PROFESSIONAL PPS PRICING SOCIETY™

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Pricing Advisor™

Contents

What Is in a Price?

What is contained within a price? Price is a composite that integrates the solution, the value drivers the solution offers and a connection between the value metrics and the pricing metrics. It is more than a number. Even as a number, how a price is perceived is determined by anchoring and framing effects, as the author explains. Author Steven Forth is a Managing Partner at Ibbaka, a consulting and technology development company focused on helping companies bring innovations to market and to help them to scale. He can be reached at info@ibbaka.com.

by Steven Forth

Is price just the number on the price tag? Conversations about pricing can quickly come to focus on the number on the price tag. We start asking questions like:

- Is this the right number?
- Should the number end in '5' or '7' or '9'?
- When and how should we discount from this number?

People involved in price setting and price optimization seem to be especially susceptible to the "price is the number trap."

I am currently reading "Pricing Analytics: Models and Advanced Quantitative Techniques for Product Pricing" by Walter Paczkowski. This is a wonderful book on many levels. It gives one of the best practical explanations of price elasticity I have seen and an excellent introduction to quantitative research methods such as conjoint analysis, discrete choice and other approaches to quantifying buyer preferences for different price points. Anyone with a serious interest in pricing should read it. But it will not help most product managers set a price. Why is that? It is focused on the number that goes on the price tag, and that is only part of the story.

The first question most product managers (and service designers) will ask is what should the product be? That is to say, "What are the packages of functionality, data, integrations and services that fit different market segments?" To answer this question, they need to understand what the different market segments are. Market segments are not defined by industry, company size, location or other firmographics.

The best definition of a market segment is: "**A market segment is a set of potential customers that get value in the same way and that buy in the same way.**"

This is where the value-based pricing approach begins. It does not start with setting a price or estimating willingness to pay (WTP).

Once you understand the market structure, as defined by value, and have selected targets and designed packages for each target, the next question is "What are the value metrics?"

"The value metric is the unit of

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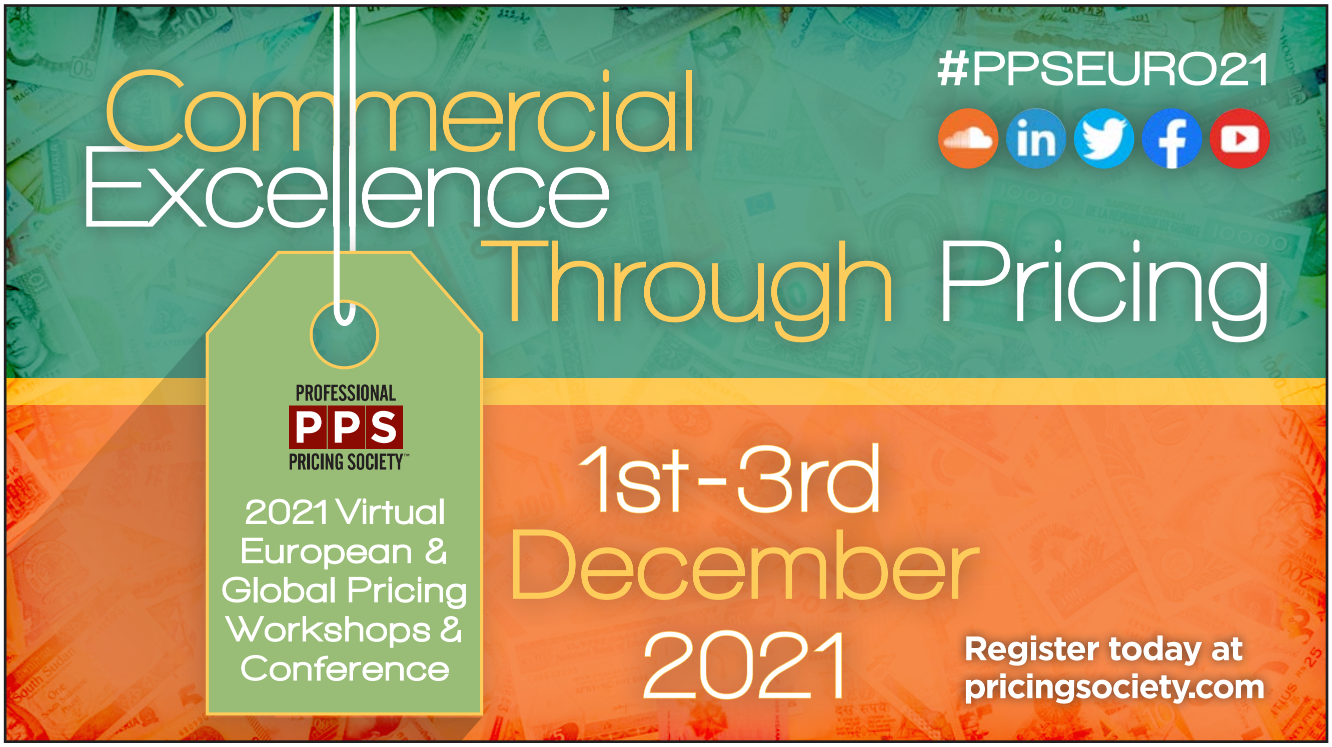

