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Demand State and Pricing Strategy

Abstract

“Pricers face different market conditions which require distinguished pricing strategies. One of the most important drivers of the variability on those conditions is the state of demand. According to Phillip Kotler², demand can be negative, nonexistent, latent, irregular, faltering, full, overfull, or unwholesome. Therefore, pricers must understand that each one of them posses a distinctive challenge.”

² Kotler, P – The Major Tasks of Marketing Management – Journal of Marketing, vol 37, pp 42 – 49.
Author Note: All demand descriptions in this article were based or transcript from this Kotler’s article

Demand State and Pricing Strategies

Although the professional pricing career is becoming more important inside larger organizations in the US and abroad, the popular image of the pricer is that s/he is a professional whose job is bureaucratic and operational, only trying to define the best price to match current demand. Unfortunately, this is too limited a view of the range of pricing challenges s/he faces. In fact, it considers only one of eight possible demand stages, each one of them requiring a specific combination of marketing and pricing strategies. Pricing management may be viewed as the problem of setting price policies for one or more products of an organization. The organization is assumed to determine a desired level of profitability, which will support the pricing decisions at an expected and forecasted demand level, permitting the organization to plan for a demand matching supply amount. However, the real demand may be below, equal or above the forecasted demand.

Based on Kotler's article mentioned in the abstract of this article, four specific demand states make up under demand: negative demand, no demand, latent demand, and faltering demand. Two specific demand states make up adequate demand: irregular demand and full demand. Finally, two demand states make up over demand: overfull demand and unwholesome demand. These eight demand states are distinguished primarily with respect to the level of current demand in relation to desired or planned demand; although two additional factors, the timing of demand (irregular demand) and the character of demand (unwholesome demand), are also important. The set of demand situations is fairly exhaustive and the order fairly continuous.

Each demand situation gives rise to a specific pricing strategy. See table 1 for a summary of pricing strategies given the demand state. All of these strategies require a managerial approach consisting of defining the situation, measurement of data, analysis of the available information, determining innovative solutions, implementation, and control. Furthermore, they all should be aligned with a broader marketing strategy pursued by the firm.

Another aspect that must be considered is the product life cycle, as it is certainly going to impact the state of demand over time for any given product. Thus, the task of pricing management is not simply set prices to match demand, but rather use price to regulate the level, timing, and character of demand for the company's products in terms of its objectives and strategies at the time. This view applies to all organizations. In the discussion that follows, each of the pricing strategies is developed and illustrated with examples drawn from real organizations.

Table 1: Demand State and Pricing Strategies suggest target price levels

Demand State	Negative	No Demand	Latent Demand	Faltering Demand	Irregular Demand	Full Demand	Overfull Demand	Unwholesome Demand
Price Strategy	Premium Price	Low or Trojan Horse	Price Skimming	Bundling or High Price	Hi - Lo	Every Day Fair Prices	High Price	Premium Price
Price Level ("+" to "+++++")	"+++++"	"+" or "+++"	"++++"	"+++" or "++++"	"+++"	"+++"	"++++"	"+++++"

Obs.: Price Level: "+" Lowest Prices; "+++++" Highest Prices

Negative Demand

Negative demand was defined by Kotler as a state in which all or most of the important segments of the potential market dislike the products and in fact might conceivably pay a price to avoid it. Negative demand is worse than no demand. In the case of no demand, the potential market has no particular feelings about the product one way or another. In the case of negative demand, they actively dislike the product and take steps to avoid it.

Negative demand, far from being a rare condition, applies to a rather large number of products and services. Vegetarians feel negative demand for meat; people in general have a negative demand for

vaccinations, dental work, or surgery. A large number of frequent flyers have a negative demand for air travel. Certain countries at war have negative demand by travelers. It is proven that the state of demand is unlikely to change to a positive demand, hence, reducing prices on the belief that demand will increase is a risky move. Hence, the challenge of negative demand to pricing management, especially in the face of a positive supply, is to sustain a premium price strategy. Indeed, a trip to Iraq is now cheaper than it used to be, however fewer tourists are traveling to that country. Surgeries, dental work or similar services are unlikely to gain demand just by lowering prices. And for vegetarians, regardless how low meat prices can be, they are not going to start to eat it just because it suddenly had a price reduction.

No Demand

There is a whole range of products and services for which there is no demand. Instead of people having negative or positive feelings about the product or service, they are indifferent or uninterested. No demand is a state in which all or important segments of the potential market are uninterested or indifferent to a particular product or service.

Following Kotler's definitions, three different categories of products are characterized by no demand. First, there are those familiar products that are perceived as having no value. Examples would be last week's newspaper, small pieces of used barbed wire, and broken pens. Second, there are those familiar products that have value but not in a particular market. Examples would be snowmobiles in areas that do not have snow and residence alarms where there is no crime. Third, there are those new, unfamiliar products or services which are innovative and face a situation of no demand because the relevant market segment has no knowledge of its benefits. Examples include certain consulting services and new software. The pricer task in those three situations is to separate them and tackle each one differently. For the first one, the idea is to understand if there is any salvage price that might be worth charging without undermining the firm's ability to sell at higher prices the other similar (substitutive) products. Hence a low price strategy is the only alternative, as long as it can be applied only to a specific segment of customers that do not value the company's more expensive products. For the second one, lower prices in most cases are not going to change the demand for the product. Therefore the pricing strategy should be the same of where the product or service has the majority of its demand. Finally, the third situation is where a strategic pricing approach might impact demand in a strategic way. The best pricing strategy is what I will call Trojan horse. Let's assume Minitab, a statistical software company, which offers its software for a free trial period of 30 days. Once the new user learns the benefits of its tools, a full year license can be purchased for US\$4,000.

