Lesson No. 15.

Topic of the lesson: Pricing for pharmaceutical products . Pricing strategy

Main issues to be discussed at the seminar:

1. Principles of pricing in the pharmaceutical market. Basic rules to consider when making any pricing decision.
2. Pricing methods. Cost-plus pricing. Advantages and disadvantages of this method.
3. Pricing based on competitors' prices.
4. Pricing based on product value.
5. Pricing strategies. “Neutral price strategy.”
6. Strategies for overpricing or underestimating prices, their consequences..
7. “Skimming” strategy.
8. Factors that a company needs to consider when setting the price for a new drug.

Principles of pricing in pharmaceuticals.

Price is not only the most important economic category that has a significant impact on the main economic indicators of an organization’s activities, including turnover, gross income and profit, but also determines the nature of the relationship between the enterprise, the organization and consumers. Thus, price acts as a marketing tool aimed at meeting consumer needs.

The basic principle that should guide us when making any pricing decision is that price affects the consumer's perceived value of a product. The other components of marketing—product, promotion, and distribution—contribute to the creation of customer value. The drug product itself must have clinical and economic value. The value of a product increases when distributed because "place utility" is provided. Availability of a product where and when it is needed adds significant value to it. Increases the value of the product and its effective promotion, since in this case consumers are explained how to use the product in the best way.

Not only must price reflect the value created by all parts of the marketing mix, it must be used by the company to capture that value.

Profitable pricing decisions provide funds to continue research, i.e. to maintain the viability of the company.

Pricing decisions are made using various types of information and taking into account internal corporate processes. Each decision is unique, it depends on the company, the drug and external factors

Marketing allows you to control drug prices, since companies compete with each other and fight for the largest market share. The production of generic drugs is based on price competition, but price competition also occurs between different branded products of the same therapeutic class. Although different products rarely have equal therapeutic value, substitutes can often be found. Thus, a drug with an excessively high price, the result of poor market analysis, will not find many buyers.

In addition, **marketing, by reducing the price of drugs, increases the number of users** . Pricing to a certain extent depends on the expected market volume, and stimulating appropriate demand through promotional methods allows you to expand the audience of users. Widespread use of the drug could increase production scale and reduce prices. The share of R&D (Research and Development) and production costs is reduced (they are distributed over a wider base), so the unit cost is reduced. This is why commonly used drugs, particularly those for chronic diseases such as arthritis or hypertension, cost significantly less than those needed by a relatively small number of consumers, such as cancer drugs .

The most important factors in making pricing decisions.

There are no easy or quick ways to determine the price, nor are there any “magic” models containing the exact price or formula that calculates the optimal figure.

No two companies have exactly the same needs, philosophies, or resources, and no two products use exactly the same strategies to bring them to market, even if they are products from the same company. These basic differences require different pricing criteria and different prices. The price of a pharmaceutical drug, like any other product or service, must be determined based on market research.

Contrary to the commonly held belief that pricing is simply a matter of adding a certain amount to costs, pricing experts agree that the level of costs helps set the price floor, but it is the market that provides the basic information for making a decision.

Fueled by competition, especially in the area of prices, the need for market-based pricing in the pharmaceutical market will increase.

Here are a few basic rules to consider when making any pricing decision:

1. Previous prices, product characteristics and competitors' actions.
2. Specific patient characteristics.
3. The economic and social value of the therapy itself.
4. Decision-making criteria for doctors and those who influence this process.
5. Characteristics of the disease for which the drug is used.
6. The interests of the company in terms of market position, profits and other factors.
7. Company capabilities, including availability of funds and commitment to support the product.
8. Current and forecast conditions for insurance compensation for acquisition costs.
9. Political environment.

These factors should be considered both from the standpoint of general company policy and “privately” - by the product manager or other official responsible for formulating the development and pricing strategy. Failure to consider these factors has led to numerous errors in the pricing of pharmaceutical products. It should be noted that the elements of the pricing model will vary widely among companies and their affiliates due to local differences in health care delivery, reimbursement, and regulatory systems. However, all these issues must be carefully studied.

Pricing strategy.

Includes the following 4 stages:

- setting pricing goals;
- development of pricing policy;
- selection and implementation of pricing strategy;
- development of a price adjustment mechanism.

Let's look at these stages.

1. Setting pricing goals

The pricing goals of any structure in market conditions are focused on:

- increase in sales
- increase in current profit
- ensuring survival in a competitive environment.

Additional goals may be set:

- maximizing long-term profits
- market stabilization
- targeting the average buyer
- restraining competitors from excessive price increases.

Prices based on sales volume

The sales volume is set in accordance with the market situation, the state of demand and supply, or in accordance with the desired sales growth.

Sales volume directly depends on the demand for the product. Demand and prices, in accordance with the law of demand, are inversely proportional. The sensitivity of demand to price is determined by the price elasticity coefficient.

To assess the elasticity of demand, it is measured at different prices or special consumer surveys are conducted.

When ED > 1 the demand for a drug **is elastic** . As a rule, this is typical for over-the-counter drugs and medical products.

