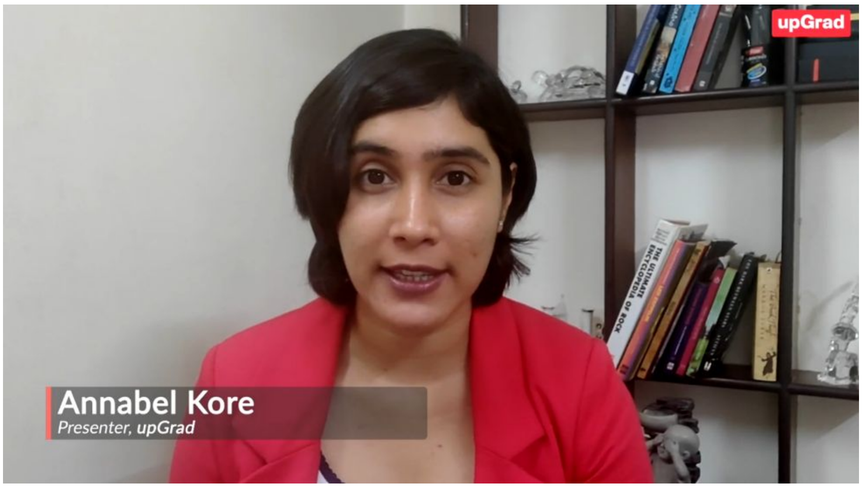
Transcription

Pricing Strategy



Hello and welcome to this session on product pricing. Having the right pricing strategy is very critical to every product. In fact, it's pricing that determines the product's profitability. As product managers, you should be aware of the various pricing strategies. In fact, also know when to introduce that pricing strategy. Let's learn more about it from our expert.

Pricing is an important aspect of your overall go to market strategy, and your product pricing has a key role in determining your overall revenues and profits. It can make or break the game as pricing a product too high can act as a barrier for adoption and pricing it too low could actually leave the money on the table for the company.

And very important to have a thorough understanding of the ecosystem, analyse the demand supply mismatch, and then set an optimal price for your products so that you're not only able to provide maximum value to the customers, but are also able to draw the maximum profit for the company.

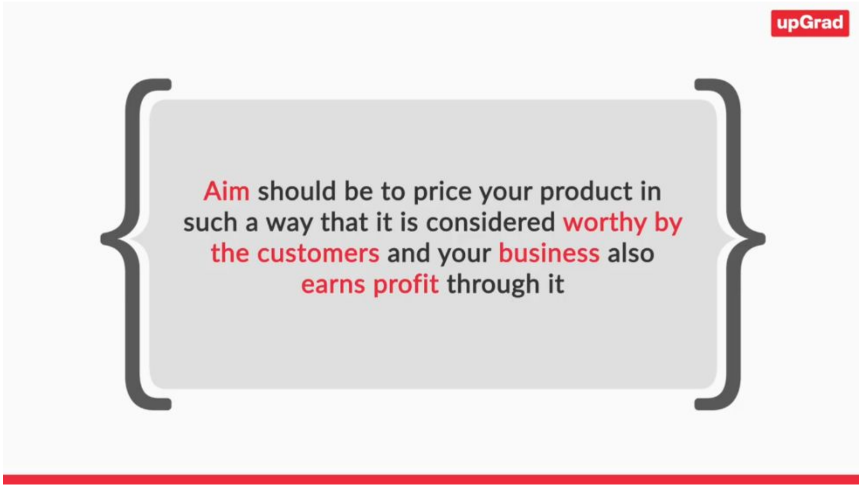
So, the objective of this segment is to make you understand why adopting a pricing strategy is important. And what is the right time to decide that pricing strategy for your product.

Pricing is a valuable tool which is required both for the consumers as well as business. Let's try to understand its value to customers in a bit more detail using the example of Apple.

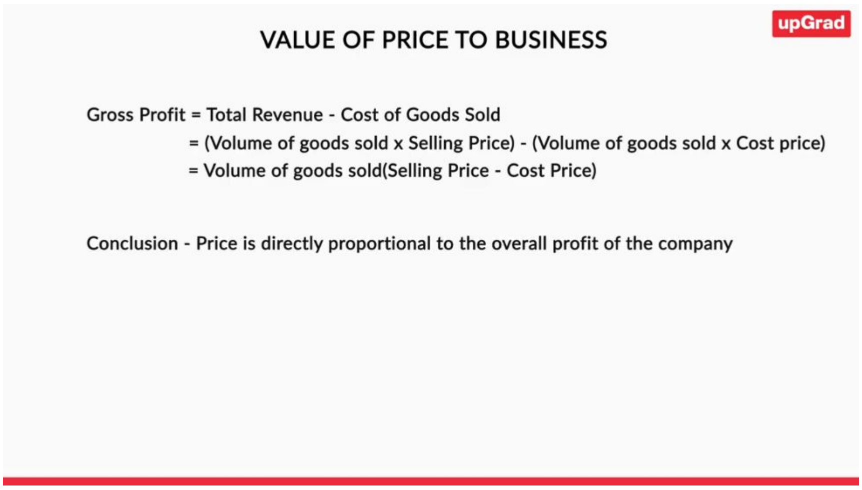
While buying Apple products, customers not only paying the price of the cost of the product. Instead, they're willing to pay a premium for the association with the brand, which in itself over the years has become synonymous with quality and being at the forefront of technological advancements.

This belief is actually built over the years through very well-planned product extensions, product improvements, and is actually a kind of mode that helps the company differentiate itself from its competitors. Customers associate the value of the product with its price.

Now, through this example, you're able to understand how Apple is able to do that premium pricing because customers associate the value of being associated with a technologically advanced company.



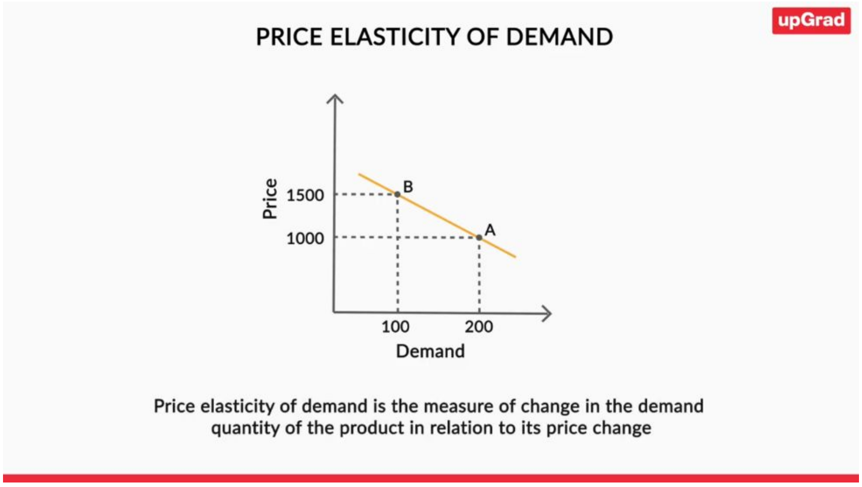
Incorrect pricing strategies can actually impact the long-term success of your product. So, your aim should always be pricing your product such that not only it is considered worthy by the customers, but your business earns profit through it as well. The value of correct pricing of the business can actually be explained through very simple profit equation.



