

Managing Services
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Lecture - 35
Service Pricing

Hello, so we are discussing about Pricing, Services Pricing, Pricing in the Services business, we discussed briefly the fundamental concepts in the last session. And as you recall I had requested you to think about the pricing strategy for the last next 2 years for a service organization like Bhojohori Manna or Oh Calcutta or 6 Ballygunge place, there all players in the Bengali Cuisine offering Bengali Cuisine in modern ambience.

And this sort of service, which is more like a Nish service, a kind of a narrow offering or specific offering for a large variety of customers, needs to be quite sensitive with respect to pricing and competitive pressures from similar outlets as well as alternative outlets, alternative food and beverage outlets. Now, if you are not familiar with these organizations or you prefer, because you are located in a different city, you can choose any fine dining sort of restaurant and do your assignment with respect to their pricing strategy.

So, if you are in Hyderabad, you can choose a famous Briyani and Kabab outlet, if you are in Mumbai, you can choose Chinese restaurant like Mainland China or any other variety, you could choose some of those famous Mangalorean and sea food restaurants and so on. So, you look at a particular type of food and beverage outlet, which can be classified as a specialized service and then, think about their pricing strategy in competition with similar specialized outlets as well as in competition with alternative food and beverage outlets.

I am choosing food and beverage, because most of you will be using such service time to time and so you will all be familiar, so it will become more relevant; if you apply your mind to it. Today, to enable a good analysis with respect to this assignment, I am going to provide some more inputs and thoughts on pricing. As I mentioned, we are now referring to chapter number 6 of the text book and obviously, it will be a good help if you also read the chapter side by side, besides listening to the lecture.

So, service pricing, now before I get to the difficulties with respect to service pricing, I would like to remind you that whenever we think of price, we think of rupees, dollars,

Euros, Pecos and so on. But, long before the concept of money emerged, exchange of goods and services existed from prehistoric times and initially; obviously, these exchange is happened on the basis of water.

So, if somebody wanted a haircut, then he will go to the specialized service provider, the barber and in exchange of that service he would possibly give that person a chicken or may be some vegetables or so on. So, similar, barter based exchange of goods and services existed always and in some way or other, in many areas in many remote areas or even in the today in the modern economy on the e-bay and others, we have such exchanges, exchange based transactions happening, value exchange based.

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WHAT MAKES SERVICE PRICING STRATEGY DIFFERENT ?

- Harder to calculate financial costs of creating a service process or performance than a manufactured good
- Variability of inputs and outputs:
- How can firms define a "unit of service" and establish basis for pricing?
- Importance of time factor – same service may have more value to customers when delivered faster

Contextual Factors

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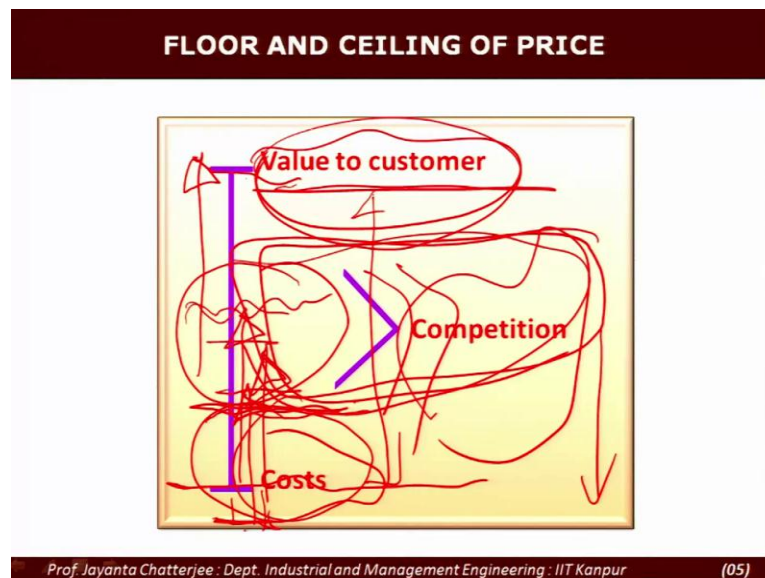
So, the key point therefore, you should not note here, that the barter system and the later on the money based system, always emerge or have emerge from the concept of value as perceived by the buyer. Which means in services, we have difficulty for example, one is very interesting is this time factor. So, if your hair has grown long and there it is high summer and you need a haircut, then your need with respect to that time and that situation is critical. So, you may be prepare to go to a higher priced saloon, if your regular barber is too busy and so on and so forth. So, which means this time and I would say expand it also to the contexts and I will explain this a little bit more toward the end of this session.

