PRICING FRAMEWORK

A pricing strategy framework is the method or model that businesses and organizations use to set the best prices for their products and services. An effective pricing strategy can help your organization maximize profits, boost shareholder value and meet changing customer demands. Within a pricing framework, companies consider several key factors that allow them to determine prices that appeal to customers and motivate them to purchase. In a pricing case the objective is to determine a methodology for pricing of any product. The product could be a new invention or it could be a product with existing competitors in the market.

The candidate should determine the objective of the company, understand the product features and market environment and then apply a relevant methodology to price the product.

It is imperative to consider the objective of the company, since it directly affects the pricing strategy to be followed. One should then attempt to understand the product characteristics and the market environment to apply a prudent pricing methodology. For example, in case the pricing needs to be done for an old product (rare scenario), the utility of the product w.r.t a new product and the depreciation/salvage value need to be taken into consideration

STEPS INVOLVING IN SOLVING A PRICING CASE

1. Reiterate the problem statement

Once the problem statement is given, make it a point to paraphrase and reiterate it in a comprehensive manner for the interviewer to know if you understood the problem correctly. If there would be any discrepancy, the interviewer would let you know then and there itself.

Note: Identify in the first step if the case is a bidding, auction or straight-forward pricing problem.

2. Ask preliminary questions

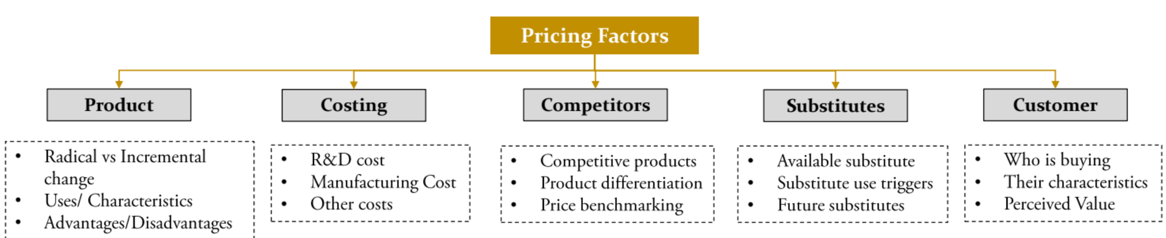
These are initial/clarifying questions that help you understand the case/client better in order to proceed. Some of the preliminary questions in the pricing case that can be asked are:

- What is the objective of the company? (Most important in order to devise a pricing strategy)
- Which industry are we talking about?
- What are the product features? Is it a single product or a product line?
- Is the product a luxury or a necessity?
- Who are the competitors and what prices are they offering?
- Who is the customer in the supply chain?
- Is the product patented? Is it easy to imitate (or are substitutes of this product available)?
- How is the product different from what the competitors are offering?
- Does the firm want to push the competitor out? Does the firm want to play price war?
- What is the expected margin and payback period?

3. Analyze the relevant factors affecting the price of a given product

In this step we analyze the various factors that need to be taken into account while determining the price of a product. This step is extremely crucial since these factors will help you understand which pricing option/strategy the given client must opt for. Some of the relevant pricing factors are:

- Product
- Costing
- Competitors
- Substitutes
- Customer



Source: The Consulting Club, FMS

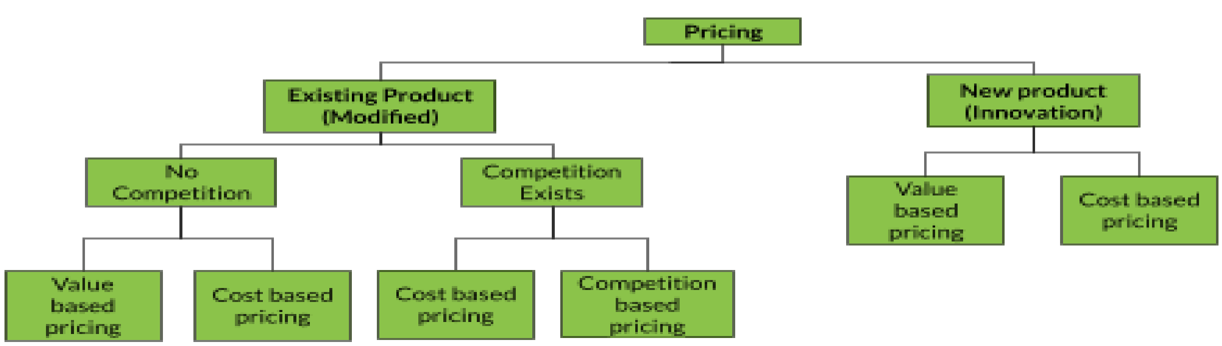
The elasticity of a product is what ultimately drives price is the customer's perceived "value" of the product. For example, if a company produces shirts with a unit cost of $10, but the market perceives the product as fashionable or has the right brand name, the shirt can then be priced to capture any consumer surplus at $50 or even $80 per shirt. The same manufacturer introduces another shirt at the same cost the following season. This time, however, the shirt is no longer considered in vogue and thus has little "value." This time, the shirt would be priced at $25.

It further reflects market competition or substitutes and whether a product is a luxury or necessity. Calculating this can actually help understand the factors affecting the price of a product better.

Formula: $Price\ Elasticity\ of\ Demand\ = \frac{\%\ Change\ in\ Quantity\ Demanded}{\%\ Change\ in\ Price}$

Elasticity (Absolute terms)	Meaning
<1	Inelastic (low elasticity): Even with a relatively high % change in price, the relative change in quantity demanded is small.
= 1	Unitary Elastic: It means that the percentage change in demand is exactly equal to the percentage change in price
>1	Highly Elastic: A relatively small change in price leads to huge change in the quantity demanded.

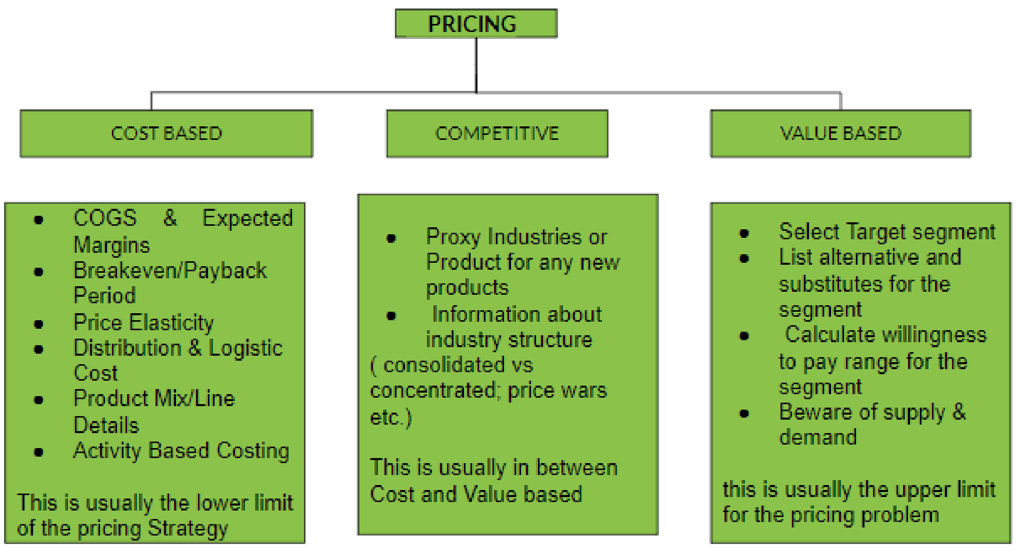
Another important thing to consider is if the product is an existing product or a new invention. Some factors will vary in such a case. For Example: If it is a case of an existing product – then there will be two cases of competition; one where it exists and one where it doesn't. Thus, the presence of competition will affect the factors taken into further analysis.



