PRICING IS...

BY MARK STIVING

PRAGMATIC MARKETING®

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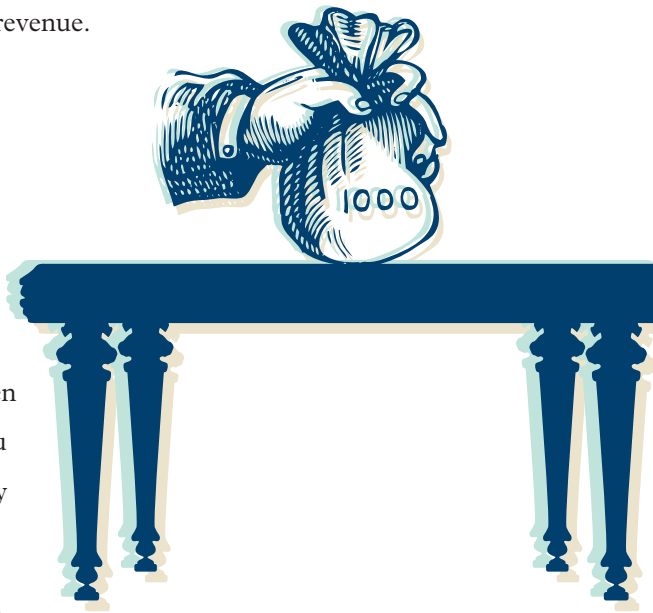
IT'S ALMOST EMBARRASSING TO STATE THIS, since it's so obvious, but here goes: Pricing is important—and it's important to both your company and your customers.

Everyone in your company wants your product to be a success—and pricing is a component of that. In addition to that making pricing important, it makes it emotional. It can cause eager, heated discussions where someone adamantly disagrees with prices set by management. But it can also generate excitement, like when we promote new pricing strategies designed to grow revenue.



For your customers, pricing too high can hinder demand and pricing too low can either leave money on the table or make the product look cheap. And it's emotional for them as well. While shopping, have you ever been elated to find something you wanted at a deeply discounted price? Alternatively, have you ever been upset because the price was much higher than you expected? And how have you felt when a company like Netflix raised prices?

Pricing is clearly so much more than just a boring function that places a number on a product. This eBook takes a look at some of the nuances of exactly what pricing is.

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1 SECRET

Or at least, it's partially secret. Companies don't advertise their pricing strategies for two key reasons: (1) They don't want their competitors to know and (2) they don't want their customers to know. More accurately, they want to manage what competitors and customers do know about their pricing.

Competitors. You want your competitors to believe you have high prices. Taking market share is about aggressive pricing, which is easier when the competition is unaware of your price.

Customers. Companies typically want customers to know their pricing is low, fair and a great deal. However, companies with great pricing strategies have levels of prices for different segments of customers. It is usually in the company's best interest, then, to not share the entire price list. Knowing that someone else is getting a better deal could keep a customer from purchasing.

Basically, pricing strategy has two opposing objectives: Convince competitors your prices are high and convince each customer his or her price is low. You can't achieve those objectives if you're transparent with your pricing strategy, which is why pricing is kept secret.

2 INSTANTANEOUS

"Instant" might be an exaggeration, but pricing changes have a much faster impact than any other marketing-mix variable.

If you decide to change a *product*, it can take months if not a year or more to develop and test the new product. Changing the *place* (i.e., your distribution channel) requires contract negotiations, web site development, relationship building and more.

And even after developing a new *promotion* campaign, it takes a while to touch your customers and potential customers enough times to change their perceptions, hopefully leading to changed behavior.

Decide to change the *price*, though, and BOOM, there it is. Your customers will absorb that information and change their behaviors almost instantly. Pricing is the most powerful marketing mix variable, and a small improvement in pricing will have a big and fast impact on profitability. This is why we see price wars and not product wars, place wars or promotion wars.

The fastest way to influence customer purchase behavior is by changing prices. Not always the best method, but certainly the fastest.

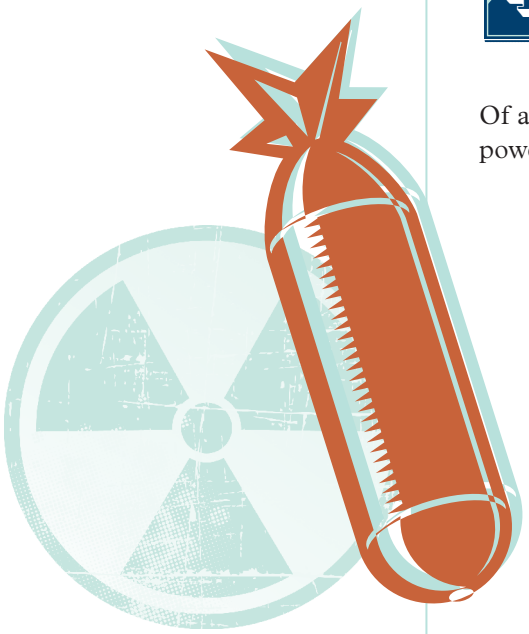
3 A KEY PERFORMANCE INDICATOR

You probably monitor revenue, profit, expenses and hopefully more at your company. But do you use price as a key performance indicator (KPI)? If not, you should consider it.