So, the time factor and the contextual factors can change the perceived value of a particular service and therefore, different sort of pricing alternatives can become

available without compromising on customer satisfaction. And this concept, we will utilize in more detail in the next session, when we discuss about revenue management and yield management to particular areas in services pricing, which are quite intricate and quite interesting.

Also, another thing that happens is that in services pricing, from the service provider side, sometimes there can be grows mistakes, because sudden activities might not have been costed properly. So, proper costing or activity based costing is very important in services as suppose to manufacture goods. Also, we have already discussed a lot about the variability of inputs and outputs due to the particular characteristics of the services and this can also change the cost and benefit calculations.

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So, if we look at therefore, this picture it becomes clearer, this is the acquisition cost for the customer. So, this can be kind of the price at which the customer is buying and this is the value as perceived by the customer. So, obviously as you can see that, if the value perceived is at a high level, then you can possibly push this point upwards, which means you can charge or you can get again a higher price level in the market place.

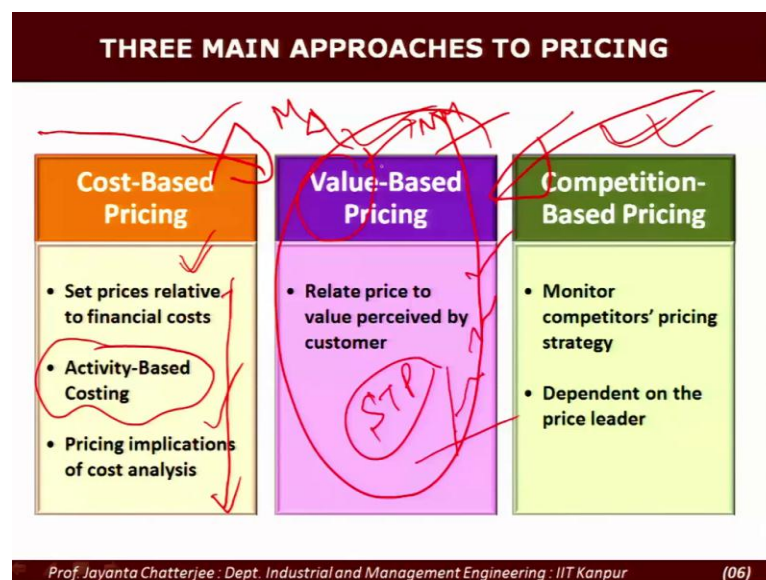
But, remember that this is a kind of a two way sword or two edged sword, because if there is a big gap between the value perceived by the customer versus the prevailing price level in the market, the acquisition cost level in the market, it attracts more and more competition, the competition goes up in this case. So, usually therefore, one has to

create a balance and strike a middle ground and see the best that can be obtained the best level of price, because your cost as a service provider will be somewhere here.

So, you would like to maximize this gap; that means, the price that your getting versus your cost and these differences are variable cost, fixed cost and the revenue and it is importance with respect to the break even, volume, etcetera, we discussed earlier. Now, why you would like to therefore enhance this difference that the price that you are getting versus your own internal costs. Remember, that this can be a futile game, if you are not constantly pushing this upwards.

That means, the delight factors of the customers, the value perceived by the customer, should be constantly pushed upwards and your cost should be constantly pushed downwards. So, that you have a good ground to play with in between.

