
Musings on Pricing
Volume 2
Jon Manning

Musings on Pricing, Volume 2

Introduction

Welcome to Musings on Pricing, Volume 2, a collection of my blog postings from the second half of 2012, and 2013.

In this edition of 'Musings', I cover topics such as traditional economic theory, the battle between Pricing and Procurement, as well as delving into the advertising industry's slow take-up of Value-Based Pricing.

Most of these articles appeared in 'The Pricing Propheteer' column on LeadingCompany.com.au. The articles on the advertising industry appeared on the TrinityP3 blog, while the Pricing Lessons from a Masterchef Restaurant first appeared on the Motivating Mum blog.

As with the first edition, I hope the second edition provides readers with some more plain English guidance to smarter pricing.

Jon Manning

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The Role of Traditional Economic Theory

What role, if any, should it play in pricing?

This article first appeared on LeadingCompany.com.au on the 29th August 2012

A couple of weeks ago, I was a panelist at the NAB Small Business Summit. Along with two other panelists, we discussed the importance of cash flow, from a tax, accounting and pricing perspective.

During the Q&A session at the end, I was asked a (commonly-asked) question about the role and importance of price elasticity in pricing decision-making, which in itself raises a broader question: how important are the assumptions and formulae of traditional economic theory in pricing? Lets look at some of its assumptions.

Assumption #1: Markets are comprised of Buyers and Sellers
Traditional economic theory assumes there are two parties in a market, a buyer and a seller. The reality today is that there are many other players, including wholesalers, distributors and affiliates, to name a few.

Score: Traditional Economic Theory: 0 | Pricing: 1

Assumption #2: Companies sell a single product
In an era where companies are 'diversified', 'horizontally integrated', 'vertically integrated', 'omni-channel' and 'multiple brand owners', its is a struggle to find a company that sells a single product or service. A full-page ad in *USA Today* from Starbucks in March 2008 talked about how their baristas can perfectly hand-make over 87,000 possible combinations of espresso beverages.

Score: Traditional Economic Theory: 0 | Pricing: 2

Assumption #3: Companies seek to maximize profits
Companies, at least in the capitalist world, are in the business of profit making and profit maximisation…but not exclusively. Non-profit objectives may also exist, such as growing the business, stabilising the market, disrupting a market, discouraging market entrants or accelerating the exit of marginal fringe players, just to name a few.

Score: Traditional Economic Theory: 0 | Pricing: 3

Assumption #4: The consumer is sovereign
Five to ten years ago, economists were questioning the concept of consumer sovereignty. It was a sellers market. Ikea told you how to navigate their stores (follow the racetrack) and transport and assemble your own purchases. Supermarkets made you pass hundreds of products as you made you way to the back wall just to pick up the milk. Social media has changed that. In 2008, UK retailer Marks & Spencer started charging £2.00 more for bras with large cup sizes (defended on the basis of the additional material costs). The ensuing social media barrage forced them to revert to a "size / pricing parity strategy" accompanied by a month-long 25% off 'goodwill' sale.

Score: Traditional Economic Theory: 1 | Pricing: 3

Pricing is more about people (customers) and their behaviour, and less about theories. And what about the opening question, the role and importance of price elasticity in pricing decision-making? I will let Scott McNealy, the former CEO of Sun Microsystems answer that one:

"Pricing [is] confusing for us too. In the whole history of Sun, we have never known what demand is, what elasticities are, or what the right prices are for our equipment"

Look After the Pennies and the Pounds Take Care of Themselves

Why not charge for something you give away for free…just to see what happens?

This article first appeared on MotivatingMum.com on the 12th September 2012

The other day, I was sitting waiting for an appointment with my optometrist. The receptionist was finalising payment from another customer, who was picking up her new glasses, which culminated in a free gift: a 30mill pump-spray bottle of lens cleaner.

Only five minutes before my optometrist appointment, I'd received a free chewy éclair with a cappuccino I'd purchased at a nearby cafe. Everybody seems to be giving something away for free these days.

So widespread is the practice that in 2009, Chris Anderson, Editor-in-Chief of Wired Magazine (and author of "*The Long Tail*") wrote an entire book on the subject, in which he described how so many goods were being provided for free, including everything from T-shirts to holiday flights.

Yet free products and services are the ideal candidate for a pricing experiment. When was the last time you experimented with your prices? You may be apprehensive…and with good reason.

In the early noughties, Amazon had to refund 6,896 customers an average of $3 when they discovered the company had tested price discounts of 30%, 35% and 40% on them when they purchased an identical product.

One of the problems with what Amazon did was they experimented with the price of something that was already priced. One of the easiest pricing experiments you can conduct, without suffering the goodwill backlash that Amazon suffered, is to experiment with the price of something you don't currently charge for.

In 2002, the UK social networking site Bebo decided to charge members to send eCards. Overnight, their revenue went from $10,000 a month to $10,000 a day.

While small businesses run by mumpreneurs are unlikely to see a revenue uplift of the magnitude Bebo experienced, there are lessons for you nevertheless.

If you are giving away something for free, and customers value it, you might be pleasantly surprised to find out they will pay for it, without any negative goodwill impact. I would pay a dollar or two for a little bottle of lens cleaner…but I didn't eat the chewy éclair that the café gave me. As the old adage goes, look after the pennies and the pounds take care of themselves.

Time for a Pricing Spring Clean?

Five simple, but critical elements of a Pricing strategy

This article first appeared on LeadingCompany.com.au on the 13th September 2012

Last weekend was the first of the Spring, and right on queue, Melbourne turned on the sunshine. All over the city, lawn movers were heard and barbeques had their winter cobwebs blown away, in anticipation of more sunny days just around the corner.

These activities obviously beg the question: what would a Pricing Spring clean look like? Here are five suggestions…

#1. Revisit your Market Segmentation

Many companies miss the point of market segmentation. They give their customer segments great names and descriptions, but if market segmentation is not actionable (i.e., you advertise differently to them, you price differently to them), then it's not worth the paper it is written on.

Take a moment to re-run all your customers through your market segmentation model and recalibrate your segments. This is an exercise the Royal Bank of Canada do every month, actioning the results with segment-specific offers, marketing collateral, and the like.