So, gross profit is revenue minus cost of goods sold, and revenue is nothing but volume into the price at which you sell. So, price is so critical in defining how much gross profit you will make.

So, overall, you can directly see price becomes so critical increasing the overall profit for the company. But as you might be aware based on your experience as well, that increasing the price is not always an option because there is something called price elasticity of demand.

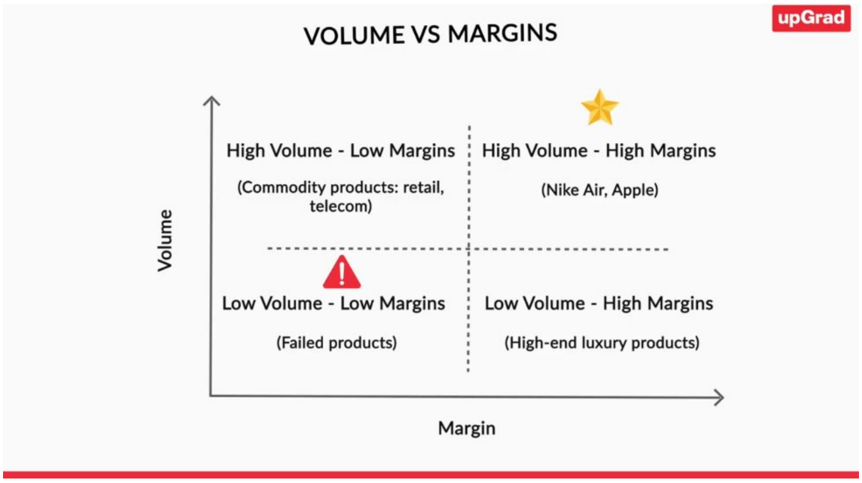
Just to explain the concept of price elasticity of demand very quickly. It basically means for most of the products, demand will start to fall if the price is not optimal, right?



For example, there might be 200 people who are ready to spend say rupees thousand to attend a seminar on personal finance planning. But if you increase the fee to say 1500 with the market price of that seminar being around 1000 only, then possibly only a hundred people will turn up for the event. Hence, as you increase the price of your offering, the number of people who find value in that session might decrease. And this is what price elasticity mean.

So, an effective pricing strategy is the one that creates a balance between value for the customers and value for the business. And if you're able to do that, that becomes a success.

Now you also need to understand that all products are different and one pricing strategy cannot be applied to everything. For example, we will try and do a 4 is to 4 depiction of volume versus margin, just to kind of explain how things can actually be placed into different quadrants and what is the ideal goal that all companies strive for, but unfortunately cannot achieve.



So, at the core of the problem, there's volume and then there is margin on one side. So, quadrant one belongs to the products that sell on high volumes, but maintain very low margin so that the overall for the company, you're still able to make money. This generally is your commodity products. For example, retail or telecom, where there is not too many differentiations that you're kind of playing on, but it's the volumes game that you're eventually playing.

Quadrant two is for products that are sold with both high volumes and high margins. This is an ideal quadrant where everybody would want to be present, but unfortunately, it's not possible for everybody to stay here for long.

Just to give you an example, this requires a really great and unique value proposition for you to stay in this corner. For example, think of Nike Air shoes or Apple, for example. You need to constantly innovate and keep up with the constant changing trends to stay ahead of the curve and be in this quadrant. But from a overall company point of view, this is the most profitable quadrant for you.

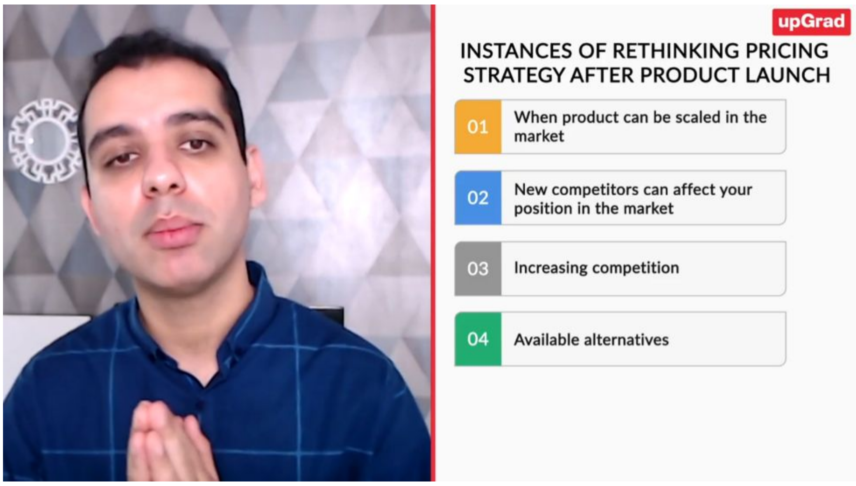
The third quadrant is where generally products are sold low in volume, but have got a very high margin. Think about your high-end luxury products, for example, your Lamborghini or Ferrari. They do not sell too many cars, but then they make huge amount of margin selling the cars that they do. Or luxury goods, the Louis Vuitton's of the world and stuff.

And the fourth quadrant is where actually no one wants to be, which is low on volumes and low on margins as well. Because this is where most of the failed products will eventually tend to move towards. So, ideal scenario, your aim should be to move to quadrant two, so that you can sell your product with the maximum volume and at the same time earn higher margins.

And that is why, as I said, pricing plays a very critical role as part of your GTM, to get people to use your product in the long-term, remain sticky to your offerings.

Now let's think about when is the right time actually work on your pricing strategy? The pricing strategy is actually at the core of your business case. Arriving at a pricing strategy to find the right price for your product requires a lot of research and attention. And it starts at a very early stage, often during the phase of ideation market research.

While conducting competitive analysis, it is a good practice to also research, not only about the features and offerings, but also about how are they pricing the products. Now it's not only at the start that you think about your pricing strategy, even after launching your product over the years, you constantly keep a check on it and adjust based on how the needs of the consumer and the market are evolving.