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And as because of that, we get these three main approaches as shown here, cost based pricing; that means, set prices related to your costs and we discussed just now that in services one has to be very careful to measure all the different costs and so activity based costing is a very good way of looking at service pricing. And therefore, when you look at your costs, you should look at costs, which are on the front stage; that means, in the visible domain and costs at the backend or backstage, these concepts we have discussed earlier.

So, which means that, if you want to understand all your costs in providing a service, it is good to draw the service blue print and follow from the input to the final delivery of

service to the consumer. And you can provide low price, high price, mid range price, but without knowing your costs, many times you can make horrible mistakes. So, this is very important, particularly for a new service, you need to very clearly understand both your monetary costs and different types of non-monetary costs.

Because, the customer also calculates either explicitly or somehow implicitly, the monetary price paid by him as well as the different costs he or she might incur in a non-monetary way for example, the wait or time is actually a kind of a non-monetary price the customer pays or Husserl or in the convenience factors. These are all different types of non-monetary price and cost factors, which one will have to remember.

And since the customer evaluates that explicitly and implicitly, you as a service provider must do this very explicitly. Then, we have value based pricing; that is pricing with respect to the value perceived by the consumer for that particular service. And as you can immediately see that, why this is quite quantitative and quite deterministic, this cost aspect that this value thing has both monetary and non-monetary aspects.

And so this is determining the value as perceived by the customer is science as well as art that has been discussed earlier, because you have to understand customer psychology, customer's behavior, consumer or requirement under different circumstances, under in different situations and for different segments. So, until and unless you very well understand your STP; that means, your Segmentation Targeting and the value proposition for your targeted market.

You will not be able to understand, because depending on this, the value for one particular service may have different types of ranges, this is you know kind of a whatever may be your pricing mechanism, this is always there in front of you, the competition. That means, what the competition is offering that is always squeezing the price level.

So, in some way one can see that as if, this is your main domain of service price setting and you have one kind of pressure coming from your cost and another kind of pressure coming from your competition and between the two is the arena, where you actually try to determine. So, this arena is that is the difference between your cost customer's cost and the value to the customer is the further understood in terms of this dual pressure; that is there on pricing of services.

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COST-BASED PRICING: TRADITIONAL VS. ACTIVITY-BASED COSTING

➤ **ABC management systems**

- Link resource expenses to variety and complexity of goods/services produced
- Yields accurate cost information

BUT, customers care about value to themselves, not what service production costs the firm

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A cost based pricing as I said should be done by very well worked out activity based management system, you have to link your resource expenses to the variety and complexity of goods and services produced, services produced. But customers this is very... that is why, I have put this in bold and in bigger letters that customers care about value to themselves not what the service production costs are to the firm to your organization.

So, this is the key that the customer value, customer value to themselves, they care to know about your costs are. So, you have to manage your cost constantly downwards and you have to reserve your costs and you have to constantly manage for enhancing the perceived value in the mind of the customer. That is why; this is often not of as the positioning of your service in the mind of the customer is often used sentence.

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**VALUE-BASED PRICING:
UNDERSTANDING NET VALUE**

- **Net Value = Perceived Benefits to Customer (Gross Value) minus All Perceived Outlays (Money, Time, Mental/Physical Effort)**
- **Consumer surplus: difference between price paid and amount customer would have been willing to pay in absence of other options**
- **Competing services are then evaluated via comparison of net value**

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Now, as I was explaining the value, which is therefore, the arena ever where we want to play, where we want to focus our attention is the perceived benefits to customer. This is the gross value minus all perceived outlays in terms of money, time, mental and physical effort etcetera. So, again as you can see here that this is another way, we are using the same diagram as we saw before.

So, this is the diagram that is the cost of acquisition in the mind of the customer verses the value perceived by the customer, this is what we mean by net value. And the customer surplus is the difference between the price paid and the amount the customer would have been willing to pay otherwise. This is something interesting again, we can go back to that same diagram and you can see that, if this is the acquisition cost of the customer and the customer might have been, if this is the difference, this is the customer, what the customer would have paid otherwise.

