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When a customer buys a product, he or she goes through the complex process of balancing the price of a product with the perceived benefits, costs, risks, and value in the use of the product. If a customer thinks this way when analyzing a purchase, say these authors, it makes a lot of sense for marketers to set prices with the same items in mind. To do this, marketers need to understand the use to which their customers put products, the benefits of performance, both physical and services that are most important, and the various variable costs that the customer perceives, such as the risk of product failure. Obviously, this is not an easy process and many minutes of calculations are involved. Also, as soon as marketers start regarding the price from a customer's point of view they will start to see that the price is an important variable in the entire product planning structure and the value of the company. To help marketers apply the customer's approach in determining prices, the authors have provided some visual techniques as well as a list of important concepts to remember. Back in the good old days of the early 1970s, industrial marketers found pricing would be a big problem. Then both customers and competitors put pressure, and since then state price control, double-digit inflation, sudden recession and, finally, economic malaise, combining some inflation and recession, just made the situation worse. Business Week's accompanying article emphasizes that these changes: The main characteristics of the new pricing strategy are flexibility and willingness to aggressively reduce prices in order to retain market share. On the way out of the window are many of the price traditions of American industrial giants. 1 Our goal in this article is not to study the causes of these changes in price practices, but not to provide a set of solutions for pets and perfect methods managers can use to respond to a situation. Instead, we present a philosophy that helps managers approach a pricing situation, a coherent, rational framework in which managers can make pricing decisions, and finally some tools and designs that will facilitate the application of the framework. While the overall approach we offer can be applied to the pricing of consumer goods, especially the more complex, such as household appliances and furniture, managers in companies operating industrial products, i.e. products not resold in their existing form directly to consumers, will find it most useful. These products include products sold in institutional markets such as hospitals and universities, as well as more typical components, capital goods, materials and raw materials sold to manufacturers. Pricing strategy managers usually set prices as one of the Ways. First, to manage to maintain a strong internal orientation, basing prices on their own costs, and usually usually, some standard industry mark-up on average costs. Cost-plus is a simple system, but it does not consider competitors, customers, or the ratio of volume, price and profit between costs. A well-known sophisticated version of this approach, targeted return pricing, was developed by General Motors in the 1920s and 1930s. While it included consideration of fluctuations in volume within the business cycle and the cost of capital involved in the business, the target yield prices were still entirely based on domestic costs rather than the market. The second approach is to allow competitors to set prices and then meet them first. This strategy assumes that the marketing company, its products, its image and market position, as well as its cost structure is just like competition. A slightly more complex version of this approach involves maintaining the dollar or the percentage difference between the prices and prices of competitors. A manager can, for example, maintain a price 5% below the market leader to ensure a stronger reputation as a leader. However, this approach is mechanistic and does not allow managers to rely on the unique strengths of their products and companies, nor to adapt to their unique weaknesses. The third approach, which is more complex than the other two, focuses on the client. This requires marketers to carefully estimate the value of customers' place on the product. As a

rule, industrial marketers shy away from this approach, but now, given the difficult market conditions that we have described, the need for such a careful customer-based approach seems obvious. Fortunately, the opportunity for its application has been enhanced by the emergence of new concepts and methods. Below, we'll take a closer look at the customer-based approach and these concepts. How customers evaluate products The basic idea of our customer-based approach may seem simple: customers balance the benefits of buying with its costs. When the benefits outweigh the costs and when a particular product is considered to have the best value-for value ratio, the customer buys the product. Although the concept is simple, it is difficult to make workable; in particular, it is difficult to determine the benefits and costs of the product from the perspective of the customer. In the industrial market, the advantages may be functional (utilitarian aspects that may be attractive to engineers), operational (reliability and durability of the product will be important for production and operating managers) or financial (aspects attractive to procurement agents and controllers). Benefits for individuals can also be personal; for example, satisfying the ego to do the job well or protecting against the risk of termination. The costs that the customer perceives are just as varied. include clearly defined acquisition costs: seller price, incoming shipping, installation, and processing costs. They also include less clearly defined costs such as the risk to the customer of product failure (which may include the personal risk of making a bad decision, as well as the risk to the company of closing the production line or repairing equipment), the fear of late or inaccurate delivery, user changes after receiving the product, and so on. The important point here is that the benefits are more complex and subtle than marketers often realize, and the costs to a potential customer are much more than just the seller's price. The customer's decision to purchase a product is an extremely complex process involving perception, not just tough and fast realities. Price is only part of this process. Simply, then, the marketer