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# CONTENTS

# PREFACE

## 1. WELCOME

Dear Learner

We have great pleasure in welcoming you to this module on Product and Pricing Management (MNM3036). We would like you to share our enthusiasm for this field of study, and as a first step we urge you to read this preface in detail. Refer to it as often as you need to, since it will definitely make studying this module a lot easier.

The field of product management and pricing management is extremely dynamic and challenging. The study material and activities contained in this study guide will therefore provide you with opportunities to explore the latest developments in this field and help you to discover this field of Marketing Management as it is practised today. We hope that you will enjoy the subject.

## 2. AIM OF THIS MODULE

The aim of this subject is to enable learners to gain a better understanding of the focus areas of product and pricing management. With this in view, we aim to identify the key aspects relating to each of these two topics and then provide the student with the tools to develop appropriate strategies that will take advantage of opportunities and strengths and overcome weaknesses and threats faced by the modern business.

## 3. LEARNING OUTCOMES

After completing this module, you should be able to

- describe the nature of a product and the various product classification systems that the marketer needs to be aware of
- make decisions regarding a single product and multiple products in order to develop a competitive product offering for all stages of a product's life span
- apply the principles of branding to a given product to ensure the development of a loyal customer base and a strong brand equity
- explain the importance of pricing in the context of the marketing mix
- develop pricing objectives for a given product or product mix for an identified company
- select an estimated price level for a given product or range of products using the various methods available for price setting

## 4. OVERVIEW OF THIS MODULE

As can be seen by the name of this module, our focus in this study guide is on product and pricing management. Product decisions determine the roles played by the other elements of the marketing mix and thus deserve a significant amount of attention from the marketer. Pricing decisions have a major influence on whether a consumer buys a product or not. The pricing of a product also goes a long way to determining the profitability of a company's product offerings.

Topic 1 simply gives a brief introduction to the module and shows the role that product decisions and pricing decisions play in the development of an effective marketing strategy.

Topic 2 has its focus on product management. In this topic, we will focus on identifying the nature of a product and the various ways in which products can be classified. The focus then moves to the various decisions that are made regarding a single product and multiple products (i.e. a product line or product mix). The concept of the product lifecycle is also given some attention with a key area being the strategies that are used over the different phases of the life cycle. The new product development process is explained and is followed by a brief discussion of the consumer adoption process. We round off this topic by introducing you to the concepts of branding and brand equity. These topics are enjoying increasing attention in the marketing environment and need to receive your fullest attention.

Topic 3 deals with the topic of pricing decisions. The study unit starts with a look at the nature and role of price in the business, as well as the role of price in the marketing mix. The role of demand and supply in price determination is also addressed. After this, a significant amount of attention is given to the identification of price objectives. Study unit 11 addresses the various methods for the selection of an estimated price level. This is an important chapter in the context of this module. The last issue addressed in this topic is that of tactical pricing decisions. This refers to decisions made over the short term in response to day-to-day events as they arise in the course of business.

The content of this study guide is by no means comprehensive, however, and you, as a student of product and pricing management, will need to read through and study the relevant sections in the prescribed book

The framework of this module on product and pricing management is given on the page after point 11 of this preface.

## 5. THE STUDY PACK

The study material for this module consists of this study guide, a prescribed book and several tutorial letters. The tutorial letters and study guide will be sent to you during the course of the year. The prescribed book is of vital importance because you will not be able to complete this module successfully without using it. In addition to the prescribed book, you are encouraged to consult other sources such as those available in the Unisa library.

Please consult Tutorial Letter 101 for the details of your prescribed book.

# 6. THE APPROACH TO LEARNING AND TEACHING IN THIS MODULE

The purpose of this study guide is to afford you the opportunity to put into practice those theoretical concepts introduced in the prescribed book, and at the same time to give you some exercises and questions that will assist you to prepare for the examinations. It is essential that you work through the study guide because, by doing so, you will improve your chances of performing well in the examinations. However, there is no substitute for being thoroughly familiar with the theory as discussed in the prescribed book. Your prescribed book and study guide complement one another in that the study guide assists in the learning process, but studying it alone and ignoring the prescribed book will not equip you for success in the examinations.

## 6.1 Suggestions on how to approach your studies in this module

Tutorial Letter 101 and the study guide will direct you in your approach to the learning and other resources and advise you on possible ways of using these to your benefit, for example making the best use of SMSs, peer collaboration groups, learning centres and career counselling. As a distance education student, you need to know whom to contact for academic and administrative matters, and know how to manage your time.

In the study guide, we make a definite distinction between the parts of the prescribed book that you simply have to read, and those parts that you have to study.

### 6.1.1 Studying

The sections that have to be studied are clearly indicated and form the basis of assignments and examinations. To be able to do the activities and assignments for this module, to achieve the learning outcomes and to be successful in the examination, you will need a thorough understanding of the content of these sections in the study guide and the prescribed book. In order to understand the study material properly, you need to accept responsibility for your own studies and to realise that learning is far more than just memorising. You will be expected to show that you understand and are able to apply the information, not just remember it.

### 6.1.2 Reading

Some parts of the study guide will tell you to read a certain section in the prescribed book or the study guide. This means that you should take note of the content of this section, as it usually provides useful background information or offers another perspective or further examples. It will give you some context, improve your ability to take notes and enhance your understanding.

You will need to spend at least 120 hours on this module. This includes approximately 40 hours of reading and studying of the study material, 40 hours of activities and assignments and 40 hours of preparation for the examination. We encourage you to follow the proposed schedule for the allocation of time for the various topics, study units and other activities as supplied in Tutorial Letter 101.

You may wish to read more widely than just the study guide and the prescribed book. When you read information in the prescribed book or in other sources, do not simply accept it without question. Critically evaluate the ideas and information that you come across.

Test your understanding of the ideas that you encounter in this module by doing your best to apply them to real-life situations.

## 6.2 Importance of completing activities, assignments and self-assessment questions

### 6.2.1 Activities

You will come across various types of activities in this study guide. They will require you to:

- reflect on work covered
- complete assessment questions
- do self-assessment

We consider your completion of the activities in the study guide and the assignments crucial to your successful completion of this module. Firstly, the activities in the study guide will help reinforce your learning and secondly, they will give you an idea of the type of application question that will be asked in the examination.

### 6.2.2 Assignments

You will find the assignments for this module in Tutorial Letter 101. The completion of assignments is crucial to helping you achieve the learning outcomes. By completing the assignments, you will get a feel for the type of question you can expect in the examination and obtain first-hand feedback from the lecturer. The assignment questions also give you the opportunity to apply the theory to a case study or a practical situation related to your own workplace. We will inform you of the purpose of each assignment and which module outcomes will be assessed by the assignment. We will also supply the criteria for assessment so that you understand how to approach the answering of specific questions.

Details of the assignments with their associated assessment criteria and the format and requirements of the examination are provided in Tutorial Letter 101.

### 6.2.3 Assessment questions

At the end of each section, you will find a list of possible assessment questions based on the work covered in that section. We advise you to work through these questions diligently, since they provide extremely useful opportunities to prepare yourself for possible examination questions. Self-assessment plays a very important role in the mastery of learning outcomes and you should therefore complete the self-assessment activities in the study guide.

You will find most of the answers to these questions in the study material in the study guide and prescribed book. We believe that you should not be faced with any surprises when you come to write the examination. Consequently, it is in your own interests to work through these assessment questions.

To do well in essay questions, you need to structure your answers logically. Also, you should use appropriate headings and subheadings and include a bibliography at the end. You will find guidelines for the technical presentation of assignments in Tutorial Letter 301 MNALLEQ.

### 6.2.4 Assessment of the module

During the semester you will be assessed on your assignments and, in the examination at the end of the semester, you will be assessed against transparent assessment criteria that link directly to the outcomes of the module.

The compulsory assignment mark(s) will count, with your final assessment, towards your total mark. Further details of the assessment and examination requirements of this module are supplied in Tutorial Letter 101.

# 7. EXAMINATIONS

## 7.1 Prescribed material

All the study material is relevant to the examinations. In addition to understanding the theoretical principles provided, we expect you to be able to apply these principles to a practical situation in a given case study or scenario.

## 7.2 Format of the examination paper

The duration of the examination is two hours. The paper comprises several short questions or multiple-choice questions worth 20 marks and longer essay-type questions worth 50 marks. The essay questions may be based on a short case study or scenario.

## 7.3 Presentation and allocation of time

Please prepare thoroughly for the examinations. When you are answering examination questions, always write neatly, use point form where possible, leave a blank line between paragraphs and underline keywords if you have time. Start each question on a new page (but write on both sides of the page). This will make your answers more readable and ensure that the lecturer does not overlook anything. Make it easy for the examiner to read and understand your work. Remember, what we cannot read, we cannot mark properly! When answering essay questions, you should always include a brief introduction and conclusion, state your theory well and neatly and provide good practical examples if you are asked to do so. Keep your answers concise and to the point – you will not earn more marks simply for writing a lengthy answer. The number of marks allocated to a question will give you a good indication of how much to write.

The time limitation means that you need to plan your time carefully. Do not waste time on long introductions and summaries, and do not include a bibliography in an answer to an examination question.

Practical application entails more than just mentioning the name of a particular company – you must apply the theoretical principles to the operations of the business in the given case study or scenario.

On the cover page of the examination answer book, please write the numbers of the questions you answered, in the order in which you answered them.

## 8. KEY CONCEPTS IN ASSIGNMENTS AND EXAMINATIONS

When we, your lecturers, formulate assignment and examination questions, we word them in specific ways so that you will know exactly what is expected of you. For example, we may ask you to list, describe, illustrate or demonstrate something, compare two things, or to construct, relate, criticise, recommend or design something.

Below is an explanation of the various levels of cognitive thinking that you will be expected to apply, and the kinds of instructions that we will give you with regard to each. This system is known as Bloom's taxonomy.

- **Knowledge**. This is essentially memorisation and the recall of information. At its simplest, it involves the recall of facts or terminology, such as names, dates and definitions. It can also involve the recall of principles and generalisations, or ways of doing things. Outcomes/instructions written at this level will typically use verbs (these are the words that tell you what you have to do) such as *name, list, define, label, select, state, write, describe, identify and recall*.

- **Comprehension**. This involves making sense of things, rather than just remembering them. Comprehension usually requires you to translate information into your own words. Outcomes/instructions written at this level will typically use verbs such as *convert, illustrate, distinguish, interpret, rewrite, discuss, give examples and summarise*.

- **Application**. This is the ability to use information and ideas in new situations, such as in solving problems that have a single or best answer. Outcomes/instructions written at this level will typically use verbs such as *calculate, demonstrate, construct, compute, solve, relate, show, use and apply*.

- **Analysis**. This is the ability to examine information in a systematic manner to identify the important ideas, the relative hierarchy of those ideas and the relations between the ideas. Outcomes/instructions written at this level will typically use verbs such as *analyse, differentiate, categorise, classify, relate, illustrate, outline, compare, contrast, discriminate, explain and hypothesise*.
- **Synthesis**. This is the ability to construct something new by combining several pieces of information to make a coherent whole (such as a plan). Outcomes/instructions written at this level will typically use verbs such as *plan, adapt, combine, create, compile, compose, construct, model, revise, design, develop, formulate and organise*.
- **Evaluation**. This is the ability to make judgements about the quality or value of things (with reference to either internal evidence or external criteria). Outcomes/instructions written at this level will typically use verbs such as assess, *judge, choose, criticise, rate, argue, justify, evaluate, decide, recommend and conclude*.

In this module, you will be asked to operate on all levels of Bloom's taxonomy. Please make sure that you know what is expected of you in each question.

## 9. USE OF ICONS

The icons that will be used in this study guide are listed below, together with an explanation of what each means?

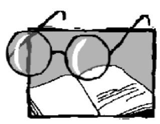
### KEY CONCEPTS

This icon draws your **attention** to certain keywords or concepts in the topic of study unit.

### LEARNING OUTCOMES

This icon indicates which aspects of the particular topic or study unit you have to master. You will need to demonstrate that you have mastered these aspects.

### STUDY



This icon indicates which sections of the prescribed textbook or the study guide you need to study and internalise.

### READ

This icon will direct you to read certain sections of the prescribed textbook for background information.

### ACTIVITY

This icon refers to activities that you must complete in order to develop a deeper understanding of the study material.

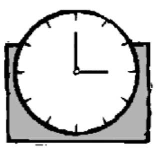
### ASSESSMENT

When you see the Assessment icon you will be required to test your knowledge, understanding and application of the material you have just studied.

### FEEDBACK

This icon indicates that you will receive feedback on your answers to the self-assessment activities.

### TIME-OUT



This icon indicates that you should take a rest because you have reached the end of a study unit or topic.

## 10. IMPORTANT ADVICE

The likelihood of your success will be improved if you consider the following hints:

- Study the prescribed study material conscientiously according to the guidelines provided.
- Discuss the subject matter with colleagues and specialists.
- Do the activities.

- Prepare in good time for the submission of compulsory assignments and also do non-compulsory assignments.
- Apply your knowledge in practice.
- Prepare properly for the examinations

## 11. WHAT YOU CAN EXPECT FROM UNISA

You can expect us to do the following:

- Provide you with up-to-date and relevant study material that is regularly compared with and benchmarked against similar local and international programmes.
- Keep the study material in line with the needs of industry and commerce by consulting regularly with the profession, and with industry leaders and government officials.
- Support you whenever you require assistance. You may contact your lecturers by making an appointment to see them in person, by telephone, via email or via the internet. We understand that studying by means of distance learning is more challenging than attending a residential university.
- Provide you with clear indications of what we expect from you in terms of your assessment.
- Provide prompt feedback on assignments. We will return your assignment and our feedback within three weeks of the due date if you submitted the assignment before the due date.

We hope you will enjoy your studies! We are certainly looking forward to being your partners in this endeavour.

Best wishes,

Your lecturers in Product and Pricing Management.

# FRAMEWORK OF THE MODULE

| | |
|---|---|
| | **TOPIC 1: INTRODUCTION TO THE MODULE** |
| Study unit 1: | Introduction to the module |
| | **TOPIC 2: PRODUCT MANAGEMENT** |
| Study unit 2: | The nature of a product |
| Study unit 3: | Product classification |
| Study unit 4: | Single product decisions |
| Study unit 5: | Multiple product decisions |
| Study unit 6: | Product life cycle |
| Study unit 7: | New product development |
| Study unit 8: | Introduction to brand management |
| | **TOPIC 3: PRICING DECISIONS** |
| Study unit 9: | The importance of pricing |
| Study unit 10: | Cost constraints and price objectives |
| Study unit 11: | The selection of an estimated price level |
| Study unit 12: | Tactical pricing decisions |

# TOPIC 1

## INTRODUCTION TO THE MODULE

# TOPIC 1

## INTRODUCTION TO THE MODULE

### AIM

The aim of this brief topic is to orientate you to the content of this module to ensure that you understand the nature of the topics being presented.

### LEARNING OUTCOME

After studying this topic, you should be able to:

- understand the composition of this module and be aware of how product and pricing decisions fit into the development of the marketing mix

Topic contents:

Study unit 1: Introduction to the module

# STUDY UNIT 1

## INTRODUCTION TO THE MODULE

**CONTENTS** **PAGE**

## OVERVIEW

As you know by now, the marketing mix consists of four elements: the product itself, the place where it is to be sold (distribution of the product), the marketing communication methods to be used to inform the consumer, and the price of the product which should reflect its value to the consumer. This module focuses on two of these variables, namely product and price. Each of these elements needs to be developed in conjunction with the others in order to present a harmonised marketing strategy that will give the organisation a competitive advantage in the marketplace.

Product decisions determine the roles played by the other elements of the marketing mix and thus deserve a significant amount of attention from the marketer. Pricing decisions have a major influence on whether a consumer buys a product or not. The pricing of a product also goes a long way to determining the profitability of a company's product offerings. These and many more issues will receive attention in this study guide.

## 1.1 PRODUCT MANAGEMENT

The product offering of an organisation is the key variable of the marketing strategy in the sense that all the other marketing decisions concerning methods of distribution, marketing communication and prices are based on and coordinated with the product decisions.

A product entails more than just its physical characteristics. As a consumer, you will probably agree that even products satisfying the same basic need vary in the extent to which the can satisfy your needs, depending on their value-added components. An example here is a motorcar (Mercedes Benz for example). A car is not only used for transport, but can provide extra value like brand name and status. A car can be bought to enhance one's self-image, for basic transportation needs, for acceptance in the group and for many more reasons. Cosmetics are not bought for their content only. The consumer buys beauty, acceptance, self-confidence and youth. A handyman is not only interested in the components of a drill; he actually buys the holes, the convenience, the quality and the new capabilities of the drill.

Product decisions are not simple decisions. There are many variables that need to take into account, and many decisions that have to be made to ensure that the product is accepted in the market. These decisions concern the variety of products to be offered, as well as the number of product lines and composition of those product lines. At a seemingly more basic level, product attributes are to be decided on, packaging and labelling needs to be developed, and in most cases, supporting services must be provided. The point to be understood is that product decisions are extremely important and entail the consideration of many different aspects. The marketer must not only be aware of these aspects, but also be able to develop a product strategy that satisfies the needs of the identified target market.

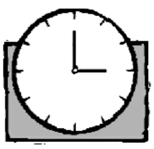
## 1.2 PRICING MANAGEMENT

The second topic to be addressed in this study guide is pricing management. Price acts as the major influence on buyer choice. Non-price factors like product features, brand name and so on also became important in buyer choice behaviour. Therefore, one could say that price plays two major roles in marketing in that it influences firstly how much of a product consumers purchase and secondly whether selling the product will be profitable.

A marketing manager needs to consider all of the elements of the marketing mix to make the best pricing decision for the organisation because the quality of the product, the type of distribution channel used, the end consumers served and the function played by intermediaries all help to establish a price range for an organisation's products or services. An important aspect to note is the relationship between the price and the product strategy, the distribution strategy and the promotional strategy, as well as the use of price when positioning an organisation or specific product or service.

Traditionally, in setting prices of products, the focus has been basing pricing decisions on costs. Simply by using a bit of logic we can see why this is the case – after all profits can only be made if costs are covered. However, customer value is much more important. Throughout your studies in marketing, you will see that the concept of customer satisfaction is emphasised. The marketing concept clearly identifies customer orientation as one of the cornerstones of any marketing effort. This being the case, it is extremely important to ensure that the product is delivering satisfactory value to the customer in terms of the price being paid.

As you will see throughout the discussions on this topic, prices can be easily manipulated and adjusted to match the needs and perceptions of the various target markets. Consumers are fickle, and it is therefore important to understand issues of consumer behaviour in order to make the most appropriate pricing decisions.



# TOPIC 2

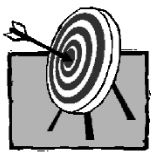
## PRODUCT MANAGEMENT

# TOPIC 2

## PRODUCT MANAGEMENT

### AIM

The main aim of this topic is to introduce you to the topic of product management and the elements that make up the product component, which need to be considered when developing product strategy for a given organisation. The secondary aim of this topic is to develop an understanding of the key issue of branding and its crucial role in product strategy development to achieve a sustainable competitive advantage for an organisation.



### LEARNING OUTCOMES

After studying this topic, you should be able to:

- describe what a product is in terms of the different layers of a product, that can be identified
- classify products according to the various product classification criteria
- discuss the various single product decision issues that need to be considered by the product manager when developing product strategy
- explain the multi-product decisions that need to be made by the product manager when making decisions concerning the product mix and product lines
- discuss the various phases of the product life cycle and the different strategies that should be followed in each phase
- explain the steps in the new product development process that should be followed when considering the introduction of new products to the market place
- describe the different branding decisions that need to be made by the product manager and highlight the importance of the concept of brand equity

## TOPIC CONTENTS

# STUDY UNIT 2

## THE NATURE OF A PRODUCT

**CONTENTS** **PAGE**

## KEY CONCEPTS

You will need to master the following key concepts in order to meet the learning outcomes for this topic:

- Product
- Core product
- Tangible product
- Augmented product
- Potential product
- Product image

## OVERVIEW

A product consists of more than just its physical characteristics. As a consumer, you will probably agree that even products satisfying the same basic need vary in the extent to which the can satisfy your needs, depending on their value-added components. An example here is a motorcar (BMW for example). A car can be used not only for transport, but also for providing extra value like brand name and status. A car can be bought to enhance one's self-image, for moving from one point to another, for acceptance in the group and for many more reasons

Our focus in this study unit is on identifying what a product is and the different levels of the product concept.

## 2.1 THE MEANING OF A PRODUCT?

(Study pages 192–193 in the prescribed book.)

A product can be anything that is offered to the targeted market to satisfy a need or desire. A product may be a tangible good (such as packet of Royco instant soup), a service like a haircut, an idea like "Don't litter", or any combination of these three. From a marketing point of view, the key element of the definition is to satisfy consumer or business needs. From the consumer's point of view, the key element of the definition is the satisfaction of their needs and wants.

### ACTIVITY 2.1

What can you conclude from the definition of a product?

## FEEDBACK

From the above definitions of a product the following conclusions can be drawn:

It is necessary to view the product from a market perspective rather than from a personal viewpoint. When consumers purchase a product, they are really buying the benefits and satisfaction they perceive or expect the product to provide.

## 2.2 LAYERS OF THE PRODUCT CONCEPT

(Study pages 193–198 in the prescribed book.)

When you study this topic in your prescribed book, you will see that the concept “total product” refers to the spectrum of tangible and intangible benefits that a buyer might gain from a product once it has been purchased. You should note that the product consists of five levels/layers, each of which adds value to the customer. Let us look at these five layers of the product concept.



- **Core product**. This is the most fundamental level and represents the fundamental service or benefit that the customer buys. The purchaser of a motorcar buys a mode of transport and the hotel guest pays for rest and sleep.
- **Tangible product**. The core product is now turned into the tangible product, the motorcar and hotel room. The hotel room has a bed, bathroom, dresser and closet.
- **Augmented product**. Attributes (features) that exceed customer expectations. The car could have electric windows, air conditioning and a CD player. This includes warranties and guarantees.
- **Potential product**. The product is defined in terms of its possible evolution, for example, a new way of distinguishing itself from its competitors. An example is British Airways introducing first class seats that can be converted into beds. M-Net, for example, has already developed a variety of interactive service that it will introduce to its subscribers in the future. Gillette is busy developing a new generation blade whilst Apple announced its revolutionary new generation PCs with “floating flat screens”

## ASSESSMENT

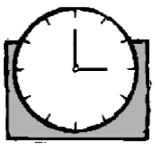
1. Describe the tangible and intangible benefits offered by a personal computer and a tube of toothpaste.
2. Explain what is meant by the concept “total product”.

