BUSINESS MARKETING - TECHNOLOGY FOCUS

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Lecture 15: Critical Underpinning Concepts

Hello, welcome to our next session on pricing in the B2B context. I am Jayanta Chatterjee. We discussed in the previous session about the various external influences on pricing decisions in the B2B context.

Internal Pricing Influences

Key external influences on pricing strategy include:

- Costs and breakeven objectives
- Targeting and positioning strategy
- Product strategy
- Other marketing decisions

Now we are going to look into internal pricing influences in the B2B context. So the key internal influences, costs and break-even objectives. Now this break-even term I think we might have introduced in the past but we will look into it in a little bit more detail right now. And of course price is one element of the marketing mix and is closely correlated with the other elements of the marketing mix like the targeting and positioning strategy.

These are all internal considerations that guide the internal strategic considerations that will guide the pricing decisions. So, as we know STP are connected to each other, segmentation targeting and pricing and then of course, Pricing has a close correlation with the product strategy, meaning the product line, product lifecycle management and all that has very close correlation with pricing strategy.

Just like at different stages of the product lifecycle, different kind of pricing considerations will be there. And pricing can be used to guide the product along the life cycle. That means a certain way when we anticipate that the product life cycle is approaching the late majority from the early majority stage, we may have to do certain things with the pricing. So that we will also discuss at a later stage but at this stage let us mention that product strategy, product life cycle positioning also play important part in as internal driver of pricing decisions in the B2B domain.

Costs and Break-Even Objectives

- Costs typically establish the theoretical "floor" of the pricing range.
- Breakeven point: the sales level at which revenues cover costs.

Now costs and break-even analysis as I mentioned is the first important internal consideration. So costs are typically the theoretical floor for the pricing and the break-even point is actually the sale level at which revenues cover costs.

Total, Fixed, and Variable Costs

- The total cost consists of both fixed and variable cost.
- Fixed costs: Overhead expenses such as rent and payroll, which do not vary with volume.
- Variable costs: Expenses such as raw materials, which do vary with volume.

So, there are various kinds of costs we already know. There are fixed cost and variable cost. So, for example, if you have a product like this, then its material cost will be element of the variable cost because you will need material for each cup.

So, it will vary according to the output units. But the machine that produces this cup is actually a fixed cost. So there are fixed costs and there are variable costs. The fixed costs get distributed over the number of units produced. So therefore fixed cost per unit comes down as your volume builds up.

But on the other hand, the variable cost is proportional to the number of units. Each unit therefore has its own variable cost. So, overhead expenses such as rent or payroll or the machine, these are all part of the fixed cost. And variable costs are, as I mentioned, the material that goes into this cup and they will vary with the volume.

Break-Even Example

- Breakeven volume = fixed cost/price-variable cost.

- Example:
  - Given:
    - Fixed cost = 30,000
    - Variable cost = 10 per unit
    - Price = 50 per unit
  - Therefore:
    - Breakeven = 30,000/(50 - 10)
    - Breakeven = 30,000/40
    - Breakeven = 750

So, let us say let us look at a break-even example that break-even volume is you take the fixed cost and divided it with the margin per unit, that means price per unit minus the variable cost per unit. So, let us take an arithmetical example, fixed cost is 30,000, variable cost per unit is 10 and price is 50. So 50 minus 10, that means the price obtained minus the variable cost is the margin per unit.

So, if you divide 30000 the fixed cost divided by the margin per unit which is 40 then we get the break even as 750 that means that is the point where that is the volume at which we completely neutralize the fixed cost with the margin that we have obtained per unit. So, 750 into 40 is equal to 30000 and 30000 is the fixed cost.

Pricing Strategy: The Product Life Cycle

- Introduction: Decision between skim and penetration pricing.
- Growth: Pricing used to stimulate demand, drive toward breakeven point.
- Maturity: Pricing used to defend market share, retain customers, pursue profitability, and expand into additional channels.
- Decline: Pricing can be used to stimulate demand and "clear out" old products, or to "milk" existing products for profitability at end of life

And that's also in a way of saying what we said that where the price line and the cost line will merge. Revenue line and the cost line will merge. Now let's look at this thing about we were just now discussing about how pricing strategy is related to the product life cycle. Product life cycle we have discussed in great detail few sessions back. And we all know that all products go through this life cycle of birth and then early growth, then mainstream growth, then late growth, then decline and sort of exit from the product line.

