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PRICING ADVISOR

JUNE 2023

Balancing Pricing With the Effects of Deflation

by: Justin Konopaske, Sean Geraghty, Ph.D., Kimberly Long



Given the past few years of record inflation, the hope of central banks is that, through the implementation of anti-inflation tools such as quantitative tightening and changes in interest rates, inflation will soon begin to come down without causing a recession. The process of inflation being reduced is known as deflation and has completely different implications for how organizations will approach running their business. In this article, the authors examine some of the challenges and opportunities that take place during periods of deflation. Justin Konopaske (justin.konopaske@syncron.com) is the Director of Industry Solutions, Sean Geraghty, Ph.D. (sean.geraghty@syncron.com), is the Director of Global Value Engineering, and Kimberly Long (kimberly.long@syncron.com) is the Director of Global Value Engineering at Syncron.

What is inflation?

This word has consumed headline news for over a year now across the globe. While it's easy to associate inflation with price increases for items such as eggs or the price for an evening stay at a hotel, the underlying drivers can be a bit more complicated. Inflation, or the rate at which prices for goods and services increase, can be attributed to three primary drivers:

1. **Demand-pull:** Increase in money supply (M2) and credit which stimulates the overall demand for goods and services. The demand increases more rapidly than the economy's production capacity. This is basic supply and demand economics.
2. **Cost-push**: This often kicks in when demand-pull inflation is going strong. Costs for raw materials increase and the business must in turn raise their prices regardless of demand. Think of this as a restaurant charging you more for your favorite dish due to the increased price of poultry – the costs are pushed downstream when margins cannot be maintained.
3. **Built-in:** When demand-pull and cost-push inflation occurs the expectation amongst employees is a salary or pay raise. To keep margins elevated, businesses then raise prices to accommodate higher wages for their workforce. This is realized annually whether you're a corporate employee at a multi-billion-dollar company or an hourly employee at the local coffee shop.

Getting paid more due to built-in inflation sounds great, right?! Only if the cost of living around you is less relative to your wage increase; otherwise, you may still be losing money each year relatively speaking. Unfortunately, as shown in the data provided by Statistica, inflation has been beating wages for some time.

Pricing during inflation

Given that we experienced a period where trillions of dollars were funneled into the economy as stimulus during the COVID-19 pandemic, it's only fitting that a combination of the above inflation drivers kicked into overdrive. This presented both a risk and an opportunity for service

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organizations with respect to pricing strategies.

- **Risks:** If prices are left unchecked, increased costs in a cost-push inflationary environment could squeeze margins. Additionally, if prices are raised too high too fast consumers may push back and demand/customer loyalty could dissipate.
- **Opportunities:** Less profitable prices can be re-negotiated leading to increased profitability in the long run. Pricing strategies can evolve, such as incorporating customer-differentiated pricing models.

Regardless of the types and number of changes made during an inflationary period for parts pricing, agility and data are keys to success!

How is inflation reduced?

To quote Sir Isaac Newton, "For every action in nature there is an equal and opposite reaction." The reaction to inflation is identified by what is called quantitative tightening and the change in interest rates:

- **Quantitative tightening:** To supply the market with supportive monetary policies, the central banks increase their balance sheet via quantitative easing with treasuries, bonds, mortgage-backed securities, etc. Quantitative tightening is the inverse action by which the central banks decrease their balance sheets by selling the collateral (treasuries, bonds, etc.) or letting them mature and removing them from their cash balance. In other words, the bank account takes on deposits and has withdrawals just like yours and mine, just with a lot more money and transactions are forced by leaders.
- **Interest rates:** Central banks have the ability to increase or decrease interest rates, which results in restricting or loosening the ability for interbank lending. The easiest comparison to everyday life is when interest rates are cheap for mortgages, people tend to want to buy new homes or refinance their current mortgages. When interest rates rise, demand drops as an inverse correlation.

The tools above have been put into play during the course of 2022 and continue to be used in 2023. The hope of central banks is that, through these tools, inflation will come down but not at the expense of causing a recession. The process of inflation being reduced is known as deflation and has completely different implications for how service organizations will approach running their business.

REGARDLESS OF THE TYPES AND NUMBER OF CHANGES MADE DURING AN INFLATIONARY PERIOD FOR PARTS PRICING, AGILITY AND DATA ARE KEYS TO SUCCESS!

What are the challenges during deflation?

Deflation – or a decline in prices for goods and services – is typically associated with a contraction of the money supply and credit in the economy. Prices declining means everything is great, right? Not so fast. Let's take a look at some of the challenges and opportunities that take place during this period:

- Cost of capital increases due to quantitative tightening, which impacts both purchasing power and **inventory management**.
- Demand destruction may occur as a result of money and credit being removed from the economy.
- Business investment may stagnate over time as companies focus on the preservation of capital on balance sheets.
- Purchasing power rises over time, and even more so when currency exchange rates normalize on a global scale.

Excluding the resurgence of purchasing power within the currency, it's very apparent that the challenges above can create quite a headache for the service leader who owns the responsibility of the organization's P&L.