3. Use the five product levels to describe the total product offered by City Lodge Hotels and Nike running shoes.

## SUMMARY

In this study unit, we introduced you to the concept of a product and the make-up of the total product. When planning the marketing offering, marketers need to consider that a product consists of five levels, each of which adds more value to the customer.

In the next study unit we will look at the topic of product classification which identifies a number of categories according to which products are classified to assist the marketer in making product decisions that are focused on customer needs.



# STUDY UNIT 3

## PRODUCT CLASSIFICATION

**CONTENTS** **PAGE**

## KEY CONCEPTS

You will need to master the following key concepts in order to meet the learning outcomes for this topic:

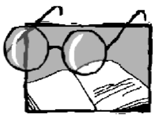
- Convenience products
- Durable products
- Goods
- Non-durable products
- Service products
- Shopping products
- Speciality products
- Industrial products
- Production goods

## OVERVIEW

All products fit into one of two general groups, namely consumer products and industrial products. Consumer products are products meant for the final customer, for example, furniture, groceries, soft drinks and clothing while industrial products are products meant for use in producing other products.

In this study unit we will discuss three key schemes that can be used to classify products. These are classification according to tangible physical characteristics, consumer products based on consumer behaviour and industrial products.

## 3.1 TANGIBLE PHYSICAL CHARACTERISTICS



(Study pages 199–201 in the prescribed book.)

All products can be classified according to either their tangibility (that is whether they are goods or services), or their durability (whether they are durable or nondurable).

- **Durable products**. Durable goods are tangible products that can be used over and over again, that is, can survive a number of uses over time. For example, a pair of shoes can be worn over and over again, satisfying your need to protect your feet or to look attractive. Further examples of durable goods include motorcars, tools, refrigerators and clothing.
- **Nondurable products**. Nondurable products are products that are consumed in one or a few uses. The satisfaction that one gains from nondurable goods is essentially short term. For example, if you were thirsty and bought a cold drink and drank it, you would experience satisfaction from that cold drink only once. If you were thirsty again, you would have to purchase another cold drink to satisfy your thirst. Further examples of

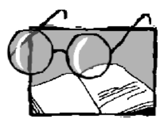
nondurable goods include soap, beverages, beer, shampoo, deodorants and cosmetics.

- **Services**. A service can be defined as any act or performance that one party can offer to another that is essentially intangible and does not result in the ownership of anything. The production of a service may or may not be tied to a physical product. In the case of services you will notice that they are intangible, variable, perishable and inseparable. Due to their nature, services require more quality control, adaptability and supplier credibility. Other examples of services include repairs, transport, banking, legal advice and haircuts.

When you study your prescribed book you will notice that there are four major characteristics that distinguish the marketing of services from the marketing of goods. These are:

- **Intangibility**. A service cannot be seen, held, touched, smelled or felt before it is purchased. To reduce uncertainty and increase confidence in the service, buyers look for signs or evidence of the service quality. Santam, for example, uses an umbrella to symbolise the protection that they provide to the clients and their assets.
- **Perishability**. Services cannot be stored. If capacity is not used, it cannot be saved for future consumption. Empty seats on a plane, empty rooms in a hotel, unused telephone time represent lost business.
- **Variability**. Services vary in quality due to the fact that standardisation of service is difficult. An airline, for example, finds it challenging to offer the same quality of service on each trip, to have all flights on time, and so on, because many factors intervene which can affect the quality of the service.
- **Inseparability**. Services are normally produced and consumed simultaneously. The interaction of buyer and seller in the delivery and consumption of the service is a special feature of services marketing. Doctors, for example, require the presence of the patient for the service to be performed.

## 3.2 CONSUMER PRODUCTS (CLASSIFIED ACCORDING TO CONSUMER BEHAVIOUR)



(Study pages 201–206 in the prescribed book.)

This topic will be discussed in the form of an activity.

## ACTIVITY 3.1

Classify each of the following products (from the customer's perspective) according to whether they are convenience, shopping or speciality products: Coca-Cola, a sports car, a winter coat, blue jeans, a fast-food hamburger, shampoo, canned vegetables, and curtains.

## FEEDBACK

Consumers are involved daily with the purchase of a wide variety of goods. These goods can be classified differently according to different criteria. The most widely accepted approach to classifying consumer products is based on the characteristics of consumer purchasing behaviour. This classification divides products into three categories:

- **Convenience products**. These are products that are relatively inexpensive, frequently purchased items for which buyers exert only minimal purchasing effort. Convenience products can be classified as staple products, impulse products and emergency products. The fast-food hamburgers, canned vegetables and Coca-Cola would fall into this category.
- **Shopping products**. These are products for which buying decisions are not made on the spur of moment. Consumers make product comparisons, seek additional information, examine merchandise, and reassure themselves about the quality, style, or value before making a purchase decision. Typical examples of shopping products are furniture, shoes and clothing. You would place the winter coat, blue jeans and curtains in this category.
- **Specialty products**. These are products for which consumers have a strong brand preference. They are willing to spend substantial time and effort in locating the desired brand. The sports car would fall into this category.

Study each of these consumer product classification types and make sure that you understand them. You must also ensure that you are able to classify different consumer products according to these classifications should you be asked to do so in an examination question.

## 3.3 INDUSTRIAL PRODUCTS

(Study pages 206–208 in the prescribed book.)

Organisations purchase a wide range of industrial products. These are products and services that are provided to other businesses that manufacture or supply products and services for end-user consumption. The term "industrial products" is too broad to use as a guideline for developing marketing programmes. Industrial products can be categorised into production goods, installations and accessories, and supplies and services.

### 3.3.1 Production goods

Production goods are products that become part of the final product. Production products can be divided into the following categories:

- **Raw materials**. These are products that are still very close to their natural state. Examples are chunks of granite, steel, tree trunks, aluminium bars, coal and cotton.
- **Manufacturing materials and component parts**. These are a step above raw materials in the processing chain. Manufacturing materials, such as fabric, thread, yarn, pulp and steel rods are created by transforming materials. Component parts have been processed even further, for example screws, computer chips, zippers, springs, rims, washers, filters, spark plugs and wires.
- **Process materials**. These are used in making finished products but do not become part of these products, for example acid, chemicals, paint, and so forth.

### 3.3.2 Installations and accessories

- **Installations**. Installations are the major capital items necessary to manufacture the final product. Buildings, assembly lines, and heating plants for example are included in this category. Many of these products are made to order and sale is normally the result of lengthy negotiations between seller and buyer.
- **Accessory equipment**. Accessory equipment constitutes products that facilitate an organisation's operations. Examples in this category are pickup trucks, forklifts, and computers.

### 3.3.3 Supplies and services

Supplies and services are closest to convenience products in the industrial products classification scheme. These products are characterised by low rand value per unit and a short life and normally assist an organisation's operations without becoming part of the finished product. Typical supplies and services are:

- Operating supplies such as paper, pencils, envelopes, light bulbs, rubber bands.

- Software packages such as PowerPoint, and Pastel.
- Services such as machine maintenance, professional services, consultants, janitorial services, waste disposal.

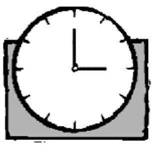
## ASSESSMENT

1. Discuss the major differences between convenience, shopping and speciality products?
2. Identify five ways in which the marketing of consumer products will differ from the marketing of industrial products.

## SUMMARY

In this study unit, we introduced you to product classification by focusing on consumer products and industrial products. Remember that all products can be classified into two general groups, namely consumer products and industrial products. The group into which a product is classified depends on the customer who will use the product as well as on the intended use of the product.

The focus of our attention in the next study unit is on single product decisions which deal with aspects like product attributes, packaging and labelling.



# STUDY UNIT 4

## SINGLE PRODUCT DECISIONS

**PAGE** **CONTENTS**

## KEY CONCEPTS

You have to master the following key concepts in order to meet the learning outcomes for this topic:

- Packaging
- Product attributes
- Product features
- Product style
- Labelling
- Family or individual packaging
- Special packaging
- Reusable packaging
- Kaleidoscopic packaging

## OVERVIEW

A product may be as tangible as a tin of beans or as intangible as an insurance policy. Whatever the type of product, marketing managers need to understand every detail of how it is constructed and how it appears to the customers. They should also have a clear understanding of how well it satisfies customers' needs.

Most companies sell more than one product; they generally have a range of products available. The entire range must be managed so that individual products contribute to the success of the whole. There is more to the idea of a product than just an item that you pick up, touch, smell or taste. No product is purely physical; all have a service element to them, such as. after-sales service, warranties, guarantees, installation assistances. Equally, very few services are single, pure services; most have a physical element to them. When you have your hair done, the hairdresser uses shampoo etcetera. When you travel by train, you get a ticket. Product providers often use the service aspects of their products to differentiate them from competitors, whereas service providers may try to use physical evidence as a point of differentiation.

In this study unit, we will look at product attributes, packaging, labelling and product support services.

## 4.1 PRODUCT ATTRIBUTES

When a product or service is developed the special benefits that it will offer consumers must be defined. These benefits are communicated and delivered through special product attributes such as quality, features, style and design. We will discuss each of these attributes in greater depth in the sections that follow.

### 4.1.1 Product features

The primary decision in product development involves selecting the features that will satisfy and serve consumers' needs. This requires providing answers to the following questions: What is the product? What does the consumer require of the product? How will the product be used? It is incorrect to believe that as marketers we can dream up unique ideas that consumers will always want to follow. This is generally not true because the majority of successful product introductions evolve through a discovery process involving some sort of market research to identify what specific features potential consumers in the target market find desirable and/or acceptable, and then using this information to determine what makes the most sense technologically and economically.

Product features play an important role in consumer decision making about purchasing a particular product or service. Some product feature decisions involve deciding on whether or not to offer product variations. Renault and Daewoo, for example, provide features such as electric windows in their cars, that are over and above those offered by competitor brands, in an effort to sell more cars. Toyota, on the other hand, provides a stripped down version of its Conquest range with limited features called the Toyota Tazz. Cellular phones are perhaps among the best-known examples of how features are being used to entice consumers to purchase products. In an effort to retain and grow market share, cellphone manufacturers such as Nokia, Motorola and recently Samsung have been competing for market share with the cellphone features that they introduce. Think about colour-screen camera cell phones. A short while ago these were not available on the market. Today these features represent standard equipment on any new cellphone.

Product failure in the marketplace can have very serious implications for any organisation because of the high cost involved in developing new product features. An important decision before implementing any new product feature is to determine directly from consumers what their specific needs and wants are. It is therefore very important to note that market research plays a critical role in determining which product features consumers desire. Important product feature decisions should always be carefully researched by asking consumers questions such as the following:

- How much do you like the product?
- Which specific product features do you like?
- What features should we add to the product to improve its performance?

By conducting regular market research surveys on consumer needs and wants, the threat of product failure is substantially reduced. Market surveys can assist in improving existing products and features and they can also contribute to the development of new product features that consumers value. This will ultimately lead to a high degree of customer satisfaction.

### 4.1.2 Product quality

Quality is a potent strategic weapon. The quality of a product and/or service plays an important role in retaining customers and building long-lasting relationships with them. Only if customers value the quality of an organisation's products and/or services will they continue to do business with that organisation. A company's profitability can be enhanced in two ways: (1) market route benefits occur when improved quality raises the value of a product in the eyes of the customer and (2) cost route benefits occur when defect-free outputs reduce operating costs per unit, thereby lowering costs and enhancing profitability. Therefore, decisions about product quality provide another important consideration for marketers. Product quality consists of two main dimensions – quality and quality consistency.

Although it is possible to distinguish these two dimensions in product quality, we should always remember that as marketers we have an interest in all the dimensions of product quality and that these should never be separated. The reason for this is that customers not only value the quality of the product that they want and can consistently obtain, but that they also value the excellent administrative, technical and after-sales product support that they receive. Therefore, when evaluating product quality you should always regard it from the customer's viewpoint.

When developing a product, the marketer must first decide on a quality level that will support that product in the target market. The quality of a product refers to the product's performance quality, meaning the ability of a product to perform its functions. Normally, product quality is directly related to cost. The higher the quality of a product, the more it costs to develop and service that product. For example, the latest C-class Mercedes models provide higher performance quality than the Kia Picanto model. The latest C-class Mercedes model is spacious and luxurious, faster, has a softer ride, handles better and lasts longer, but it also costs much more. Hence, organisations will very rarely offer the maximum peak quality levels. The main reason for this is that there are very few customers in the market who want or can afford the high performance levels found in products like the C-class. High quality levels also mean high levels of quality consistency. Product quality consistency refers to conformance to quality factors such as zero defects and consistently providing the same level of performance. Achieving product quality consistency involves a much broader approach to managing product quality. It involves ongoing measurement and improvement at all stages of product development and after-sales service.

Having realised the importance of quality, many enterprises have followed the example of Japanese organisations such as Honda and Toyota by adopting the total quality management philosophy (TQM). TQM is a quality assurance system that ensures that all those involved in the development and service of a product takes personal responsibility for building quality into whatever they do. The central objectives behind total quality initiatives are to improve customer value and satisfaction. Besides product performance, consumers perceive a number of other product quality dimensions such as the following:

- Performance relates to the basic operating characteristics of products.
- Features are secondary product characteristics that are designed to contribute to and enhance the product's basic functions.
- Reliability refers to how well the product performs over time. Reliability as a quality factor is very important because of the repair costs and downtime involved in unreliable products. Large companies with billion-rand turnovers place a lot of emphasis on computer network reliability because of the costs associated with downtime.
- Conformance refers to the extent to which a product meets the user's expectations.
- Durability is a measure of the product's life. It takes into account both technical (replacement) and economic (cost of repair) considerations.
- Serviceability involves considerations of how easy it is to service the product. The speed and ease of obtaining components and effecting repair will be a major consideration.
- Aesthetics refer to features of the product such as taste, sound, tactility (tactile sensation), and smell. Because these judgements are highly subjective, they are related to the way the customer perceives quality.
- Perceived quality generally results from the use of indirect measures arising from a consumer's lack or misunderstanding of information regarding the particular attributes of a product. As a result, perceptions may be created by such things as price, brand name, advertising, reputation and country of origin.

### 4.1.3 Product style and design

Customer value can also be created through style and design. Style describes the appearance of a product. Design, on the other hand, is a much broader concept than style and involves more than aesthetically changing a product. In fact, it involves changing the actual product itself. A design that is good will make a useful contribution to both the functionality and the appearance of the product.

Style, however, only contributes to changing the aesthetic appearance of the product. Many organisations have adopted style and design as part of a focused product development strategy. Nokia, Sony Ericsson, LG and Samsung are good examples of cellphone-manufacturing organisations that have incorporated style and design as part of their cellular product development strategy. Other examples include Black & Decker for cordless tools and appliances, Sony for home entertainment appliances, BMW for motorcars and Levi Strauss for clothing. Product design, if used correctly, can be a very powerful tool to establish competitive advantage over market rivals. Nestle, for example, has reinvented itself in the South African chocolate market through careful redesign of most of its chocolate brands. Cadbury has also realised the immense power of redesign and style as a marketing tool, and has implemented a product strategy to redesign its products.

## 4.2 PACKAGING

(Study pages 221–224 in the prescribed book.)

Packaging is an important part of the product that not only serves a functional purpose (protection), but also acts as means of communicating product information and brand character. The packaging is often the consumer's first point of contact with the actual product and so it is essential to make it attractive, and appropriate to the needs of both the product and customer.

### 4.2.1 The role of packaging

Seven roles of packaging are described in detail on page 222 of the prescribed book. These include enclosure and protection, reusability, communication, market segmentation, distribution, product development and differentiation. Study each of these functions in greater detail and make sure that you understand them and are able to describe them.

### 4.2.2 Types of packaging

Packaging is available in various types. Let us look at variety of packaging that an enterprise can select:

#### 4.2.2.1 Family or individual packaging

Family packaging is the packaging that is used by enterprises for the purpose of similarity and uniformity with regard to main features of the packaging used for a line of products. All varieties of Sta-soft fabric softener are packaged in identical plastic bottles. The different fragrances are distinguishable by the different colours of the bottles.

#### 4.2.2.2 Special packaging

Special packaging is a different type of package that gives the product a certain type of image. This type of package is commonly used in products such as perfumes, promotional gifts and chocolates.

#### 4.2.2.3 Reusable packaging

Reusable packaging is a packaging that is designed to be used over and over again. The consumer can use this type of packaging for refills. The Sta-soft plastic bottle can be used for refill purposes. Ice cream containers can be used for storing things like food.

#### 4.2.2.4 Multiple packaging

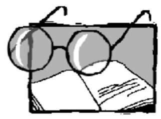
Multiple packaging is used for packing more than one related product in a single container. It is useful to introduce new products and to build a brand name. It is often used for special-offer products – a tool box that contains a variety of tools.

#### 4.2.2.5 Kaleidoscope packaging

The term “kaleidoscope” is used to identify packaging decisions according to which certain aspects of the packaging are changed continually. For example, photographic reproductions of a series of personalities such as Soccer World Cup personalities were recently shown on Coca-cola soft drink cans.

## 4.3 LABELLING

(Study page 224 in the prescribed book.)



A label is the part of product that carries information about the product itself or about the seller. It might be part of the packaging, or might be a tag attached directly to the product.

Labels include warnings and instructions, as well as information required by law or best industry practices. Information on the label may include the weight or volume, a barcode and the name and contact address of the producer and product information such as ingredients, nutritional information and information about the product’s effect on the environment.

Labels types consist of the following:

- **Trademark labels**. Trademark labels are labels which appear on the product items or their packaging, for example the Bon-aqua trademark on flavoured sparkling water.

- **Grading labels**. The quality of the product is identified by means of a letter, number or word. Red meat for example uses grading labels such as Super AX, prime BX, grade A1Y, grade B1Y and grade C1X. These grading labels reflect the differences in the quality of the meat.
- **Informative labels**. These labels provide written and visual objective information on the product's ingredients, use, care, performance, precautions and nutritional value.

## ACTIVITY 4.1

Visit your local supermarket; select a 750 g tin of Ricoffy. Identify and describe the type of packaging and labelling used. Do you think the packaging and label meet the requirements for a good package and label?

## FEEDBACK

In answering this activity, you probably discovered that there are different kinds of coffee in your local supermarket; your task was to focus on Ricoffy of a specific size. You should have identified the packaging, branding and labelling of Ricoffy.

- As you know, packaging plays an important role in protecting and conveying the message. Nescafé Ricoffy is packaged in a tin container with a plastic lid. It is available in different sizes and packaging is suitable for storage and display.
- Branding make it easy for consumers to identify goods and services by providing a name, term, sign and or special design. Ricoffy is an established brand that is well known and is easy to identify. Branding has made it look different from other brands.
- Labelling carries information about the product itself. Ricoffy's label carries the product's ingredients, logo, brand name, nutritional information, and usage instructions.

## 4.4 PRODUCT SUPPORT SERVICES

(Read pages 224–226 in the prescribed book.)

Product support services are the services provided to help the customer with the purchase or use of the product. A company should design its product and support services to meet the needs of the target customers. The first step in deciding which product support services to offer is to determine both the services that target consumers' value and the relative importance of these services. It is always important to conduct a survey on customers' experiences of your service and to identify new service ideas so that you can improve what you are offering.

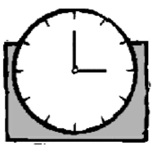
## ASSESSMENT

1. Justify the role of quality as a tool for delivering long-term sustainable profitability and competitive advantage.
2. Explain how style and design can be used as part of a focused product development strategy. Illustrate your answer with practical examples.
3. Compile a report for your marketing director, in which you explain the different product quality dimensions that customers perceive.
4. Use practical examples to explain how consumer benefits are communicated and delivered through special product attributes such as quality, features, style and design.
5. Explain the role and importance of product packaging as a marketing tool.
6. Discuss the main characteristics of labelling.
7. Discuss the importance of customer service as a product support service.
8. Comment on how a company's products and services should be designed to meet the needs of its target market.

## SUMMARY

In this study unit we discussed the different individual product decisions that marketers encounter, such as product attributes, packaging, labelling and product support services. Each of these decisions contributes substantially to the development of a product strategy that is focused on taking products through a process which begins with the idea stage and culminates in the commercialisation stage. The ultimate objective is to distinguish these products from competitor products, thereby ensuring that competitive advantage and profitability are achieved.

In the next study unit we will look at multiple product decisions. This will entail looking at product line decisions and strategies as well as product mix decisions and strategies that involve more than one product.



# STUDY UNIT 5

## MULTIPLE PRODUCT DECISIONS

**CONTENTS** **PAGE**

## KEY CONCEPTS

You will need to master the following key concepts in order to meet the learning outcomes for this topic:

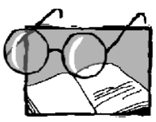
- Trading up
- Trading down
- Breadth of product mix
- Depth of product mix
- Product diversification
- Product line
- Line stretching
- Line featuring
- Product mix
- Product portfolio
- BCG growth/share matrix

## OVERVIEW

Products need managing throughout their life cycles. Someone has to decide what product to capitalise on, what its strengths are and how to iron out its weaknesses. Someone has to decide whether an older product, past its prime, should have its life extended through modification or marketing strategy or whether it should be allowed to die. Such decisions are critical to an organisation's strategy because the product range is at the heart of the supplier-buyer relationship. Product management, therefore, requires a clear line of authority and effective and efficient organisation. In consumer markets, many product decisions are made by the marketing manager and responsibility is shared across a range of functional areas, including research and development, engineering and after-sales service personnel.

In this study unit, we will look at the key concepts of product line decisions, product line strategies, modernising of the product line, line stretching, line featuring, product mix and product portfolio.

## 5.1 PRODUCT LINE DECISIONS



(Study pages 208–209 in the prescribed book.)

