

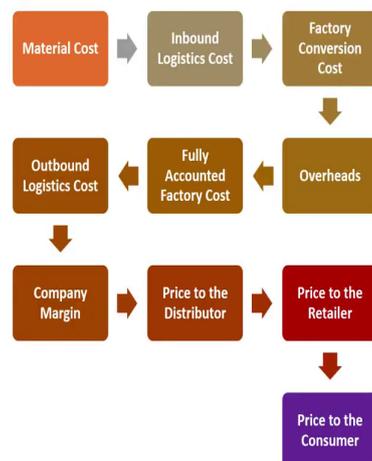
**Business Development from Start to Scale**  
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**Week - 07**  
**Branding and Pricing**  
**Lecture - 35**  
**Pricing**

Hi friends. Welcome to the NPTEL course, Business Development from Start to Scale. We are in week 7, with the theme of Branding and Pricing. In this lecture, the 35th series, we discuss the topic of Pricing.

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**Cost and Price**



Price is a function of cost, but at times it is a function of managerial leadership judgment in a company. There are several cost elements that get built up before the price can be computed.

It starts with the material cost to which inbound logistics cost is added. The material which is at the factory gets converted into a finished product.

But for the cost element to be completed, the overheads are allocated based on certain principles, then you get the fully accounted factory cost. And to that you add outbound logistics cost as well as the minimum margin you must have as a company. Thereafter, you have two pricing levels, price to the distributor, in some cases there would be a wholesaler as well then you would have the price to the retailer. At the end of the cost and price build up you have the price to the consumer.

There would of course, be certain buffers in the pricing level, so that in case it is needed additional incentives can be offered to the distributor, wholesaler or the retailer or all of these as the case may be.

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#### Pricing is Dependent on the Cost Build-up

The more the number of layers in the manufacturing value chain, the higher would be the cost additions

The more the number of layers in the distribution value chain, the higher would be the cost additions

The competitiveness of customer pricing would depend on delayering as well as cost compression in each layer

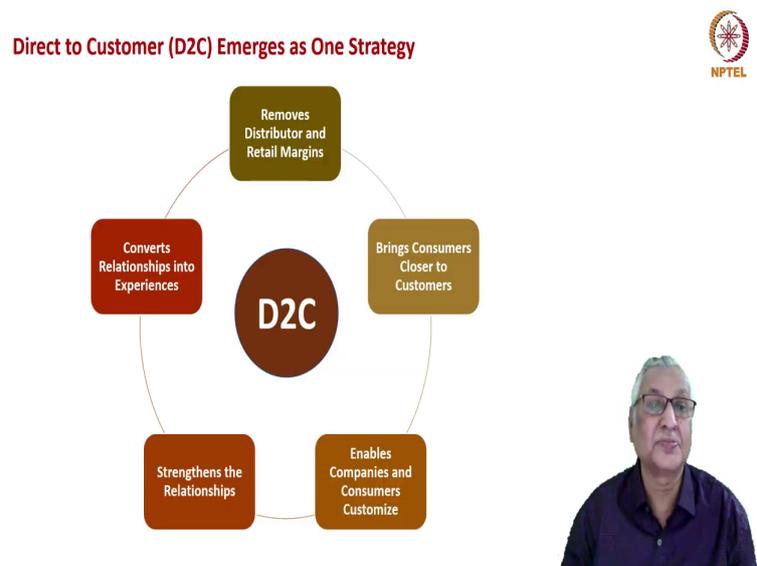


Pricing is dependent on the built up of cost. If you have more number of layers in the manufacturing value chain, the higher would be the cost additions naturally.

However, even if the number of layers is low, if each layer consumes a whole lot of materials and the intensity of manufacture is high, then the cost also could be high. Similarly, if you have the layers in the distribution value chain that are in excess then you would have higher cost additions.

The competitiveness of customer pricing would dependent on delayering as well as cost comparison in each layer. This is an important aspect of pricing.

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Direct to consumer has emerged as one strategy in this scenario because if you are able to disintermediate between the company and the customer, huge cost levels related to

distribution and retailing could go away. There are products where the actual factory cost along with the margin could just be 100 rupees. But the maximum retail price is as high as 300 rupees.

Two-thirds of the price which the consumer pays could be going in for the distribution and retail margins and that is how the life of distribution of a product is in India. So, if you have a direct to customer strategy, wherein you can reach a product directly to the consumer, then you have lot more advantage.

So, what are the advantages of a D2C strategy? It removes distributor and retail margins. It brings consumers closer to the customers. Thirdly, it enables companies and customers customize to each other. It strengthens the relationship and those relationships can be converted into experiences. There is however, one challenge in D2C.

Normally, the supply of products through distributors and purchase of products by the customers at the retail level or based on small lots which are brought in as big lots to the distributor. The distributor distributes those big lots which are logistically efficient to be transported into small lots to the contiguous retailers. When you look at the D2C aspect, you will face the need to deliver the products directly to the customer in small lots.

So, you have on one hand the inventory costs are associated with a traditional distributor based model and the logistics cost associated with the smarter direct to consumer model. An operational model is required to understand for each product and for each region the appropriate D2C versus physical model that could be followed.

But there is also another angle to having the D2C. Typically, the distribution of products in the physical space is based on repeatability. It is based on what the company thinks is more sellable. We have seen in the earlier lectures that discovery of the actual consumer mind is challenging. You need to do lot of market research and the samples may not be representative of the universe.

So, by enlarge the trend seems to be distribute more of the more selling or higher selling products. And that may be hiding some consumer preferences that are not exhibited properly in this system. The D2C strategy helps you overcome this lacuna. The consumer by way of the access to the universal portal can choose any product that he or she likes, and as a result you may be getting to know certain purchase preferences that were never known to the company.

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### D2C and Indian D2C Market



Direct to Consumers (D2C) is a customer-centric business model where companies reach out to consumers with no intermediaries involved. D2C brands sell products via e-commerce websites, mobile applications, own retail stores, and factory outlets

India's direct-to-consumer (D2C) market, which is likely to reach a size of \$100 billion by 2025, has grown exponentially in the last few years

As of 2021, India had more than 800 D2C startups. In the FMCG sector, several leading companies such as HUL, ITC, Emami and Nestle India have launched D2C portals in the recent times



So, talking about D2C and the Indian D2C market, let us look at some of the important aspects. It is a consumer centric business model. Companies reach out to consumers and there are no intermediaries that are involved. D2C brands sell products via e-commerce websites, mobile applications, own retail stores and factory outlets.

India's D2C market is growing rapidly. Although it could be 1000s of crores as of now, it could reach a size of 100 billion dollars by 2025. And it has grown exponentially in recent years.

It is also a great area for startups to function. As of 2021, India had more than 800 D2C startups. In the FMCG sector, several leading companies such as HUL, ITC, Emami, Nestle India have launched D2C portals in the recent times. And these companies have also been acquiring D2C brands from time to time from the startups.

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#### D2C Portal from Dabur



Dabur India, the latest FMCG company to enter the D2C business, is planning to make its D2C portal live by the end of 2022. The company is positioning it as a one-stop shop for its entire range of product portfolio.

The company's intent is to provide consumer access to the entire Dabur range and not restricting it to their widely distributed products

Source: <https://economictimes.indiatimes.com/>



I take two case studies, one is that of Dabur. Dabur has decided to launch by end of 2022 a D2C portal and that would be a one stop shop for all of the Dabur products. And the consumer will be provided access to the entire Dabur range across various product categories

and various business verticals. And the portal will not be limited to the widely distributed products. That is the advantage which I have mentioned earlier too.

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### D2C Portal from Dabur

Dabur will leverage on its D2C portal to scale up its digitally curated or digital-first brands and products which they have launched in the past two years. Examples are baby care range, apple cider vinegar, ghee, peanut butter, honey, and cold pressed mustard oil



The company is expecting to cross Rs 100 crore mark by the end of 2022 with its digital-first brands portfolio

Source: <https://economictimes.indiatimes.com/>



It also will have digital first brands, specially curated brands, such as baby care range, apple cider vinegar, ghee, peanut butter, honey and cold press mustard oil. The company is expecting to cross 100 crore mark by the end of 2022 with its digital-first brands portfolio.

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### Marico's D2C Bet

Marico is looking at its next phase of growth in the digital and ecommerce sector by venturing into the direct-to-consumer (D2C) sales



Marico's acquisitions in the recent times, have proved fruitful for the company in venturing into D2C. Marico acquired men's grooming brand **Beardo** which had already scaled up its distribution online as well as omnichannel mediums. Beardo crossed a revenue of Rs 100 crore at the end of FY22

Marico's other acquisitions, Ayurvedic hair and skin care brand **Just Herbs** and healthy breakfast and snack brand **True Elements** are expected to scale up over the next two years



Source: yourstory.com

Marico is another company which is betting big on the direct to consumer sales. The company has made certain acquisitions which have been very fruitful for the D2C sector. Baerdo is one such example. It has already crossed 100 crores. It has stepped up its physical distribution, digital distribution as well as omnichannel presence. It has also acquired other company's Ayurvedic hair and skin care brand Just Herbs and also healthy breakfast and snack brand True Elements. These are expected to scale up over the next 2 years.

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**Marico's D2C Bet**



Marico expects its household brands such as Parachute, Saffola, Hair and Care, Nihar Naturals, and Livon to register an increase. The share of online/e-commerce business in the company's overall revenue would move from 9% to 15%.

The company's D2C strategy is similar to the house of brands model of Mensa Brands, with a higher focus on the personal care and food categories

Source: yourstory.com



Marico of course, has several household brands which are distributed in the physical distribution system, Parachute coconut oil, Saffola, Hair and Care, Nihar Naturals, and Livon have continued to register increase in the fiscal space. But addition of these products in the D2C area could increase the overall share of D2C business to 15 percent from the existing 9 percent.

