PROFESSIONAL PRICING SOCIETY

The PRICING ADVISOR

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Competition in the market can restrict pricers' options for adjusting pricing strategy. Rather than reacting to competitors' strategies with pricing concessions, as many companies do, the author suggests analyzing each situation and calculating the proper response to specific competitive price pressures. He presents a "Strategic Price Reaction Matrix" to facilitate this analysis. Tim J. Smith is the managing principal at Wiglaf Pricing, adjunct professor at DePaul University, a frequent PPS speaker, instructor and presenter, and the Academic Advisor for the Certified Pricing Professional designation. His most recent book is Pricing Strategy: Setting Price Levels, Managing Price Discounts, & Establishing Price Structures *(South-Western Cengage Learning, 2012). He can be reached at tsmith@wiglafpricing.com.*

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Competitive Price Pressures? How to React and Why

In free markets, competition is the norm, not the exception, and that competition will limit your latitude for pricing. When competitors lower prices or new competition enters at a lower price, many a novice manager's gut reaction is to lower prices—but the cost of price concessions may be higher than the cost of customer losses. Experience will temper these beginner instincts over time, but there must be easier and less costly ways to identify the proper reaction to competitive price moves than the school of hard knocks. Perhaps we need a refreshed guide map to show how the game should be played depending on the cards one is dealt.

In an attempt to address this issue, what follows is a **Strategic Price Reaction Matrix** that can be used to calculate the proper response to competitive price pressure. Kinichi Ohmea's 3 C's of corporate strategy—customers, competitors, and the company itself—defines the players. The principals of competitive advantage and value-based pricing define the dimensions. To win, the firm must earn more profits than its competitors.

Second place goes to the survivors who will live to compete again in the next round. Losers are the firms that go under. Given these ground rules and objectives, we can identify the optimal moves dependent on the firm's position.

The Positions

The first obvious dimension of the Strategic Price Reaction Matrix is a measure of the **relative attractiveness of the firm's offer to customers.** We choose to examine the relative attractiveness to customers, not the absolute attractiveness, because customers make tradeoffs between offers. Also, we are examining the whole offer, not just the price, because, in aggregate, customers will choose offers that deliver them more value after comparing both benefits and price.

If the firm's offer is more attractive to

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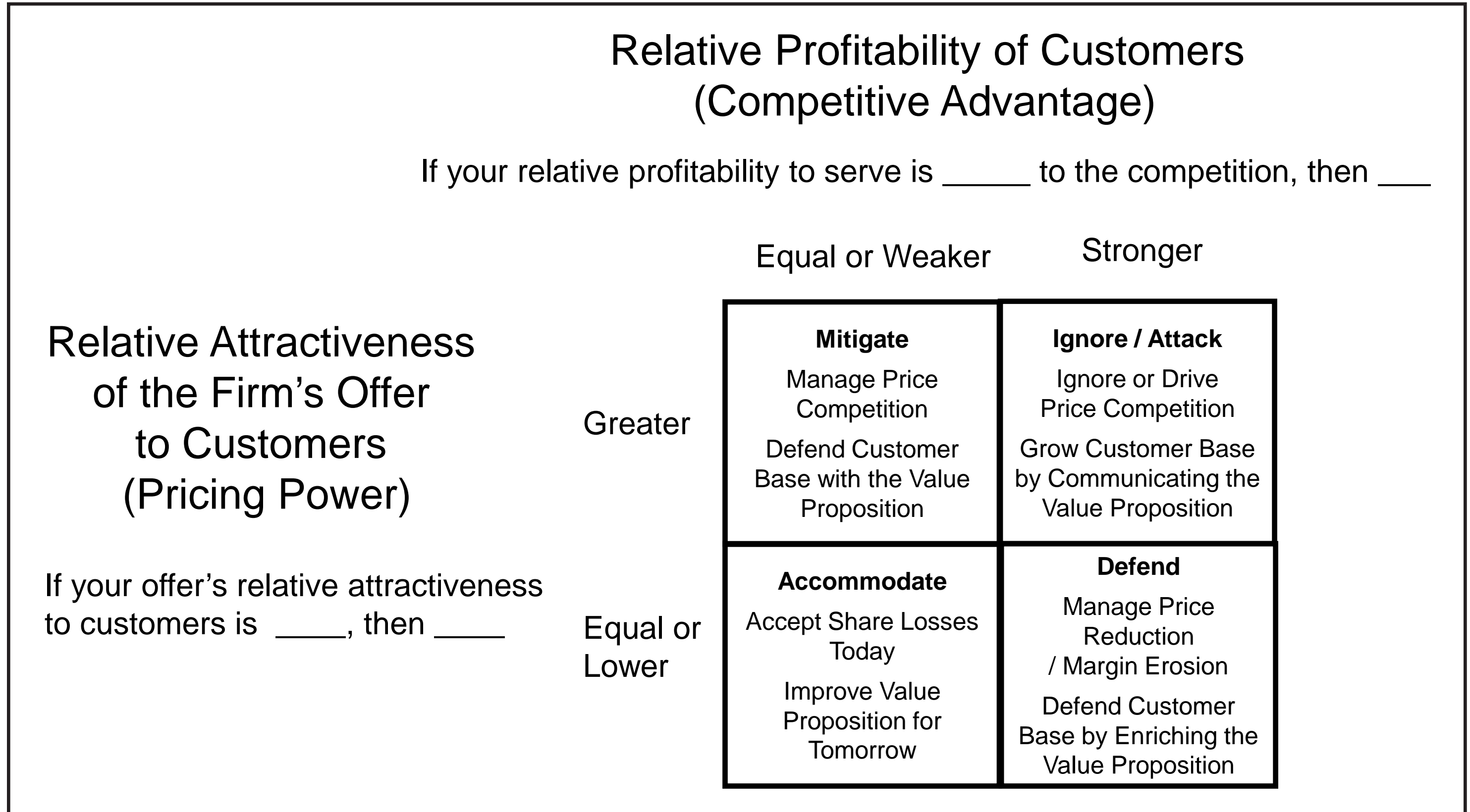
Figure 1: Strategic Price Reaction Matrix