Marketing and development create a product, build in value and set a price to capture that value. Your sales department does its best to sell at that price. But as new competitors and technologies come into the market, the value our customers perceive relative to the alternative declines. They become willing to pay less.

If you are tracking average selling price (ASP) over time, you will likely see that it declines. When it declines too much, that is likely an indicator that market conditions have changed. Small decreases in ASP may be noise in the market, or they may be early indicators that the market is changing.

Other price metrics you may want to monitor include gross margin, pocket price (realized price after all discounts and considerations) and average discount used by sales. Think hard enough about price and you'll find that using pricing metrics can be a great measure of the health of your business.



4 THE NUCLEAR BOMB OF BUSINESS

Of all of the tools business people have, pricing is the most powerful and the most dangerous:

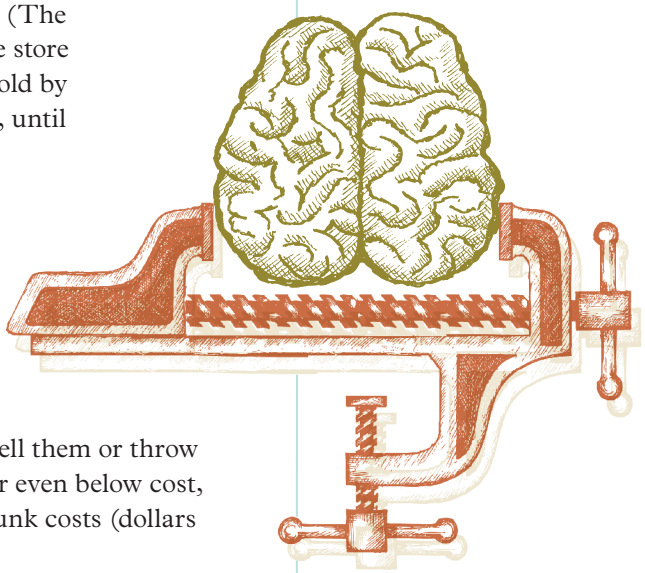
- **It can be very destructive.** Lowering your prices hurts your competitors. When they retaliate, and they almost certainly will, that will hurt you as well. In the end, the most likely result is lower industry profits, including yours.
- **You can't un-explode it**. It is extremely difficult to raise prices again once a price war begins. Companies rarely want to unilaterally raise prices and risk giving up market share to their competitors. Coordinating price increases in an industry is challenging, and it's illegal if done through direct communication.
- **It can be a deterrent.** Your competitors are much less likely to lower prices if they believe you are going to follow suit and not let them easily take your market share, but you don't want to be in the position where they can price below your cost of doing business.

Avoid using your most powerful weapon aggressively. Feel free to chase market share with branding, marketing, sales, product attributes, advertising—anything but pricing. ☞

5 UNINTUITIVE

A colleague told me this story about his father, who managed a small grocery store in Ireland many years ago:

In Ireland, strawberries and cream were a popular dish, so Jack would buy strawberries for a shilling and sell them for 2 shillings. (The numbers are made up, but go with the point.) However, the store was closed on Sundays, so any strawberries that were not sold by Saturday night were thrown out. And that is what they did, until Jack got a new boss.



When the new boss heard of the practice of throwing away unsold strawberries he told Jack to lower the price of strawberries on Saturday afternoon to a shilling. Why do you think he would propose such a strategy, when that would mean selling the strawberries at cost?

First, purchasing the strawberries was a sunk cost. Once the store owned the strawberries, they would either sell them or throw them away—and it's obviously better to sell them at cost, or even below cost, than to trash them. The choice is some revenue or none. Sunk costs (dollars already spent) are never relevant to pricing decisions.

Second, customers who bought the strawberries (at cost) also bought cream. The store made plenty of money on cream. Notice that this is an example of pricing as a portfolio. Pricing aggressively on one product, strawberries, influences the sale of complementary products, cream, at better margins.

6 CUSTOMIZABLE

We don't force everyone to wear the same clothing style, eat the same foods or drive the same cars. Similarly, we don't have to force everyone to pay the same price. We can customize pricing.

Car pricing is customized. I just bought a new car and it is very unlikely that I paid the same price as anyone else for the same car at that dealership. I certainly negotiated differently and had a different willingness to pay.

Airline seats are also pretty customized. Although a few people on the plane may be paying the same price, the airlines have figured out great techniques for charging different customers different prices to capture more margin.

Some items, like potato chips, are harder to customize for just a few people. But they do charge different prices for different flavors in different regions of the country—and they offer coupons to let the price sensitive pay less.

Pricing is customizable. The challenge is figuring out how to charge more for people who are willing to pay more and less for those who will only pay less—all while everyone thinks it is fair. ☞

7 INFORMATION

A price is the amount of money someone has to give up to acquire a product or service. Everyone knows this, but customers also use price to infer characteristics of the offering.

