PROFESSIONAL PRICING SOCIETY

The PRICING ADVISOR

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Banks cannot expect customers to be loyal purely for the sake of convenience. Customers know that they are doing their bank a service and expect to be rewarded. In this article, the authors explore loyalty schemes for banks to employ that will help them both retain higher levels of customers and also increase the revenue from this customer base. This industry specific example provides pricing strategies that can be employed in multiple industries. Dr. Jan Engelke, based in Switzerland, is Partner in Simon-Kucher's Banking Competence Center. Matthew Jackson is Manager in the consultancy's Banking Competence Center and located in Simon-Kucher's office in Dubai.

Loyalty 2.0: Time for Banks to Level Up

Banks are continually frustrated as they try to develop new methods for retaining customers, selling them more products, and increasing their satisfaction. Looking outside, they perceive a hoard of cutthroat competitors; within, they see a fickle customer base that will switch to a competitor at the mere hint of a better rate.

The data would seem to support this pessimistic conclusion, as findings of a study by Simon-Kucher & Partners in association with the market research company GMI show. A sample of approximately 1,000 UAE banking customers were asked to identify their main bank, and then say which products they held with other banks (see figure 1).

Clearly, there are certain products that customers are more likely to shop around for, e.g. insurance, mortgages, investments, auto loans and remittances.

Put into perspective, however, the situation does not look that bleak. Although many customers shop around for these products, very few would actively choose it as a pastime compared with, say, gardening or shopping for clothes. Moreover, no customer relishes the prospect of juggling multiple banking relationships, multiple PINs, and an avalanche of paper work.

The survey revealed that when it comes to purchasing banking products only 29 percent of customers were concerned *solely* with getting the best price. The remainder were primarily concerned with fairness and value for money (29 percent), convenience (20 percent) and brand and service quality (22 percent).

So the question arises, if having one bank is simpler and more convenient for customers, and if banks themselves

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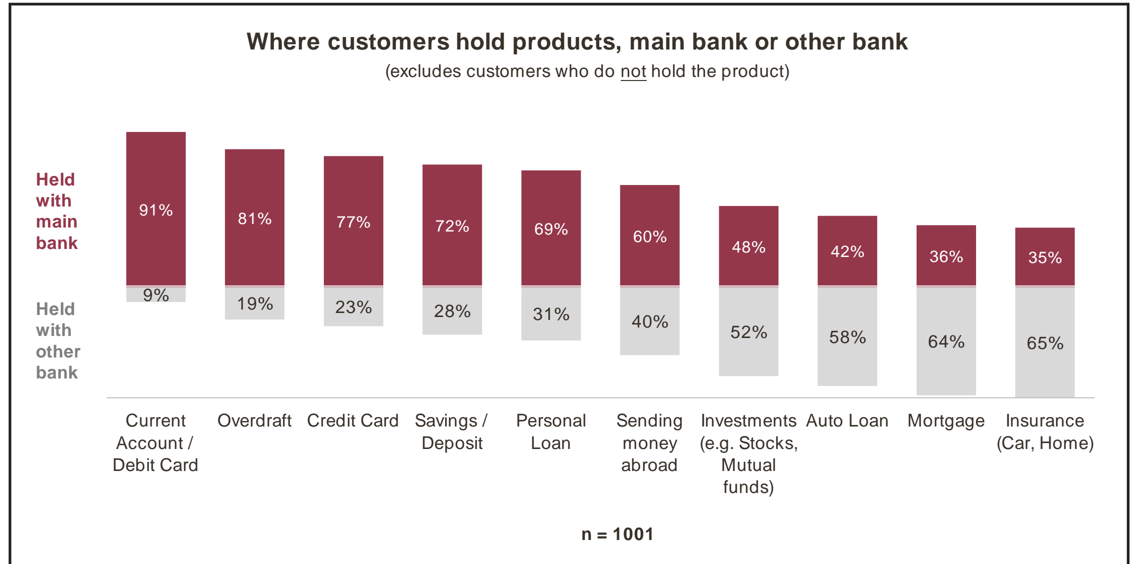
also prefer loyal customers, why are their rates of loyal customers not higher?

Loyalty schemes increase customer satisfaction

Banks cannot expect customers to be loyal purely for the sake of convenience. Customers know that they are doing their bank a service and expect to be rewarded. This is where loyalty schemes come into play.