The Bullwhip effect

To make matters more challenging for manufacturing companies and supply chain leaders, the past several years have been a textbook example of what is known as the bullwhip effect for some manufacturers and service organizations. This is a scenario in which small changes in demand at the consumer end of the **supply chain** become amplified when moving up the supply chain from retail to the manufacturing end. Manufacturers are often left holding significant inventory (or the proverbial bag) at the end of this sequence, which may or may not coincide with slowing demand. Carrying excess inventory in any situation is not looked highly upon; however, in today's environment when the cost of capital is so high and the technology landscape is moving so quickly, the risks are amplified.

Companies often run campaigns or discount programs to move the excessive inventory but must

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balance this carefully to not destroy profitability. In a perfect world, lowering prices leads to a direct correlation with increasing demand and allows inventory to be reduced in line with company goals. This is also known as **Price Elasticity of Demand**. While some view this ratio as a means to increase total demand for a product, it's our view that demand doesn't actually increase or decrease, but rather is shifted forward and backward in time. Additionally, demand may be shifted from finished goods sales at the OEM to the aftermarket in the event discounts are appealing enough for consumers to continue the operation of existing assets. Using another physics example, our view on Price Elasticity of Demand is very similar to the **Law of Conservation of Energy** where energy can neither be created nor destroyed – only converted from one form of energy to another.

While not specific to aftermarket sales, a well-known example of this in recent months is Tesla. The car manufacturer **dropped prices** up to 20% for certain models to start 2023. The individuals who jumped on this deal and purchased vehicles were likely already interested in purchasing an Electric Vehicle. This move by Tesla shifted the timing of demand up in line with the discount offering window.

Pricing during deflation

While the challenges associated with deflation can often be ominous from a top-line growth perspective near term, they do present an opportunity to increase customer base and brand loyalty. During deflation, companies really have two options:

1. Reduce pricing and profitability in order to pass on savings to customers, by which the increase in customer base may offset the drop in top-line revenue.
2. Maintain or increase pricing to grow top-line revenue and margins, resulting in no savings for customers and risk of churn.

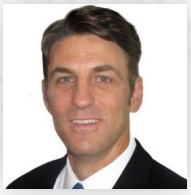
Assuming companies elect to go with option 1 (fingers crossed as a consumer), they can't just blindly reduce their prices in a race to $0. There are three questions that need to be addressed in order to develop a comprehensive strategy:

1. When do I need to start lowering prices?
2. How much do I need to lower prices?
3. For which customers and products do I need to lower prices?

With consumer expectations increasing at a significant rate, it's critical that data be available on a consistent basis to support these questions as part of an ongoing business review. As we all know from the past several years, market sentiment and economic conditions can pivot on a dime. The importance of data and technology cannot be overstated as a means to driving a successful pricing strategy in aftermarket parts organizations.

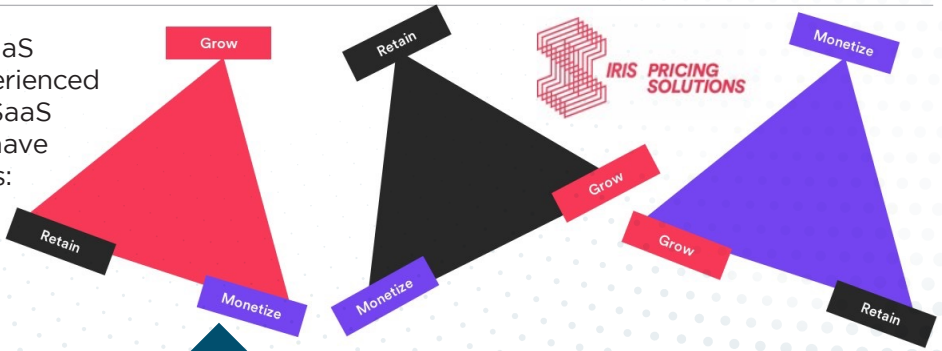
Refocusing Your SaaS Strategy

by: Kirk Jackisch



To achieve success, SaaS (Software-as-a-Service) companies have focused on managing three main levers: growth, retention, and monetization. Of these three, growth has been the main priority for SaaS organizations. However, as market and economic conditions change, SaaS companies are now shifting their attention to the other two levers. By focusing on these levers in tandem, SaaS companies can drive profitable growth while maintaining customer loyalty and satisfaction, as the author explains. Kirk Jackisch is the Global President of Iris Pricing Solutions. He can be reached at kjackisch@pricingsolutions.com.

Over the past decade, numerous SaaS companies have emerged and experienced success. To achieve this success, SaaS (Software-as-a- Service) companies have focused on managing three main levers: growth, retention, and monetization. Of these three, growth has been the main priority for SaaS organizations.



