Business Data Management
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Objectives of Pricing Strategies

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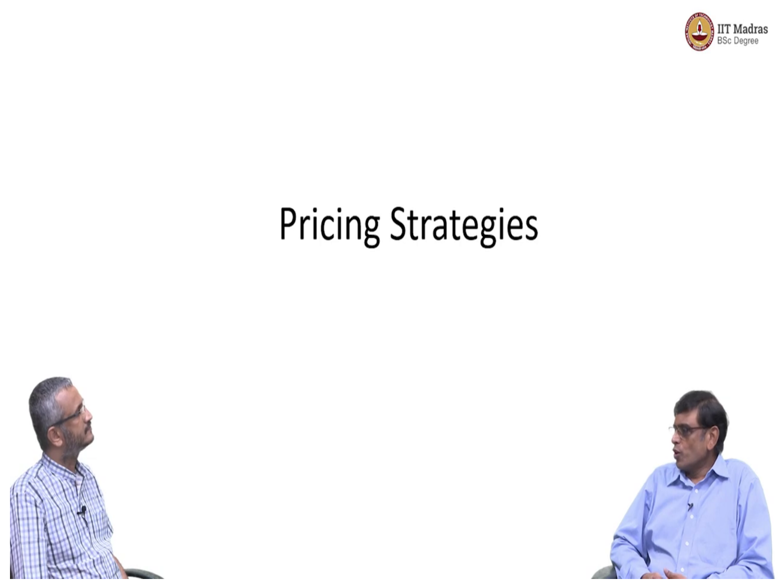

Professor G Venkatesh: So, Suresh, we have discussed costing in the last lecture. So, for firms, for producers, costing is a very important component. But equally important is this issue of pricing. So, they have two variables to control, one is how do they manage their cost and another is how they price their product. So, can you say something about the pricing aspect?

Professor M Suresh Babu: So, the important decision that the firm has to make is in terms of pricing strategies. Because firms always have an idea of the cost. That's something which is within the firm, within the control of the firm. Now, using this variable then they decide what should be the appropriate price for the product. There are two-three things that we need to keep in mind here. One pricing is also a function of the kind of market in which they operate.

In a competitive market, the pricing strategy is different from a monopoly market kind of thing. Competition means a large number of firms and monopoly means only one firm, so pricing strategy varies. Second, pricing also varies depending on the type of product that you are producing. Third, pricing has to be aligned with the larger objectives of the firm. What is that you want to have in the long run? We want to maximize profits. We want to maximize sales, or market shares, in that sense. So, it is a variable that brings in a lot of different information and then you have to decide on an appropriate strategy.

Professor G Venkatesh: So, you are saying pricing, there is a tactical element. So, for example, when you want to capture market share, you might use pricing as a vehicle to do so. So, you are basically saying that pricing is a tactical element which means we should use price too. We can drop the price and try to get more market share, something like that. There is also a strategic element in pricing as you want to send a signal to the market where you stand. So, are you a premium player? With your pricing signals, you can set your position in the market.

Professor M Suresh Babu: So, pricing is an important strategic variable. Because it is used in different contexts in different manners in order to fulfil the objectives of the firm. So, in that context, I think it would be useful to look at what are the various pricing strategies that firms use and then we can draw some inferences from that.

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Professor M Suresh Babu: So, when we look at pricing strategies well, I think the objectives of the firm have to be very clear in that. That is, do you want to have long run profits or you want to have short run profits? For example, in certain markets and for certain firms, you are there to stay whereas in certain other markets, and for certain other firms, there is a kind of a hit and run kind of a thing. In the short run I want to make maximum profits but I will try my best.

So, pricing has to be decided according to this objective of the firm. Second important thing is that we also need to consider where do you want to be in the market? Do you want to have a high market share and maintain that over a period of time or do you want to have a lower market share but higher profits?

So, increasing the sales volume and the growth of the firm or company's growth, that is the other kind of an objective which the firm needs to keep in mind. Then there is also an important component that we were just talking about, that, as a strategic variable, do you want to match your competitors' price. Because in a market where there is a lot of competition, sometimes you will have to match it or you will have to undercut the price to get a higher market share.