#2. Optimise Discount Schedules

Customers these days, in both B2B and B2C markets, love a bargain (and accompanying bragging rights) just as much as they love the hunt for that bargain.

There's no point optimising list prices when no one is paying list price. Instead, take a look at (and fine-tune) your discounting schedules to maximise revenue.

#3. Get Ready for Summer

Many businesses have a seasonal element to them, often most pronounced over the summer. What are your forward bookings or reservations like? Do you have to prepare for the obligatory Boxing Day sale? What are you going to do if your competitor launches their Boxing Day sale earlier than you?

These are all contingencies that Leading Companies should start to think about, and plan for, now.

#4. Scan the Competitive Market

Winter is a time when a new competitor may have been preparing their assault on your market, or existing competitors have been working on a new product initiative.

Do a quick but thorough scan of the market for new or potential competitive threats, be they companies or products.

#5. Go on a Ride-Along

As I mentioned in my last column, Pricing is not about economic theories: it's about human (customer) behavior, and you can't see that behavior from corporate headquarters.

Spring is a great time to be out and about. Go down to the call centre (if its still in Australia) and listen in on some calls by the telesales staff. Better still, jump in the car with a sales rep and go visit a customer. See how her business if fairing in this tough economic climate. Better still, spend 'a day in the life' of a customer.

As with a Spring clean at home, once you get into it, you find there is so much more you can, or have to, do. Your Pricing Spring clean won't be any different.

I've Just Seen the Coffee Shop of the Future…

…and it ain't Starbucks

This article first appeared on LeadingCompany.com.au on the 27th September 2012

I've just returned from Bangkok, where I ran a two-day workshop called "Pricing Excellence". On the Sunday before the workshop, I went down to Siam Square to do a bit of shopping, and stumbled across the coffee shop of the future.

Nestled up on the third or fourth floor of the Paragon Centre is True Urban Park. What attracted me to it, and I didn't even feel like a coffee at the time, was the enormous red and black flap display that simple read "True".

Upon entering the café, and in front of the flap display, you find a florist selling fresh oriental flowers. Turn to the left and there are PC's, lounge chairs and sofas where you can surf the Internet and watch your tweets come up on a huge Tweetdeck "megawall". In the back corner there's a selection of books, CDs and DVDs you can browse.

To get to the other end of the shop, you walk through a nicely laid out 'gadgets' section, where you can browse and buy all the latest smart phones and tablets, with the assistance of plenty of attentive and helpful staff.

This takes you to the coffee bar, with a fairly extensive and affordable menu (a cappuccino and cake cost the equivalent of $A5). Sit down in front of another Tweetdeck "megawall", and you can either watch whatever is showing on HBO, enjoy the free Wi-Fi access or, plug your preferred Apple device into one of the leads on the coffee table, and listen to your choice of music as you sit under a "Sound Tube".

Readers are probably thinking to themselves right now "*What has this got to do with Pricing?*" Shouldn't this be appearing on UrbanSpoon, or some other ratings and reviews website? Well maybe it should, but there are also some important lessons here for retailers and other industries:

- Firstly, the flap display is impressive and enticing. It just makes you want to walk into the store, and what retailer doesn't want more foot-fall these days?
- Furthermore, the one word that appears on the flap display is powerful, and chosen, I imagine, to reflect their beliefs, their value proposition;
- Interestingly, you can't experience True Urban Park online. They don't have a website, although they do have a Facebook and Twitter presence;
- But most importantly, and what I liked the most, is the fact that the store has multiple revenue streams, offering products and services that appeal to different market segments (coffee lovers, book lovers, gadget lovers, flower buyers, etc.)

There is only one True Urban Park store, and it wouldn't have been there for six years if it weren't doing something right. This is a location I would happily call my "third space", and spend time and money in, much to the disappointment of Starbucks.

Two Pricing Lessons From a Masterchef Restaurant

How two little mistakes left money on the table

This article first appeared on MotivatingMum.com on the 10th October 2012

Two Pricing Consultants walk into a restaurant. They haven't seen each other for a couple of years, so a bit of a celebration is in order, which also partly explains the choice of restaurant, which is run by one of the Australian judges of Masterchef (but will remain nameless).

The waitress shows them to their reserved table, informs them what the specials of the day are, and leaves them to mull over the rest of the menu and the wine list.

By the time the waitress returns to take the drinks order, the two Pricing consultants have both opted for a glass of a $9 boutique beer, on tap, from South Australia. "*Oh. I'm terribly sorry*" the waitress replies. "*That beer is not available. The beer tap stopped working this afternoon. These two* [cheaper] *beers are both available and on tap though*".

The waitress heads to the bar with their order, and the two Pricing consultants look at each other with glazed, rolling eyes. You don't have to be a rocket scientist (or a pricing consultant!) to work out what's wrong with this scene.

Firstly, the tap dispensing the most expensive beer stopped working hours before the Pricing consultants arrived for dinner. From a revenue maximisation perspective, the restaurant would have been better off putting the more expensive beer through a tap that worked, and making apologies for not having one of the cheaper beers available.

Even if that was not possible, the waitress should have been advised not to recommend the cheaper beers that are available on tap, but rather to recommend a similarly (or more expensive) priced bottled beer.

As a Pricing consultant (yes, this is a true story and not a yarn), I often see businesses of all sizes making mistakes like this that lower revenue, when it doesn't need to happen.

There are two major mistakes made here that have lowered the restaurant's taking for the day. You now have no excuse for making the same mistakes yourself.

Firstly, always try to sell your premium priced products or services. If you can't close a sale with a premium priced product, there's still a chance you can close the sale with a cheaper product. If you've started to close a sale with a cheap product, and you're unsuccessful, chances are you won't make a sale at all.

Secondly, Pricing is holistic and touches every part of a business. That includes the frontline sales force, who should be kept informed of product availability, and encouraged to upsell rather than letting customers trade down.

This Christmas, Smart Retailers will Price Like Airlines!

What would happen if airlines were retailers?

This article first appeared on LeadingCompany.com.au on the 10th October 2012

In 1998, Alan Hess published a very humorous take on what would happen if airlines sold paint. This Christmas, retailers of all products (not just paint) may want to seriously ask themselves if they should be running their business like an airline?