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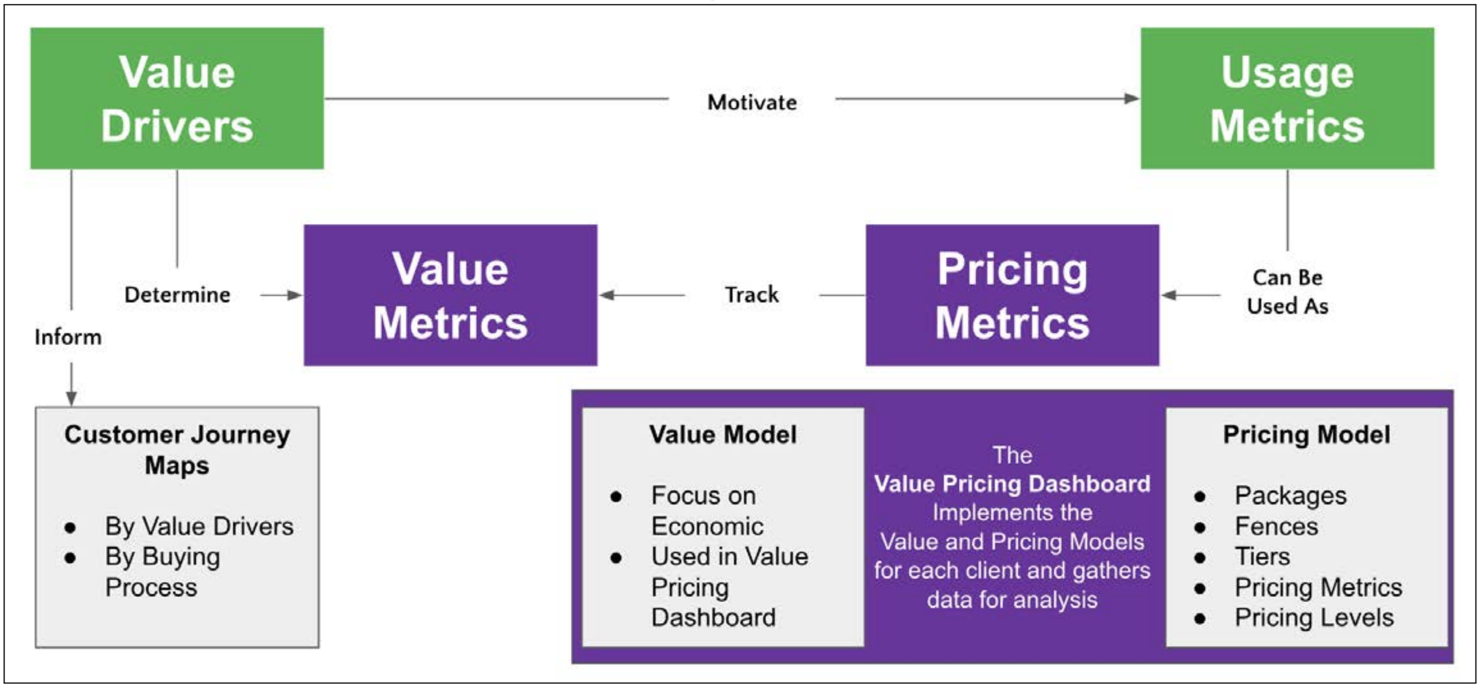
Figure 1



consumption by which a customer gets value."

The value metrics are discovered during the value-based market segmentation research. The next step is to choose a pricing metric. This is what the price tag represents, and not the number on the tag.

"The pricing metric is the unit of consumption for which the customer is charged."

The essence of value-based pricing is to find ways to connect the value metric to the pricing metric. Figure 1 shows how all of these pieces fit together.

Are we now ready to set the price on the price tag?

