PROFESSIONAL PPS PRICING SOCIETY™

The PRICING ADVISOR

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In this article, the author breaks down the three critical steps in the Innovation Pricing Process: internal research with economic value to customer, external research with voice of customer, and pricing strategy decisions. Tim J. Smith, PhD is the founder and CEO of Wiglaf Pricing, adjunct professor at DePaul University, and Academic Advisor for the Certified Pricing Professional designation. His most recent book is Pricing Done Right: The Pricing Framework Proven Successful by the World's Most Profitable Companies *(Bloomberg Financial, 2016). He can be reached at tsmith@wiglafpricing.com.*

Pricing Innovation

How do you price an innovation? You have been working on a new product or service and are getting ready to launch, but what price should you put on it? If there is nothing else like it, how do you price it? What is the process?

As most people have heard, companies should have started the pricing exercise before building the innovation. Especially if the innovation is designed to drive profits, the value of the innovation should have been quantified, at least at the bracket level. This ensures that the innovation is worth developing. But it is likely your company didn't do that.

So, now you need to get a price on it and the launch date is coming. What do you do?

The standard consultant answer, "it depends" isn't good enough. We can do better.

The Innovation Pricing Process can be broken down into three key steps; two are focused on gathering facts, one involves fact-based decision-making:

1. Internal Research with Economic Value to Customer
2. External Research with Voice of Customer
3. Pricing Strategy Decision

Internal Research with Economic Value to Customer (EVC)

Economic Value to Customer (EVC)

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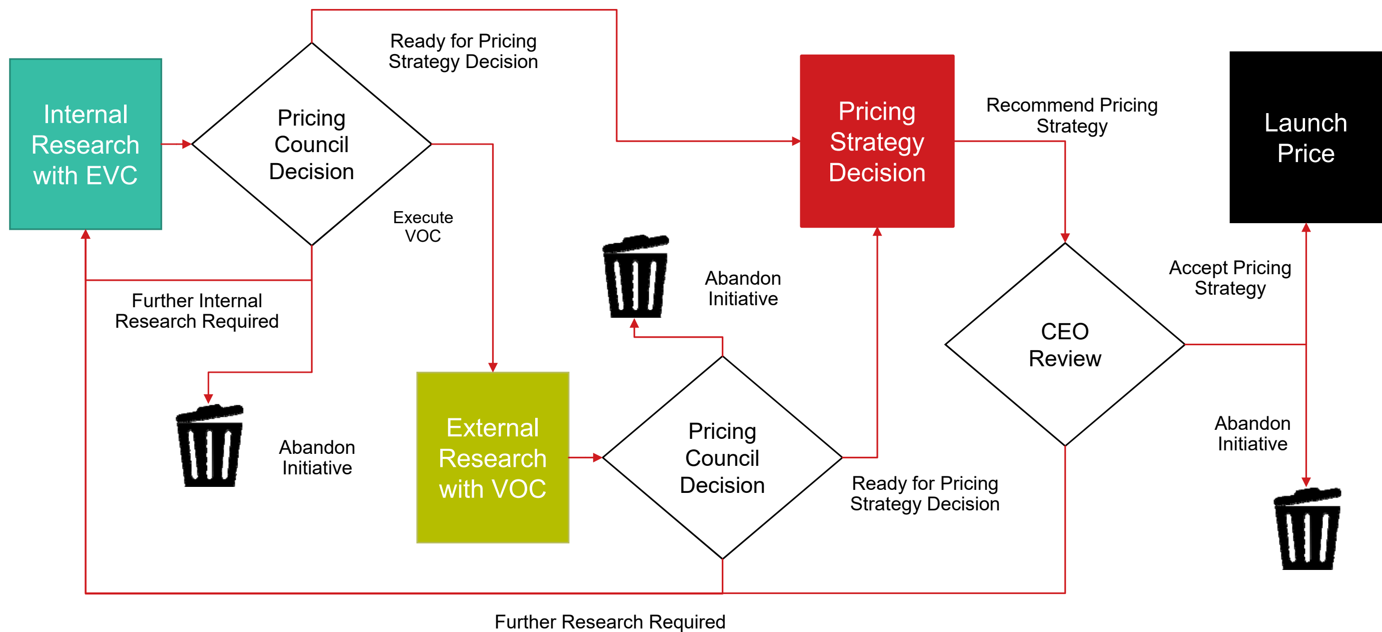
Figure 1



defines the true value of the innovation for the customer. It looks at the financial impact of your innovation compared to the competitive alternatives or status quo.