Customers appreciate good loyalty schemes. According to the survey, 90 percent of loyalty program participants profess either basic or total satisfaction with their bank. And what is even more, the average product holdings of such customers is 25 percent higher than non-scheme members. In other words, they are 25 percent more loyal. On the other hand, 59 percent of the customers surveyed did not even participate in their bank's loyalty scheme (see figure 2).

Figure 1: Where customers hold products, main bank or other bank (excludes customers who do not hold hte product)



Ostensibly, the banking market is awash with rewards of every shape and hue. Is it that the right rewards are not being offered? We received informative answers when asking customers what kind of rewards would lead them to want more products with one bank. However, answers did not highlight a 'killer' benefit of appeal to all customers. The root of the problem must lie elsewhere.

If we take a second glance (see figure 3), we see that for all their apparent variety, current loyalty schemes are generally quite limited. Most schemes revolve largely around credit cards. This means that points are not used to incentivize customers to want other products. Meanwhile, the bank incurs the full cost and burden of an air miles scheme or cash-back program, which makes little commercial sense.

New approach needed

Banks need a new approach – specifically one that makes customer programs more appealing, more extensive, and less expensive at the same time.

Banks that have made the transition to 'Loyalty 2.0' have seen radical improvements in loyalty and cross-selling by proceeding along the following three principles:

1. Reward loyalty

The irony of many so-called loyalty schemes is that they do not reward loyalty at all. Go into any bank in the Middle East and ask, "Suppose I have four or five products with you – do I re-

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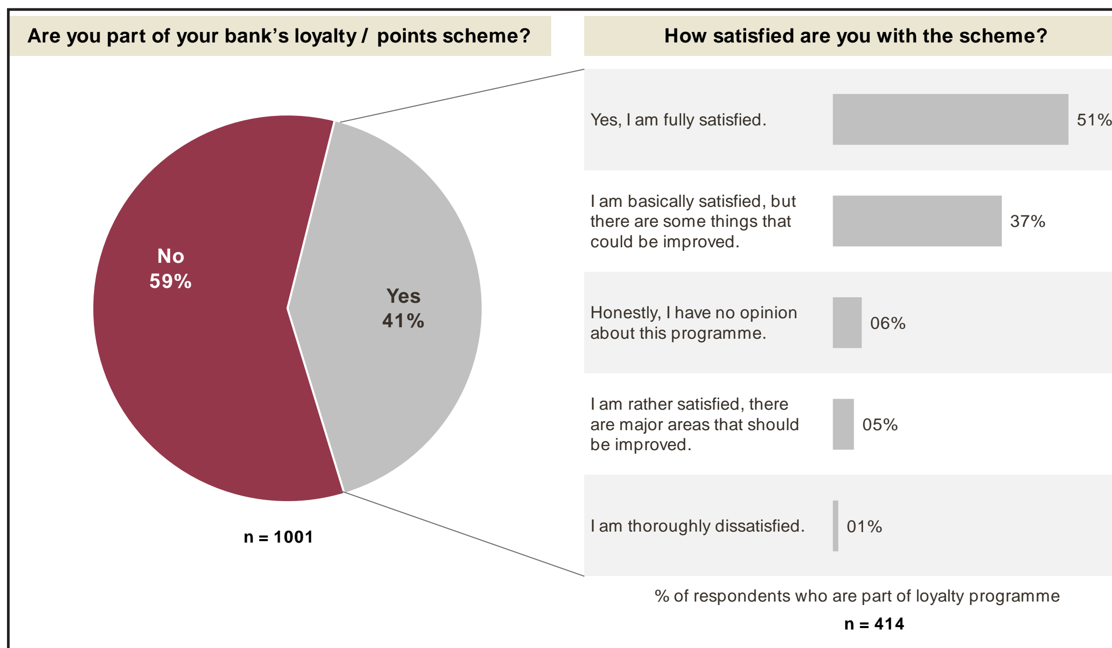
Figure 2



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ceive any benefits for this?" Almost without exception, the answer will be "No."