Yes, but there are other things to consider. The price is not just a number. It frames how buyers will perceive value. This is where behavioral economics comes in. Buyers do not evaluate prices alone. They do so in the context of their alternatives. Value-based pricing is built on differentiation value, as seen in Figure 2.

Behavioral economics teaches us to be concerned about two things: anchoring effects and framing effects. Both of these play a big role in pricing design.

Anchoring effects: The anchoring effect is a cognitive bias whereby an individual's decisions are influenced by a particular reference point (or 'anchor'). Once the value of the anchor is set, subsequent arguments, estimates, etc. made by an individual may change from what they would have otherwise been without the anchor.

Guiding a buyer to an anchor that positions value in a way that emphasizes positive differentiation is critical to effective pricing.

An example: One company had brought to market an innovative new tool for consensus-based decision making. They had positioned it relative to survey tools and were charging about $2,900 per month. However, after conducting some pricing analysis and consumer research, they were able to reposition their solution as an alternative to consultants and were able to increase the average sale to $19,000 per month. What the offer is compared to has a defining impact on how it will be

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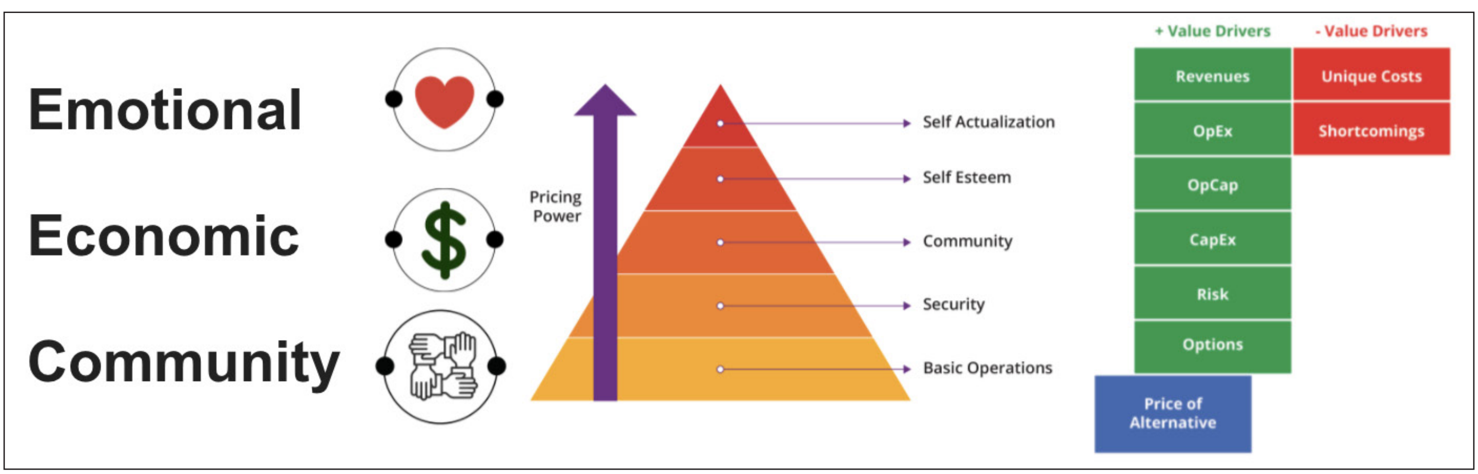
Figure 2



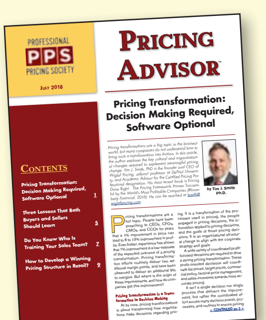
priced. Think very carefully about anchoring effects.

Framing effects are a cognitive bias where people decide on options based on positive or negative connotations (e.g., as a loss or as a gain). People tend to avoid risk when a positive frame is presented but seek risks when a negative frame is presented. In other words, most people prefer to avoid a loss rather than achieve a gain. This is one reason why reducing costs can be better received than increasing revenue. One needs to take framing effects into account when constructing value messages.

Note though that there is a segment of people with the opposite behavior. These people, who are disproportionately represented among salespeople, entrepreneurs and early-stage investors, prefer the chance of a gain more than they fear the risk of a loss.

What is in a price then?

