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**Chemicals**

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# Pricing Professionally

How to strategically determine,  
tactically differentiate and  
operatively implement prices

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**A** brief survey of the current economic crisis reveals that declining prices, growing discounts, unruly buyers or aggressive competition are responsible for the margin drops in companies and industries. The way out of the current price and value crises requires something more complex than the simple call for price increases and cost reductions.

If the pressure on prices, volumes and margins is high enough, then why is there still resistance to changing the thought process and behavior in pricing? In our pricing consultancy we have observed two developments that explain the resistance in pricing.

## 1. It's not your fault, but it is your problem

### The Real Pricing Problems

Inflationary discounts, sinking prices, rising costs and drops in demand are only the tip of the iceberg of the pricing problems. The real problems go even deeper:

1. Companies are unfamiliar with the true rules of the game and the price's significance.
2. There are unwarranted price differences between customers.
3. Countless individual agreements exist: pricing can no longer be understood, calculated and controlled.
4. There is a lack of information on de facto price realizations in the market: risks are recognized too late, individual consequences over-estimated.
5. A tooth and nail fight is taking place between marketing and sales over pricing power, competencies and responsibilities: the last thing needed in this situation.

The first indication of resistance in pricing can be found among large customers with buying power. In international purchasing of key accounts, for example, price comparisons are made on two levels: internally between locations/countries and externally with other suppliers. A price harmonization, which results from this comparison, drives the price down to the lowest level. The price decline is not usually compensated with a volume increase, leading therefore to direct margin losses.

When purchasing core products or becoming involved in major projects, more and more customers are inviting bids or holding

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auctions. The asymmetry of the price information (the customer “knows everything”, the seller “knows nothing”) and the high purchasing volumes foster a price dynamic downwards.

The command to increase productivity and the pressure to make transparent calculations first started in the automotive industry. These practices are now common in almost every industry.

Moreover, the supplier is always driven into an interface trap when the service delivery (in technology) is systematically separated from the service payment (through the purchase). (Added) value is delivered to one location and must be paid by another. Performance-oriented prices are extremely difficult to achieve in this situation.

## 2. Because nothing can exist unless it ought to exist

The second manifestation of resistance in pricing is found internally in companies. The price has become a topic of hot debate in the effort to cover costs, operate at full capacity and maximize profits. In these three areas, the price is always being subjected to a pull test.

” The price is seldom seen as a problem internally. ”

However, the price is seldom seen as the problem: “We don’t have a problem with pricing; the market determines the price.” In line with this view, those responsible for pricing accept help only grudgingly. We frequently hear that pricing is done by successful individuals with many years of experience who supposedly know exactly what to do. Before giving in and conducting an “ominous” pricing audit, these individuals prefer to cite the competition first. If you do not follow the competition, you will be out of the game, is the most frequent reply. The need for an industry solution is becoming desperate. However, the fears and negative emotions in pricing cannot be dispelled so easily.

The effect of the resistance and negativity on pricing are catastrophic: the prices no longer match up with the performance. Yet the problem does not lie in value

delivery, but in pricing. Consistent, calculable and stringent price leadership is needed more urgently than ever before. Such leadership involves setting clear rules that specifically position the price as a competitive instrument (price positioning), while selectively and systematically differentiating it (price differentiation). And strong price leadership must be able to guarantee effective price implementation. Consequently, pricing must take place on three levels.

## First Level: Price Positioning

” It is just as incorrect to believe that the lowest price always tips the scales as it is to assume that additional services or improved products can achieve a higher value and, with that, a higher price. ”