In such a case, to increase sales volume it is necessary to reduce prices. This reduction will generate more total sales revenue. This approach is appropriate as long as there is no proportional increase in the costs of production and distribution of goods.

If the demand for a drug **is slightly elastic (ED < 1),** then this situation is explained by the following circumstances:

- there is no replacement for the product (insulin for insulin-dependent patients);
- buyers do not notice price increases immediately (chronic patients, as a rule, have a supply of medicines);
- buyers slowly change their purchasing habits (the consumer is confident that this particular drug works well)
- dispensing medications using free and discounted prescriptions.

With inelastic demand, a price reduction will do little to stimulate sales volume. Therefore, when trying to farm. structures to increase sales in such conditions should focus on non-price determinants of demand, study consumer demands and try to satisfy them.

If **the demand** for a drug **is elastic (ED > 1),** reducing the price must be considered to increase sales. The reduced price will generate more total revenue from the sale. This approach is logical as long as there is no proportional increase in the costs of production and marketing of goods (as a rule, demand is elastic for over-the-counter drugs and medical products).

Profit-oriented pricing

A price is selected that ensures maximum profit and full cost recovery when assessing demand, the need to recoup investments or the costs of production and sales of goods. Demand sets the maximum price, and the minimum price is determined by production and distribution costs. The price must cover all costs of production, distribution and marketing, including a fair rate of return for the effort and risk involved.

Prices aimed at survival in a competitive environment.

It is necessary to know the prices and quality of competitors' products. This information is the starting point for your own pricing. Such a strategy is justified if the pharmaceutical structure has a price similar to its competitors and at the same time covers the costs of the pharmaceutical structure.

A pharmaceutical structure may have several pricing goals: maximizing profits, targeting the average buyer. There are long-term and short-term pricing goals. The main thing is that they must be linked to the strategic and current plans of the enterprise. If strategic planning of pharma. structure is based on cost control, then the goal of pricing may be to increase current profits in the short term, and in the long term - to focus on the average buyer.

Therefore, when choosing a pricing goal, the main factors are the structure and volume of demand, costs and prices of competitors.

Development of pricing policy.

A document is drawn up containing sections:

- method of determining the price when calculating it for:

a) new products

b) products that are established on the market

- price ratio of competitors
- frequency of price changes

- price changes depending on the product life cycle
- use of price discounts.

The most important aspect of pricing policy is **the choice of product pricing method** .

Pricing for new products.

Penetration pricing (a strategy for establishing strong market penetration) is used to achieve goals based on sales volume. This approach is based on entering the market of goods with a low initial price in order to attract a large number of buyers and gain a larger market share. Such pricing can be used if a new product has a high price elasticity of demand, as well as to deter competitors from entering the market.

Pricing based on buyer psychology.

Psychological prices are set slightly below the dominant price on the market for a similar product and slightly below a certain round sum (44 rubles 99 kopecks).

Pricing based on the reputation (prestige) of the company.

The prestigious price is set for prestigious goods, luxury items, and goods of companies of special quality. Thus, Bayer aspirin is 5 times more expensive than aspirin from other companies and 20 times more expensive than domestic ones.

To set such prices, an enterprise must be confident in the reputation of these products, and know for sure that analogues available on the market do not have qualities for which the consumer is willing to pay more.

"Costs are a plus"
(average costs + profit)

The approach is to add a predetermined profit to the cost of the product. This is the simplest pricing method. You can use the formula:

Price = (Total fixed costs + Total variable costs + profit) / (quantity of goods produced)

The method has a number of disadvantages. If the price is not tied to demand, and profit is expressed as a percentage of costs, then the company has no interest in low costs.

The method is also unacceptable for companies with a high level of research and development.

“Cream skimming” strategy (Skimming method)

The approach involves setting a high initial price for the product to skim the cream, which corresponds to the upper part of the demand curve. The method is aimed at achieving goals based on profit. “Skimming” is acceptable if the company has allocated a large amount of research costs for the development of a new product, high costs are envisaged for product promotion (advertising), when a competitor is expected to have a similar product in the near future, when the product is new and the market is not yet saturated, when the nature of demand is not determined.

Deciding how high the SP method is depends on 2 factors:
- chances of competitors entering the market
- price elasticity at the top of the demand curve.

If competitors do not put similar products on the market soon, the price will be high. If competitors have been developing a similar product for years, SP prices should not be very high. At the top of the demand curve, price elasticity is low, and in the absence of analogues or close substitutes (competitors), cross-elasticity is low.

Therefore, given the novelty of the product and price inelasticity of demand, you can get an immediate effect by setting high SP prices. If the initial price is too high, it may be reduced. This is better than setting the price low at first and then raising it later. If the price elasticity is higher than expected, then the lower price will be most profitable and generate more income.

Pricing taking into account the pricing policy for similar products of the market leader.

When introducing a new product to the market, the leader's policy for similar products should be taken into account. The price of a new product may deviate upward from the price of the leader, but only if the quality of the product is higher.

Competition based pricing.

In such a case, the starting points are not information about demand or costs, but information about competitors' prices. The approach is simple and does not require calculations of demand curves, price elasticities or unit costs. It is assumed that the current price level satisfies both buyers and the company.