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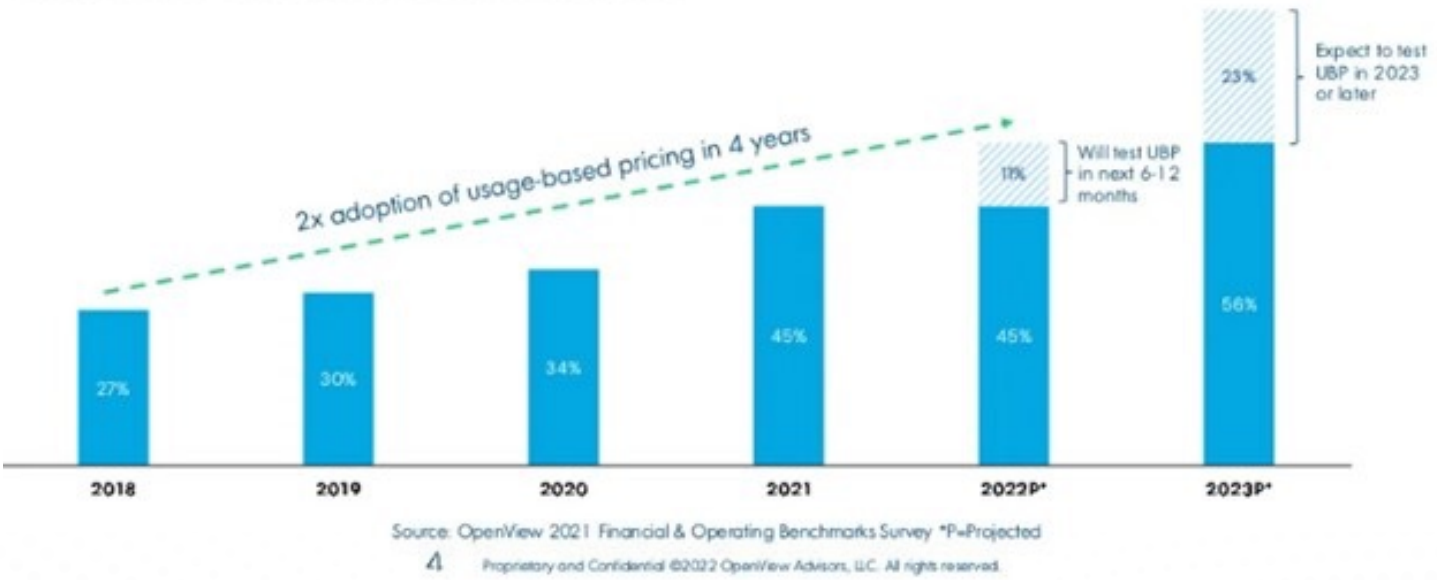
However, as market and economic conditions change, SaaS companies are now shifting their attention to the other two levers.

Retention:

SaaS companies that prioritize retention understand that it is more cost-effective and profitable to focus on existing customers to drive growth. Companies are now focusing on improving profitability to expand their share of wallet with the customers that fueled their growth. A retention mindset encourages companies to develop better customer experiences, drive usage, introduce valuable add-ons, and improve customer engagement. Successful SaaS companies have found highly effective ways to remove friction in the critical renewal process. For example, ProfitWell helps SaaS companies reduce customer churn by identifying and managing the process of credit card expirations. There is a whole science focused on account retention that continues to emerge as companies prioritize this critical part of their SaaS business.

USAGE-BASED PRICING ADOPTION OVER TIME



Source: OpenView 2021 Financial & Operating Benchmarks Survey *P=Projected

Monetization:

Another strategic pivot for many SaaS organizations is putting monetization at the top of the pyramid. Monetization focuses on **optimizing value capture** through the smart implementation of pricing metrics, price levels, and market segmentation strategies. Companies that prioritize monetization are constantly evaluating and experimenting with price metrics and levels that are better aligned with how customers benefit from the solution. They seek to tie price to value more effectively to optimize their value capture strategies. A recent study by OpenView Partners shows that companies are increasingly implementing a usage-driven price metric as a more effective way to both deliver and capture value. This highlights the importance of tweaking and testing new price metrics to achieve business objectives.

Additionally, a big part of a **monetization-led strategy** is developing robust processes for raising prices on existing offerings, especially as the value of those offerings increases over time. Raising prices for many organizations that lack confidence and a robust process is a very delicate and emotional subject, especially when the company has avoided those difficult price increase conversations with customers for years. To bring an objective view into the effectiveness of raising prices, it is important to assess the breakeven point between increasing revenue and margin through price increases and the potential loss in customer retention. Typically, what we see in SaaS is that a **10% price increase requires a customer retention rate of 89%**. In other words, if we can retain more than 89% of customers after executing a 10% price increase, then the business will see a boost in profitability.

Finally, a third component of effective monetization is the **execution of price discounts**. For many of our customers, discounts play a big role in driving sales. However, if discounts are not managed carefully, it may lead to the habitual use and even

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abuse of discounting and that could have a significant impact on profitability. It is important to have clear discounting guidelines that the organization can adhere to in order to prevent the potential abuse of this useful sales tool. Successfully managing value capture through pricing and monetization strategies requires planning, confidence in the value your solution delivers, and the ability to articulate your unique differentiation to customers. It is critical to equip sales teams with the tools they need to succeed, like developing **actionable playbooks** for handling **price objections** and boosting negotiating abilities aimed at improving outcomes. To drive confidence, companies must develop tools and models that equip their commercial teams with the ability to demonstrate value proactively at every stage of the customer journey.