The term "product line" refers to the group of products intended for basically similar uses, possessing reasonably similar physical characteristics, being sold to the same customer groups and being marketed through the same type of outlets. For example, Nestlé manufactures coffee. The coffee product line in this case includes include instant coffee, coffee beans, ground coffee and coffee sachets.

A product line can be defined either broadly (e.g. a line of home appliances) or narrowly (e.g. a separate line of televisions, stereos, and home entertainment equipment). The definition depends on the kind of organisation in which they are offered for sale. For example, in a departmental store, men's clothing is regarded as one line of clothing and women's clothing is considered a separate product line.

Product lines tend to lengthen over time. The length of the product line can be increased by stretching the line. Product line stretching happens when a company lengthens its product beyond its current range, by trading down, trading up or trading both ways. Let's look at each of these concepts in a little bit more detail.

- **Trading down.**

  Some enterprises begin their business by more offering expensive and prestigious products and later extend their product lines downward by adding less expensive and prestigious products. The enterprise may add low-end product to plug a market hole that would attract a new competitor or, if attacked at the high end, respond by entering the low end. For example, BMW added the less expensive 318 model to its product mix, a car that is closely associated with the prestige image of the 325 and 330 motorcars.

- **Trading up.**

  Trading up happens when enterprises at the lower end decide to enter the higher end. They may be attracted by faster growth rate and higher margins; for example, Nissan Motor Company introduced the Nissan Z350 sports car and the Nissan Murano SUV with the expectation that the sales of its lower-priced cars would increase as the result of the prestige image of the Z350 and Murano.

### 5.1.1 Depth of the line

The depth of the line refers to the number of different sizes, symbols or flavours within a particular range. The product line length refers to the number of product items in the product line. A product-line depth strategy involves providing a variety of choices for the same item. For example, South African Breweries is offering additional types of beer such as Castle Lager, Castle Light, Black Label, Hansa Pilsner and Hansa Marzen, thereby pursuing a product line depth strategy.

When more items are added to an existing product line the process is referred to as "line filling". One method of increasing a product range is to provide a number of variants of the same product, the main purpose and objective of line filling is to satisfy the different needs and wants of customers using the same product, and to increase product sales and profits. Line filling can lead to an excessively long line and therefore the need arises to trim/prune the line.

A company's objectives have a major influence on its line length. In addition, the length of a product line depends on the number of market segments that are served/targeted and the way an organisation seeks to position itself in the market. A product line is considered short if adding more items to the line will increase profits but it can be considered too long if by dropping items profit can be increased. A short line is suitable during the early stages of a product's life cycle. A company seeking high market share and growth will want a long product line, while a company seeking high profitability will favour a shorter line consisting of only a few carefully selected items. However, short lines need to be uniquely positioned against competitors who will fragment the market further in an effort to satisfy the needs of these market segments.

### 5.1.2 Breadth of the line

The breadth of a line refers to the different products in a line. By adding more items to a current product range we are actually deepening a product line and by extending a product range into related product categories we increase the diversity of the line. For example, when Toyota introduces more Toyota Yaris models, it is actually deepening its Yaris product range. However, when Toyota introduced the Auris model, it broadened its product line by extending beyond its current line of products to reach different market segments using similar products.

## 5.2 PRODUCT LINE STRATEGIES

Changes taking place in an organisation's business environment make it necessary from time to time to make changes to its product items, line and mix. These changes will enable the organisation to take advantage of improvements or innovations in technology and other product developments. As mentioned in the previous section, an organisation can change the depth and breadth of its product range by modifying its products, either by adding items to its product range or by deleting items. Each of these strategies is addressed in the following activity.

### ACTIVITY 5.1

Read the following mini case study.

Vodacom is a Pan-African cellular communication company providing a world-class GSM service to more than 21,5 million customers in South Africa,

/continued ...

Tanzania, Democratic Republic of the Congo and Lesotho. Vodacom is a market leader in all countries where it currently operates, with satisfactory customer growth. Vodacom has a 57 per cent share of the South African market, Africa's largest in cellular market, and the company GSM covers more than 6 percent of the total landmass of South African population. To generate new revenue Vodacom has introduced SMS, E-mail, GPRS, 3G data card, conference call, MMS, Internet service and number portability.

Comment on the product line strategies that Vodacom is following. Do you think these strategies are appropriate for Vodacom?

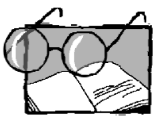
## FEEDBACK

There are four main strategies that Vodacom could follow to promote its product lines; namely line extensions, brand leverage, line pruning and line retrenchment. Vodacom has opted to follow a line extension strategy because it is making additions to the same product category. It is also adopting a brand leveraging strategy by introducing new products such as a DSTV select package and a Vodacom credit card under its brand name. However, you should also point out that, in the longer term, Vodacom will have to adopt a much more aggressive approach in its brand leveraging strategy by introducing more product lines to its existing basket of products.

## 5.3 MODERNISING OF THE PRODUCT LINE

Although a product's line length may be sufficient, the line may need to be modernised because of changes taking place in the company's environment. The rapid changes taking place in the business environment, especially the number of new entrants entering the market with innovative products, may make a company's product lines insufficient. A major decision that the marketer faces is whether or not the line should be overhauled in one go, or whether it should be changed gradually through a trial-and-error approach. A trial-and error approach involves making gradual changes to the product line and evaluating how well customers and dealers accept these changes. If the changes are not well received, they can be shelved and new ones introduced. It is important to note that both methods ultimately involve hidden dangers. If the organisation attempts to overhaul the line in one go it could result in failure if the market does not take to the modernised line. It can also be very expensive. On the other hand, if the organisation approaches line modernisation cautiously on a step-by-step basis, competitors could gain insight into the organisation's changes and begin implementing their own changes. Another important concept in line modernisation is called planned obsolescence. Planned obsolescence is the term that is used to describe the activity of intentionally modernising a product so that it becomes obsolete at a later stage.

## 5.4 LINE STRETCHING



The prescribed book does not discuss line stretching in sufficient detail. Therefore you should regard this section as supplementary to the other product line strategies discussed in your prescribed book.

A total product line covers all the possible ranges of a product. A company's product line may extend to only some parts of the range. For example, Mercedes is located in the upper price range of the motor car market. Line stretching takes place when an organisation lengthens its current product line beyond its existing range. When engaging in line stretching, a company can stretch its product line either upward or downward or it could apply a combination of the two techniques.

*Downward stretching* occurs when an organisation's product line is located in the upper end of the market and the company stretches its product range towards the lower end of the market. Normally, companies add models at the lower end of their line to advertise their brand as beginning at a low price. BMW, for example, might advertise a brand new 318 model. This tactic is aimed at drawing customers into their showroom. Once in, customers can be persuaded to upgrade to the more highly priced models. However, it is important to note that this strategy must be used with utmost caution. The following are cautionary actions that a company using this strategy might take:

- Ensure that the promotional brand, although stripped, supports the "quality image" of the brand. At the time of advertising the seller must ensure that the advertised model is available, otherwise customers could feel they are being deceived.
- Customers should never be made to feel that they are being exploited.

One of the main risks associated with downward stretching is that the new low-end items may cannibalise the higher-end products. This means that the lower priced items will take sales away from the more highly priced items.

*Upward stretching* involves moving from the lower end to the higher end of the product line. Sometimes a company is lured by higher growth rates, higher margins or simply the attraction of positioning itself as a full line manufacturer. To achieve this it may contemplate moving into the higher end. Stretching upward can be very risky because of the following:

- The higher end may be very well entrenched and may retaliate by moving down market.
- Customer confidence may be lacking because of the belief that lower end companies are incapable of producing higher-end products.
- The company's sales representatives may lack the talent and skills required to service the higher end of the market.

For example, BMW may introduce the M3 model to position itself as a full line manufacturer.

Two-way stretching involves companies that are mainly serving the middle market who may decide to stretch their product line both upwards and downwards. Companies using this strategy aim to capture all segments of the market, namely higher, middle and lower end segments. A possible weakness of this strategy is that customers at the higher and middle ends might try out the lower end, discover that all their needs are met at this level and decide to stay there. This, however, would be much better than losing the customer to a competitor.

## 5.5 LINE FEATURING

A major problem with most organisations today is that very few of them carry out a regular audit on their product lines to determine which products should be continued and which should be discontinued. Quite often, an organisation might find that one of its product lines is selling extremely well while another is not selling at all. To overcome this situation, the organisation will obviously try to stimulate demand for its slow-selling items by selecting one or a few items and making these stand out to attract the attention of customers. This kind of action is referred to as "line featuring". For example, an organisation could announce a special low price on an item to attract customers or it could select a high-end item to grant prestige to the product line.

## 5.6 PRODUCT MIX

In today's complex and competitive society, most organisations offer a number of product lines instead of depending on only one kind. A product mix, or product assortment as it is sometimes called, refers to the complete set of product lines and items that a company offers for sale to buyers. For example, Samsung's product mix consists of household appliances and communication products. Woolworths' product mix consists of food and clothing, Ericsson's product mix consists of fixed and mobile communications equipment and ABSA provides a product mix that comprises asset management banking and insurance products. When you study this section take note of the following generalisations concerning a product mix:

- A product mix consists of all the product lines that an organisation offers.
- A product mix consists of multiple product lines that in turn are made up of multiple sub-lines.
- Each sub-line consists of various product items.
- A different strategy is required for each product item.
- Some strategy components can in certain instances be shared between product lines and complete product mixes.

## 5.7 PRODUCT PORTFOLIO

This topic is not covered in your prescribed book and you should therefore study it in detail in this section

A product portfolio can be seen as a collection of items that are balanced as a group. Decisions on product portfolios are mainly concerned with relationships, harmony and synergy between the different product lines in the product mix and include both product length and product depth. The need to have a product portfolio or range of different products exists because of the changing nature of all products and technologies demonstrated in their respective life cycles. An in-depth discussion of the product life cycle is provided in study unit 6 and will not be discussed here. A well-planned product portfolio includes a mixture of both long-standing products that provide a continuous stream of income and some new products that may be risky, but have the potential to provide a high return. Instead of focusing on the problems of individual products in the portfolio, marketers normally tend to concentrate on the relationships and cash flow of the complete product mix. Although there are many models that can be used in product portfolio analysis, we will discuss one of the best-known models called the Boston Consulting Group (BCG) portfolio matrix.

### 5.7.1 The BCG growth share matrix

The BCG growth share matrix is based on the assumption that cash flow and profitability are related to sales volume. As a result, the BCG growth share matrix classifies products according to their relative market share and the Growth rates of the market they are in. By using a combination of market share and growth rate, products are classified as either stars, cash cows, dogs or question marks. The BCG matrix model is presented in figure 5.1.

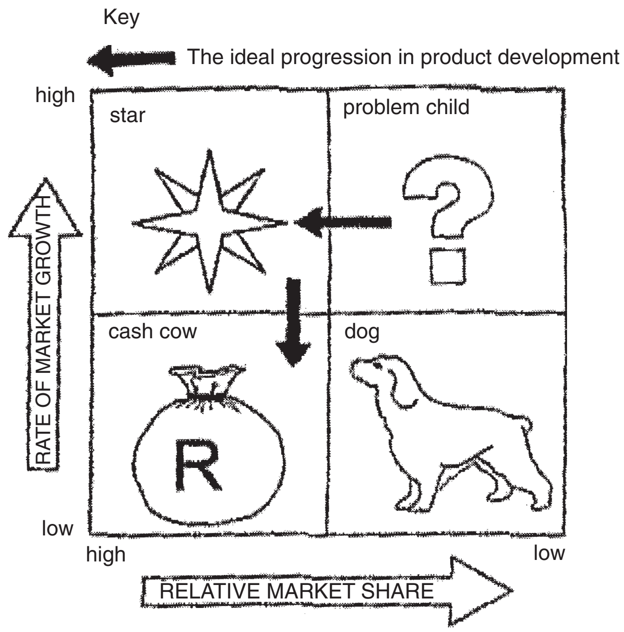



*Figure 5.1 The BCG growth share matrix*

As depicted in the figure above, each quadrant of the matrix provides an indication of the market share and growth rate prospects of the business in that quadrant. The vertical axis measures the rate of growth of a product in the industry and the horizontal axis measures the relevant market share of the product. It is important for you to take note, as discussed previously, that an organisation's product portfolio can consist of products in one or more of these quadrants. Rather than limit an organisation's products to only one product item that falls in a particular quadrant, we prefer to refer to strategic business units, each unit being responsible for a particular product line. For example, a company having five different product lines normally has five strategic business units. Each strategic business unit is responsible for a different product line. For example, MTN has three distinct product lines, namely voice, data and multimedia, and each of these will operate as a strategic business unit.

Let us now look at each of the quadrants in the BCG growth share matrix.

#### 5.7.1.1 Problem children/question mark

An organisation whose strategic business unit is located in this quadrant is in a high growth market but the organisation has a low market share. Businesses with products in this quadrant will have to inject huge sums of cash to expand to keep up with the growing market and to retain and grow its market share. Quite often problem child/question mark strategic business units are new strategic business units with potential for future growth, but require large sums of cash for support in order to grow in a rapidly growing market. Products in this category generally turn out to be the stars of tomorrow.

#### 5.7.1.2 Stars

Strategic business units that fall in the star category are in a market growth stage of the industry and also have a high market share. All organisations wish that all their strategic business units could be stars, because stars are fundamental to an organisation's growth and continued existence. However, it is important to point out that stars produce a lot of cash but can equally consume large amounts of cash. The reason for this is that a star strategic business unit needs to be maintained on a continuous basis to keep up with market growth. This is achieved by implementing initiatives such as continuous research and development and marketing activities to prevent competitors from gaining advantage.

#### 5.7.1.3 Cash cows

Business units in this category are in a low growth industry but have a high market share. These strategic business units are cash generators for an organisation, hence the name cash cow. They continuously and consistently contribute to an organisation's revenue streams.

#### 5.7.1.4 Dogs

A strategic business unit that falls into this category is in a low growth industry and has a low market share. Although these strategic business units might generate some cash, they tend to be unprofitable and generally incur losses.

According to Kotler (1997:73) once an organisation has completed plotting all its strategic business units in the growth share matrix, it must then determine whether its portfolio is balanced. An unbalanced portfolio highlights the presence of too many dogs or problem children, and very few stars and cash cow strategic business units. The next step would be to determine the objective and strategy of the strategic business unit and the financial resources (budget) that must be assigned to the unit. Kotler (1997:73) suggests four strategies that an organisation can follow for this purpose. The organisation will have to decide on the basis of the information available which strategy it will deploy. These strategies can be used on their own or in combination. The four strategies are as follows:

- **Build**. The objective of this strategy is to increase the strategic business unit's market share, even if it means that short-term earnings will have to be sacrificed. A building strategy is very appropriate for problem child/question mark strategic business units because their market shares must grow if they are to progress to becoming stars.
- **Hold**. By engaging a hold strategy the main objective of the organisation is to maintain the strategic business unit's market share. This is a very good strategy for strategic business units that are strong cash cows if they are to continue providing a large positive cash flow.

- **Harvest**. This strategy involves increasing the strategic business unit's short-term cash flow irrespective of the long-term effects. By using a harvest strategy the organisation's main objective is to eventually withdraw from the business by continuously reducing its costs. Harvesting involves milking the business without incurring any further costs by cutting research and development as well as capital and operational expenditure, for instance by not building and maintaining plant and not replacing its sales force.
- **Divest**. The objective of a divestment strategy is to sell or liquidate the business because the company can better utilise the resources elsewhere. This is a good strategy to employ for dogs and problem child/question mark strategic business units that are depleting the organisation's profits without showing future potential for development.

It is important to note that, with the passage of time, strategic business units change their strategic positions in the growth share matrix. Those strategic business units that are successful normally have life cycles that begin as question marks, become stars, then cash cows and finally end up as dogs when their lifecycles come to an end.

You should make sure that you are familiar with these strategies and be able to discuss each of them should you be asked to do so.

### 5.7.2 Limitations of the growth share matrix

Portfolio models have traditionally been very beneficial to managers. They have played an important role in assisting managers to think strategically, understand the economics of their company better, improve the quality of their planning, identify information gaps, discharge poorly performing business units and strengthen their investment in businesses with future potential.

We must point out, however, that portfolio models such as the BCG growth share matrix should be used with great caution. There are some weaknesses of the model that need to be kept in mind by the marketer at all times. These weaknesses include the following:

- The model tends to be very arbitrary and theoretical.
- Strategic business units or products are placed into different quadrants without sufficient evidence and placement is based on questionable and limited knowledge.
- The model fails to delineate the synergies between two or more strategic business units.
- Market growth rate inadequately depicts the overall attractiveness of the market.

- Relative market share inadequately describes overall competitive strength.

This section concludes our discussion of this study unit.

## ASSESSMENT

1. Explain what is meant by the depth of a line.
2. Explain what the breadth of a product line means.
3. Distinguish between depth of a line and breadth of a line. Use product examples to illustrate the differences.
4. Explain the importance of having a multiple product mix.
5. Explain how you would use the BCG growth share matrix as a planning tool.
6. You are the marketing manager of Motshega Enterprises. After carrying out a detailed audit of the organisation's strategic business units, you find that it has an unbalanced portfolio mix containing more dogs and question marks than cash cows and stars. Prepare a report for the head of Motshega Enterprises and include suggestions on how to rectify this situation.
7. It is better to have strategic business units that are cash cows than stars. Analyse this statement critically.

## SUMMARY

In this study unit we briefly explained that products change during the course of their life cycle. We discussed some of the major decisions that marketers need to take when dealing with multiple products. Furthermore, we showed that in companies offering a variety of products, marketers not only have to make decisions about multiple products but they also have to craft strategies to accommodate those products. We ended this study unit with a brief discussion of the growth share matrix and explained that, as a tool for managing a portfolio of products based on resource allocation, it has both useful attributes and weaknesses.

In the next study unit we will look at the concept of the product life cycle. A key focal point will be how the marketing mix should be adapted for a product at each stage of the life cycle to ensure that the product remains competitive in the market place.

# STUDY UNIT 6

## PRODUCT LIFE CYCLE

**CONTENTS** **PAGE**

## KEY CONCEPTS

You will need to master the following key concepts in order to meet the learning outcomes for this topic:

- Product life cycle
- Introduction phase
- Growth phase
- Maturity phase
- Declining phase
- Classic PLC
- Fashion fad PLC
- Extended fashion fad PLC
- Seasonal PLC
- Revival PLC
- Marketing strategy
- Integrated marketing strategy

## OVERVIEW

Over time, changes need to be made to marketing strategies to keep up to date with changing market needs and competitive products. The concept of the product life cycle involves a number of phases, such as introduction, growth, maturity and declining. These phases will be illustrated as follows. A new product, such as a Defy washing machine was initially introduced in the market. Then its sales increased, which led to the washing machine going into the growth phase. From the growth phase the Defy washing machine moved to the maturity phase. After the maturity phase sales of the washing machine started to decline rapidly.

In this study unit, we are going to study the product life cycle and the different phases that make up this product life cycle. We will focus on the characteristics of the different phases of the PLC, and then spend time looking at the changes to be made to the marketing mix at each phase as the product moves through the cycle.

## 6.1 THE MEANING AND IMPORTANCE OF THE PRODUCT LIFE CYCLE

This brief section is not found in your prescribed book and should therefore be studied in this study guide.

Jooste, Berndt, Herbst and Klopper (2005:97), define the product life cycle as a planning tool that describes the stages a product will pass through from its introduction to its decline. The stages or phases are the introductory, growth, maturity and declining phases.

The product life cycle is important to various organisations and brands in the following ways:

- The PLC is a tool that can be used in the planning and analysis of products and in the management of a product. It helps to explain the changes that have taken place in sales and profits over a certain period. The PLC provides a guideline within which various strategies can be implemented and evaluated.
- The importance of the PLC is also experienced when a product moves through four different phases (namely introduction, growth, maturity and declining), a process which requires management to apply different actions and strategies during each phase.
- The concept of a product life cycle is applicable to all the products or services that are marketed. The only difference is that other brands or products may not have followed the same pattern over the exact time period, but the PLC concept can give an indication of the time period of a specific product idea. The PLC concept can be used as an aid to understanding the life cycle of a product category (motor vehicle), a product form (commercial vehicle), a product (sedan) or a brand (Mercedes-Benz).



## 6.2 THE DIFFERENT PHASES IN THE PRODUCT LIFE CYCLE

(Study pages 241–243 in the prescribed book.)

A product usually passes through four clearly defined phases during the course of its lifetime, namely the introductory, growth, maturity and declining phases. Let us now briefly discuss each of these phases.

### 6.2.1 Introductory phase

In this, the first phase in the product life cycle, the product is introduced for sale in the market. Sales are initially very low and the costs of marketing are very high.

The introductory phase has the following characteristics:

- Usually relatively low initial sales
- Customer resistance to new (unknown) products
- High marketing costs
- Few distribution channels
- High manufacturing costs and production problems
- Very few competitors in the market
- Low profit levels (if any)
- Price determined by nature of product

### 6.2.2 Growth phase

The growth phase is the second phase in the product's life cycle and marks an increase in sales of the product. The reasons for this increase in sales are that the product is now known to potential consumers and there is an increased spending on promotion. This phase also sees an increase in the number of competitors.

Characteristics of the growth phase are the following:

- Strong growth in sales
- Increase in number of competitors
- Product improvements
- Increase in the number of intermediaries
- A rapid increase in profits
- Lowering of prices (where necessary)

### 6.2.3 Maturity phase

During the maturity phase, the sales growth of the product continues to increase albeit at a slower rate. Eventually sales start to level off. This phase will involve the introduction of product improvements and additional incentives will be granted to intermediaries with the aim of increasing and sustaining sales.

In the maturity phase the following characteristics can be identified:

- Levelling off of sales growth
- Increased level of competition (saturated)
- Lowering of prices
- Increased marketing cost to maintain position
- Declining profits
- Product differentiation and modification

### 6.2.4 Decline phase

In this phase, the product sales start to decline and the organisation is faced with long-term decisions about the product's future. Here the management has to decide on whether to revive the product by introducing a new and aggressive marketing campaign or to withdraw the product from the market altogether.

