… thorny prices

How high is price on your agenda? It is one of the classical four P's of the marketing mix … but why is price important, how should we think about pricing and how much thought should be given to prices?

What is your price?

Price is the economic sacrifice a customer will make to acquire a product / service. Price isn't the key driver in the vast majority of purchases, as consumers we buy the highest net value …

Highest net value = perceived value - price

Why is pricing important?

Every business is a process, a "value creation" process. This process must justify the price that funds it in the eyes of customers and/or end-users. The fundamental foundation of any business strategy must be adjusting processes to best position the business for future profit, ideally reducing risk. Both of these motivations should influence the detail of marketing strategy and – within it – pricing. There are three profit drivers within a business: sales volume, sales price and costs.

Profit = (sales volume x sales price) – costs.

A successful business strives to constantly control all three profit drivers but where is the focus of the efforts in your business this quarter? Using a simple exercise, grasp can show you how cutting costs or selling more volume are often a less fruitful activity than driving sales price.

You could try comparing the profit impacts of – individually – a 10% increase in sales, a 12.5% decrease in costs or a 5% increase in price in your organisation. If your variable costs outweigh your fixed costs you may find a 5% price increase less attractive than other options but the real picture should be based on how easily you can deliver any of the changes. In the current environment it may be very hard for you to sell more volume profitably OR to cut any more fixed costs!

How should we manage price?

The variety of positions that can be taken on pricing are often simplified into two extremes:

> **Skimming** – Higher than average market prices, to deliver profit above the norm for the sector, supported by value-driving elements of the product/service package. Purchasing is often driven by opinion leaders (cf the growth of iPod sales with the launch of the mini).
>
> **Penetration** – Sacrificing some of the profit potential of regular market pricing to deliver strong volumes over a short period of time, hopefully changing long-term purchasing behaviour.

In reality, price is a complex mix of influences. For example: **gross** pricing may be set by strategy but **net** pricing is frequently the result of trade discounts, waste (that may not be visible to you) and sales promotions.

The price you can realise is generally related to the demand for your products (many monopolies have adopted modest pricing to politically secure their position). **Marketing research from grasp can identify what your customers would expect to pay for a new or revised product/service**.

The competition you face is also a key criterion, **mystery shopping** (eg obtaining benchmarking quotes) **and price checks** (eg from store visits) **from grasp can clarify what your competitors are offering**.

Furthermore, **marketing research from grasp can help identify and predict future substitutes for your products/services**. Hamel and Prahalad, authors of the highly influential "Competing for the Future", encourage businesses to contemplate the effect of dramatic price reductions (eg of 50-90%) on their business and their markets. For example: the dramatic fall in mobile telephony costs (for example) has now brought mobiles into direct competition with landlines.

When setting prices, be wary of the following:

- **Too much uniformity** – Different customers will have different demands and will incur your business different costs. Uniform pricing may mean some products are less profitable than other lines with the same price, is there a clear reason why? (Are they strategic opportunities?) *Ever been annoyed by a salesperson refusing you a discount for bulk buying?*

- **Divorcing pricing from value** – Understanding the value of products/services to your customers is vital to avoid under-pricing high value lines, and to avoid nasty surprises when lines deliver less value than you thought they did. Many consumers are suspicious of low prices (even on high value goods); other consumers have very clear (and low!) price ceilings regardless of value. *Gerald Ratners' prices had to spiral so they could shift their closing down sale stock after he labelled the products "crap"! Hoover underestimated the value people attached to transatlantic flights when they gave them away with vacuum cleaners!*

- **Not understanding the marketplace –** Challenging the statement that "the market fixes prices" is the argument that prices are actually set by relationships. *What would it cost your business to produce the world-beating solution that your best customer/prospect would love to buy from you?*

- **Chasing turnover** – "Volume is vanity, profit is sanity". Most importantly, *don't be <u>seen</u> to be chasing volume!*

How can we look at price afresh?