So, not only your factors, factors outside the firm's control, that is the price of your competitor etc. are also very important. So, that has also to be considered when we talk about pricing. And then we need to very importantly create a kind of an interest in your product. Otherwise, we know that the products have their lifecycle. So, when you introduce the product it will be slightly slow to enter the market.

Then it gets diffused. By the time it gets diffused well, there will be competitors who might actually take on this product. Then the product reaches a maturity stage beyond which it is difficult to really push the volumes. Then comes the declining phase of a product. So, at each phase of this product life cycle, perhaps, you might need different pricing strategies. So, that is very important in terms of having excitement, keeping the excitement of the product always kind of a thing.

Professor G Venkatesh: So, Jio, for example, introduced telecom for free in the period.

Professor M Suresh Babu: Jio is a very interesting example.

Professor G Venkatesh: Then made it free. All you need is a basic plan. And then flat rate. But subsequently, they enter because regulation also requires that you can't just do that. That is predatory. But after some time basically, they have to introduce a price. But that was a strategy. You step by step. You keep using a higher and higher price once you have got the customers.

Professor M Suresh Babu: So, that is very interesting because your pricing strategy will overlap a lot of models that we are talking about. It is not one kind of model. It is a kind of what I would call is an amalgam of a lot of models that we are really talking about. Then of course some firms have social and ethical and ideological objectives. This comes a little more relevant in the context of certain public sector firms and service firms.

Because they do not want to really have higher profits, but they want to just break even. So, pricing is used to fulfill certain social objectives also there. And then we have a very interesting kind of a strategy which firms use if there is thought of an entry of a new player coming into the market. Then the price is used as a signal to discourage that entry. What do they do? What firms do or what because incumbent firms do is something like limit pricing or predatory pricing. They just lower the price. And that makes it very hard for the new entrant to come in.

Professor G Venkatesh: Make any money at all.

Professor M Suresh Babu: And that will be to discourage entry.

Professor G Venkatesh: But the government should watch this.

Professor M Suresh Babu: That there is a regulatory angle.

Professor G Venkatesh: Because this way you, if you do not allow competition to come and then you eventually become a monopoly.

Professor M Suresh Babu: There is a regulatory issue mechanism to control that. And finally, there is also the question of the survival of certain firms in the market. And that survival requires a certain kind of pricing or another with a certain approach towards pricing, only the firm can survive in certain markets. If you vary the price it might not be able to survive. For example, if we recall our earlier discussions, we talked about inferior goods.

So, if we realize that what we are producing is an inferior good and if we try to tinker with the price, well, the bandwidth is not very high for you to really vary the price. So, I want to be in the market and I just want to survive in the market. So, I will keep the price in that particular band. So, various considerations come in terms of a pricing strategy.

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Professor M Suresh Babu: Now, when we are looking at pricing strategy. There are a lot of data requirements. Also, that is a very important point. One is of course, pricing strategy is intimately related to the costs. Because we saw in our last discussion that firms have to decide when to shut down and when to exit depending on your cost considerations, which is very important. Second, we talked about the question of markets and competition in the market.

Because interdependence of firms especially in an oligopolistic situation where there are few firms and an oligopoly is a market situation where there are a few firms. And competition between these oligopoly firms could be very high or could be even low, could be very high in certain situations because the action of one firm could immediately invite a reaction from the other firm. But if you can cooperate with the other firm then perhaps you can behave like a monopolist.

So, it is a very difficult kind of a market situation to survive. So, the extent of competition in the market becomes very important. And basically, the other issues we talked about in our discussions right now. But very importantly, we also need to understand what the demand situation is in the market. And that is where our concepts of elasticity of demand will become very important. Depending on the elasticity of demand then we will have to really arrive at a pricing formula for a product that we are actually putting out.

Professor G Venkatesh: And this demand may be seasonal. So, accordingly, your price also will be seasonal. For example, for the Diwali period, the festival period, you know that there is going to be a month. And so, you may tweak your prices to take into account the maximum you want to capture the maximum amount of the demand in that period. But in the regular period you may not do that easily. Your pricing strategy may depend on.