Price is a composite that integrates the solution, the value drivers the solution offers and a connection between the value metrics and the pricing metrics. It is more than a number. Even as a number, how a price is perceived is determined by anchoring and framing effects. There is no way that a simplistic estimation of pricing elasticity or willingness to pay is enough to guide pricing decisions. It is not even enough to put a number on that price tag! ❖


PROFESSIONAL PPS PRICING SOCIETY
PRICING ADVISOR
Pricing Transformation: Decision Making Required, Software Optional
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Partner Pricing Strategies and the Semiconductor Power Struggle

Strategic partnerships go hand-in-hand with strategic pricing. As the explosion of electronic devices and demand for them continue, and as the shortage of semiconductors continues to exacerbate issues, it's never been more apparent that all companies need to adapt by understanding their customer and building value beyond pricing. Although focused on the semiconductor industry, this article highlights post-COVID pricing challenges and potential solutions for many sectors. Author Jennifer Gross is the Industry Marketing Manager at Vistex. She can be reached at jennifer.gross@vistex.com.

by Jennifer Gross

When the chips are down, how do we defeat the pain of pricing? "If you build it, he will come" doesn't work for the semiconductor industry. And for their manufacturing customers, that field of dreams where you carry no inventory and offer short-term flexibility is likely disappearing. As industries such as automotive ponder their next moves and the semiconductor industry struggles to keep up with demand, all players will need to become partners and align their short-term and long-term pricing strategies to come out on top of the supply chain disruption as successfully as possible.

It's time to prioritize your next move, not throw in the towel

If carmakers re-think just-in-time ordering and commit to contracts that can't be canceled, they can develop a win-win situation with chipmakers and their own customers. This will require pricing strategies that work for everyone. Many large companies understand this way of doing business and are making the move today. Even in the automotive industry a few have already accepted the proposition. Toyota is already a step ahead, which is ironic given they were the pioneers of just-in-time ordering. With data in-hand, Toyota made the strategic decision to purchase a large enough inventory of chips to return to pre-pandemic profitability. In the short term, Tesla's pricing strategy is to pre-pay for inventory to secure stock and lock in pricing. As a long-term strategy, they are considering buying their own foundry.

Now more than ever it's important to think differently and creatively to drive better pricing. Fabricators are raising prices, so there's no longer discussion on price. Now the discussion is: how much more are you willing to pay?

No magic formula needed

Better pricing is developing a framework to collect the right data and identify what strategy is appropriate in what context.

We know that rebates and cross-selling strategies drive better pricing. Rethinking your pricing structure for design registration is another way to make a significant shift. You can drive better pricing by tying pricing and discounts to the complete design. When electronic components are designed, registered with a supplier, and the design is supported, the manufacturer can give the distributor a preferential buy price so that the savings pass on to the customers. Using rebates to ensure the full design is purchased is another consideration that will drive better pricing.

Line of sight is crucial to your winning strategy

Pricing in the semiconductor industry is developed more scientifically compared to other industries such as consumer goods and healthcare. The objective is to find the right strategy for the specific product category. Determination to win at building a stabilized relationship and eliminating some of the massive industry ups and downs is a significant shift needed moving forward. A defined window of time for supply over a fixed period is a commitment to fabricators that manufacturers need to achieve.

How do you get there? What determines that window of time?

You reach that pivotal point by having the mindset to mine your data appropriately and efficiently, so you understand where you're at without getting stuck. It's painful to do the soul-crushing work of trying to glue all of your data together to appropriately develop a strategy when you're working within disconnected systems. You create a "swivel chair" effect working through many different tools and systems on multiple screens that consume your workspace. You will work more efficiently and win at pricing strategies more frequently by using a centralized pricing tool to create one set of data rather than sifting through multiple data sources.

> **As the explosion of electronic devices and demand for them continues, it's never been more apparent that all companies need to adapt by understanding their customer and building value beyond pricing.**

Come out bigger and stronger

Strategic partnerships go hand-in-hand with strategic pricing. As the explosion of electronic devices and demand for them continues, it's never been more apparent that all companies need to adapt by understanding their customer and building value beyond pricing. ❖

When Pricing, Don't Forget Your Story

Pricing professionals have many tools in their toolboxes, but in this article, the author reminds pricers to not underestimate the power of storytelling in pricing projects. Shepherding a management decision can be difficult. Without a story that goes beyond presenting pricing analysis and clearly communicates the results of the analysis, it is nearly impossible. Author Nathan L. Phipps is a Consultant at Wiglaf Pricing. He can be reached at nphipps@wiglafpricing.com. Nathan will be presenting at the PPS European Virtual Conference in December. Register today at www.pricingsociety.com.

by Nathan L. Phipps

When I first started my career as a pricing professional, I was under the impression that my pricing analysis would simply speak for itself. I would take the time to crunch the numbers and to create striking visualizations that would guide management in their decision making and lead them to the optimal solution. Management would be impressed with my impeccable equations. They would simply affirm my results, congratulate me on a job well done, and then point out the direction of the next dragon for me to slay.