has to determine the highest price that the customer will be willing to pay for the product. One could consider this as: a benefit-cost other than the price and the highest price the customer would pay. To determine this price, the marketer must understand the customer's perception of the benefits, as well as his or her perception of costs other than the price. The marketer should also remember that his or her value is irrelevant in determining the customer's perception. The customer cares about the price of the marketer, not the cost. In fact, to make the statement even more accurate, the customer cares about their own costs, much more than the price of the marketer. In addition, marketers should be aware of the choices their competitors offer to the customer. These options help define the environment in which customers perceive benefits and costs; and, of course, they are possible substitute purchases. This customer-based orientation is called utility or cost price. In this approach, the marketer looks at the usefulness or cost of the product for the customer and compares it to the utility or cost offered by competitors. A specific example that includes a published study by E.I. duPont de Nemours Company,2 illustrates how important cost pricing is. In July 1954, DuPont introduced the Alathon 25, a new plastic resin used in pipe manufacturing. Until that time, all plastic pipe was made of out-of-grade resin. While the pipe produced from Alathon 25 looked exactly like an extracurricular resin pipe, it had a longer lifespan than a competitive pipe and could withstand more pressure. After the product's shaky market launch, DuPont developed a strong advertising program for Alathon 25, which reported its notable benefits to the careful selection of extruders who made the pitch in the pipe. Alathon 25 sales rose strongly despite the fact that extruders sold the pipe to distributors between \$ and \$13.00 for 100 feet against. Against. \$5.00 to \$7.00 price per pipe out of out-of-class resin. This price ratio, almost 1.9, is more than the relative life of the pipes would suggest. The ads reproduced in the example show the secret to the success of this strategy. It shows the application of the farm, the typical use of the pipe where the pipe goes underground. It is clear that if the pipe bursts, it will have to dig - taking a lot of time on an expensive routine. The value or utility of the pipe is great because it is part of a complex system. In this way, we can overwork our simple concept from a marketer's point of view: with a full understanding of the end use, set a price based on the utility or value of the product. Obviously, this approach requires that the marketer has considerable knowledge about their customers to fully understand their applications, including their subtle operating and organizational relationships. A marketer can gain this knowledge by analyzing the costs and benefits of customer trade-offs. By analysing customer perceptions when setting prices, industrial marketers should do the following: 1. Understand the overall use of the product. 2. Analyze the variable benefits. 3. Analyze the cost variables. 4. Make costs and benefits compromises. While the first area is perhaps the most important, it's the least easy to generalize because each application is so different. A marketer just has to study every final use. If the product is a raw material or component, it will be part of both the final product and the process by which the product is made. If it is part of the capital equipment, it is often only part of a larger production system. The newly mentioned plastic pipe is a good example. It is part of two important larger systems; complex and tedious installation process and completed water transportation system. Focusing on the variable benefits a marketer can begin to develop a more complex sense of the usefulness of a product as he or she analyzes the benefits to customers. In this analysis, it is useful to consider the product as a set of physical attributes and as a set of soft service attributes. Theodore Levitt called this latest set of characteristics an enhanced product. 3 Let's first look at the physical attributes of the product. One of the best ways to analyze a set of competitive products is to place them in a performance space (or map or graph) where the axis represent different performance variables.4 While at the first cut you can think of many different measurements along which to describe product offerings on the market, when further analyzed by a marketer, you will usually find that two carefully selected variables tell a big part of the story. In the case of electric motors, for example, the variables may be horse and torque. The exhibition I showed such a space. Every element in competitive competition lines can be placed at a point in space. The construction of such a space has three advantages. First, it forces the marketing manager to clearly identify the main attributes of the product. Second, it provides a visual way to compare competing lines. And third, and perhaps most importantly, it encourages the manager to develop a clear product policy based on the basic characteristics of the product. Exhibit I Product Space for Electric Motors As an exhibition I show products usually do not appear at all points in the product space. Instead, they appear at points that have a special technical significance or historical tradition. Thus, engines can be offered at 5 HP and 10 HP, but not at 8.273 HP; Printing machines will always be the size of paper sizes. This fact makes it much easier to work with the product space. Space in Exhibition I, for example, has nine feasible products, seven of which are manufactured. Sometimes, of course, managers can choose to break with established traditions of product positioning, but such situations are rare. Product space is a particularly powerful tool when it is used as a visual technique for market segmentation. Returning to our example of an electric motor, we can map different segments of the market in space. Exhibit II shows what such a map might look like. In some industries, where the market accounts for a small number of specific accounts or a significant share of the market, the needs of individual accounts can even be mapped in this space. Exhibition II Product space for motor pumps showing two segments of the market Note: In this idealized product space, the engines for the hammelisa pump market will be high horsepower and low torque because the hazelnuts are