Dun & Bradstreet's *National Business Expectation Survey* just revealed that expectations for inventory levels have risen to their highest point since 2000. For retailers, this Christmas is going to be just as much about inventory management as it is about pricing management, which is something airlines have mastered since American Airlines first introduced the practice of Revenue Management 40 years ago.

Most airline passengers have now been conditioned that if they want the cheapest airfare, they have to book early. As the day of departure approaches, airfares tend to increase in price, as the airlines manage their inventory ensuring they have sufficient seats remaining for the price-insensitive, time-sensitive business traveller.

For retailers, Christmas day is the day of departure. And as that day approaches, shoppers who haven't completed their Christmas shopping become increasingly price-insensitive and time-sensitive. Like an airline, retailers' prices can likewise reflect this pattern of demand: the best prices are available during November, but as Christmas approaches, prices are slowly increased.

This strategy also allows you to be price-competitive when it counts, with all those overseas online retailers who have been eating into your margins all year. And as Christmas approaches, their window of opportunity to deliver before Christmas gets more and more tenuous.

Bundling can also play a useful role in the lead-up to Christmas. Put some complimentary products together into a bundle or package, offering them at a discount on the sum of the individual prices, but make sure the products are available individually to make the bundle attractive.

Finally, focus on the in-store experience. While you're competitive on price, and you've got customers in your store (and not online), give customers an in-store experience they will want to come back to. Scott Kilmartin, who runs a shop call Haul in North Fitzroy has just given his store a new look ahead of Christmas. In fact, why not give them an offer that brings them back to the store during the back-end of January or early February (which is probably going to be a very tough period for retailers).

As we all know, buying paint from a hardware store goes something like this:

Customer: *Hi, how much is your interior flat latex paint in Bone White?*

Store Assistant: *We have a medium quality, which is $16 a gallon, and premium, which is $22 a gallon. How many gallons would you like?*

Customer: *I'll take five gallons of the medium quality, please.*

Store Assistant: *That will be $80 plus GST.*

But if we were buying paint from an airline, it might sound something like this:

Customer: *Hi, how much is your paint?*

Store Assistant: *Well, sir, that all depends.*

Customer: *Depends on what?*

Store Assistant: *Actually a lot of things.*

Customer: *How about giving me an average price?*

Store Assistant: *Wow, that's too hard a question. The lowest price is $9 a gallon, and we have 150 different prices up to $200 a gallon.*

Customer: *What's the difference in the paint?*

Store Assistant: *Oh, there isn't any difference; it's all the same paint.*

Customer: *Well, then, I'd like some of that $9 paint.*

Store Assistant: *Well, first I need to ask you a few questions. When do you intend to use it?*

Customer: *I want to paint tomorrow, on my day off.*

Store Assistant: *Sir, the paint for tomorrow is the $200 paint.*

Customer: *What? When would I have to paint in order to get the $9 version?*

Store Assistant: *That would be in three weeks, but you will also have to agree to start painting before Friday of that week and continue painting until at least Sunday.*

Customer: *You've got to be kidding!*

Store Assistant: *Sir, we don't kid around here. Of course, I'll have to check to see if we have any of that paint available before I can sell it to you.*

Customer: *What do you mean check to see if you can sell it to me? You have shelves full of that stuff; I can see it right there.*

Store Assistant: *Just because you can see it doesn't mean that we have it. It may be the same paint, but we sell only a certain number of gallons on any given week. Oh, and by the way, the price just went to $12.*

Customer: *You mean the price went up while we were talking?*

Store Assistant: *Yes, sir. You see, we change prices and rules thousands of times a day, and since you haven't actually walked out of the store with your paint yet, we just decided to change. Unless you want the same thing to happen again, I would suggest that you get on with your purchase. How many gallons do you want?*

Customer: *I don't know exactly. Maybe five gallons. Maybe I should buy six gallons just to make sure I have enough.*

Store Assistant: *Oh, no, sir, you can't do that. If you buy the paint and then don't use it, you will be liable for penalties and possible confiscation of the paint you already have.*

Customer: *What?*

Store Assistant: *That's right. We can sell you enough paint to do your kitchen, bathroom, hall, and north bedroom, but if you stop painting before you do the bedroom, you will violation of our tariffs.*

Customer: *But what does it matter to your whether I use all the paint? I already paid for it!*

Store Assistant:
Sir, there's no point in getting upset; that's just the way it is. We make plans upon the idea that you will use all the paint, and when you don't, it just causes us all kinds of problems.

Customer: *This is crazy! I suppose something terrible will happen if I don't keep painting until after Saturday night!*

Store Assistant: *Yes, sir, it will.*

Customer: *Well, that does it! I'm going somewhere else to buy my paint.*

Store Assistant: *That won't do you any good, sir. We all have the same rules.*

Source:
By Alan H. Hess. Originally published in Travel Weekly, October 1998.

The Pitbull vs. The Peacekeeper

How to deal with Procurement Managers, Gwyneth Paltrow -style

This article first appeared on LeadingCompany.com.au on the 30th October 2012

In the 1998 movie *Sliding Doors*, there are two plots that play out between the leads Gwyneth Paltrow and John Hannah, depending on whether or not the former caught a London Underground train.

Imagine, for a minute, that you are negotiating a huge contract, worth millions of dollars, with a customer. You're inches away from the biggest deal your company has ever signed.

But then something unexpected happens. The head of Procurement at the company you're negotiating with enters the room and tells you they need another 10% cost saving from you, or the deal is off.

Just like the plots in *Sliding* Doors, what happens next could go one of two ways. The Head of Procurement could play the Pitbull, which looks a bit like this:

- She starts shouting and bullying, part of her sledgehammer approach to an adversarial negotiation to this single transaction;
- She want to "screw you into the ground" and take all of that 10% cost saving and rob you of any profit you might make on this deal;
- To her, profit isn't good: its dysfunctional behavior;
- She insist on 'Open Book Costing' to mercilessly drive down your costs;
- Your pricing, according to her, is cost-plus or 'time and materials' (Labour + Materials + Overheads + Margin), and she doesn't want to bear any unnecessary overhead costs, probing you on what your overhead allocation methodology is so she can get a cheaper price.

