



# A Practical Guide to Pricing

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## Introduction

# The Importance of Pricing

Intelligently managing price structures and levels is the most important topic to secure business success. Get it right and you will thrive. Get it wrong and risk permanent damage to your business. Excellence in pricing goes far beyond the price of an individual product. It involves strategy, goals, positioning, but also governance, tools and finally all of a company's processes and culture that ultimately result in the price tag. In this guide, we discuss the many reasons why pricing is important, and share expert insights and tips for overcoming the top pricing challenges.

Pricing is a game of intelligence. Are you ready to start playing it?

### **Pricing for profit: A simple formula**

Optimal pricing plays a pivotal role in achieving profitable growth. It requires experts with an in-depth understanding of customer segments, the products' value-to-customer, and experience in handling the relevant business data to come to the right conclusions.

A 5% improvement in pricing without volume loss and average margins can boost profits easily by 30% to 50%. You may already have a cost-cutting strategy in place to boost profits. But no matter how heavily you invest in increasing volumes and cutting costs, this can only take you so far, and intensive efforts have often already exhausted all potential. So where should you go next? Let's start by breaking down profit into a simple formula with three drivers:

$$\text{Profit} = \text{Price} \times \text{Volume} - \text{Costs}$$

Even though price is a multiplicative factor in this formula, our experience is that it often receives the least attention. However, pricing is often the only untapped lever left to achieve higher profits. How can you shift from a predominantly internal and cost-cutting focus to an outside-in focus? There is always a profit-optimal price point and the way to find it is through a systematic and quantified approach. It's all about closing the gap between what a customer is willing to pay and what you actually get.

### **Know your value**

Rather than factoring in value-to-customer, unsuccessful companies often follow a historically grown or cost-plus pricing model, communicating and selling too heavily on price. Unaware of the premium they deserve for their products and services, these companies leave substantial amounts of money on the table. The solution? Follow a value pricing approach! Understand and quantify the value you deliver, and whenever possible charge for the "extras" you provide or unbundle them from the product.

### **Differentiate your prices and offering**

One-size-fits-all pricing is another major pitfall. Offering one product at one price does not tap into willingness to pay and leaves many customers out of reach. Instead, companies should segment customers based on their behavior and needs and then provide a differentiated offering and prices. Which customer should pay which price? Who should pay more? For what? And why? Clean out unimportant elements to create a lean-price product, and then enrich it with valuable elements for demanding customers. Use psychological aspects of pricing to design your well differentiated offering and set the right price levels in your offered product portfolio.

### **Avoid and diffuse price wars**

Increasing price transparency is making the market more attractive for price-aggressive sellers, and everyone blames the "others" for attacking them and starting a price war. Often what's actually needed is a more peaceful approach toward your competitors

“Pricing is a leadership task”

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and a harder approach toward your customers! Get control over your rebates and discounts out there in the market. Guide your sales team towards healthy price levels rather than making the deal at any cost.



### Check your digital readiness

Your digital transformation programs should ultimately lead to higher revenues and profits for your company. Here it is key to check the digital readiness of your service offering and pricing. In most industries you will face radical disruptions: Offerings with lower development times, lower marginal costs, more segment/customer-specific solutions, and higher economies of scale. On the pricing side you will be confronted with higher transparency, dynamic pricing, low price competition, totally new pricing metrics etc. Check if and how your digital transformation efforts lead to better offering or pricing and don't make it an infrastructure or IT exercise. Be ready to monetize your digital solutions differently than you have done in the analog world!

### Make pricing a leadership task!

Pricing is a continuous process, and not a one-time project. It starts with determining the right pricing strategy, then setting the right price and, finally, im-

plementing it. But even the best pricing strategies will fail without strong leadership and enforcement: Make pricing a regular boardroom topic! Yes, you can identify your product's value, but even harder is ensuring your sales people defend that value, especially if for decades they have always set prices based on gut-feeling. Internal incentives need to be adapted, target achievement monitored and controlled, roles and responsibilities redefined. Pricing can become a very emotive topic, and it requires clear initiation and communication from the top.

### Why is pricing important?

In markets with increasing volume and price pressure, the right pricing approach is essential to remain competitive. It brings you the value you deserve for your products and services offered and secures the profits you need to invest in change and growth. Let's be clear, it is still important to run cost-cutting initiatives on a regular basis and to increase the efficiency of your sales organization. But be consistent and honest with yourself: Invest at least the same amount of energy, time, and money in improving the biggest profit driver "PRICE".