Introduction stage we have to take decision between a skimming price and penetration price. We will discuss a little bit more that just a little later. Growth is the pricing growth stage that means after introduction you know you remember the product life cycle graph which goes like a bell curve. So what we call the normal distribution. So, we have the introduction stage and going into the growth stage.

So, at the growth stage to stimulate demand to gain maximum market share possible, we have to drive beyond the break-even point. guide the price which can be sort of a penetration pricing at that stage usually because at both stage our aim is market share and that is when actually often the emphasis will move from product leadership to operational excellence or the lowest cost strategy all that we discussed when we discussed product life cycle. So that time you remember we mentioned all these pricing elements and then when it comes to the maturity stage later on pricing has to on one hand defend the market

share and retain the existing customers but it also has to pursue almost harvesting approach.

That means we try to maximize our return on that whole business at that stage. We have to actually at that time often create subsidiary brands or associated brands or flanking brands and so on. And we have to also sometimes get into variants so that other channels can open up. So we are in that particular approach is important for B2C as well as B2B. So in this respect, pricing strategies often emulate each other in between B2B and B2C at the maturity stage.

And the decline stage also price can be used to stimulate demand and clear out old products stock cleared and sale as we are quite familiar with in the B2C, but it also happens in B2B where customers are often given warning that this particular product is going to become obsolescence. So, this is the time to stock up on spares or have your backup supplies available and so on. So, sometimes you also try to milk the existing products for the best return at the end of the life. So these are all pricing considerations which are related to the product life cycle concept.

Skim Pricing

Favorable conditions:

- Considerable differentiation
- Quality-sensitive customers
- Sustainable advantage
- Few competitors
- Few substitutes
- Difficult competitor entry

Now, let me talk a little bit about skim pricing which I just now mentioned. Skim pricing usually is a strategy followed at introduction stage. So, companies who are technologically superior and also have to do a lot with patenting and intellectual property

protection. They often are in a almost monopolistic situation or oligopolistic situation at the introductory stage and therefore they can charge premium pricing. So, DuPont for example has in the industrial chemical market has used this strategy for many years.

And in today's world, not exactly B2B, but in the professional product market, we can look at Apple. And we know that if Apple introduces the latest generation, say if they are in generation 15, then they will be charging premium pricing for that generation phone. iPhone but of course they will offer some superior features maybe like the Apple intelligence and various other kind of interactive facilities but at that stage at the same time they may actually reduce the some of the phones of the earlier generation which may be still in the market. So, on one hand, you push the price to the maximum level that is possible. On the other hand, you actually bring down some of the earlier products.

So, you try to create a double engine for revenue growth at that stage. So, skim pricing is very favorable as I just now discussed when there is a significant differentiation possible and protectable differentiation through either patenting other forms of intellectual property protection are available to the marketer and the customers are quality sensitive, customers are feature sensitive, customers want the new facilities whether from the new generation iPhone or from the newest chemical from DuPont. So they also sustainable advantage for some time at least, where this protection is available or the distinctiveness is available.

So, that's when you can do the skim pricing. And the skimming means that over a span of time, the price declines very slowly. So, even when demand is going up, the price is hold steady usually as the demand builds up the pricing usually will come down slightly but that here in skimming that is not the case and skimming also has to will be applied only when it is possible to make the competitors entry very difficult by way of intellectual property protection like patents or to ensure a certain kind of supply chain exclusivity which does not allow others to build comparable products.

Penetration Pricing

More appropriate when business is focused on building unit volume.

Most likely to occur at the early stages of the PLC.

Favorable conditions:

- No/Limited differentiation
- Price-sensitive customers
- No sustainable advantage
- Many competitors
- Many substitutes

And penetration pricing is just kind of the opposite of that. Penetration pricing is where when actually at the growth stage we are trying to increase the volume, maximize the volume, then our aim is to offer the optimal price so that we can maximize our market share. So, the penetration pricing is an early stage strategy just like the skimming is also an early stage strategy. At the introductory stage, if we do not have any intellectual property protection or certain kind of material supply chain protection by way of where we can retain the exclusivity, then we have to use price as a penetration tool for increasing the market share.

