PROFESSIONAL PPS PRICING SOCIETY™

The PRICING ADVISOR

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In This Issue:

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The Real Commodity Trap

Leaders in many companies complain about the commoditization of their products and services. They face extraordinary market conditions, with aggressive competitive pressures and sophisticated commodity buyers. Markets are soft and competitors are fighting for the same pie. **Whether you are in the B2C, the B2B, or the B2G world, we are all exposed to the acceleration of business change and the rise in the level of competitive pressure.**

Procurement teams pay attention. They know that they are in the driver's seat right now and they are getting more equipped than ever with technology and tools to extract cost savings from their suppliers. The worst scenario is when buyers actually categorize your products and services as commodities, and approach you with different processes than they do with suppliers of premium, engineered and differentiated products and services.

Faced with this level of competitive pressure and soft demand levels, I often face leadership teams with high levels of pessimism and low levels of confidence. They accept the fact that the market sets prices and that right now they have no choice but to surrender to pricing pressures. The materialization of this perceived fatality is that the term commodity is used over and over during business meetings, during interactions with the sales force and in other situations. The commodity mindset has totally infiltrated the organization and the mindset. To be honest with you, it drives me completely crazy when I see the following use of the word commodity:

1. **Commodity in the name of their business unit:** This is probably the worst-case scenario. If you name your business unit as a commodity, it is not realistic to think that you'll do anything other than sell commodities. That also bleeds into your service offerings and your corporate

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PPS Happenings Serving the Pricing Community Since 1984

Upcoming Events

29th Annual Spring Pricing Workshops & Conference – Loews Chicago O'Hare Hotel – Rosemont, IL / May 1-4, 2018

- Full-Day Workshops and Special Programs / May 1-2, 2018
- Conference Keynotes and Breakouts / May 3-4, 2018

For the most up-to-date information about PPS events and programs, please visit our website at pricingsociety.com frequently.

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brand. So this is not a very smart idea.

2. **Commodity in the annual report and other official communications:** Ditto. If you use the word commodity in all official communications, do not expect to be treated differently by procurement teams you face daily.

3. **Commodity in the daily vocabulary used in front of customers:** This is also not very smart. The word commodity connotes high volume and inexpensive price point. It implies there is little chance for differentiation and room for price improvement, with expectations of annual cost savings and price erosion.

4. **Commodity in their business and pricing strategies:** Obviously, if you do 1 through 3, chances are your business and pricing strategies will be commodity- or cost-based. So it might be irrational to expect anything other than discount requests, tough price negotiations and eroding margins if you surrender your pricing to market conditions.

5. **Commodity as a cop out mechanism in front of competitive pressure:** Finally, based on your pricing strategies, your sales force will be faced with commodity-type buyers. I am sure you have heard to following statement: "We are in a commodity business; I cannot do anything on price." Does this sound familiar?

The end result of the constant use of the word commodity is that its use can pose devastating effects inside your organization and in the minds of some of your organizational team members. A commodity mindset kills creativity and reduces the level of effort teams put into the defense of pricing and potential premiums. In fact, I often say that commodity is just another word for lack of imagination.

There is a real danger in accepting this commodity mindset:

1. **Self-fulfilling prophecy in their approach to market:** It is a slippery slope. Once you are in the commodity spiral, it is difficult to get out of it. The buyers you are facing know that.

2. **Commoditization of the organizational culture:** If you use the word commodity over and over, you will quickly move to a commodity-like culture with all the implications that connotes.

3. **Lack of confidence of the sales force in front of "commodity" buyers:** This is probably one of the worst outcomes. When your sales force refers to your products or service as commodities, they have a tendency to lack confidence in pricing. Any chance of catching additional pricing power in the market might not materialize.

My opinion is very straight forward. **There is no such thing as a commodity. If your business is transacting with customers today, there has to be some type of differentiation.** You have to find it, extract its value, and capture it through price. It might not reside in your core products or services. It might be hidden somewhere else. But for crying out loud, stopping using the word commodity over and over. Use "general-purpose products" or "high-volume specialties" instead. That is far more reasonable. The word commodity should be banned.

So to get out of this spiral of commodity, I propose the following actions:

1. Design a series of workshops on the topics of differentiation and hidden assets your business might have. These workshops need to include relevant functions and be deployed over a series of 90 days across your organizations.

2. Design specific product or service benchmarks with your product or service manager to rationally extract tangible and rational differentiation. These exercises need to be done in parallel with point 1.