customers than its competitors', the firm has **pricing power**. That is, the firm may be able to maintain or increase a positive price differential between its offer and its competitors' without losing market share due to the customers perceiving that the firm's offer delivers more benefits than its competitors.

If the firm's offer is no more attractive to customers than its competitors' offer, or, worse, is less attractive, then the firm will have little-to-no pricing power and price competition will be felt acutely across the firm. In these situations, the firm must either match price reductions and manage margin erosion or otherwise cede market share. It may be able to take steps to reduce pricing pressure, but in the short term, margins, share, or both will be reduced and the firm will have to manage these challenges until it can develop and deliver an improved offer.

The second dimension of the Strategic Price Reaction Matrix measures the **relative profitability of customers**. We choose to examine the relative profitability, not the absolute profitability, because relative profitability reflects the competitive advantages of the firm, if any. In the resource-based view of the firm, competitive advantage is created through having a unique and inimitable resource that enables the firm to deliver more benefits to customers with a smaller comparable cost increase than its competitors, or reduce costs with a smaller comparable benefits decrease than its competitors, or both simultaneously. Either way, a competitive advantage should be reflected in the firm's relative profitability.

If the firm's profitability for the impacted customers is higher than the profitability which the competitor could achieve with those customers, then the firm has a competitive advantage. The firm can use that competitive advantage to either attack a competitor's customer base or defend its own customer base.

Alternatively, if the firm's profitability for the impacted customers is equal or lower than the profitability that the competitor could achieve with those customers, then the firm has no competitive advantage in that market. In this situation, the firm may be able to take actions to limit price competition, but without a competitive advantage it may be more profitable to accommodate a competitor than compete with them head-on in a price war.

The Moves

Having defined the dimensions and metrics of the Strategic Price Reaction Matrix, we identify four stances a firm should take in response to a competitive price threat depending on its situation: Attack, Defend, Mitigate, or Accommodate.

If the firm both earns stronger profits in serving the impacted customers (possess a competitive advantage) and customers perceive the offer as more attractive (possess pricing power), then the firm should **attack**. In this position, the firm can leverage its value proposition to attract customers profitably. Even if a competitor lowers prices or enters with lower prices, the firm in this position can ignore some of this price competition due

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to its overall value proposition of delivering more benefits after subtracting the price to capture those benefits than its competitors. This is clearly the ideal position to attain, but not all firms can attain this position.