The D2C strategy of Marico is similar to the house of brands model of Mensa Brands, with higher focus on the personal care and food categories.

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### Marico's Target



In FY22, Marico reported a revenue of Rs 9,512 crore. It operates in key categories such as personal care, foods, and digital-first or D2C Brands. The digital-first brand portfolio clocked an exit run rate of Rs 180 crore in FY22.



Marico has three homegrown D2C brands, coconut-based gourmet hair and skin care brand CocoSoul, clean beauty brand PureSense, and nutraceutical brand Fittify. Among these, the first one to show potential to scale up is Fittify



Source: yourstory.com



Marico's target is to have a significant share that is 15 percent from the overall revenue of about 10,000 crores it registers in each year. And the digital first brand portfolio as of now clocked 180 crores which is a small proportion in the 10,000 crore, but the target is big.

Marico also has got 3 organic D2C brands, coconut-based gourmet hair oil, then a skincare brand called CocoSoul, clean beauty brand PureSense, and nutraceutical brand Fittify. Amongst these, the first one to show potential to scale up is stated to be Fittify

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### Marico's Target



To Generate  
**Rs 450 – Rs 500 Crore**  
From its D2C or digital first brands by FY24

To Generate  
**15%**  
of revenues from online sales over the next  
few years

Source: yourstory.com



Marico's target as I said is to get about 500 crores from its D2C or digital first brands by FY24 and to generate 15 percent of revenues from online sales over the next few years maybe by 2027 or so.

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**Investing in D2C Brands**



- In the past year, about seven FMCG companies, including Emami, ITC, and Tata Consumer, have invested in D2C startups. Colgate-Palmolive and Reckitt both hold a minority stake in Bombay Shaving Company. Almost all big private retailers have announced their intentions to step into the space, besides Marico, HUL, ITC and Dabur.
- Marico is emerging as a strategic investor of choice for D2C brands owing to the expertise and resources available to the investee companies at the tap. This becomes especially important in the current market conditions as D2C brands struggle to raise growth funds to break the Rs 100-crore target.

source: yourstory.com



Investing in D2C brands is always good for the FMCG companies. 7 FMCG companies have invested in D2C brands. Colgate-Palmolive and Reckitt both hold a minority stake in Bombay Shaving Company. Almost all private retailers have announced their intentions to step into this space, besides the companies we frequently hear about, Marico, HUL, ITC and Dabur

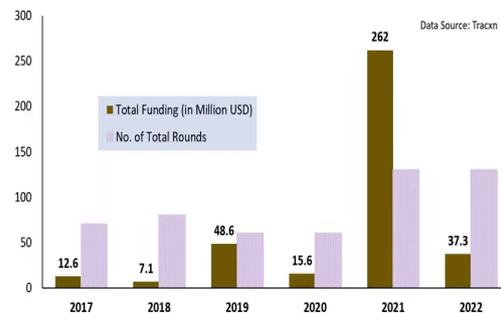
Marico is emerging as a strategic investor of choice for D2C brands owing to the expertise and resources available to the investing companies at the tap. This becomes especially important in the current market conditions as D2C brands struggle to raise growth fronts to break the 100 crore target.

Eventually, there could be opportunity for the FMCG companies which are established to acquire many startups which are facing funding winter, but have got good D2C brands. There are companies which make [FL] items, those could be acquired by companies such as ITC.

There are companies very much in the nutritional supplement area, these could be acquired by Zydus Wellness kind of companies or HUL and other consumer oriented companies.

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### D2C Bets



- A recent Research firm Tracxn estimates that the D2C market will be at USD 12 billion in 2022 and it is expected to reach USD 60 billion by 2027, growing at a CAGR of 40%.
- Data from Tracxn also shows that about USD 37.3 million has been invested in D2C companies, across 10 funding rounds, by larger, traditional FMCG players in 2022, so far. That is in comparison to USD 262 million invested in 2021.

Source: yourstory.com



Overall, the D2C bets have been very high. We have had several funding rounds and those funding rounds have been going up from 75 in 2017. The funding rounds have increased to 125 in 2022.

The amount that has been invested in terms of million us dollars has increased from a measly 13 million dollars to as much as 262 million dollars in 2021. And 2022 may not be matching

that it could probably half of that level, but however, there is no doubt that D2C has attracted strong investment potential and has built a base of startups that could be utilized by the FMCG measures to strengthen their own D2C play.

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### Possible Consumer Reference Prices

Pricing decisions related to products can be taken by companies based on a variety of pricing parameters as below.



Possible Consumer Reference Prices
▪ "Fair Price" (what consumers feel the product should cost)
▪ Typical Price
▪ Last Price Paid
▪ Upper-Bound Price (reservation price or the maximum most consumers would pay)
▪ Lower-Bound Price (lower threshold price or the minimum most consumers would pay)
▪ Historical Competitor Prices
▪ Expected Future Price
▪ Usual Discounted Price

Source: Adapted from Russell S. Winer, *Pricing MSI Relevant Knowledge Series* (Cambridge, MA: Marketing Science Institute, 2006)

Pricing options could be many, but the cost base is only one. For strategic pricing, cost management is a great tool.



Now, let us come to the pricing topic per se. Pricing decisions related to products can be taken by companies based on a variety of pricing parameters because as I said there is some level of managerial and leadership judgment involved in pricing of a product. It is important to consider these kinds of approaches.

You may have a cost structure, but you may like to price the product in such a manner that the consumer feel that the company is fair in its pricing policy. So, it is a fair price. And this fair price may occur above the cost or even below the cost, it could be at cost.

Fair price is what the market assumes is fair. So, if your cost is 100 rupees and the customers can pay 300 rupees, but you price at 200 rupees, probably you are pricing it at a fair price which motivates the consumers to be loyal to this brand. There could be a typical price, if soaps are priced at a level of let say 25 rupees or 30 rupees, it may be a typical price that any new soap maker must follow.

Then, there could be a last price paid. That is you have been having a series of products and those products have been fetching a certain level of pricing. And if you are introducing a new product, you may be adding a premium or not add a premium, but you may price with reference to the last price paid.

Then, there could be an upper bound price that is it is the top level reservation price or the maximum that any consumer would like to pay. Then, there would be a lower bound price as well, that is the lowest threshold price or the minimum most consumers would pay. These are the two things. That is the consumer would not take any product just because it is too cheap.

Let say a product is getting sold at 400 rupees think of a nice hair tonic, just because you price it at 50 rupees nobody is going to pay. There is a law in economics which says that if a price is too cheap or too low customers will think that it is a cheap product. At times if the price is high, customers will feel that it is a premium product. But keeping those economic principles in mind, you got to set up an upper bound price and a lower bound price.

Then, there could be historical competitor prices as well. You may price it based on the expected future price. Suppose, you are an import dependent company, all your basic materials are imported and depending upon what the import price is likely to be when your product is going to be actually delivered, you might price it in such a manner that the market sentiment of increased price is taken into account while you are pricing the current product. So, that is the expected future price.

Then you may also have a situation where customers and retailers like discounting. Therefore, you keep in mind the discount that you may eventually have to offer and price it in such a

manner that you still have some caution after giving the discounts. So, pricing options are many and the cost base is 1.

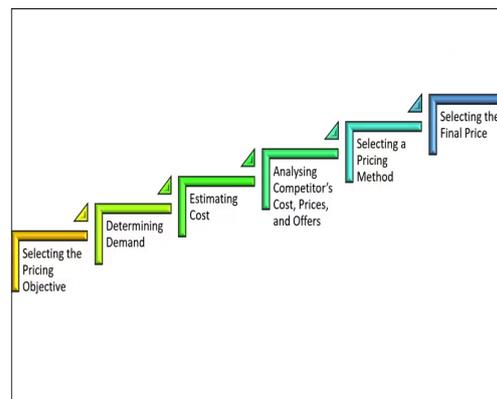
So, for strategic pricing, proper management of the cost base is essential. Cost management is the greatest enabler for strategic pricing decisions. If you are cost efficient and cost effective and cost competitive, you can afford to be flexible in your pricing strategy.

Depending upon how the market is moving, how the competition is moving, you can enjoy higher margin or a reasonable margin. Therefore, in all pricing studies cost structure must be taken note of and carefully calibrated.

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### Steps in Setting a Pricing Policy

The strategy of pricing is based on the objective that is set in terms of revenue, profitability and growth for a product.



These steps are not independent, however. The demand base sets the stage for costs. Higher volumes-Lower costs, or vice versa, for example.



So, what are the steps in setting a pricing policy? Any pricing policy has to be in terms of revenue profitability and growth for a product. And price being an important factor it has the

ability to swing the market demand for a product more. So, if there is price elasticity of demand in respect of that product.

So, the first step is to select the price objective. The second step is to determine the demand. The third step is to estimate the cost. And also, analyze the competitor's cost, prices and offers. Then, you develop and adopt an appropriate pricing method some of that could be based on the previous discussion I have had with you. Then finally, you select the final price.

These steps are not independent however. The demand base sets the stage for cost. If you have higher demand your volume of production from the same factory would be higher, therefore, cost economics would be better. And if you have low demand then you have to have more idle time in the factory, therefore, more allocation of cost on a less number of products and therefore, you will have higher cost.

So, there is a relationship between price, volume, cost, which you need to keep in mind.

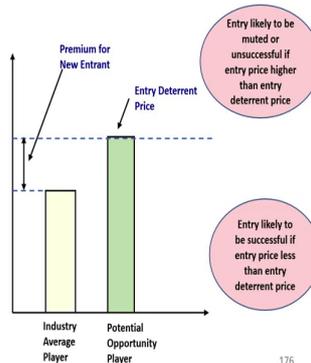
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### Strategic Capability: Entry Deterrent Price



Propounded by Professor Michael Porter, entry deterrent price is a hypothetical concept that focuses on the prevailing structure of prices (and related factors such as product quality and service) which just balances the potential rewards from entry (forecast by the potential entrant) with the expected costs of overcoming structural entry barriers and rising retaliation. This represents a case of strategic marketing.