If the customer did in buy your service would have paid this, then obviously, you enjoy a very huge surplus. In reality, what happens is that, even though the customers perceived value, the customer may be delighted in customers mind. He might have got a or she might have got a very good deal; that means, a lot of satisfaction for in his or her opinion in a very reasonable price, then that gap should have been this.

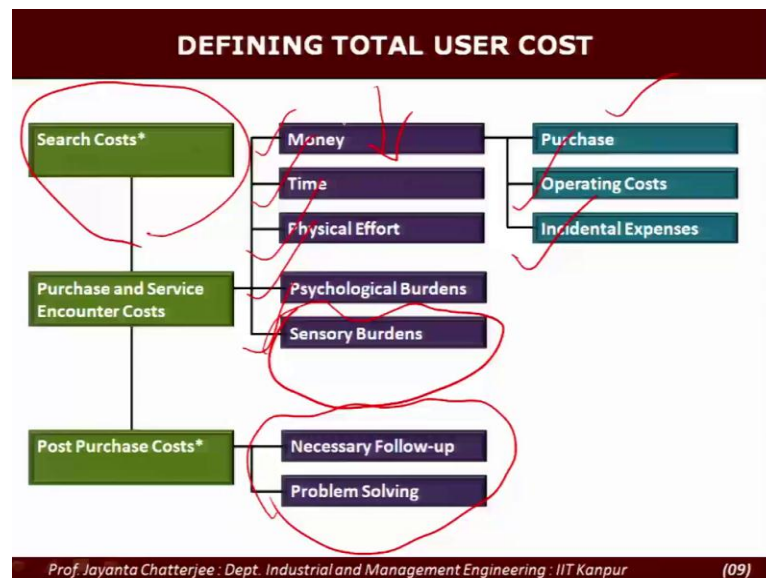
But, in reality, what the customer feels that, he might have been prepare to spend at this level, but he will not considering a good price here, I mean in his mind, the difference can actually go from this gap to actually a much smaller gap. And that whether the gap

will be small or larger will depend on what are the contextual factors. So, that this difference between the price paid and amount the customer would have been willing to pay in absence of other options this usually is somewhere here.

And in reality the customer may go up to this point and so as I said this gap, may not be achievable, but smaller gap in terms of consumer surplus perception may be possible to achieve and this is the game or this is the strategy that we have to deploy. So, customer therefore, often does not have the good idea about this level; that means, of this level; that means, what is the perceive value, really perceived value.

So, customer of an use a some kind of reference, for example, if the menu price is 100 in a restaurant and we as IIT faculty get of 10 percent discount in a nearby restaurant, then we feel you know that, you feel a higher level of satisfaction. So, the point is that, we then compare our perception with respect to that reference value, which is the menu value. Some times when this short of comparison is not available, the customer may look at the cover price of a magazine with respect to the subscription price and feel that, he is paying a lower price. All these are different types of references. In the absence of this menu price or cover price of the magazine, customer may use something like a competitor pricing ultimately.

