricing in the way that the price that maximizes the our current profit in the maximum possible way. So, we try to maximize our current profit cash flows or rate of returns. But what we will see that in this kind of where we are trying to maximize our current profit.

We may eventually heard our long run performance by ignoring the effects of other marketing mix variables and we may not be able to very clearly understand that competitor's reactions and the regulations that might be existing in the market with respect to the pricing. So those kind of things we may ignore in this kind of method and eventually what will happen is that it may not work very well for the organization.

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The third type of pricing objective that we see in the market is this Maximum market share. We also understand this kind of pricing in the way that it is a penetration it is a penetration pricing. Now, you see in the penetration pricing what happen is that the companies try to reach the maximum possible customers in the market or they try to maximize their reach in the market.

So, the basic believe that exist in the market about this kind of pricing is that higher sales would higher sales volume would lead to a lower unit cost and higher long run profit and in this kind of pricing one of the thing that we believe is that customers are very price sensitive or affordability is the issue where the prices could be could lead product not to sell because the customers might not the long or the big part of the market may not be able to afford the products.

So, the idea is that, when you go to maximum number of the customers and you are able to reach the maximum possible sales volume what happens in that case is that your unit cost goes down. Because you will see that when we talk about the cost we will see that the fixed cost as well as variable cost both will go down. When we reach to the maximum possible levels of production.

So, our cost goes down when whenever the cost goes down with respect to our competitors one thing also happens is that with over P over the period of time when we are operating on a higher sales volume. So, we are producing on a higher side our learning curve is also very far high. So, in that way also we are able to reduce our production and other costs. So in that sense our costs are very low compared to competitor and we are in a very advantageous situation that we will be able to gain more profit by selling it have a particular price point compared to our competitors.

So, you will see that the one thing that works for the Maximum market share of this penetration pricing is that low prices stimulates the market growth because when the price is on the lower side the customers are motivated to have the product think of a drug where the price of a drug is on is on a very higher side. So, in a society that drug will can be afforded by only a few people.

But if a drug is on a on a very affordable price and that government regulations also comes into the picture that the most of the people in the society can afford the product. So, whether they can directly afford or there is some kind of funding mechanism through the government or other bodies. The product can be made available and it basically stimulates the growth or the consumption of that product and some of the things that work in favor of the things that work in favor of this kind of prior pricing is that costs also false.

As I have already said owing to the learning experience and this kind of penetration pricing is actually a repulsion to your competitors. So, when your margins are very low the complete four competitors are for a new entrance. It will not be a very attractive market. Another very important aspect with the case of penetration pricing is that, if you as a one of the supplier has reached to a higher sales volume your cost will on a lower side we are on the other side a new intern which is entering into the market they will not realize the sales volume on a higher side very easily and they will take a lot of time or lot of efforts from their side. And in fact, they will require a lot of investment also to gain the sales.

So, in that case what happens is their cost of production or the cost of offering the product to a customer will be a very high compared to you. So that is something which is a repulsion to the competitors not to enter into such kind of market.

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The last two types of the pricing objectives are Maximum market is skimming. Skimming is opposite of the penetration. Where the organization understand that they are bringing something very new and very innovative. So, in that case the company try to maximize their the current gain and in this kind of thing you will see that quite often. The technology forms to have this kind of pricing where they price their product on a very higher side the latest kind of I-phone or a latest kind of a new technological gadget you will see it is on a very higher side of the price.

Because, their large number of potential buyers exist, they are technology enthusiasts. They are ready to purchase a product irrespective of its prices as long as it is they can afford it. So, the maximum ceiling can be reached. In this kind of Market Skimming pricing and one thing one has to keep in mind, that unit cost should not be very high to cancel the price advantage. Because when you operate on the low volume the production volume your cost will also be high, but that should not negate the price advantage.

One thing which with Market Skimming is which is exactly opposite to this penetration pricing is that when your margins are very high you as an industry will be very lucrative to your competitors also. Now Skimming basically is used also to communicate the superior product image.

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The last type of the pricing is that product quality leadership where these are you can also say sort of affordable luxuries. So, product is of perceived as a very high-quality state and status and they are price in a way they are just within the reach of the customer. So, they are pricing just below the ceiling level and whomsoever as a customer potential. Customer wants to have it they can have this kind of luxurious product within their range and lot of companies.

Basically, come out or operate in this space because they operate to a larger market segment. So, these are the five four different pricing objective with this. I will stop there and when we will meet you in the next session, we will talk about the remaining aspects of setting the prices and then we will also try to look into the some other related concept and the issues which are related with the pricing. Thank you very much!