GETTING THE PRICE RIGHT

BY JAY GARCIA

PRICES ARE IMPORTANT – IN FACT, THEY'RE OFTEN A DETERMINING FACTOR FOR BUSINESSES AND CONSUMERS ALIKE. BUT HOW OFTEN DO COMPANIES SERIOUSLY EVALUATE THE BEST PRICING STRATEGY FOR THE BUSINESS AND ITS CUSTOMERS?

Price is a big factor for many people and businesses. Consumers hunt products down and often make a decision based on prices. Thanks to the internet, range has become extensive and accessible, meaning prices have never been more crucial to the success of a product or a service.

From an executive's perspective, price is one of those niggling little details rarely given a second thought. Businesses often use a formulaic method to discern an appropriate price, taking into account the basics such as input costs, competitors' pricing, and market demand.

However, it's important to step back a little and determine who decides on this formula and which factors need to be considered.

PricingProphets founder and Managing Director Jon Manning discusses the difficulties in determining how to best price your products or services. He recognises the importance of affordability in pricing, and highlights: "If you want to get advice on pricing, there is not a lot in the way of affordable alternatives. You can send your employees to pricing workshops or seminars, which will cost you something like $3,000, but you'll receive general knowledge that's not specific to your product or service.

"You could buy a book, which is obviously cheaper; but then you factor in reading time, and again you may not get specific information about your particular product or service. It's really a hit or miss option. There are also market research companies that will do various types of pricing research for you. You might do a focus group for $25,000; you might do a full-blown conjoint analysis project where you may not get much change from $150,000–$200,000. There's another opportunity here, which is to utilise the knowledge and expertise of people who do pricing day-in, day-out."

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Pricing should be as simple as possible to free managers up so they can focus on their core competencies. PricingProphets offers clients affordable and accessible pricing solutions, and strives to deliver quick, tailored services through its online communication channel. This gives businesses the opportunity to access everything remotely, while providing a global network of experts to their customers. "Our experts are located all around the world," Jon emphasises. "Clients may have a preference for more American or more Australian experts, and we can cater to that.

"When a client submits a project, our experts are required to respond in five working days. They're asked what price the client should charge for their product or service, what's the rationale for that price, and any other advice. Once those results come in, we have two working days to review. If there are queries, we have inroads with the experts and we can get back to them. We'll add some editorial commentary, and then we'll push a button and the clients receive an email saying, 'Your report is ready to be reviewed on the site'."

The company is very wary of traditional cost–price models. "We strongly recommend value-based pricing," Jon notes. "And that's one of the unique features of PricingProphets. Among those 40 questions, there is not one that mentions cost, but there's one question that asks the minimum price that you want to charge. That minimum price may occur because that is the cost for providing a product or service. But it could also be the price of the lowest competition. We don't ask about cost and we don't care about it. At the end of the day, a customer isn't going to buy a product or service based on what it costs to manufacture; they purchase it because of the value it delivers to them. How you approach value-based pricing varies based on your product and the type of market you're in.

"In strong B2B markets where you've got a good economic value proposition, we try to price on the basis of additional revenue a product or service can generate for a customer, the expenses that are reduced, or the risks that are minimised, because those are sources of value that you can easily quantify. So if you've got a product that generates $100,000 incremental revenue for a client, you use that as the basis for the pricing and say, 'We're going to split this with you X per cent and make it attractive for you', and you're pricing suitably on value."

Pricing is often a determining factor in the success of a product or service, as Jon affirms: "The critical thing about pricing is that it is the most effective profit-driver that the company has. Most people in the pricing field will tell you that if you can improve your fixed cost by 1 per cent, you'll get about a 2.3-per-cent uplift in operating profit. If you can improve your volume and the amount of product that you sell by 1 per cent, you'll get about a 3.3-per-cent uplift in operating profit.

"The variable cost for 1 per cent gives you a 7.8-per-cent uplift. A 1-per-cent pricing improvement just goes straight through to the bottom line and will give you an 11–12-per-cent uplift in operating profit. So it's very powerful and often very underutilised and misunderstood. There's a lack of resources and things like that."

Pricing mistakes can often spell disaster for a company, and the CEO often bears the brunt of these repercussions. "I think we've seen some really interesting events in the last 12–18 months," Jon illustrates. "Obviously, the most recent one has been the CEO at Brumby's, who has now fallen on his sword because he recommended his franchisees increase prices and blame it on the carbon tax. That is definitely not something that a pricing specialist would put forward. Most pricing people need to understand the competition laws, ACCC compliance, and so on. They would have known that the ACCC would have come down on them like a tonne of bricks, not to mention the public opinion backlash."

Jon offers another example of how pricing model changes have the potential to alienate customers. "Another example is Reed Hastings, the guy who started Netflix in the US. They were offering one subscription for $9.99 a month, and with that subscription you could get your DVD rental and online streaming. Now, quite rightly, Reed Hastings thought he could split that into two because DVD is declining and streaming is growing, so there was nothing wrong with that. But he didn't really understand his customers and he probably went a bit too aggressive on pricing. So instead of $9.99 for both, he announced $7.99 for each, and there was still a good chunk of customers who wanted both.

"But, within a week, he had over 80,000 hostile comments on the company's Facebook page. Share prices took a hammering, and they still haven't really recovered. They also lost almost half a million subscribers, and so forth. Rather than making these decisions, I think the role of the CEO or executive in pricing is more like a champion. People who have knowledge and experience of pricing are probably the ones better qualified to make these calls, identify opportunities, and then leave it for the CEO to champion, rather than fall on their sword as was the case at Brumby's."

More businesses are realising the value of pricing products and services, whereas this was viewed as a minor detail in the past. "I think pricing has been neglected in the past because it's easy to change," Jon notes. "If a competitor lowers their cost, people will just say, 'We'll drop our price and get it back up there later'. But it doesn't always work like that. We've known this through behavioural economics where consumers buy milk for $5 and get 50 cents off for cash, or pay $4.50 and spend 50 cents more for credit card. The rational person knows both offers are the same; the irrational person actually goes for the cash option because they're getting something. There's a better understanding of both rational and irrational behaviour emerging."

As customers are becoming more diligent in researching and choosing prior to purchase, businesses need to rethink traditional pricing models that are applicable to their market. "I think with the way stuff is moving online, the opportunities are much shorter lived, and there's a move towards trying to sell as many things as possible through subscription models," Jon observes. "We're moving towards a subscription economy. You can subscribe to a car-sharing scheme. People don't go down to Blockbuster to rent DVDs anymore; they just subscribe to Quickflix or Netflix.

"These things require more nimble pricing opportunities, and I think some of the business models in themselves have far greater interest and awareness in pricing as well. So instead of monetising your customers, a third party, advertisers, and things like that, place greater emphasis on pricing as the premium model. For example, 75 per cent of the people on LinkedIn have free profiles, but the other 25 per cent are paying for the service and are premium customers."

As Jon highlighted, pricing can make or break a business; furthermore, a CEO can face serious backlash from consumers and even directors if proper considerations aren't made towards a company pricing strategy.

With more active consumers and the public eye trying to keep businesses more honest, it is a worthwhile investment finding an experienced pricing expert to look over your company and see if your price is right for your market, your competition, and your business.

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