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## Pricing Power, and How You Can Profit From It

In an ideal world, your company sells a unique or patent protected product, and there are few or no other players in the market. Then your pricing power is likely to be substantial. You can increase your prices without major risk of losing business to a competitor. However, for most companies, this is not the case, and pricing power is much more difficult to achieve.

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## Price needs a consistent storyline

Pricing power is a company's ability to get the price it deserves for the value it delivers. It is often the difference between a company that succeeds and one that fails. Pricing power is not down to chance, it depends on the right measures and focus.

### Pricing power is especially important when:

- You are not earning your cost of capital: Your products are chronically underpriced and you need to move up margins substantially.
- Industry pricing practices work against you: You have to cope with market disruptions and need to change industry practices in pricing.
- A price war is on the horizon: You have to cope with short-term opportunistic behavior in the market to avoid a price war.

Striving for pricing power requires your entire company to embark on a challenging transformation journey. Draw up a price roadmap to ensure a clear and common internal understanding of where prices should be, outline target prices, and align your pricing strategy and tactics. A price roadmap is typically driven by profitability requirements,

differentiated by products, segments or markets, and capped by import parities or substitution risk. It is also a useful tool for monitoring and controlling your actions to ensure your pricing strategy is enforced accordingly.

Pricing power requires your company to speak with one voice. You need to ensure there are clear principles, standards, and tools within an overarching pricing framework. Clearly communicate and share pricing principles with everyone in your company, review and clarify your existing pricing principles internally, and establish completely new ones if they no longer reflect the market requirements or strategy. By reinforcing the reasons for your price strategy, customers can plan ahead for price changes. Price needs a consistent storyline.

How do you get pricing power? You strive for it with your head, heart, and guts. Head means strong leadership of a skilled team that creates and delivers your roadmap to success. Heart is the belief that you deserve to make a return on your investment, and that a price increase is what needs to happen for you to win. Finally, your sales team needs the guts, will, skills, materials, and confidence to embark on your pricing power journey, execute your strategy, and ultimately reach your goals.

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# 3

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## Why Prices End in 99... and Other Psychological Pricing Tactics

Ever wondered why prices end in 90 or 99? You can find “99” price tags everywhere, from your bar of chocolate at the supermarket to your monthly gym subscription. Due to what is known as the left-digit effect, customers tend to round to the next lowest monetary unit. A lower number at the start of a price has a huge impact, even though the price is more or less the same. Customers are not always rational when thinking about price, and this is where psychological pricing comes into play.

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The left-digit effect is one of the oldest and simplest examples to explain customer behavior. However, the potential of psychological pricing extends much further beyond price tags set at 99. Companies can use many advantages of psychological pricing to make prices more attractive to customers – which mechanisms to use often depend on your product and business. Here are some more examples:

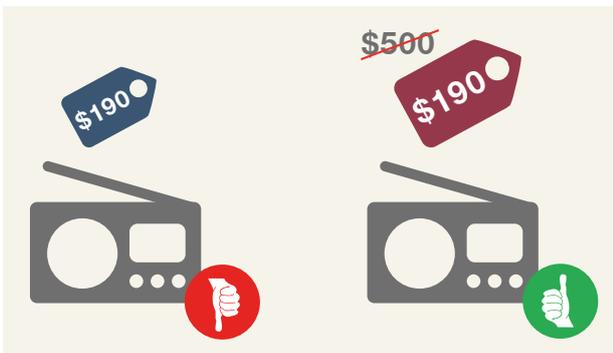
### 1. Compromise effect

You can't go wrong with the middle option, right? An adequate number of available options can nudge the customer to a more valuable product choice, and by that we mean also valuable for you, the seller.



### 2. Transaction utility effect

Two groups are offered the same radio for the same price, but those offered the discount are much more willing to buy the product. The price itself is what signals and generates value in the eyes of the customer.



### 3. Endowment effect

Possessing something, even figuratively, triggers emotional responses. Mechanisms like trial periods and free samples create ownership of the product before buying. When customers do make a purchase, they try to avoid loss, which increases their willingness to pay.

### 4. The decoy effect

It can even make sense to offer a product you don't want to sell, and nobody wants to buy. It's easier to make a decision with an existing reference point. Inferior dummy options within your offering nudge customers to the more valuable product or package, and are especially effective for upselling bundles.

### 5. The value effect

You would probably be willing to pay more for drinks from a fancy hotel than a run-down store, right? Making your product the hotel is an important value creation task. Explicit recallers such as specifying uses and risks, or pictures and other cognitive support, help customers understand a product's value.