Factor	Cost (\$)
Material Cost	1000
Conversion Cost	400
Cost of Goods	1400
Marketing Cost + Fixed Dealership Cost	100
Advertising & Sales promotion Cost	100
Sales Force Cost	100
Total Cost	1700
Margin	300
Target Price	2000



There is the concept of entry deterrent price which Professor Michael Porter nicely articulated. This is a hypothetical price concept. It focuses on the prevailing structure of prices and related factors such as product, quality and service. It balances the potential rewards from entry as forecast by the potential entrant with the expected costs of overcoming structural entry barriers and the rise in retaliation, which any new entry triggers. This is a case of strategic marketing

Let us take the case of a product, where the material cost is 1000 dollars conversion cost is 400 dollars, therefore, you have a cost of goods at 1400 dollars. Let us add fixed dealership cost of 100, advertising and sales promotion cost of another 100, sales force cost of 100. The total cost will be 1700. You want to have a margin of 300 dollars. Target price is therefore, 2000.

Now, once you have this target price, you have to see where you need to pitch your price. Typically, an industry average player has a price of let us say 1800, then your target price is higher than the industry average price. But will there be entry deterrence because of that price that you got to analyze and then have a judgment on.

If you have an entry determined price which is very high, then entry is likely to be muted. Instead of 2000, you price it at 3000 which is 1200 dollars higher than the average price then the entry is likely to be muted and it could be even unsuccessful. So, it is above the entry deterrent price.

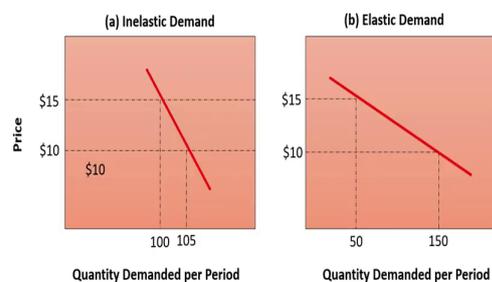
However, if you price it below the entry deterrent price that entry is likely to be successful. So, this entry deterrent price is not determined by anybody, it is a managerial judgment. So, the level of price between entry deterrent price and the industry average player, represents the premium for the new entrant. You can as a new entrant price your product in an appropriate manner.

So, it is a hypothetical concept, but it is a great hypothesis for any company to work on during the time of strategic pricing.

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### Developing Pricing Strategies and Programs

The nature of demand, i.e., price-quantity relationship, is a key determinant of the pricing strategy by a firm.



Inelastic and Elastic Demand

It is generally not possible to have completely elastic or inelastic demand patterns for products.



Pricing strategies and programs are macroeconomic or microeconomic. If you analyze, pricing is all about costs and costs are all about microeconomics in terms of the production equations. And fundamentally first you should look at demand elasticity.

You see the left side graphic, that is inelastic demand. The price has come down from 15 to 10 let say, but the quantity demanded has only gone up from 100 to 105. Let us compare this with the graph on the right side. The price has come down for that product from 15 dollars to 10 dollars, but the quantity has jumped up from 50 to 150; that means, there is greater elasticity of demand for the price.

So, for such products you can afford to be price competitive, that is you can play upon the price to enhance the demand. But for other products even if you reduce price drastically there

may not be a proportionate increase in the demand. Therefore, the band of pricing that is available to you for playing is relatively small inelastic products compared to elastic products.

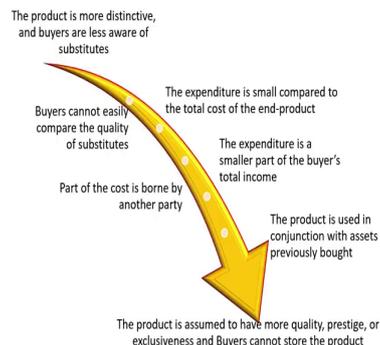
Generally, you may not have a completely inelastic demand equation or completely elastic demand equation. When the macroeconomic environment is one of recession or inflation or when the macroeconomic environment is threatened by geopolitical considerations leading to supply disruptions, then these equations may get changed.

A price inelastic product, a price inelastic product can become elastic product suddenly and vice versa. Those have to be kept in mind.

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### Factors that Reduce Price Sensitivity

Generally, most markets are sensitive to price. The sensitivity can be blunted in certain types of cases.



Source: Based on information from Thomas T.Nagle, John E Hogan and Joseph Zale, *The Strategy and Tactics of Pricing*, 5<sup>th</sup> ed, (Upper Saddle River, NJ: Pearson, 2011). Printed and electronically reproduced by permission of Pearson Education, Inc, Upper Saddle River, New Jersey.

The product features and usage parameters can reduce the price sensitivity to a considerable extent.



There are certain factors which reduce price sensitivity of a product. Generally, most markets and all consumers are sensitive to price. Nobody buys a product without understanding the

price. Some customers of course, are enthused by high prices for reasons of esteem luxury, ego, whatever you may call and they may be happy to buy high priced products.

But every customer whether it is the bottom of the pyramid customers or the top of the pyramid customer, would look at price. The sensitivity to pricing can be blunted in certain types of cases particularly when you are wanting a broad enough market. If the product is more distinctive and the buyers are less aware of substitutes, there would be less sensitivity to price.

Second, if the bias cannot easily compare the quality of substitutes that is you know that Zara is a great brand, great product, but you would like to compare Zara with a similarly purchased product of the United States or United Kingdom. But you have no means to do that, then your sensitivity to pricing of that Zara product is lower. That is another case where the price sensitivity is made lower.

Or the expenditure you are incurring on that particular item is small compared to the total cost of the end product, then also you will be less price sensitive. That is you are buying a sofa on an interior workspace of several times over the sofa cost, then you might not mind paying a little more for the sofa.

If the expenditure is a smaller part of the buyers total income; that means, what you are spending on that particular item is going in a rounding of error so to speak in your expenditure list. Then, you would not mind. Let say it is shared by another party in a large family, you want to buy a costly item. Everybody chips in to say that we will share the cost of that product, then that cost becomes bearable for you.

Let say this product is required to be used in conjunction with other assets, that is you want to buy a digital watch because it is going to supplement your mobile phone. And therefore, there is an incremental value for the phone as well as to the watch because of that purchase. Therefore, even if you think that the price is high you might like to buy one.

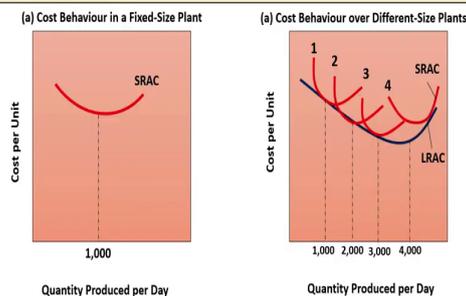
A typical case your iPhone may be costing 60,000 rupees, but digital watch could be costing 30,000 rupees. So, even though it is 50 percent of your mobile phone cost, you are inclined to buy because together they provide you with a greater value. Price sensitivity will be low when the product is assumed to have more quality, prestige or exclusiveness and buyers cannot store the product. These are the areas when the product will have less sensitivity to price.

The product features and usage parameters can reduce prices to a considerable extent. So, this, that is if you are able to use the product for a long time. You may say that this price gets amortized so to speak in your own home accounting terms and the price impact is extended to a longer period.

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### Cost per Unit at Different Levels of Production per Period

A detailed understanding of the cost curves is essential for all strategic decisions – from facility planning to product planning.



For a growth oriented firm, the long run average cost, rather than the short run average costs, should guide pricing.



I said pricing and costing are functions of microeconomics. We need to understand the cost curves, microeconomics cost curves. Here is an example of the cost curve. The quantity

produced per day varies and the cost per unit varies. The cost curve typically is of a crucible type.

There would be a point where cost would be optimal. If you produce too low, the cost will be high. If you produce too high, which will require let say putting in place of extra over time putting in place extra manpower, running multiple shifts, higher logic cost, then the cost again will go up. So, it is not that always higher output will lead to lower cost. In some cases, it will lead to higher cost as well therefore, you have to have an optimal cost equation.

Similarly, you cannot decide which plant is the right plant to use. There could be different plants which could give different levels of cost advantage and there is a long run cost equation and there are several short run cost equations.

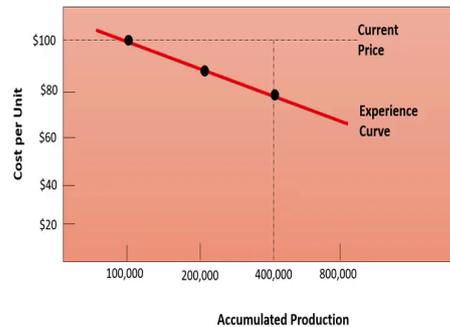
You got to decide how you would meet this. Every time you cannot have a plant for a particular level. So, the latest trend is to have modularity in building up of facility. So, that as the elasticity of demand increases, you are able to add modules and keep ensuring that the long run cost advantage is retained.

For growth oriented firms the long run average cost rather than the short run average cost should guide the pricing.

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### Cost per Unit as a Function of Accumulated Production: The Experience Curve

Experience curve is one of the foundational concepts of strategic costing, and hence strategic pricing.



Automobile industry has been, for decades, a showcase of the experience curve driving down unit costs.



Then, if you have accumulated production that is the learning curve or the experience curve. By doing nothing, the cost of production will come down automatically. If the plant knows to produce more and more with time, it will be able to get better material economics from its vendors.