As SaaS companies shift their focus towards retention and monetization, it's important to note that these levers aren't mutually exclusive. In fact, they are interdependent and should be managed in tandem. For instance, a company that has a strong retention strategy can more easily experiment with different monetization models. By maintaining a loyal customer base, SaaS companies can better understand their customers' needs and adjust their pricing strategies accordingly. Similarly, a company that has a strong monetization strategy can use pricing as a way to incentivize customer retention. For example, by offering discounts to customers who commit to longer contracts or higher usage levels, companies can drive customer loyalty while also increasing revenue.

In summary, while growth has been the main driver for SaaS companies in the past, a shift towards retention and monetization is becoming increasingly important. By focusing on these levers in tandem, SaaS companies can drive profitable growth while maintaining customer loyalty and satisfaction.

The 8 Dos and Don'ts of Dynamic Pricing

by: Dimitris Hiotis

Dynamic pricing is one of the most exciting topics in the pricing world right now. With digitalization providing many great business opportunities, companies are becoming more responsive with their pricing. But despite its technological underpinnings, dynamic pricing requires strong human oversight directed by a clear strategy, as the author explains. Dimitris Hiotis is a Partner in the London office of Simon-Kucher & Partners. He can be reached at Dimitris.Hiotis@simon-kucher.com.

Dynamic pricing is certainly not new. It was pioneered by airlines in the 70s and is now widely used by hotels, airlines, car rental companies, and tour operators. Today, there are more and more non-travel players moving toward dynamic pricing. For example, entertainment providers, online retailers, and businesses within the automotive industry are also implementing this model.

And it is not only being used in online environments. Traditional brick-and-mortar companies are also changing how they monetize, finding new ways to tap into customers' willingness to pay.

Dynamic pricing using digital and data

This shift has been largely enabled by digitalization; data is becoming more richly available. Processing power is increasing and new technologies like electronic price tags are emerging. That makes it much easier for companies to adjust prices quickly and effectively.

Dynamic pricing can be located within a broader move toward customization and personalization with the emergence of data. Companies now have the power to learn more about their customers and segment them by price sensitivity. We link this insight with key market variables, such as supply and demand, timing, and perishability.

The potential of dynamic pricing is huge. Companies have newfound ways to maximize monetization, reduce waste, and balance supply and demand. A dynamic price model allows businesses to respond more nimbly to market trends.

However, dynamic pricing is not embraced by all consumer groups, nor is it appropriate to every situation. Dynamic pricing, when

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used devoid of human oversight and a clear strategy, can at its worst destroy brand reputation and erode consumer trust. Others will only choose to accept it hesitantly. We've seen many cases where dynamic pricing has worked and also cases in which it's gone very wrong.

What are the dos and don'ts of dynamic pricing

1. Be dynamic when the inventory is perishable or there's a clear capacity constraint.

You should consider dynamic pricing when there's perishable fixed inventory or capacity constraint and a varied willingness to pay among your customers. Just think of the airline industry. There is a fixed capacity in terms of seats available on a flight as well as varying willingness to pay. Typically, early bookers are price sensitive, whereas late bookers are business customers with higher willingness to pay.

Consequently, airlines traditionally offer cheaper prices for earlier bookings that tend to increase as you book closer to departure. At the same time, given the capacity constraint for very popular flights and dates, the airline can monetize excess demand. They can increase prices, which is why peak travel dates tend to have higher prices than off-peak ones.

2. Be dynamic when you can use it to balance supply and demand.

Dynamic pricing can be used effectively to balance supply and demand in two-sided marketplaces. The classic example is Uber's dynamic pricing model. It encourages supply in supply-scarce situations through higher prices. At the same time, it reduces demand to maintain acceptable waiting times for the customers willing to pay a premium.

THE POTENTIAL OF DYNAMIC PRICING IS HUGE. COMPANIES HAVE NEWFOUND WAYS TO MAXIMIZE MONETIZATION, REDUCE WASTE, AND BALANCE SUPPLY AND DEMAND. A DYNAMIC PRICE MODEL ALLOWS BUSINESSES TO RESPOND MORE NIMBLY TO MARKET TRENDS.

Through dynamic pricing, the marketplace can balance supply and demand and avoid long wait times. As a result, the customers are happy with faster service and drivers are happy as they get paid more per trip. Uber is happy as it generates more revenue.

3. Be dynamic when your price is fluid, you're elastic and it's cost-efficient.

Who would have thought 10 years ago that supermarkets would move to dynamic pricing? Now it is possible with the use of digital price tags. And it works because so many of their products have an expiry date. They also have perishable inventory and thus a supply constraint.

In other words, while increased sales increase revenue, there is also a cost benefit because supermarkets can now reduce waste. Firms can affect 90,000 price changes a day. Using dynamic pricing, German supermarkets have achieved a 2.5% revenue increase and 30% drop in waste.