not viscous. Molasses, on the other hand, is goolier, has more viscosity and companies, making it need pumps with high torque (or turning power) in relation to horsepower. But so far we have discussed only the physical attributes of competitive products, which in many industrial markets are identical or almost identical. Products are often purchased according to specification. In such situations, the products are not differentiated, but companies can be on the services they offer. One company can emphasize the reliability of delivery, and the other - the quality of technical support. These service attributes can be displayed in much the same way that physical characteristics are displayed in the product space. For example, the market for variable copiers may have a total price for the response of the copy and repair service. With most industrial products, the customer buys an extremely complex system with many variables. While compromise can be explored explicitly Surveys like this would certainly be justified in large markets, it is often possible for a marketer to determine important buying criteria simply by knowing closely his or her customer needs. Customers, only on product attributes and services companies can, however, lead marketers into a very dangerous trap that marketing functions rather than benefits. While every good sales manager stresses to their sellers that the customer buys the benefits, most sellers and many marketing managers emphasize the features and forget about the benefits. To quote a familiar phrase: A man who bought a 1/4-inch drill bit doesn't want a bit of a drill, but wants to be able to drill 1/4-inch holes. Therefore, for the client, durability refers to the ability to drill more holes before the bit needs to be replaced rather than the hardness of the bit. Many marketing managers (and sellers), however, would mistakenly emphasize the new, harder alloy bits made of, rather than favoring more holes between bit changes. A very smart way to avoid the trap is to develop performance space sizes based on customer needs (i.e. the number of holes drilled by a bit) instead of physical or service attributes. This procedure carries the orientation of the client one important step forward. Calculating variable costs Just as the benefits are a complex group of physical and service attributes perceived differently by different people, the cost is much more than just the price the customer pays. When trying to calculate costs, it is useful to start with the purchase price and then add on clear, clear acquisition and usage costs such as incoming transportation, installation, repair, labor, power, and so on. Using the concept of lifecycle cost, the manager can consider all the costs associated with a piece of equipment or manufacturing process throughout the 20 years of the product. Although the cost of a life cycle is usually used for capital equipment, it can apply to almost any purchase, including a service or a supply commodity. Most basic make-or-buy analyses have life cycle value elements if they are done correctly. Using the concept, the manager can exchange his client's operating expenses, power or labor for capital investments. But effective cost analysis involves analysing less obvious costs. For example, if a product failure or a break in the production process poses a great risk to the customer, he or she is much more likely to pay a high price to ensure reliability than someone who does not perceive the same risk. Some companies, for example, purchase good components for their products because they know that their customers are very sensitive to performance. If the product fails, the customer loses more than the monetary value of the component, and the company's relationship with the customer decreases by that amount as well. Creative ways to look at customer's perception of value can to powerful, but sometimes simple, marketing approaches. One manufacturer Tools suffer from a large number of very small orders for a limited variety of repair parts for one particular product line. In the analysis, the product manager found that customers were annoyed to order small parts because the cost of the order was more than the price of parts. In addition, for the same reason, the company lost money on spare parts. Even more costly, customers were upset by the outage caused by not having the right parts in stock. Several customers with many tools seem to be able to keep the right mix of parts in stock, but others with limited experience may not develop good inventory rules. To alleviate the problem, the product manager developed repair kits with several different ranges of parts and offered them to customers using a wide variety of tools. The company's costs decreased, customer costs decreased, and customer satisfaction increased because the tools were available longer. Creating cost-benefit compromises If the customer makes costs and benefits compromises when analyzing the purchase, it seems reasonable for a marketer to do the same in analyzing how to approach a customer. The easiest way to start understanding a compromise is to first look only at the physical attributes of the product and the price. Leave to then consider the variable services and other factors that make up the cost of the customer. In many industrial markets, you can identify and study the overall price-performance ratio. The main variable performance in tracked tractors, such as horsepower. The price-performance ratio here thus becomes dollars per horsepower. The low ratio (1:0) indicates a higher horsepower per dollar than the higher ratio (2:0). A marketer can use the previously described performance space for such analysis, replacing one product performance variable with a price tag. On the graph in Exhibition III, every element in the product line can be represented by a point. Any specific product line can be represented by combining dots for each item in a row to form a curve. Price performance curves have been used in the computer industry with some success to show the development of the industry over time. There, for example, you can see better performance per dollar (or performance) as a result of each subsequent generation of computers. Exhibit III Price-Performance Curves Theoretically, one could build a three-dimensional (or more) price-performance space, with multiple product performance measurements built against a single price measure. But because managers can't visualize three-dimensional space, let alone more it's more practical for them