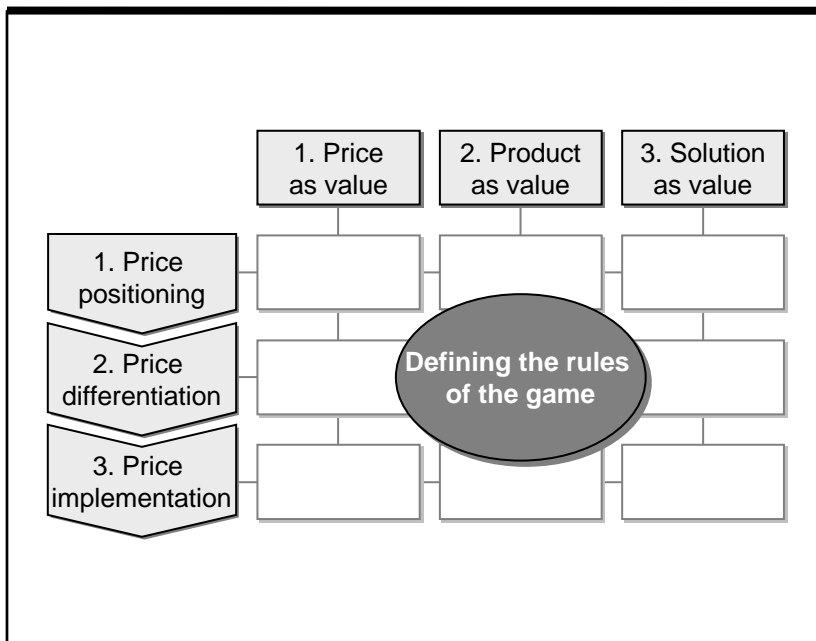
Price positioning involves first asking a strategic question: which performance (product/service) can be offered for which price? Part of the answer to this question is the value delivered to the customer (value delivery) and how this value is extracted by the price (value extraction). In the framework of a value orientation, there are three cases that differentiate strongly in value and character. In the first case it is the price as value, in the second, the product as value, and in the third, the solution as value.

*Case 1: The Price as Value.* The lowest price determines the value if the product is completely exchangeable and if there are few barriers to changing the supplier. This applies to homogeneous mass products or commodities which, regardless of the supplier, exhibit the same product attributes. A customer's lack of orientation on the lowest price would be culpable in such a situation. Look at discounters in the consumer business. In these cases, the search for ways to differentiate from the competition through product improvements or supplemental service offers would definitely be fruitless.

The competitiveness of prices has the highest priority. Strong competitiveness in prices ensures the market position and, consequently, the margins. Profitability is best achieved through the lowest costs and an active steering of the market prices.

*Case 2: The Product as Value.* In this case, added value offers play a key role. A competitive differentiation results from improved products that do not sell by themselves, nor do they inevitably cause higher prices. It is crucial to determine to what extent these product benefits are also

reflected in the customer benefits. Even if a screw, for example, were coated in gold, it would still offer no



additional benefit to the customer. On the other hand, a colored label that eases and speeds up a customer's use of tools and screws is a real benefit. While pricing is based on product and customer benefits, it is also based on the solid argumentation of the economic impacts of using the product. Only then can the willingness to pay be exhausted and a price premium achieved.

*Case 3: The Solution as Value.* A solution is developed based on the business processes and competencies of the customers. The solution requires to be highly integrated into the customer processes. A good example of a solution can be found in the automotive industry, where entire coating lines are run completely by the coating manufacturers; or, in the construction industry, construction technology companies with more than 50,000 articles take over the entire c-parts management for their major customers. These examples point towards process optimization as solution content.

The solutions offer seems to remedy all problems in pricing simultaneously: direct price comparisons are apparently no longer possible due to the offer's high degree of customer individuality. Threats of bid invitations or auctions are supposedly banned. The customers seem to be loyal because of the high degree of process integration. A price premium should be achievable because of the added value of the solution that is reflected in higher revenues and earnings.

These seemingly plausible considerations juxtapose a substantial risk. Rudimentary added value from a simple product bundling does not fulfill the demand for a customer solution. In addition, it is not uncommon for customers to try to reduce the complexity and the lack of

**”Solution offers seem to be a universal remedy against the main pricing challenges, however, such an approach is highly sensible and applicable only in selected cases.”**

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transparency of prices through a one-dimensional cost per unit concept which allows for a direct price comparison. With pricing solutions, it is a case by case decision making process on a customer-specific level. Such an approach is highly sensible and can be executed only with a very limited selection of key customers.