3. Conduct an audit of your external and internal documents to find out how prevalent the use of the word

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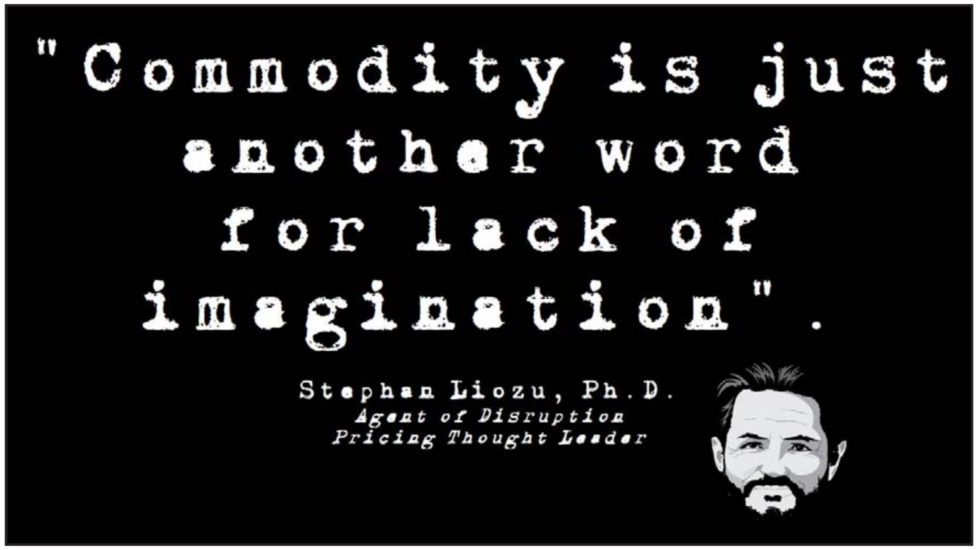

commodity actually is in your formal documents. Make sure you flag these during the next management meeting and take immediate action to replace the words with more positive words.

4. Prepare new marketing documents with statements of differentiation and positioning. These could be new product data sheets, product or service customer value propositions, competitive bulletins, and differentiation stories.

5. Develop and design a series of lectures, webinars, and other communications to widely reinforce your company's sources of differentiation. Make sure your entire organization gets exposed to your differentiation statements. Use the newly created marketing documents.

6. Get the C-suite on board and get them involved in communicating differentiation statements and in building the collective beliefs of internal teams. They need to establish a new level of confidence and lead by example.

7. Pay particular attention to the sales force and how they project the company values and differentiation position. Include differentiation as a key training module for all sales employees including customer service, sales operations, and sales support.

8. Be courageous by correcting people who use the word commodity right and left. I do this constantly and I do not accept the constant surrendering to market forces. Control what you can control and go fight. Be strong and be bold. There is no such thing as a commodity.

Are you with me? If you project messages of commodity, you will be treated like one. To change this situation, you have to hit the reset button. Pricing folks play a critical role in making sure this is understood across the organization. They can engage their marketing counterparts and co-design all the necessary tools and messages to change the mindset. Never hesitate to bring the outside in to show how best-in-class companies do it. Companies like Apple, Hilti, Lego, Cisco, 3M and others are facing tremendous competition and pricing challenges. We all do. The key is having the resilience in front of competitive pressures to fight for differentiation and innovation. Commoditization is not a fatality. Fighting it starts internally and then in front of the all-mighty buyers.

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How to Profit in Global Markets with Psychological Pricing

Many companies make the mistake of keeping their pricing strategy sedentary as they expand to different markets. However, there are many types of robust pricing research that your business should conduct before entering new markets. In this article, the author explores the importance of one of the most critical elements of this research: psychological pricing in your target market. Author Paul Hunt is the president of Pricing Solutions and a frequent PPS presenter, instructor, and contributor. He can be reached at phunt@pricingsolutions.com.

Pricing your product or service to a new geographic market may seem risky, but conducting research on psychological pricing can ease the challenge significantly.

It is a common mistake for growing companies to keep their pricing strategy sedentary as they expand to different markets. The truth is, consumers across different geographical areas perceive prices differently, so the pricing strategy must be responsive to the market perceptions in order to maximize profits.

Price Perceptions Change by Location

In Roger M. Heelers paper "High-Low Context Culture and Pricing-Ending Practice," he outlines a simplified way to break down international market psychological pricing. The concept revolves around High- and Low-Contexts, and how much a particular culture draws meaning from their context, or just takes numbers at face value.