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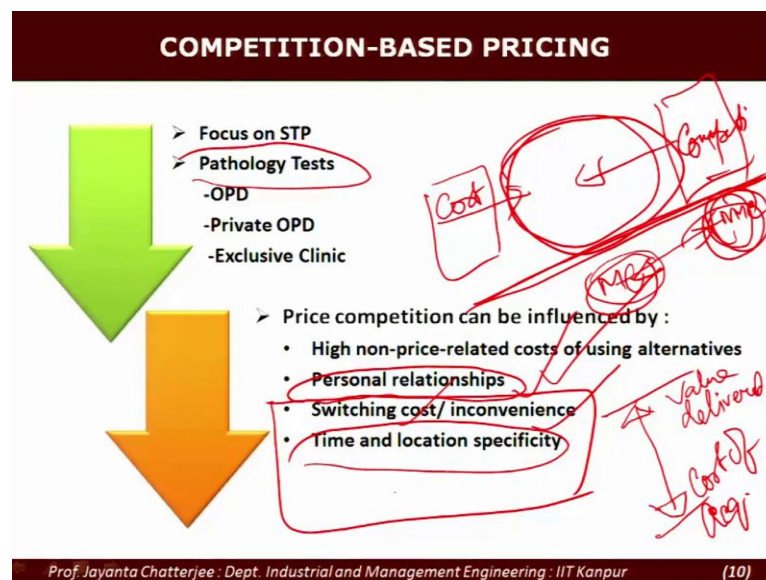
So, let us summarize by looking at all the different types of cost explicitly and implicitly own by the consumer. So, there is search cost, there is purchase and service, search research cost is that happens even before the consumer is approaching the service

provider. This is actually when the customer has felt the need and customer has spend the time or references to find that which service you assured like to use.

So, this is also the time spent on Google or the time spent on Zomato or the spent on food Panda to search out your particular service outlet is the search cost. And then, that is a purchase and service encounter cost, this is what we have been discussing and here as you see there is money; that is time, physical effort, psychological burden, sensory burden. So; that means, if you know you are in a restaurant, where there is the toilet is not very good and this is not clean, then that this particular a sensory burden can actually affect a lot, even though the money wise the customer may be paying less and so on.

And then, there are of course post purchase cost with respect to follow our problem solving, often we call this after same service and so on and within money, there is a money paid for the purchase, there are incidental expenses and there are operating costs. So, if you thing about any particular service that you have procured or any particular service that you might be offering, whether you have in a software service company or in an engineering service company or a consumer service company, you will be able to see all this elements apply between you or your organization is the service provider and the customer or the consumer.

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And lastly, this is the competition base pricing. So, as I said earlier that there is a constant pressure from the cost side and there is a constant pressure from the competition side and in between is the arena, where you are setting your pricing.

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Clinic A	Clinic B	Clinic C
<ul style="list-style-type: none">• Price Rs 450.00• Located 1 hour away by car or transit• Next available appointment is in 3 weeks• Hours: Monday–Friday, 9 A.M.–5 P.M.• Estimated wait at clinic is about 2 hours	<ul style="list-style-type: none">• Price Rs 850.00• Located 15 minutes away by car or transit• Next available appointment is in 1 week• Hours: Monday–Friday, 8 A.M.–10 P.M.• Estimated wait at clinic is about 30 to 45 minutes	<ul style="list-style-type: none">• Price Rs 1050.00• Located next to your office building (or college)• Next available appointment is in 1 day• Hours: Monday–Saturday, 8 A.M.–10 P.M.• By appointment; estimated wait at clinic is about 0 to 15 minutes

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So, if you look at page number 144 in the text book, there is a figure number 6.6 and that shows that for say for example, you want an x-ray taken and there can be three alternatives to you, Clinic A, Clinic B and Clinic C. And in Clinic A, which is just located 1 hour away by car, but it may be very famous or it may be very good and highly recommended.

But, the next possible appointment is 3 weeks later and they operate only 9 to 5 pm and the estimated wait because that clinic is very highly recommended may be 2 hours and there price is 450. Normally, you know the services which are good services provided to the lower price; obviously, there in much higher demand and such a situation only merge. Now, the next alternative Clinic B might be offering 850 rupees and it is just located 15 minutes away from your office.

And the next available appointment is 1 week later; they also operate from 8 am to 10 pm a little longer in the evening. So, it is easier to for an office goer and estimated weight avenue a write that may be 30 to 45 minutes and they may be charging 850 rupees. And there is a Clinic C, which charges the highest which is 1050 and it is just located quite close by and the next available appointment is, you have an appointment just the next day and there hours are 8 am to 10 pm.