to choose one basic performance feature. The clearest price and performance curve, however, leads one to feature against the benefits of the trap again. Once again. Performance attribute, on the price performance curves chart, is usually a function, not an advantage. The buyer of a tracked tractor, for example, is not very interested in horsepower, but in the amount of land moves per hour. Again, space can be defined in client-oriented conditions, such as ground yards being moved per hour. Thus, instead of contrasting the price with features or performance, the marketer should be mindful of the final use of the product and look at the price along with the benefits and costs. A constructive assessment of the benefits and costs of a complex system requires a lot of creativity and careful calculation. Throughout, the marketer must keep his or her eyes on customers and their perception. In addition, the marketer may have to consider as possible customer spending problems, which usually do not even consider a quantitative evaluation. For example, if someone is marketing a piece of capital equipment crucial to the overall production system, when considering the benefits of reliability a marketer may well estimate the cost to their customer of disabling the entire production system if that risk is important to the customer. Different customers will clearly have different problems and will use the product in different systems. As a result, they are more likely to perceive the same product as having different benefits and costs. For a quick of important cost-benefit concepts, see 1. Commitment to the philosophy that the customer chooses products by measuring the benefits of costs. 2. Understanding that benefits are far more related than physical attributes, and that in many industrial situations it is soft services that distinguish products. 3. Awareness that value involves more negative aspects of buying than price alone. Prospects for benefits and costs in terms of a full use system rather than an isolated part of the system. 5. Aware of the fact that different customers view benefits and costs differently, which requires careful market segmentation. 6. Applying graphic techniques to understand the position of products and product lines in terms of customer needs and competitive offerings As marketers have to determine the price for an industrial marketer, the price-determining process is much more complex than simply choosing a price. Because the customer considers the price as an integral aspect of the product and the manufacturer. Therefore, price should be seen as a design variable when planning a product as one of several critical performance attributes. The intimate relationship between price and product policy has a big impact on the entire product planning and pricing process. For a specific example, let's on the tracked tractor business.6 In the U.S. market, Caterpillar was dominated the market for large tractors over 100 horsepower. On the other hand, Deere dominated the market for smaller utility vehicles with less than 100 horsepower. Then, around the same time, Deere and Caterpillar entered each other's domain market. The new large Deere tractor had a hydrostatic transmission, which, according to Deere management, provided about 15% higher performance on horsepower than comparable existing units. Deere, however, was unfamiliar with the large tractor market and something unknown to the customer in this market. While designing his new tractors, Deere had four course actions open to him:7 1. It can introduce units a little more in horsepower than a competitive Caterpillar unit. 2. It can enter units with the same horsepower as Caterpillar units. 3. It can enter units a little smaller than Caterpillar units. 4. It can place its records between existing Caterpillar units. The latter option would require a re-education of the market, which is an ambitious exercise in the face of such competent, well-established competition. Since this product was so complex, involving several years of development time and millions of dollars in design and tool costs, Deere's decision was difficult and important. Obviously, it was both a food policy and a decision on prices. In the tractor industry, part of the price is determined by the cost of production. The cost, in turn, is determined by the size of the product, as well as other variables such as unit volume. Another important point is that the price can be changed, especially reduced, much easier and faster than the product can be changed. (The overall inflation tenor of the economy has greatly eased price increases than it once did, however. Price increases are not a shock as it was a rage. Basic product design in itself is the most difficult thing to change in any tangible way. When considering these options, it is important to note the role of customer perception of performance. The appropriate pricing strategy may differ in a situation where customers view horsepower as the main variable than in one where they view performance (yards move per hour) as a key variable. According to the study (which masked some of the data), Deere appears to have presented its tractor at about the same price and at a slightly greater horsepower than the competing Caterpillar unit. To encourage the rapid testing and adoption of its product, Deere management appears to have conveyed to the customer all the benefits of higher performance in new technologies. In addition, it seemed to do not want to stray far from the size of tractors in the industry. Pricing and product planning if one one The main importance of the customer's point of view when setting the price, as well as the concept of the customer balancing the benefits and costs, it becomes clear that product planning and pricing become one process. In fact, in industrial marketing, it is almost impossible to separate them. To a large extent, the price determines the market of the product, competition and potential application. This is strongly influenced by cost, which in turn is related to unit volume and performance. In the other direction, the price affects the unit volume. Once the product is in the price space, it is not fixed there forever; it can be moved either by changing its price or by changing its physical or service performance attributes. Despite this, product planning and pricing must be managed at the same time. Perhaps two examples would be useful here. In one of them, the manufacturer of expensive engineering plastic developed a new version of