- In **High-Context Cultures**, there is strong attention to implicit and nonverbal cues from routine communication (such as prices). Many things are left unsaid but are never-the-less understood.

- In contrast, **Low-Context Cultures** can be simply understood as "what is said is what is meant." Verbal cues are not used extensively to communicate.

Heelers selected ten countries/regions from both developed and developing countries, spanning Asia, North America, South America and Europe. **Six high-context countries included China, Hong Kong, Japan, India, Brazil and Argentina, and three low-context countries were USA, Australia, and Norway.**

Italy was also selected as a Western, but the high-context country was utilized to provide stronger evidence that it's the high-low context difference that leads to different price ending practices, instead of the Western vs. non-western categorization.

To study price perceptions across chosen countries, Heelers collected prices on the web mainly from MSN, Yahoo and AOL shopping portals. Product categories included grocery, gift, handmade crafts, clothing, cosmetics and other general merchandise. An average of 350-650 price point samples was selected in each country for analysis.

Key Findings

Heelers study discovered key interesting differences in psychological pricing across different markets:

- **9-ending occurs more frequently in low-context countries** (44% compared to 23% in high context countries).

- **0-ending has predominance in high-context countries** (50% compared to 30% in low-context countries).

- **The predominance of 0-ending is even supported in China, Hong Kong and Japan where 8-ending has symbolic significance.**

- **5-ending occurs more frequently in low-context countries** (14% compared to 11% in high-context countries) except for India (26%).

A practical way to see these findings in motion is by going to the Apple online store. The price for the lowest-end 13-inch MacBook Pro in the Japanese store (high-context market) is ¥142,800 vs. $1,299 in the American Store (low-context market). If you browse through Apple's prices in North America, you will see that they almost always end in '9'. While at the same time price endings in the Japanese Apple store are mostly even numbers, usually '0'.

Applying Psychological Pricing for Profit

Consumers from high-context countries are less attracted to the illusion of cheapness or small gain created by "just below the round" odd end-

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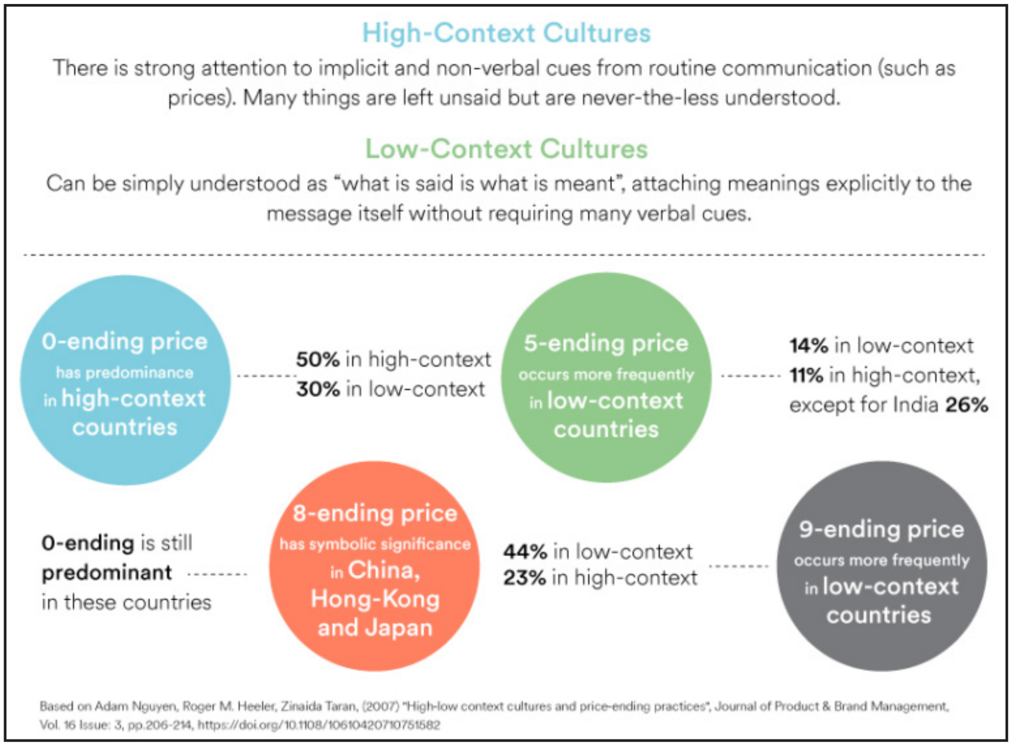
ings. Instead, they are more likely to perceive such a pricing structure as manipulative or a marketing tool to "fool" them. Therefore, those markets might link negative feelings to the retailer/manufacturer. Even endings are a "safer" pricing practice in high context countries, such as India, Brazil and China. Accordingly, odd endings should be operated in a 'realistic' way that communicates real savings and value that is of significance to consumers.