In construction, one uses the cost of the alternative that is being displaced as a starting point. Then, one identifies the differential benefits, both positive and negative differentials. For each benefit differential, one attempts to define a model of the economic impact sprung by having or not having that benefit. The key in this model is developing rational expressions of how the benefit drives value (or value drivers) that are based on fact, and not conjecture or plug estimates.

For business markets, these value drivers generally translate into monetary value around how the offering drives revenue, reduces costs, or impacts risks. Once all have been quantified, one starts with the cost of the alternative, adds the positive benefits differentials then subtracts the negative benefit differentials.

In essence, EVC uses a part-worth utility approach, just like conjoint analysis, when defining the value. Unlike conjoint, it quantifies the true economic value rather than customers price expectations.

Why is EVC necessary? Because the company needs to know the value it creates for customers, and how it creates that value if it wants to be able to either communicate its value proposition or capture its fair share.

EVC can be likened to a value discovery phase in pricing innovation: "How much value are we really creating here? Is this a big deal or a small issue?"

With a skilled team, a solid EVC can be done in weeks. Without a skilled team, the results are likely to be poor and the effort to drag on to an ill-defined future.

Once the EVC is complete, or as complete as it is going to get given the facts that can be gathered, it is time for a decision:

- Abandon the Initiative,
- Do More Internal Research,
- Move Forward to External Research, or
- Go Directly to the Pricing Strategy Decision.

External Research with Voice of Customer (VoC)

Voice of Customer (VoC) reveals customers' perceptions of the innovations. One can use this approach to:

1. Clarify uncertainties in the core facts underlying the EVC,
2. Understand how customers perceive the benefits and the offering overall, and
3. Reveal customer price expectations.

In execution, one starts with designing the areas of inquiry, sample informant size and target segment requirements. Once well-constructed, interviews are held and information collected. This raw information is then synthesized (ana-

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lyzed and summarized) for management digestion.

In VoC design for pricing, one will often use Gabor-Grainger or Van Westendorp Price Sensitivity Meter techniques. While these have been repeatedly proven to be poor research techniques for estimating willingness-to-pay much less optimal prices, they do reveal customer price expectations. They are also relatively easy to execute and are suitable with smaller samples, such as is common in VoC research.

With a skilled team, a solid VoC effort can be done in weeks. Without a skilled team, the results are likely to be poor, and the effort may appear herculean.

Once the VoC is complete, it is time for a decision:

- Abandon the Initiative?
- Do more Internal or External Research?
- Or Make a Pricing Strategy Decision?

Pricing Strategy Decision

A good pricing decision is two-fold: one defines an aspirational list price and a commercial policy that deducts from this list price known discounts, which lead to the expected target prices by customer segment and perhaps channel.

To drive this decision, one updates the previously constructed EVC with the facts gathered via external research. As necessary, one also calculates the EVC by segment since different customer segments will value the innovation differently.

From the EVC, and informed by the VoC price expectation work, one then defines the capturable value. We suggest starting with the Half-Gains/Double-Losses Rule, then overlaying the 50/30/15% Rule as appropriate. From this, one will identify the price by market segment.

Using segment sizes and now knowing the expected capturable price by segment, one can define block demand curves and the expected optimal price.

Again, with a skilled team, the pricing strategy decision can be driven relatively quickly. Without a skilled team, the results are questionable and the decision making will seem highly uncertain—if not mere guesswork.

Once the pricing strategy decision has been formulated, it is time for review. We listed it as CEO review to denote the person accountable for the decision. At that point her/his options are:

- Abandon the Initiative,
- Do more Internal or External Research, or
- Launch with a Price.

A good pricing decision is two-fold: one defines an aspirational list price and a commercial policy that deducts from this list price known discounts, which lead to the expected target prices by customer segment and perhaps channel.

Getting Pricing Done Right

Pricing innovation isn't a mystery, much less should it be a "gut feel." It is a process. How much of this a company does will depend on the importance of the innovation, the pricing maturity level of the company, and the time and budget restrictions. But, as you can tell from above, it can be done efficiently with a well-defined process.

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Price Increases: Get it Right This Time by Following These Eight Steps

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Most of us would agree that Warren Buffet has figured it out. Here is what he has to say about price increases: "The single most important decision in evaluating a business is pricing power. If you've got the power to raise prices without losing business to a competitor, you've got a very good business. And if you have to have a prayer session before raising the price by 10 percent, then you've got a terrible business."