4. Use dynamic pricing when there's seasonal demand.

In these cases, it's not about a supply constraint, a perishable element, or a need to match supply and demand. But customers still need the product urgently. Online retail giant Amazon implemented a dynamic pricing model on various products that exhibit seasonality in demand.

One example is Pumpkin Pie Spice, an American product which is very popular during Thanksgiving and Christmas. Usually, you can buy it on Amazon for $4.49. But before Christmas, it has been listed for as high

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as $8.49. This is purely driven by demand during the holiday period, impacting customers' willingness to pay.

Due to customer urgency and infrequency of buying a product, there's limited price recollection. Eventually, customers are less price-elastic – they'll accept the higher price more willingly. A dynamic pricing model can allow for effective monetization of seasonal demand and urgency when price sensitivity drops.

5. Don't be dynamic if it doesn't align with your strategy.

Just because your competitors implement dynamic pricing doesn't mean you have to follow suit. Take Uber competitor Addison Lee as an example. They decided to focus on the service quality instead of using dynamic pricing as a strategic decision. Each ride they offer guarantees the same price, same type of car, mobile charger, etc. Their choice not to use dynamic pricing has become their unique selling proposition. And it was beneficial– their revenue increased by 31%.

6. Don't use dynamic pricing when there's no seasonality or urgency but there's full comparability.

The dynamic pricing model should never be taken too far. Even a market leader like Amazon can get it wrong. Prices on online retailers can be fully compared using best-price tracker websites. Unlike flights, products sold online can usually be found elsewhere in the same format, and there is usually no supply constraint. If they don't like the price, customers can just buy the product at another retailer. If they believe the price will drop, they can also buy it later.

Savvy shoppers have learned to look out for bargains and are quite happy to shop around online. So, dynamic pricing can shift consumer demand from when they wanted to purchase an item to when they expect a lower price. This is clearly revenue sub-optimal for online retailers.

7. Don't over rely on algorithms and neglect the human element.

While dynamic pricing can be greatly assisted by data and algorithms, these should also have a clear strategy. Amazon made headlines when they listed a book on the platform for several million dollars. However, that was not a best-seller. In this case, two booksellers were listing the same book and were tracking each other. So, as one raised their price, the other soon followed without anyone checking, until the price reached $23.7 million.

This case emphasizes how important it is to track dynamic prices and apply checks. It is to ensure prices remain reasonable and in line with broader company and pricing goals. Forgetting the human element in dynamic pricing is a guarantee for failure.

8. Don't use dynamic pricing in situations that can be deemed insensitive or as profiteering.

Unfettered dynamic prices can create bad publicity. When Whitney Houston passed away, the price of her album increased from $4.99 to $7.99 on Apple's iTunes Store. This was only hours after her death, bringing Sony Music under fire. The 60% increase was driven purely by algorithms sensing higher demand for her music. While price increases due to increased demand are coherent, customers may perceive them as pure profiteering, especially in delicate situations. Customer trust is an important factor in the success of any business, so make sure that you clearly state the prices.

Walking before running

These lessons underline how important it is to know your customers, your market, and the variables pertaining to your business. Understanding product perishability, supply and demand changes, price elasticity, and constraints will help you make the right decision.

With more digital solutions entering the market, companies are looking for creative ways to monetize their business. Even having powerful data and algorithms now at their disposal, the human element should never be forgotten. In fact, dynamic pricing, while reliant on technology, also requires fundamental business process changes to succeed. This makes human input ever more important.

Dynamic pricing must be led by a step-by-step approach, embedded within broader company and pricing goals. In addition, this model needs to be built upon a thorough understanding of your product and market.

How One Number Changed the Entire Gaming Industry: 299. One Price That Changed it All.

by: Karan Sood

The 90s gaming industry arms race between Sega, Nintendo, and Sony is packed with caution ary tales for pricing mistakes and multiple strategic gaffes. In this article, the author recounts the key actions of each company during this pivotal time for, and highlights lessons that today's pricers can take when considering product pricing strategy, pricing innovation, pricing communication, and more. Karan Sood is the Director of Sales Operations at Rakuten Kobo and has over 15 years of pricing experience working in the automotive sector, digital media, CPG, and electronics hardware. He can be reached at karan.sood@rakuten.com.

299. That's all Steve Race said at the first Electronics Entertainment Expo in 1995.

With that one word, Steve Race announced the death of Sega as a gaming hardware giant and the start of Sony's dominant position in the gaming industry. An Oscar worthy big mic drop moment! Watch for yourself.

Before Sony's moment in 1995, the video game industry was dominated by Nintendo and Sega. Nintendo's NES console had sold more than 50 million units, and Sega's Genesis system wasn't far behind with 30 million units. Both were household names globally.