While psychological pricing is important, it is just one component of the robust pricing research that your business should conduct before entering new markets. In-depth pricing research can provide you with the customer information you need to make informed strategic decisions in the new space. Strong pricing strategy backed by with data and research brings millions in pricing opportunities within a few months.

Figure 1: Psychological Pricing Across Different Markets



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BankThink: How to Go From Free to Fee Without A Customer Revolt

In this article, the authors examine the difficulties pricers face in moving from a "free" to a "fee-based" service, and present four valuable lessons learned from examples of this type of transition in both the digital and banking industries. This industry specific example is valuable for pricers in any industry faced with the need to monetize free services without angering or alienating customers. Dr. Wei Ke is a Partner in the Global Banking Division based in Simon-Kucher's New York and Toronto offices, and David Chung is a Director in the Global Banking Division in the New York office. They can both be reached via www.simon-kucher.com.

Transitioning customers from a free-to-fee service is never easy.

Case in point, the popular savings app Digit announced earlier this year it was going to start charging a monthly fee to help users save. The move offended some of the Financial Technology (fintech) company's customers who took to social media to express their displeasure over the new $2.99 per month charge. Banks have also encountered this reputational challenge over the years. In 2011, Bank of America announced it was going to charge customers a monthly fee of $5 for debit card purchases, for instance. Customers revolted. Less than two months later, the bank retreated and abandoned its debit card fee plan.

But charging customers for services doesn't have to end in customers getting angry. To successfully move from a free to a fee model, let's learn these four lessons from Digit and Bank of America's experiences.

Banks must accompany new fees with benefits of equal or higher value

When companies impose a fee on a previously free service, customers experience this event as a loss. It does not matter that they never had to pay for the service; there is still a mental perception of loss. To make matters worse, economics and decision theory tell us that humans feel the pain of loss more acutely than the pleasure of gain.

To overcome this phenomenon, companies have to add new benefits when they add any new fees or fee increases. Bank of America's debit card fee, for instance, might have been more palatable if the bank included attractive new add-ons like cash rewards or free overdraft protection when it announced the new charge. Similarly, if Digit had made a stronger communications campaign that articulated the value of its new higher savings bonus and the addition of other exciting perks because of the new fee, customers may have felt less angry.

For nonpaying customers, provide an option to stay

It is not enough just to add new features along with a new fee. Companies must also provide nonpaying customers with an option to stay for free. In both the Digit and Bank of America examples, a fee was "imposed" and customers had two options: stay and pay the fee or close the account. Many people said online that they chose the latter. Again, this decision is rooted in human psychology. It feels good when we have choices and it feels bad when our ability to choose is taken away. Instead of a mandatory fee, Digit could have added a premium option where users could enjoy higher savings bonuses, rewards and other attractive perks for $2.99 per month. Meanwhile, nonpaying users could continue with a free basic level. Then, the company could nudge clients toward the paying option by making it increasingly uncomfortable to stay at the basic level of service. New features and innovative updates can be walled off and reserved for paying customers, which lets the consumer retain the power to choose.

Tread lightly — especially when free alternatives are widely available

Both Digit and Bank of America also overlooked the highly competitive nature of their businesses where free alternatives abounded. Soon after Digit's fee announcement, rivals including BoostUp, Chime, Clarity Money and Qapital took to social media to emphasize the free nature of their savings apps. Similarly, unhappy customers at Bank of America did not have to look far to find a free alternative. There was a long list of banks — including Wells Fargo and JPMorgan Chase — that were offering fee-free debit card purchases.

Consider monetization options early in product development

Before financial institutions charge fees, they must develop an understanding of their customers' willingness and ability to pay. This is arguably the most important first step; it cannot wait until the end of the product development process, or worse, after a bank has launched a new feature or service. By that point, it is too late for corrections, adjustments and alternative approaches.

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The Dangers of A Low Price

Economists would have us believe that no price is too low. But as pricers, we know that this is not the case, as our price communicates a great deal to our customers about the value of our product or service. In this article, the author examines the importance of the price-quality effect in developing profitable pricing strategy. Author Richard Harrington is a Pricing Consultant at Holden Advisors, and can be reached at rharrington@holdenadvisors.com.