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## Value Pricing Changes the Rules of the Game

Value pricing is recognized as the superior pricing strategy for both new and existing offers. Companies understand the importance of moving away from the cost-plus pricing approach and aim to set prices that customers are willing to pay based on how they perceive value. However, many struggle to overcome the obstacles that developing and implementing a value-based strategy entails.

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Get it right, and a value-based pricing approach can lead to maximized and sustainable profitability. It not only ensures that your customers accept paying for the value they receive, it also creates new norms and practices associated with your offer. It creates a situation where everyone can win – your company and your customer. Value-based pricing can completely transform your company, and even change the rules of the game for your entire business.

### 1. Map the key value drivers

Are there direct competitors, or alternative solutions? Are you faster, more efficient, reliable? Start by asking your customers. Rather than just a quick phone call, really dig deep and conduct extensive customer interviews to understand their business. In a complex value chain, you might even create value for your customers' customers.

### 2. Calculate the monetary benefits

Now you know the perceived value, the next question is what the customer is willing to “sacrifice” in exchange. Instead of focusing on costs, ask what savings and benefits the customer gains. What costs would be generated on the customer side if particular services did not exist? This is the starting point of value you can monetize.

### 3. Adapt revenue models

It's tempting to profit entirely from created value, but products still need to be appealing. Challenge existing revenue models, cut out undervalued features, rebuild service packages, and create new value-based offers to accommodate customer needs. Successful value pricing creates a win-win situation for both company and customer.

### 4. Train your team to sell the value, not the price!

Value selling and value communication are just as important as value delivery – if the customer doesn't understand or perceive the value, you can't capture it. But it isn't always the customer who is hardest to convince. Bring your salesforce up to speed on the value of your offers and then prepare them to properly sell and defend that value!

Ask each of your departments individually and they will probably tell you they are focused on value. R&D strive to create a valuable product

and aim at reaching the most advanced performance levels, Quality Assurance maintain the value, Marketing think about how to package it, etc. But do each of these departments know what the customer truly values? And where are the efforts to monetize the added value that the product, service, or solution provides? True value pricing needs to be the golden thread within your company that unites every department and function. All efforts need to be aligned to focus on how to identify, create, and monetize value – this often involves a drastic mindset change that extends far beyond price alone.

“  
Instead of focusing on costs,  
ask what savings and benefits  
the customer gains

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## Digital Transformation – A New Way of Working

Digital transformation requires a new way of working: From selling products to developing customer relationships. Moving to this customer-centric approach might mean overhauling your entire organization. Are you using new technologies to develop persistent, one-on-one relationships with your customers, to understand their evolving needs, and to deliver and monetize the highest value products and services in a customized way? How you price your products in the future will depend on the transformation strategy you put in place today.

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Digitalization can destroy, preserve, or enhance revenues. It can mean you win or lose customers. To remain competitive, you need to keep up with the accelerating pace at which technologies are changing society. Transform or face extinction? Easier said than done. What's required is an all-encompassing transformation strategy that fully taps into the opportunities that digitalization has to offer.

### Impact of innovations

Artificial intelligence and the Internet of Things display major transformation potential. Physical products are turning digital. In today's world, customers can own their music and films without ever holding a physical copy in their hands. Other physical products are being digitally enhanced, such as smart appliances and wearables. From online banking to app-placed orders in restaurants, even services are receiving a digital layer!

### New technologies, new needs

The modern customer has greater expectations of products and services – simple, convenient, easy to use, personalized. Everywhere and at the touch of a button. All of this radically changes how companies deliver value to customers and requires a customer-centric view like never before. That's why enhancing customer experience and value pricing are top goals of many digital transformation strategies.

### New channels and revenue models

Online agents and brokers are entering the scene, and webstores that sell directly to the customer are pushing out the middlemen. Producers of daily goods are starting to use Amazon to sell their goods, many in subscription models. Also in the

B2B context, many existing players are in pursuit of new business models, tapping into new revenue sources or even abandoning their original core business completely.

### Modern ecosystems

Alongside modern technology, the modern channel, and the modern customer, there is another important strand in the maze: modern ecosystems. To best serve demanding customers via multiple channels and with state-of-the-art technologies, companies with diverse backgrounds are joining forces, moving away from outdated processes, and revolutionizing their business models as they try to keep up with this rapid pace of digital change.

### Information becomes the product

Modern technologies also enable more efficient and effective processes within the business itself, from recruitment and administration to marketing and customer service. Most transformation activities involve the innovative use of data, such as analytics and machine learning. Plus, "reading" the data and drawing the right conclusions leads to new business assets: it's becoming increasingly possible to profit from the "intangible".