And usually you do not have to wait more than 50 minutes there, because there only operate on the business of appointment. So, as you can see for at price of 1050, this is the more exclusive service or mote a higher price premium service, where fewer people

come and therefore, there is a better time and effort saving of waiting or for appointment or waiting, when you arrive there and it may be more conveniently located and so on.

So, there can be a combination that means some there can be a very exclusive x-ray or a pathology shop, pathology organization, which may be even at a distance, but they save time big. Then, only operate on the basis of appointment the prices are higher, but; obviously, all these cases will assume that the service level is, that x-ray level is, x-ray quality is good. So, there is no problem with respect to the quality of service.

So, quality of service being the same, normally you would prefer, so there is price of 450, 850 and 1050. So, if the services same or the quality of the final core product, which is they are x-ray image is the same, you prefer 450, but there are other non-monetary costs like time, like distance travel, like the weight when you arrive or wait before you get an appointment. For all these non-monetary costs, you might actually take the 1050 and still feel good because that is in the context of where adjacency; that is the solution which was the optimum solution.

So, as you can see here, besides this constant pressure between cost and competition, there is also a constant rate of between monetary costs and non-monetary costs. So, there is a constant rate of between these two, which happens in customer's mind, consumer's mind and the customer's value perception that thing that is what the customer considers as this value derived or value delivered to him or her versus the cost of acquisition of the service.

Now, here this is one range of conflicting pressures, which are at play and this is another duality, this a trade-off between monetary and non-monetary costs, which is also applicable. So, price competition therefore, can be influenced by high non-price related costs of using alternatives. Sometimes people may particularly in more credence based services, which we will discuss again like a management consultancy or doctor's advice or legal advice.

The personal relationships stressed faith all this also can highly influence the monetary pricing and the sense of value. So, we will there look at also besides this a non-monetary costs and time and location specificity, we will see how different a price zones and can be fenced. We are going to focus in the next lecture on revenue management or yield management, an interesting area for pricing considerations in the services business.

And there, we have to understand that, in customer's mind besides the monetary prices, besides the influence that can be there for personal relationships from the example, we

discussed of that x-ray clinic. If you go beyond there are certain times of services, where the switching cost, inconvenience and time and locations specificity can give us opportunities for different types of price setting.

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MAXIMIZING REVENUE FROM AVAILABLE CAPACITY AT A GIVEN TIME

- **Most effective in the following conditions:**
 - High fixed cost structure
 - Relatively fixed capacity
 - Perishable inventory
 - Variable and uncertain demand
 - Varying customer price sensitivity
- **Revenue management (RM) is price customization**
 - Charge different value segments different prices for same product based on price sensitivity

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This yield management or revenue management or RM as we call it in short is most effective in the following conditions. When, there is a high fixed cost structure, when there is a relatively fixed capacity. Service inventory; that means, the service opportunity of the service vocation is perishable, which is true for most services. Variable and uncertain demand, which is also true for many services, but in some services, it is truer and there is varying customer price sensitivity.

So, when a buying a soap, you are not prepared to pay higher price for that soap in the evening, because the shop is very crowded or nowhere can you actually get a lower price in the middle of the afternoon, when the shop is seldom visited by consumer. There can be some you know end blocks discounts, given on a certain particular day at super market and so on. But, normally goods do not vary with respect to time and therefore, customers are sensitive, you cannot charge the same customer one price in the morning and one price in the evening.

But, there are many other services, where actually customer may not have that price sensitivity. So, I would request you to think about such services and if you are quick, then respond in the forum living names of two or three services, which in your mind full

fill these criteria; that is high fixed cost structure, relatively fixed capacity, perishable inventory, variable non certain demand and varying customer price sensitivity.

Then, if you thing about this tomorrow when we discussed Revenue Management or RM, which uses various kinds of nice mathematical models, etcetera, but those models of discussions will become for more comprehensible, if you can actually thing in your mind today. That what are the kinds of services, which satisfy these five conditions, so that is your overnight assignment and let us continue to discuss this topic tomorrow.

Thank you.