Here is why price increases are that powerful:

- A 2% price increase boosts your profit by 10% (assuming a 20% margin and constant volumes)
- Most prices can be changed immediately
- Contrary to cost cutting, price increases require no investment and involve little resources

However, most price increases fail. Within the building materials industry, realized increases are 68% below their target. For example, a 5% target gets converted into a 1.6% increase only. Admittedly, even if anchoring high is on every "How to…?" blog, these numbers are shocking. It doesn't have to be that way.

We have looked at what price increase champions do differently and classified their best-practices into 8 areas.

1. Create a clear vision for your sales team: At the end of the sales meeting the VP says, "You need to raise your prices by 5%." Don't be that VP. Because it won't work. Rather understand how much better your product offering is compared to last year. Maybe you have improved customer service or expanded your product portfolio. Don't just ask just for higher prices. Make sure you understand the change in your value proposition.

2. Provide a price increase range for your sales team: A price increase campaign is not an all or nothing game. Rather, develop an escalation process that requires approvals. For example: If the old price was $100 and the new price is $105. A price below $103 needs to be approved by regional management and a price below $101 by VP.

3. Provide implementation support tools for your sales team: Develop a list of concessions that you can offer while still sticking to the price increase rate. Think extended payment terms, delayed implementation of the increase, free shipping etc.

4. Differentiate price increases between customers and product categories: Segment your products and customers by elasticity. A 10% price increase on a slow mover will barely be noticed and on items with low competitive intensity your customers will have little opportunities to switch. Take advantage of that.

5. Consider a surcharge approach instead of a price raise: If you take a look at your last rental car bill, you will probably see a daily rate of $30-$40. However, the final bill was over $100. Do we need to say more?

> If you've got the power to raise prices without losing business to a competitor, you've got a very good business.

6. Consider non-contracted business only: Special conditions, fixed terms, key account pricing, and net price agreements are just some examples for categories that prevent increases. It is not unusual that only 75% of your business is

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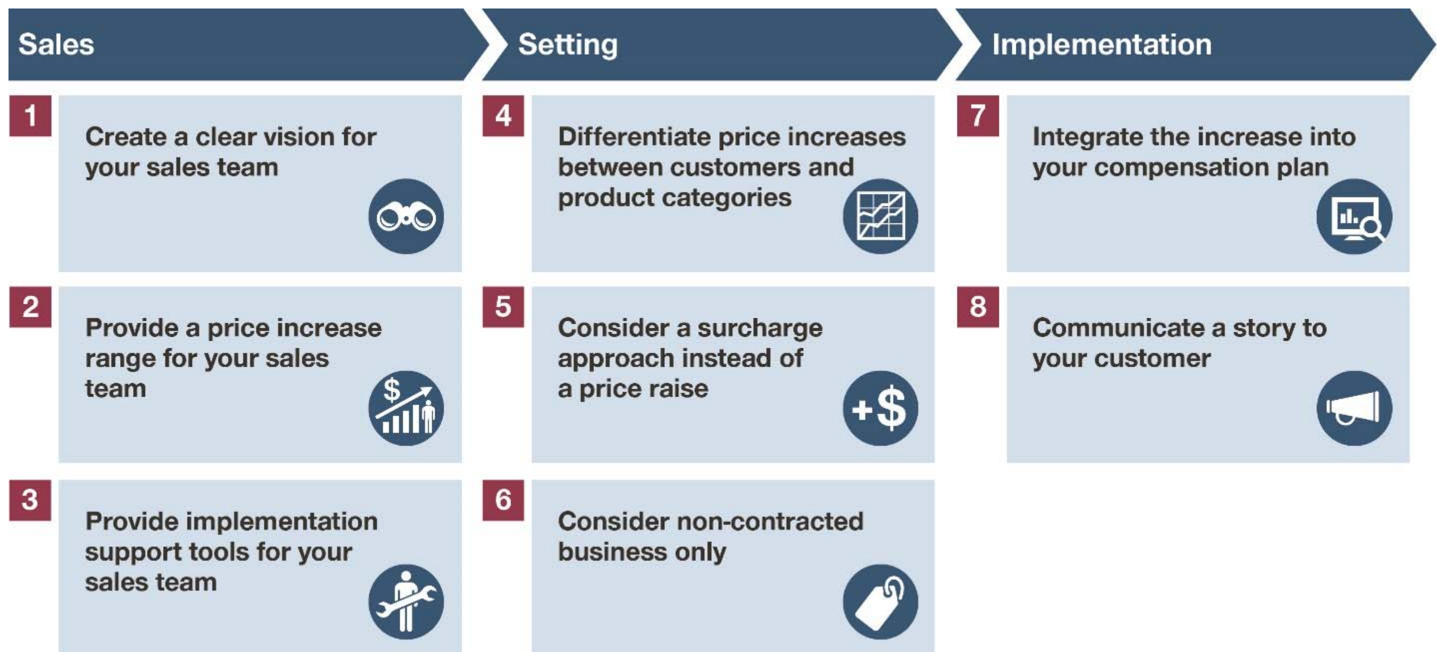
Figure 1: Price increase champions best-practices