Pricing for established products in the market.

Throughout the life cycle of a drug, the pricing strategy must change. Classically, price changes throughout the product life cycle look like this: Product launch on the market → High price; Growth → Price slightly lower; Maturity → lowest price; Decline → increasing price.

When choosing a pricing method for goods on the market, 3 approaches are possible :

1. Maintain price. It is possible throughout the entire life cycle, if the market segment that forms the sales volume is not subject to competition and the influence of other factors. The following price types apply:

- Long-term price. It is weakly subject to change over a long period. Such prices exist for consumer goods.
- Elastic (flexible) price. Reacts quickly to changes in supply and demand, both upward and downward.
- Consumer segment price. It assumes different prices for the same products in different market segments, designed for different buyers.

2. Price reduction. This is a defensive measure in a competitive environment and an offensive strategy when costs fall. The following types of prices can be used:

- Sliding falling price. Based on supply and demand. As the market becomes saturated, demand falls. When price elasticity is high, lower prices may attract buyers.
- Preferential price. One type of defensive strategy. It is acceptable if the enterprise controls a large market share and the product has high prestige. A slight reduction in price will help maintain market advantages over competitors.
- The price is lower than most companies. Applicable for complementary products. Such items may be sold at regular prices along with reduced-price items. It is important to draw attention to the main products, and products whose prices have been reduced are a kind of advertising.

3. Increase in price. In an inflationary economy, prices rise, as do all types of costs, to ensure profits at an adequate level. An increase in prices may be a reaction to a drop in income associated with changes in demand, which is observed under conditions of monopoly production.

Competition

Typically, information on competing drugs is first collected to prepare pricing recommendations. If a new drug is launched into a market within its therapeutic class where there are already one or two competitors, their prices should serve as an initial guide.

What prices should be taken for analysis (for example, manufacturer's price list prices, discounted prices, prices per dose, cost of one day of treatment, packaging, course of treatment) depends on the purpose of the analysis and the product being studied. It's best to start with the factory price for an equivalent unit of treatment, whether it's one day of treatment for a chronic condition or a full course of treatment for an acute condition.

Discounts and the like are tactical in nature, and the first steps in any initial pricing analysis should be focused on strategy.

In addition to the current prices of competing drugs, you should examine the price history of products in that class to note any recent changes. Consideration should also be given to the presence of other new products being prepared for launch. It is also necessary to study the price range (from highest to lowest) for branded products existing in this market. If price levels vary

markedly with the success of drugs (for example, those with large market shares often cost either more or less than their less successful competitors), then this may indicate the presence or absence of price elasticity. Markets in which the leader sets the lowest price have price elasticity, while markets in which the leader has the highest price have low or no price elasticity.

The prices of other products sold by major competitors and those companies that have recently entered the market should also be examined. This will help determine whether their prices reflect the overall corporate pricing policy or are selected specifically for a given product. If prices reflect a deviation from the company's typical pricing approach, this may signal that the market is price elastic, or that the company believes so.

Competitive factors to consider at this stage include the level of promotion of other drugs, how their sales are growing, and the extent of discounts in price-sensitive markets such as hospitals and insurance companies. Again, the level of discounts must be compared to the success of the product in those markets.

The high level of promotional costs makes it difficult to introduce a new drug. If decision makers can be swayed by the lowest possible price, then markets with significant promotional costs may be a good place to use a low-price strategy, provided, of course, that you determine how much the price must be reduced to attract consumers' attention. .

A low level of promotional costs is usually characteristic of a mature, demand-satisfied market, which is less favorable for implementing a low-price policy. This policy is also suitable for a mature market where there is little competition and patients with unmet needs. In these markets, a new drug that has advantages over those already on the market can often be launched at a higher price without affecting its prescription rate. Sometimes, due to improved characteristics, new drugs are perceived by doctors as expensive - they believe that a better quality product should cost more. In this case, doctors' standard beliefs play a major role in price decisions.

Relative market share compared to price levels also speaks volumes. Markets in which the leading products have the lowest price appear to have very high price elasticities.

Many researchers agree that the prevailing pricing system in the market and the presence of competitors, coupled with the uniqueness or special therapeutic value of a new drug, are the most important factors determining its price at launch. As a health economic researcher wrote:

Duncan Reekie, the main thing to consider when setting the price of a drug is the cost of drugs from competitors and the possibility of new players entering the market

An interesting result of Duncan Rickey's research was that even for unique drugs that had noticeable advantages over other drugs, in anticipation of the emergence of stronger or equal competitors within two years from the date of launch on the market, the price was set at a lower level than at those for which new competitors were not predicted to emerge in the near future.

1. **"Skimming."** A product that faces no direct competition is priced above the mainstream in order to maximize profits. The price of Prilosec, the first proton pump inhibitor, was set in this way - at a level significantly higher than the prices of H2-receptor antagonists, although they matched it in value.

2. **Parity.** The price of the product is set at the level of its main competitors. The most commonly used approach, mainly by companies launching products into established markets.

3. **Penetration.** The price of the product is set at a lower level than the market average. This is how many products were launched. Since the market is generally price insensitive, it can be concluded that most companies using this strategy have decided to exclude price from marketing their products.