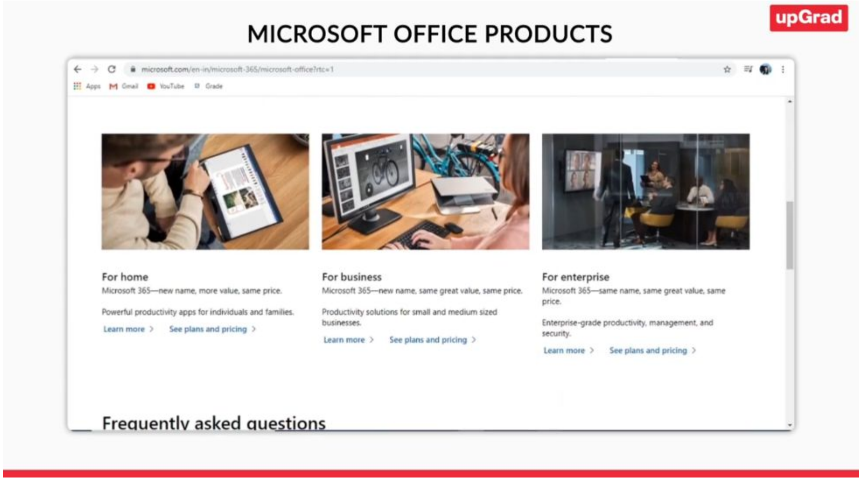
So, for example, here are a few of the cases which will require you to rethink your pricing strategy even after you've kind of launched it up as well.

1. First, you need to look at how the product has actually scaled. Have you added features that the customers are now ready to pay for? For example, loyalty programs normally do this. They start free, but once they gain traction and they have services which are bundled together, they start charging for them or value-added services.

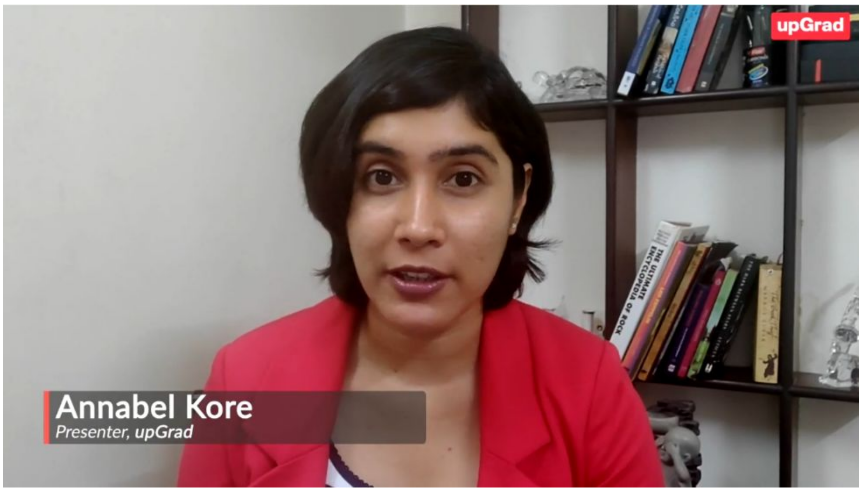
2. You can also have to look at what is your standing in the market, and do you need an additional driver to improve conversions? Are there new players which are coming into the market, and thus, taking away your customers? In those cases, you will want to reduce your pricing. You will probably want to give higher discounts.

3. Third, competition also keeps changing with the time and you need to keep a look at if the competition is providing the same value to the customers at a much lower price. Is there a new player which has come up in the market, which is actually giving the same value at a lower price? In that case, again, you will have to rethink your pricing strategy so that you again, remain ahead in terms of the value that you're giving and at the price that you're giving it in.

4. Another example could be, you should also consider when there are available alternatives. Now alternatives can actually provide a great direction to you to see how the market is moving, but also can actually be a threat to your long-term success.



For example, Microsoft Office was one of the most successful Microsoft products and they had a healthy pool of paying customers. Then Google entered with their own offering and started offering Doc suit, which was on cloud and for free. This actually led Microsoft to also move into cloud with much reduced rates and also offer many of the basic utilities free of cost. Again, done primarily to make sure that the competition doesn't really eat away the market it has built over the years.

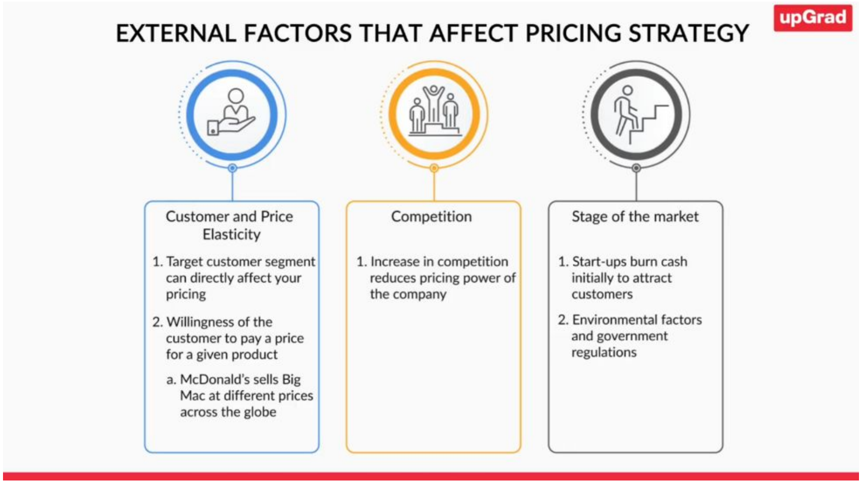


That was an insightful session on pricing strategy. You learned about why different products require various pricing strategies. And you also learned when to introduce that pricing strategy. However, there are internal and external factors that impact this pricing strategy. Let's learn more about that in our next segment.

I'm quite curious to know how companies decide pricing of a product they are about to launch in the market. Is it just the external factors that they consider or are internal factors considered as well? Let's find out the answers to those questions in our next segment.

It is important for any product or company to arrive at a pricing strategy. There are a lot of factors that influence this strategy, and in this segment, what we are going to do is we are going to learn them about those things in details.

Ideally, we have kind of segregated them into two major buckets. One is your internal factors and the other is your external factors. So, let's start by looking at some of the external factors that are influencing the pricing strategy.



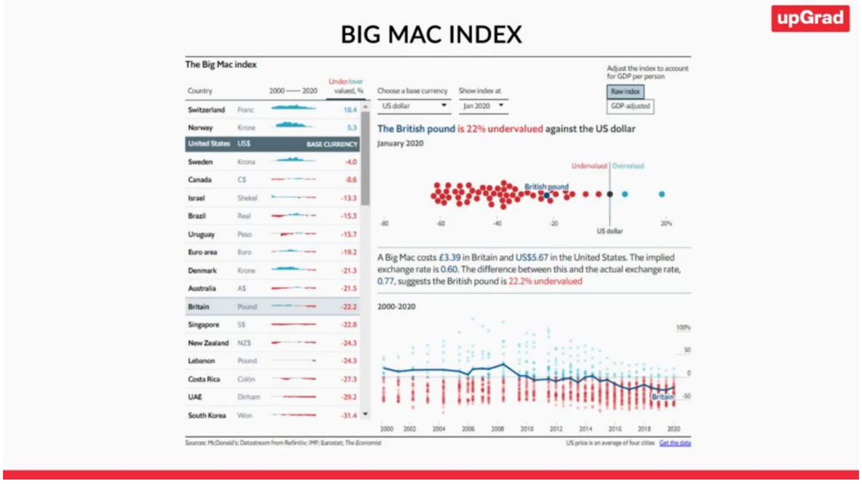
- First is definitely your customer, and the price elasticity. Target customer segment can directly affect your pricing. Now think about it, is it a mass premium, premium or luxury product that you kind of bring into the market. Now, price has a very strong correlation when you're trying to bring up a mass market product, and even a slight change in price can actually lead to a big drop in demands in the mass market segment.