What I did not count on is that executing a quantitative analysis requires a different skillset than communicating the results of that analysis. It is an insight that I am sure that many pricing professionals can confirm.

Shepherding a management decision can be difficult. Without a story, it is nearly impossible.

Start with your quantitative analysis

Pricing professionals must deal with numbers. Standard transactional analysis will involve analyzing prices (both invoice and pocket), quantities, rebates, discounts, and costs.

Any topic with numbers can be quantified, and we use these numbers to represent reality. Quantitative analysis applies mathematics and statistics to these numbers to provide insight into prior events or the prediction of future events.

However, you cannot just throw your numbers into a few equations and walk away. Your true goal is to provide context and facilitate management conversations to drive pricing decisions. Mountains of data visualizations alone cannot drive pricing decisions.

You must make your audience care, and you do that by answering why. Why are these results important? Why does this impact us? Why does it matter?

For every single slide, your audience will be asking, "Why are you showing me this?" So, you must begin your presentation with "why?" in mind.

Find the compelling narrative

The trick is to find the story in your data. Where is the compelling narrative? By applying storytelling to your data, you will be able to have a more meaningful impact on your audience in less time.

People do not remember numbers. People remember stories. People are inspired by stories. Stories engage people emotionally, and that can be an impetus for change.

Finding your pricing story is important. Human brains do not react to data the same way they react to stories. Storytelling has deep roots in the human psyche, eliciting responses that were developed thousands and thousands of years ago. Anthropologists have found that all cultures engage in storytelling. Before the written word, people passed down their histories using stories.

At the most fundamental, a story has three parts: 1) how things were before (i.e., the status quo), 2) something happens, and 3) how things changed after. So, look at all the players in your story. Look at the data. Determine what changed. And find the story that your facts support.

Storytelling tactics

Not everyone is a natural storyteller, but storytelling is a skill that you can practice. There are many tactics to tell better stories. First, you can add some suspense or a cliffhanger to your story. Suspense will keep your audience focused on your narrative. Draw it out. Built it up. Spice up your story with details.

Second, tell your story with empathy.

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Always be aware of the human element and strive to bring that to the forefront. Using empathy will connect you to your audience. Connecting to your audience makes it more likely that they will bond with you and trust you. If you can, speak to your audience's experience directly. And be vulnerable enough in your storytelling that your audience can live vicariously through your experience.

Finally, use humor if you can. Humor puts people at ease and can help to break the tension. Naturally, keep the humor appropriate, and recognize that humor takes practice. In a high-stakes meeting, you may want to shoot for a base hit instead of swinging for the fences.

And always be mindful of the makeup of your audience. You will want to present a different story to a panel of technical experts than to the executive team.

Pricing professionals have many tools in their toolboxes, but I advise all of you to not underestimate the power of storytelling in your projects. ❖

Data-Driven Pricing Can Increase Your Profit

Many pricing professionals believe that a value-based approach is the best way to set a fair price for your products and services. But data-driven pricing, when done right, will also lift your profit margins in the short term. Here's the story of how hunting down hidden data turned profits around for one company. Author Mike Cannestra is Vice President at Holden Advisors, where he focuses on helping companies improve their pricing practices with a focus on getting closer to the customer. Over his career, Mike has worked in Business Development, Sales, Sales Operations, Finance and Accounting across various industries. He can be reached at mcannestra@holdenadvisors.com.

by Mike Cannestra

I am a firm believer in value-based pricing. But more often than not, companies don't commit the time nor the resources to uncover and quantify the value they create for their customers. Instead, they depend on cost-plus pricing, market pricing, or even "gut-feeling" pricing because that is what they have done historically.

In lieu of value-based pricing, using a data-driven approach is often the next best option. In fact, data analysis is a critical step in price setting or refining prices.

Let me tell you a story about harnessing the power of analytics. Fifteen years ago, I was in charge of worldwide pricing for a data storage company that mainly sold hard drives. It was my responsibility to set the channel price in the Americas, EMEA, and APAC. Before I was assigned the role, the only piece of pricing data collected was the competitive price. Interestingly, this data was supplied by the sales team, who received the data from the distributors. I had a strong suspicion this data was compromised as the distributors had the motive to reduce our pricing to them in order to make more profit.