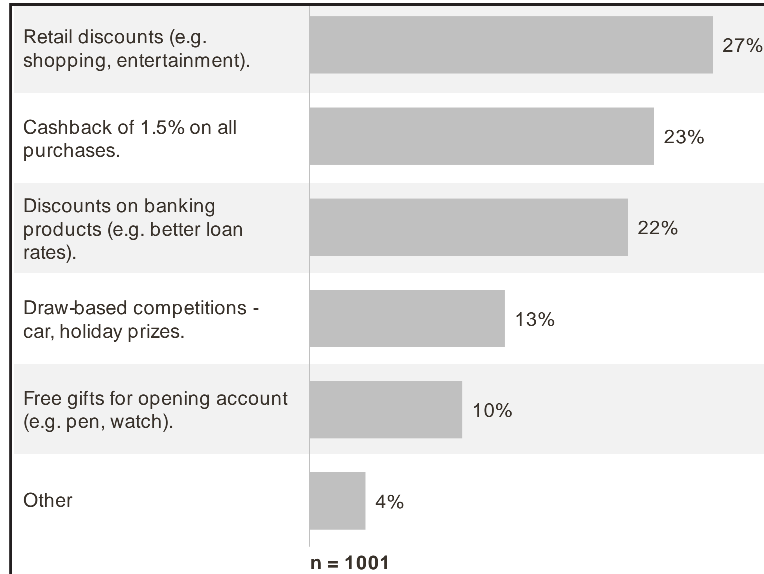
Any true loyalty scheme should reward customers the more they use the bank. This cannot be done if multiple-product holdings are not explicitly rewarded. Banks need to develop a more customer-centric approach, and those that do will find themselves at a great competitive advantage.

2. Make it clear

A bank that has successfully realized the first principle will devise a cross-product scheme, incrementally rewarding customers for increased business across products. The rewards will be sufficiently appealing to the diverse customer segments without turning out to be too expensive and thus unprofitable. Ideally, customers will be rewarded for desirable behaviors, such as carrying out transactions online.

However, all of this good work can be lost if the customer does not understand the scheme and the benefits it offers. Benefits need to be self-explanatory – to customers and sales staff alike. The easiest way to achieve this is through effective visualization, which brings us to the final principle.

Figure 3: Measures that would incentivize customer to hold more products with one bank (% of respondents, multiple choices allowed)



3. Make it fun

Gabe Zichermann, one of the foremost proponents of game mechanics in business, once observed that airline loyalty schemes are not really about redeeming miles. The most successful loyalty schemes reward users in non-tangible ways, utilizing the incentives of status or achievement. Gamification of financial services is one such approach, and banks that have taken the first steps already find themselves in a field with virtually no competition.

Customers do not tend to see bank products as particularly exciting, so upping the amusement factor will have immediate positive effects; and non-tangible rewards of a game situation are often much cheaper for a bank than tangible rewards such as cashback. A German bank, for example, worked to gamify the financial needs of its customers in a computer puzzle. The customer can add and remove product puzzle pieces, while a status bar provides an instant score (see figure 4).

If this and other examples of banks moving to more compelling forms of cross-product incentives are any indication of the future, then the goal of customer loyalty may finally be within reach. Banks have a lot to gain from assuming a more holistic approach. It would be a welcome change for everyday users, weary of shopping around in a one-dimensional marketplace focused on price competition. Even though the road to success might be stony, the time for 'Loyalty 2.0' is ripe. Game on!

Figure 4

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Maintaining Pricing Excellence During Currency Depreciation

Currency depreciation creates a tough environment for pricers, especially those operating in multiple international markets, but there is a plus side in terms of maintaining profitability rather than slashing prices. Unless a competitor has a very different production structure, it is unlikely it has a substantial competitive advantage under currency depreciation, which means they are facing the same challenges that you are. All in all, the price pressures caused by a depreciating currency are fairly favorable for avoiding a price war if you know how to handle the situation, as the author explains. Kyle Thompson-Westra is a Senior Pricing Analyst at Wiglaf Pricing. He can be reached at kthompson-westra@wiglafpricing.com.

The Colombian peso has had a rough 18 months. During this period, it has lost over 70% of its value relative to the US dollar (see figure 1).

A good deal of this can be explained by the collapsing market price of oil, as Colombia is a major regional exporter of oil, especially to the US. Oil is also being blamed for Colombia's creeping inflation, which has reached a seven-year high. Both from depreciation and inflation, the Colombian peso is being hit hard.

This makes life especially tough for businesses within Colombia that must deal in foreign currencies. If you are importing goods, your costs have shot up quickly and in a manner that is completely outside of your control.

Risks of Price War

With contracting margins due to rising costs, some companies face the temptation to lash out with lower prices in order to chase market share. They sense trouble, and the only way to make the company look strong is to take share away from a competitor.

They may also mistakenly believe that they can easily make up for lower margins with higher volumes. But this is easier imagined than executed. The amount of increased quantity you must sell at a lower price to make more profit than without a price change is calculated with the volume hurdle equation:

$$\%\Delta Q \geq \frac{-\%\Delta P}{(\%CM_i + \%\Delta P)}$$

Where:
Q = Quantity
P = Price
CMi = Initial contribution margin

Just a few minutes of playing around with the differences demonstrates that a small decrease in price requires quite a large increase in quantity to be justifiable in terms of profit.