  Example in the case of commodity products, right? Say for example, your washing powder. If it's the same value, and there is a cheaper product alternative, which is available, normally people tend towards, move towards the cheaper option.

  But however, if you're selling a luxury item or a habit-forming item, such as say for example, tobacco, then you have much more Liberty to play around with the pricing. Because it will have less impact on the demand because the association of higher price is also associated with a promise of a unique experience, or just the dependence of the product itself.

  So, that is why the way your product is whether it's catering to a mass segment or a luxury segment will also differentiate and give you the pricing power, which is different in nature.

  Second, obviously one of the external factors that we've kind of spoken about is the willingness of the customers to pay a price for the given set of product services.



For example, the Big Mac by McDonald's is sold at different locations across the globe, and so much so that there is actually a Big Mac index, which has become a proxy for purchasing power parity across different geographical location, which means a Big Mac sold in the US could be very differently priced from a Big Mac sold in India. And the difference in pricing is actually a pseudo to the purchasing power parity difference between US and India.

- Next important external factor would be competition. Competition has a major influence on the pricing power of a company. Too many companies trying to provide the same product or trying to provide the same value will obviously reduce the pricing power that you will have.

EXAMPLE FOR LARGE COMPETITION IN APARTMENT RENTALS REDUCING PRICING POWER

	Case 1	Case 2
Available Apartments	10	100
Demand of Apartments	50	50
Rent Per Month - 2BHK	Rs 20,000	Rs 10,000

Increase in competition has decreased the pricing power of the company

Let's just try to understand with an example of rentals in India. For example, there are 10 apartments available in an area, and there is a demand for 50 apartments. People would be willing to pay, say 20,000 rupees for a 2BHK that should ideally cost only about 10,000 rupees.

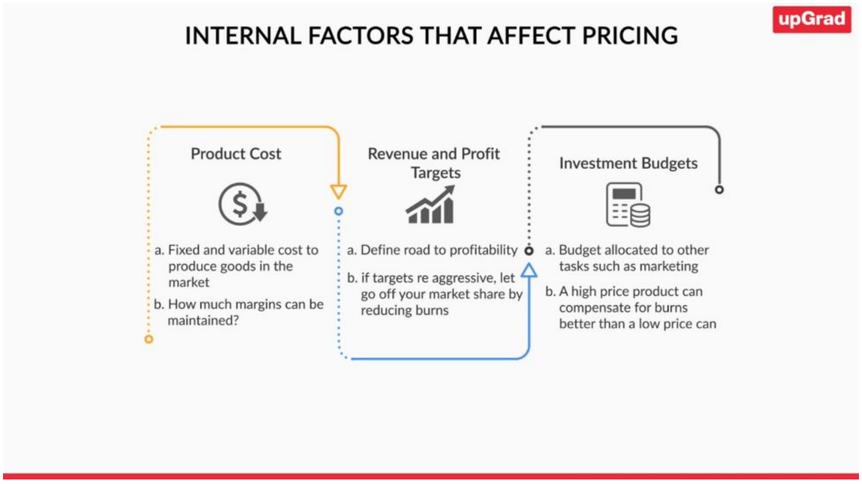
However, seeing higher rental income, if the supply increases or more people start putting up their apartments for rent, then let's take the case where there are now a hundred apartments in your area for the same demand for 50 units. The older pricing will no longer hold in this scenario. People will become more demanding and actually can end up bargaining more aggressively, thus driving the rentals down to say 10,000 rupees or 15,000.

So, in this case, the competition has actually brought down the pricing and the pricing part control that you had for your products.

- The stage of the market is also a key aspect in deciding price. Start-ups burn through extra discounts so that people can try their services and understand the value proposition before they agree to spend on it. For example, think of food delivery, Swiggy, cab services Ola etc., they burned a lot of money through extra discounts in the starting so that people eventually get hooked to it, and which is the larger aim for the start-up in that phase of period.

  Now consider amazon.com, which is at that point in time posting record breaking revenues. But initially, it took them six years to achieve profitability because one, it held up to the low prices in order to achieve the customer penetration.

  Finally, factor like environment and government regulations. These are things which are just mandated by the market where you are kind of operated. For example, pricing controls on medicinal products. This becomes an important, important factor for you to decide what pricing strategy you will go ahead.



Till now, we've kind of looked at some of the external factors. Now there are a bunch of internal factors as well.

1. For example, the first one product costs. What are the fixed and variable costs to produce these goods into the market? That's a deciding factor, how much you'll be able to maintain the margins.

2. Leaning on, revenue and profit targets. What is your road to profitability? The longer the path you have, the longer you can keep the prices low to gain the market share. However, if your targets are aggressive, then you have to let go of the market share by reducing your burns. You will not be able to price your product low, and eventually you have to push towards profitability.

3. Third, investment budgets. How much of a budget is the company allocating for marketing? All investments that are made towards reaching a wider audience in the shortest possible time are incurred by the company.

This could include TV ads, print, digital communication, all of this add to the cost for the company, and are a direct burn on your bottom line. Hence, high price product is able to compensate for these factors much better than a low-price product.

Clearly, several internal and external factors impact the pricing strategy of a product. As a product manager, you must evaluate or consider these factors while devising that pricing strategy. What's got me curious though, is not every product has the same pricing strategy. So, are there different types of pricing strategies? Let's find out more about that in our next segment.

The pricing strategy normally does not work in isolations and companies do change it as per the long-term strategies. Now we look at few of the major pricing strategies, which are there in play in the market, cost plus pricing.

1. The cost-plus pricing strategy has two main consideration for calculating the final price. One, the cost of production, and second, the margin that you require on it. So, you start with the cost of the product and then add your margin on top of it. That's what your cost-plus pricing eventually comes up.

   For example, most of the manufacturing companies thrive on cost plus pricing because the products they manufacture have a relatively predictable, hard costs, such as labour, machine, raw material. And hence, you're able to assign a margin on top of it that sustains the business.