The following characteristics of the declining phase can be identified:

- Rapid and permanent decline in sales
- Decline in market size
- Declining profits
- Decrease in competitor numbers

- Decisions by management on whether to withdraw or harvest the product
- Reduction and elimination of product promotion

**ACTIVITY 6.1**

As the brand manager of washing and drying machines for Whirlpool, you have the responsibility of monitoring the phases of your product life cycle. Illustrate, by means of practical examples, the four (4) phases that the Whirlpool washing and drying machine will pass through in the product life cycle.



## FEEDBACK

Let us look at the phases that the Whirlpool washing and drying machine will pass through in the life cycle. These examples revolve around four (4) phases in the product life cycle, namely the introduction, growth, maturity and declining phases.

- **Phase 1 – Introductory phase**

  For example, Whirlpool washing and drying machines may be new in the home appliances market. The company's intention may be to provide quality washing and drying machines that wash, clean and dry quickly. Whirlpool may decide to advertise the attributes and benefits of washing and tumble dryers in newspapers, on television and on the Internet. Initial sales may be low due the fact that the brand name is relatively unknown but, with repeated advertising exposure, this should change.

- **Phase 2 – Growth phase**

  During the second phase, for example, Whirlpool may decide to expand its business by distributing its washing and drying machines through wholesalers and retailers and also establish agent offices throughout the country, but it will be faced with intense competition from other home appliance manufacturers, such as LG, Hitachi, AEG and many more. Use can be made of penetration pricing to increase and grow its market share. The sales of the Whirlpool washing and drying machine will rapidly increase as a result of increasing consumer awareness and the expansion of the distribution channel.

- **Phase 3 – Maturity phase**

  The third phase will involve the levelling out of sales for Whirlpool washing and drying machines. As the brand manager for Whirlpool, you will now be faced with the decision of whether you are satisfied with the washing and drying machines' current positioning or whether new actions should be taken to establish renewed growth in sales. Product adaptations may be made during this phase and additional incentives might be provided. You may decide to increase washing and drying machine sales by offering discounts to customers and increasing the commission of sales agents in order to prolong this stage.

- **Phase 4 – Decline phase**

  This is the last phase of the product life cycle when sales start to decline on a fairly consistent basis. As the brand manager for Whirlpool during this phase, you will be prompted to make a decision about the future of the washing and drying machine. You may decide to revive the product by introducing a new and aggressive marketing campaign. For example, you may decide to add features to Whirlpool existing washing and drying machines and communicate added features through advertisements by using newspaper, television and the Internet. Alternatively, Whirlpool can phase out the product and focus on newer product lines.

## 6.3 DIFFERENT KINDS OF PRODUCT LIFE CYCLES

(Read page 244 in the prescribed book.)

It is important to note that not all products strictly exhibit the traditional PLC shape. As illustrated in figure 6.12 in your prescribed book, different products follow different PLC patterns. In this section of the work, we will briefly look at the different PLC patterns that can be experienced.

- **The traditional PLC**. The traditional PLC pattern follows the clearly distinguishable periods of introduction, growth, maturity and decline. For example the VHS video machines where first introduced as new products in the market, then they went through the growth phase as they became popular, then proceeded to the maturity phase. VHS video machines are currently threatened by DVD players, which will eventually lead to VHS videos reaching the decline phase and disappearing from the market.

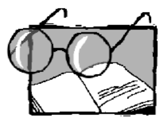
- **The classic PLC**. This pattern shows a rapid rise in sales, which reach a peak and then a plateau, and eventually stagnate because of a lack of new customers and sales outlets. For example, Coca-Cola no longer attracts new consumers because most soft drink users repeatedly buy Coke and all available sales outlets have been captured.

- **The fashion fad PLC**. This pattern depicts a product that rapidly gains popularity but loses its popularity just as quickly. For example, the rapid buying of tracksuits, T-shirts and caps associated with the soccer world cup whereas, as soon as this event is over, the sales and popularity of these items drop.
- **The extended fashion fad PLC**. This pattern is similar to the fashion fad except that sales stabilise at a lower level after the initial success.
- **The season or fashion PLC**. This pattern reflects a well selling product in successive periods or seasons. For example, the increase in buying of jerseys and blankets during winter months, followed by a slowing down of sales in summer, then an increase yet again the next winter.
- **The revival PLC**. This pattern is reflective of a product that has followed the traditional life cycle but has been able to regain sales because of aggressive marketing campaigns. An example is the repackaging and repositioning of Shield deodorant.
- **The fiasco PLC**. This pattern depicts a product that was a failure from its inception in the market.



## 6.4 STRATEGIES OVER THE DIFFERENT PHASES OF THE PLC: INTEGRATED MARKETING STRATEGY

(Study pages 245–253 in the prescribed book.)



Marketing management deals with the management of product on a daily basis, and it is therefore important that managers know and understand the use of the PLC. The PLC offers the marketer a number of benefits. Managers are in a better position to explain sales levels using the PLC; it empowers them to properly manage the components of the marketing mix, and helps management to make new product decisions.

### 6.4.1 Marketing instruments and the PLC

In this section we are going to focus on how the marketing instruments can be adapted and applied during each phase of the PLC. It is important to bear in mind that for the organisation to be profitable and successful it has to manage its products throughout their life cycles. The process of managing the organisation's product life cycle involves the development of a marketing strategy that integrates decisions and actions with regard to the product, pricing, distribution and promotion.

## 6.4.2 Strategies over the different phases of the PLC

Next, let us examine the various strategies that can be followed in the different phases of the PLC. We will start by looking at the meaning of marketing strategy. The prescribed book refers to marketing strategy as marketing management's plan to achieve specific objectives. Usually the main objective is to strive for maximisation of profits in the long term. Product, distribution, marketing communication and pricing decisions are used as tactics to execute the marketing management's plan. The abovementioned techniques form the basis of the marketing strategy.

The decisions to be made at each phase are the following:

### 6.4.2.1 Strategies in the introductory phase

In the introductory phase the product is new to the market and therefore a major objective of the marketing manager will be to create awareness and promote trial of the product. This being the case, let us consider the marketing strategies that can be considered in the introductory phase:

- **Product decisions**. Here the product decisions can entail minor product modifications or the product can be left unchanged.
- **Distribution decisions**. Marketing management can decide on the number and kind of middlemen which affect price and marketing communication decision.
- **Price and marketing communication decisions**. Price and marketing communications can be used to create primary demand for the product. This can be achieved by applying the following four combinations; rapid skimming strategy, low skimming strategy, rapid penetration and slow penetration strategies.

### 6.4.2.2 Strategies in the growth phase

The next phase is the growth phase which has a rapid increase in sales and the emphasis will be on building brand preference and loyalty as well as increasing the number of outlets stocking the product. The following are strategies that can be considered in the growth phase:

- **Product decisions**. The product decisions will revolve around producing sufficient quantities and the designing of a service strategy that will enhance long-term relationships with clients.
- **Distribution decisions**. Here the management will have to decide about how to expand the availability of the product through additional intermediaries.

- **Price decisions**. Price decisions that reduce the selling price can be looked into as a result of increased competition.

- **Marketing communication decisions**. Management can focus on creating secondary demand and on reminding and persuading potential consumers to buy the product.

### 6.4.2.3 Strategies in the maturity phase

In the maturity phase, the growth rate levels off because of saturated market penetration. The following strategies can be followed in the maturity phase.

- Retain the existing marketing strategy.
- Retain the current product and revise other marketing instruments.
- Change all the marketing instruments.
- Introduce product differentiation.
- Extend product range.
- Modify marketing instruments.



### 6.4.2.4 Strategies in the declining phase

During the decline phase of the product life cycle, the major objective of the company is to reduce costs and brand expenditure and to milk the product for as much revenue and profit as possible. Three major strategies can be considered in the declining phase:

- Continue with the existing marketing strategy.
- Revise the existing marketing strategy partly or entirely.
- Withdraw the products from all markets.

Refer to the prescribed textbook for a detailed discussion of this topic.

## ASSESSMENT

1. Describe the meaning and importance of the product life cycle.

2. Explain the importance of the product life cycle to the marketer.

3. Discuss the different phases in the product life cycle with specific reference to their characteristics.

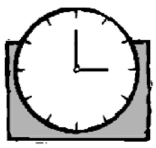
4. Explain the integrated marketing strategies that can be adopted by the marketer during each phase of the product life cycle.

5. Identify and discuss the different PLC patterns that the marketer can encounter.

## SUMMARY

In this study unit, we focused on the product life cycle which is a planning tool that describes stages a product will pass through during its life cycle. A lot of attention was given to the different phases in the product life cycle. We briefly discussed the introduction phase that is identifiable by relatively low sales, the growth phase that undergoes the rapid increase in sales, the maturity and the declining phases that are characterised by quick and permanent decline in sale. We also discussed the characteristics of the different phases of the PLC. An important matter considered was the use of the product life cycle by marketing management and how marketing strategies need to be adapted at each phase. Finally, we looked at the different PLC patterns that marketers can encounter for products in their product mix.

In the next study unit we will be focusing on the new product development process. The new product development is a result of decisions and actions taken at the PLC level. Remember that when a product reaches the declining phase, the management can decide to introduce a new product, which will then lead to a new offering being developed for the market. Note that the PLC and new product development process form part of the product decisions that must be implemented by management to remain competitive in the market.



# STUDY UNIT 7

## NEW-PRODUCT DEVELOPMENT

**CONTENTS** **PAGE**

## KEY CONCEPTS

You will need to master the following key concepts in order to meet the learning outcomes for this topic:

- New product classification
- New product development process
- Idea generation
- Idea screening
- Concept testing
- Business analysis
- Product development
- Test marketing
- Commercialisation
- Consumer adoption process (acceptance process)

## OVERVIEW

The development of new products forms a vital part of any organisation's growth and survival. When an organisation, such as SABMiller, decides to develop a new flavoured alcoholic drink that is aimed at appealing to the woman's market, it will go through a series of phases before introducing this new product to the market. SABMiller will start by conducting research to find out if woman are happy with the flavoured alcoholic drinks currently being offered in the market. Then SABMiller will move to the next phase where it will expand and test the new flavoured alcoholic drink concept that will be matched with the woman's desires and lifestyle. As soon as SABMiller have collected satisfactory information about the woman's market, it will then develop the physical product. This physical product will be an alcoholic beverage blended from a medley of four classic apple varieties contained in an alluring 330 ml bottle and branded Sarita. The next phase will involve test marketing Sarita in metropolitan areas where independent, progressive, discerning woman are located. The last and final phase will entail the commercialisation and full launch of the Sarita exclusive and superior quality alcoholic beverage.

In this study unit, we will focus on the topic of new-product development. We start by looking at the classification of new products, as well as the success and failure of new products. We then move on to examine the management of ideas for new-product development, the role of marketing management and strategies for new-product development. A large part of this study unit will focus on the different phases of product development process. The study unit will close off with a discussion of the consumer process.

## 7.1 TYPES OF NEW PRODUCTS

(Study pages 226–227 in the prescribed book.)

It is important to take note that new products can be viewed from both the product developer's perspective and from the consumer's point of view.

### 7.1.1 Classification of new products from the manufacturer's point of view

Let us consider the accepted categories of new products from a manufacture's perspective.

- **New-to-the-world product**s. These are totally new products or inventions, for example the first MP3 player to be produced.
- **New-to-the-marketer products**. These products are not inventions but instead they take an organisation into a product category that is new to the organisation, for example the opening of liquor or bottle stores by Pick n Pay.
- **Line extensions**. These products provide line extensions to the organisation's current markets, for example Castle Lite from Castle Lager.
- **Repositioned products**. These are existing products that are repositioned or marketed in a new way to change their position or application in the marketplace, for example the EGO deodorants where repositioned as new AXE deodorants, and also recently the repositioning of PEP stores from selling at the "lowest prices" to selling at the "best prices and more".
- **Improved products**. These are existing products that are improved to provide better performance or greater perceived value, for example a Nokia cellular phone with a camera and video features.



### 7.1.2 Classification of new products from a consumer's point of view

A consumer's new product classification is based on the level of new learning or behavioural change that is required to use the new product. The different classifications of product categories from a consumer's viewpoint include the following:

- **Continuous innovations**. The majority of new products, such as new models of motorcars fall in this category. Continuously innovated products undergo annual changes to their style, packaging, size and colour.
- **Dynamically continuous innovations**. This refers to the use of new technology to improve products and to provide some learning where

needed. Examples of these innovations encompass LCD TVs, computers and compact disc players.

- **Discontinuous innovations**. This category of products includes totally new products that perform either a previously unknown function or an existing function in a new way. An example is the use of an Ipod 80GB Video for storing and recording16000 songs and having 100 hours of video playback.

## 7.2 THE SUCCESS AND FAILURE OF NEW PRODUCTS

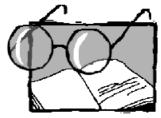
According to Jooste et al (2005:23) new product development demands effort, time, talent and skills, and the risks and costs of failure are high. Usually the success of new products is based on the following:

- The organisation must have the capability and systems to pinpoint and identify customer needs.
- The organisation must be able to make optimal use of its existing strengths and resources.
- The organisation must concentrate on making sure that screening and testing is stringently done before investing any money in product development.
- The organisation must ensure that strong coordination between research and development (R&D) and marketing is encouraged and well managed.
- The organisation must develop an atmosphere that promotes entrepreneurship and risk taking among employees.
- Lastly, the organisation must establish a link that will ensure that new product development is matched with the achievement of organisational vision, mission and goals.

Another point to note is that new product development may also lead to failure. The following reasons are given for the failure of new products:

- Organisations fail to offer unique product benefits.
- Competition is underestimated.
- Cost of production is higher than anticipated.
- Some organisations rush to introduce a new product on the market without developing a thorough, well-thought-out marketing plan.

## 7.3 THE MANAGEMENT OF IDEAS FOR NEW-PRODUCT DEVELOPMENT



(Study page 228–229 in the prescribed book.)

It is essential that a business must establish an organisational level or structure in which new product development can be stimulated, planned, coordinated and controlled.

- **Organisational levels for product development**. In major corporate organisations such as Standard Bank, Vodacom, and SABMiller for example, where multiple operating divisions exist, new product development and planning responsibility may be located at either the corporate level or divisional level, or both.
- **Organisational structures for product development**. Once the decision has been made about the level at which the responsibility for new product development should reside, the organisation should then determine and implement a suitable organisational structure to support the new product development initiative. A number of organisational structures can be used to support new product development and planning.

Lets look at the most common methods that many organisations use in dealing with the organisational aspects of new product development.

- **Product managers**: Many organisations appoint a product manager that will oversee all the activities that have to do with new product development in the entire organisation.
- **New-product managers**: This position is an extension of a product manager, the only difference is that the new product manager is specifically focused on developing new products and has to report to the product manager. New-product managers' responsibilities are limited to thinking about product modifications or line extensions within their product market or category.
- **New-product committees**: Many organisations assign the responsibility of developing and approving new product proposals to a high-level management committee. The people serving on these committees could meet on a regular basis to do some brainstorming and screening of new product ideas, assist in managing the introduction of new products and any other function that will help the organisation to make optimal use of its resources in the development of new products ideas.
- **New-product departments**: Many large organisations use the new-product department to manage the product development process. This department is headed by a manager who has links with the individuals who are serving at the top level of management in the organisation. The major

responsibilities of this department include recommending new-product objectives, planning and screening new-product ideas, providing assistance in the development of new-product specification, implementing test marketing and the commercialisation of new products.

- **New-product venture teams**: In the managing of new-product development many organisations can opt to appoint a venture team. To facilitate understanding of the concept of a venture team the following definition will be used: "A venture team is a group of individuals brought together from various operating departments and charged with developing a specific product, service or business".

## 7.4 THE ROLE OF MARKETING MANAGEMENT IN NEW-PRODUCT DEVELOPMENT

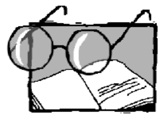
The development and marketing of a new product have an effect on the organisation in general and each functional area in particular. But more significantly it must be noted that marketing management controls all product decisions, therefore its role in the development of new products is significant. The marketing function helps with improved teamwork, especially between related functional areas. The following aspects outline how product decisions can influence the functional areas of the organisation:

- Product decisions have a substantial influence on the financial management of an organisation in terms of investment and distribution of capital to the new product development process.
- Product decisions directly affect the human resources of an organisation, in that if a new product has to be developed, this may lead to new personnel being recruited or the establishment of a new-product department and venture teams requiring additional staff members.
- Product decisions influence information management in the organisation because the organisation might have to establish a research and development (R&D) department to work closely with the marketing department whose members are exposed to new ideas on developing new product from customers and competitors.
- The purchasing department in an organisation is affected in a special way by product development and other product decisions. This means the purchasing department will need to adjust its buying pattern as soon as the new-product idea is approved and a physical product has to be manufactured. As an example, assume that the purchasing department of Goldstar appliances has learnt that the marketing director has approved the idea to manufacture and add computers to their current product mix. This outcome

will prompt the purchasing department to source new suppliers of computer components with whom they have not previously done business.

- The marketing department in the organisation can also effectively use information on the product mix that the organisation manufactures and markets. In this case, new-product development information will be communicated and disseminated to existing as well as new markets of the organisation. This helps the organisation to keep its consumers up to date with new developments within the firm, which can lead to trust and loyalty.

## 7.5 STRATEGIES FOR NEW-PRODUCT DEVELOPMENT



The following discussion revolves around planned, physical and psychological obsolescence as well as product standardisation. Let us first look at the concept of obsolescence. Obsolescence is a condition or situation that occurs when a product or service is no longer wanted even though it is still functioning or performing in an acceptable way. As stated by Rix (2004:226), the consumer seems to be on a constant quest for new but not too new products.

- **Planned obsolescence**. This involves the building-in of operational or style features into a product that will give the product a predictable and a finite life. The superficial characteristics of a product can be altered so that the new model is easily differentiated from the old one. Marketers deliberately design products to have a shortened product life cycle so that people will be dissatisfied with the old model, as a result of technological advances in the new model. By using planned obsolescence as a strategy for new product development, the organisation is aiming to generate long-term sales volume by reducing and shortening the time between repeat purchases.

- **Physical obsolescence**. This usually happens because the product wears out and becomes physically non-functional and useless for further consumption. This condition occurs as a result of repeated use and exposure of the product. Examples of such products are car batteries and light bulbs.

- **Psychological obsolescence**. Psychological obsolescence often arises from the development of new competitive products which provide the consumer with greater real or perceived need satisfaction, even though the old product may physically still be effective (Marx & Walt, 1990:159). This type of product obsolescence stems from the organisation's attempts to wear a product out in the owner's mind.

- **Product standardisation**. As a product strategy, product standardisation involves the use of similar or the same components in manufacturing a product within a company or the industry. For example, car manufacturers usually use the same parts in producing different makes and models. This standardisation will greatly help the organisation to reduce manufacturing and inventory handling costs.

## 7.6 THE NEW-PRODUCT DEVELOPMENT PROCESS

(Study pages 229–238 in the prescribed book.)

The new product development process steps consists of the following seven steps:

- idea generation
- idea screening
- concept testing
- business analysis
- product development
- test marketing
- commercialisation

Refer to the prescribed textbook for a detailed discussion of each step. The new product development process is illustrated in figure 6.8 in the prescribed book. Let us look at each of these steps.

### 7.6.1 Idea generation

New-product development starts with an idea. It is particularly important to develop a system within an organisation for stimulating new ideas, and then to acknowledge and review the system promptly. Ideas may come from various sources such as customers, competitors, employees, R&D staff and top management.

- **Customers**. Customers are the logical place to start looking for ideas. This is done by identifying customers' needs and wants by means of surveys, focus groups and even letters of suggestion or complaint from customers. Many good ideas come from having customers describe the problems they have with current products.

- **Competitors**. Many organisations keep a close eye on the research and development (R&D) activities of their competitors. Industrial espionage is a very real phenomenon and many high-tech companies spend sizeable amounts on making sure that their R&D activities are kept secret. Many Japanese organisations actually started out by imitating and improving competitors' products. Often an organisation buys a competitor's product and then dismantles it to see what new improvements or developments have been made!

- **Employees and R&D staff.** The use of suggestion boxes and competitions can help to generate new ideas through the workforce. Many forward-thinking organisations successfully operate such schemes and fully utilise the knowledge of the workforce to help them become more competitive. Continuous improvement often results from the effective processing of new ideas in the organisation. Toyota, one of the most striking examples of continuous improvement, claims that its employees submit 2 million ideas annually (about 35 suggestions per employee) and that over 85 per cent of these are implemented. The organisation's R&D section should be an obvious source of new product ideas.

- **Top management**. Top management can be the catalyst for new-product development, either driving new product development themselves or making it easier for others in the organisation to generate ideas and develop successful products. They provide the leadership role necessary to ensure that the new-product development process remains a key result area for the business.

## ACTIVITY 7.1

You have been appointed the new-product manager for McDonald's SA. Discuss four (4) sources that you would utilise to generate new-product ideas that can be added to McDonald's SA product mix.

## FEEDBACK

There are many sources of ideas, including customers, competitors, employees, research and development, channel members and even top management that you, as the new-product manager, could utilise to generate new ideas.

- **Customers**. For example, McDonald's SA could generate new product ideas by providing their customers with a customer care line. Customers could be given an opportunity to phone in with suggestions regarding any improvement to the current product mix or any complaints regarding the products sold. They could also make use of surveys and focus groups to identify customers' needs and wants.
- **Competitors**. McDonald's SA can generate new product ideas by keeping a close eye on the Research and Development of Steers, Wimpy and Nando's, as well as any other family restaurants. They could also buy their competitors products to analyse them. Management would make it their duty to ensure that they are always ahead of their main competitors.
- **Incentives**. Employees and R&D staff. McDonald's SA could encourage and promote a policy of asking its employees come up with new-product ideas.

Each McDonald's outlet could, for example, have a suggestion box for employees and could host competitions stating that if an employee comes with a brilliant product idea he or she will be rewarded with a trip to McDonald's Head Office in the USA for example.

- **Top management**. McDonald's SA management could be the drivers of new-product development by creating systems in the organisation that will make it easier for employees as well as customers to come up with new-product ideas. The management could embrace any individuals who propose a new product by writing them a personalised letter thanking them for their input and possibly giving them a gift as a sign of appreciating their efforts even if their suggested product idea was not successful or chosen in the idea-screening phase.