The employees will be able to produce products faster and with higher quality and as a result the cost per unit will come down. So, experience curve is an important aspect of enhancing the strategic costing advantage. Therefore, the strategic pricing and strategic margin advantage The automobile industry has shown for decades how experience curve is going to help in cost management of its automobile products.

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### A Model for Price Setting

The pricing spectrum for a product or service can be analysed based on concepts of floor and ceiling prices.



The price points need to be evaluated in terms of price elasticity of demand for the product by each firm.



Having got all of these inputs what is a fair model for fair price setting? The pricing spectrum for a product or service can be analyzed based on the concepts of floor and ceiling prices. Let say you set a high price, that is if you price this product at this level there will not be any demand and that comes from expert opinions, your market research, your experience in the field, and your judgements. Then, you also set a low price. That is if you price your product here you will be out of pocket.

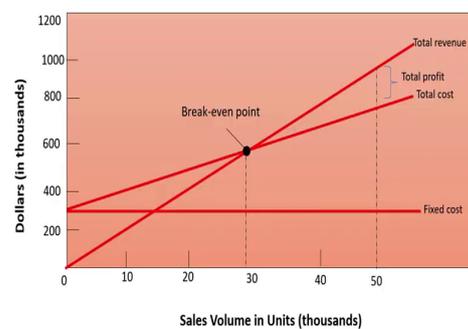
There will not be any profit at all at this price. And it will not be a price that will help you to gain volumes at the expense of revenue. It will not give you volumes even in the later years. That means, there is no possible profit now or in future based on that. And once you set this there is a ceiling price which you are willing to accept from the customer point of view, and there is a floor price which you are willing to accept from the company point of view.

The ceiling price is the customer's assessment of unique product features and the floor price is the competitor's use of prices of their own assessment as well as the prices of substitutes that are available, including the competitors between. The ceiling price and the floor price you have the orienting point that is the kind of price you should fix it. These price points need to be evaluated in terms of price elasticity of demand for the product by each firm.

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#### Break-Even Chart for Determining Target-Return Price and Break-Even Volume

The break-even concept is age-old but comes to the fore whenever firms face demand loss and production slump.



Wise managements always strive for lower levels of breakeven in good times as in bad times.



Breakeven point is an important concept. COVID-19 has demonstrated to all of us the importance of gaining cash which comes only when you are break even. Only when you are able to price your products higher than your cost you can get cash, and without cash you cannot run a business. But at the same time you should be able to achieve that break even at lower level of production.

And if you are able to have a capacity of 100,000, but if you are able to break even at 50,000 capacity that is at 50 percent, you have managed your cost and price equation in the best manner. Because you are profitable even when the demand is low, and you are going to be super profitable when the demand is high and the facility is fully utilized.

This graphic illustrates, the sales volume in units in 1000s and dollar price in 1000s, and the total revenue equation is 1. There is a total cost equation and the gap between the two is the total profit. When the total revenue equation crosses the total cost equation, then you get that breakeven point.

And if this total revenue equation crosses the total cost point earlier, then the breakeven point becomes even lower. At any point of time the breakeven point cannot be lower than the fixed cost that are implicit in your facility and in your operation. So, wise managements always strive for lower levels of breakeven in good times as well as in bad times. And one of the reasons to achieve that is to have as low a fixed cost as possible, that is you should be frugal in your engineering, frugal in your manpower deployment.

Appropriate in the mix of the on roll and off roll employees, and also appropriate in terms of devising your salary structure in such that there are enough incentives for increasing the output or sales. When that happens you will get a good breakeven chart for your company's operations.

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### Developing Pricing and Strategies and Programs



Caterpillar uses perceived value to set prices on its construction equipment. It might price its tractor at \$100,000, though a similar competitor's tractor might be priced at \$90,000. When a prospective customer asks a Caterpillar dealer why he should pay \$10,000 more for the Caterpillar tractor, the dealer answers as below.

\$90,000 is the price if it is only equipment to the competitor's tractor
\$7,000 is the price premium for Caterpillar's superior durability
\$6,000 is the price premium for Caterpillar's superior reliability
\$5,000 is the price premium for Caterpillar's superior service
\$2,000 is the price premium for Caterpillar's longer warranty on parts
\$110,000 is the normal price to cover Caterpillar's superior value
-\$10,000 discount
\$100,000 final price

The Caterpillar dealer is able to show that although the customer is asked to pay a \$10,000 premium, the customer is actually getting \$20,000 extra value! The customer chooses the Caterpillar tractor because he is convinced its lifetime operating costs will be lower.



Now, no two products will be same in pricing. The marketing person always has the challenge in marketing a higher priced product. Here is an example of role modelling. Let say caterpillar is a tractor producer and seller, and caterpillar wants to price its products at 100,000 dollars which is costlier than the competitor's tractor at 90,000 dollars.

So, when a prospective customer goes to caterpillar dealer and ask why the payment should be in excess of 10,000 dollars for the caterpillar tractor. The dealer may answer as below. Actually, my price is 90,000 dollar if it is the only equipment to the competitor's tractor. However, I have superior durability which works out to 7,000 dollars because you will not be having any repairs for longer time.

Then, there is reliability that is you take a tractor, you are 100 percent sure that it will deliver on its stack its power and its expected performance characteristics. Therefore, there is a price

premium which is 6,000. Then god forbid, if a tractor does not work. I have got superior service to come to you in the shortest possible time with the most affordable parts and set it right for you. Therefore, there is a price premium for that which is 5,000 dollars.

Then, I am also giving you longer warranty as caterpillar on the parts therefore, there is a price advantage for you. And therefore, a price premium for me of 2000 dollars. So, if I add all of these things to my cost which is 90,000 which is actually the same as the competitors tractor, my total advantage to you is because of 110,000 dollars being my it is actual price in terms of all the cost and the premium. And the price which I am giving to you at 100,000 is not actually an excess, it is a 10,000 discount to my normal price and which is a value giving price for you as the customer.

So, with this logic, the caterpillar dealer is able to show that although the customer is asked to pay a 10,000 dollars premium the customer is actually getting 20,000 dollars extra value. The customer then chooses the caterpillar tractor because he is convinced that its lifetime operating cost will be lower.

So, developing an optimal lifetime costing equation is an important aspect of marketing a product which has a higher acquisition cost relative to the competitors.

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### Price Discounts and Allowances



The traditional discount structures have been fairly straightforward, leaving cash in the hands of customers.

Price Discounts and Allowances	
<b>Discount</b>	A price reduction to buyers who pay bills promptly. A typical example is "2/10, net 30," which means payment is due within 30 days and the buyer can deduct 2 percent by paying within 10 days.
<b>Quantity Discount</b>	A price reduction to those who buy large volumes. A typical example is \$10 per unit for fewer than 100 units; \$9 per unit for 100 or more units. Quantity discounts must be offered equally to all customers and must not exceed the cost saving to the seller. They can be offered on each order placed or on the number of units ordered over a given period.
<b>Functional Discount</b>	Discount (also called trade discount) offered by a manufacturer to trade-channel members if they perform certain functions, such as selling, storing and record keeping. Manufacturers must offer the same functional discounts within each channel.
<b>Seasonal Discount</b>	A price reduction to those who buy merchandise or services out of season. Hotels, motels and airlines offer seasonal discounts in slow selling periods.
<b>Allowance</b>	An extra payment designed to gain reseller participation in special programs. Trade-in allowances are granted for turning in an old item when buying a new one. Promotional allowances reward dealers for participating in advertising and sales support programs.

What is pertinent is the level of cash benefit the ultimate consumer derives from the firm-level schemes.



But price discounts and allowances cannot be avoided in any marketing operation. So, pricing is one aspect, but price discounts and allowances are another aspect.

What is a discount? Discount is a price reduction to buyers who pay bills promptly, that happens in B2B transactions very much or in home delivery cases where you run a monthly grocery thing. So, the monthly groceries are supplied on the basis that if you pay every week, you will get a discount of 10 percent, but if you pay every month you get a discount of 5 percent.

Similarly, at times in collections as well you will have to use incentives that is if the traditional payment period is 30 days and you get the collections within 20 days, you will say that I will incentivize by 1 percent. That is the payer can keep 1 percent to himself. On the

other hand, if the payments are made immediately within 3 days, then a higher discount of 2 percent may be given. So, that is the discounting principle.

Then, you have a quantity discount, that is if you buy more than a set quantity, you will get a quantity discount for more number of units that are you know, that are ordered. Quantity discounts must be offered equally to all customers and must not exceed the cost savings. There is no point in offering quantity discount and together with the discount you should not be ending up with lower revenue vis-a-vis the lot that could be sold without the discount.

Then, there could be a trade discount or functional discount. That is if the trade does its job very well you may offer a scheme. That is if you are able to sell a box of fruit juices effectively within 10 days of the distribution, then per box you may give 1 rupee extra that is a discount.

Manufacturers must offer the same functional discount to all the distributors. If you do not offer then items will move from one territory to another territory. Then there will be seasonal discount, all of us are familiar with the seasonal discounts that are showered on consumers during the festival seasons or during special occasions.

Hotels also give those discounts. Then, there are happy hours that are offered for food items during certain hours etcetera. Then, there would be allowances and extra payment designed to gain reseller participation in special programs. Trade in allowances are there, promotional allowances are there. These are all the allowances which supplement the discount schemes.

What is pertinent is the level of cash benefit, the ultimate consumer derives from the firm level schemes. Therefore, companies such as Horlicks are the original proponents of Horlicks deployed direct consumer schemes. Horlicks was known as a mug and jug brand because very Horlicks fetch a mug or a jug to incentivize the consumer and to build a brand connect and build a brand loyalty.