Either way, decreasing price, especially in such currency conditions, is hard to justify. Winning market share at the expense of profitability is a great way to destroy your company's value.

Aggressive price cutting will also likely spark retaliatory action from your competitors, resulting in market share trending toward the status quo with nothing to show but destroyed industry profits.

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Figure 1: Graphic from (www.xe.com/currencycharts/?from=USD&to=COP&view=2Y)

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How to Avoid the Price War

Currency depreciation creates a tough environment, but there is a plus side in terms of maintaining profitability. All in all, the price pressures caused by a depreciating currency are fairly favorable for avoiding a price war.

Remember, your competitors are facing the same currency pressures. Everyone importing feels the squeeze of a weakening currency. The cost of doing business increases across the line. **Unless a competitor has a very different production structure, it is unlikely it has a substantial competitive advantage under currency depreciation.**

Additionally, your customers are well-aware of the ongoing depreciation. They are primed to acknowledge that higher costs are affecting the entire economy and that businesses must adapt. That does not mean that they would enjoy being asked to pay their share of rising costs, but they will have a much better and more comprehensive understanding of why prices must rise than if it were for a reason particular to your individual company.

This should make it relatively easier to maintain or increase prices. The hardest position from which to justify price increases due to cost increases is if the costs are affecting only your company. After all, your company cost structure is your problem, not your customers'.

However, under depreciation, costs are rising for everyone. This increases the likelihood that companies will be able to pass on at least some of the cost increase to customers in the form of higher prices.

All the while, it is important to communicate with your customers why prices need to change. By emphasizing value and the systemic nature of the cost increases facing your company, you can help to maintain good customer relationships and price advantage despite the downturn. This also gives a much better position from which to take advantage of market conditions once they do improve.

Remember: the goal of a company is to be profitable, not to own the market. Better to be systematic and resilient, keep the target on profit, and maintain a structure of excellence, rather than react in a disorganized and destructive manner to situations outside of your industry's control.

Depreciation is tough, but it is no excuse to cede pricing power.

The hardest position from which to justify price increases due to cost increases is if the costs are affecting only your company. After all, your company cost structure is your problem, not your customers'.

Outcome

It is preferable to maintain or carefully increase prices in a clear, methodical way, only decreasing cost slowly and with much consideration. Careful analysis is required to take into account different SKUs, product lines, geographies, and customer segments, adjusting prices in the way that fits best each unique category.

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Pricing Discounts: Saying NO the Right Way

In this article, the author explores the pressures pricers and salespeople often face that lead to excessive discounting and customer concessions. Stephan Liozu (www.stephanliozu.com) is Assistant Professor in Management in Strategy at Chatham University in Pittsburgh, PA. He is also the Founder of Value Innoruption Advisors and specializes in disruptive approaches in innovation, pricing and value management. He earned his PhD in Management from Case Western Reserve University, is a member of the PPS Board of Advisors, and can be reached at sliozu@gmail.com. This article originally appeared in Sales Mastery.

For the longest time, I have taught and lectured about saying NO to price discount requests and special price concessions when they're not justified or necessary. From behind my desk or from a stage, it is far easier said than done. As a matter of fact, I was in sales many years and rarely said NO. I did use the usual tricks of asking for something in return: special requests, more volume, information, access to site, etc. It does not change the fact that saying NO to a customer face-to-face or on the phone is not easy. Today, when I attend pricing or sales conferences and hear consultants yell "just say NO," I realize there is much more involved behind the NO. Sales reps are faced with a variety of fears, such as:

1. **Fear of rejection:** The fear of rejection is a powerful force. We don't like to be rejected, and as a result, we also fear being rejected by the buyer or the partner. Rejection challenges our self-esteem and confidence. It actually might trigger fears and anxiety developed during our childhood.

2. **Fear of uncertainty:** Business is about predicting and forecasting. We are comfortable in this environment. Saying NO creates an unstable situation in the business relationship. What will be the reaction? What will the buyer do next? Will they still buy from us next month?

3. **Fear of disappointing:** As human beings, we like to please and make people happy. When we say NO, we face a disappointed buyer or partner, which triggers a sense of guilt and empathy. So you hear statements such as "sorry to disappoint you…" or "I have done all I could do, sorry…"

4. **Fear of damaging the relationship:** Relationships are important in the buying process, especially if you are dealing with a relationship buyer. Hearing NO for the first time might be a real surprise to them. In fact, they might be shocked by your statement and might tell the sales representative that the relationship may never be the same again.

