

Pricing

Questions to Consider

- What are the key issues of pricing in dynamic environments?
- What are the key considerations prior to setting prices?
- Why is the pricing of after-sales service crucial in high-tech markets?
- When should specific pricing strategies be used?

The High-Tech Pricing Environment

Need to recoup R&D investments in light of:

- Rapid pace of change
- Short, volatile product life cycles
- Pressure on Price/Performance Ratios: Moore's Law
 - Every 18 months, improvements in technology cut price in half for same level of performance
- Network externalities
 - Value of product increases with usage
- Unit-one costs
 - Cost of producing the *first* unit is very high

Cost

- Low-Price Basis
 - Sustainable, non-imitable cost advantage
- Experience Curve
 - Savings from learning, volume, & specialization
 - Employee efficiency
 - Smooth production lines
 - Decreased purchasing costs
 - Pricing Strategies
 - Begin with higher prices
 - Lower price as curve takes effect and/or competitors emerge

Competition

- Benchmark against which to evaluate prices
- Even new innovations have competitors
 - Customer's may not choose to adopt the new technology
 - Competitive substitutes
- Cross-Price elasticity of demand
 - % change in one product's sales due to a % change in a price of another product
- Increase in complementary competitors may increase prices

Customers

- Price ceiling is determined by customer's perception of value & competitive options
- Product Benefits
 - Functional: attractive to users
 - Operational: reliability, durability, efficiency
 - Financial: credit terms, leasing options
 - Personal: psychological satisfaction
- Costs
 - Monetary: price, transportation, installation
 - Nonmonetary: product failure, obsolescence

Customers

- Reference Price: pricing standard used by customer
 - Prior experience or current competitor's prices
 - Current purchase environment
- Total cost of ownership (life cycle costing)
 - Important to company's value proposition
 - Monetary + nonmonetary costs over the life of the product

Customer- Oriented Pricing

1. Understand customer use of the product
 - Each end use may have a different cost/benefit analysis
 - Vertical markets: price accordingly
2. Focus on the benefits customers receive from using the product
 - Customers buy benefits, not features
3. Calculate customer costs
 - Monetary and nonmonetary costs
 - Understand customer cost/benefit trade-offs

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Customer- Oriented Pricing: Implications

- Pricing decisions
 - Are part of product design decisions
 - Should be made early
 - Tradeoff analysis and target costing are useful tools
- Different segments value the product differently
 - Different customers yield differential profitability
 - Costs to serve customers varies
 - Consumers are affected by perception of fairness
- Firms should track profitability of different customer accounts

How is production cost estimated?

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How is production cost estimated?



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National Association of Manufacturers (NAM): NAM's mission is to enhance the competitiveness of manufacturers by shaping a legislative and regulatory environment conducive to U.S. economic growth and to increase understanding among policymakers, the media and the general public about the vital role of manufacturing to America's economic future and living standards.

Regional Manufacturing Institute (RMI): RMI is a non-profit association created for manufacturers in the Baltimore Metropolitan area. Its mission is to:

- Ensure that the human resource skill needs of manufacturers are known and met.
- Promote the image of manufacturing in Maryland.
- Advocate issues/concerns with state and local Governments.
- Provide services to and networking opportunities among members and with other organizations.

Maryland World Class Manufacturing Consortium: A group of Maryland manufacturers that have organized into a not-for-profit organization with the support of the Maryland Department of Business and Economic Development (DBED). Its purpose is to identify and make available to members world class practitioner resources while developing the criteria, measurements, training and implementation assistance by which companies can become "World Class Manufacturers."

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Pricing of After-Sales Services: Based on segmentation

- Basic needs
 - Want standard service with basic inspections and periodic maintenance
 - Fixed-price, well-defined, limited service contract
- Risk avoiders
 - Want to avoid big bills but don't care about response time
 - Combine fixed price plus time and materials add-on option
- Hand-holders
 - Need high level of service and are willing to pay
 - Full-coverage contract



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The Technology Paradox

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The Technology Paradox Solutions

- Find new revenue streams
 - New uses for existing products
 - Offer whole product (end-to-end solution)
 - Offer product bundles
 - New, less price-sensitive, segments
 - Offer product derivatives under a price lining strategy

What degree of property rights should the customer have?

Options include:

1. Outright sale vs. licensing agreements
2. Single vs. multiple users
3. Pay-per-use vs. subscription (fixed or unlimited)



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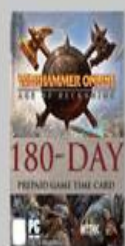
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Price Promotions

- Sell at discounted price
- Offer temporary discounts
 - Induce trial (i.e. 30 day trial)
- Mitigate negative impacts on brand equity:
 - Distinguish between prospective and existing customers
 - Consider the long-term impact of the promotions

Summary

- Pricing requires understanding current & future customer & competitor desires & plans.
- Customer-oriented pricing considerations are critical to setting prices throughout the product lifecycle; starting at the R&D stage.
- Pricing strategies require constant evaluation & refinement as the market reacts & evolves.