So, what consumer gets is also important. One of the lacuna of the distributor retailer practice as it exists today is that most of the incentives, schemes, discounts are taken in by the

distribution value chain very little comes to the customer that is that has to be avoided somehow.

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### Profits Before and After a Price Increase



The relationship between pricing and profitability is not easily understood because of the impact on the demand base

Case 1	Profits Before and After a Price Increase		
	Before	After	
Price	\$10	\$10.10	(a 1% price increase)
Units Sold	100	100	
Revenue	\$1,000	\$1,010	
Costs	-970	-970	
Profit	\$30	\$40	(a 33 1/3% profit increase)

Case 2	Profits Before and After a Price Increase		
	Before	After	
Price	\$10	\$10.10	(a 1% price increase)
Units Sold	100	99	(a 1 unit decrease in sales)
Revenue	\$1,000	\$999.9	
Costs	-970	-975	(a 5 unit increase in cost)
Profit	\$30	\$24.9	(a 17% profit decrease)

Any pricing action should consider the impact on demand and costs, before arriving at a potential profit outcome.



As I said just because we meddle with the prices, there will be higher demand, there will be higher profit. This is not an automatic thesis. We have to understand on a case by case, the relationship between pricing and profitability and for that the price elasticity of demand as well as demand projection is necessary.

Let us look at two cases here, before and after. Let say a product which is priced at 10 dollars is priced with a 1 percent price increase at 10.10 dollars, but the demand does not change. Then, the revenue increases by a particular portion. Cost let say are 970 and the profit increases by 10 dollars that is a 33 one-third percent profit increase.

So, people may say that what is the use of this, the pricing has not brought any decline in unit sold. So, we may try to increase it a little more. Somebody, will say that no this happened because our product is inelastic to price. But let us look at another case, where you have priced it at 10.1 as usual, but there is a slump in the demand by 1 unit decrease, then the revenue gets reduced to 999.9.

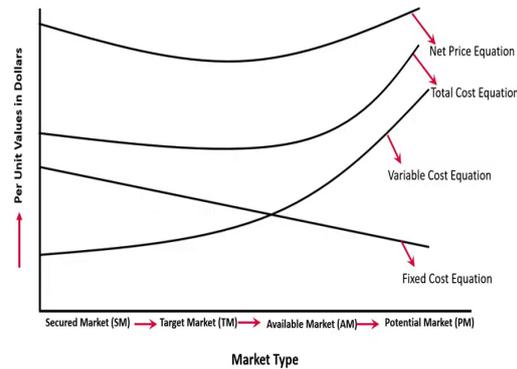
If you have the same kind of costs and there is a increase in cost because the volume has gone down, then the profit increase comes down to 17 percent compared to 33 one-third percent profit increase in the other case. Therefore, studying of the price elasticity of demand in terms of the impact on the volumes is necessary before you take arbitrary pricing decisions.

Therefore, any pricing action should consider the impact on demand and cost before arriving at a potential profit outcome.

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### The Market Reach Economic Equation

The SM-TM-AM-PM pathway has its costs. Typically, if the start is from a tough market, the initial cost base would be the highest, with successive market expansions coming in at relatively lower cost additions



The total price and cost curves determine when the point of diminishing returns sets in for the market reach-out push



There are 4 types of markets which I discussed earlier too. There is a secured market, there is a target market, there is an available market, there is a potential market. Potential market is the whole market universe which is the largest. Then, there is an available market which theoretically you can target, but you may not target because of various other considerations, including high competition in those markets, the logistics costs, lack of managerial bandwidth or people base etcetera.

Then, there would be a target market on which you are quite focused saying that this is the market on which you should have your the best play. But eventually, you end up with only the secured market which is smaller than the target market. Now, the per unit values keep changing depending upon the access to the higher levels of market. The fixed cost equation goes down sharply as you move from secured market to potential market.

The variable cost equation keeps on going up slowly as you go to the potential market because when you try to get to the available market and potential market, you got to spend more than proportionate in marketing, sales, advertising etcetera. That is why some brands prefer to be regional brands.

And that is why some brands do not want to have the highest market share is, 33 percent market share or 20 percent market share is provided, they are happy. The summation of the total fixed cost and the total variable cost leads to the total cost equation. Then, there is the price equation that also applies depending upon the type of markets that you are there.

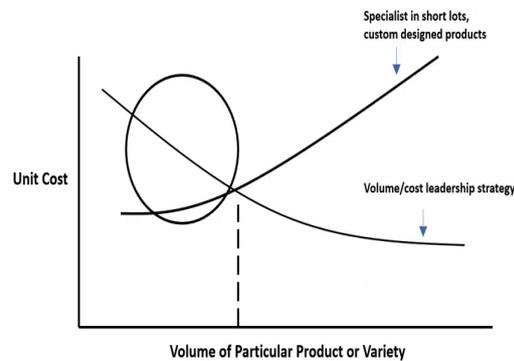
In your target market if you are choosing your target market well, the price cost equations will be optimal. If you stay with only the secured market or if you aspire too ambitiously and too aggressively for the potential market, these price and cost equations could go or a, and the price margins that are available to you could shrink.

So, you have to decide the cost equations based on scientific analysis, understand where the point of diminishing returns of volumes, will start coming into play. That is important.

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### Alternative Cost Curves

The difference in cost curves of cost leadership and differentiation/focus is well-depicted below.



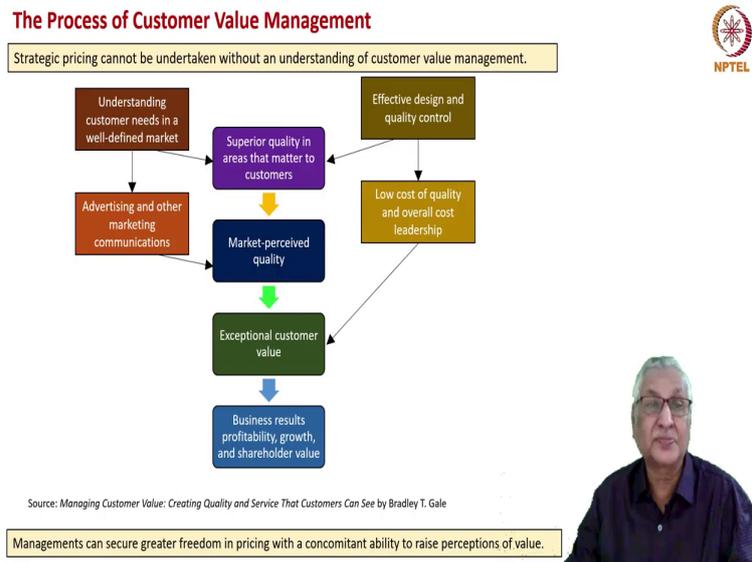
The curves get impacted over time through cost efficiencies and feature enhancements, respectively.



Then there could be alternate cost curves as well. That is you have a cost leadership strategy and that says that the more you produce, the less will be the cost. You could also have a strategy by which you produce a niche product. And if you do short lots, if you do custom design products the cost would go up.

So, again there is a circle of convergence between the cost leadership strategy and the short lot strategy. Over time you got to achieve cost efficiencies whichever strategy you adopt and you have to balance the future enhancements with the cost escalations in respect of the specialization strategy. You have to balance the volumes with the cost levels in respect of the cost leadership strategy.

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The process of customer value management is important because you have to understand the superior quality of your product, in areas that matter to customers. There is no point in giving superior features in areas which the customer is not able to appreciate. There was a case study in Coca-Cola.

Then, they marketed their bottled water, they discovered that the bottle was so exotic and it was so cost additive to the whole product that the company was making losses. But on analysis, the company found out that the that level of quality of the bottle made no sense to the customers. So, they down spec the cost to a functional level which is safe high quality, but is devoid of unnecessary frills.

Same could apply to a coconut hair oil bottle as well. Everything has to be designed in a fit for purpose manner. So, if you put superior quality in areas that matter to customer, your sales

would improve. So, to be able to do that you have to understand the customer needs in a well-defined market and you have to effectively design and administer quality in achievement of such as appropriate quality purpose match.

Then, to improve the understanding by the marketplace of your quality, you have to do advertising and other marketing communications which emanate from understanding of the customer needs which we have spoken about earlier. Then, you have to use your design and quality control tools and platforms to say that there is a low cost of quality and overall cost leadership.

When I say low cost of quality you provide high quality, but at a low cost. When you provide such high quality at low prices, the customer will say that the product is of the highest quality, but is being provided at the lowest possible cost. So, the cost of quality must be made low as part of the overall cost leadership strategy, then you get the exceptional customer value and that flow will lead to business results of profitability growth and shareholder value.

Managements can secure greater freedom in pricing with a concomitant ability to raise perceptions of value. When you understand your marketing environment better, the customers better, you also have a firm grasp of your design manufacturing and quality system. And this is the process of total customer value management.

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There are several dimensions of product quality that we must keep in mind because pricing and costing can never be discussed in terms of just arithmetic. They have to be discussed in terms of the product features and product quality. Let us take the case of a washing machine. The first question the consumer will ask is that how well this washing machine be washing clothes. So, performance is the first key driver.

Then, for another product how long will the lawnmower last, durability factor. Conformance with specifications is the third aspect, what is the incidence of product defects in this particular product. In respect of an airliner, does this airliner offer a good movie and dinner as part of my flight schedule? Therefore, features are important.