Latent Demand

A state of latent demand exists when a substantial number of people share a strong need for something which does not exist in the form of an actual product and service. For example, how much a driver of any large metropolitan area would be willing to pay for a fast city road? Or what is the optimal price for an HIV vaccine? Finding perceived value white spaces price points can support pricing strategies for current products and guide R&D investments in order to develop new solutions for customers needs. In this situation a pricer must investigate different price levels that potential customers or segments might be willing to pay. Once the new product is in the market, usually the best approach is to pursue a price skimming strategy.

Faltering Demand

All kinds of products and services eventually experience declining of faltering demand. Faltering demand is a state in which the demand for a product is less than its former level and where further decline is expected in the absence of remedial efforts to revise the target market, product, and/or marketing strategy. For example, the cigarette industry in developed markets is in trouble today, as demand declines in the face of the trend towards more healthy life styles and the media attacks that see the cigarette industry preying young children. Other faltering demand situations are driven by technology change, such as DVD or CD sales, which are declining due to on line merchants selling video and music via the internet. The challenge of faltering demand is revitalization, and the pricing strategy aims to minimize the decline of the product. Effective pricing strategies are bundling the faltering product with other, less price sensitive, products. In case of products that are at the end of its life cycle, the most profitable alternative is to transform it in a cash cow, avoiding reducing its price further. In fact, music CD sales are steadily declining in mature markets; however the average CD price remains stable. Indeed, sustaining this price level or even increasing it a couple of dollars is the best alternative for the industry.

Irregular Demand

Sometimes an organization is satisfied with the average level of demand, but quite unhappy with its temporal pattern. Some seasons are marked by demand surging beyond the supply capacity of the firm, and other periods are marked by a wasteful underutilization of the organization supply capacity. Irregular demand is defined as a state in which the current timing pattern of demand is marked by seasonal or volatile fluctuations that depart from the timing pattern of supply. Many examples of irregular demand can be mentioned. Hotels at vacation destinations are often idle during off-season months; theaters are under visited during weekdays and overcrowded during weekends. Hospitals ORs are often overbooked during the morning and underutilized toward the end of the day, to meet doctors' preferences. The pricing manager goal is to improve the match between supply and demand synchronizing them. The best alternative is a Hi – Lo strategy. There is a particular one already being used in the transportation and lodging business, called yield management approach. This strategy captures demand variations and tries to price accordingly to different levels of demand. Hence, you have a better chance to pay low prices in flights where demand is consistently below capacity. In the retail business, prices may go down to improve demand for certain goods during oversupply or go up for fruits, for example, that are with short supply during periods that people yearned for them.

Full Demand

The most desirable situation that a seller can face is that of full demand. Full demand is a state in which the current level and timing of demand is equal to the desired level and timing of demand. Various products and services achieve this condition from time to time. When this sort of equilibrium is achieved pricers must pay attention to two forces. The first one is changing market needs. American car companies were experiencing an equilibrium level between its truck supply and demand, but after the Iraq war and ever more oil price increases, the consumer preference started to move towards smaller, more fuel efficient cars. The other force is competition activity. Full demand is an inviting market condition for competitive firms to disturb.

Pricers must avoid disrupting this equilibrium by practicing an Every Day Fair Price (EDFP) strategy to its products and services. By not charging too much or too little s/he will signal to the market that this state is a desired level. Avoiding the premium price strategy reduces the interest of competitive firms to enter the market or capture more market share at a lower price, not charging low prices avoid the risk of an increase in supply (at a profit expense), but even more important, the firm will not be generating a

potential price war that could damage all the industry profitability level. Many B2B contracts are under this state of demand today. Companies are looking for long-term contracts in a win-win situation.

Overfull Demand

Sometimes the demand for a product substantially begins to outpace supply. Known as overfull demand, it is defined as a state in which demand exceeds the level at which the firm feels able or motivated to supply it. It is essentially the reverse situation described as faltering demand. The pricing strategy in this situation is to discourage customers in general or a certain segment in particular on either a temporary or permanent basis. The energy crisis in California was created because of an overfull demand situation. High price is usually the most effective alternative in order to reduce demand. Preferably it should be done in a selective way, targeting unwanted market segments (expensive to serve, convenience buyers, etc). This is not popular among customers and may be an incentive for more firms to enter the market, which in turn may be an issue in the long run as customers decline to buy your products in favor of the new competitor. However, not having enough supply, as painful as it may be in the long run, pricers should use a high price strategy. Prices can be raised selectively (limited number of customers segments) or for the entire market.

Unwholesome Demand

There are many products for which the demand may be judged insalubrious, distasteful or unpleasant from the viewpoint of the consumer's benefit, the public's interest, or the supplier's welfare. Unwholesome demand is a state in which any positive level of demand is felt to be excessive because of undesirable qualities associated with the product. Classic examples of unselling efforts have revolved around the so-called "vice" products: cigarette and drugs. Unselling is the opposite of innovation. Since innovation is the effort to bring new things to the consumer inventory of options to spend money, unselling is the attempt to eliminate certain products or habits. Certainly, by charging the highest possible price is the best alternative, in a pricer perspective, to facilitate this process. Moreover, a premium price strategy might be justifiable to provide money for unselling campaigns and other marketing activities focusing on demand reduction. However, it is important to mention that price alone, in many cases, is not going to be sufficient to eliminate the issue.

Conclusions

The pricer is a professional whose basic interest lies in improving a firm's profitability level while adapting price strategies to different states of demand and supply. S/he faces up to eight types of demand: negative, no demand, latent demand, faltering demand, irregular demand, full demand, overfull demand and unwholesome demand. This article attempted to suggest the best pricing strategy for each demand situation. Price alone is unlikely to solve all the demand states presented, but it is certainly one of the most important weapons available for firms to adjust profitably to different market conditions.