Chapter 10: Answers to Questions for Review and Discussion

5. When would R&D costs be a relevant cost to consider in pricing decisions?

R&D costs are a relevant cost to consider in a pricing decision when they have yet to be incurred, i.e. at the early part of the new product development process. At this time, R&D costs are avoidable and result from the decision to proceed.

7. Under what general conditions would you want to use a price skimming strategy? A penetration price strategy?

A price skimming strategy is ideally used the when price of the offering is a reflection of its value as perceived by the market, and

- *the market is somewhat inelastic*
- *the marketer has a sustainable market advantage over any possible competition via patents, availability*
- *competitive entry is difficult if not altogether blocked*
- *production methods must be profitable at the lower volumes – economies of scale may not be feasible or desirable.*

Skimming also makes sense when the marketer is the first to enter a market but expects to drop out of the market when the large competitor inevitably enters and dominates. It makes sense in such circumstances to get as much profit from the early adopters as possible.

A penetration strategy is appropriate to build heavy market penetration when creation of a large installed base gives the marketer an advantage. Ideally:

- *the market is somewhat elastic,*
- *when a low existing price level acts as a barrier against competition.*
- *economies of scale in manufacturing as well as distribution are necessary and available.*

If the marketer believes that competition is forthcoming and the marketer wishes to stay in the market, a penetration price is usually called for. (See Exhibit 10-10)

8. Under what conditions would you switch from a skimming strategy to a penetration strategy? What elements of the marketing mix other than price would be involved?

You would switch from skimming to penetration when a competitive product or substitute was introduced effectively into the marketplace. Re-pricing of an existing product would make sense in order to penetrate a different, price-sensitive segment at this time. The marketer would also be inclined to switch strategies to address new segments with sustaining innovations based on previous versions of the product (or service). A natural place to switch from skimming to penetration pricing is when the targeted segments switch from visionaries to pragmatists, i.e. when the marketer's company is crossing the chasm.

In addition to price and product, other elements of the marketing mix to be affected would be

- *place (through expanded distribution to reach larger as well as new market segments),*
- *marketing communications (through aggressive announcement of pricing policy*

changes, different appeals to new market segments), and
- *selling (through changed sales messages and methods).*

In many organizations this change must also be accompanied by a change in the product design, though not the function of the product. Skim pricing scenarios may have a higher percentage of product cost as variable, avoiding the high investment in infrastructure to obtain economies of scale. The change at the chasm involves product redesign for automated manufacturing, etc, whatever will produce the necessary economies of scale. This will create a product with higher fixed costs but lower variable costs. Such changes will often impact the marketing organization as well, as customers expect different levels of support at different points in the TALC and PLC. In a new (start-up) organization, this change can have a significant impact on organization culture and control.

9. The chapter relates the "second in, low-cost producer" to the acquisition of small technology companies by large firms as two strategies that have potentially similar strategic outcomes. In a fast-paced market, which strategy would be most effective for a) an established, large manufacturer of consumer products and, b) a large high technology network equipment manufacturer?

a). An established manufacturer likely has existing investment and economies of scale that will support a high volume market. It is most likely that, assuming the manufacturing and marketing capability of the large manufacturer and the "slower" pace of consumer markets, the "second in, low cost producer strategy would work best – assuming the new product/offering is not a disruptive innovation.

b). The high-tech network equipment manufacturer is likely faced with rapidly changing markets a greater difficulty that "a" above in predicting which technologies will succeed in the long run. The tech company is more likely to find it effective to acquire small technology companies (even to the point of funding the smaller firms). The competition between the smaller firms to be the acquired firm can lead to leveraged results in a fast changing market.

10. Discuss the organizational and marketing-mix changes required when a small company hits the chasm. From question 9, above, of the two strategies discussed, which would be the most appropriate in today's marketplace?

The chasm generally occurs at late-introduction/early-growth of the product life cycle. The chasm occurs because pragmatist buyers are not yet satisfied that a "whole product" exists or has been proven. Marketers have not yet found and developed the segments in the pragmatist market that are most likely to adopt. Until they do, the growth part of the product life cycle will not take off. After pragmatist buyers begin to buy, the suppliers of the new products much undergo rapid and wrenching internal changes.

16. Explain "Evaluated Price?"

One view of evaluated price is what your customer believes it will cost to select you as a supplier – the overall cost of doing business with you. Thus, evaluated price includes all of the factors

noted in Exhibit 10-2, plus the value image and quality of relationship between the companies and the individuals. How have previous differences been resolved? Has the supplier treated the customer as a partner in success (and vice-versa)? Many intangibles contributed to evaluated price.
Example: It is likely that the evaluated price of doing business with Firestone (at least from the Ford perspective) was significantly higher after the tire blow-out and rollovers on SUVs.

- *The supplier must shift from a start-up to a growing company*
- *Procedures must be more standardized with more "professional" management.*
- *Several cultural as well as structural changes occur, including the need for different professional skills.*

As markets grow, the firm may embrace a decentralized decision structure (e.g. different management skills and working environment), develop an infrastructure to achieve economies of scale, and redesign the offering in face of new economic realities of competition and high volume (e.g. different engineering skill-sets). Outside the organization, the competitive environment will change as more competitors enter the market that has now been demonstrated to exist (e.g. different marketing approach).

Of the two strategies discussed in Question 9, the appropriate strategy would be the one that most fits with the existing organization's competencies. Since consumer markets do not embrace new technologies as quickly as business markets (technology must become readily available at a relatively low price for consumers to accept it), the most likely candidate is the small high-tech company – if that's what it wants to become. The "second in, low cost producer" strategy occurs after the chasm.