If the firm earns stronger profits in serving the impacted customers (possess a competitive advantage) but customers do not perceive its offering as more attractive (lacks pricing power), then **defending** its market position is merited. Defending the firm's market position might require enriching its value proposition through a price reduction. Clearly, price reductions will erode margins, but due to the firm's relative competitive advantage it should retain a more profitable position than its competitors and the cost of this price reduction should be less challenging then the potential cost of lost market share.

If the firm does not earn stronger profits in serving the impacted customers (lacks a competitive advantage) but customers' do perceive the offer as more attractive (possess pricing power), then the firm may find itself **mitigating** price competition. In mitigating price competition, the firm will be forced to engage in some level of reacting to a competitor's price moves, but only up to a point.

Due to the attractiveness of the firm's value proposition, market share should be somewhat defendable without heavy price concessions through communicating the benefits of the firm's offering. When direct price competition does heat up, it will harm the firm as much if not more than its competitors, therefore the firm should try to manage price wars towards swift conclusions and otherwise avoid direct price competition.

Finally, if the firm both does not earn stronger profits in serving the impacted customers (lacks a competitive advantage) and customers do not perceive its offering as more attractive (lacks pricing power), then the firm will have to **accommodate** competitive share gains in the short term in the hopes of improving its value offering for the next cycle of competitive engagement. In this position, the firm does not have the pricing power to ignore competitive price moves nor does it have the margin position to win a price war, therefore customer losses are likely to be less costly than margin losses.

Not all of the positions are equally attractive – yet real life doesn't always deal you a winning hand. Just as in a standard hand of Texas Hold 'Em, the chances of holding the strongest hand is only one in ten. So it is in free market competition: you won't always have pricing power and a competitive advantage and you can't always win every customer profitably. Yet in an evening of playing Texas Hold 'Em, the real winners are determined by how they read their relative situation and act accordingly. So it is in business. Perhaps this Strategic Price Reaction Matrix will help some managers read their cards and play the game better.

So it is in free market competition: you won't always have pricing power and a competitive advantage and you can't always win every customer profitably.

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Ten Growth Initiatives for B2B-Focused Companies in the Middle East

In this article, the author presents ten growth initiatives that can help companies, particularly new market entrants, avoid price wars and grow profitably in the challenging market environments of the Middle East. Although this article is market specific, it presents numerous strategies that pricers in any global market can apply to their specific pricing situations and challenges. Author Lovrenc Kessler is Managing Director of Simon-Kucher & Partners' Middle East office in Dubai. He can be reached at lovrenc.kessler@simon-kucher.com.

With Gulf Cooperative Council's (GCC) GDP growth accelerating again, companies are proudly announcing revenue growth quarter after quarter. Yet economic growth also attracts more competition, and the arrival of new market players inevitably puts prices and profits under pressure. B2B industries are particularly susceptible to these risks.

These ten growth initiatives can help companies, particularly new market entrants, avoid price wars and grow profitably in the challenging market environments of the Middle East.

1. Prioritize your goals and define your pricing strategy

Successful companies have a clear goal hierarchy in place: They know exactly what they are after in terms of revenues, profits, market share, and so on.

Equally important is a consistent pricing strategy that defines the price-value positioning in the market. "Should we address the low end? Should we be premium? How will we react if competitors cut their prices?" Market leaders have answered these questions in a clearly phrased pricing strategy.

2. Select your target customers: Which customers do you – and don't you – want?

Key account managers are primarily rewarded according to their annual sales volume. While this ensures that they fight for every deal, they tend to forget the profitability side. Best-in-class companies consistently monitor the margin contribution of their accounts (which can be tricky in B2B industries with complex products). If customers generate a negative margin contribution, contracts are adjusted promptly.

3. Choose the optimal revenue model for your products/services

A successful revenue model is based not on internal (variable) costs, but on the value it delivers to the customer. B2B sales contracts involve a wide range of pricing dimensions that need to be tailored to the needs of specific customer segments. Should you charge per item? Per customer? Per product category? Per delivery? Per weight unit? Per unit of usage (e.g. per km)?

In one case, a logistics company signed a five-year contract with a TV manufacturer to become its exclusive TV delivery partner. It negotiated a fixed price per TV delivered. But over the years, TV sizes increased from an average of 37 inches to 45 inches, so the company could no longer deliver as many TVs per truck. This resulted in negative margins and almost made the logistics company bankrupt.