eligible for price increases. That means, if you would like to see a 2% effect in your P&L, you have to achieve a 3% raise within you eligible business.

7. Integrate the increase into your compensation plan: Measure the success rate of price increases and grant special bonuses as an on-top incentive. This will put additional emphasis on the increase campaign without having to re-define the existing compensation scheme.

8. Communicate a story to your customer: In accordance with that, create KPIs to prove the added value for your customers. Maybe your lead time has improved from 2 weeks to 1 week. That creates a competitive advantage for your customers and improves their +5%. Once your customers see the added value for them, a price increase will seem just fair.

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Top Ten Pricing Mistakes of MedTech Innovators

Pricing innovation can be a highly complex decision and one of the more challenging tasks marketers face. This is especially true in the MedTech industry, as the author explains. Although focusing on the MedTech industry, this article provides pricing advice that can be valuable to pricers in multiple markets. Chris Provines is a 24-year veteran of the healthcare industry. He is the CEO of ValueVantage, and the author of Strategic Pricing for Medical Technologies (2012), and his newest book Healthcare Value Selling (2014). He is on the PPS Board of Advisors and is an Adjunct Professor at Rutgers University where he teaches in the MBA program. He can be reached at chris@valuevantagepartners.com.

Pricing innovation can be a highly complex decision and one of the more challenging tasks marketers face. With all the time, resources and money invested in bringing an innovation to market, there are often great expectations for the technology and for the profit impact on the company. Many times, however, pricing mistakes are made that cost the company money.

According to one publication, 80-90% of new products are under-priced (Marn et al, 2003). In one academic study, researchers showed that inappropriate pricing practices led to a decline in new product performance and a loss of any competitive advantage (Ingenbleek et. al., 2013).

The root cause of an inappropriate pricing decision was a failure to consider all factors and a lack of clear pricing objectives.

For medical technology (MedTech) innovators, pricing a new solution can seem even more challenging. This is due to a number of factors not present in other markets.

One key factor in MedTech is the role and influence of numerous stakeholders involved in access and utilization decisions (physicians, providers, insurers, value analysis committees, health technology assessment groups, group purchasing organizations (GPOs), government regulators, etc.).

Another key factor leading to complexity of a decision is reimbursement and funding. Different reimbursement mechanisms (diagnosis related groups – DRGs – vs. value-based purchasing vs. global budgets), evidence requirements, and health systems make Medtech pricing more complex.

Top 10 Pricing Mistakes of MedTech Innovators

Here are the top 10 pricing mistakes that MedTech innovators make.

Mistake #1: Unrealistic or no value analysis – Value should be the foundation of the pricing strategy. This includes clinical, economic, strategic and emotional value. It's important to be clear and realistic about the value. It is critical to understanding the true cost offsets, customer economics, and who receives the value from the innovation.

Mistake #2: Missing a critical input – Good pricing strategy should require a holistic review of critical inputs. These include cost, competition, channel, capacity, customer value, reimbursement, etc. Missing a key input can lead to the wrong strategy.

Mistake #3: Poor segmentation – If the technology has the potential to be used in different clinical applications, indications, settings of care or patient subpopulations, there will be a significant value variation. As a result, the price potential could vary significantly across segments. Value across markets will differ and pricing and launch strategy should consider this.

Mistake #4: Not understanding the role of pricing and other factors in new technology adoption – There are many factors that impact technology adoption. Price and economics are just two. Often the lack of adoption of a technology has less to do with its pricing and more to do with other factors (for example, insurer coverage). For a more comprehensive view of barriers to adoption see Everett Rogers.

> Good pricing strategy should require a holistic review of critical inputs.

Mistake #5: Starting too late – Pricing is sometimes an afterthought. Pricing work should begin at the idea/concept stage and continue through the new product development (NPD) process.