That 90s gaming arms race is packed with cautionary tales for pricing in the form of strategic gaffes from Sega, Nintendo, and Sony, such as:

1. Nominal price gaps that overestimate the volume impact of elasticity
2. Trouble with pricing innovation
3. The impact of price wars
4. Errors in price communication and price lifecycle management

When Sega Genesis was launched in 1988, it was introduced at a $189 price point, $10 cheaper than the market leading Nintendo NES system, which was priced at $199. Sega believed that undercutting Nintendo by $10 would be a game changing and volume moving move, but it wasn't. Genesis sold 30 million units - still far fewer than Nintendo - and likely wiped out $300 million in potential profits from Sega ($10*30 million units). Fight the urge to undercut competition by nominal amounts that may not swing the sales and buyer psychology. A $10 cut is less meaningful when purchasing a $200 product that will last 5 years versus a $10 cut when you are selling a $20 product. Both have a very different impact on buyer psychology. **Don't make small, gut-based price cuts even if they come from the highest level! Quantify the impact of that nominal cut on volume before making that change. Price elasticity is different at different price levels. Know your elasticity even before a dollar is cut from price.**

THAT 90S GAMING ARMS RACE IS PACKED WITH CAUTIONARY TALES FOR PRICING IN THE FORM OF STRATEGIC GAFFES FROM SEGA, NINTENDO, AND SONY.

Pricing product innovation

Games in the early 90s were still 2D in nature and 3D gaming was still far from being introduced to the market. Cartridge based systems only allowed for so much innovation and game performance. This was a problem that Sony was motivated to solve.

Sony approached Nintendo to help build a system that could bring CDs to Nintendo's system, thereby increasing its ability to provide better game experiences and superior performance. The rub was that Sony would get a licensing fee from all games sold by Nintendo via the new CD format - plus a future gaming device that they would produce together. A match made in heaven (only it wasn't)!

Sony announced the new partnership at CES, the annual Consumer Technology Association trade show, only to find out two days later that Nintendo had quietly ended the deal and announced it was partnering with Philips to work on a CD extension for its SNES (Super Nintendo Entertainment System) console. Sony was furious. **This was dubbed the biggest betrayal in the gaming hardware history.** That incident started the launch countdown to Sony's own system, which changed the gaming history forever.

Rival Sega eventually launched a CD-ROM add-on to its Genesis

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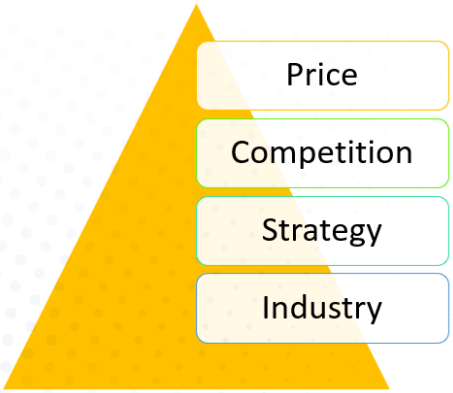
system at $299, a price point higher than the Genesis system itself. The technology didn't get much traction, and the project was shut down after just over a year. Price was a key factor in its failure. Sega failed to see that a $299 CD-ROM accessory, on top of a $199 console, was a spending hurdle customers could not bring themselves to climb. Sega didn't see the big picture of the industry's direction, priced their innovation too high, and failed to get people to adopt.

Price your innovation correctly. Know the broader dynamic of where the customer and industry are headed, and line up your own business strategy accordingly. Know who your competition is and what customers are willing to pay for your competition, and then, armed with that information, price your product accordingly. Your pricing strategy - aka' "price" - should come last. First, figure out the broader strategy for the product.



But the biggest pricing move was yet to happen.

That brings us to that fateful morning at the Entertainment Software Association E3 Expo in 1995. First on the stage was Sega! They did the big reveal of the Sega Saturn device. It had CD technology, was 3D capable, and boasted popular arcade titles. **The price was set at $399! It was double the price of the current leading product in the market - SNES at $199.** But there was one major problem: the retailers sitting in the crowd had no idea of the product's launch date and therefore no one was prepared for distribution. **Sega wanted to beat Sony's launch timing and ended up harming distribution with limited access. That's a business strategy decision that you can't get wrong. A bad price with good distribution is okay, but a bad price plus bad distribution strategy is just plain wrong.**

A few mins after the Sega announcement, Sony Computer Entertainment of America CEO Steve Race walked on stage, said "$299," and walked off! He staged the biggest pricing coup in gaming history, undercutting Sega's Saturn price announced moments before by $100. **Sony had its moment after the public humiliation from 4 years earlier.** If there was an Oscar awarded for best price announcement, he deserved it! The Sega console got undercut by 25% in a theatrical way within minutes of its reveal.

What did Sony get right in its pricing strategy?

Sony realized the potential of future CD-ROM sales, the huge market for devices globally, the innovations possible with 3-D capable devices, and the potential accessory sales. With this knowledge, they priced the PlayStation accordingly. Sony knew it was competing in the home entertainment space as well as the gaming hardware market. As such, the company went with a mass market penetrating price knowing very well that long-term customer value would be very high with their console.

Sony didn't just change pricing alone. **They made it easier for developers to create and improve games, and they took friction out of the process. Frictionless processes mean more games, and more games mean more revenue. Simple. It's a subtle strategy to expedite monetization. Take friction out of your revenue generation strategy.**

So, while a great mass market price provided a steady stream of hardware users, a great frictionless content strategy on the other side amplified its growth.