Professor M Suresh Babu: So, we find this kind of huge discount sales. In Tamil Nadu, we find that in Aadi month, there is a huge Aadi offer that is coming. And then again when the festival season is Diwali time you find that there are not only discounts but also, a kind of bundling that happens so…Buy two get two free. Those kinds of things that happen

Professor G Venkatesh: Great! People buy more.

Professor M Suresh Babu: To buy more kind of a thing, so, all that is a function of the demand that we just discussed in the earlier sessions.

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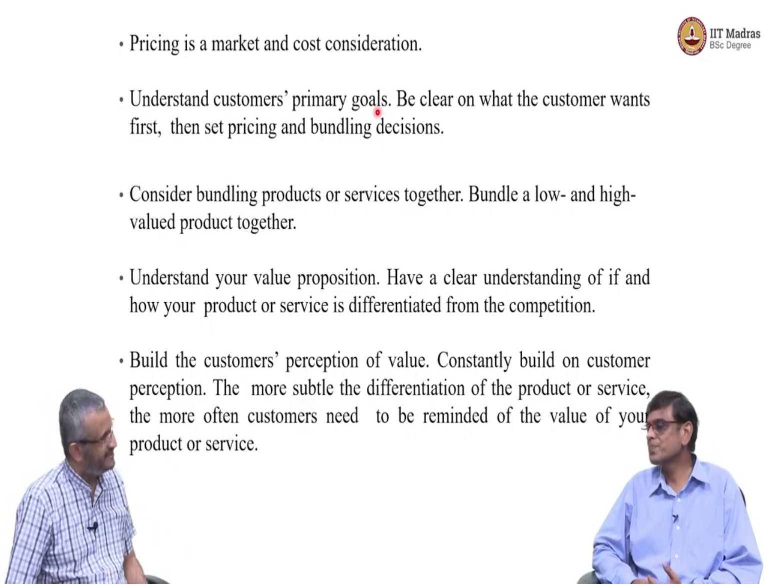

Professor M Suresh Babu: So, the sum and substance of our argument is that pricing is a market and cost consideration. There is a market consideration. There Is also a cost cut. We need to have a balance between these two and then arrive at an appropriate pricing formula taking into account the demand conditions, very much seasonality, fluctuations in demand elasticity etc. Now, here we need to also understand what your consumers' primary goal is?

Remember, we talked about utility maximization and how they substitute. So, how our customers assess your product is very important. And we talked about the large-scale surveys and how certain consulting companies put out data on all that becomes very important to assess this now. Because some of the products are considered as premium products by the consumers. So, the pricing strategies should be kind of a differentiated pricing strategy.

You have to differentiate your product with the existing products or from the existing products in the market. So, customers' primary goals have to be understood. And given that in certain situations, we will have to have bundling because customers think that this single thing might not be of much value for me. If I had x + y perhaps it could be useful. So, all those pricing strategies become very important there.

Now, the other important thing is that this perception of value is built over time. So, pricing strategy is also related to that. Initially as we just discussed, when the product is introduced to the market in the initial phase of a product's life, the utility derived for the consumption of such a product perhaps might not be high. So, you keep deriving the customers' perceptions or keep deriving the value in the minds of the customer over a period of time by an appropriate pricing strategy. Very, very interesting examples we can see from the auto market.

Some cars, when they are introduced, find it very difficult to position themselves in the same segments. You might not be in the hatchback segment but you want to pack it with the features of a sedan. Now, what we are trying to do is basically you are trying to price over a hatchback and below a sedan there. But then sometimes customers think that if I pay one lakh more or something I can get a sedan first.

Then why should I really settle for a hatchback? And the hatchback fellow might think that well, I do not need these kinds of features. I buy a proper hatchback which is enough for me.

Professor G Venkatesh: That is not a continuum.

Professor M Suresh Babu: It is not a continuum. So, building this over time sometimes creates new segments in the market.

Professor G Venkatesh: Temporarily, it will be created at least.