5. **Fear of losing business:** This is a more rational fear. Saying NO is a part of the negotiation process. Saying NO and walking away gracefully sends a clear signal to the buyer that you are willing to lose the business. Are you really? When the salesforce is paid on volume, revenues or market share, it is hard to walk away!

There are also internal contradictions within organizations that lead to the sales force pursuing deals and giving discounts that do not make sense. This is what call the tyranny of growth.

Some firms and their leaders are extremely focused on growing top line at the cost of delivering profit numbers. These contradictions reflect high level misalignment between various functions within the organizations. In the front lines though, making the number is what counts, especially when variable income targets are clearly set to do so.

I have been working for myself now for the past 3 years. I'm enjoying the business development side of doing so. But I have to walk the talk. I recently declined an engagement request with a prestigious client that had asked me to conduct a one-day workshop. Despite several sessions of discussion by phone, I ultimately declined the opportunity to participate. I felt the disappointment and the real surprise on the phone. I had just said NO to a prestigious organization that swore I would get business out of speaking and doing a workshop for free. The bottom line is that I'm a pricing and value management thought leader. Doing things for free doesn't really make sense. But the experience of respectfully walking away was eye opening. The prospect of dealing with people's disappointment and the sense of guilt make it easy to accept and to say YES. Saying NO generates emotions from both sides. Dealing with the surprise and the silence on the phone is a powerful experience that requires empathy, self-esteem and courage.

During my numerous interactions with clients, I often say that the sales force rarely wakes up in the morning with

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an intense desire to discount. **When a firm has a discounting issue, it is most often that there is a bigger problem somewhere else in the business or that the sales force was not given the proper tools to do their negotiation and value selling work.**

In my opinion, it is the responsibility of marketing to deliver these value and pricing tools to the sales force so that they can reach sales effectiveness in the face of growing competition and pricing pressure. Marketing is the R&D of sales. These tools are the ones depicted in the cartoon below. These represent some of the myths that pricing and marketing people have about sales folks. In fact, you will be surprised about the misrepresentation of the sales profession. Other functions are quick in throwing the sales force under the bus!

With the emergence of technology, sales analytics, and value management concepts, there are new tools that can be designed and deployed to better prepare the sales force. In fact, my professional research shows a direct and positive relationship between preparation before negotiation and the sales force confidence in pricing.

The better you prepare before a sales call or a tough negotiation, the greater the level of confidence that you'll have in sticking with list price and in not giving in discount requests.

So it is time for you to get the tools and skills to be able to say NO and/or to properly walk away from a negotiation situation:

1. Become equipped with real-time sales data including timely and relevant pricing recommendations. There are analytical tools that will get you ready to face bluff situations or irrational buyer's requests.

2. Get educated on the value proposition of the offering that you are selling. That includes product and service features and benefits. That needs to touch on *true differentiation* from competition so that you can quickly respond to buyers' misconceptions and tricks. That means that you need to know your competition better than they know themselves.

3. Be prepared to negotiate for value and to get to YES. Don't just go in ready to say NO. Seek training, coaching and empowerment to give you the self-esteem needed to respectfully walk away and maintain relationships. Be prepared to address pricing objections and practice your standard value responses.

4. Understand the rationale of why and when to say NO outside of the pricing guidelines. Use deal management and contract compliance data to support the decision.

5. Understand the difference between negotiating and walking away from a deal. Walking away requires skills to the leave the door opened for future business and to maintain the relationship.

6. Work with leadership to gain the empowerment to say NO without hurting your compensation plan. Propose a way to make up for the lost income and support in the event large chunks of business are lost.

7. Celebrate the successes and the failures in negotiations. After walking away and maybe losing the business, take the opportunity to analyze how the outcome was reached. Debrief leadership on the process and celebrate taking a stand for profitability.

8. If your industry is very competitive and dynamic in nature, arrange with leadership a way to get quick responses to negotiation situations. Sales reps in the field cannot wait forever for answers. The first step is to maneuver within the pricing guidelines. Outside of the guidelines, create a system with leadership that provides quick analysis and feedback.

Saying NO is an emotional experience that is powerful, especially if you are a compassionate and caring individual. Today, learning how to say NO needs to draw from science as well as from art. I am still learning how and when to say NO. But now I am doing what I preach and doing so respectfully. Saying NO is not the end of the world and, if done right, can help preserve the value of you and your company.