These approaches also depend on other factors, such as the needs and capabilities of the company, the price elasticity of a given market segment, and the therapeutic value of the drug.

Thus, the factors described here are a complex system of elements that must be assessed as a whole.

The weak response to deep discounting in many markets means that:

1) markets are not price sensitive

2) the companies supplying products to these markets act as if the markets are price sensitive.

Below are the key questions to answer regarding competition: Who are the competitors? Are new competitors expected to emerge? How did competitors react to other companies' pricing strategies? What can competitors do if they see a new product as a threat to their position?

Patient characteristics

In many markets, patients do not bear a direct financial cost of treatment, but this is not a common phenomenon. In markets where patients are not fully reimbursed for the cost of drugs, their views as end users of a new drug must be taken into account when setting its price. If the majority of the patient population is elderly, most of whom do not have insurance coverage for medications and must therefore pay out-of-pocket for treatment, then the ability of these individuals to afford the drug in addition to other products must be taken into account. This medication may be relatively inexpensive per daily dose, but if a patient on a fixed income must take three to four of these prescription drugs daily, the total cost may become prohibitive for the patient.

About 50% of patients who are prescribed a drug to treat a chronic disease with virtually no external symptoms stop taking it within the first year. Perhaps it is a lack of understanding of the importance of adherence to treatment or an inability to afford an as-yet unknown drug, but if some of these considerations were removed by lowering the price, the product could generate more revenue than if it were sold at a higher price. Some patient groups are very well organized and are able to exert political and economic pressure on the pharmaceutical company. Patients with diseases such as mental illness, Parkinson's disease, HIV and cancer have active support groups, the role of which in the choice of treatment has recently increased significantly . Patient involvement in treatment decisions is increasing across all major therapeutic categories, and the increasing power of such groups in the market must be taken into account when making pricing decisions.

However, even if patients are protected from the financial consequences of drug use, they can play a role in deciding which drugs to take, and this ability can be accommodated through flexible pricing.

Basic questions to identify patient characteristics include: What potential positive benefits might consumers see from the drug (does it provide symptom relief or healing)? Is it possible for the patient to protest about the price? Is it likely that patients will not be able to afford the product, and can affordability be made a major selling point?

Cost of treatment

It would be reasonable to begin the development of a new drug by studying the economic aspects along with the clinical ones. The first step is to examine the “financial structure” of the disease for which the drug is being developed. This will help to correctly fit the drug into this structure to determine its subsequent impact on the overall cost of treatment. Ideally, a new drug should help reduce the cost of treatment, especially when other treatment options are available. Theoretically, the value of a new drug is determined by the level of reduction in treatment costs achieved with its help.

A drug whose benefits in terms of reducing the cost of treatment are documented should be very well taken (ideally). This is driven by public interest in health care reform and price containment policies. For this argument to play its role, attention should be paid to other circumstances. The pricing process may be influenced by the existing system of insurance and compensation payments in society.

Key questions related to the cost of care: What is the cost of the disease to the health care system and society? What are the possibilities of reducing this cost with a new drug? What information is needed to prove savings? Does this drug have the potential to generate increased profits at an increased price?

In outpatient practice, the doctor can often choose the treatment method regardless of its cost. However, this does not mean that the market is completely insensitive to price:

Key questions related to market decision making are: What role does price play in the decision process to prescribe, dispense, consume or purchase drugs in this category? How likely is it that doctors will receive negative feedback from patients related to the price of the drug?

Characteristics of the disease

Disease characteristics themselves can provide one of the most valuable pricing guides. Experience shows that illnesses that are acute in nature, such as mild infections or traumatic pain, are likely to be insensitive to price. A prescription for an antibiotic or analgesic is usually given to a patient once, and most often the patient does not continue to see the doctor. This is true even when the patient pays full price for the drug. However, in the case of chronic diseases, people are forced to buy the drug every month and often complain to the doctor about its high cost. Research shows that another factor to consider is the symptoms of the disease. Doctors tend to overestimate the cost of drugs to treat chronic, asymptomatic conditions, such as hypertension, and underestimate the cost of drugs to treat conditions with obvious symptoms, such as arthritis or acute infections. This is believed to be caused by patient and physician feedback.

In hospital settings, the principle of reimbursement of drug costs by insurance companies influences the choice of drugs. An important factor in drug reimbursement is the “formulary effect” of the healthcare management system.

Key questions regarding the drug reimbursement system: How is the product reimbursed? Who loses and who gains financial resources with the help of a new product? Are there any special features in the reimbursement system for drugs of this class?

Company needs

Although the cost of drugs and the company's minimum margin play a role in setting the price floor, other company-specific factors may also come into play when deciding this issue. New investments or activities that are estimated to require significant investments may also result in a higher price for the upcoming drug, a price that does not adversely affect sales of the drug.

Conversely, a company may view a new drug as a test stone, an opportunity to gain experience in a particular market before a new, more important drug is introduced in a few years. In this case, a low-price strategy for the drug could allow the company to gain experience and important relationships with physicians and key opinion leaders in this market.