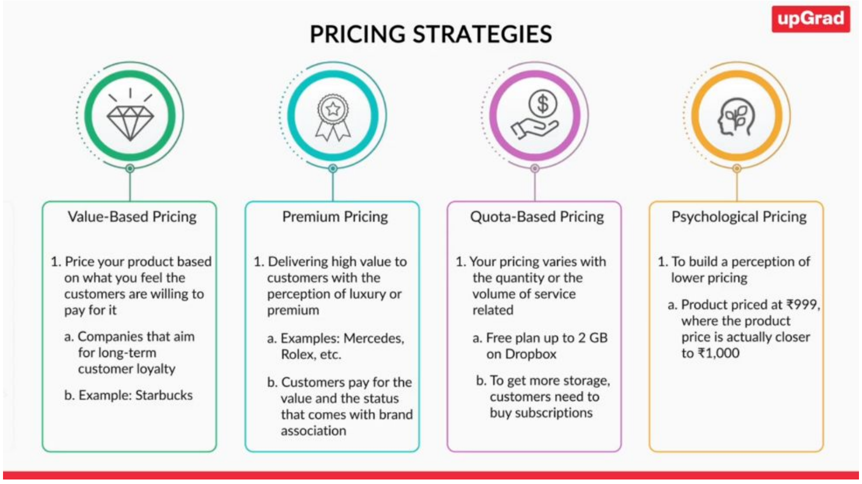
2. Second is demand based pricing. Demand based pricing is the pricing where pricing actually fluctuates with respect to the customer and market demands. This is also known as dynamic pricing. Obviously given the constant change, that's where the name comes from. Example, you would have seen this in airlines. Increase in airline prices coming in because of high demand or for example, discounts on hotel booking rooms going when they are actually in off season, right? So, that's the dynamic pricing or demand-based pricing.

3. There's another form called as high-low pricing. In high-low pricing, the strategy is actually initially to sell the products at a high price and then going forward, price them lower either based on how the market is offering by giving higher discounts. Think of your clearance sales, year-end sales.

   Now why this is done is because high prices are associated with high quality and a lower average selling price, which is after discount price actually makes move people to buy the product.

   For example, a private fashion label tends to price their products very high and offer higher discounts so that the ASP or average selling price becomes more acceptable to the customer. So, they've used the high price and the association with high quality, and then they've discounted it to bring the ASP into a range where more people are able to buy that.

4. Moving ahead, then there is value-based pricing. In value-based pricing, the strategy is to price your product based on what you feel the customers are willing to pay for it. The pricing strategies used by companies when they aim for long-term customer loyalty and retention, and hence, a price variation would also be required at different price. For example, Starbucks, they carry out research and customer analysis to arrive at the highest prices that the customers are willing to pay without actually dropping off.

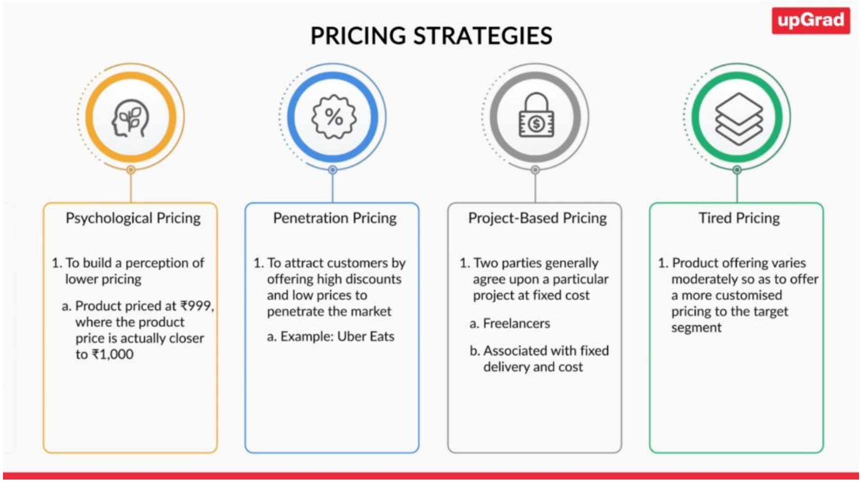


5. A very similar construct is premium pricing, also known as prestige or luxury pricing. The premium pricing strategy of company focuses on high value being delivered to customers with the perception that the products are luxury or premium. Think of your Mercedes, your Rolex watches are few of the companies in this segment, right where the customers are willing to pay that extra amount, to get the value and status which comes with being associated with the products.

6. Moving ahead, there is quota-based pricing as well. In this pricing model, your pricing varies with the quantity or the volume of service related. You must be very familiar using, say a Google or Dropbox. Dropbox, the popular cloud storage offers you a free plan up to 2GB of storage. After that, the pro plan significantly offers you large amounts say, one TB for nine $999 a month. So, this is what is called as quota-based pricing.

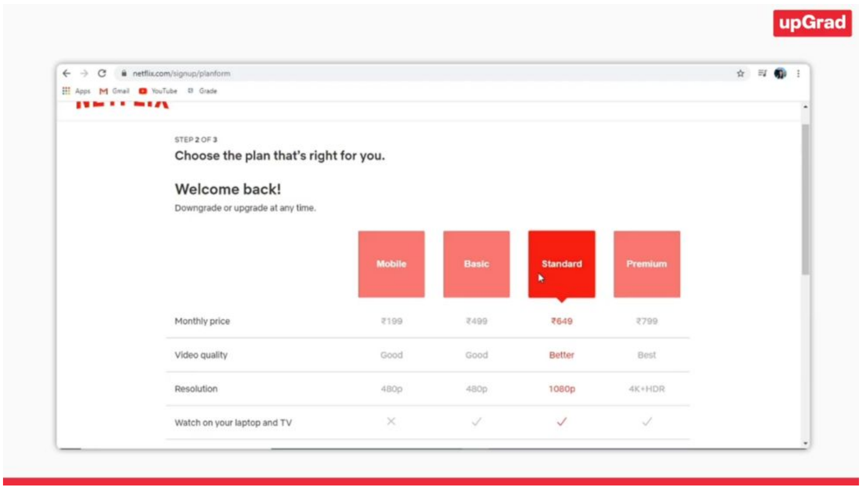
7. Another pricing strategy, which is used in the market is psychological pricing. This is a psychological trick that many of you would've seen many stores use it. This is actually to build a perception of lower pricing. For example, a product being priced at 999, where the product price is actually closer to 1000 rupees, but it appears more in the three-figure range, a 900 rupees product. Hence, people are more willing to buy it just purely the way our mind perceives number. So, that's psychological price.

8. There are other forms as well. Moving ahead, there's penetration pricing. Companies use this strategy to attack customers by offering high discounts and low prices to penetrate the market. So, think about Uber eats. When it was launched in the Indian food tech, Uber eats was offering high discounts to entice customers to use the product.