Professor M Suresh Babu: Temporarily it will create and at that point you really need to price appropriately. A very appropriate formula can be used to price that product. And then move on to another product, introduce another product and that is the continuous kind of value creation that we see with the pricing.

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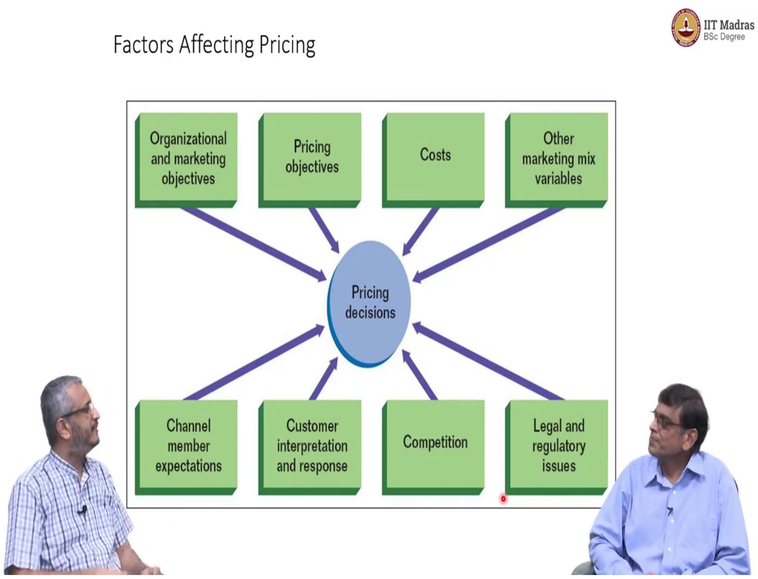

Professor M Suresh Babu: So, broadly we summarize the factors that affect pricing as, 1. organizational and marketing objectives of the firm. Do you want to have sales maximization? Do you want to have a higher profitability per unit? What should be the objective of the firm? Very important. Two, the objectives of pricing which we talked about like utility higher or the perception of higher utility to the consumer or do you have a social objective to fulfil.

In certain public sector units, we know that especially in health or education the quality may be very high but still it might not be priced very high because they think that there is a social objective that has to be fulfilled. Costs, very important. Other marketing mix variables are very important. In some of these things we use certain channels for marketing. So, those channels ' expectations are very important. Customer interpretation and response, I think that is where…

Professor G Venkatesh: So, the channel, what do you mean by channel. The channel is like a distributor?

Professor M Suresh Babu: Distributor

Professor G Venkatesh: So, for example car companies they sell via this distribution company who have stores because they keep the cars. So, they may say that only this kind of car sells in this market? They may say that at least in my city, these cars are moving more than some other cars. So, in Coimbatore, for example, more premium cars might move. Traditionally that is what happened. But as in Chennai, you might find more value cars.

Professor M Suresh Babu: And kind of geographical segmentation of market becomes very important, certain cities with certain income groups, certain activities. And very importantly sometimes the share of the geography of the city might become very important.

Professor G Venkatesh: That is true.

Professor M Suresh Babu: Because certain products have to be tailor-made for the weather or certain geographies. So, all that becomes very important. And this is where perhaps we might have a lot of data work to do, customer interpretation and responses to a product, where we will have to look at large scale data, count those numbers and see what are the patterns.

Professor G Venkatesh: Some people do FMCG. They do trials. They actually will get children and they will give them some new Cadbury's new chocolate or something. And then see how they respond to it. So, that interpretation response actually does a real experiment.

Professor M Suresh Babu: And they do it in multiple locations, multiple times. And then see how the responses for the product are. And then sometimes there is also a kind of below price variation that is also experimented with. For a particular period, there is 10 % off or 20 % off.

Professor G Venkatesh: And they will see what happens?

Professor M Suresh Babu: And is it really having an impact on the market kind of thing? So, this is where, from a data point of view, has a very important role to play for data analysts. And competition, that’s an analysis of a firm because you should know your competitors in the business. And according to that, you pitch your product. And finally, there is this legal and regulatory issue which we just talked about in Jio’s kind of a case and things of that sort. You cannot have predatory pricing for a long period of time which actually hurts competition in the market.