“Enhancing customer experience and value pricing are top goals of many digital transformation strategies.”

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# 6



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## Price Increase? No Problem. Preparation Beats Price Pressure!

Price hikes. A delicate topic that companies prefer to avoid. You don't get anything if you don't ask for it, and thanks to the healthy economy in recent years, nobody had to ask. However, higher prices for raw materials, inflation, and new environmental regulations are reversing the trend. Cost increases will make their way to customers' wallets, one way or another. Increasing prices for a product or service can be uncomfortable. But with the right preparation, it is definitely possible!

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Unable to increase your prices? It is easy to blame price pressure. Take a closer look and you might find you are standing in your own way. Don't let poor preparation and compromises in negotiations derail your efforts. Our checklist makes sure you are ready to implement a price increase:



### Know your power

Have price increases been successfully executed in the past? What were the typical challenges and what can you learn from them? Your current relationship with the customer will play a role in the success of the planned price increase. Consider when your contract allows for a price increase and keep an eye on T&Cs! Your conditions system may need adjusting to prevent high discounts from canceling out the effect of your price increases. Increasing price could even open up an opportunity to save on discounts.



### Know your story

Don't leave success to chance. One of the biggest increase fails is that no specific reasons are given to the customer. That might fly with a 2% increase, but higher increases definitely need justification. Understand your customer's supply chain to create a powerful story around price increases. Start with the main benefits you deliver and focus on value, not cost. Refer to factors surrounding the upcoming increases in all calls, letters, and customer visits. Be concise, customer-specific, and consistent!



### Know the impact

Conduct an impact analysis to understand where customers accept increases, and where they are price-sensitive. Differentiating on a brand, category, or product level can make increases appear more acceptable. Prices for services and surcharges often fall below the radar and are typically accepted without discussion.



### Know your strategy

Sales should not be scared to lose customers or business through price increases. Communication from the top is essential to avoid conflict between price and volume targets. Modify the compensation model to reward price increases, and hold reps accountable for deviations. It's about switching the mindset from volume to value.



### Know your negotiation range

Where do you have room to maneuver? When should you stop or escalate? Clearly define your entry and walk-away price points. Prepare a set of bargaining chips, including non-price concessions prioritized by value. Who is involved in the negotiation? Map out a decision tree that quickly identifies techniques for different seniority levels and roles.

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## Stay Strong – How to Fight a Price War

More than half of all companies worldwide believe they're involved in a price war. What do they have in common? Most think it's not their fault and blame their competitors. This can't be true for everyone. Let's look at why price wars flare up so quickly and what companies can do to escape them.

Read the **whole article** ►

Price wars sound dangerous, and they are – for everyone involved. So why do companies find themselves participating in price wars time and time again? “It’s always the other companies that initiate the combative behavior. They are price aggressive. We are just reacting rationally to their competitors’ actions”. The problem? Your competitors have the exact same mindset.

A price war is particularly likely to occur when consumers’ price awareness is high and switching costs are low, or when product differentiation is minimal causing consumers to consider price a key decision criterion.

#### Companies vulnerable to price wars:

- Offer commodity products
- Experience excess capacity
- Face new market entrants following penetration pricing strategies
- Need to keep sales volumes high to reduce average fixed costs per unit

Companies that believe the following common myths about price wars can end up in a disastrous situation:

**“A price war can be won”:** Price wars are highly effective profit killers, where nobody ever truly wins. All they do is destroy huge amounts of profits in the process.

**“Significant market shares can be won”:** If all market players are trying to steal customers by constantly undercutting each other, there will be no significant shift of market share. The battle for customers simply continues.

**“Market price level will recover”:** Recovery only happens in rare cases and involves significant effort. In reality, prices hardly ever return to their pre-war levels.

Okay, so you’ve gotten yourself in trouble and are stuck in a price war. What now? These steps will enable you to make it out of the danger zone in one piece:

### 1 Change your mindset

Always be on the lookout for competitors trying to halt the price war and respond accordingly. The most beneficial outcome for everyone is to end the price war.

### 2 Develop a backup plan

Determine what your fair share is and decide which concessions on market share you’re willing to make. Then prepare a detailed roadmap for communication and product launches.

### 3 End price aggression

You have to stop retaliating and start communicating a clear and consistent value story to the market. Focus on value, not price when launching new products.

Following these guidelines will lead you back to healthy market development and competition. A much better and easier option is, of course, to never get into a price war in the first place. Just don’t do it.