Faced with this approach, what do you do? Three things are probably certain: you're going to try and hide more costs, you're not going to put your best people on this project and you're certainly going to lose interest in the customer who is looking for further cost savings.

But image what might happen if, like in *Sliding Doors*, the Procurement Pitball wasn't let off the leash, but rather the Pricing Peacekeeper took control. The scene might play out like this:

- A collaborative workshop is proposed…
- …the objective of which is to find and share a 10% cost saving, which allows you to continue making a profit;
- Both parties agree to put their best people on the project;
- The profit incentive remains and margins will remain healthy, resulting in predictable behavior by both parties;
- The relationship is open and transparent, and as both parties work through the Open Book Costing exercise, cost reduction opportunities that can be shared are identified;
- This relationship-based approach focuses on total cost of ownership and lifetime customer value, and;
- The teams recognise that there are alternatives to Cost-Plus and Time & Materials pricing, such as Guaranteed Maximum Pricing.

Without a doubt, the movie has a better ending for all concerned with the latter, rather than the former, plot.

Debunking a Market Research Myth

What customers say they will do, and what they actually do, can be two completely different things

This article first appeared on LeadingCompany.com.au on the 8th November 2012

As all Leading Companies know, when it comes to customers, what they say they will do (in market research), and what they actually do, are two completely different things. All too often, I see revenue forecasts or sales projections that fall into this trap. This week was no exception.

Apple recently announced the launch of the iPad mini. The next day, I stumbled across some research[1] (obviously completed in record time!) that suggested that 14% of respondents 'would definitely buy' the product, and 32% said they 'probably would'. Add the two numbers together and you've got 46% take-up. Fantastic!

The Urban and Hauser scale tells us that, of the 14% who said they would definitely buy, you can be reasonably sure that 90% of them will actually buy, while 40% of those who said they 'probably would' will actually buy, Do the sums, and your take-up forecast becomes 25.4%.

Later in the week, I was discussing with a Pricing Manager, the importance of having a decoy product. When asked if we could model the impact of a decoy product, I remembered some forecasts made in an experiment conducted by the Behavioural Economist, Dan Ariely.

In his talk at the London School of Economics in March 2008 (which is also described in his book *Predictably Irrational*), Professor Ariely described an experiment where **16%** of participants would take up a digital-only subscription to *The Economist* at $US59, none would take up a print only subscription (the decoy) priced at $US125, but 84% would take up a print and digital subscription at $US125.

When the experiment was repeated without the decoy, the 16% became 68% and the 84% became 32%. A quick calculation, assuming 1mill subscribers at the above-mentioned prices, reveals that revenue would be nearly 43% higher with the decoy product than without.

Following a quick search on Google, I discovered that *The Economist* (which doesn't appear to report subscriber numbers) had digital-only circulation of 100,00[2], out of a total circulation of 1,574,803. This implies a digital-only circulation of 6.35%, significantly lower than Professor Ariely's number. Could this be another example of market research not catering for the difference between what customers say they will do, and what they actually do?

In a previous post "*Are you Pricing Like Dennis Denuto?*" (See Musings on Pricing, Volume 1), I talked about why scenario analysis was one of the pricing traps companies often fell into (liking a set of number from one scenario without reality-checking the assumptions the scenario is built upon). Leading Companies now have no excuse of falling into this trap anymore with their revenue or sales volume forecasts.

[1] http://www.screenwerk.com/2012/10/25/survey-despite-price-people-planning-to-buy-ipad-mini/

[2] http://www.economistgroupmedia.com/planning-tools/circulation

How a Burger Joint Got Me to Pay More Than Ten Bucks

Or how to bust through a psychological price point

This article first appeared on the Motivating Mum blog on the 14th November 2012

Oscar Wild once famously said "*a cynic is a person who knows the price of everything and the value of nothing*". I wouldn't classify myself as a cynic, but being a pricing consultant, I probably notice prices a bit more than your average Tom, Dick or Oscar.

Like everyone, every now and then, good, healthy eating goes out the window, and I grab some fast food. At one particular burger joint, I know the price of my preferred meal deal of a chicken burger, chips and a can of Diet Coke. It's $10.

It's been $10 for a couple of years now. Before that, when this particular burger joint started out, it was $9.95. When they put the price up five cents to $10, I noticed, but I doubt many other people either noticed or cared.

The next move was going to be critical however. How do you raise prices over a psychological price point like $10? Unlike the increase from $9.95 to $10.00, breaching a psychological price point is where you often see a change in demand (i.e., people say "ouch!").

This week, I found out. The burger joint increased the price of my meal deal by $0.50 to $10.50, but when asked what drink I wanted, I received a 450ml bottle of Diet Coke, rather than a 375ml can.

"OK", I thought to myself, as I searched my pockets for a fifty-cent piece. "They want me to pay a little bit more, but I'm also getting a little bit more" (not that I was 75ml thirstier).

I've been trying to do the sums on this price change, but have struggled to find the retail price of a 450ml bottle of Diet Coke. Seems it might be a "trade only" product. But what I assume the burger joint has done is added 75mls of value to the meal deal, the cost of which to them is less than the additional fifty cents they're asking customers to pay.

Increasing price and increasing value is a great way to increase prices. It also worked for Apple when the first iPod with photo functionality came out (they increased prices by $100, but the functionality only cost Apple $20 to put into their devices.

It can work for you too.

A Pricing Lesson from Richard Gere

Customers will tell you what they will pay…after the deal is done

This article first appeared on LeadingCompany.com.au on the 22nd November 2012

At the moment, I'm two-thirds of the way through a pricing roadshow for a large business-to-business company that plays in the industrial market. One of the most frequently asked questions by attendees in these workshops is *"How do we know we're charging the right price?"* The latest Richard Gere movie offers an answer.

In *Arbitrage*, Richard Gere plays a businessman who is in the process of selling his company. Eventually, the negotiation leads to a one-on-one meeting with his suitor.

Over a meal, they agree a price. Richard Gere takes the restaurant menu, writes down the agreed price and both parties sign the document.