### 7.6.2 Idea screening

At this stage ideas are evaluated to determine which ones warrant further study. The aim is to screen out those ideas that do not fit the company's overall strategy or positioning, or those that involve an unacceptable level of competitive, operational and legal risk. Take note of the types of mistakes that can occur during this stage.

### 7.6.3 Concept testing

This step takes place when the idea, which has been approved internally in the previous phase, is tested externally with potential consumers and the market. There are two main types of concept statements, namely core ideas and positioning statements. The core ideas are usually composed of short, general statements explaining what the product can do, for example, a fast moving consumer goods (an FMCG) company can have an idea to manufacture a product that will help to remove stubborn stains from clothes and home appliances, whereas the positioning statements generally outline the main and secondary benefits as well as the product's integrated marketing strategy.

### 7.6.4 Business analysis

An idea that survives to this stage is expanded into a concrete business proposal. Management conducts a formal study that identifies product features, then estimates market demand, competition and the product's profitability potential.

### 7.6.5 Product development

The “idea on paper” is converted into physical product. Pilot models, or small quantities, are manufactured to designated specifications, and laboratory tests and other technical evaluations are made to determine the product feasibility.

Here the product developers have to communicate both the functional and psychological characteristics. The product will go through two tests, namely a functional test (this makes sure that the product performs safely and effectively) and a consumer test (in which the management tests all marketing elements, such as brand identity and the broad marketing mix).

### 7.6.6 Test marketing

Market tests, in-use tests and other commercial experiments in limited geographic areas are conducted to ascertain the feasibility of a full-scale marketing programme. Test marketing may be used by selling the product in a limited geographic area. This is done to establish whether customers will actually buy the product.

### 7.6.7 Commercialisation

Full-scale production and marketing programmes are planned, and the product is launched. Up to this point in the development process, management has complete control over the product. Once the product is developed and enters the market, the external competitive environment becomes a major determinant of its destiny. In launching the product, management has two options; embark on an immediate national launch or a rolling launch. Study these two options in detail in the prescribed book.

## 7.7 THE CONSUMER ADOPTION PROCESS

(Study pages 238–241 in the prescribed book.)



Consumers do not automatically accept new products that are introduced into the market place. It takes time for consumers, the market and society to get to know the product, and to understand how it adds value for them. Users of the new product can only really understand how a new product provides them with value by trying out the new product. Therefore, to effectively craft strategies for early market penetration, it is vital for marketers to understand the process whereby customers adopt new products.

What is the distinction between diffusion and adoption? Diffusion is the process whereby the acceptance of an innovation is spread by communication from the manufacturer to its target market which constitutes the ultimate users or adopters. The diffusion process is a group concept because it involves consumers adopting the new product or innovation as a collective. Whereas the adoption process is an individual concept referring to the stages through which a consumer passes after first hearing about a product/service before finally adopting it.

### 7.7.1 The stages of new product acceptance

The consumer adoption process focuses on the mental processes that individuals experience from the moment they become aware of the new product right through to the stage when they adopt or accept the product. New product adopters move through five stages which include:

- **Awareness**. In this stage consumers become aware of the innovation but lack information about it.
- **Interest**. During this stage interest is stimulated and consumers desire more information.
- **Evaluation**. Now, at this stage consumers consider trying out the innovation.
- **Trial**. During the trial stage consumers try out the innovation and determine their estimation of the innovation's value.
- **Adoption**. In the adoption stage, consumers decide to use the product.

The different stages of the product adoption process are crucial to marketing. Marketers of new products should use their understanding of these stages to facilitate and encourage consumers' movement through these phases. This is done using the elements of the marketing mix.

### 7.7.2 Factors influencing the adoption process

It is important for marketers to understand the factors that influence this adoption process in order to make the introduction of the new product or service more effective. Study them in more detail in the prescribed book. The factors that influence the adoption process are:

- Differences in people's readiness to try a new product
- Personal influence on the adoption of new products
- The effect of an innovation's characteristics on its rate of adoption

## ASSESSMENT

1. Discuss the classification of new products from both the manufacturer's and the consumer's perspectives.
2. Explain the reasons behind the success and failure of new products.
3. Discuss the role of marketing management in new product development and its influence on other functional areas.
4. Describe the different phases of the new-product development process.
5. Explain the concepts of obsolescence and standardisation.

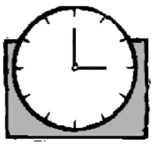
6. Identify and describe the stages of the consumer adoption process.

7. Discuss the factors that influence the adoption process.

## SUMMARY

In this study unit, we looked at the classification of new products and the success and failure of new products. We further examined the management of ideas for new product development, the role of marketing in new-product development and strategies for new-product development. A key section of the study unit was the discussion on the stages in the new-product development process. It is essential that you are able to discuss each of these stages and have a clear understanding of what happens at each stage. The study unit concluded with a look at the consumer adoption process and the factors that influence this adoption process.

In the next study unit, we will be looking at product decisions that involve branding. It is important to brand products because branding helps the organisation to distinguish its product offering from those of competitors. Key issues in this regard will be addressed.



# STUDY UNIT 8

## INTRODUCTION TO BRAND MANAGEMENT

**CONTENTS** **PAGE**

## KEY CONCEPTS

You will need to master the following key concepts in order to meet the learning outcomes for this topic:

- Branding
- Brand name
- Brand symbols
- Trademark
- Retailer brand
- Manufacturer brand
- Generic brand
- Family brand
- Individual brand
- Brand extension
- Brand equity
- Brand positioning
- Brand image

## OVERVIEW

Imagine a world where everybody looked exactly the same and everyone was called by the same name. It would be impossible to tell people apart or to know whom to trust. We would not know who was a criminal or who was a policeman, in short we would live in a world of utter chaos. In business, we could face a similar situation if all products were exactly the same and referred to by the same name. Imagine you could not buy a BMW or a Mercedes-Benz, you could only buy a "CAR", there was no difference between a Sony and a Panasonic, and they were all called "TV". Consumers would not be able to distinguish between producers, suppliers or quality. We would be buying blind! In this study unit we will consider the concept of branding. Branding is what organisations use to identify and differentiate their products or services from the competition. We will look at the basics of branding and its advantages, the major branding decisions, brand equity and brand positioning.

## 8.1 THE MEANING OF BRANDS

(Study pages 213–214 in the prescribed book.)

Let us define branding by examining the following example:

The prescribed book defines a brand as a name, term, design, symbol or any other feature that identifies a product as unique from competitors. The ABSA brand above consists of a brand mark:

and a brand name:

The brand as a whole is trademarked.

Together the name and the mark represent the bank ABSA and distinguish this particular bank from its competitors.

**ACTIVITY 8.1**

See if you can identify the following products or organisations based on the symbols used in their brand:

## FEEDBACK

The brand symbols are so well known that you should have found this exercise quite easy! The first symbol is that of First National Bank (FNB); the second is Nike; the third Spur and the last Toyota. The better a brand is marketed, the easier it is to identify the organisation or product.

After studying page 214 in your prescribed book you should be able to identify all of the different components of a brand.

The question that can now be asked is "Why should organisations brand their products?" Let us consider the benefits of branding.

## 8.2 THE BENEFITS OF BRANDING

(Study pages 214–217 in the prescribed book.)

Branding holds benefits for both the consumer and the supplier. Figure 6.7 in your prescribed book clearly outlines the benefits to the manufacturer, the consumer and the retailer. When you study this section make sure that you can explain and discuss the benefits of branding to any or all of the groups.

### ACTIVITY 8.2

Imagine that you are a Pick n Pay customer who is looking at the battery display rack. You notice that there is a Pick n Pay Choice battery hanging next to a Duracell battery. Discuss the benefits of branding to the consumer by using the two brands of batteries to illustrate your point.

## FEEDBACK

Did you mention the following?

- Branding facilitates product identification – you can clearly see the difference between the products on the shelf and identify which is the Duracell and which is the Pick n Pay battery.
- Branding communicates features and benefits – as consumers we are aware that Duracell last much longer than ordinary batteries due to their advertising.
- Helps product evaluation – the branding assists us in choosing which battery to buy.

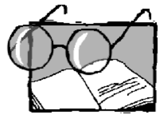
- Reduces risks in purchasing – by selecting a brand that we are familiar with, we believe that we are taking fewer risks when purchasing a product like the Duracell battery.
- Creates interest and character for the product image – the Duracell Bunny gives personality to an otherwise dull product.

Now that we know what branding is all about, let us look at the decisions that marketers need to take concerning the branding of their market offerings.

## 8.3 BRANDING DECISIONS

So far in this study unit we have mentioned some examples of brands like Toyota, Spur and Pick n Pay Choice. Can you spot any differences between these examples? Toyota is a manufacturer while Spur and Pick n Pay are retailers. Also Pick n Pay Choice is the retailer's own brand (the products do not carry the manufacturers name, but only the Pick n Pay Choice branding). This represents the first branding decision that marketers must take: the type of brand.

### 8.3.1 Types of brands



(Study pages 217–221 in the prescribed book.)

When you study this section in your prescribed book, you should be able to identify the three major types of brands:

- Manufacturer or retailer brands
- Generic brands
- Family or individual brands

It is sometimes difficult to distinguish between the types so let us have a closer look at each of them.

#### 8.3.1.1 Manufacturer or retailer brands

Manufacturer or retailer brands clearly identify either the manufacturer or the retailer of the product. Retailer brands are often referred to as in-house brands or private label brands. Consider the following activity:

**ACTIVITY 8.3**

Can you identify the manufacturer or retailer by looking at the following products:

/continued ...


## FEEDBACK

Did you notice how easy it is to identify the manufacturer brands – Nescafé made by Nestlé and Kelloggs makes the corn flakes. The Pick n Pay Choice coffee granules product does not indicate the manufacturer but does indicate the retailer, namely Pick n Pay.

### 8.3.1.2 Generic brands

Generic brands do not indicate either the manufacturer or the retailer; in fact they only indicate the type of product. Imagine a plain white box that simply has the word “Soap” on it. This would be a generic brand of soap. Although many retailers market their home brands as “generic”, if there is any form of identification then it is NOT a generic brand.

Do the following activity:

## ACTIVITY 8.4

Identify the manufacturer or retailer from the following pictures:

/continued ...


## FEEDBACK

The chocolates on the left do not indicate either the retailer or the manufacturer: this is clearly a generic brand. The cutlery set on the right identifies Spar as the seller; therefore it is a retailer brand.

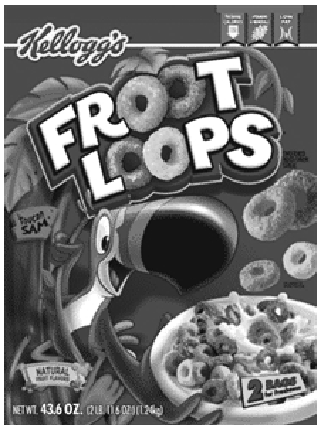
The final type of brand that we will scrutinise is the family brand versus the individual brand.

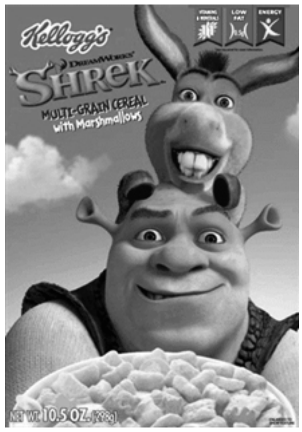
### 8.3.1.3 Family and individual brand

When products have brands that are unique to that product we call them individual brands. Let us look at the following products all produced by South African Breweries:


Even though each of these products is produced by the same manufacturer (SAB), they are branded as individual products with different marketing plans and strategies.

Kelloggs, the cereal manufacturer, uses a different approach:


Do you see that each of the products identifies the manufacturer and a relationship between the products? The prescribed book refers to this as a company name with a brand.

Unilever produces the Sunlight brand in South Africa.  Look at the following products:




Can you see that all the products are part of the Sunlight family?  This is an example of family branding; the Unilever name is not mentioned as part of the brand or in any advertising.

Once marketers have decided on a type of brand, they need to consider the brand strategy and also the equity (value) of the brand.  In the next section we will explore brand strategy and the selection of the actual brand name.

### 8.3.2 Brand extension

(Read page 220 in the prescribed book.)

Once manufacturers or retailers have established a successful brand, one of the strategic options available to them is to extend the brand name to other products. Many of these so-called brand extensions happen into other product categories. Caterpillar, the well-known manufacturer of heavy industrial equipment, successfully extended its brand into clothing by selling Caterpillar branded shoes. This strategy makes sense to marketers because consumers associate the quality and strength of the Caterpillar machinery with the shoes. If the shoes were of substandard quality then the brand extension strategy could damage the original brand.

### 8.3.3 Selecting a brand name

(Study pages 200–221 in the prescribed book.)

Selecting a brand name for a product is a complicated and important decision. If you select the wrong name you could damage the product image before it is even properly launched. The prescribed book provides some guidelines for selecting brand names. Study these before attempting the following activity.

**ACTIVITY 8.5**

Discuss the following brand names according to the guidelines for selecting a brand name identified in the prescribed book:

- Nissan Qashqai
- Cadbury Boost

### FEEDBACK

Did you consider that the Qashqai brand does not directly mean anything to the consumer? In fact the Qashqai are a confederacy of tribes living in Iran, which could transfer rugged, nomadic connotations to the car (if consumers were aware of the tribes). Cadbury Boost on the other hand clearly indicates that the chocolate bar will give you a boost of energy. The second criterion mentioned in the prescribed book is that the name should be easy to pronounce. The Qashqai obviously falls short of this criterion. Thirdly the name must be original and distinctive; the Nissan Qashqai meets this requirement very well. Fourthly the name must create an exclusive image; once again the Qashqai can be perceived as exclusive. Fifthly, the brand name should indicate high quality. Neither of the brands directly refers to quality; both companies are relying on the manufacturer's name (Cadbury and Nissan) to convey the image of quality. In the sixth place, the name should be versatile. Nissan can apply the Qashqai name to any variant of the product, 160, 200 or Diesel, while Cadbury cannot refer to any of its other products as Boost. Lastly, the name should translate into other languages. Fortunately for Nissan, Qashqai already exists as name, so it is referred to as Qashqai in all languages.

In the next section we will examine the value of a brand, also referred to as brand equity.

## 8.4 BRAND EQUITY

Read chapter seven in your prescribed book BUT study this section in the study guide as well.

Brand equity can quite easily be defined as the monetary value of a brand. Another way of looking at the definition is to consider what the product could be sold for with and without the brand name.

Think about it: What would you pay for a can of Coca-Cola if it didn't say Coca-Cola on the can? Most consumers are not prepared to pay the same high price for a well-known product if it is not branded.

The calculation of brand equity is however a different (and more difficult) matter. Let us consider the following elements that contribute to brand equity:

### 8.4.1 Brand awareness

As a general rule, the more consumers there are who are aware of the brand's existence, the more valuable it is. Have you ever met anyone who did not know of Coca-Cola? Marketers can create awareness among their target audience through repetitive advertising and publicity. Brand awareness can provide a host of competitive advantages for the marketer. These include the following:

- Brand awareness provides the brand with a sense of familiarity.
- Name awareness can be a signal of presence, commitment and substance.
- The salience of a brand will determine whether it is recalled at a key time in the purchasing process.
- Brand awareness is an asset that can be remarkably durable and thus sustainable. It may be extremely difficult to dislodge a brand that has achieved a dominant awareness level.

Organisations can create brand awareness first, by having a broad sales base, and second, by becoming skilled at operating outside the normal media channels. A brand with high brand awareness and with positively distinguishing associations will have a high added value for consumers.

### 8.4.2 Perceived quality

If consumers perceive a brand to be of high quality, the brand is generally worth more than one that is perceived as being of low quality. Consider the BMW brand relative to the TATA brand. Perceived quality is a brand association that is elevated to the status of a brand asset for various reasons, such as the following:

- Perceived quality drives financial performance.
- Perceived quality is often a major strategic thrust of products.
- Perceived quality is linked to and often drives other aspects of how a brand is perceived.

Part of a consumer's image of a brand is based on actual facts and experiences. However, another part of that image is based on perceptions born out of a product's reputation, media coverage and other indirect sources of information. A successful brand has a recognisable name which signals specific attributes to the consumer.

### 8.4.3 Brand loyalty

Loyal customers return to a brand again and again in spite of difficulties with obtaining that brand. Imagine if your favourite take-away restaurant moved to the other side of town. If you are prepared to drive across town to get that specific food, you are a loyal customer. A brand with many loyal customers increases the value of that brand. An existing base of loyal customers provides sustainable competitive advantages for organisations, which include the following:

- Since existing customers are usually relatively easy to hold, it reduces the marketing costs of doing business.
- The loyalty of existing customers represents a substantial entry barrier to competitors.
- A relatively large, satisfied customer base provides an image of a brand as an accepted, successful, enduring product that will include service backup and product improvements.
- Brand loyalty provides the time to respond to competitive moves.

### 8.4.4 Brand association

When consumers associate a brand with the intended qualities such as quality, value for money, reliability or availability, the value of that brand is increased. Consumers associate BMW with stylish motorcars, a fact which immediately increases the value of the BMW brand.

Brand equity really comes into play when one organisation purchases a brand from another organisation in order to enter into the marketplace. Brands with higher equity will be sold for many times more than the tangible asset value.

Organisations that have decided on the type of brand and the ultimate brand name have to consider the positioning of the brand and the associated brand image. In the next section we will look at these two aspects of branding.

## 8.5 BRAND POSITIONING AND IMAGE

(Study pages 136–145 in your prescribed book.)

Positioning is defined as the psychological position that your organisation's brand has, relative to the competition, in the minds of the consumer. For example if we were asked to compare Toyota and Volkswagen in terms of reliability, or Cadbury and Nestlé in terms of taste, each of us would immediately "position" one of the brands above the other. This psychological position is what marketers strive to create via advertising and product education. When you study this section in your prescribed book, pay special attention to the positioning methods on page 143.

## ACTIVITY 8.6

A television advertisement for Mitchum deodorants demonstrates the long-lasting effects of the deodorant while emphasising that there are less effective, cheaper options available to consumers. Which positioning methods are being used?

## FEEDBACK

The Mitchum marketers are using a combination of at least two of the positioning methods. Firstly they are using benefit positioning to illustrate the benefits of using Mitchum deodorants. Secondly they are using price/quality positioning to set Mitchum apart from the "cheaper" competition.

The concept of positioning is indelibly tied in to the brand image. If a product is positioned as high quality with many benefits, the image created in the consumers' minds is exactly that – a high quality product that will be of benefit to them. Marketers spend large portions of their marketing budgets to create brand images of their products in the consumers' minds. It is important to ensure that they perceive the desired image.

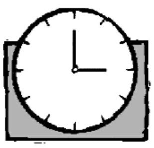
## ASSESSMENT

1. Explain what a brand is by using practical examples to illustrate each element of the definition.
2. Discuss the advantages of branding to consumers and manufacturers.
3. Describe the different types of brands that are available to the marketer, using practical examples to illustrate each type.
4. Discuss the various positioning methods that marketers can use to position their brands relative to their competitors.
5. Differentiate between the elements that contribute towards the monetary value (brand equity) of a brand. Provide examples of products that you are familiar with to illustrate each point.

## SUMMARY

In this study unit we looked at all the aspects surrounding the branding of a product or service. We considered that branding is the unique way of identifying a product or service relative to the competition. We went on to examine the advantages that branding holds, not only for the manufacturer but also for the consumer. The various branding decisions that marketers need to take and the equity or value of the brand we also considered. The study unit concluded with a discussion of how a brand can be positioned and the methods that can be used to achieve an appropriate position.

In the next study unit we move from the topic of product and focus our attention on pricing. Study unit nine starts by defining what pricing is and considers the various pricing constraints that exist.



# TOPIC 3

## PRICING DECISIONS

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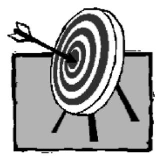
### AIM

To introduce you to the topic of pricing decisions and the elements making up the price component, that need to be considered when developing a pricing strategy for a given organisation. The aim of this topic is also to develop an understanding of the issue of tactical pricing decisions and their role in pricing strategy to achieve the results desired by an organisation.



### LEARNING OUTCOMES

After studying this topic, you should be able to:

- explain the concept of pricing and the relationship between demand and product pricing
- discuss the various cost constraints that affect the pricing decisions for a product
- describe the various pricing objectives that the marketing manger can set when developing pricing strategy
- explain the various pricing methods that the marketing manager can use when establishing a pricing strategy in order to achieve the set pricing objectives
- discuss the different tactical pricing decisions that marketers can make when responding to short-term situational changes that arise in the business environment

Topic contents:

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| Study unit 9: | The importance of pricing |
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# STUDY UNIT 9

## THE IMPORTANCE OF PRICING

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## KEY CONCEPTS

You will need to master the following key concepts in order to meet the learning outcomes for this topic:

- Price
- Price value relationship
- Marketing mix
- Elasticity of demand
- Price elasticity
- Price sensitivity
- Demand revenue
- Supply schedule

## OVERVIEW

Price is all around us. You pay rent for your accommodation or an instalment on your bond every month, tuition fees for you studies, taxi fare to get to work or university every day, money for bread and milk, and even bank charges every time you draw money from your own bank account!

Even though we “hate” paying for the above expenses every day, the price we pay for certain products or services plays an important role in our lives. From a marketing point of view, price plays two very important roles. Firstly, price determines how much of a product a consumer purchases, and secondly it influences whether selling the product will in fact be profitable to the organisation or not. These two roles make setting the price of a product one of the most important marketing decisions.

In this study unit, we will discuss the nature and role of price in marketing, and the meaning of price. The bulk of the discussion will focus on the pricing model and demand constraints in pricing that affect the price that can be set.

## 9.1 THE ROLE OF PRICE IN MARKETING

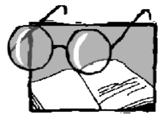
(Study pages 321–323 in the prescribed book.)

As you are aware, the marketing mix consists of the four Ps, namely price, product, place (distribution) and promotion. A marketing manager needs to consider all these elements to make the best pricing decision for the organisation, because the quality of the product, the type of distribution channel used, the end consumers served and the function played by intermediaries all help to establish a price range for an organisation's products or services. When studying this section in the prescribed book you should note the relationship between price and the product strategy, the distribution strategy and the promotional strategy, as well as the use of price when positioning an organisation or specific product or service.