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**Jan Haemer**

## Skimming or Penetration Pricing?

All new hit innovations need a winning price. But having never priced the product before, how do companies know what to put on the price tag? Many companies fall into the trap of leaving the price decision to last minute, with almost no time for analysis or research. Defining the pricing strategy essentially determines the economics of the product's entire lifecycle. It boils down to a choice between two strategies: skimming or penetration pricing.

Read the **whole article** ►



Many companies fail with a penetration pricing strategy. It is risky from a profit standpoint. You need to be able to follow through on future price increases. Often, too little attention is paid to mid-term monetization routes, or how companies will ultimately make money.

Here are five points for an informed decision:

### 1. Type of innovation: Breakthrough or just me-too?

With a unique, proprietary solution there is neither a reference price nor direct competition. Your goal is to create a market and penetrate it. Whereas undifferentiated “me-too” products face many competitors. Only if your offering delivers superior value do you have the foundation for a skimming strategy.

### 2. Goals: Margin or share?

Trade-offs have to be made. You can't pursue all goals at once. Some companies have production capacity constraints during the launch phase. Others with high CAPEX requirements need to meet cash flow targets, follow a penetration strategy as a “safe bet” and forego skimming options.

### 3. Price sensitivity: High or low?

If a low price translates into significantly higher volume or more customers, penetration pricing can work. The market must be sensitive enough to compensate for the lower margin. Skimming makes

sense if demand shows low price elasticity. Prepare for low volume and ensure profits through a high price until your product secures a market position.

### 4. Customer segments: Just one or many?

Some customers do not want to wait for a new product to become mainstream. They want to show off their newest tech gadgets to their peers. Likewise, B2B companies want to use state-of-the-art technology to gain a competitive advantage. In both cases, early adopters might be willing to pay more than late followers. The more the willingness to pay differs between segments, the more appropriate a skimming strategy becomes.

### 5. Product portfolio: Isolated or dependent?

Sometimes products cannot be launched in isolation from the rest of your portfolio. Consider portfolio and cannibalization effects. The order in which you launch products also plays an important role. For example, with Porsche's Panamera, the high-end eight-cylinder model first skimmed the market, then the six-cylinder model was released a year later at a lower price.

Whether you choose a penetration or skimming pricing strategy determines the economics of your product's entire lifecycle. It is a decision that decides the success or failure of a new product. You have one shot. Make sure you get it right.

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## Why Is Pricing Important?

Price can be the biggest profit lever, but also the most dangerous profit destroyer.

It's tempting to compete on price when increasing transparency is making the market more attractive for aggressive sellers. But remember: every market has a top end and a bottom end, and there will always be someone who does it cheaper. How low are you willing to go?

Real pricing pioneers are true to their topline. They avoid price wars and one-size-fits-all pricing. Instead, they pick a winning strategy from the beginning, focus on tapping into the new opportunities brought about by digitalization, and use psychological aspects of pricing to design a well differentiated offering.

Gaining an in-depth understanding of the importance of pricing is what makes you best equipped to guide your sales teams toward healthy price levels, prepare thoroughly for price increases, and ultimately lead your company to higher revenues and profits. It's about building a consistent storyline around price, the value you deliver, and the premium you deserve for your products and services. Think of an investment in pricing as an investment in the future.

## Simon-Kucher & Partners, Strategy & Marketing Consultants

Simon-Kucher & Partners is a global consulting firm with more than 1,400 professionals in 39 offices worldwide focusing on TopLine Power®. Founded in 1985, the company has 35 years of experience providing strategy, marketing, and sales consulting and is regarded as the world's leading pricing advisor.



**Global locations**

39 offices in 25 countries



Average annual **growth rate** since 1990

+18%



**Revenue** in 2019

€358m



Clients' average **increased return on sales** thanks to our projects

+2 to 4% points ROS



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*Capital*, survey of the best consultancies in France, 2016, 2018  
(conducted every two years)

Forbes



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*Forbes*, survey of the best management consulting firms in the US, October 2016, 2018  
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*Bilanz Magazine* ranking, survey of the best consulting firms in Switzerland, 2019

## What others say about us

Simon-Kucher & Partners was a great partner during our research phase. We appreciated their support, expertise, and partnership throughout the process of developing Uber Rewards

*Barney Harford, former COO, Uber*

Simon-Kucher & Partners did some excellent work to help us break one of the great myths in our organization. They radically changed how we understood our core audience

*Chris Stibbs, CEO, The Economist Group*

World leader in giving advice to companies on how to price their products

*BusinessWeek*

Pricing strategy specialists

*The Wall Street Journal*

In pricing, you offer something nobody else does

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No one knows more about pricing than Simon-Kucher

*Philip Kotler, marketing guru*

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