That is why this is called the penetration pricing. So, favorable conditions are when there is very no differentiation or limited differentiation. So, or when price companies are, customers are very price sensitive, no differentiation sustainable advantage for long. So, as opposed to the iPhone, I am going to continue to use this smartphone example because it is not exactly a B2B product but in its nature it is a professional product which explains many of the points that I am trying to illustrate. So, if you look at the Android smartphone mid-range market, so there the standard is already quite well set.

So, you can actually have some differentiation by way of a more advanced camera or you may have some differentiation by way of a little bigger screen or maybe a little bit more color schemes available on the screen. But there is not a very significant differentiation feasible in the low end or the mid range smartphone market as it is available because of

the strong loyalty from the iPhone customers that Apple has been able to create. So, that has a very strong ecosystem which goes hand in hand. So, Apple will come with the latest generation phone which will have many features that are not easy to emulate by the other smartphone manufacturers and their co-suppliers or their partners, development partners, the app developers will also come with a host of new offerings along with the new generation phone and that will make the innovators or early adopters who are dominant iPhone buyers very delighted and they will very nicely respond to the pricing strategy for the latest generation premium pricing of the iPhone. But this is not possible in case of the low end or the mid range smartphone.

So, there that is why every advertisement, every promotion will talk prominently about the pricing advantage. Sometimes, of course, this pricing may be by way of offering no cost EMI installment pricing that means and it may also offer various kinds of discounts by through trading of the old phone, trading in of the old phone or by way of co-branding or co-offers from the banks or from the credit cards and so on.

But on the whole, this is a domain of penetration pricing. So it is a similar product, but as you see in one case, skimming is the strategy of Apple. On the other hand, penetration pricing is the strategy of many of the other players in the low-end, mid-end smartphone market. Because there are many competitors, there is no distinctive differentiation that is feasible in that market.

Impact of Other Marketing Mix Variables

- Channel members, suppliers, and logistics
  - Each independent business partner has its own business objectives.
- Promotion strategy
  - Higher-priced products often promoted differently.
  - Personal selling: Customers expect to negotiate prices with salespeople.

We now move to impact of other marketing mix variables on pricing strategy. One is this place or the channel partners. So, channel members, suppliers, logistics players, the each independent business partner here in the chain as we say the delivery chain or we can look at the total value chain of the product.

Each player in that chain they have their own business objectives and that is why they are all interacting to which ultimately results in the pricing strategy of the end marketer. Similarly, promotion strategy also is closely correlated with the pricing strategy because higher priced products often will have to be promoted differently. That is why you will see that while normal watches will be sold maybe even supermarkets, but high priced exclusive Rado or Tissot or Omega watches will be available only in exclusive showrooms. So, higher priced products often are promoted differently and here some of the products as I mentioned very high priced watches.

These are consumer products but these are luxury consumer products. In its behaviour with respect to pricing, it has many B2B features. But in B2B market when it comes to a very high value CNC machine or a adaptive manufacturing, additive manufacturing system with latest technology with very high sophistication or a laser cutting machine in all these cases promotion cannot be done by just sending out some leaflets, pamphlets or by sending some emails. Personal selling, which is the highest cost, most expensive, but when applied skillfully is the most effective method of promotion and that must go hand in hand with high priced complex B2B products.

Adapting Prices

- Modifying and fine-tuning prices within an acceptable range.
- Sometimes prompted by changes in customer behavior.
- The chosen adaptation depends on the company's:
  - Resources and capabilities
  - Goals and strategic direction, and
  - Marketing plan objectives.

Prices as I mentioned right in the earlier session that in the B2B prices are normally not a fixed price. So there are always modifying and fine tuning of the price within an acceptable range required. And that is why negotiations happen. And this happens due to the customer.

Also it happens due to various other external influence, competitive moves and so on. So therefore prices in the B2B remain sort of flexible. So, it's not like the price of soap which for a particular season for a particular time will remain the same for everybody. Here each just like the product has a lot of customization potential and happens customization happens in the same way the price also is a customized price.

The chosen adaptation of the price will depend on the company's resources and capabilities. I mean, sometimes even if it is desired, you may not be able to meet the pricing demanded by the buyer because of resource constraint. So certain goals and strategic directions and marketing plan objectives as well as resources all put together will be guiding the kind of discounts you can offer or kind of terms and conditions you can accept. So, that sort of takes us to the end of this particular session and we will continue our discussion on prices as we go forward. Thank you.