It is general knowledge that consumers tend to associate a high price with high quality, and low price with low quality, even though this is not always true. It is true, however, that the quality and the features of a product will affect the price strategy. Price is also influenced by the type of channel that is most suitable for the product, the distribution intensity required and the channel configuration. When setting prices, the marketing executive should take care not only to look at his or her own company's needs and objectives, but also to consider the needs and motivation of intermediaries. The price of products and services also directly influences the promotional strategy of the organisation. High-quality, highly priced products should be advertised in media that, by association, complement or endorse the image of the product, whereas the use of inappropriate media could lower the image of the product. Price is used in various ways in the marketing positioning strategy – as a signal to the buyer, as an instrument of competition, a means to improve financial performance, and a way to perform other marketing mix functions; promotional pricing for instance.

The key to effective pricing is to ensure that the price charged reflects the amount of value a customer is receiving. See table 9.1 in your prescribed book on the differences between a cost orientation and a value orientation to price.

## 9.2 THE MEANING OF PRICE



(Study pages 323–324 in the prescribed book.)

In this section of your prescribed book, the basic concept of price is introduced. It is important that you understand the meaning of price, as well as the role played by price in the economy and in an organisation. Various definitions of price exist but, generally speaking, price refers to the money that is exchanged for a product or a service. Table 9.2 in your prescribed book identifies all the various terms that can be used when referring to the concept of price.

Price is the value of the utility one receives from products and services. Utility is a measure of the relative satisfaction obtained from the consumption of goods or of how much the goods are desired. The degree of utility a person receives corresponds to the person's level of consumption. Usually, the more the person consumes, the larger his or her total utility will be. Marginal utility is the additional satisfaction, or additional degree of utility gained from each extra unit of consumption.

Although total utility usually increases as more of a good is consumed, marginal utility usually decreases with each additional increase in the consumption of goods.

## 9.3 THE PRICING MODEL

(Study pages 324–325 in the prescribed book.)

A step-by-step procedure to be followed when a pricing decision is to be made is shown in figure 9.1. This is normally done in the case of new products. There are factors that a marker should take into consideration when selecting a price of a product. These factors include the marketing strategy of the organisation, the competition, and other businesses' costs. Study this pricing model and make sure that you understand the process that is followed.

## 9.4 DEMAND CONSTRAINTS IN PRICING

(Study pages 325–335 in the prescribed book.)

You will note when you study this section in the prescribed book that it is important for a marketing manager to understand the relationship between demand and the price that is set for a product. Demand is the amount of product that will be sold in the market at various prices for a specific period of time. The usual relationship we expect is that the higher the price, the lower the demand. On the other hand, the lower the price is set, the more products consumers will demand.

Supply is the amount of product that will be offered to a market by suppliers at various prices for a specific period. When the demand graph is drawn, it slopes upwards from right to left (at higher prices, the quantity demanded decreases). The supply curve slopes downwards from right to left (at lower prices, the quantity demanded increases). Study figure 9.2 in your prescribed book in this regard. If the demand curve and the supply curve are drawn on the same axis, where the two curves touch each other is the equilibrium price. This means that at that point the price of demand and supply are equal. The following are the demand constraints in pricing:

### 9.4.1 Demand according to the market structure

The seller's pricing freedom varies with different types of markets. Economists recognise four types of markets, each of which presents a different pricing challenge, namely pure competition, monopolistic competition, oligopolistic competition and pure monopoly competition. Under pure competition, the market consists of many buyers and sellers who trade in a uniform commodity such as wheat, copper or corn. No single buyer or seller has much effect on the going market price. A seller cannot charge more than the going price because buyers can obtain as much as they need at the going price. Nor would sellers charge less than the market price, simply because they can sell all they want at this price. Under monopolistic competition, the market consists of many buyers and sellers who trade over a range of prices rather than a single market price. A range of prices occurs because sellers can change their offers to buyers. Either the physical product can be varied in quality, features or style, or the accompanying services can be varied. Buyers see differences in seller's products and will pay different prices for them. Sellers try to develop different offers for different customer segments and, in addition to price, freely use branding, advertising and personal selling to distinguish their offers from competitors. For example, Koo and Nestlé which are national brands, compete with local brands, and all are differentiated by price and nonprice factors. Because there are many competitors, each company is less affected by competitors' marketing strategies than is the case in oligopolistic markets.

Under oligopolistic competition, the market consists of a few sellers who are highly sensitive to each other's pricing and marketing strategies. The product can be uniform (steel, aluminium) or nonuniform (cars, furniture). In this case, there are few sellers because it is difficult for new sellers to enter the market. Each seller is alert to competitors' strategies and moves. If a car company slashes its prices by 10 per cent, buyers will switch to this supplier. The other manufacturers must respond by lowering their prices or increasing their services. An oligopolist is never sure that it will gain anything permanent through a price cut. In contrast, if an oligopolist raises its prices, its competitors might not follow this lead. The oligopolist will then have to retract its price increase or risk losing customers to competitors.

In a pure monopoly, the market consists of one seller. The seller may be a government monopoly (postal service) or a private, nonregulated monopoly (SABMiller). Pricing is handled differently in each case. A government monopoly can pursue a variety of pricing objectives. It might set a price below cost because the product is important to buyers who cannot afford to pay full cost. Or the price might be set either to cover costs or to produce good revenue. It can even be set quite high to slow down consumption. In a regulated monopoly, the government permits the company to set rates that will yield a fair return, that is, one that will let the company maintain and expand its operations as needed. Nonregulated monopolies are free to set the price at what the market will bear. However, they do not always charge the full price for a number of reasons: the desire not to attract competition, the desire to penetrate the market faster by using a low pricing strategy, or the fear of government regulations.

### 9.4.2 Elasticity of demand (ED)

Elasticity of demand measures the responsiveness of demand. A change in demand could occur if there is a change in price or income, or a change in price of substitute or complementary goods.

#### 9.4.2.1 Price elasticity

Price elasticity of demand can be defined as the sensitivity of the demand for a product in reaction to changes in the price of the product, and is obtained by dividing the change in the quantity demanded by the change in the price of the product.

It is important that when you study this section in the prescribed book, you are able to distinguish between the different types of price elastics of demand and can provide practical examples to illustrate the differences. The different types of elasticity that are addressed include perfect elasticity, relative price elasticity, price elasticity of one, relative price inelasticity, and perfect price inelasticity.

#### 9.4.2.2 Income elasticity of demand

If there is a change in the consumer's income, automatically his or her demand for a product or services will change. When studying this section in the prescribed book, you will realise that three different types of income elasticities of demand can be distinguished. They are: an income elasticity > 0 and < 1, an income elasticity > 1, and negative income elasticity. You should be able to distinguish between the three income elasticities and give examples.

#### 9.4.2.3 Cross-elasticity of demand

The sensitivity of demand for a product in reaction to changes in the price of a substitute or complementary product is measured. Products are said to be a positive substitutes or good substitutes if the decrease in price of one product results in the decrease of demand of the other product. The products are complementary if the price decrease of one product results in an increase in demand for the other product.

### 9.4.3 Consumer's price behaviour

When you go to the shop to buy butter, and you find that the butter is too expensive and you do not have enough money to buy it, what do you do? You decide to buy the closest substitute, margarine! This example illustrates the principle of price sensitivity: if a product has close substitutes (like butter and margarine), price sensitivity usually increases because the option to switch products is available to the buyer if the price of the original product happens to increase. When you study this section in your prescribed book, make sure that you concentrate on the factors that influence price sensitivity.

Consumers evaluate prices of products before they decide to buy or not to buy the products. The marketers should try to understand the way consumers evaluate the prices so that their prices are presented in a way that will lead consumers to buy the products. Consumer price behaviour includes the study of:

- perceptions of price difference
- reference prices
- price-quality relationships
- demand band
- price as a statement of value

You should study this in your prescribed book. For example, reference price is the price that the consumer regards as being fair and is prepared to pay for the product. As regards the price /quality relationship, most consumers believe the higher the price of the product, the better the quality.

**ACTIVITY 9.1**

Can you think of any examples of products that are not price sensitive? Provide reasons for thinking that the sales of these types of products are not sensitive to price increases or decreases.

## FEEDBACK

When answering this question, you might have mentioned that electricity or petrol and diesel are not price sensitive, because even though the prices of these services and products keep on rising, we are forced to continue using them because there are no substitutes. But in contrast, if the price of butter goes up, consumers will consider buying margarine.

## ASSESSMENT

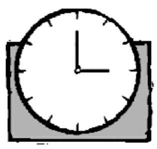
1. Explain the role of price in marketing.
2. Give an account of the different meanings of price.
3. Explain the difference between the cost orientation approach to pricing and the value orientation approach to pricing.
4. Explain how demand for a product can be affected by different market structures.
5. Use practical examples to explain the concept of elasticity of demand.

6. Describe, with the aid of practical examples, how consumer behaviour patterns influence the demand for a product.

## SUMMARY

In this study unit, we discussed the meaning of price, the role of price in marketing. Price influences how much of a product consumers can buy. It also influences whether selling the product will be profitable to the marketer or not. In addition we examined the pricing model and the demand constraints in pricing. Different markets were discussed (monopoly etc.) and pricing under the different market structures was highlighted. Elasticity of demand (how consumers react to price change) and consumers' price behaviour were discussed with emphasis on how their buying behaviour is affected.

As you saw, the focus of this study unit was on demand constraints in pricing. In the next study unit we shift our focus to cost constraints that need to be considered by the marketer when addressing the issue of pricing.



# STUDY UNIT 10

## COST CONSTRAINTS AND PRICE OBJECTIVES

**CONTENTS** **PAGE**

## KEY CONCEPTS

You will need to master the following key concepts in order to meet the learning outcomes for this topic:

- Total cost
- Fixed cost
- Variable cost
- Marginal cost
- Economies of scale
- Maximum profit
- Target profit

## OVERVIEW

Every transaction involves a price, even if the price is zero. People pay fares to travel in taxis, interest on loans, fees to consult medical doctors and premiums to insure their lives and property. In order to market a product or service successfully, the seller must establish a price. Pricing forms the cornerstone of a company's marketing strategy. Discounters such as Clicks rely on their low-price image. Many products and brands employ relatively high prices to enforce an image of superior quality, for example Gucci, Levis and BMW. The existence of price helps buyers decide how to allocate their power to various goods and services. Buyers compare the prices of alternative products and services and then decide how to spend their money. Price influences the demand for a company's products or services and forms an essential dimension of the marketing strategy. Therefore any decision about pricing should be made after evaluating its expected impact on demand and its consistency with the rest of the marketing strategy. In this study unit we will identify pricing constraints and objectives of companies when they set prices for their products. Pricing constraints are internal and external factors which limit the company's flexibility in price setting, for example, demand for a product class and brand, newness of the product, cost and competition. These constraints will be addressed in this study unit. A company should decide where it wants to position its market offering. The clearer the company's objectives the easier it is to set prices.

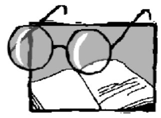
## 10.1 INTRODUCTION

Many companies find price setting a difficult task; therefore the identification of price constraints and the setting of objectives are imperative for the survival of companies. For example, you went shopping at Pick n Pay and bought 2 litres of dairy milk for R15,99. Imagine how cross you would be if you found out that Checkers charged only R9,99! Do you think that Pick n Pay who charge R15,99 will sell a lot of milk? Of course not. Therefore, competition is one constraint on pricing. If there were no other shops selling milk within, say, 40km or 100 km, then Pick n Pay might get away with charging such high prices.

This example illustrates that marketers should be aware of pricing constraints when setting prices because pricing constraints limit the choice of the price range that may be charged. In this study unit pricing constraints and objectives will be discussed.

## 10.2 COST CONSTRAINTS IN PRICING

Study pages 335–337 in the prescribed book.)





Understanding the role and behaviour of costs is critical for all marketing decisions, but particularly for pricing decisions. The four cost concepts, namely total cost, fixed cost, variable cost and marginal cost are important in pricing decisions. The cost concepts will be the focus of the next section.

### 10.2.1 Types of costs

- **Total cost (TC)**. Total cost (TC) is the total expense incurred by a firm in producing and marketing the product. Total cost is the sum of fixed cost and variable cost.
- **Fixed cost (FC)**. This is the sum of the expenses of the firm that are stable and do not change with the volume of product that is produced and sold. Examples of fixed costs are rent on the building, executive salaries and insurance.
- **Variable cost (VC)**. Variable cost (VC) is the sum of the business's expenses that varies directly with the volume of product produced and sold. For example, as the quantity sold doubles, the variable cost doubles. Examples are the direct labour and direct materials used in producing the product and the sales commissions that are tied directly to the quantity sold. As mentioned above: TC = FC+VC
- **Marginal/incremental cost (MC)**. Marginal/incremental cost (MC) is the change in total cost that results from producing and marketing one additional unit.

### 10.2.2 Cost-volume relationship

Costs are not the same in different levels of production. If more goods are produced, the lesser the production cost becomes due to economies of scale. In production there are two things that marketers should take into account; economies of scale and the learning curve the organisation gains in producing goods (see section 9.5.2 in your prescribed book).

### 10.2.3 Competitors' costs and prices

Competitors' prices help the organisation to establish where its prices could be set. The organisation should always compare its prices with those of its competitors. The prices should always be more or less the same or as close as possible to those of its competitors (study section 9.5.3 in your prescribed book).

## 10.3 PRICE OBJECTIVES

(Study pages 338–340 in the prescribed book.)

Many companies have established corporate pricing objectives that provide strong direction for pricing decisions. Generally these objectives are designed to reflect the firm's organisational objectives. Although the pricing objectives alone are not sufficient to identify the single best list price, they often help managers narrow the range of possible prices. To survive in today's highly competitive marketplace, companies need pricing objectives that are specific, attainable and measurable. Realistic pricing goals therefore require periodic monitoring to determine the effectiveness of the company's strategy.

For convenience, pricing objectives can be divided into: profit objectives, sales volume objectives and “other” pricing objectives. Each of these is addressed in the following subsections.

### 10.3.1 Profit-oriented pricing objectives

Profit-oriented objectives include profit maximisation, satisfactory profits and target return on investment. Make sure that you understand them and are able to discuss them.

#### 10.3.1.1 Profit maximisation as a pricing objective

Profit maximisation means setting prices to maximise total revenue relative to total costs. This does not always signify unreasonably high prices however. Both pricing and profits depend on the type of competitive environment a company faces such as being in a monopoly position (being the only seller) or selling in a much more competitive situation.

Managers sometimes say that their company is trying to maximise profits – in other words, trying to make as much money as possible. Although this goal may sound impressive to stockholders, it is not sufficient for planning purposes. The statement “We want to make all the money we can” is vague and lacks focus.

#### 10.3.1.2 Satisfactory profits as a pricing objective

Satisfactory profits represent a reasonable level of profits. Rather than maximising profits, many companies strive for profits that are satisfactory to the stockholders and management – in other words, the company tries to achieve a profit level that is consistent with the risk level the company faces. In a high-risk industry, a satisfactory profit maybe 35 to 40 per cent. In a low-risk industry, it might be 10 to12 per cent.

To maximise profits, a small-business owner might have to keep his or her store open seven days a week. But the owner might not want to work that hard and might be satisfied with less profit. Take, for example, the spaza shops in townships: many open at 6 o'clock in the morning but close at 10 or 11 o'clock at night. By doing this, they may be trying to maximise profits, or simply make enough profit to survive.



#### 10.3.1.3 Target profit as a pricing objective (Target return on investment)

The most common profit objective is target return on investment (ROI), sometimes called the company's return on total assets. ROI measures management's overall effectiveness in generating profits with its available assets. The higher the company's return on investment, the better off the company is. Return on investment is calculated as follows:

$$\text{Return on investment} = \frac{\text{Net profits after taxes}}{\text{Total assets}}$$

Assume that in 2008 Khumalo Enterprises had assets of R4,5 million, net profits of R550 000 and a target ROI of 10 per cent. This was the actual ROI:

$$\begin{aligned} \text{RO} &= \frac{550\ 000}{4\ 500\ 000} \\ &= 12{,}2 \text{ per cent} \end{aligned}$$

As you can see, the ROI for Khumalo Enterprises exceeded its target, which indicates that the company prospered in 2008.

Comparing the 12,2 per cent ROI with the industry average provides a more meaningful picture. However any ROI needs to be evaluated in terms of the competitive environment, risks in the industry and economic conditions. Generally speaking, companies pursue ROIs in the 10 to 30 per cent range but in certain industries, such as the grocery industry, a return of less than 5 per cent is common and acceptable.

A company with a target ROI can predetermine its desired level of profitability. The marketing manager can use the standard, such as 10 per cent ROI, to determine whether a particular price and marketing mix are feasible. In addition, however, the manager must weigh the risk of a given strategy even if the return is acceptable.

#### 10.3.1.4 Profit on each product item

Organisations should strive to make profit on each product item. If the organisation produces one type of product, it is logical that they have to make a profit on that product. If the organisation has more than one type of product being produced, the company could make a loss on one of the products and make more profit on the other products. A good example of this type of profit is that of a company which gives a special offer on that product.

## ACTIVITY 10.1

How should the acceptance of a profit maximisation as a pricing objective affect the development of a company's strategy? Illustrate your answer.

## FEEDBACK

A profit-oriented objective would suggest a careful blending of all four Ps and use of a demand curve (to set the price) which reflects expected customer reaction to the total mix being planned. Of course, the marketing mix ought to be compatible with the target market selected; that is, the whole marketing strategy should be compatible. The selection of alternate strategies would be based on their relative profitability applying the profit-maximisation objective.

### 10.3.2 Sales volume objectives

Sales-oriented pricing objectives are based either on market share or on rand or unit sales. Marketing managers should be familiar with these pricing objectives. Each will be briefly discussed below.

#### 10.3.2.1 Maintain or increase market share

Market share constitutes a company's product sales as a percentage of total sales for that industry. Sales can be indicated in Rands or in units of product. It is very important to know whether market share is expressed in revenue or units, because the results maybe different. Many companies believe that maintaining or increasing market share is an indicator of the effectiveness of their marketing mix. Indeed, larger market shares often do mean higher profits, thanks to greater economies of scale, market power, and the ability to compensate top-quality management.

Market share and return on investment are, however, strongly related. Nevertheless, many companies with low market share survive and even prosper. To succeed with a low market share, companies need to compete in industries with slow growth and few product changes – for instance, industrial component parts and supplies.

#### 10.3.2.2 Maintain or increase sales volume

Rather than striving for market share, sometimes companies try to maximise sales. The objective of maximising sales ignores profits, competition and the marketing environment as long as sales are increasing. If a company needs funds or faces an uncertain future, it may try to generate a maximum mount of cash in the short run. When using this objective, management's task is to calculate which price-quantity relationship generates the greatest cash revenue. Sales maximisation can also be effectively used on a temporary basis to sell off excess inventory. It is not uncommon, for example, to find Christmas cards, ornaments and so on discounted at 50 to 70 per cent off retail prices after the December holiday season.



### 10.3.3 Other pricing objectives

(Read this section on pages 339–340 in the prescribed book.)

For this section you simply need to be able to identify the "other" pricing objectives that exist.

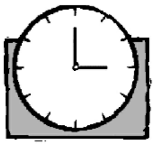
## ASSESSMENT

1. Describe the different types of costs and give practical examples for each.
2. Profit-oriented objectives include profit maximisation, satisfactory profit, target profit, and profit on each product item. Comment on each of these objectives
3. The choice of pricing objectives is influenced by the objectives of the business and the prevailing market conditions. Discuss the different pricing objectives that are available for selection to the marketer.

## SUMMARY

In this study unit, we discussed types of costs, the cost-volume relationship and competitor's cost and prices. We also examined pricing objectives. The pricing variable offers an alert manager many possibilities for varying marketing mixes. Pricing policies should be selected according to the pricing objectives. We looked at profit-oriented, sales-oriented objectives. Throughout this study unit, we mentioned the different objectives a firm may set to guide its pricing policies. It is important that the marketing manager be aware of all these variables and able to set a competitive price so that the firm's products can compete effectively in the marketplace.

Study units nine and ten focused on giving you an understanding of what price is and the various constraints influencing the price that can be set.  Our focus in the next study unit turns to the actual setting of a price and the selection of an estimated price level.



# STUDY UNIT 11

## THE SELECTION OF AN ESTIMATED PRICE LEVEL

**CONTENTS** **PAGE**

## KEY CONCEPTS

You will need to master the following key concepts in order to meet the learning outcomes for this topic:

- Cost-plus pricing
- Breakeven analysis
- Rate-of-return pricing
- Prestige pricing
- Odd-even pricing
- Price lining
- Value-based pricing
- Price bundling
- Demand-backward pricing
- Loss-leader pricing
- Adaptive pricing
- Competitive bidding
- Predatory pricing
- Opportunistic pricing

## OVERVIEW

In the previous study unit of this study guide the steps involved in setting the final price of a product were shown. In the first three steps the internal and external factors influencing price setting were discussed. Factors such as the product mix of the organisation, its pricing objectives, its cost-volume-profit relationship, the competitive situation in the industry and supply and demand relationships were considered. We are now in the position to start thinking about the price that should be set for the product. First of all, the internal and external variables mentioned earlier need to be qualified in terms of their influence on the price level. This is called setting the approximate price level. Thereafter, the list or quoted price is set, which again considers many internal and external factors. After final adjustments are made the final price is set. In this study unit we are considering the fourth step in the process for setting the final price, namely setting the approximate price level.

You have to be able to name and explain the different pricing methods. We start our discussion by looking at cost-based pricing.

## 11.1 COST-BASED PRICING

(Study pages 340–342 in the prescribed book.)

Pricing your product or service is one of the most important business decisions you will make. You must offer your products at a price your target market is willing to pay – and one that produces a profit for your company – or you will not be in business for long.