Gere gets up to leave and asks *"What would you have paid?"* The buyer replies with a figure much higher than the one just agreed to.

The buyer in turn, asks Gere what price would he have accepted, to which he replies a price figure much lower that that agreed.

This insight is of no use to the now-concluded, one-off transaction. But for Leading Companies selling products and services day-in day-out, it is a question well worth asking.

Just like this scene in *Arbitrage*, companies have a tendency to over-estimate customers price sensitivity, and under-estimate their willingness to pay. But the question should be asked in every Win-Loss analysis that a company completes: what would you have been prepared to pay?

Ask the question enough times, and feed the answers back into your next pitch, quote or contract, and over time Leading Companies will get closer and closer to charging the perfect price.

Finding the Pricing Sweet Spot

Five simple steps to charging the right price

This article first appeared on LeadingCompany.com.au on the 6th December 2012

In my last column, A Pricing Lesson from Richard Gere, I mentioned that the most frequently asked question I was being asked during a series of in-house workshops was *"How do we know we're charging the right price?"*

As my roadshow for this client rolled into Auckland this week, an attendee told me how he thought he'd found the perfect price for a product he'd launched a couple of years ago with another employer.

He described five textbook steps that contributed to the products success in achieving New Zealand market share dominance.

Step 1: Understand the buying process. The product in question here was a domestic building product, and just as important as understanding who the key participants in the buying process are, it is equally important to understand the relationships between the players and their value drivers.

For example, architects are interested in great looking (hopefully award-winning) designs, so aesthetics may be a more important value driver than structural integrity, which is important to Engineers. Builders, on the other hand want a product that's is safe, easy and efficient to work with. And homeowners and landlords are obviously the ones paying the bill.

Step 2: This involves understanding not only your own product, but also critically, the competitor's products. Ask yourself the following three questions:

(a) What are the points of similarity?
(b) What are the points of difference?
(c) What are the points of contention?

Step 3: This is the logical extension of Step 2 above: once you know and understand the value proposition of your product, vis-à-vis the competition, quantify it. Typically in B2B markets, that value can come from one or more of the following three sources:

(a) the product increases your customers' revenue;
(b) the product reduces your customers expenses, or;
(c) the product minimises your customer's risk.

In the case of this particular product, because its useful life was twice as long as anything else on the market, the product reduced the buyer's risk and saved them money. Sales reps were trained in not only communicating the value proposition, but also how the economic value had been quantified in the process of setting the price.

Step 4: Start from a position of strength. In communicating the economic value provided (e.g., we help to reduce your expenses), it is always best that sales reps start from a position of strength. In the case of this home building product, there's no point discussing how

the product reduces expenses until the benefit that accrues from risk minimization is explained to the customer.

Step 5: Finally, wear your heart on your sleeve. Once this building product was fixed to a house, so too was a badge that said the product is guaranteed to last for 25 years. Not only does this reinforce the value proposition, and help justify the price tag, it was highly valued buy new homeowners or landlords when the property later changed hands.

Take A Look Outside Your Industry

The benefits of looking at pricing in other industries

This article first appeared on LeadingCompany.com.au on the 31st January 2013

Were you inundated with suggested New Year resolutions this year? Have you already broken the ones you made a month ago? Did you make a Pricing resolution? If not, let me suggest one for the remaining 11 months of the year: take a look at how other industries do their Pricing.

There are some compelling reasons for taking the pricing model from one industry and applying it to another. Why re-invent the wheel, if someone else has already gone before you and done so? Reed Hastings, the founder of Netflix asked himself why a DVD rental business shouldn't adopt a gymnasium–type pricing model, where customers could borrow as many DVD as they liked as part of their monthly subscription.

Sometimes it makes sense to adopt the pricing model of an adjacent industry. Airlines have been doing revenue / yield management for forty years now, which has now moved into adjacent industries like rail travel, via the likes of Virgin Trains, Amtrak's Acela services in the US and the European high speed rail alliance, Railteam. As many rail passengers will also be air passengers, they already "get it" when it comes to revenue / yield management.

Another industry's pricing model may prove to be more cash-flow friendly. Valve software, for example, has created "episodic" pricing, where gamers, rather than buying a $50 - $60 game, buy a $20 game, followed by subsequent downloads.

Several years ago, Virgin Blue took the humble pub happy hour and put it on their website between 13:00 – 14:00hrs to dispose of unsold inventory. One could argue that this initiative provided some welcomed PR, but perhaps it also created a new channel to reach the extremely price sensitive passenger.

Meanwhile, Johnson & Johnson's cancer drug Velcade is offered to Britain's NHS under a pay-for-performance pricing model, not dissimilar to Google's cost-per-click pricing model. Patients who do not respond to the drug (in part or in total) will be taken off the drug, with J&J honouring a money-back guarantee to the NHS. Those that do respond will be fully funded by the NHS.

There are also examples of companies adopting a pricing model that is under-pressure and being rejected by customers in other industries. Take time-based pricing for example, so prevalent in the professional services industries.

Tsiferblat, a Moscow-based chain of cafés doesn't charge for lattes, mocha's and cappuccinos the way most cafes do. It charges for the time you spend in the café: two rubles per minute for the first hour, and one ruble a minute thereafter, up to a maximum of five hours.

And speaking of the legal industry, the UK law firm Addleshaw Goddard recently won the "Most Innovative Law Firm In Value Resourcing" in the FT 2012 Innovative Lawyers Survey. The judges

commended its "…*new and uniquely comprehensive approach to its pricing, which shows impressive learning from other industries and offers options to suit all clients.*"

Now wouldn't that be an achievement to celebrate next New Years Eve?

Pricing Opportunities in The Long Tail

Customers in the long tail may have pricing amnesia

This article first appeared on LeadingCompany.com.au on the 14th February 2013

In 1906, the Italian Economist, Vilfredo Pareto discovered that 80% of the land in Italy belonged to 20% of the population, a finding that has been popularised into the 80:20 (or Pareto) rule. The converse (20% of the land being owned by 80% of the population) was never as popular as the 80:20 rule, until Chris Anderson published his book, "The Long Tail", in 2006.