Choosing an innovative pricing strategy that implies savings, guarantees or anything else can become the basis for a favorable company image and will be useful when establishing relationships with investors or consumers.

Key questions from the point of view of the company's needs: How important is the new product for the company's activities? Will pricing this product make it more difficult to price the company's other products, or vice versa?

Taking into account the political situation

Last but not least is the socio-political environment. For the foreseeable future, pricing will have to take into account the reactions and actions of both government officials and patient advocates.

Key public policy question: How likely is a drug's price to attract the attention of the press or legislators?

All of these factors and aspects will influence each new pricing decision.

Note that the socio-political environment is the element that surrounds all other elements. When making any decision about pricing, it should be given the greatest attention.

Pharmaceutical **pricing is a complex system with no easy answers to important questions.** Although every pricing decision is unique, many steps in the process are common. Failure to consider all of the elements described above may result in poor pricing decisions.

Example

Principles of pricing in pharmaceuticals. By the product of the Joint Stock Company of the Implementation Center "Protek" understands a full-fledged service provided to the client. The company broadcasts the manufacturer's price, adding its costs for distribution, delivery of

goods, promotion and takes into account the market situation. The pricing policy is additionally influenced by whether the drug is included in the List of Vital and Essential Drugs, the list of preferential and free drugs (25-30% of CV Protek purchases).

"At the entrance," when the manufacturer announces the price of the drug, Protek specialists analyze market sales of analogues in all regions. As a rule, the manufacturer himself determines the price niche of the product and the geography of its distribution. If there are no restrictions, the drug is supplied to all regions of the country.

The value of a product for a distributor is determined by the following indicators:

1. drug rating;
2. manufacturer rating;
3. price of the drug;
4. availability of analogues;
5. domestic or imported drug;
6. innovative drug or generic;
7. manufacturer's budget for promoting the drug;
8. relations with the manufacturer;
9. positioning of the drug.

Protek is not faced with the task of "equalizing" the price of drugs + analogues. When an analogue appears, the distributor revises previous sales plans in a given price group and changes sales forecasts. When a competitive situation arises, the manufacturer also receives new sales forecasts. The Marketing Department analyzes daily how actively the drug "leaves" from our warehouses.

When a manufacturer announces a discount program (participation in a tender or competition for targeted healthcare programs), the low price is compensated by supply volumes. Protek "broadcasts" discounts on retail deliveries and monitors reporting by groups of buyers in a specific market segment. Promotions are held under similar conditions with pharmacies or chain pharmacies. Discounts depend on the volume of the batch purchased by the client, his loyalty and the duration of work with the distributor. Since sales are carried out in designated segments, each market segment has its own pricing policy - for pharmacies, pharmacy chains, medical organizations and other clients. In the company's branches, marketers have the opportunity to adjust prices depending on market conditions in the region. The head office gives them this opportunity, setting the range within which they can adjust prices.

The company's policy is aimed at identifying shortcomings in its own infrastructure and bringing it into optimal operating mode. In relations with other distributors, Protek strives to form mutually beneficial partnerships.

Protek's prices are not the lowest on the market, and the company welcomes non-price forms of competition. Protek works with other distributors, viewing these wholesalers as a channel for promoting exclusive products. Other distributors also have exclusive positions that are interesting to Protek.

Every month, pharmacies hold promotions organized by Protek together with manufacturers. This allows you to introduce the retail segment to companies + manufacturers and motivate customers. The company's logistics are used to move promotional materials, prizes and gifts to customers across the country. Apart from national distributors, no one has the distribution channel and warehouse capacity for such a full-scale operation.

Pricing management in the company

The company's goals and their reflection in the pricing policy

Price is an instrument of a company's commercial policy, so discussing pricing methods and rules makes sense only if we imagine what the company was able to achieve by setting prices for its products or services.

With all the variety of goals and missions that may be preferable for the owners and managers of various companies, one goal is always significant - increasing competitiveness,

since without it successful sales, and therefore the financial survival of the company, are impossible. Increasing competitiveness is usually not so much the result of the fight for restrictive duties on the import of imported goods, but rather the consequence of the choice and implementation of a well-thought-out marketing strategy, which requires firm managers to regularly analyze four main elements:

1) the position of the company in the market, i.e. how its products are perceived by potential buyers, what level of technical excellence, quality and reliability they expect in this case;

2) market requests, i.e. what needs are presented by consumers in the market today or what needs can be tried to be satisfied tomorrow;

3) opportunities to reduce production costs of goods more quickly and to a greater extent than competitors, which will allow it to sell them at a lower price;

4) opportunities to create differentiated products, i.e. modifications of their products that have different properties from what competitors do and are therefore more attractive to consumers even at the same or higher price than competitors.

This kind of analysis is the basis of any marketing activity. Managers of many Russian enterprises neglect it, which often leads to extremely unsuccessful marketing strategies and, accordingly, to unsuccessful pricing decisions, which in the worst case scenario can lead to the death of the enterprise.