Reliability is another factor of product quality. Will each visit to your restaurant result in consistent quality? Can I think that this service is reliable? What percentage of the time will a

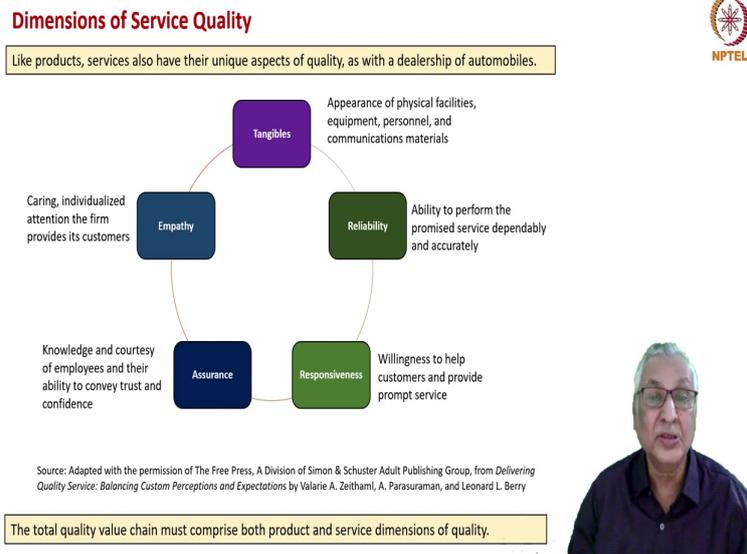
product perform satisfactorily? Is the product easy to service? Then whether it is easy to service or difficult to service?

The serviceability itself should be good. Therefore, is the service system efficient, competent, and convenient? Then, you look at the fit and finish. Does the product look and feel like a quality product? Does it have a good brand name? Is this a name that customers associate with quality?

What is the brand's image? The brand name is a resultant of all the factors which we have discussed so far, the performance, durability, conformance with specifications, features, reliability, serviceability and the fit and finish. Brand name is resultant of all of these things. And that is the resultant of the quality.

And many of the facets which I have described here as quality facets are all tangible, but they have to be used synergistically to bring the value of the brand.

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Then, service itself has got several facets. Every service you provide be the telecommunication service or the OTT service, they have got their own unique aspects of quality. A dealership of automobiles which is a service activity because they manufacture nothing is a service activity.

Tangibles, appearance of the dealership physically, the equipment, the personnel, the communication materials that are available in the dealership. Reliability, ability to perform the promised service dependably and accurately. Responsiveness, that is willingness to help customers and provide prompt service.

Assurance, knowledge and courtesy of employers employees and their ability to convey trust and confidence to the customers who walk in. Caring individualized attention the firm provides to its customers, that is anytime a product or device fails that is the point of

customer requiring a huge amount of empathy from the manufacturer or the service provider. Therefore, empathy must be ingrained as part of the service DNA.

The total quality value chain must comprise both product and service dimensions of quality. When both of these things combine then only the overall quality level will be of standard that the customer loves.

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**Perceived Importance of Service Quality Dimensions in 4 Different Industries – 1**



Regardless of the nature of an industry, reliability ranks high in the respondents' perceptions.

	Mean Importance Rating on 10-Point Scale*	Percentage of Respondents Indicating Dimension Is Most Important
<b>Credit-card customers (n = 187)</b>		
Tangibles	7.43	0.6%
Reliability	9.45	48.6
Responsiveness	9.37	19.8
Assurance	9.25	17.5
Empathy	9.09	13.6
<b>Repair-and-maintenance customers (n = 183)</b>		
Tangibles	8.48	1.2
Reliability	9.64	57.2
Responsiveness	9.54	19.9
Assurance	9.62	12.0
Empathy	9.30	9.6

\*Scale ranges from 1 (not at all important) to 10 (extremely important)

Responsiveness is another dimension that is given significant weightage by the customers.



Perceived importance of service quality dimensions in 4 different industries has been looked at. Regardless of the nature of an industry, reliability ranks high in the respondent's perceptions. In respect of credit card customers as well as repair and maintenance customers, reliability has had the highest score

On the other hand, tangibles has had the lowest score. Responsiveness is another dimension which has been given significant weightage by the customers.

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**Perceived Importance of Service Quality Dimensions in 4 Different Industries – 2**



Surprisingly, empathy ranks low in three of the four industries. It has high weightage in banking though.

	Mean Importance Rating on 10-Point Scale*	Percentage of Respondents Indicating Dimension Is Most Important
Long-distance telephone customers (n = 184)		
Tangibles	7.14	0.6
Reliability	9.67	60.6
Responsiveness	9.57	16.0
Assurance	9.29	12.6
Empathy	9.25	10.3
Bank customers (n = 177)		
Tangibles	8.56	1.1
Reliability	9.44	42.1
Responsiveness	9.34	18.0
Assurance	9.18	13.6
Empathy	9.30	25.1

\*Scale ranges from 1 (not at all important) to 10 (extremely important)

Source: Adapted with the permission of The Free Press, a Division of Simon & Schuster Adult Publishing Group, from *Delivering Quality Service: Balancing Customer Perceptions and Expectations* by Valerie A. Zeithaml, A. Parasuraman, and Leonard L. Berry

The lowest ranking comes to the dimension of tangibles; others being in similar bands.



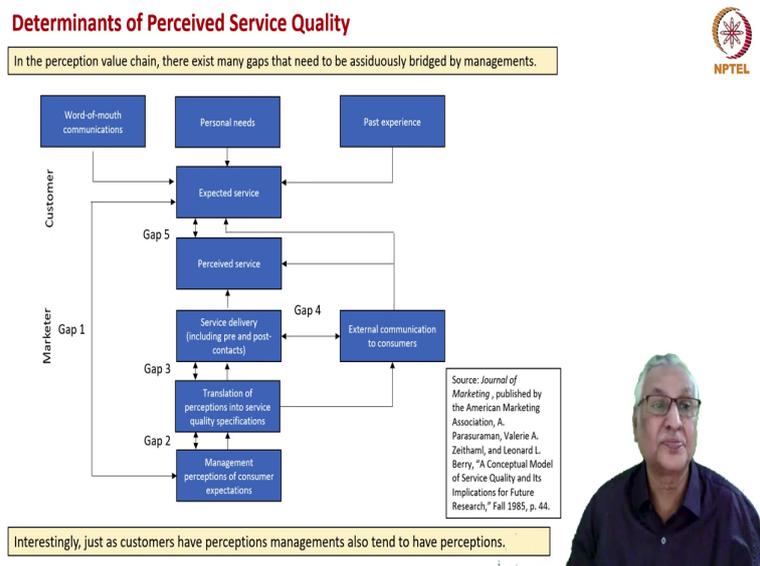
Same applies to long distance telephone customers as well as bank customers. Reliability is very high on the reckoning. Responsiveness is also high on the reckoning. Tangibles are lower. Why is that empathy ranks low in the 3 or 4 industries? Mainly because the customer interface probably is low and customer did not have, I mean the same occasion to judge a company by empathy level.

But we must note that in respect of banking, where the customer company interface is very intense, tangibles also has received high rating, 8.56 compared to reliability. So, there is

something in respect of customer touch points of a company. So, we can argue this in two ways. We can say that empathy is irrelevant when customer touch points are low.

On the other hand, you should reverse the hypothesis increase your customer touch points and make sure that the company is perceived as empathetic, and that is what customer relationship management is as I discussed in one of the earlier lectures.

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So, in the perception value chain, there tend to be many gaps and they need to be assiduously understood and bridged managed by the managements. So, the customer starts with the level of personal needs, and those can be got in to the company system through the customer's word of mouth communications as well as past experiences. And together they constitute the expected service.

Then, marketer has to deliver against the expected service. When the service is of a level which is only perceived, when the service delivery is of another level which is lower, and translation of perceptions into service quality specifications is even lower, and management's perception of consumer expectations is even lower, then you have gaps all along.

So, there are 5 gaps to be managed. One, management perceptions of consumer expectations vis-a-vis the expected service that is the biggest gap, and that gap should be as small as possible. And this gap itself comprises 4 gaps. This gap between the translation of perceptions into the service quality specifications, the other gap being service delivery versus translation of perceptions.

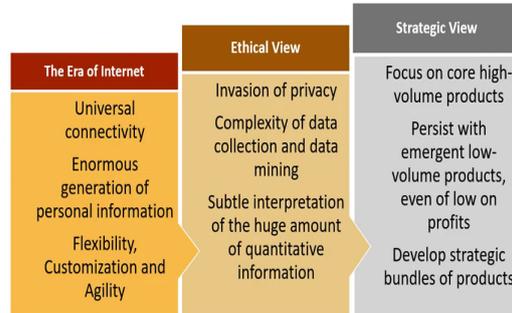
Other gap between the external communication to consumers and the actual service delivery, and the gap between service delivery and the perceived service. And finally, the gap between perceived service and the expected service. All of these things have to be merged into as small gap as possible, that covers management perceptions versus the consumer perceptions of the service.

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### Pros and Cons of Varying Service Levels According to Customers' Profitability



From a purely economic viewpoint, tailoring different levels of service and benefits to different customer segments depending on their profitability makes sense, at least in the short run.



Sources: Diane Brady, "Why Service Stinks," *BusinessWeek*, October 23, 2000, pp. 118-28; and Christian Homburg, Mathias Droll, and Dirk Totzek, "Customer Prioritization: Does It Pay off and How Should It be Implemented?" *Journal of Marketing* 72 (September 2008), pp 110-130

In a mature industry, particularly one with substantial economies of scale, such a loss of market share can increase unit costs and reduce the profitability of those high-volume customers that do remain loyal. A creative competitor may find ways to make other firms' cast-off customers very profitable.



So, how do you vary service levels based on the customer's profitability? We should not say that because a particular product is unprofitable we will not serve that product. From a purely technical economic point of view, different levels of service and benefits to different customer segments depending on their profitability makes sense, at least in the short run.

Why should you give a product to a customer when the product is not yielding any revenues or profits worth the name? But we also have to look at 3 views, first the era of internet. There is universal connectivity. There is enormous generation of personal information. There is flexibility, customization and agility. So, even with respect to failure of satisfying one product could lead to an amplified impact, in terms of the internet social media appreciation of what the company has done or not done.