### 11.1.1 Cost-plus pricing

Supermarkets and other retail stores have such a large number of products that estimating the demand for each product as a means of setting price is simply impossible. They therefore use cost-plus pricing (a so-called standard mark-up pricing, which entails adding a fixed percentage to the cost of all items in a specific product class). This percentage mark-up varies depending on the type of store (e.g. furniture, clothing or grocery) and the product involved. High-volume products usually have smaller mark-ups than low-volume products. Supermarkets have different mark-ups for staple items and discretionary items. The mark-up on staple items such as sugar, flour and dairy products varies from 10 per cent to 23 per cent, whereas mark-ups on discretionary items such as snack foods and sweets range from 27 per cent to 47 per cent. These mark-ups must cover the entire store's expenses, pay for overhead costs and contribute something to profits. These mark-ups may seem very high, but for supermarkets they result in only a 1 per cent profit on sales revenue and that is only if the store is operating efficiently.

**ACTIVITY 11.1**

Calculate the mark-up price of a kettle manufacturer, as well as a retailer selling kettles, based on the following facts:

| | |
|---|---|
| Variable cost | R10,00 per unit |
| Fixed cost | R300 000,00 |
| Expected units sales | 50 000 |
| Manufacturer's mark-up | 20% on sales |
| Dealer's mark-up | 50% on sales price |



**FEEDBACK**

The manufacturer's cost per kettle is given as follows:

| | |
|---|---|
| Variable cost | R10,00 per unit |
| Fixed cost | R300 000,00 |
| Expected unit sales | 50 000 |
| Manufacturer's mark-up | 20% on sales |
| Dealer's mark-up | 50% on sales price |

$$\begin{aligned}\text{Unit cost} &= \text{variable cost} + \frac{\text{fixed cost}}{\text{unit sales}} \\ &= \text{R}10{,}00 + \frac{\text{R}300\ 000{,}00}{50\ 000} \\ &= \text{R}10{,}00 + \text{R}6{,}00 \\ &= \text{R}16{,}00\end{aligned}$$

The manufacturer's mark-up price is given as follows:

$$\begin{aligned}\text{Manufacturer's mark-up price} &= \frac{\text{unit cost}}{1} - \text{desired return on sales} \\ &= \frac{\text{R}16{,}00}{1} - 0{,}20 \\ &= \text{R}20{,}00 \text{ (Profit } = \text{ R}4{,}00 \text{ per unit)}\end{aligned}$$

The dealer's mark-up price in turn is given as follows:

$$\begin{aligned}\text{Dealer's mark-up price} &= \frac{\text{average cost per unit}}{1} - \text{desired return on sales} \\ &= \frac{20}{1} - 0{,}50 \\ &= \text{R}40{,}00\end{aligned}$$

The dealer's/retailer's mark-up on cost is 100% (R20,00/R20,00).

Suppose the kettle manufacturer charged R20,00, but sold only 30 000 kettles instead of 50 000. The unit cost would then have been higher since the fixed costs would be spread over fewer units, and the realised percentage mark-up on sales would be lower. Mark-up pricing only works if that price actually brings in the expected level of sales.

Still, mark-up pricing remains popular for a number of reasons. Firstly, sellers are more certain about costs than about demand. By tying the price to cost, sellers simplify pricing – they do not have to make frequent adjustments as demand changes. Secondly, when all companies in the industry use this pricing method, prices tend to be similar and price competition is thus minimised. Thirdly, many people feel that cost-plus pricing is fairer to both buyers and sellers. Sellers earn a fair return on their investment, but do not take advantage of buyers if and when buyers' demand increases

### 11.1.2 Cost-plus-percentage-of-cost pricing

In this case the mark-up is not set on the desired return on sales, but as a desired percentage of cost. If the kettle manufacturer adopted above-mentioned aims for a 10 per cent mark-up on cost, his mark-up price would be as follows:

Mark-up price = Total cost + 10% × total cost
= R300 000,00 + R10,00 (variable cost) × 50 000 units + 10% × total cost
= R80 000,00 + 10% × R80 000,00
= R880 000,00

Manufacturer's mark-up price = 880 000,00
50 000 (units)
= R17,60

### 11.1.3 Price determination according to cost plus fixed-fee pricing

Cost plus fixed-fee pricing requires the organisation to add a standard fee to the costs. For example, if the organisation always adds a standard fee of R15,00 to the costs, a product costing R100,00 would have an initial price of R115,00

### 11.1.4 Price determination according to experience curve

The method of experience curve pricing is based on the learning-and-scale effect, which means that the unit cost of products and services declines as a company gains experience at producing and selling its products. Learning effect refers to the phenomenon where products are manufactured more efficiently as employees gain a better understanding of the manufacturing and marketing of their product(s). Scale effect refers to the phenomenon of a decline in the unit cost where an increasing number of units manufactured and marketed share in the same fixed cost. This reduction is regular or predictable enough to make it possible to mathematically estimate the average cost for each unit at different production levels. For example, if the company estimates that costs will fall by 15 per cent each time volume doubles, then the cost of the 100th unit produced and sold will be about 85 per cent of the cost of the 50th unit, and the 200th unit will be 85 per cent of the100th unit.



### 11.1.5 Price determination according to the breakeven analysis

(Study pages 343–345 in the prescribed book.)

This pricing method is based on a breakeven analysis which aims to determine, firstly, at which sales level the firm would cover its costs, given a specific price per unit. Secondly, a desired sales level can be estimated if a specific profit target is added to the equation. This pricing method is only useful if combined with both the demand-based and profit-based pricing methods since the breakeven analysis uses two variables, a selling price and a profit target. Let us now look a profit-based pricing.

## 11.2 PROFIT-BASED PRICE DETERMINATION

(Study pages 342–345 in the prescribed book.)

### 11.2.1 Price determination according target profits

This is the simplest profit-based method of pricing if variable and fixed cost and units sold can be accurately estimated. In this case target profit is expressed in rand value.

### 11.2.2 Price determination according to target return on sales

When using this method, total cost and units sold can be estimated accurately and, together with an acceptable target-return-on-sales percentage, the unit price is easily calculated.

### 11.2.3 Price determination according to ROI

This method is also called target-return pricing and uses the target-return percentage, estimated units sold (Q), total cost (unit cost (UC) × Q) and total capital invested in order to calculate the target-return price per unit. A formula is presented in the study material, but a simpler one is provided below:

$$\text{ROI} = \frac{\text{Profit}}{\text{Investment}}$$

$$= \frac{\text{Total income } (P \times Q) - \text{Total cost } (UC \times Q)}{\text{Investment}}$$

Given the figures in the example in the prescribed book (page 343), the calculation is done as follows:

$$20\% = \frac{(P \times 50\ 000) - (20 \times 50\ 000)}{1\ 000\ 000}$$

$$0{,}20 = \frac{P(50\ 000) - 1\ 000\ 000}{1\ 000\ 000}$$

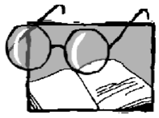
$$\frac{(0{,}20 \times 1\ 000\ 000) + 1\ 000\ 000}{50\ 000} = P$$

R24,00 = P (target-return price per unit)

The three pricing methods referred to above are actually financially based approaches. Marketing has relatively little contribution to make to setting these prices.

## 11.3 DEMAND-BASED PRICING

(Study page 345–347 in your prescribed book)



The next three techniques, however, require input from the marketing division based on their research into customer competition behaviour. The first two methods (demand-based and new-product pricing) are based on how consumers perceive prices in terms of the full product line being offered, what a specific price reflects in relation to the prices of other competitors' products and what consumers believe to be a fair price-value relationship. In turn, setting prices based on competitors' actions (competition-based pricing) essentially involves deciding whether price will be used as a competitive weapon, or merely to maintain the organisation's competitive position. Now let us look at these market-oriented pricing methods.

### 11.3.1 Value-based pricing

As hinted to above, customers attach different values to products. Some customers are likely to attach much value to a particular product because it plays an important part in their consumption patterns, while others might perceive it as a fairly unimportant product and would regard it as having less value. The organisation should attempt to determine what value different market segments attach to a specific product. These findings should feature prominently when deciding on a target market such as a price of a product like an expensive Persian carpet will be priced according to the value of the carpet

$$\text{Value} = \frac{\text{Perceived benefits}}{\text{Price}}$$

3M Corporation's Post-it notes are highly priced relative to their cost – they are in fact rejects and off-cuts.

### 11.3.2 Demand-backward pricing

Most successful businesses flourish on the fact that customers are prepared to pay much more for their product than it costs them to manufacture it. Sometimes, however, this is not the case and then the marketer has to make adjustments to the other elements of the marketing mix, for instance by lowering the cost of raw materials, cutting down on distribution and promotion costs, or attempting to persuade customers to pay more for the product through an effective promotion campaign.

## ACTIVITY 11.2

Consider the retailers in your area and discuss which methods you believe they could use to determine the base price of their products.

## FEEDBACK

Do you realise that any retailer could easily have applied any of the techniques that have so far been discussed in order to set the base or initial prices? Retailers incur certain costs in acquiring products and these need to be covered before they can start to show a profit. Retailers could therefore use cost-based pricing techniques. They also have clearly defined targets such as profitability targets or rate-of-return figures. Retailers could therefore quite easily apply profit-based pricing methods to determine the initial selling price. Demand-based methods may be less easy to apply, yet are still possible options since retailers have a fair idea of what consumers are willing to pay for each product.

### 11.3.3 Prestige pricing

This pricing method is based on the principle that better quality products usually cost more to manufacture and therefore have to be more highly priced. We as consumers therefore believe that high prices imply better quality. We all know that this is not always the case, but we still assume this to be true with all products. Many products are therefore more highly priced than normal, although their quality is not above the average, in the hope that consumers will assume them to be top of the range.

Premium brands (e.g. Amstel, Camel, Mercedes-Benz) are typical of excellent quality, are highly priced and selectively distributed through exclusive channels. Companies marketing premium brands try to be leaders in quality and image.

This positioning approach is usually accompanied by promotion and distribution actions that support this aim. Remember that prestige pricing is a deliberate attempt by the marketer to enhance the image of a product by setting a high price for it.

### 11.3.4 Odd-even pricing

Odd prices (i.e. R9,99 or R2 499,00) are set for products at psychological levels where consumers distinguish between acceptable and higher prices. A consumer may regard a specific product priced at R9,99 as reasonable, but as expensive if it is priced at R10,00 or higher. This approach is based on the belief that consumers round off a price to its lower base point (R9,99 becomes R9,00 and R2 499,00 becomes R2 400,00).

### 11.3.5 Price lining

Price lining is used if research shows that different market segments for a specific type of product buy within a specific price range or price band. For instance, in the small car market some consumers are interested in a basic model, priced under R80 000,00. The next segment might require a few extra features and would be prepared to pay slightly more – say R95 000,00. The top segment is interested in a car with many more features such as power steering, an ABS brake system and airbags. This segment might be prepared to pay more than R100 000,00 for such a “prestige” model.

If such price ranges or bands can be distinguished, marketers set their prices at the top end of each price band to maximise profits.

### 11.3.6 Traditional pricing

This happens when tradition, a standardised channel of distribution or other competitive factors dictate the price. For example, cold drinks offered through standard vending machines have a customary price of R5,00 and a significant departure from this price may result in a loss of sales for the supplier.

### 11.3.7 Bundle prices

By combining several related or even auxiliary products and selling them together at one price, marketers create a bundle of benefits that meets consumers' needs and represents better value to them. Many software companies now sell “solutions” that consist of a bundle of software programmes. For example, SAA offers vacation packages including airfare, car rental and hotel accommodation, or Mercedes-Benz offers a financial package and a maintenance and warranty scheme to purchasers of new vehicles.



## 11.4 NEW-PRODUCT PRICING

(Study pages 359–360 in the prescribed book.)

In the prescribed book, new-product pricing is not regarded as a separate approach to setting the approximate price level. In this module, however, we treat it as such. Remember, this is the second market-oriented pricing method. Basically, a business has three pricing choices when entering a market with a new product: it can set its price higher or lower than competitors, or come in with a middle-of-the-range price. When setting the price higher or lower than competitors, a business is using it as a competitive weapon. A low price is aimed at selling more products than competitors, which will ensure an increasing scale-and-experience effect that would lower cost levels and eventually lead to higher profit margins. This is called a penetration strategy. If, on the other hand, a high price is set, the marketer hopes to sell enough products to the top end of the market to make above average profits. If huge development costs were incurred earlier the high profit would quickly offset it, which would allow prices to be lowered when competition becomes more stringent. This is called a skimming strategy.

## 11.5 COMPETITION-ORIENTED METHODS

(Study page 349 in the prescribed book.)

In the highly competitive modern business environment – mainly due to technological advances and globalisation – a study of the strategic moves and decisions of competitors is necessary. One area of analysis is their pricing strategies. Once competitors' plans are known, the organisation can decide how to set its own price for optimum results. As mentioned in the previous section, the organisation could set its prices at a level which is close to the industry's average price (going-rate pricing), higher than the average (above-market pricing) or below the average (below-market pricing). Three other competitive pricing strategies could also be pursued under specific market conditions, namely customary pricing, loss-leader pricing and sealed-bid pricing.

### 11.5.1 Customary pricing

For some products customary pricing is used. This happens when tradition, a standardised channel of distribution or other competitive factors dictate the price. For example, cold drinks offered through standard vending machines have a customary price of R5,00 and a significant departure from this price may result in a loss of sales for the supplier.

### 11.5.2 Loss-leader pricing

Many retail stores deliberately sell a product below its customary price to attract consumers to the store – this is a special type of promotion known as loss-leader pricing. For example, a “killer” price for a table at Makro may be R99,00 which is below cost. The purpose of this loss-leader pricing is not to increase sales of tables, but to attract customers to the store in the hope that they will buy other products as well, particularly discretionary items carrying large mark-ups.

### 11.5.3 Sealed-bid pricing

When the government wants to buy school books it would probably use sealed-bid pricing. The government informs a large number of prospective companies of the specifications these books must meet. The companies are then invited to submit a bid or tender that includes a specific price for the quantity ordered. The bid must be submitted by a specific time to a specific location. Several days later the bids are opened in public and read aloud, and the lowest bidder who meets the specification is awarded the contract.

## ASSESSMENT

1. Discuss cost-based pricing and the various cost-based methods that the marketer could use to set prices.
2. Your sister, Liza, has started her own business and is planning to introduce a variety of new products to the market. Explain to her the alternative new pricing strategies that are available to the marketer.
3. Discuss the competition-oriented pricing methods that are available to the marketer. Use practical examples to illustrate the various methods.

## SUMMARY

In this study unit we looked at the various methods of setting initial prices. We considered the cost-based, profit-based, demand-based and competition-based techniques. We focused our attention on the step where the approximate price level is set. There are five methods that can be used by marketers to set the approximate price level, and all focus on the fact that, through price, the marketers capture the value that was delivered to the target market. Price is the way money is brought into the business. The basic or approximate price level can be adjusted even further before arriving at a final price and this will be shown in subsequent study units. The techniques for pricing new products were also discussed.

This study unit focused on a pricing strategy; that is how we plan our pricing in the longer term. However, things change very quickly in the business environment and this may necessitate some immediate short-term changes to a product's price. Our attention in the final study unit of the module focuses on tactical pricing decisions.

# STUDY UNIT 12

## TACTICAL PRICING DECISIONS

**CONTENTS** **PAGE**

## KEY CONCEPTS

You will need to master the following key concepts in order to meet the learning outcomes for this topic:

- Segmented pricing
- Customer-segment pricing
- Product-form pricing
- Location pricing
- Time pricing
- Psychological pricing
- Geographical pricing
- Free-on-rail pricing
- Freight-absorption pricing
- Uniform regional pricing
- Base-point pricing
- International pricing
- Internet pricing
- Price cuts
- Price increases
- Discounts, trade or functional discounts
- Quantity discounts
- Cash discounts
- Seasonal discounts

## OVERVIEW

Have you ever purchased a grocery item such as meat and seen that the price per kilogram has increased from one week to the next? This could be the result of tactical pricing. Tactical pricing refers to the day-to-day reactions of organisations to events or circumstances that they encounter as regards their prices. Organisations usually adjust their basic prices to account for customer differences and changing situations, as well as to reward customers for certain responses such as the early payment of accounts, volume purchases and off-season buying. When you buy a large number of items from certain stores you can usually ask for a discount – and get it. These price adjustments – called discounts and allowances – take many forms.

An organisation can adopt various price adjustment strategies. These strategies are summarised in table 12.1 and are discussed in the following sections.

*TABLE 12.1 PRICE ADJUSTMENT STRATEGIES*

| STRATEGY | DESCRIPTION |
|---|---|
| Discount and allowance pricing | Reducing prices to reward customer responses such as paying in advance or promoting the product |
| Segmented pricing | Adjusting prices to allow for differences in customers, products or locations |
| Psychological pricing | Adjusting prices for psychological effect |
| Geographical pricing | Adjusting prices to account for the geographic location of customers |
| International pricing | Adjusting prices to international markets |
| Internet pricing | Adjusting prices to accommodate the unique features of the Internet |
| Promotional pricing | Temporarily reducing prices to increase short-run sales |
| Value pricing | Adjusting prices to offer the right combination of quality and service at a fair price |

In this study unit we look at a number of important issues relating to price adjustments. We start by looking at the various types of discounts and allowances companies offer their customers. Next we consider geographical pricing and the ways in which companies can manage their price changes. We also consider the basis on which organisations might set different prices for particular customers, referred to as segmented pricing. The importance of the psychology behind price setting is briefly discussed followed by a discussion of the unique features associated with international pricing and Internet pricing. The study unit rounds out with a discussion on promotional and value-based pricing.

Take note that a lot of the topics addressed in this study unit are not covered in the prescribed book and therefore you should study them in detail in this guide.

## 12.1 DISCOUNTS

(Study pages 350–354 in the prescribed book.)

A common price adjustment that we are all aware of and have seen in many forms in retail outlets is that of discounts. The key discounts that are encountered are addressed in the subsections that follow.

### 12.1.1 Trade or functional discounts

A trade discount, also called a functional discount, is offered by the seller to trade channel members who perform certain functions such as selling to and advising customers, storing goods and reducing bulk lots into smaller sellable quantities, delivering goods to customers, granting credit and record keeping. These are not discounts available to the general public. Manufacturers may offer different functional discounts to different trade channels because of the different services they provide, but manufacturers must offer the same functional discounts within each trade channel. The textbook identifies the following factors that need to be considered in determining the size of the trade discount:

- Existing traditional trade discounts (Some trade discounts exist for some products and a manufacturer who drastically deviates from this will probably not obtain the intermediary's cooperation.)
- The expectations of intermediaries (also referred to as "middlemen") (Intermediaries often expect various trade discounts for the products in a product line.)
- The relation of the trade discount to the services rendered by intermediaries
- The operating costs of intermediaries
- The costs of marketing to intermediaries
- The trade discounts granted by competitors to intermediaries
- The intensity of distribution
- The turnover of intermediaries
- The negotiating abilities and persuasiveness of producers and intermediaries

### 12.1.2 Quantity discounts

A quantity discount is a price reduction offered to buyers who buy large volumes. These types of discounts are available to channel partners as well as to the final customer. A typical example for the channel members might be "R10,00 per unit for fewer than 100 units, and R9,00 per unit for 100 units or more", while customers might get a "two for the price of one" discount or a "Buy three and get one free" discount. Discounts provide an incentive to the customer to buy more from one seller, rather than buy from a number of different sources.

Generally speaking, quantity discounts are of three kinds; noncumulative, cumulative and minimum-order.

- Noncumulative quantity discounts are based on the size of an individual purchase order. They encourage large individual purchase orders, not a series of orders.
- Cumulative quantity discounts apply to the accumulation of purchases of a product over a given time period, usually a year. Cumulative quantity discounts encourage a single customer to repeat buy far more than noncumulative quantity discounts.
- Finally, minimum-order discounts make it obligatory for wholesalers to purchase minimum quantities (usually measured in cases, truckloads, etc.).

### 12.1.3 Cash discounts

A cash discount is a price reduction to buyers or customers who pay their accounts promptly. A typical example is "2/10, net 30," which means that although payment is due within 30 days, the buyer can deduct 2 per cent if the account is paid within 10 day so this is common in the business-to-business environment. The discount must be granted to all buyers meeting these terms. Such discounts are customary in many industries; they help to improve the sellers' cash situation and reduce bad debts and credit-collection costs. On the consumer side, it is also not uncommon for retailers to offer the walk-in customer a cash discount when he or she makes a purchase.

### 12.1.4 Seasonal discounts

Seasonal discounts are price reductions to buyers who buy merchandise or services out of season. For example, lawn and garden equipment manufacturers will offer seasonal discounts to retailers during the autumn and winter to encourage early ordering in anticipation of the heavy spring and summer selling seasons. This is also the case for consumer sales where you will find special offers in the off-peak season. For example, hotels and airlines will offer seasonal discounts in their slower selling periods. Seasonal discounts allow the seller to keep production or sales steady during an entire year.

## ACTIVITY 12.1

You are the manager of a South Coast branch of Markhams. It is the winter season and you are considering what special discounts to offer your customers. Identify and discuss the various discounts you could offer.

## FEEDBACK

From the discussions here and in your prescribed book, you know that there are four essential types of discounts that you could offer. These are the following:

- **Trade or functional discounts**. Being a trade discount, this type of discount is not appropriate for customers.
- **Quantity discounts**. You could offer your customers a quantity discount, such as a two-for-the-price-of-one discount, or if they buy three units, they could get the next unit free. It is unlikely that you would apply minimum-order discounts, although both cumulative and noncumulative discounts are used in the consumer environment. Noncumulative discounts are the most common, but organisations that use loyalty cards to track how often the customer makes purchases and in what quantities, and then offer them discounts based on their total purchases over a period of time, represent examples of cumulative discounts.
- **Cash discounts**. These can also be used to encourage cash sales or to settle accounts promptly in the consumer environment, although such discounts are more likely to be used by smaller retailers for whom cash flow may be a problem. Large retailing groups are unlikely to offer cash discounts at the point-of-sale or for early settlement of accounts, although they may well apply a hefty penalty in cases of overdue accounts.
- **Seasonal discounts**. This is definitely a form of discount that Markhams may apply in order to move stock that is now at the end of the season. It is quite common to find seasonal promotions offering attractive discounts on swimwear in winter, for example.

## 12.2 GEOGRAPHICAL PRICING

(Study pages 354–355 in the prescribed book.)