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Five Reasons Why Performance-Based Contracting Will Grow for MedTech

In this article, the author explores what performance-based pricing and contracting means in the healthcare industry, and provides industry specific examples of pricing strategies that can be applied by pricers in multiple industries. Author 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.*

There has been a lot of press recently on performance-based contracting and pricing in healthcare. Just recently, the *Wall Street Journal* ran an article on performance-based pricing for pharmaceuticals. Performance-based pricing in business-to-business (B2B) and business-to-government (B2G) markets is not new. It has been around since at least the early 1960s. Healthcare, an industry many experts regard as being behind in procurement practices, is finally catching up.

I've done a number of presentations recently to healthcare supplier audiences about performance-based pricing and contracting. There does appear to be some confusion about the term "performance-based contracting and pricing." Some suppliers think it is about setting prices to reward customers who purchase more volume from them. Others think it is about aligning price levels to a good-better-best product line strategy.

Better Align Buyer-Seller Interests

Performance-based contracting (PBC) or pricing is really about aligning the interests of buyers and sellers. The seller is paid for achieving an outcome or the actual value delivered by the product, service or solution. In a way, it's insurance for both the buyer and seller. The arrangement could be a penalty if an outcome is not achieved or a guarantee of an outcome. It may also take the form of pricing per outcome achieved or some other pricing mechanism to share value and risk. The outcome is usually related to cost, time or quality metrics.

Rolls-Royce's Power-by-the-Hour program for aircraft engine repair and maintenance is an example of paying per outcome achieved. Rather than pricing aircraft engine service and parts on a time and materials basis, the Power-by-The-Hour program prices based on cost-per-flying-hour basis. This aligns the interests of the manufacturer and operator, who only pays for engines that performed well.

One academic study of the Rolls-Royce program showed that pricing based on the outcome rather than time and materials resulted in a reduction in unplanned downtime of 25%-40%.

In B2G markets, performance-based contracting has been used extensively for purchases and projects such as building roads and maintaining costly capital equipment. In B2B markets, PBC has been used for some time in advertising, commercial airlines, oil and gas, services, outsourcing, manufacturing, commercial shipping, and other markets. In many instances, PBC helps to push buyers and sellers beyond a transactional relationship.

MedTech Examples of Performance-Based Contracting

In healthcare, performance-based contracting has been used in the in vitro diagnostics segment for a while. Many in vitro diagnostic equipment manufacturers offer the customer an option to pay per-test-result (the outcome) rather than pay separately for the reagents and equipment used to generate a test result. PBC is also starting to be used more often for expensive drugs and medical devices. For example, St. Jude Medical announced that they would rebate 45 percent of the price paid for a Quadra heart rhythm device if revi-

PBC is also starting to be used more often for expensive drugs and medical devices. For example, St. Jude Medical announced that they would rebate 45 percent of the price paid for a Quadra heart rhythm device if revision surgery is needed in the first year after it is implanted.

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sion surgery is needed in the first year after it is implanted.

5 Reasons Why MedTech Suppliers will Need to Put More Skin in the Game

Here are five reasons performance-based contracting and pricing is here to stay, and healthcare suppliers will need to have more skin in the game.

Improvements in data will better enable measurement and tracking of outcomes to help make these arrangements less of an administrative burden.

1. **Reimbursement Model**: An increasing share of customer reimbursement is being tied to performance-based measures by payers. An example is the CMS value-based purchasing program in the USA.

2. **Buyer Sophistication**: Buyers are becoming more sophisticated and have a deeper understanding of total cost of ownership/care and the capabilities to do PBC.

3. **Data and Analytics**: Improvements in data will better enable measurement and tracking of outcomes to help make these arrangements less of an administrative burden.

4. **Cost-Pressures**: Customers will continue to be under cost-pressure, and will no longer be willing to “trust” a supplier’s statement that a solution will deliver outcomes. Many hospital administrators, for example, can cite numerous instances of expensive devices and drugs that did not work as promised and cost hospitals millions.

5. **Move to Collaborative Models**: Buyer-seller relationship models will continue to evolve from transactional to a more collaborative model which should will help enable risk-sharing arrangements.

A recent survey I conducted, along with Model N, of medical device executives showed that 43% of respondents believe 30% or more of their revenue will be tied to performance-based arrangements in ten years. This should be an opportunity for suppliers who are prepared, and can use these arrangements proactively and appropriately.