The lack of skill in such analysis often leads managers to the erroneous conclusion that it is the level of costs that is the main factor determining prices. In a market economy, those firms that survive and succeed are those that have realized a completely different logic of the relationship between costs and prices. And this logic lies in the fact that the economic management of a company begins precisely with the choice of price

The selection criterion is the ability to actually ensure sales at this price in the current competitive environment in the market. Accordingly, the main factors in searching for such a price are comparison with the prices of competitors and comparison of the properties and quality of the company's product with already sold analogues of competing companies.

The selected price (taking into account the elasticity of demand and competitive supply) determines the possible sales volume, which, taking into account the seasonality of demand and the cost of storing inventory, determines the possible production volume over a period of time. The volume of production (taking into account the effect of scale and the learning effect, which will be discussed below) determines the cost per unit of production. And then the resulting value becomes the desired profitability of sales.

Only by understanding this logic can managers take the next step towards successful pricing management: build an operating business model that is adequate to the competitive situation and consumer needs, and therefore choose the right pricing strategy and methodology for their company. There are many examples of successful implementation of this logic in world practice. Suffice it to recall the project to rescue the Nissan company from bankruptcy, during which the cost of cars was reduced by 30%. At the same time, you need to strive not just for the opportunity to sell goods or services due to the competitiveness of your product offer, but also for sales at a profit. A company that has solved many problems, but does not have normal (from the position of the owners) profit, cannot be considered successful. In addition, without a profit, the company is deprived of the opportunity to effectively solve the problems of its development, which can quickly lead to the loss of its position in the market and its margin of efficiency.

Raising prices is the most powerful lever for increasing a company's profits. As an example, consider a fictitious company with the following performance results:

What will allow the company to improve these parameters in the same proportion - by 1%? It is easy to calculate that:

- reducing fixed costs by 1% will increase profits by 1%;
- reducing variable costs by 1% will increase profits by 3%;
- a price increase of 1% will increase profits by 5%.

Pricing policy and pricing strategy of the company.

Whatever the market position of the company and whatever goals it sets for itself, it cannot afford one thing - to determine prices without a serious analysis of the possible consequences of each of the decision options. Moreover, an analysis of the activities of successful companies shows that they, as a rule, have both a clear pricing policy and a specific pricing strategy.

By pricing policy in this context we will understand the general principles that a company intends to adhere to in setting prices for its goods or services, and by pricing strategy - a set of methods by which these principles can be implemented in practice.

Returning to what was said above, one of the options for price policy can be considered the task of maintaining prices slightly below the level of the main competitors in order to ensure accelerated sales growth compared to the general rate of market expansion. The pricing strategy consistent with this policy will determine the set of procedures and activities by which such a policy will be implemented in practice.

If in your practice you often ask the question: “What price should you set to cover costs and make a good profit?”, this means that you do not have your own pricing policy and, accordingly, there can be no question of any strategy for it. implementation. We can talk about pricing policy if the question sounds completely different: “What costs can we afford to earn a profit at the market prices that we can achieve?”

However, it is impossible to say that a company has a pricing policy or strategy even if your question is completely market-oriented: “What price will the buyer be willing to pay for this product?” A manager's concern in the area of pricing would be, for example: “What value does this product provide to our customer, and how can we convince him that our price corresponds to this value?”

After all, if the value (subjectively perceived usefulness) of a product does not justify its price for the buyer, then a qualified pricing strategist will not frantically offer customers ever larger discounts, hoping to find the ideal price-utility ratio.

He will take a different path: he will begin to explore the possibilities of different market segmentation or the use of other sales channels in order to find his buyer who will buy this product at this price.

In addition, we must not forget that a low or reduced price is perceived by many potential buyers as evidence of the not very high value of the product (we will talk about the peculiarities of buyer psychology and the role of this factor in pricing later). That is why low prices and overly hasty establishment of discounts may not increase sales, but reduce them (buyers may react according to the well-known model: “We are not rich enough to buy cheap and low-quality goods”).

Finally, a true pricing strategist would not ask the question, “What prices will allow us to achieve maximum sales or market share?” He will look at the problem differently: “What volume of sales or what share of the market can be most profitable for us?”

The most clear differences between pricing by chance, market, and strategic pricing are manifested in conflicts between the heads of the financial and marketing services of the company. Ideally, they should achieve a balance of their interests, but in practice we more often see that marketers try to defend the interests of buyers who want to receive a product no more expensive than what it costs, arguing that only by paying attention to such requirements can a company achieve their commercial purposes. On the contrary, financiers require things more mundane: that the company sells goods at prices that cover its costs and make a profit.

Reconciling the interests of financial and marketing services is the task of the company’s top management, which must achieve:

- from financiers and accountants - the ability to manage costs, reducing them to a minimum, ensuring the required level of quality, as well as determining clear relationships between costs and sales volumes, so that they can be used to more clearly set tasks for marketers;

- from marketing specialists - the ability to select products (services), as well as market segments, which can become the basis of the company's commercial policy given its existing competitive advantages.

Strictly speaking, conflicts between financiers and marketers over pricing policy usually arise in firms whose management has not made a clear choice between two alternative approaches to pricing: cost and value.