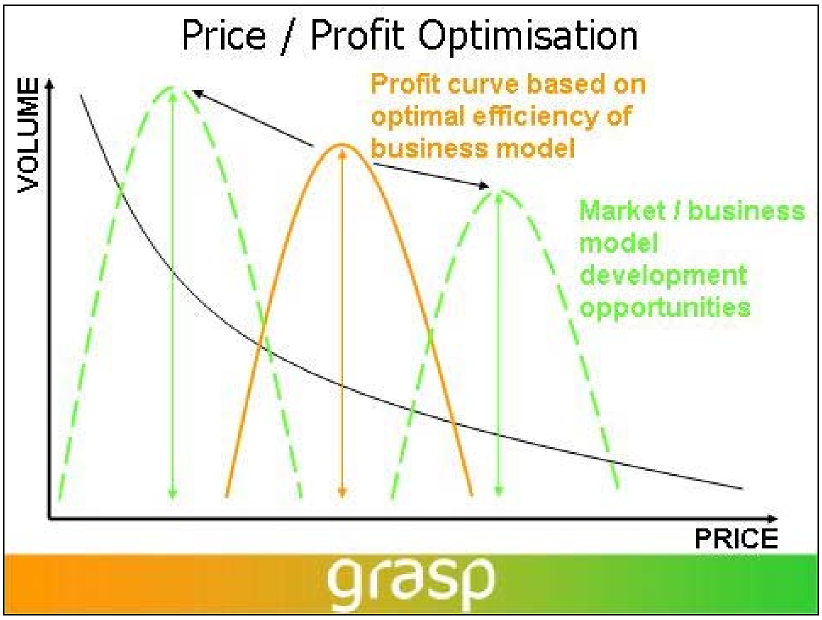
Classical thinking on price – driven by economists – argued that the balance of supply and demand would determine an "equilibrium price" that was relatively predictable. Historically, low volume producers were best differentiating themselves to secure a price premium. Conversely large volume business historically focused on producing commodity products.

Increasingly, markets have seen their prices tier over recent years. Tesco commonly express this policy as:

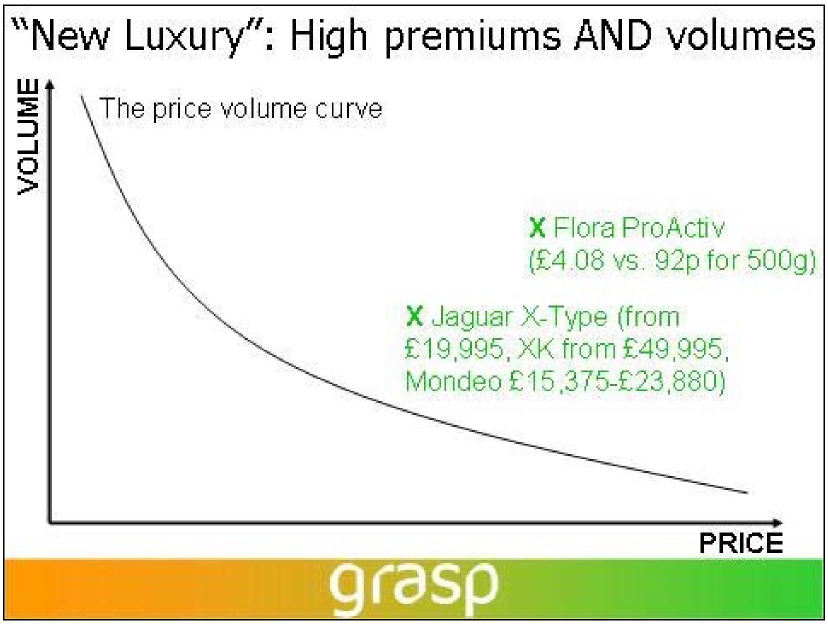
- **Good** (Value products – fit for purpose but purely commodity lines),
- **Better** (core products including some differentiated lines such as healthy / Cherokee clothing)
- **Best** (*Finest**).

Contemporary thinking, based on the diversity of today's markets, is that the optimum price for your products/services is now directly determined by your business model (or "value chain").

Silverstein and Fiske have been more widely acknowledged in the United States than the UK for their work in understanding the shifts in price-elated consumer behaviour. They argue that recent shifts afford businesses the opportunity to set their prices well above the price-volume curve (above).



Large businesses are increasingly attracted by price premiums and this is going to make life harder for many smaller players. However, there is still room in this model for smaller businesses but their very size, and **the locality of their markets are increasingly the critical emotional factors that differentiate them**.



(Based on Silverstein & Fiske, 2003)

Whilst price merits attention as part of the marketing process, it is increasingly seen as a consequence of business strategy. If you are a business that supports premium prices, these premiums must be supported by your value-adding activities. If you do not want to (or are unable to) add value to your products/services you <u>must</u> rigorously analyse your cost base and accept you are a commodity producer.

Some businesses, usually through technology, are able to adopt hybrid strategies that do both: get cheaper whilst adding value. Prime historical examples are Japanese car manufacturers, more recently mobile phones have got cheaper whilst integral cameras have become standard.

One interesting way to get a new perspective on price is to decide on a new pricing position and work backwards to your costing (rather like zero-based budgeting). In our experience many businesses start by asking themselves what it will cost them to produce something, rather than starting with the end in mind.

Summary

Pricing is as complicated as you want it to be but the more you know about your customers, the simpler you can make it. Importantly: which customers do you want and how are they likely to use your products? Don't forget your competitors and substitute products/services (and what other markets could your business enter by changing it's pricing!?).

Research and/or facilitation can help you take a fresh look at your business' pricing, informing the strategic development of your business and supporting long-term profits.

References

Hamel & Prahalad (1994) *"Competing for the Future"* Harvard Business School Press, Boston.

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