INTRODUCTION TO THE PRICING STRATEGY AND PRACTICE

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Servitization: Creating the market by understanding price, cost, contracts and financing
What is the issue?

Why is it important?

What can be done?
What is the issue?

Why is it important?

What can be done?
Pricing your product

PRICE TOO HIGH

- Drive customer away

PRICE TOO LOW

- Limited profit margin
- Negative effect on how customer perceives the product quality
Pricing your service

CHARACTERISTICS

- Intangibility
- Inseparability
- Variability
- Perishability

CHALLENGES

- Underpriced
- Promised at performance levels that cannot be delivered profitably
- Insufficient estimation of costs related to risks

Source: Avlonitis and Indounas, 2005
Pricing as a challenge

Price is undermanaged

RETHINK the pricing strategy

SETTING the profitable price

PARADOX

Struggle for profit

Substantial costs

Substantial investment

Increased product-service offerings

Source: Gebauer, Fleisch and Friedli, 2005
What is the issue?

Why is it important?

What can be done?
Pricing is a key aspect of your business

Everything in your business works to justify your value for a price
The power of pricing

- Pricing has the highest impact on increasing profit

<table>
<thead>
<tr>
<th>Price increase of 1%</th>
<th>Profit increase of 8%</th>
</tr>
</thead>
<tbody>
<tr>
<td>101</td>
<td>13.5</td>
</tr>
<tr>
<td>No change</td>
<td>No change</td>
</tr>
<tr>
<td>No change</td>
<td>12.5</td>
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</tbody>
</table>

Price/Revenue: 100
Fixed costs: 19.2
Variable costs: 68.3
Operating profit: 12.5

Source: Compustat; McKinsey analysis, 2003
Pricing has the highest impact on increasing profit.

A 1% rise/decrease in price increases company profits by 8%.

- In variable costs: 4%
- In sales volume: 4%
- In fixed costs: 3%

Source: Rüdiger, Ellige and Weigell, 2007
What is the issue?

Why is it important?

What can be done?
Pricing Strategies

3 major pricing strategy

- Cost-based pricing
- Customer value-based pricing
- Competition-based pricing

Source: Nagle, Hogan and Zale, 2005
Price range

Customer’s perception of value

Profit margin

Competitor’s price

Total costs per unit

Product/service costs

No demand

Price ceiling

Price floor

No profits

No profits
Cost-based pricing

- Setting prices based on costs and desired profit margin
- Focus on seller’s cost (price floor)

- The most common and simplest method of setting prices
- Data readily available

- Don’t take demand (willingness to pay) and competition into account
- Produce sub-standard profitability

Source: Hinterhuber, 2008; Myers et al., 2002; Simon et al., 2003
Cost-based pricing

Assumption: One can first determine sales levels, then calculate unit cost and profit objectives, and then set a price.
Customer value-based pricing

Benefit → Price

Set the price accordingly

Set the price to as a function of value

Derive target costs

Design product/service to deliver desired value at target price

How much value customers place on benefits

Understanding sources of value for customer and value perceptions

Source: https://marketing-insider.eu/
Customer value-based pricing

Setting prices based on customer’s perception of value (price ceiling)

Take customer perspective into account

Data are difficult to obtain and interpret

Customer value is not a given

Apple
Lufthansa
BMW

Source: Hinterhuber, 2008
Competition-based pricing

- Setting prices based on anticipated or observed price levels of competitors (price reference)
- Data readily available
- Low risk
- Don’t take customer into account
- Lead to missed opportunity

Gasoline industry

Source: Hinterhuber, 2008
‘Our ValueScan survey, covering more than 200 companies in both consumer and business markets, found that firms developing and effectively executing value-based pricing strategies earn 31 percent higher operating income than competitors whose pricing is driven by market share goals or target margins’ (Zale, 2014).

Cost-based pricing

Customer value-based pricing
The popularity

Adoption of alternative pricing strategies in practice

Summary of all published research (1983-2006) on the diffusion of alternative pricing approaches in practice

- **Competition oriented approaches**: 44%
- **Cost-based approaches**: 37%
- **Customer value oriented approaches**: 17%
- **Other approaches**: 3%

More market share  VS  Greater profit

PROFITABILITY  => Pricing for profit

Making informed trade-offs between price and volume in order to maximize profits.
Thank you

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Discussion 1

- Customer value-based pricing strategy: is it your choice? If not, why companies resist?

- Suppliers - Which pricing strategy is right for your business and why? Would it be possible to have mixed pricing strategies?

- Customers - Which factors bring you the customer benefits (eg. price, quality, performance, finance, low risk)?
Customer value-based pricing strategy: WHY companies resist?

Obstacles to the implementation of value-based pricing strategies

- Value assessment: 79%
- Value communication: 65%
- Market segmentation: 60%
- Sales force management: 58%
- Top management support: 50%
- Other factors: 65%

**Value assessment**

Value to customer = reference value (the price of customer’s best alternative) + differentiation value (the value of whatever differentiates offering from the alternative)

**Value communication**

- Product / service features
- Customer benefits
- Customer benefits in accordance with customer needs

**Market segmentation**

**Sales force management**

**Top management support**

**Other factors**

Customer value-based pricing strategy: is it your choice? If not, why companies resist?

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Next steps

- Pricing seminar report
- Price modeling
- Bilateral industry dialogues and case studies

7 thematic seminars

1) Target costing as a strategic tool to commercialize the product and service innovation (3 Oct, 2017)

2) Pricing management and strategy for the maritime equipment manufacturers and service providers (14 December, 2017)

3) Optimization and handling of risks and cost within the service contracts (1 March, 2017)

4) The strategic decision making of ship owners in investing in maritime equipment manufacturers and service providers (7 June 2017)

5) Financing of new business models that can promote business and sales within the maritime industry – general (20 Sep 2017)

6) Financing of new business models that can promote business and sales within the maritime industry – cases (6 Dec 2017)

7) Negotiation and collaboration through international contracts (22 March 2018)