Cost pricing

In many Russian companies, a cost-based approach to management still prevails. We will dwell on it in more detail. Historically, it is the oldest and, at first glance, the most reliable, because it is based on such a real category as the company's costs for the production and sale of goods - costs confirmed by accounting documents.

The credibility of this approach is supported to some extent by economic theory, which views pricing in terms of the firm's need to earn a normal return, taking into account costs fully and correctly distributed among products.

In fact, the cost approach has a big drawback: in many cases, the unit cost per unit of output, which should actually be the basis of the price in this approach, cannot be determined before the price is set.

With a market organization of product sales, the price level determines the possible sales volume and, accordingly, the possible scale of production. Meanwhile, both economic theory and accounting recognize that the magnitude of unit costs for producing a unit of output directly depends on the scale of production. With an increase (to a certain level) in the scale of production, the amount of fixed costs per product decreases, and, accordingly, the average cost of its production decreases.

A comparison of the cost and value approaches to pricing shows that a reasonable manager should not take the path of passive pricing, i.e. find himself in a situation where his decisions in this area are determined by the desire to cover actual costs and obtain an acceptable amount of profit under the already established operating conditions.

The most reasonable approach is active pricing, when through price management the desired sales volume and the corresponding average cost are achieved, which ultimately brings the company to the desired level of profitability of operations.

If we try to formulate questions that are most adequate to the logic of active pricing, they will sound something like this.

• How much do we need to increase the quantity of goods sold in order to get a larger profit at a lower price?

• How much of the goods sold can we sacrifice in order to make a larger profit margin at a higher price than before?

It is this approach to making pricing decisions by assessing the impact of various pricing options on the company's profit that allows one to avoid the serious flaw of cost pricing - setting too high prices in weak (with deteriorating conditions) markets or too low prices in strong (with growing demand) markets.

The value approach to pricing and mistakes in its use

Although managers of Russian companies often question the possibility of implementing the value approach, examples of its successful implementation can be found in domestic practice. The goal of a value-based pricing approach is not to keep the firm's customers happy. Such favor, after all, is not difficult to acquire through large discounts. But there is no greater mistake than believing that the high sales volume thus achieved is the fruit of a successful marketing strategy. In fact, value pricing is designed primarily to ensure greater profits by achieving a profitable value-cost ratio for the company, and not at all by maximizing sales volumes (this is an element of a different strategy).

When marketers confuse these objectives, they suggest setting prices based on what customers are willing to pay for a product rather than on a realistic assessment of what price the

product deserves. In the end, they certainly achieve sales targets, but they undermine the basis for the company to remain profitable in the long term.

Why can't pricing simply be based on how much buyers are willing to pay for a product? There are at least two reasons for this.

Firstly, experienced buyers are rarely completely honest when they name the amount they are willing to pay for an item. This is especially true for procurement specialists. If they understand that prices can be flexible, they begin not only to hide the true value of the product they need, but also find ways to mislead sellers. In this case, all the intelligence efforts of the firm's marketers, based on establishing relationships with customers, can be nullified by misinformation.

Secondly, the task of sales specialists is not at all to obtain as many orders as possible at prices that suit buyers. The art of marketers and sales people is to get buyers to be willing to pay a price for a product that better reflects its real value. That is why contacting customers with a direct question at what price they are willing to purchase the company's new products is a mistake. The answer is unlikely to be particularly valuable, since buyers may undervalue the new product or deliberately try to underprice it. In practice, real sales prices rarely coincide with the results of such "marketing" research.

In other words, marketers and sales must convince customers that they are worth paying a higher price for this product, because it is much more useful and necessary for them than they initially thought. And if the efforts of financiers and accountants (or rather, specialists in management accounting, i.e., production cost management) are added to this, exactly the result that the company should strive for will be achieved - the maximum difference between the value of the product for the buyer and costs incurred by a company to produce a product with the required properties.

The goal of pricing is to ensure that as much of this difference as possible turns into a profit for the company and as little as possible into a gain for the buyer.

The solution to this problem, as a rule, also depends on a third party - other firms competing in this market. That is why, normally, a company's pricing policy is born and improved in the course of constant cooperation between accountants, financiers, marketers and information service employees who study the market situation.

Cost pricing model.

Russian firms that are leading the process of market transformation have already passed the stage of returning to cost-based pricing and have begun to gradually master marketing approaches to solving this problem. For example, airlines and hotels are mastering the technology of customized pricing, where the starting point is precisely the different perceptions of the value of the same product or service by different customers. Reforming pricing methods is not easy: there are often no personnel skilled in new approaches, and the old-school specialists on staff at firms do not strive to master these approaches. In the latter case, companies have to fire such employees and look for specialists with a different attitude to the problem.

For the majority of domestic companies, the task of mastering competent cost pricing methods in combination with strict management of these costs is still relevant. And here, Russian economists can easily take advantage of the experience of foreign companies, in whose practice cost pricing is still used quite widely. At first glance, this situation is surprising for countries with developed market mechanisms. Indeed, from the point of view of modern economic theory, such an approach to justifying prices is completely unacceptable, because:

- does not take into account the conditions for the formation of demand and the economic value of the product (the price is determined based on a given sales volume, although this volume, by virtue of the law of demand, itself depends on the price);
- relies on accounting rather than economic (full) costs;
- uses average variables rather than marginal costs as the basis for determining prices.