Andersons' book was primarily written from a digital product perspective. There are blockbusters movies at the "pointy end" of the long tail (e.g. *Titanic*), but at the other end of the curve are the most obscure and unknown movies that few, if any, have ever heard of, never mind watched.

Many Leading Company's have a long tail of products they sell in relatively small volumes, yet Anderson's book was inconclusive when it came to pricing strategies for products in the long tail. Should those obscure products be priced high to reflect their scarcity, or low to reflect their demand?

Long tail products are those that are purchased infrequently and in small volumes. This implies that customers probably have pricing amnesia: they probably can't remember what price they paid for the product the last time they purchased it, if they have in fact purchased the product at all in the past.

With that in mind, here are some pricing strategies that I have recommended to clients with long tail products, in both B2B and B2C markets, many of which are inter-related.

Firstly, consider imposing or increasing minimum order quantities (MOQs). This helps to make it profitable to make a batch of your product or service. Better still, get the customer to buy in bulk (catering for their future needs) and to store or warehouse it themselves.

Given the infrequent purchase of long tail products, customers will occasionally ring up wanting a long tail product in the next 24 hours or so. Urgency is something that can be surcharged, so monetise any urgent deliveries and production runs.

A third opportunity is to remove technical support for the product. This should have already been provided (perhaps when the product was at the blockbuster end of the long tail), or deliver technical support online. This helps reduce the cost-to-serve the customer, which in effect is a stealth price increase.

Exclude long tail products from contract negotiations. Focus these discussions on the key products and services the customer is buying from you, rather than peripheral products.

Finally, monitor customer needs and the product life cycle, particularly in the case of spare parts, which commonly exhibit long tail product characteristics. At some point in time, some products become collectors items (take cars for example), and the fanatical owners of these products are less price sensitive and have a higher willingness to pay than when the product was in earlier stages of its product life cycle.

It is very easy to neglect the pricing of products in the long tail, but as the old adage goes, "*look after the pennies and the pounds take care of themselves*". I know of one company that hadn't reviewed prices in seventeen years (yes, you read right!). There are pricing opportunities in the long tail.

The Time Has Come to Give Your Pricing a Brand

There are more advantages than disadvantages to giving your pricing its own brand

This article first appeared on LeadingCompany.com.au on the 28th February 2013

We've all heard about "corporate branding" and "personal branding", but have you ever thought of giving your Pricing a brand of its own?

As I mentioned in my SmartCompany webinar last year, Apple could easily brand their iTunes Pricing "*Why Not?*" pricing. You hear a song on the radio you really want on your iPhone/iPod. It's only $1.99. Why not buy it? And supermarkets, from Wal-Mart, to Tesco and Asda commonly adopt the generic branding of EDLP, or "*Everyday Low Pricing*".

Last week I caught up with the Managing Partner of a law firm. Not because I need some legal work done, and not because this law firm got rid of time sheets eight or nine months ago (although that was of interest). As part of the move to value-based pricing, this firm has also branded their Pricing "*Moore's Agreed Pricing*", or MAP.

It's really worth thinking about just some of the benefits of this approach to Pricing:

- By branding your pricing with your corporate name (something that users of EDLP often don't do), you make it unique. As a result, you've just differentiated yourself with something the competition can never match (unless they acquire you). You have ownership.

- But for this to be successful, your pricing has to be truly different from the competition. No more picking up an industry benchmarking report and charging the going rate, or something a few percentage points above or below the competition, just to keep the status quo. Leave it for others to tackle customers' perceptions of "sameness" and "commoditisation".

- As a result of the change required, there's a high likelihood that some sort of company-wide cultural change program will be required. This provides closure to the old pricing model or approach, and excitement and belief around the new pricing model.

- And that sort of change has to include the support from the upper echelons of the organisation: a corporate pricing champion is mandatory.

- Last, but definitely not least, this new approach to pricing needs to get built into the corporate induction program so all new employees understand how and why the business prices this way. This, along with the pricing champion and the cultural change required, embeds the new approach to pricing in the business.

Branding your Pricing is not going to be without its challenges however. Some people will be fast, early adopters, while others will take a while to master it. Some people will have trouble having value conversations with customers, when they've been used to having price-based (and discounting) conversations with them. And they will need to think about pricing on outputs and deliverables, rather than inputs.

But given that all these challenges can be mitigated, it seems to me that there are more advantages than disadvantages to branding your Pricing.

The Rise of the Corporate Pricing Function in China

How pricing is changing in the Middle Kingdom

This article first appeared on LeadingCompany.com.au on the 14th March 2013

As I wrote in a previous posting, Pricing is on the move and gaining prominence in China. In this article, I reprise that earlier article, but also expand on it.

In March 2013, I made my sixth visit to China in a little over three years, to conduct my ninth Value-Based Pricing workshop. Many of these workshops are 'open enrollment', attended by delegates from a wide variety of industries, and several have been corporate, in-house workshops.

When I first started going to China, sales of the open-enrolment workshops were relatively slow (but ultimately well attended). Approximately 80% of delegates come from business-to-business Multinational Corporations (MNCs) usually sporting job titles like Marketing Manager, Sales Manager or Product Manager. The other 20% hails from business-to-consumer multinationals. Local (domestic) Chinese companies never make an appearance.

My last visit to China (March 2013) was very different. The workshop sold out weeks in advance, and over 1/3rd of attendees were newly installed in roles with 'Pricing' in their title. One woman was even an (internal) "Customer Value Management Consultant". What's behind the change?

Among the drivers mentioned by attendees, a few were particularly interesting. The first is that the establishment of a corporate pricing function is a defensive measure. For three years, I've been hearing delegates say their European and American Head Offices have been telling these Chinese subsidiaries to improve their pricing. But rarely, if ever, is any sort of training and support provided to assist in the attainment of this objective.

One of the primary motivations for establishing a Chinese pricing function is to manage those expectations, and the gap between what prices the Chinese market will bear, and what Europeans and Americans think Chinese prices should be. Many attendees spoke of their pricing being "80% 'strategic" and "20% localised".

MNC's operating in China need to understand than not all markets are homogeneous. The level of economic development is one explanation, but so too are cultural differences, business customs and sales acumen (more on some of these shortly). Just because a product commands a certain price in North-Rhine / Westphalia, doesn't mean that price will be obtained in Jiangsu Province. The Chinese don't want to be selling a German pricing structure to a Chinese customer.