What happened after?

Sega announced a price decrease to $299 to match Sony PlayStation in the following months, but by that point it was too late. Sega sold 9 million Saturn units. After a few more years and a few more disappointing devices that failed to compete with the PS1, they completely exited the gaming hardware market. The price creation and communication errors were already done. PlayStation went on to sell over 100 million units globally. People moved to 3-D games in droves. Armed with this new information on customer long-term value, PlayStation decreased the price from $299 to $199 to sell more hardware and to build a bigger base for content/gaming revenue growth off new consoles sold. A few years later, PlayStation 2 was announced, which put the nail on Sega's coffin and the former market leader in gaming abandoned the gaming console industry entirely.

Since then, Sony has sold over half a billion PlayStation units and generated hundreds of billions in revenue for Sony over the years.

Tip of the day:

Play long term games, make long term decisions, and price innovation right.

The Expert Guide to Retail Pricing: An Analytics-Based Approach to Maximise Margins

by: Kiran Gange

This article is an excerpt from the book ***The Expert Guide to Retail Pricing*** which will be published by Routledge on July 7th, 2023. The book can be purchased here. Going under the hood of retail strategy, this book provides in-depth coverage of how retailers can leverage the latest in data analytics and technology to improve profitability and customer value through pricing. Retail and pricing managers, retail sector consultants, and students of sales and marketing will welcome this book's innovative solutions to one of bricks-and-mortar retailing's most critical challenges. Author Kiran Gange is the CEO and founder of RapidPricer, an Artificial Intelligence based company in Amsterdam that specializes in reducing food waste through real-time pricing for retailers. He can be reached at kirang@rapidpricer.nl.

Retail pricing is one of the most critical functions within a retail business. Not only is price a key determining factor in purchasing a product, but it also plays a vital role in many other aspects of the retail business such as price image, market share, and customer loyalty.

Pricing in retail can be defined as the value put on a product or service at the point of purchase. This value is not constant. It fluctuates constantly. It is different for different consumers at different points in time. However, the price at which a retailer sells can be constant for months together – this inherent mismatch of price and value results in market inefficiencies. The result is either the consumer paying a price less than the value the person places on the product or the consumer not being able to afford the price as it is beyond the value the person places on the product.

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The value placed by each customer on a product depends on the need for the product at the time of purchase. This also depends on the prices of the substitutable set of products and the price for the same product in the market. Perhaps, even the weather, day of the week, time of the day, and, in some cases, a customer's salary date. Having the right price for each purchase may enable consumers to buy a larger number of affordable products. The retailer may benefit by selling more products, reducing waste, and making more profit, which can enable more business growth and employment opportunities. However, the right price is different for each consumer and perhaps even different at different times of the day. Is this even possible? Well, yes - some online retail giants already change their prices based on customer demographics, time, and other user behaviors on a continuous basis. This differentiation has made them hugely successful and profitable. According to a recent report, Amazon changed the price of each product on average every 10 minutes.

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This book is about how retailers can master the art of win-win pricing that will ensure market efficiency: where consumers can afford more products and high profit for retailers. In the following chapters, we will discuss the various pillars of retail strategy that form the backbone for an efficient pricing process for retail stores. Scientific pricing allows retailers to enhance a customer's experience, whether in-store or online, by using best practices in strategy, economics, and mathematics to achieve the desired market efficiency. This book outlines the benefits and limitations of scientific retail pricing. It includes case studies of retailers from various industries who have effectively used these tools and approaches.

This book also deals with recent developments in retail pricing optimisation and evolving pricing practices. We start by looking at how retailers usually make pricing selections based on time-tested observations to determine the best options. However, traditional approaches can be inefficient because they ignore the effects of demand on the pricing of the product and are usually based on the cost of the product. The traditional pricing approaches also tend to ignore the dynamic impact of seasonality, competition, weather, and other factors. Most traditional pricing approaches do not consider how price elasticity changes over time (for example, in items with short shelf lives, such as fresh produce) or how different market segments react to price increases differently.

Many retailers also struggle to determine how to price items when their suppliers offer limited-time specials and are often unaware of the impact their pricing approach has on their overall image. Optimal pricing is not a static problem. Changes in the environment or sales patterns require retailers to react swiftly. This book includes examples of advanced pricing approaches that are now being tried in the real world. Finally, we will go through the key elements that must be considered for developing a pricing system for retail organisations. Market dynamics are reasonably predictable in normal times. However, the Covid-19 pandemic was not a "normal" time. Retailers in several countries had to close outlets. E-commerce became a viable alternative almost overnight and, in some circumstances, the only option for purchasing items. Engagement with e-commerce hit an all-time high in countries that were unfamiliar with online purchasing. Electronic payment systems also improved efficiency and security, offering customers a dependable solution for payments. To attract customers, retailers expanded their product lines and looked into a variety of sales channels and pricing methods.