Cost pricing is based on actually available data. All the information necessary to set prices using this method can be obtained within the company itself on the basis of financial

statements and documents regulating the amount of markups. No market research or customer surveys are needed, so pricing decisions can be made quickly.

The company does not always have specialists and managers who have more advanced pricing methods. Modern approaches to price justification (some of which are discussed in previous chapters) combine both scientific elements and creativity. Many companies (including most Russian ones) simply do not have specialists with the necessary knowledge and experience, and managers who speak the same language with them. However, any manager understands what costs are and that the price should be greater than costs by the amount of acceptable profit.

Cost pricing may be common in the industry . If this is exactly the situation, then the company's managers do not consider it necessary to master other approaches to justifying prices, knowing that market leaders also rely on costs and markups. This is still typical for most sectors of the Russian economy. As for the prices of imported products, they are perceived as a given, born of certain "world markets". *Cost pricing is often perceived by company managers as the most reasonable and fair* . Pricing based on costs is traditional. In addition, the basis of cost pricing is the completely reasonable idea that an "honest producer" should be able to recover his costs and receive a normal profit as a reward for his efforts. That is why, using the costly method of pricing, company managers (especially directors of Russian enterprises, who, as is known, have predominantly a technical education) perceive it not only as natural, but also as more secure than methods based on marketing ideas.

The basis of cost pricing is the formation of price as the sum of three elements:

1) variable costs of producing a unit of goods;
2) average overhead costs;
3) specific profit.

At first glance, this approach to justifying prices is extremely simple. In fact, there are many pitfalls in it, and in order to get around them, you need to use the cost pricing technique quite skillfully.

A study of commercial practices shows that the most common cost pricing methods are:

- determination of prices based on cost-benefit standards. This method is used primarily by product manufacturers;
- calculation of prices based on the standard markup value. This method is widely used in retail and service industries, including B2B markets;
- pricing based on target return on investment. They are used for the initial establishment of prices for new goods and services, especially when there is a small assortment or the ability to clearly differentiate the assets used by the company between different products;
- determination of prices based on trade discounts and surcharges. In this way, prices are determined by trade organizations of the wholesale and retail levels.

Development of the company's pricing strategy.

If a company has chosen a strategy of following a competitor, i.e. focuses on the price levels used by the market leader company, it is doomed to passive pricing.

In contrast, a premium pricing strategy (or, as it is more commonly called, a skimming strategy) is characterized by the firm setting a price at a level that is perceived by most buyers as too high in relation to the economic value of the product. However, this value-to-price ratio suits buyers of a certain narrow market segment. And the company makes a profit due to the fact that it sells goods at prices that include a premium premium for the most complete satisfaction of the needs of this group of customers.

With a neutral strategy, the firm sets prices at a level that is perceived by the majority of buyers as generally consistent with the economic value of the product, i.e. adequate to the price-value ratio prevailing in this market.

Let us emphasize once again that in all cases we are not talking about absolute price levels. A product may be absolutely expensive, but be perceived by buyers as relatively cheap (undervalued) compared to products from other companies that have the same level of economic

value. For example, Russian high-end car speakers (*URAL Warhead brand) have appeared on the domestic audio market.* Such equipment is expensive, but in relation to similar equipment (with the same parameters) from Western companies, its prices are perceived as relatively low. This is a real manifestation of the price breakout strategy.

In practice, you can also find a combined version of the pricing strategy (a combination of elements of the price breakthrough strategy and the **“cream skimming” strategy).** It is called the speedy return strategy.

It should not be assumed that the company is completely free in choosing its pricing strategy. The choice is determined by its cost structure, the motives of its customers in the market, as well as the company's previous market position and reputation with customers. In addition, it is possible that a company simultaneously implements several types of pricing strategies (this is especially typical for industries with high fixed costs).

The following conclusions can be drawn. Price is an instrument of a company’s commercial policy, therefore any discussion of pricing methods and rules makes sense only if you understand what the company actually wants to achieve by setting prices for its products or services. The economic management of a company begins with the choice of prices for its goods or services. The selection criterion is the ability to actually ensure sales at this price in the current competitive environment in the market. Accordingly, the main factors in searching for such a price are comparison with the prices of competitors and comparison of the properties and qualities of the company's product with already sold analogues of competing companies. It should be noted that raising prices is the most powerful lever for increasing a company's profits.

No matter what market position the company is in and what goals it sets for itself, it cannot afford one thing - to set prices without a serious analysis of the possible consequences of each decision option. Moreover, an analysis of the activities of successful companies shows that they, as a rule, have both a clear pricing policy and a specific pricing strategy.

Conflicts between financiers and marketers over pricing policy usually arise in firms whose management has not made a clear choice between two alternative approaches to pricing - cost and value. The most reasonable approach is active pricing, when through price management the desired sales volume and the corresponding average cost are achieved, which ultimately brings the company to the desired level of profitability of operations.

The art of marketers and sales people is to get buyers to be more willing to pay a price for a product that better reflects its real value.