Another interesting driver was input costs. As raw material prices rose about two years ago, more and more Chinese companies saw their margins eroded, primarily due to maintaining a cost-plus approach to Pricing. Resources were added not only to protect such margin erosion, but also to facilitate a move towards a more sustainable, value-based, approach to Pricing.

What can be concluded from these observations? Clearly, even the Chinese now recognise that customers don't care about what things costs to manufacture. Customers care about the value they receive, and that cost-plus pricing is a flawed approach to pricing.

And for the first time this trip, I heard several Chinese companies admit that, if customers don't see value in the price they charge, they're more than happy to "sack the customer" and let them buy from the competition.

Other Chinese Pricing Challenges

One of the biggest challenges in China is the monetisation of services, and strategies used in Western economies don't necessarily provide the solution. This challenge is particularly acute for B2B manufacturers of goods, and less so for companies providing services only (professional or otherwise), or technology companies.

This challenge is both a marketing one and a cultural one. Market segmentation is made difficult by the existence of "*Guanxi*" (discussed below), which makes it very difficult to charge different prices to different customers or industries. There is also room to improve the distinction between "setting prices" and "getting prices" (one company in attendance had recently gone from 60 day payment terms to 180 day payment terms).

From a cultural perspective, "seeing is believing" in China. Bigger is better, and measurement is critical to its quantification. Many customers do not see any value in B2B services procured from a manufacturer, and won't pay for them because size and measurement are abstract concepts for intangible services.

Pay now and receive the benefits later is another paradigm that doesn't conform to the "seeing is believing" manta. Chinese customers want instant gratification, benefits and return on their investment.

Not only is there a shift to value-based pricing occurring in corporate Pricing in China, but there is also a small, emerging interest in pricing solutions, not just pricing technology, but also a suite of holistic processes, policies and procedures as well. Many are still managing their Pricing in Excel spreadsheets. One or two have developed sophisticated Access database tools, but an interest in more sophisticated technology solutions is slowly staring to emerge.

Ironically, I heard (secondhand) reports of one European company using pricing technology globally, except in China. But they do treat their Chinese subsidiary as a customer for the purposes of this technology solution, in an attempt to charge higher prices in the Middle Kingdom.

So if there is a shift, from cost-plus to value-based pricing underway in China, is it being accompanied by a shift towards value-based selling? Unfortunately, the jury is out on this question. Ask a Chinese salesperson if s/he is selling on the basis of value, and the answer will be in the affirmative. Ask anyone else (including expats, of whom there have been many attend my workshops), and they will tell you the opposite. The author has initiated research in this area to seek a definitive answer to this question.

What is unquestionably clear is that Sales Management has a huge role to play in China, as does a "carrot-and-stick" approach to sales force compensation.

What cannot be denied however is that culturally, doing business in China is different from doing it in the West, in many ways:

The Chinese acknowledge and respect hierarchy. Chinese organisations are vertical, and place a very strong emphasis on seniority, rank and title. As a result, employees are very cautious about what they say when their boss is in the room;

Personal interests and initiatives can be subordinated. Being the first to come up with an innovative idea can be considered "showing off". Group thinking is preferred over personal initiatives because groups, not individuals, are accountable;

This hierarchy and bureaucracy means that the Chinese take longer to make decision, and decisions are based on ensuring that the balance of all parties is taken into account;

This reciprocity, trust and mutual obligation among all parties forms a social and business platform in China known as "*Guanxi*";

And for these reasons, the Chinese often find it difficult to say "No", they prefer to make concessions at the end of a negotiations, rather than as it progresses, and they often don't consider contracts legally binding (rather, they are a 'draft', subject to change).

There is no doubt the Chinese economy has slowed down over the last three years. I predict that those Chinese companies that have recently established Pricing Departments will weather the storm much better than those that have not. The tight Chinese economy will really test those low-cost (domestic) Chinese companies that have been applying downward pressure on prices over the years.

Advertising's Slow Road to Value-Based Pricing

One of two industries where customers are forcing suppliers to adopt Value-Based Pricing

This article first appeared on TrinityP3 blog on the 23rd January 2013

As a pricing consultant, I am frequently asked by companies from all sorts of industries to assist them in a move to Value-Based Pricing (VBP). These companies tend to be acting proactively and initiate the move to Value-Based Pricing themselves. So what is Value-Based Pricing and why do companies initiate the move?

Value-Based Pricing is where a company monetises part or all of the economic value it creates for its customers. The economic value is created by the vendors' products and services either increasing the client's revenue, reducing their costs or minimising their risks. These three sources of value are not necessarily mutually exclusive: some products can increase revenue and reduce costs, for example.

One of the most commonly cited reasons by companies for shifting to Value-Based Pricing is that their customers don't buy from them because of what it costs the vendor to provide the product or service purchased. They buy from them because of the value they receive. If the research is to be believed, then the 70% - 80% of companies that resort to cost-plus pricing are pricing on a dimension that their customers just don't care about.

To put it another way, cost-plus pricing (like billing by the hour) is based on inputs, while Value-Based Pricing is based on outputs.

Value-Based Pricing requires vendors to have a knowledge and understanding their customers' value-chain and their value creation process, and this is achieved via long-term, sustainable relationships, rather than the odd transaction here and there.

As a result, Value-Based Pricing is more holistic than alternative methodologies. It enables companies selling goods to monetise the services involved in the provision of such goods, while enabling service companies to shift their focus to the provision of solutions.

The majority of companies I work with want to move to Value-Based Pricing so they can become the "price maker" in their industry, and reap the rewards that go with wearing that crown. Such a move also helps differentiate them, particularly in industries that are being commoditised or disrupted.

Which brings me to the advertising industry, which is one of two major industries where customers are demanding a shift to Value-Based Pricing because the industry itself is refusing to go there (the other industry is Professional Services, such as Lawyers, Accountants and the like).