9. Project based prices. Here, two parties generally agree upon to a particular project and there is a fixed cost associated with the project. Think of freelance projects or even enterprise delivery projects. There is a fixed delivery and there's a fixed cost associated with it.

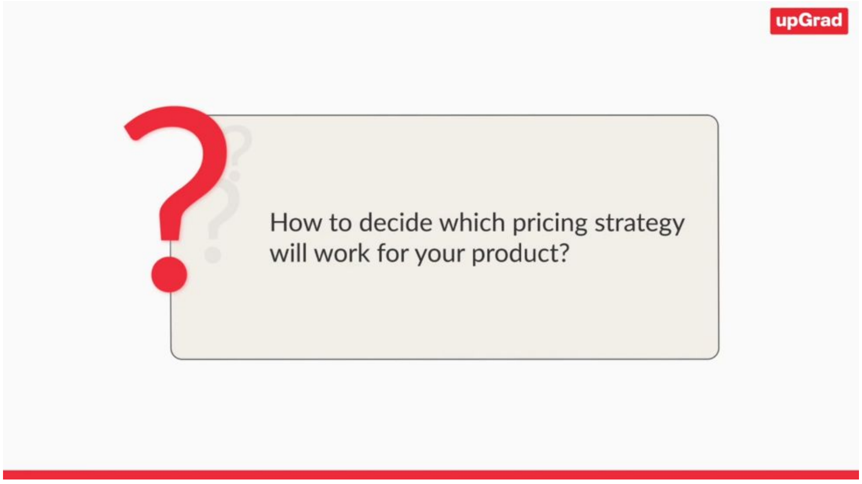
10. Then comes tiered pricing. Here, the product offering varies moderately, so as to offer a more customized pricing to the target segment.



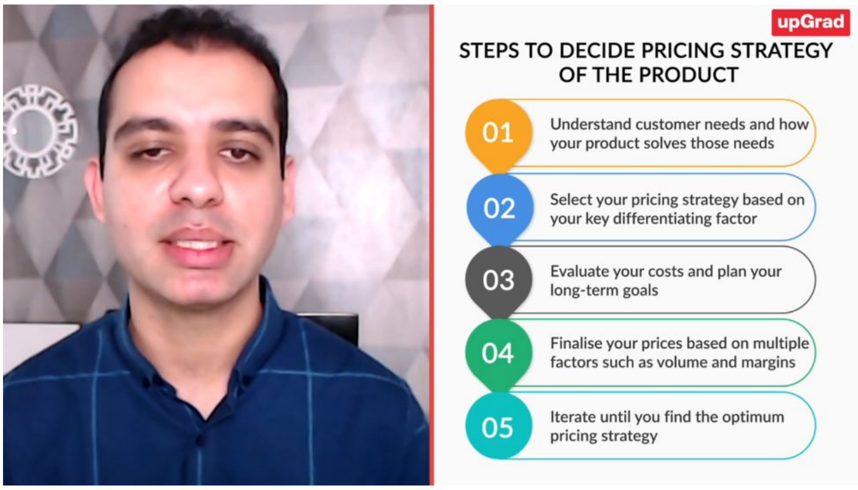
I'm sure most of you are aware of Netflix in India and how they've kind of come up with this tiered construct, right? 199 for only smartphone viewing, 499 for one screen basic plan, but it can only have one simultaneous user. 649, which is more suitable for a couple where you can actually view screens in HD on 2 screens simultaneously, but no Ultra HD there.

And finally, there's these 799 plans, which comes with all the bells and whistles and which is suitable for a family of four. So, these are tiered structure where for each of your target segment, you're trying to give some value proposition.

Now that you know about the different types of pricing strategies, the question rises, how do you decide which pricing strategy is suitable for your product? Let's learn more about that from our experts.



So, the important question is how do you decide which pricing strategy will work for your product? Here are the key important points to consider when arriving at a product strategy.



- First, understand the customer needs and how your product fulfils those needs. The close the product is to the needs of the customer, the higher pricing power the company would enjoy. So, spend time understanding the customer personas and then tweaking your pricing to meet those requirements.

- Next, pivot on your strengths to make the value proposition more compelling. Most companies will not be able to do all the things and that too, you know, really great. And hence, you should focus to make efforts to perfect that major value proposition.

  Example, if supply chain is your company strength, then you should try and bring your costs down by optimizing the supply chain to the maximum possible level. Hence, for a given product, for the same price, you can enjoy much better margin as opposed to your competition can. And that in the long term helps you be a much more profitable company.

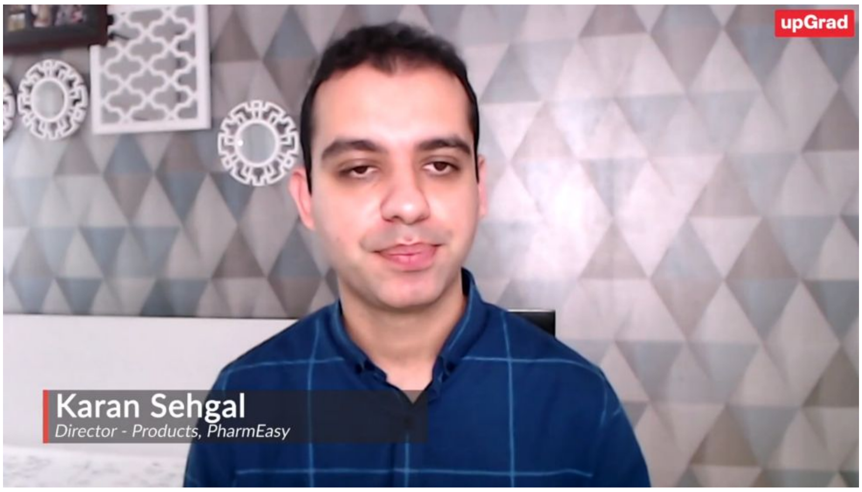
- Third, select your pricing strategy, whether it's margin, premium, high-low, etc., based on your differentiating factor. The strategy to choose should reinforce the differentiating factor of your products to your end customers, so that in the long run, they are willing to pay more, to enjoy the unique benefits that you are offering.

- Going ahead, evaluate your cost and plan your long-term goals. As an example, think of that Domino's 30-minute delivery promise. It banks on having a minimum density of stores in an area. And in the end, it actually affects your overall cost. Hence, pricing should factor in these inherent costs so that the customer delight goes hand in hand the long-term health of the company.