4. Be consistent with your list prices (price levels, gaps, upsell path)

Companies in B2B industries often sell hundreds of product categories and several thousands of SKUs. The key challenge is to have consistent prices across all these products. A simple example from the automotive industry: A supplier sells alloy rims for multiple car segments in multiple sizes (diameter, width), resulting in hundreds of variations.

A systematic assessment revealed that medium-sized rims (16x7) were priced 15 percent lower than small rims (16x6.5), although production costs were equal. By adjusting prices (medium-sized rims priced above small rims), the supplier was able to increase its revenues by almost 30 percent.

5. Introduce new pricing dimensions, e.g., monetize value-added services and systematically introduce surcharges

Have you recently checked the variety of VAS that you offer your clients, and, more importantly, how often do you charge for them? B2B customers quite often ask for additional services and have special requests regarding delivery, technical support, and so on, yet only a few companies dare to charge for them. Take road toll charges, for example: In the UAE, home/office deliveries are typically free of charge. Until recently, toll charges were capped at AED 24 (USD 6.50) per day. Since this cap was lifted, only a few companies have started to add toll charges to their invoices to protect their margins.

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6. Establish a consistent discount structure in line with your pricing strategy

When dealing with key accounts, it is vital for every company to give the sales force a systematic discount structure to protect margins and avoid revenue dilution. How much should the maximum discount be? What should it be based on: order size, sales volume, length of customer relationship? A simple "growth matrix" can help to plot various scenarios (e.g. large volumes, rapid growth of the client) to determine the right discounts. Successful companies have very stringent discount schemes that give the largest rewards to the customers that contribute the highest revenues and profits.

7. Implement a simple, transparent sales commission/incentive scheme that supports your goal hierarchy

Far too often, sales commission schemes reward those who generate the largest sales volumes. However, this might not be in line with the company's goal hierarchy. If the goal is to increase profitability, the incentive scheme should also factor in the profitability of each deal, i.e. a sales manager who generates a high margin should also receive a large bonus. Best-in-class companies provide their sales force with easy-to-use decision support tools. Account managers can check during customer negotiations how the price will impact their commission.

8. Provide systematic guidance to your sales force in deal negotiations

Closing a deal in the B2B world can be tough. Many companies compete for a single customer, and the customer likes to exert pressure with phrases such as "If you don't lower your price, I'll buy from somebody else." Yet in most cases, the situation is not hopeless.

Price is an important factor, but not the only one. Instead of willingly conceding price discounts, successful companies have coached their sales force on how to act in difficult price negotiations. They suggest drafting a consistent "order of concessions". Starting with the list price, account managers may offer incremental value (a) first. The next step is a one-time discount (b) and, only if required, the customer may be granted a recurring discount (c). If that is still not enough, the sales manager should stop at the internally set "walk-away price" (i.e. no deal beyond that price point). When was the last time you congratulated a salesperson for walking away from a (prospective) customer? If you can't remember, you should reconsider your sales strategy.

Today's poor pricing is tomorrow's forgone profit – and the day after tomorrow's lost investment capital.

9. Monetize alterations to the standard payment terms

In banking, interest rates are a reflection of risk: the higher the risks, the higher the rates. The same goes for payment terms. Earlier payments reduce the risk for the beneficiary; that's why companies are willing to grant their customers a discount in exchange for early payments.

But how about late or partial payments? Very few companies have institutionalized their payment terms in their T&Cs to the extent that automatic fees are imposed in response to payment violations. In B2B industries where free cash flow can become an issue, charges for late payments should be automatically imposed. Yet this can be done in a "positive" way. Best-in-class companies offer their customers late payment options as a value proposition for a price premium.

10. Institutionalize annual price level adjustments

In many B2B industries, raw materials and supplier costs account for the largest portion of variable costs. These costs typically augment year by year, but producers struggle to pass these cost increases on to their customers. Even inflation is hardly factored into the final price.

To avoid margin dilution, best-in-class companies have introduced annual price increases (known as APIs) in their terms and conditions. Towards Q3 of each year, they communicate the APIs for the next year to their customers, who immediately incorporate them in their budget planning.