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Although brick-and-mortar sales of retail are now back to their original levels, the pandemic not only pushed e-commerce to previously unheard-of levels but also the emergence of new business intelligence strategies and algorithms. Most traditional pricing approaches are based on costs. While this approach is easy and safe, it is a very inefficient way to price a product. The driver behind the price for every product should be the customer's demand for the product. In almost all cases, the cost of manufacturing a product does not have any connection to the customer's demand. Hence the retailer who chooses a cost-plus-based pricing strategy is inherently operating at inefficient prices, which results in the prices being too high for customers or too low to accommodate a sufficient profit for the retailer.

While science-based price optimisation, perhaps even in real-time, might be an ideal goal, oftentimes, retailers might need to take several intermediary strategies to move away from cost-based pricing strategies. Below is a brief introduction to various pricing strategies for increasing levels of efficiency and profitability.

1. **Rules-Based Pricing:** One of the most important techniques and easy fixes to implement in retail pricing is called Rules-Based Pricing. A simple walk through a store shelf oftentimes can reveal many glaring mistakes in pricing, which can be both confusing for the consumer and loss-making for a retailer. Retailers can set a wide variety of simple rules to make sure all prices in all stores comply with these rules. These rules can be simple rules such as line pricing, size rules, competitive rules, margin rules, last digit ending rules, and even category role-based rules. Oftentimes, this can be accomplished in a simple spreadsheet with algebraic formulas.
2. **Market-Based Pricing:** Once we have a good understanding of the basic pricing rules, a retailer should look at their own environment to make sure

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their pricing strategy is in line with the needs of the market. Frequently, retailers operate in highly competitive and evolved marketplaces, which means the other competitors in the market can hold several valuable lessons that can help the retailer establish their own pricing strategies. A simple comparison of prices of the top- selling items to nearby competitors can reveal many opportunities in pricing. For example, a competitor might be selling milk or eggs at prices significantly lower and leading traffic away. On the other hand, there might be a high-priced holiday gift that is being sold at a much higher price in the marketplace, which could allow a retailer to increase his own price. While competitive pricing can become much more data-driven and scientific, a good place to start is a simple process to note and track the prices of a retailer's competition.

3. **Science-Based Pricing:** Using data to complement intuition can be a powerful combination. The core material of this book is dedicated to helping retailers understand device data and science-based processes for retail pricing. This will include strategy formulation, category and product role definitions, pricing rules, competitive strategy, price optimisation, and price maintenance.
4. **Real-Time Pricing:** Once a robust framework for data management and pricing is set in place, it can be the right time to move tasks towards automation. Several tasks, such as reacting to cost changes, competitive price changes, and even change in the product's value (such as a banana changing from green to yellow) can be connected to automatic price changes. This, however, requires certain hardware components such as Electronic Shelf Labels and various in-store sensing technologies.
5. **Customer Level Pricing:** As retailing continues to evolve towards becoming more of a commodity, customers will demand a higher level of customization for their own individual needs. As is already evident in some segments of retail, the future of retail will mean the demands of the consumers will be met with as little friction as possible at the right price and at the right time, which will be unique for each customer. For example, imagine a situation where a sensor enables a fitness t-shirt to work with an algorithm to replenish the right nutrients for the wearer into his kitchen with an order timed to arrive in time at the right price automatically.

A retailer should critically examine where it stands in the retail evolution cycle in its own marketplace. The goal of higher efficiency in retail is a continuous journey that should never end. However, it is always a good idea to utilise the best practices that have already evolved through innovations and experiments across the globe.

Pricing is rightly identified as one of the most important factors in the profitability and survival of the business, but traditional retailers often have resistance to changing their pricing strategy. In the past, retailers have relied on intuition and standardised safe processes, such as cost-based pricing, but the need to adopt a more efficient process is critical in today's competitive environment.

Most retailers do not utilise price as a basis for creating a permanent competitive advantage since low-price strategies are too easy for competitors to adopt. Only a few retailers can succeed with a pure low-cost–low-price approach. Price can, however, always be utilised strategically, even if it is not always to determine the lowest price.

Until recently, retailers' initial pricing and subsequent markdown decisions to drop the price and value of a product to boost sales were often based on arbitrary principles that they believed had worked well in the past. Today, various specialised organisations have developed methodologies and tools to assist retailers in making these critical pricing decisions.

Many retailers today use price and promotion optimisation software. Controlled field tests show that their solution routinely beats the control group in improving profit while maintaining or increasing sales and market share depending on the retailer's desired goals. Furthermore, planning assortments, initial pricing, sourcing/vendor coordination, buying, item allocation to stores, promotion, planning replenishment, space management, and markdown pricing are just a few of the decision-making tools accessible to retailers.

While it is important to adapt retailing practices to the established best practices in scientific retailing, it should also be noted that retailers do not have to understand every component of pricing science to its core to leverage the science. For example, the most efficient ride from an airport to a conference might be calling a cab through an app, but there is simply no need to understand the mechanisms of a combustion engine or a carburetor. Similarly, retailers can use several tools and existing algorithms to establish a pricing strategy that is right for them instead of having to hire and train the world's best data scientists, data engineers, or hardware developers.