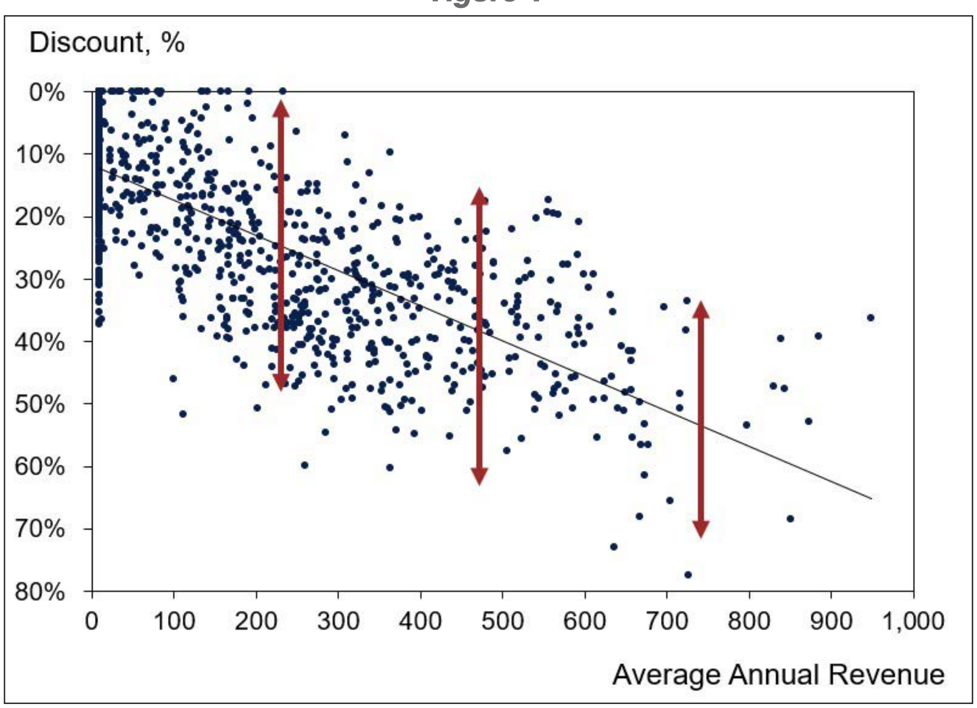
To get a more balanced picture of pricing, I immediately searched for additional data sources. I found an IT person with incredible knowledge of the data collected in the accounting systems. With his help, we pulled together reports that painted a picture of demand, supply, and distributor operations. See Figure 1.

Within a month, we had weekly reports that examined:

- **Special pricing authority requests by both region and product.** This told us:
  - How often and at what volume special pricing was requested. From this, we could see whether there had been pricing pressure across a region or just for a specific opportunity.
  - Which distributor originated the special pricing request and if there was consistency across the region.
- **Distributor inventory reports.** We had access to the distributors' inventory levels, so we started pulling reports based on inventory levels like:
  - **"Weeks on Hand" reports:** These helped us see if distributors were asking for pricing discounts when they had less than two weeks of supply.
  - **Inventory turnover reports:** This provided a view of end-customer demand. From these, we learned distributors were asking for reduced prices even though the product only sat on their shelves for a day or two.
- **Order demand reports.** As it turns out, distributors placed regular product orders going out six months because they knew their customers had large builds. This proved our distributors had no reason to ask for discounted pricing as those orders had confirmed pricing.

Within a few months, we generated a robust reporting system across all product lines and all three regions. Based on the data, we were able to make calculated decisions on whether to increase or decrease our list prices. As you can imagine, we INCREASED prices. In fact, we increased prices at a pace the industry had never experienced with little to no im-

Figure 1



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pact on order volumes, driving this price improvement straight to the bottom line.

The sales team pushed back on our new process, as they were getting an earful from the distributors who saw some of their profit become our profit. Explaining our new data-driven methodology to the sales teams in every region was a big task, though it was worth the effort as it took the emotion out of pricing decisions.

I still think value-based pricing is the best pricing method. But if you do not have the time or resources, data-driven pricing can impact decisions immediately. And with your successes, the increased profits will fund the resources to tackle value-based pricing initiatives.

My advice: find yourself a great data partner who understands all the information that lurks in the accounting and operational systems. You will be amazed at the number of reports you can generate and the impact you can have to drive higher margins! ❖