Achieving profitable revenue growth is a constant battle, and each industry and company faces its own particular challenges. Yet top management should constantly keep an eye on pricing, as this is the key indicator of long-term growth. Today's poor pricing is tomorrow's forgone profit – and the day after tomorrow's lost investment capital.

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Price Transparency is Leaving Many Companies Feeling Naked!

Handling global price transparency is becoming a priority for most organizations, as consumers are able to access and compare global market pricers online before making a purchasing decision. Companies must become more adept at developing pricing strategies that address the challenges of price transparency or be faced with conflict both internally with channel partners, and with end users. In this article, the author presents steps for effectively managing price transparency. Author Paul Hunt is the president of Pricing Solutions and a frequent PPS contributor (phunt@pricingsolutions.com). He also writes a monthly pricing column for the Financial Post (www.financialpost.com).

Handling global pricing transparency has become a hot button for many companies, with Amazon acting as the catalyst. Customers are getting access to prices on a global basis from the web, and are able to compare the prices they pay in their market versus what the product costs in another market, all in a matter of minutes.

For example, one U.S.-headquartered company started experiencing a sharp decline in sales in some of its key markets such as Europe, Japan and Australia, while sales in the U.S. were growing rapidly. The root cause? The price gap between buying online from the U.S. versus the local market was so large that customers were ordering the product from the U.S. Even with the additional shipping and duties, the total savings were sufficient enough to warrant the additional costs.

This problem is very noticeable among companies selling through distribution channels. **Price transparency is increasingly conflicted because channel partners are being embarrassed by prices customers are finding on the web.**

In Japan for example, the electronics industry has historically had retailers that provide a great deal of service to their retail customers: at a price premium. The price gap has been as much as 50-60% higher versus the price paid in the U.S.

However, now that Japanese consumers are seeing the gap in pricing between the U.S. and Japan they are going to stores to help with product selection, but then ordering online. So what if shipping costs an additional 15%? It's still worth it!

If you are a U.S. manufacturer and value your Japanese channel customers, how do you adjust your pricing strategy to ensure you are competitive? I suggest following these steps to start gaining control of your pricing, and managing price transparency rather than being managed by it.

Customers are getting access to prices on a global basis from the web, and are able to compare the prices they pay in their market versus what the product costs in another market, all in a matter of minutes.

1. Understand all elements of pricing (price waterfall) between you and your end user. This includes:

- Freight costs
- Importation duty
- Local taxes
- Currency considerations
- Proximity to the lowest priced market and visibility of pricing in the lowest priced market
- Channel margin expectations

This will help you understand when a price gap is excessive. Identifying excessive price gaps requires some tough decisions. Are your channel partners providing sufficient value to warrant the margins they are charging? Do we need to take a price cut in markets in which we are overpriced?

2. Develop a baseline price from which you can index all other prices. If your headquarters is in the U.S., then your base price is likely to be the U.S. market. If it is in Europe, then it is likely to be Europe.

Whichever the market, you need to be continually monitoring the price gap between different markets into which you are selling. For example, one company made the U.S. MAP price their index price, and they have set a threshold price gap for each of the other markets into which they sell. When they go outside of that price band then they need to make an adjustment to get back inside guide-

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lines to avoid pricing conflict.

3. Recognize differences in product profitability and lifecycle. Value differences for a product can be significant between different markets. For example, a brand in one market may be seen as a premium product while in another market it is considered a "me too." This can lead to significant price variation, but with price transparency the customer can now see the price in the "me too" market and get access to it.

Now, companies must manage value globally. It is not good enough to do it on a regional basis. And you must determine which markets will be the drivers of pricing for your product.

If a company has a product with very high perceived value in Europe (say, worth 30% more than next best alternative), but it is "me too" in the U.S. (worth parity to next best alternative), then the company must decide which market will play the more important role in its pricing and adjust accordingly. This may involve raising the prices in the "me too" market or lowering the price in the high value market. Either way it's not a desirable position to be in; it raises the importance of creating "global brands" that are valued by customers in all markets.

Global pricing transparency is a difficult challenge to wrestle to the ground. It requires more coordination between the regions and much greater transparency internally. But there is no choice about whether to manage prices globally!

Companies must become more adept at developing pricing strategies that address this challenge. Those that succeed, will experience greater growth and profitability. Those that don't will be embroiled in conflict both internally with channel partners, and with end users.