Secondly, there is an ethical view that the more of this happening, there is an unnecessary invasion of privacy for the individual. So, how much of user reviews should you be encouraging would, they not be biased or in wanting to know the user characteristics are you not intervening into the personal life far too much. So, how do I balance the benefits provided by the internet with the challenges that are implicit in internet?

But even if you get all of these things, the complexity of data collection and data mining and how do I certainly interpret the huge amount of quantitative information. Then, purely from a strategic view I would like to focus on core high volume products. I will persist with emergent low volume products even if they are low on profits because I see them growing, but I will not encourage loss making products.

However, you may choose from a strategic point of view, a bundle of products which cover everything. In a hospital setting, as I as I might have told earlier, it is important not only to have a costly intensive care unit injection, but also a low priced affordable product which can be consumed in the home.

So, it is important to have the full bundle irrespective of the profitability because your company must be seen as the provider of a total product range, so that you are a one stop shop for the company. In a mature industry, particularly one with substantial economies of scale, a loss of market share can increase unit cost and reduce the profitability of the high volume customers that do remain with you as loyal customers.

A creative competitor may find ways to make other firms cast off customers very profitable. That is if you lose customers by not wanting to satisfy them, competitors may just be waiting to take them. So, the cost decisions and price decisions have to be taken in with 360 degree view of the entire marketplace and the competitive landscape.

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### Stringent Costing and Strategic Pricing



Strategic pricing requires stringent costing to be effective. Costs need to be factual and accurate while pricing can be judgmental and strategic.



Prices of materials and components (ie., input costs for a product) tend to be cyclical in proportion to the movements in global and national commodity prices. Whether all the cost increases can be passed on is dependent on the competitive pressures in the industry, and in some cases on the regulatory expectations.



So, stringent costing is important, but flexible pricing is also required. Stringent costing refers to the cost within the firms control and those have to be product specific. Judgment of product profitability is one of the weakest areas of managements, because they would not like to look at each product category in terms of individual costing and pricing.

People would not like to factor in the lead log effects of material prices and cost vary vis-a-vis the output cost and prices that could vary based on market considerations in a different time span. So, that is about costing. Then, you need to have flexible pricing which is subject to market forces needs to be product range oriented.

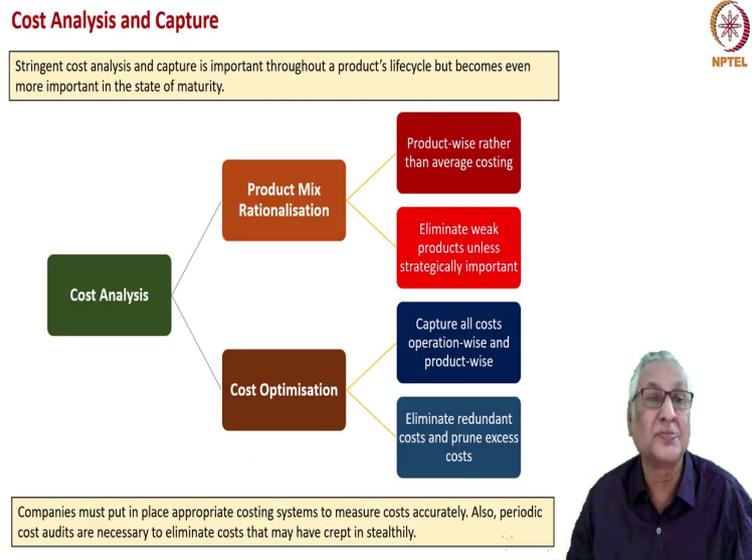
Cost leadership or at least cost control and cost awareness is required and it provides more degrees of freedom in strategic pricing. Strategic pricing should not be routinely used to buy market share without consideration to sustainability.

Many a times we hear in corporate planning discussions that let us reduce the price by 10 percent, so that we occupy the shelf space and drive out the competition. That can be one of strategy, but it cannot be an eternal strategy because it will lead everybody down the road and industry profitability will be eroded. So, you got to be a responsible producer, you got to be a responsible marketer as well.

So, prices of materials and components that is input cost for a product tend to be always cyclical and they are in proportion to the global and national commodity prices. Whether all the cost increases can be passed on is dependent on the competitive pressures in the industry and in some cases on the regulatory expectations. So, you need to have a cost and price curve that is hypothesized and accordingly you take your decisions.

You may also look at the unit of time by which you assess the constant prices, should I do it every week or should I do it over a long period of time, or do it every week, but view it from two angles on a weekly basis as well as on a monthly basis and also as on a quarterly basis.

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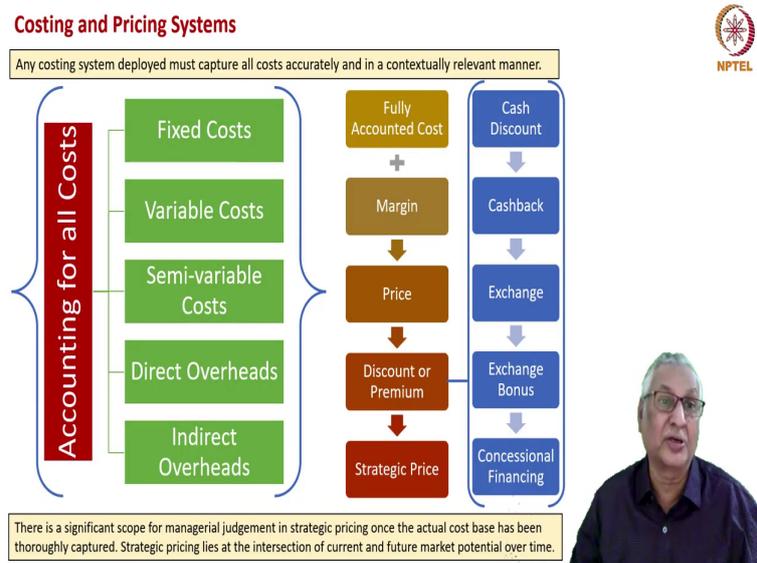


So, to do cost analysis and capture, which is an important aspect of products life cycle, we got to ensure that the following factors are taken care of. Cost analysis has two dimensions, one is product mixed rationalization the other is cost optimization. Product mix rationalization itself comprises two aspects, product wise costing rather than average costing. You got to eliminate weak products unless they are strategically important.

Cost optimization capture all cost operation wise and product wise leave nothing to chance. Eliminate redundant costs and prune excess costs. Companies must put in place appropriate costing systems to measure cost accurately. Also, periodic cost audits are necessary to eliminate costs that may have crept in stealthily. It could be the boiler working all the time when there is no production.

It could be a HVAC system working all the time when there are no people in the office. Those are the kinds of things which must be watched and must be controlled. One of the ways you control them is to index all the cost to the output levels and see how the index trend been moving over time over time.

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Any costing system deployed must capture all costs accurately and in a contextually relevant manner is what I said in the previous slide. So, to account for all the costs, you have to have a clear understanding of all the fixed costs that you have, all the variable costs you have. You also must understand the semi variable costs direct overheads, indirect overheads.

Then you will get the cost equation which is fully accounted cost as described earlier, the margin, the price, the discount or premium you are wanting to give and finally, the strategic pricing. Now, this discount of price could again be split into cash discount, cash back,

exchange, exchange bonus, concessional financing. You should never be in a situation where you are knee jerk in terms of your pricing determination as well as discount and premium determination.

It is appropriate for every constant price specialist and its leadership to do cost and price analysis upfront before the start of a sales period. It will be week month or quarter. And then have decision on each of these price levels and each of these discount and incentive levels.

There is always lot of scope for managerial judgment in strategic pricing. But that must always follow understanding of the actual cost base and the potential price level. Strategic pricing lies at the intersection of current and future market potential over time.

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### Pricing Systems

Different companies have different pricing systems. Some follow their systems regardless of the competition or variations in customer profile. Some are sensitive to the market forces as well as customer inclinations.



Companies tend to have strategic pricing policies that are related to the strategic product pricing policies that they have. Even companies that resolutely believe in premium pricing are forced to follow at least bundle pricing.



There are several pricing systems that are available. Different companies have different pricing systems. Some follow their systems regardless of the competition or variations in customer profile. Some are very sensitive to the market forces as well as customer inclinations.

So, of the several pricing strategies that are available, these 6 are most important. The first is the price skimming strategy, that is you give high pricing when a product is introduced, skimming the consumer surplus. Lower the price as competitors enter. The second is penetration pricing, whether or not competitors exist, resort to the lowest possible pricing to capture the market.

Premium pricing, suited to products of high quality and features, set high price tags to create perception of superiority for the products. Economy pricing, a pricing level that is aligned to the household savings needs of lower income groups. So, that you capture the bottom of the pyramid market.

Bundle pricing, use different pricing levels within a product range to move the whole range in the marketplace. For example, in respect of hair oils, there are two categories as I discussed earlier, pre-wash hair oils, post-wash hair oils. You may like to bundle these two products together based on your expected demand, so that together one offsets the other in terms of the price loss if any or price premium the other any. So, that the overall demand equation is improved.

Then, you have the custom pricing, microsegment the customers and adopt customized pricing strategies to satisfy each microsegment. Companies as I said, will have strategic pricing policies, but they have to be related to the strategic product plans and category plans. Even companies that resolutely believe in premium pricing are forced to follow at least bundle pricing.