We expect customers to analyze the quantity and quality and then decide if it is worth the price, but people often infer higher prices to mean higher quality and lower prices to mean lower quality. They likely have experienced unlimited examples firsthand of where they could get more quality if they were willing to pay more. It's all around them, so they subconsciously learn that higher prices mean higher quality.

Their justification of the behavior might look like this: "The manufacturer (or the retailer) knows this one is better so they priced it higher. Besides, many other people who know more than I do have done the analysis and think this one is worth more. Otherwise, nobody would buy it and the company would lower the price."

Price is more than just what the customer needs to buy your product or service. It is also telling the customer more about your offering. Take care that your prices are telling the right story.

8 WIN-WIN

Pricing is usually seen as that step in business where companies try to trick consumers out of their money, but I much prefer to think about the win-win aspects. Your customer wins and you win.

Customer. People buy a product (or service) when they get value that is equal to or more than the price they have to pay. This means whenever customers exchange cash for a product, they receive more value than it cost them—otherwise they wouldn't have made the purchase.

Company. Your company wins when you charge more for your products than they cost. That is the only way to make a profit and stay in business.

The customer wins with excess value; your company wins with profit margin. It's a win-win. 👉

9 YOUR LAST MOVE

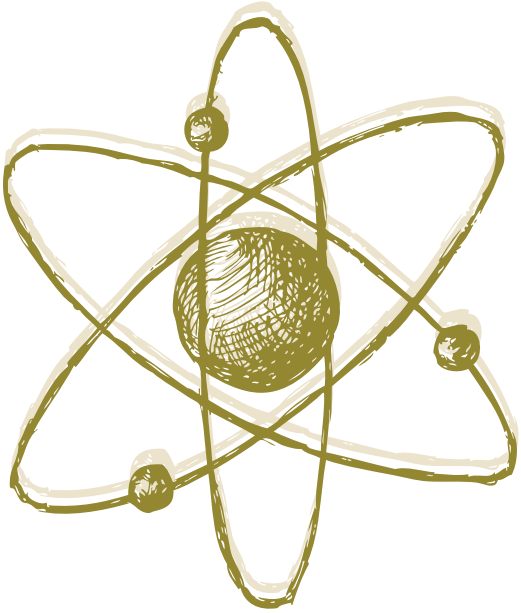
Business is like a game: You make a move, your competitor makes a move, your distribution channel makes a move and then customers make a move. You win when they buy from you—and the more profit, the greater the victory.

The strategy of winning any game is to look ahead as far as possible and then reason backward to make your best decision (move) for the current situation. Product development happens, then marketing and channel development and then maybe direct sales and customer support training. Because price is so easy and quick to change, it is your last move.

Keep in mind, however, that in the game of business, the last move is actually someone buying from either you or your competitor—and it is not your move.

10 COMPLICATED

There is a lot to pricing, beyond what we can cover in a short eBook. Pricing excellence requires understanding your products, your competitors' products and how your customers perceive the differences. It requires estimating your customers' willingness to pay and finding ways to charge different customers different prices. It requires understanding how your pricing will change as your costs change, as your competitors' prices change and as the economy changes. It requires product development to create differentiation, marketing to communicate that value and sales to sell the value. It requires negotiation skills. It requires developing the method to quote prices to your customers. It requires designing processes employees can follow. It requires …



You get the idea.

But while so much goes into pricing, it also delivers a lot. Pricing has the power to make your customers love you, hate you or anything in between. It also has the power—both internally and externally—to generate powerful emotions, to touch people's lives. Wield your power carefully. ☞

ABOUT PRAGMATIC MARKETING

Being tuned in to the market throughout the product life cycle—from strategic product planning through launch—is critical, and getting the entire organization centered on the market is paramount to achieving success.

But while it may be easy to get an organization to recognize the need to be market driven, it can be challenging to turn that belief into action. That's where Pragmatic Marketing comes in. We have provided practical training and a common framework to more than 100,000 product professionals at over 7,000 companies on six continents. We've helped them build, market and launch products that sell—and now we're also helping them set the right price for each product in each market.

For more information, please visit **www.pragmaticmarketing.com** or call **(480) 515-1411.**

ABOUT THE AUTHOR

MARK STIVING is an instructor at Pragmatic Marketing with more than 20 years of experience in business startup, development, management, turnaround and sales engineering and design engineering. He has helped companies create and implement new pricing strategies to capture more from the value they create, and has consulted with Cisco, Procter & Gamble, Grimes Aerospace, Rogers Corporation and many small businesses and entrepreneurial ventures. He has led pricing initiatives as director of pricing at Maxim Integrated and as a member of technical staff at National Semiconductor. Mark also has served as president of both Home Director Inc. and Destiny Networks Inc. and as an assistant professor of marketing at The Ohio State University. He is also the author of "Impact Pricing: Your Blueprint to Driving Profits" (Entrepreneur Press, 2011).