Mistake #6: Lack of alignment – The

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pricing strategy and the evidence development plans, payer strategy and marketing investment and objectives need to be in alignment. A premium price won't work without investments in evidence development, payer related market development, and marketing.

Mistake #7: Relying too heavily on pricing market research – Pricing market research can be a helpful input to the strategy. It should, however, be one of many inputs used in the decision process. Any pricing research is "stated preferences" and actual buying behaviors can vary for a variety of reasons.

Mistake #8: Not understanding the price-volume-profit trade-off – There are many ways to estimate the price-volume relationship. These methods range from simple and cheap to complex and expensive. You should try to get a sense of the profit impact of different price-volume scenarios and estimate the impact of price on adoption.

Mistake #9: Tactical and/or implementation issues – While the price level is important, it is equally important to consider the price structure, price implementation, and different ways to monetize the value. This includes the list price, a floor price, price metrics, fences, bundles, offering strategy, and discount strategies. In addition, formalizing price rules, guidelines and a price management process is necessary to avoid price leaks.

Mistake #10: Not preparing sales – New technologies don't sell themselves. The sales team has to drive it. All the good work done to develop a robust pricing strategy is lost if you don't prepare the sales team to sell the value and defend the price.

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Three Qualities of a High Performance Pricing Team

In this article, the author presents three essential qualities to improve pricing teamwork and ultimately profits. Each recommendation centers on building a strong understanding of pricing objectives well before beginning price conversations with customers. Travis Umpleby is Business Consulting Manager at Holden Advisors. He focuses on creating a collaborative environment that draws on the strengths of the team and ensures skill development in the process. He can be reached at tumpleby@holdenadvisors.com.

The CEO of a $9B technology firm reviewed various reports, each indicating that profitability was not improving despite taking several actions to increase revenues. The CEO met with senior leadership to urgently address this profit shortfall. Pricing, product, marketing, and even IT acted to address pricing and improve profitability. Unfortunately, confusion reigned as each department made demands of the other, independently made decisions, and resources were stretched thin. Implementations were delayed or poorly executed. It looked like the next quarter's results were going to show little profit improvement.

Does this scenario sound familiar? Probably all too familiar. In fact, a 2015 HBR article stated 75% of cross-functional teams are dysfunctional.

What's the failure point in this story? There could be many. But the lack of cross-functional coordination was a critical point of failure to accomplish pricing performance improvement.

Here are three essential qualities to improve pricing teamwork and ultimately profits. Each recommendation centers on building a strong understanding of pricing objectives well before beginning price conversations with customers.

First, communication is essential. I am not referring to volume of communication here. I mean more quality communication is essential. Short, in-the-moment feedback sessions will help the team focus on organizational goals. These brief sessions address challenges that often distract individuals and put team success at risk. These discussions also offer frequent opportunities to share the "why" of the goal and not just the "how." **An individual's decisions can better serve the team when they understand how their contribution fits into the larger objective.**

For example, one data services company was under customer pressure to discount. The cross-functional team evaluated the risk of losing the opportunity. They decided to stand their ground and communicated that decision to their functional teams. This allowed all teams to support the decision and prepare for a worst-case of losing the opportunity. The customer had no outlets for finding discounts—the team stood firm and closed the deal without further discounting.

Second, focus on the price setting process, not a point in time. Even with the best price, team members need to be prepared for market changes. Frequent input from the field allows the team to be more agile in planning and response. This planning prepares team members to better anticipate customer demands and develop responses that are supported by the entire organization.

Third, trust is the overarching principle of a successful team. One paragraph is not going to do justice to this topic. Yet teams need to focus on building and sustaining trust to be truly high-performing. Trust is the foundation of teaming. No one can be in all places at all times so they must trust that others will do what is needed. Trust enables individuals to react to the unexpected, respond appropriately, and to make trade-offs with the team goal in mind. **Trust empowers each member of pricing team to proceed with confidence.**

Developing a reaction plan is a good way to build trust within a team. For example, when rolling out price changes, identify several potential customer reactions and then the team's appropriate responses. This planning prepares the team to react to specific situations and not react in the heat of the moment. This type of preparation helps your team stay true to the end goal.

Cross-functional teams draw on the expertise of capable people to accomplish a goal. A high functioning team develops a solution for the entire organization, better aligns multiple functions, and reduces preventable and damaging conflict. The payoff is often faster growth and higher profits – a goal worth pursuing!