the product, which provided some clear performance benefits compared to the existing version. Also, on a straight basis, the new version was cheaper than the old one. However, when the depreciation of development costs was added to the direct costs, the total amount was more than the fully allocated cost of the old version. The company had several clear options related to pricing for both items, as well as the timing of the introduction of the new product. For example, you could introduce a new product at a higher price than the old one, holding it at the current price. Or management can lower the price of the senior. This option seemed particularly interesting because the company's engineers hoped to reduce the cost of processing an old product due to a new production process that does not apply to the new version. To reduce the price, management must decide whether to do so before or at the same time. Finally, the company can simply replace the older version with a newer version. As they approached this situation, managers had to consider the benefits, costs of customers, the usage system, and customer perception, not just the company's own expenses. In another situation, the manufacturer of a specialized type of electric motor was pressured by a new competitor, which offered a cheaper, lower quality unit, designed for the needs of a rapidly growing segment of the market. In this case, management can either develop a specialized engine for the same segment, or meet with their competitor primarily by lowering the price of the entire lineup. Management decided to develop a new engine for this segment, rather than cut the price and sacrifice margins throughout its lineup. Accidentally, the manufacturer then discovered other segments of the market where its penetration was low, which had applications for a new, cheaper, engine quality. As a competitive tool, pricing has a strong advantage over product planning is almost always faster and easier to change the price than to change a product or service. Changes in the soft service part of the product take a long time to implement. It's easy to develop the best application engineering capabilities, upgrade sales power, or implement a quick processing and delivery program. Thus, in the electric engine the situation is just described, if the problem was urgent and the development of a new line is a long process, the manufacturer would almost be forced to respond by price cuts. Price changes, however, are easy for competitors to copy. If a company does not have a major price advantage over another company, it is difficult to develop strong positions solely on the basis of price. Exhibit IV shows the impact, cost, risk and ease of competitive response to different types of product line and price changes. Exhibit IV Planning Factors to consider when changing the price of the product line Note: It is important to note that the term risk used here may not be a true risk. We focused on short-term and moderate risks. The true long-term risks can be quite different. In situations of rapid change, especially technological ones, it can be much more risky to make small changes to the product and process than to make significant changes. The price ratio to the cost structure up to this point our focus has been almost entirely on the customer. But the company's own structure also plays an important role in the pricing planning process. The pricing policy should be structured in such a way as to make the most of the company's cost structure and, if possible, to rely on the distinctive competitive competence of the company. It should be noted, however, that in most cases the price can be used to generate demand, but not to radically change it. There are, after all, other elements of the customer's costs as well as benefits that need to be considered. A company that has a highly automated manufacturing plant, for example, and expensive sales forces may want to generate big orders, giving substantial volume discounts to help do so.8 Large orders that make good use of economical equipment of long-running, justify the high cost of call sales. On the other hand, another company with a wide range of products, more time-consuming production activities and a large distribution network with associated high fixed costs may have a much softer slope to the volume discount curve. Managers can't assume, however, that a big company-big order, a small company-small-order relationship always applies. In many situations, a small company can carve out a specialized niche around orders and long runs. With top managers acting as customer service managers, a small company can serve customers capable of placing large orders on a direct basis. Teh Teh manufacturer, on the other hand, can cover all market segments with a wide range of products and intensive distribution. At the same time, it serves both a small user and a large user. The manager must base his other product policy, the kind of market segmentation and the price on use (measured by the size of one line of entry into the order form) the customer is going to make out of the product, not on the size of the customer or the overall business that he gives the company manager. There are many other situations where managers build price policies around the existing cost structure. For example, managers can develop cost structure and underlying production, marketing, sales, and distribution strategies in addition to specific pricing policies and strategies. It seems to us that if product policy and pricing strategy are truly in line with the needs of customers, then the best long-term approach is to build a cost structure for them. While perhaps appropriate in the short term, market strategies that sacrifice benefits to customers to protect the interests of the company, such as the existing cost structure, are doomed in the long run. The final note we started this article by discussing the basic philosophy built around customers and their perception of benefits and costs. This concept is really important. Pricing should be done based on customers' perception of the value of the product, which depends on their overall usage system. Techniques such as performance space and price performance curves help realize the concept of the customer's primacy. But these are methods, not in themselves. Industrial marketers win or lose in the customer's mind. A version of this article appeared in the November 1978 issue of Harvard Business Review. 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