On 20th April 2009, Coca-Cola said it would adopt a "value-based" compensation system for the advertisers that do work for its 400 brands. Rather than paying advertising agencies for hours worked, Coke will pay for results achieved"

The Economist, 14th May 2009

The situation where customers demand Value-Based Pricing is not one you want forced onto you. It will catch you off-guard and force you to make mistakes that come with not planning ahead and being reactive to customer needs. You will be a commoditised "price taker", constantly beaten up by powerful procurement managers.

Perhaps more worryingly, there is a huge risk of polarisation across the advertising industry. Those that can provide value-based advertising solutions to customers will command premium pricing.

And for everybody else, there's "*commoditisation hell*".

Value-Based Pricing is a Process, not a Project

Value-Based Pricing options for the advertising industry

This article first appeared on TrinityP3 blog on the 18th February 2013

In my last post, I talked about what Value-Based Pricing is, why companies are adopting it, and why advertising agencies run the risk of "*commoditisation hell*" by not adopting it. But it would be remiss of me not to tell you how to start your Value-Based Pricing journey.

A couple of years ago, I went on a ride-along with a Sales Rep from one of Australia's biggest online advertising portals. During the sales pitch, the rep told the advertiser about all the value they were receiving from their advertising: unlimited listings, preferential pricing on enhancement products, page impressions, click-thrus, email enquiries, phone calls, and so on.

The advertiser silently took all of this in, and then replied, "I hate phone calls!" The sales rep was taken aback. "What do you mean, you hate phone calls? That's the most qualified lead to your business that we provide", she said. "I don't want to be answering my phone at all hours of the day or night. I value email enquiries because I can respond to them when it suits me."

This (true) story epitomises why the adverting industry has been a laggard in adopting Value-Based Pricing: they haven't worked out the real value they are offering. Value-Based Pricing starts with understanding value from the customers' perspective. The Sales Rep thought that phone calls were the most valuable ROI metric. She was wrong, because value is in the eyes of the beholder (the advertiser).

As I mentioned in my last post, there are three ways a vendor can provide value to a client, either by increasing their revenue, reducing their costs, or minimising their risk. The table below provides just a couple of examples in each category for the advertising industry (there are many more):

Increase Revenue	The advertised products command a higher selling price New or incremental sales (via new channels or new markets)
Reduce Costs	Creative campaigns foster greater customer awareness and loyalty, which… Reduces the Cost-to-Serve
Minimise Risk	Campaigns are optimised in (next to) real time PR & Reputation Management

Sometimes, finding sources of value to monetise requires "out-of-the-box" thinking. Over Thanksgiving last year, Facebook sent a "swat team" to Wal-Mart's headquarters in Bentonville with the specific objective of optimising 50 million mobile ads that Facebook users would see for toys, televisions and other discounted products. According to MarketingWeek, "…*Wal-Mart's senior team were apparently won over by the service they received and the results*".

So how do you monetise advertising services on the basis of value? Here are just three alternatives:

Option 1: Upfront Pricing

One of the best ways to align the price paid with the value received is to ask the advertiser upfront how much they think the solution you offer is worth. Not convinced that pay-what-you-want (PWYW) will work? Ask the owners of HumbleBundle.com, a website that has

generated $23mill in payments since launch, utilising a PWYW pricing model.

Option 2: Contingency Pricing
If the advertising solution delivered achieves a satisfactory outcome, the agency's fee is significantly higher than what it would earn under a normal fee arrangement. But in the case of a below par result, the agency gets paid less, costs only, or in the worst case, nothing.

Like PWYW, this pricing model may appear scary too, something that must have crossed Google's mind when they realised that if a user doesn't click on an ad, they wouldn't get paid.

Option 3: Guaranteed Pricing
This is not a Value-Based Pricing model that agencies should jump to from the go-get, but where an agency has the knowledge and experience to offer an ironclad guarantee around a satisfactory outcome for a campaign, it can be a highly differentiated, premium priced alternative.

Value-Based Pricing is a process, not a project. Careful consideration needs to be given to which clients it is applied to, and in what magnitude. It won't happen in the advertising industry overnight…but it will happen!

Musings on Pricing, Volume 2

About the Author

Jon Manning has spent most of his career pricing products and services, in both the corporate world, as well as advising clients via his consulting business Sans Prix Pty Ltd.

In 2011, he launched the world's first and only online pricing advisory service (PricingProphets.com) where companies can ask a panel of global pricing experts and thought-leaders what price they should charge for a product or service and why.

Over the last 12 years, Jon has completed dozens of major consulting projects for companies in the Dow Jones Industrial Average, the Fortune 100, the FTSE100 and the CAC Next20 stock market indices, and in the process has generated millions of dollars in incremental revenue for clients in places such as the UK, USA, India, & Australia.

Increasingly in demand as both a speaker and educator, Jon has spoken at over seventy-five conferences, workshops, educational institutions and other events across the Asia-Pacific, the Middle East and the UK. Between 2007 and 2009, he co-presented the "Pricing Strategy & Revenue Management" Executive Education Programme at Lancaster University Management School.

Jon holds a Bachelor of Business (Applied Economics) from Deakin University (Australia), a Graduate Diploma of Business (Management) from Monash University (Australia) and a Master of Arts (European Studies), from the University of West London (formerly Thames Valley University) in the UK.

He is also a member of the Professional Pricing Society. His articles have been published in The Journal of Professional Pricing, The Journal of Revenue and Pricing Management, The Pricing Advisor, The Wiglaf Journal.

About Pricing Prophets.com

Most people in business frequently talk to an accountant and a lawyer, but why don't they talk to a Pricing expert? One reason is that they don't know Pricing experts exist and another is that they don't know there are alternatives to the 'traditional' cost-plus approach to Pricing.

With so many of todays challenges and problems now being solved online, we asked ourselves "*...why not solve Pricing problems online?*" and set about building a solution that is affordable, accessible, egalitarian and timely.

At PricingProphets.com, we've assembled a global panel of Pricing experts and thought-leaders that will tell you not only what price you should charge, but more importantly, why you should charge that price.

Clients can upload their pricing challenge by themselves, or with our assistance. We then send it to the most relevant experts, all of whom we've verified as experts in their field. Then, in about seven working days time, clients receive an email telling them to log in to their secure PricingProphets.com workbench and see what the experts had to say about their pricing challenge.

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