Now, companies must manage value globally. It is not good enough to do it on a regional basis.

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Adding Fees That Consumers Won't Hate

In this article, the author examines a recent lawsuit against TicketMaster and resulting pricing strategies by large industry competitor StubHub and uses these examples to demonstrate how all companies can benefit from smarter sequential pricing. By strategically setting customary additional charges in a manner that engenders a sense of fairness, companies can enhance their brand. Rafi Mohammed is the founder of Culture of Profit LLC, a Cambridge, Massachusetts-based company that helps businesses develop and improve their pricing strategy, and author of the The 1% Windfall: How Successful Companies Use Price to Profit and Grow. *This article originally appeared on the Harvard Business Review web site at HBR.org.*

TicketMaster recently settled a pricing-related class action lawsuit that provides important pricing lessons to all businesses. In addition to paying for admission to an event, the ticketing giant used to tack on additional charges such as convenience, facility, order-processing, and delivery fees to purchases. The class action plaintiffs claimed these fees were misleading; had they known TicketMaster was making profit off the order-processing and delivery fees, the suit claimed, they might not have purchased.

As a pricing consultant who goes to a lot of concerts, I'm particularly interested in this litigation. When I read the lawsuit, my first thought was that it's crazy. Why is it anyone's business how a company's profit is structured? Isn't it the final price that matters—if you pay $25 to attend an event, does it really matter what individual fees (and the associated profit structure) that cumulatively make up the final price?

But then I thought about a purchase I recently *didn't* make. I send engraved thank you cards to friends and business associates as an expression of my gratitude.

Recently, I was pleased to see my favorite cards on sale for $19 (for a box of 10) on a leading ecommerce site. Ready to purchase, at checkout a $6 shipping fee popped up. "Six dollars to ship a box of cards?" I noted with a twinge of anger. I felt the e-tailer was taking advantage of me and as a result, I didn't make the purchase. I later reflected on this experience and concluded that had the price been structured as $25 including shipping, or even $22 plus $3 shipping, I would have purchased. It was simply the $6 shipping fee – not the total price – that bothered me. All of a sudden, $25 wasn't $25.

Understanding this consumer behavior, StubHub recently moved to an "all-in" pricing strategy. Market research by the eBay-owned ticket reseller revealed their buyers didn't care for the mandatory additional fees that were tacked on at checkout. Previously, after agreeing to a ticket price, customers were hit with a delivery charge as well as a sketchy 10% "buyer fee." While a delivery charge is reasonable and customary, this "buyer fee" seemed out of place (or at least could have been phrased better). For example, since StubHub provides excellent fraud insurance (if a resold ticket is fake, one call to StubHub will get you into the event no matter what), this charge would have been more consumer friendly had it been labeled a "buyer security fee." Now Stubhub includes all fees in the initially viewed price. As a result of moving to this all-in pricing strategy, StubHub claims its customer satisfaction ratings have increased by 10 points and sales are growing.

Since $25 is indeed $25, why do individual component prices matter? To be clear, customers don't always behave in an economically rational manner. After all, is 99 cents significantly cheaper than one dollar? Most consumers behave as if it is, which is why so many prices for consumer goods are set at a penny below a round dollar value.

The key lesson is that many customers evaluate prices sequentially. Each presented price in a transaction is judged for fairness. Thus, even if the total price is acceptable, a charge that is not customary or seems unusually high puts the entire transaction at risk.

Companies can use this understanding of sequential pricing decision-making to their advantage. To be clear, I don't recommend including all of the customary charges into the initially presented price – as StubHub now does – for two reasons. First, this "all-in" price will likely be higher than the "first" price (before additional charges) of competitors, which can be disadvantageous.

But more importantly, it's the act of having customers review (and evaluate) these customary charges that is critical to boosting a company's brand. For instance, if shipping is "free," we all know that it is baked into the price. However if shipping is presented as a low-priced "pass through" cost to customers, many of us will code this as being fair.

I'm dubious on the merit of class action plaintiffs' key claim – they might not have purchased had they known TicketMaster was earning profit from ancillary fees. After all, what's next? Outlawing "free shipping" in favor of "shipping included?" Still, the lawsuit highlights how all companies can benefit from smarter sequential pricing. By strategically setting customary additional charges in a manner that engenders a sense of fairness, companies can enhance their brand.