An analysis of the value driver of the business indicates which case best applies: price, product or solution as value. A simultaneous application of all three cases is either impossible or nearly impossible in one organization. A random change of the cases is utterly impossible.

## Level Two: Price Differentiation

Prices can be differentiated depending on products and customers. The price differentiation accommodates situations in which various customers have a different willingness to pay for a service according to their region, time of purchase and the product value.

In the first case, *the price as value*, the price differentiation is based on customer characteristics. The product is homogenous and exchangeable, the customer is usually not. Industry customers, for example, differentiate in their size, potential, market importance and location. A differentiation of these customers in price is therefore a given. Some instruments of a customer-specific price differentiation are graduated prices, volume discounts and bonuses. Price discounts need to be closely related to customer performance (e.g. consumption, volume, loyalty, purchase of product bundles/systems or a purchased sum). Only in exchange for performance discounts are granted. When strong price competitiveness prevails, only very small price differentiation is possible.

In the second case, *the product as value*, both dimensions of price differentiation – the product and the customer – come into play. A product-oriented differentiation, influenced by varying product importance for the customer, allows for price flexibility. The price is the focal point with core products. The customers are normally precisely aware of the core product prices. In contrast, they are quite disinterested in side and complementary

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products, revealing potentials for price increases. Therefore, when pricing core products, the competitive price must be kept in view. Price advantages for these products are practically impossible to achieve on the long-term.

The third case, *the solution as value*, which is oriented towards price individualization, enables the greatest possible price differentiation based on the attributes of the solution and the customer.

In comparison to a unit price strategy, a differentiation strategy can help a company to significantly increase profits. While there are definite advantages of a price differentiation, there are also risks. The high complexity, cannibalization effects and irritations in buying behavior in cases of inconsistent and wide spread prices must be evaluated for their effects on profits and costs. When designing a price differentiation strategy, it is imperative that the markets and the customers, which are differentiated, are partitioned from one another and that the complexity of the price diversity stays under control. Otherwise, the price implementation is put at risk.

## Level Three: Price Implementation

Price positioning, differentiation and its implementation are only seldom handled by the same person or function in a company. More often there is a clear distribution of competencies in marketing and sales and, where applicable, in division management. The responsibility for price positioning and differentiation usually lies in marketing. A strong familiarity with customers and a solid knowledge of the competitive environment are required of sales. Division managers are usually responsible for the selling of solutions, because solutions are generally of a strategic significance to the business and are placed at the top decision making level on the customer side too.

In case one, *the price as value*, it is necessary in price implementation that sales concentrates on the core of every economic transaction and keeps the price benefits of the business in mind. Defined minimum prices must be strictly adhered to.

In the second case, *the product as value*, the price implementation is conducted according to two rules. These rules determine the range of the target prices as well as the conditions for providing discounts. Sales has the task of implementing prices within this specified range in customer negotiations. Incentive and price defense systems should reward the best price performers.

## Five Steps towards Professional Pricing

Pricing professionals abide by five rules.

1. Pricing professionals pay great attention to price positioning and the crystal clear definition of the game (the price as value, the product as value or the solution as value).
2. They determine the price parameters in the context of the defined playing field (parameters of price differentiation).
3. They establish the degree of price differentiation.
4. The price implementation must have a process and guidelines for calculation and completion.
5. Effective pricing is only possible through a strict control and monitoring over actions and their consequences.

Particularly in the third case, *the solution as value*, the price implementation is not for the faint-hearted. The success of the price implementation is determined by power and behavior factors: the customer benefit, the uniqueness (the USP) and the flexibility of resources strengthen the negotiating position of the supplier. As a next move in the power play, the customer challenges these factors with the size of his purchasing volume and price transparency. Experience, skill and consistency play a key role in the supplier's behavior. Effective price implementation is achieved by going for a win-win situation for both customer and supplier.

Before resorting once again to short-winded tactics in the battle against pricing problems, the real problems and their causes should first be revealed. This is the basis for professional pricing.

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