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### Apple iPhone 13 Pricing

Apple iPhone 13 presents an example of strategic pricing that is leveraged along with multi-layered specifications to emphasise premium aura on one hand and at the same encourage base level affordability on the other.

	iPhone 13 Mini	iPhone 13	iPhone 13 Pro	iPhone 13 Pro Max
128 GB	Rs 69,990	Rs 79,990	Rs 119,900	Rs 129,990
256 GB	Rs 79,990	Rs 89,990	Rs 129,990	Rs 139,990
512 GB	Rs 99,900	Rs 109,900	Rs 149,990	Rs 159,990
1 TB	-	-	Rs 169,990	Rs 179,990

Specification	iPhone 13 Mini	iPhone 13	iPhone 13 Pro	iPhone 13 Pro Max
Screen Size	5.4 inches	6.1 inches	6.1 inches	6.7 inches
Rear Camera	12 MP + 12 MP	12 MP + 12 MP	12MP + 12MP + 12MP	12MP + 12MP + 12MP
Front Camera	12 MP	12 MP	12MP	12MP

The above clearly demonstrates how a top-end premium iPhone 13 (Pro Max of 1 TB) is 2.25 times the base level iPhone 13 (128 GB). The pricing is based on the assumption that certain consumers will pursue certain models regardless of the pricing.



Let us take the example of iPhone 13. Apple is always known to be a premium pricing Product Company. However, irrespective of the base model in its iPhones, it adopts a strategic pricing model that is leveraged along with the multi-layered specifications of the premium capability of the phone, but offering in base level pricing that attracts the most people.

So, you have 4 types of iPhones, iPhone 13 mini, iPhone 13, iPhone 13 pro, iPhone 13 pro max. These are available in different RAM and memory classifications. In terms of memory 128 GB, 256, 512 GB and 1 terabyte. As you can see the iPhone mini is priced always in a distinctive manner relative to the other iPhones.

The price difference between iPhone 13 mini and iPhone 13 pro max is as high as almost 50 percent you can say. And the specification differences are also very visible to see particularly in terms of the camera department and the processing capability.

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### Apple iPhone 13 Pricing

Apple has used a few discount and trade in components to make the base model attractive for the Indian consumers.



Hypothetical Example of 128 GB Model, in Each Case

	iPhone 13 Mini	iPhone 13	iPhone 13 Pro	iPhone 13 Pro Max
List Price	Rs 69,990	Rs 79,990	Rs 119,900	Rs 129,990
Discount				
Cashback	Rs 3,000	Rs 4,000	Rs 5,000	Rs 6,000
Exchange Value*	Rs 5,000	Rs 12,000	Rs 15,000	Rs 20,000
Exchange Bonus	Rs 3,000	Rs 4,000	Rs 5,000	Rs 6,000
Net Effective Price	Rs 58,990	59,990	Rs 94,500	Rs 97,990
Reduction Profile	16%	25%	21%	25%

\* For a corresponding model of previous generation

iPhone 13 became the most briskly selling model in the Apple range, validating Apple's strategy of strategic pricing strategy. The same strategy is getting repeated with the latest series of iPhone 14 models.



However, when it comes to marketing the product, the company adopts a different approach. Each of the products has a discount level, a cash back level and exchange value, and exchange bonus, and then net effective price. As a result of that, the discount levels of each of these products varies making the base model even more attractive, a discount of 20,000 rupees compared to this price of 79,990 for iPhone 13.

But it is not so visible in respect of the iPhone 13 pro max. Therefore, iPhone 13 automatically became the most briskly selling model in the Apple range. And this strategy is getting followed even in respect of iPhone 14.

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**Apple Versus Samsung Strategic Pricing**

Apple has used a few discount and trade in components to make the base model attractive for the Indian consumers.

Despite the lack of bundling, iPhone 13 became the most briskly selling model in the Apple range, validating Apple's strategy of strategic pricing strategy. iPhone 14 also follows a similar pricing approach.

NPTEL

Now, in respect of strategic pricing Apple and Samsung being the largest producers and sellers of these high technology smart devices adopt different strategies. Apple one product family that is the iPhone 13, 14 or whatever that series is. Very structured pricing.

Net price as a driver of demand in certain cases and no product bundling at all, whereas, Samsung has many product families to cover as many segments as possible. Multi-layered pricing, net price being the same of course. But near free bundled products, that is you buy S22 Ultra, you get a ear buds at a particular price or a watch at a particular price.

So, despite the lack of bundling iPhone 13 became the most briskly selling model in the Apple range. It validated Apple's strategy of strategic pricing. iPhone 14 also follows a similar pricing approach.

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**BS IV to BS VI Truck Prices**

Mandatory changes to truck configurations, driven by regulatory changes, provide an opportunity for premium pricing.

**BS IV Truck**

- 37 MT GVW
- Rs 31 lakhs

**BS VI Truck**

- 32 MT GVW
- Rs 37 lakhs

A 40% increase in Per MT GVW Price – from 0.84 to 1.15; driven by mandatory regulations of move to BS VI emission standards

**BS VI Truck**

- Commodity price increases of 10% plus

**BS VI Truck**

- End product price increase of less than 5%

When under pressure, even genuine commodity price increases cannot be passed on; forcing a move from premium pricing to economy pricing

Companies must put in place appropriate costing systems to measure costs accurately. Also, periodic cost audits are necessary to eliminate costs that may have crept in over time without being noticed.

NPTTEL

When you see another segment such as trucks, you will find that there are some aspects of strategic pricing even with such a product. Let us look at a BS 4 truck, which has got 37 metric ton gross vehicle weight price of 31 lakhs. You can look at a BS 6 truck which has faced not only the superior technology, but also commodity price increase of 10 percent plus. Then, you have got BS 6 truck which is 32 MT GVW at 37 lakhs and a BS 6 truck has end product price increase of less than 5 percent.

So, what is the impact of this? A 40 percent increase in per MT GVW price that is 0.84 to 1.5 was driven by mandatory regulations of move to BS 6 emission standards. That is on a case

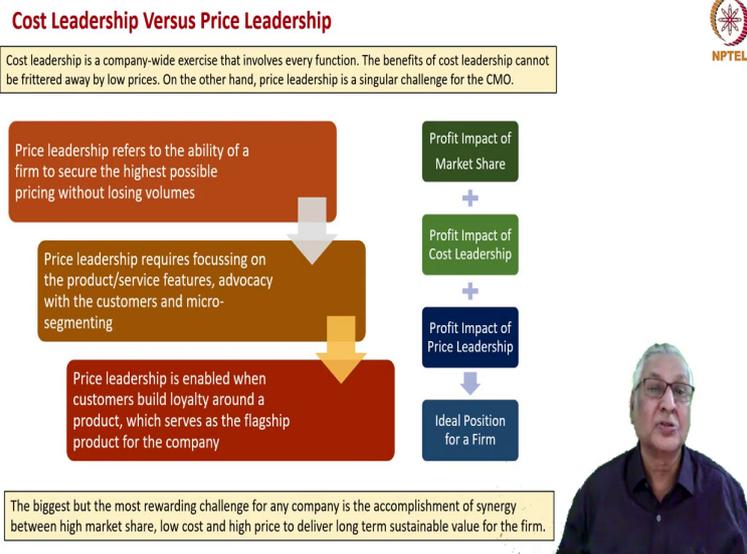
by case basis a 37 MT GVW truck of BS 4 variety which cost 31 lakhs with lower GVW began costing higher level. Therefore, per MT GVW price has increased, that is the operator has to pay more because of the BS 6 emissions mandate.

Similarly, the BS 6 which has suffered commodity price increase of 10 percent plus could only pass on 5 percent of that as end product price. Therefore, when under pressure even genuine commodity price increases cannot be passed on and that forces a move from premium pricing to economy pricing.

Companies again must place in their system appropriate costing approaches to measure cost accurately. Also, periodic cost audits are necessary to eliminate cost that may have been creeping into the system over time without being noticed. This is a stark example of how technology and how regulatory mandates can upset a particular consumer cost equation in this case GVW per a lakh of rupee.

Similarly, how commodity price can upset the cost equation, but cannot be fully recovered by the price equation. So, understanding of the cost structure in its entirety and reduction of cost wherever feasible and optimization of the overall cost and price equation are mandatory for strategic pricing in any company.

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So, what should we aim at should we aim at prize leadership or should we aim at cost leadership? Cost leadership is a companywide exercise that involves every function. The benefits of cost leadership cannot be fitted away with low prices. It cannot be that the entire network and the entire factory works on reducing cost. But by means of judgments or knee jerk reactions price decreases are granted or discounts are granted and the entire effort is frittered away.

Therefore, we have to make sure that cost leadership must be robust, but people who have the responsibility for pricing must be fully aware of the ground realities and excess their judgment with due caution and with due understanding of the company's revenue and profit implications. That is why for the chief marketing officer prize leadership is the singular challenge.

So, prize leadership refers to the ability of a firm to secure the highest possible pricing without losing volumes. Many times, many products are sold at low prices without understanding that there is a higher premium that is possible.

So, the concept of premiumization has come in. We do not understand the price premium that the customers are willing just because we have not studied the customers and the products properly. So, chief marketing officer has the responsibility to premiumize the product as much as possible.

Secondly, prize leadership requires focusing on the product service features and advocacy of the features with the customers. The marketing must also do micro segmenting wherever necessary. Prize leadership is enabled when customers build loyalty around a product and around the brand.

And when the product becomes the flagship product for the company. So, the chief marketing officer must study the profit impact of market share, profit impact of cost leadership, profit impact of prize leadership. And based on the study of all these 3 aspects, you should be able to arrive at the ideal position for a firm.

The biggest, but the most rewarding challenge for any company is the accomplishment of synergy between high market share, low cost, and high price to deliver long term sustainable value for the firm. Ensuring the highest quality in product and service as alluded to earlier is of course, taken as a fundamental base level requirement.

With this we come to the end of this week's lectures.

Thank you for your kind attention. Hope to see you in the next lecture.