The geographical location of the buyer in relation to the marketer means that decisions have to be taken about who should be responsible for transport costs. Geographical price differences or price differentials are as follows: free-on-rail pricing, freight-absorption pricing, uniform regional pricing and base point pricing. Let us look at each of these in a little more detail.

### 12.2.1 Free-on-rail pricing

According to free-on-rail (free-on-board) pricing, the seller quotes prices that exclude delivery costs. The seller pays the cost of loading the products onto some vehicle. This vehicle could be a truck, train or ship. The buyer pays the full transport costs of the products from the seller's location. The buyer pays the freight and takes responsibility for damage to goods in transit, unless it is covered by the transportation company. This geographical pricing decision means that, all other factors being equal, the buyer located a long distance away from the seller has a price disadvantage compared with buyers located nearer the seller.

### 12.2.2 Freight-absorption pricing

A disadvantage of free-on-rail pricing is that it can help to create monopolies. To prevent this, some businesses adopt freight-absorption pricing. Here, the seller absorbs all freight costs and quotes uniform prices irrespective of the buyer's location. The total transport costs are usually estimated and an average transport cost for each order is included in the cost price of the product.

### 12.2.3 Uniform regional pricing

Uniform regional pricing is a combination of a free-on-rail pricing approach and freight-absorption pricing. Prices within a particular region are therefore uniform, but vary between regions because of transport costs (free-on-rail pricing). A typical example of uniform regional pricing in South Africa is the price of petrol where petrol is more expensive in Gauteng than it is at the coastal regions.

### 12.2.4 Base-point pricing

A base-point price corresponds, to some extent, with a free-on-rail price, except that the seller quotes prices that include the transport costs from a certain place (base point). The seller often uses more than one base point; these base points may be located at the same places as the factories (although not necessarily so). Either individual businesses or an entire industry can use base-point pricing.

Some of the advantages that participants gain from an industry base-point price are that price competition based on differences in transport costs is eliminated; and the market's geographical extent is not limited by transport costs. Possible disadvantages are that the elimination of price competition can result in higher and rigid prices, and consumer resistance can develop if consumers discover that they are paying transport costs from a place other than the place of origin.

## 12.3 MANAGING PRICE CHANGES

(Study pages 357–359 in the prescribed book.)

In the earlier sections of this study unit we worked through the steps involved in developing a price structure and pricing strategies. Organisations often face situations in which they must initiate price increases or cuts. In either instance, the organisation must anticipate possible buyer and competitor reactions to these price changes. The organisation may also need to initiate a response to competitors' price changes. In this section we examine how organisations can go about managing their price changes.

### 12.3.1 Initiating price cuts

Several situations may lead an organisation to consider cutting its price. One such circumstance is excess capacity. In this case, the organisation needs more business and cannot get it through increased sales effort, product improvement or other measures. It may drop its "follow-the-leader pricing" – that is, charging approximately the same price as their leading competitor – and aggressively cut prices to boost sales. But as the airline, construction equipment and other industries have learnt in recent years, cutting prices in an industry loaded with excess capacity may lead to price wars as competitors try to hold on to market share.

A good example of this was the recent price war between the low-cost airlines, Mango, kulula.com and 1time. When SAA introduced its budget airline, Mango, it undercut all the prices of its competitors. kulula.com responded by providing even lower prices, but One-time could not respond in the same manner. This resulted in the loss of customers over the short term.

An organisation may also cut prices in a drive to dominate the market through lower costs. Either the organisation starts with lower costs than its competitors or it cuts prices in the hope of gaining market share that will cut costs even more (i.e. as a result of larger volume).

### 12.3.2 Initiating price increases

On the other hand, many organisations have had to raise prices in recent years. They do this knowing that the price increases may be resented by customers, dealers and even their own sales force. Yet a successful price increase can greatly increase profits. For example, if the organisation's profit margin is 3 per cent of sales, a 1 per cent price increase will increase profits by 33 per cent if sales volume is unaffected.

A major factor in price increases is cost inflation. Rising costs squeeze profit margins and lead organisations to implement regular rounds of price increases. Organisations often raise their prices by more than the cost increase in anticipation of further inflation. Another factor leading to price increases is excessive demand: when an organisation cannot fulfil all its customers' needs, it can raise its prices, ration products to customers, or both.

Organisations can increase their prices in a number of ways to keep up with rising costs. Prices can be raised unobtrusively by dropping discounts and adding higher-priced units to the line or prices can be raised openly (increase price from R100 to R110).

Where possible, of course, the organisation should consider ways to meet higher costs or demand without raising prices. For example, it can make the product physically smaller instead of raising the price, as chocolate bar manufacturers often do. Have you noticed that the number of matches in a box has declined over the years? It can substitute less expensive ingredients, or even remove certain product features, packaging or services.

### 12.3.3 Buyer reactions to price changes

Whether the price is raised or lowered, the action will influence buyers, competitors, distributors and suppliers. Customers do not always interpret prices in a straight-forward way. They may view a price cut in several ways. For example, what would you think if BMW were suddenly to cut the prices of its X3/X5 series by 50 per cent ? You might think that these cars were about to be replaced by newer models or that they have some defect and are not selling well. You might think that BMW is in financial trouble and may not stay in this business long enough to supply future parts. You might believe that quality has been drastically reduced or you might think that the price will come down even further and that it will pay to wait and see. Similarly, a price increase, which would normally lower sales, may have some positive meanings for buyers. What would you think if BMW raised the price of its latest model? On the one hand, you might think that the item is very "hot" and may be unobtainable unless you buy it soon, or you might think that the car is unusually good value. On the other hand, you might think that BMW is greedy and charging what the market will bear.

### 12.3.4 Competitors' reactions to price changes

An organisation considering a price change has to worry about the reactions of its competitors as well as its customers. Competitors are most likely to react when:

- the number of organisations involved is small
- the product is uniform

- the buyers are well informed

How can the organisation work out the likely reactions of its competitors? If the organisation faces one large competitor, and if the competitor tends to react in a set way to price changes, it will be easy to anticipate the competitor's reaction.

The problem is complex because, like the customer, the competitor can interpret an organisation's price cut in many ways. It might think the organisation is trying to grab a larger market share, that the organisation is doing poorly and trying to boost its sales, or that the organisation wants the whole industry to cut prices to increase total demand.

When there are several competitors, the organisation must guess the probable reaction of each competitor. If all competitors behave alike, this amounts to no more than analysing only a typical competitor. In contrast, if the competitors do not behave alike – perhaps because of differences in size, market shares or policies – then separate analyses are necessary.

However, if some competitors match the price change, there is good reason to expect that the rest will do the same.

### 12.3.5 Responding to competitors' price changes

Here we reverse the question and ask how an organisation should respond to a competitor's price change. The organisation needs to consider several issues:

- Why did the competitor change the price?
- Was it to gain more market share, to use up excess capacity, to meet changing cost conditions, or to create a price change in the industry as a whole?
- Is the price change temporary or permanent?
- What will happen to the organisation's market share and profits if it does not respond to the competitor's price change?
- Are other organisations going to respond?

Besides these issues, the organisation must do a broader analysis by considering its own product's stage in the life cycle, the product's importance in the organisation's product mix, the intentions and resources of the competitor, and possible consumer reactions to price changes. However, the organisation cannot always make an extended analysis of its alternatives at the time of a price change. The competitor may have spent much time preparing for its price change, but the organisation may have to react within hours or days. The only way to cut down reaction time is to plan ahead for both possible competitor price changes and possible responses. Figure 12.1 shows the ways in which an organisation might assess and respond to a competitor's price cut. Once the organisation has determined that the competitor has cut its price and that this price reduction is likely to harm the organisation's sales and profits, it might simply decide to hold its current price and profit margin. The organisation might believe that it will not lose too much market share, or that it will lose too much profit if it reduced its own price. It might decide that it should wait and respond when it has more information on the effects of the competitor's price change. For now, it might be willing to hold on to good customers, while giving up poorer ones to the competitor. The arguments against this holding strategy, however, are that the competitor may get stronger and more confident as its sales increase, and that the organisation might end up waiting too long before acting.

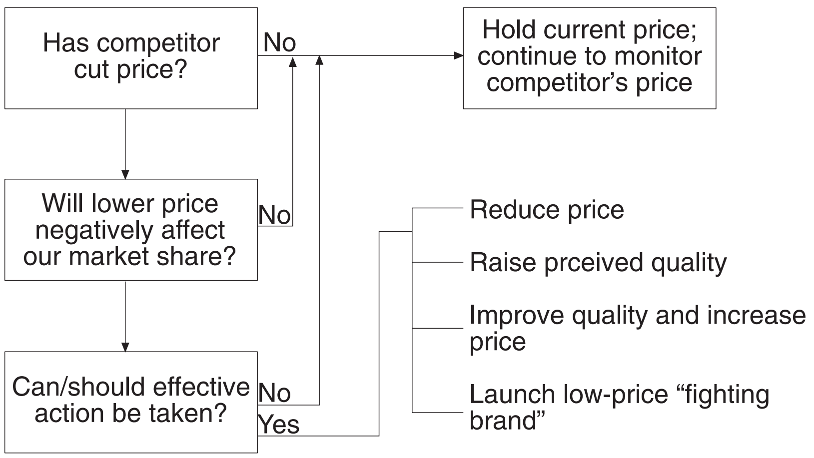



*Figure 12.1 Assessing and responding to competitor's price changes*

If the organisation decides that effective action can and should be taken, it might respond in any one of four ways. Firstly, it could reduce its price to match the competitor's price. Secondly, it may decide that the market is price sensitive, and that it would lose too much market share to the lower-priced competitor. Thirdly it might worry about the difficulty of recapturing lost market share later on.

Finally, the organisation might maintain its price, but raise the perceived quality of its product or service. It could improve its communications, or stress the relative quality of its product over that of the competitor offering a lower price.

Another option is for the organisation to improve its quality and increase price; in other words, move its brand into a higher price position.

The higher quality justifies the higher price which, in turn, preserves the organisation's higher margins.

Finally, the organisation might launch a low-price "fighting brand". Often, one of the best responses is to add lower-price items to the line or to create a separate lower-priced brand. Examples here include Comair introducing their low-cost product – kulula.com or South African Airways introducing Mango. This is necessary if the particular market segment being lost is price sensitive and will not respond to higher quality products.

## ACTIVITY 12.2

You are the manager of a small corner grocery store. You believe that the local branch of Shoprite-Checkers is planning to initiate certain price changes in the near future, but you are not sure whether these will represent price increases or cuts. You want to have a strategy prepared to deal with any such changes. Explain what actions you could take should Shoprite-Checkers introduce such price changes.

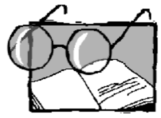
## FEEDBACK

To begin with, you need to consider several issues: Why is Shoprite-Checkers likely to change its prices? Is it to gain more market share, use up excess capacity, meet changing cost conditions, or create a price change in the industry as a whole? Is the price change likely to be temporary or permanent? You also need to consider what will happen to your store's market share and profits if you do not respond to the price changes. Are there other grocery stores in the area and how will they respond to these price changes? Will Shoprite-Checkers be changing its prices across the whole spectrum of groceries it stocks or only within certain product categories (e.g. tinned foods)?

In addition, you are relatively small in comparison to Shoprite-Checkers and you need to consider your firm's ability to react to these price changes as well as how your customers are likely to react to these price changes. It is unlikely that you will be able to compete head-on with Shoprite-Checkers and reduce your prices lower than theirs. It may be necessary for you to consider bringing your prices in line with those being offered by Shoprite-Checkers. Alternatively, if you believe this to be part of a regular but time-limited promotion (i.e. a promotion for only two weeks), it may pay you to ride out these price changes as it will be more costly to keep changing your prices in line with those being offered by Shoprite-Checkers.

Figure 12.1 and the associated discussion provide a framework that you can use to decide how you should react to the changes being introduced by Shoprite-Checkers.

## 12.4 SEGMENTED PRICING



Have you noticed that certain theatres have different prices for scholars and pensioners, and sometimes they have different prices based on the proximity of seats to the stage? You might also notice that Kenwood has different prices for the different food processors available. These pricing strategies are referred to as segmented pricing strategies. Organisations will often adjust their basic prices to allow for differences in customers, products and locations. In segmented pricing, the organisation sells a product or service at a number of different prices, even though the difference in prices is not based on differences in costs. Segmented pricing takes several forms. Let us have a look at these forms.

### 12.4.1 Customer-segment pricing

Different customers pay different prices for the same product or service. Museums, for example, will charge a lower admission for students and senior citizens. At most rugby stadiums, scholars pay a reduced fee.

### 12.4.2 Product-form pricing

Different versions of the product are priced differently, but not according to differences in their costs. For instance, Ryobi prices its most expensive drill at R1 700,00, which is R1 400,00 more than the price of its least expensive drill. The top model has extra features, but these extra features cost Ryobi only a few more rands to make.

### 12.4.3 Location pricing

Different locations are priced differently, even though the cost of the offering at each location is the same. For instance, theatres vary their seat prices because of audience preferences for certain seats.

### 12.4.4 Time pricing

Prices vary by the season, the month, the day and even the hour. Telkom offers lower "off-peak" rates and swimming pool builders offer lower prices in winter. You might also notice that holiday resorts and airlines have different prices for different seasons. Seaside resorts price their products more cheaply in winter than in summer. International airline travel packages differ significantly from one season to the next.

For segmented pricing to be an effective strategy, certain conditions must exist. The market must be segmentable, and the segments must show different degrees of demand. Members of the segment paying the lower price should not be permitted to resell the product to another segment paying the higher price. Competitors should not be permitted to undersell the organisation in that segment being charged the higher price, nor should the costs of segmenting and monitoring the market exceed the extra revenue obtained from the price difference.

For a view on how customer-segmented pricing could be unfair, read the case study below.

## One price for you, one price for me

The ways in which different people pay different amounts for ostensibly the same thing remains a mystery to me. Multi-millionaires paying less tax than you and I do is one example. The man on the seat next to me, I discover, is paying about twice the airfare I paid is another example.

Paying different amounts is best described as a parable (yes, I nicked the concept from the New Testament) and this is the one about the Dutch beer drinker.

Many years ago, on a sultry Cape Town evening, I found myself in the company of three friends in a bar somewhere in the Navigator's Den area. (A typical evening which began as a sedate affair but descended into something less than sedate.)

The four of us found our way to the bar and ordered four beers. (I've adjusted the amount for inflation and for easier calculation.) The not unattractive but seriously "don't mess with me" attitude barmaid handed us the beers and said "That's R20", which we paid.

Being basically friendly folk we started chatting to a Dutch merchant seaman. At some stage we offered him a beer and ordered another round of five beers. They arrived and the barmaid said "That's R25" (Following me on the math so far?). Then our Dutch friend said he'd like to buy us a round and, being friendly and accommodating chaps, we thanked him.

The barmaid delivered the five beers and turned to the Dutch guy and said "That's R50" which he paid without a murmur. Of course this upset us no end so we asked him why he was paying double what he knew we were paying. "Because I'm a Dutch Merchant Seaman."

/continued ...

Duh?

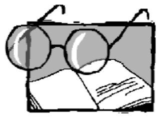
He explained: "I get ripped off wherever I go. It's okay."

You see, he'd been in bars all around the world and inevitably paid more than the locals did and so, after a time, it became the norm. It was expected. A bit like the "Stockholm Syndrome" I suppose. It becomes so entrenched that you just don't realise anymore that you're paying well over the odds.

I often wonder if he ever woke up to the fact that it was unnecessary to pay double. It's in the budget so why worry?

Source
http://www.marketingweb.co.za/marketingweb/view/marketingweb/en/page74845?oid= 76314&sn=Dailyy%20news%20detail

## 12.5 PSYCHOLOGICAL PRICING



Price often causes emotional reactions in people. For example, many consumers use price to judge quality of products. Mitchum deodorant has an advertising campaign which addresses this situation. Mitchum deodorant costs up to double the price of other brands, but the product is said to be of superior value and therefore justifies the higher price. Their pay-off line "You get what you paid for" supports this view. Customers might decide that Mitchum must be a good deodorant to use because of the higher price charged for it.

When using psychological pricing, sellers consider the psychology of prices and not simply the economics. For example, one study of the relationship between price and quality perceptions of cars found that consumers perceive more highly priced cars as being of better quality. By the same token, higher-quality cars are perceived to be even more highly priced than they actually are. When consumers can judge the quality of a product by examining it or by referring to past experience of the product, they are relying less on price to judge quality. But when consumers cannot judge quality because they lack the information or skill, price becomes an important quality signal.

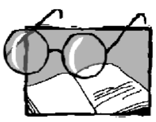
Another aspect of psychological pricing is found in reference prices – these are the prices that buyers have in their minds and refer to when looking at a given product. The reference price might be formed by noting current prices, remembering past prices or assessing the buying situation. The airline kulula.com might show current prices of their competitors and then show kulula.com prices to indicate the value customers get from travelling with kulula.com.

Sellers can influence or use these consumers' reference prices when setting prices. For example, an organisation could display its product next to more expensive ones to imply that it belongs in the same class. Instead of displaying products that are more expensive Mr Price implies that its products are similar or belong to the same class by means of its pricing tags. On the tag of any Mr Price item you will notice that a reference price is given as well as the words "Don't pay". This implies that you can get the same class product at Mr Price for a lower price.

Sometimes retailers are a little more indirect when it comes to pricing from a psychological point of view. Woolworths and Edgars often sell women's clothing in separate departments differentiated by price: clothing found in the more expensive department is assumed to be better quality. For example, W Collection clothing within Woolworths and Charter Club within Edgars are viewed by customers as higher-quality products.

Even small differences in price can suggest product differences. Consider a hi-fi priced as R520,00 compared with one priced at 519,95. The actual price difference is only 5 cents, but the psychological difference can be much greater. For example, some consumers will see R119,95 as a price in the R110,00 range rather than the R120,00 range. The R519,95 is more likely to be seen as a bargain price, while the R520,00 price suggests better quality. Some psychologists argue that each digit has symbolic and visual characteristics that should be considered in pricing. Thus, 8 is round and even and creates a soothing effect, whereas 7 is angular and creates a jarring effect in consumers' minds.

## 12.6 INTERNATIONAL PRICING



Organisations that market their products internationally must decide what prices to charge in the different countries in which they operate. In some cases, an organisation can set a uniform worldwide price. For example, Boeing sells its jetliners at about the same price everywhere, whether in the United States, Europe or South Africa. However, most organisations adjust their prices to reflect local market conditions and cost considerations.

The price that an organisation should charge in a specific country depends on many factors, including economic conditions, competitive situations, laws and regulations, and the wholesaling and retailing system in that country. Consumer perceptions and preferences may also vary from country to country, which will mean charging different prices. In addition the organisation may have different marketing objectives in different countries, and this, too, will require changes in pricing strategy.

Costs play an important role in setting international prices. Travellers abroad are often surprised to find that goods that are relatively inexpensive at home may carry outrageously higher price tags in other countries. A pair of Levis selling for $11,00 in the United States goes for about $63,00 in Tokyo and $88,00 in Paris. A McDonald's Big Mac sells for a modest $2,65 in the USA and R14,05 in South Africa (2003 figures). Conversely, a Gucci handbag going for only $60,00 in Milan, Italy, fetches $240,00 in the United States. Such price escalations may result from differences in selling strategies or market conditions. In most instances, however, it is simply a result of the higher costs of selling in foreign markets.

## 12.7 PRICING ON THE INTERNET

The unique World Wide Web is introducing new paradigms that impact upon price management. The transparent nature of the internet is likely to result in greater price competition, more standardised pricing and ultimately lower prices and greater value for customers. The internet:

- facilitates a buyer's acquisition of quality information for various goods
- enables suppliers to update prices dynamically in response to observed demand
- allows a seller to create a meaningful market of potential buyers with price being the outcome of an auction process rather than a pre-specification by the seller
- permits a prospective buyer to specify in detail the product's requirements and put fulfilment out to bid to an organised market of potential buyers.

## 12.8 PROMOTIONAL PRICING

In the case of promotional pricing, organisations will temporarily price their products below list price and sometimes even below cost. Promotional pricing takes several forms. Supermarkets and department stores will price a few products as loss leaders to attract customers to the store in the hope that they will buy other items at normal mark-ups. Sellers will also use special event pricing in certain seasons to draw more customers. Thus, linens are promotionally priced every January to attract weary Christmas shoppers back into stores. Some manufacturers offer low-interest financing, longer warranties or free maintenance to reduce the price that the consumer pays. The seller may simply offer discounts from normal prices to increase sales and/or reduce inventories.

## 12.9 VALUE PRICING

During the recession of the 1990s, many organisations adjusted their prices to bring them into line with economic conditions and the fundamental shift that occurred in consumer attitudes toward quality and value. Increasingly, marketers have adopted value pricing strategies offering just the right combination of quality and good service at a fair price. In many cases this has involved the introduction of less expensive versions of established, brand name products. For example, Holiday Inn opened several Holiday Express budget hotels; fast-food restaurants such as McDonald's offered "value menus".

## ASSESSMENT

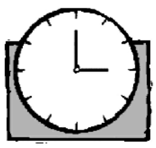
1. You are the manager of a branch of Pick n Pay. Identify and discuss the various discounts your store can offer its customers.
2. You are the owner of a firm that manufactures lounge suites. Use examples to illustrate how your firm could segment its pricing to allow for differences in customers, products and locations.
3. Explain what is meant by psychological pricing and give examples.
4. You are the owner of a small manufacturer of children's toys. How might you address the question of transport costs in your firm's pricing strategies?
5. Discuss the various reasons an organisation might have for introducing price increases and price cuts.

## SUMMARY

Pricing strategies and tactics form an important element of an organisation's marketing mix. In setting prices, organisations must carefully consider a great many internal and external factors before choosing a price that will give them the greatest competitive advantage in selected target markets. However, organisations are usually not free to charge whatever prices they wish. Several laws restrict pricing practices, and pricing decisions are influenced by a number of ethical considerations.

Organisations need to take all these factors into consideration when deciding about making price changes.

You have now reached the end of the study material for this subject. I hope that you have found it interesting and useful in your chosen career. Should you have any questions relating to the content of the subject, feel free to contact your lecturers who will assist you.



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