As I went to pick up my morning coffee this week, I saw a sign that made me chuckle. In the window of a Dollar Store was an advertisement for steak – a full steak for only a dollar! Would you buy steak for a buck? Would you go for all-you-can-eat sushi for the low price of $10? Any takers? No one?

But why do we scoff? Economics would have us believe that no price is too low. As a steak lover, I should jump at the chance to have a favorite meal for so little money. So why did I pass up the opportunity? What is at play here is trust. It's assumed in economics, but trust drives business relationships and you ignore it at your peril.

In this case, we are looking at the price-quality effect. Any time I purchase a steak, I am trusting that every part of the supply chain is honest and is delivering me a fresh cut of meat that won't leave me in the bathroom at 2 am.

Absent the ability to view each part of the supply chain, two pieces of information fall in to place to drive trust:

- **Brand:** If a company has built up a reputation so a bad experience can do them damage, they have skin in the game and customers feel they can be trusted.
- **Price:** A high price signals that the cost to bring to market is reasonable, putting customers at ease about the quality of the purchase and the risks they are undertaking when they consume.

In B2B markets, the price-quality effect is especially important for products in the introductory phase of the lifecycle. As new customers have no experience with the industry as a whole, they see the risk of purchase as high.

If you price too low, they will be weary that you have priced in risks that they are not aware exist. In these circumstances, a low price can actually drive customers away from the market and a high price can soothe fears and encourage adoption.

In conclusion, beware dropping price and expecting a bump in volume, there are other factors at play that could come back and bite you!

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What Have Discounts Done for Us?

In this article, the author examines the pros and cons of discounting strategies and special pricing promotions, including offering insights and best practices for how frequently to use discounts and ways to design them profitably, using humorous parallels from the classic film "Monty Python's Life of Brian" *to drive home his points in a memorable way. Author Ben Langleben is VP Price and Portfolio Management at SKIM, a global market research and decision behavior analysis firm. He can be reached via https://skimgroup.com.*

Lessons on price promotions from "Monty Python's Life of Brian"

They've bled us white, the bastards. They've taken everything we had, not just from us, from our fathers and from our fathers' fathers.

– Life of Brian

This impassioned rallying cry, from a would-be rebel leader in the classic film "Monty Python's Life of Brian" might equally be on the lips of revenue management teams bemoaning the impact of price promotions which trade-off brand equity for a temporary sales spike.

With savvy shoppers snapping up bargains to squirrel away for the rainy days of regular prices, brands are lucky if fewer than 75% of discounted sales are cannibalistic in the long term. This leaves corporations to count the cost of deep discounts, when receipts are lower than might have been projected had no "special offers" have been offered. And that's even before factoring in the additional costs to manufacture the extra volume and get it into stores, further impacting margin, or the erosion of brand perception that chips away at one's ability to command a price premium.

All right, all right. But apart from better sanitation and medicine and education and irrigation and public health and roads and a freshwater system and baths and public order, what have the Romans done for us?

Corporations may wish they did not need to contend with price promotions. But for all their evils, promotions have several uses such as generating trial, growing and protecting share, monetizing spare capacity, and safeguarding distribution. They can even be useful for gleaning insights into what drives loyalty among the minority paying full price in the face of discounted alternatives. As such, promotions form an unavoidable part of pricing strategy life, though there is a limit to the pain before it outweighs the benefits.

Certain discounts are sufficiently deep that they yield no net gain at all. Merely measuring the success of a promotion on breaking even over the longer term suggests that tactical objectives may be distracting from the overall strategy, if not actively undermining it.

Every night, they take me down for twenty minutes, then they hang me up again, which I regard as very fair, in view of what I done, and, if nothing else, it's taught me to respect the Romans, and it's taught me that you'll never get anywhere in this life, unless you're prepared to do a fair day's work for a fair day's pay!

Volume growth might be delivered through price discounting, but it should rarely be treated as anything more than a proxy for the true objective of increased value. And optimizing the depth to discount is only part of the equation. At least as important is the timing of the promotion. Or to be more precise, the timing of promotion bursts relative to those of key competitors.

Shallower but staggered discounting may result in equal volume for the brands in question, but leave less money on the table from consumers just looking to buy the cheapest among brands in their consideration set on that particular day. Otherwise, an oft-used discount becomes the de facto "normal" price, above which consumers are not willing to pay. And the brand that once commanded a premium is reduced to being a price fighter, as Eric Idle concludes at the end of the film:

> An oft-used discount becomes the de facto "normal" price, above which consumers are not willing to pay.

They'll never make their money back, you know.