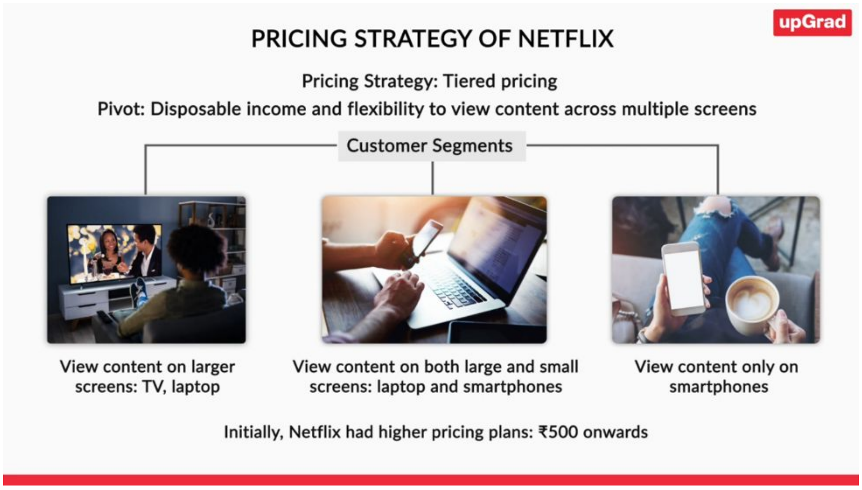
- Moving on, finalize your prices based on factors, such as volume and margin. You need to understand the relationship which you will have and which your price will have to your product and the volumes and gross margins you can achieve through it. Because once able to get that business case sorted out with pricing at the core, you will know how and where the money's going to come to eventually help you in the long-term success.

- Finally, iterate till you get that optimum pricing strategy. Especially for start-ups, you will have to work through a few iterations, try different various pricing models and strategies before you get that right one.

So, the process of multiple iterations might not always apply to enterprise level and more mature companies that would have got a decent experience in pricing their products and would have already gone through the process of trying out various pricing strategy. And hence, coming to a price that has worked best for them. This kind of iterations is mostly used at the initial state for start-ups.



Let's look at the pricing strategy for Netflix in India as of year 2020. There are different ways to identify customer segments. Although in this case, because of the tiered pricing structure, Netflix seems to be pivoting onto disposable income, plus the flexibility to view content across multiple screens. Now, this is again a hypothetical look at their pricing strategy, but a very similar exercise would have been undertaken by Netflix to come up with this tiered structured in the first place.

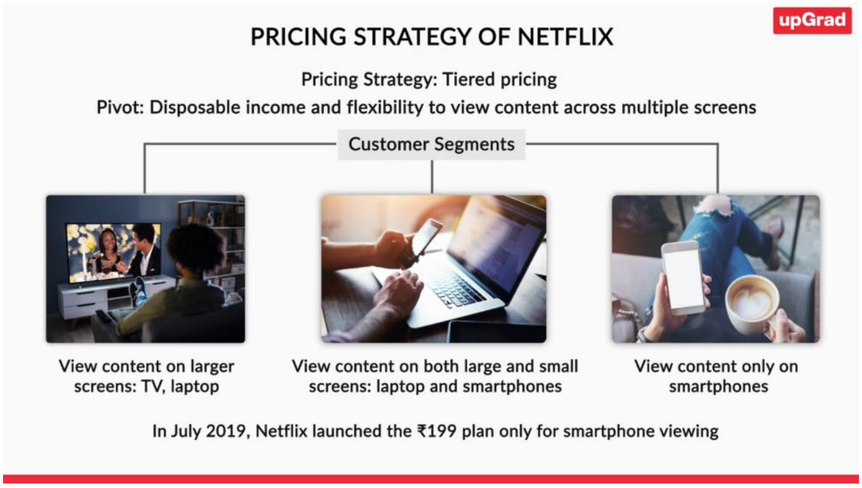


So, let's say, they started off by segmenting their customers by the screens that they're viewing on and how many other viewings. So, the first customer segment for them is one which views content on larger screens, TCs, laptops, etc. Second could be the customer segment, which is majorly viewing on bigger screens, which we've spoken about, but also sometimes watches on smaller screens. Like for example, a smartphone or tablet.

And the third for them could be the one which is actually, you know, just viewing the content on smartphones. And as part of their India GTM, which started in 2016, Netflix in the starting phases seemed to have primarily targeted the first and second customer segment because obviously they had much higher pricing plans which started 500 rupees onwards. And in the Indian context, were on the higher side specifically, when you have competitions from Prime and Hotstar as well.

With superior content, which included many of the Netflix original, they were able to create a niche and reach about 1 to 1.2 million paying subscribers. And that actually worked great for them as an entry pricing strategy.

However, soon they realized that the target segment, which can afford these higher prices is limited and a bigger market exists for low price offering. And that's why the company moved towards reaching that milestone or, you know, thinking about that milestone of reaching that hundred million plus subscribers.

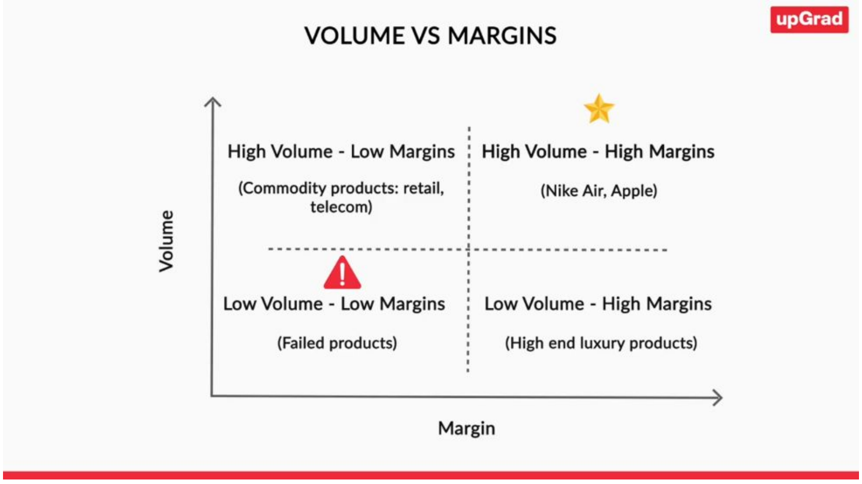


If it had to do that, it had to start focusing on that segment three. The segment three in this case was synonymous with the mass market segment, which would not probably have the buying power of 500 rupee plus plan. And hence, in July 2019, they launched that 199 rupees plan, which was only for smartphone viewing.