4. Pricing strategies/options

Keeping in mind the objectives of the client company and factors affecting price, start getting into the depth of the pricing options:

- Cost based
- Competitive
- Value/Price based



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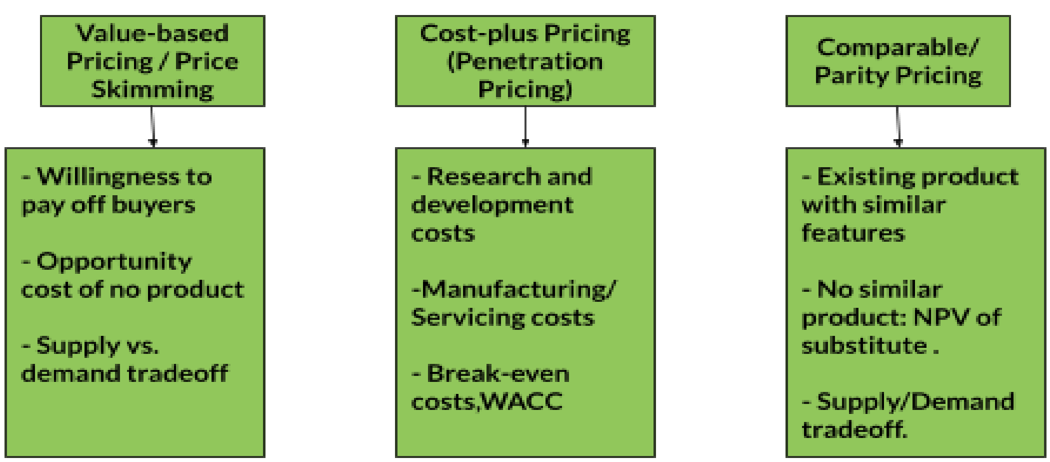

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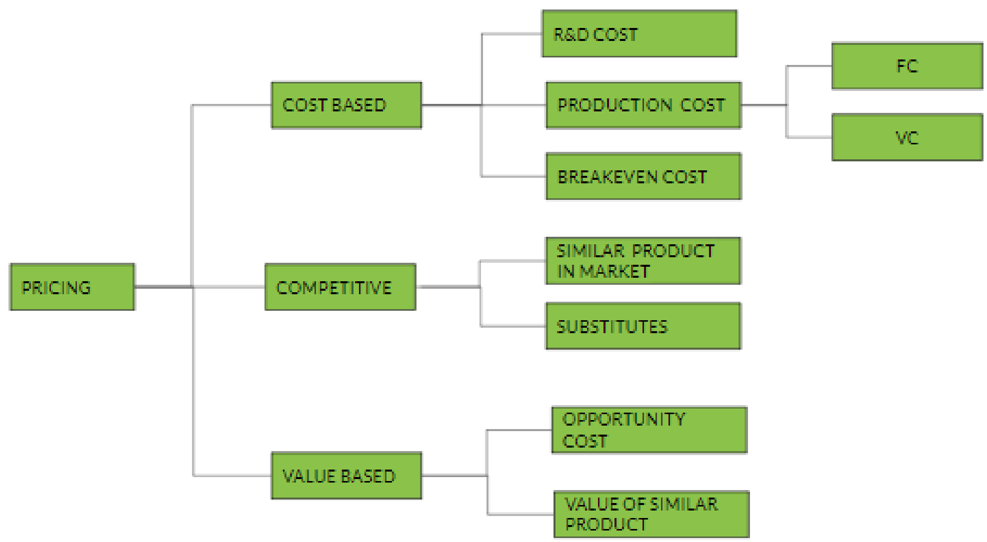


Other than the three most commonly used pricing strategies, some common strategies that businesses and organizations often use to price their products and services are:

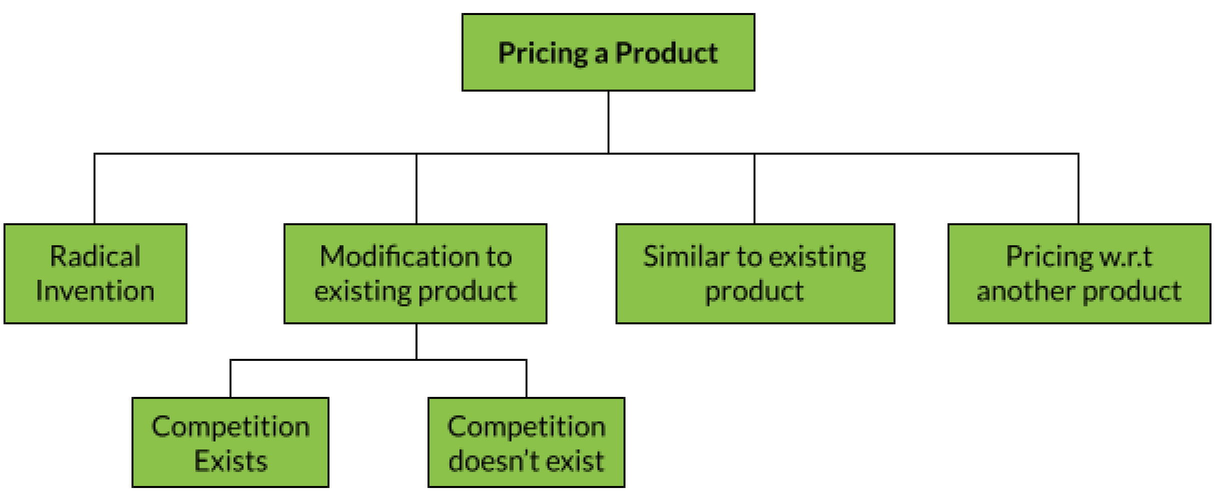
- **Economy pricing:** An economy pricing framework focuses on low prices and low manufacturing and distribution costs.
- **Premium pricing:** Companies that produce and distribute luxury items often use premium pricing frameworks with high prices for the perceived value.
- **Price skimming:** A price skimming framework can allow a company to enter the market with high product prices and reduce these prices over time as competitors follow the company.
- **Penetration pricing:** Businesses that implement a penetration pricing strategy set low prices to enter—or penetrate—new markets. Over time, businesses often raise prices to reflect quality and value.
- **Version-based pricing:** In a version-based or versioning pricing framework, companies offer various tiers or levels of products and services, each with differing prices.
- **Competitive pricing:** Competitive pricing is a common strategy in service sectors, where a business sets prices that are equal to competitive prices and ensures its service quality beats competitor businesses.

- **Psychological pricing:** Psychological pricing strategies motivate customers to take action, such as pricing items just under what customers perceive as too high.
- **Value pricing:** Businesses that implement value-based pricing understand the value customers are looking for and what they're willing to pay and produce goods and services that meet customers' standards of value.
- **Sandwich pricing:** Sandwich pricing sets low, medium and high prices for a similar item to motivate customers to purchase the item that's in the middle price range.
- **Promotional pricing:** Promotional pricing employs one time discounts, sales over time and limited-time offers to encourage customers to make purchases.

Note: Recognize border or limiting constraints such as policies and other regulations

Once the lower and upper ends of the pricing are calculated - offer a rational explanation reasoning to the price range you would choose. These could include customer switching costs, fluctuations in WTP etc.

In a nutshell, in a pricing case the objective is to determine a methodology for pricing of any product. The product could be a new invention, it could have other competitor products in the market etc. The student should determine the objective of the company, understand the product features and market environment and then apply a relevant methodology to price the product.
This basic framework can be kept in kind:



5. Making a recommendation

Arrive at a fair price range for the product to maximize the revenue of the company, while giving appropriate reasons for your choice. Make it a point to always give a price range because arriving at a correct price is not feasible.

TIPS

- A supply vs. demand tradeoff approximation is always helpful in such key questions, considering graphical representations.
- Many pricing problems are masked 'market size' estimation problems. When the conversation goes in that direction, ensure you specify that you'd calculate the market size before pricing the product.
- There's no single price – always offer a price range.
- Mentioning the sensitivity metrics in calculations would fetch additional brownie points.
- Think about competitive reaction in the market.
- Topics like bundling and other innovative prices (discount scheme etc.) will fetch brownie points.
- Many Pricing cases also turn out to be masked 'market demand estimation' cases.