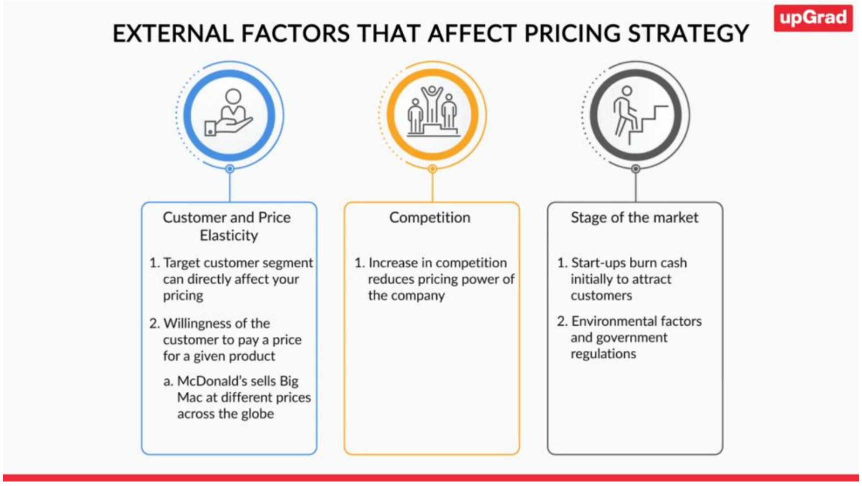
So, you can see that you can actually gain a much better market share by doing an increase in volume as well. Now this was also driven by the fact that India is a mid to lower income company. This could also be driven by the fact that India is a mid to lower income country with higher disposable income audience making actually a small portion of the users. So, as you can see, the strategy of Netflix is to use a kind of a tiered pricing along with that psychological pricing.

By now, you have a fair understanding of different types of pricing strategies, and you've also understood how to decide the right pricing strategy for your product. This brings us to an end of an insightful session. Let's quickly summarize what we've learned so far. See you in the next segment.

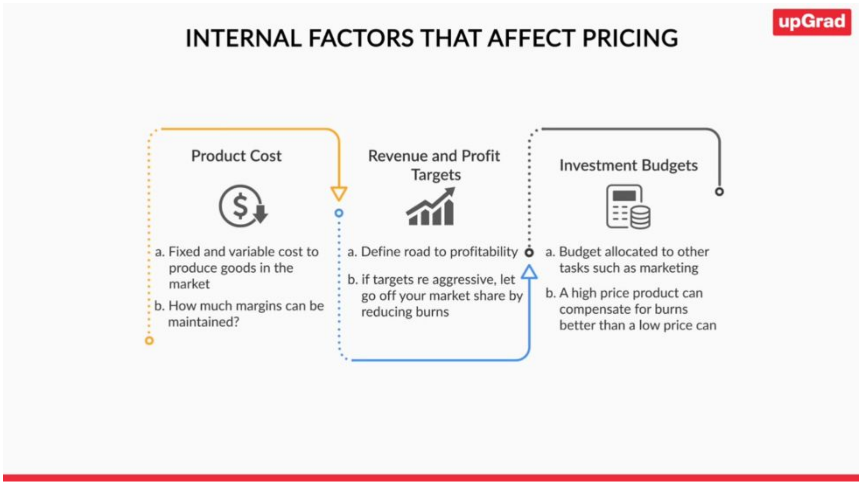
So, we've come to the end of the session on product pricing. In this session, you understood the importance of having an effective pricing strategy, because it is the price of a product that determines its profitability. It is important for you to understand that all products are different in nature. Hence a single pricing strategy cannot be applied to all products.



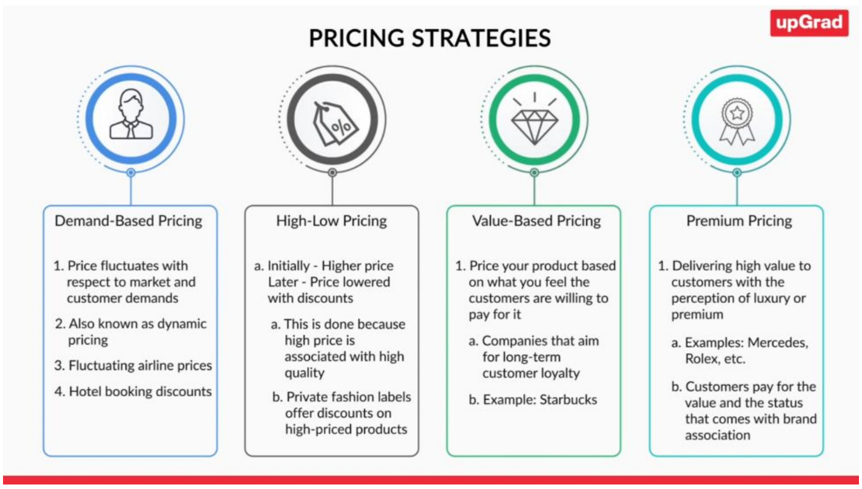
You learned about the four quadrants classified based on the type of product. As a product manager, you will be working in one of these quadrants and your objective should always be to move towards quadrant two so that you can sell your product or service in high volumes at the same time and own higher margins.



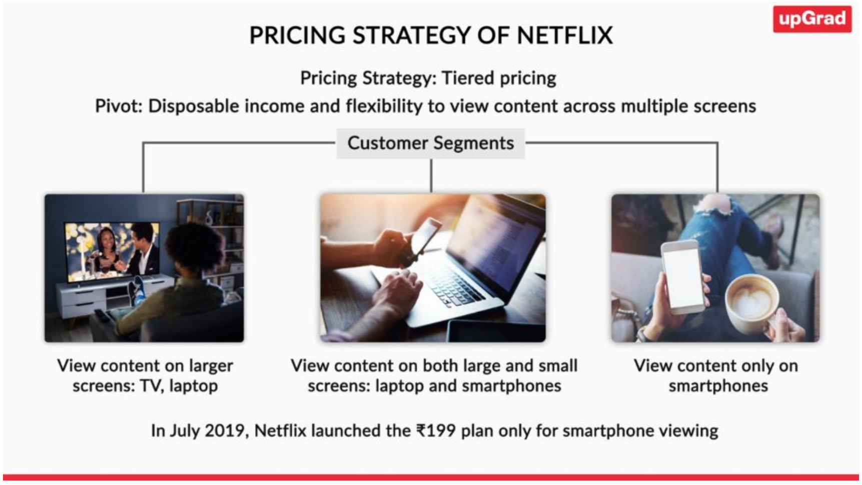
Next, you learned about several internal and external factors that impact the pricing strategy of a product. Some of the major external factors are price elasticity, the competitive landscape of the market, the stage of the market.



Internal factors that affect the pricing strategy of the product are the cost of the product, revenue and profit targets, the investment budget. These should be critically evaluated while devising the pricing strategy of a product.



Lastly, you learned about the different types of pricing strategies. Some of the commonly used pricing strategies are cost plus pricing, demand-based pricing, high-low pricing value based pricing, premium pricing, and a few others which our expert discussed in detail.



You must have an understanding of these pricing strategies to determine the right one for your product. To understand how a company decides this pricing strategy, you went through an example of Netflix's pricing strategy in India.

That's all you learned in this session on pricing strategy. In the next session, you will learn more about the utmost important components of a go to market strategy, the sales and marketing strategy. See you there.