PROFESSIONAL PRICING SOCIETY

The PRICING ADVISOR

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The much-anticipated Bombardier CSeries commercial airplane line provides a uniquely positioned offering, bringing fewer CO2 emissions, larger fuel savings, and significantly less cash operating expenses to the market than comparable alternatives. Bombardier poses a significant threat to the once dominated duopoly market of passenger fleet aircraft. How will the dominant market powers, Boeing and Airbus, respond to a fringe firm encroaching on their market share and revenue? In this article, the author explores the situation and offers several suggestions for counter techniques. Curry W. Hilton is a senior pricing analyst at Wiglaf Pricing and economics lecturer at Elon University. He can be reached at chilton@wiglafpricing.com.

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Market Entry Impact Analysis: Bombardier's CSeries

The much-anticipated Bombardier CSeries commercial airplane line provides a uniquely positioned offering, boasting 20% fewer CO_2 emissions, 20% fuel savings, and 15% less cash operating expenses than comparable alternatives. With expected fulfillment of initial CSeries orders occurring in mid-to-late 2013, Bombardier poses a significant threat to the once dominated duopoly market of passenger fleet 100 to 149 seat capacity aircrafts. Over the next decade, Bombardier's CSeries product line specifically targets Airbus' A320 and Boeing's 737 aircrafts with the intentions of capturing at least 50% of current market share enjoyed by the heavy hitters.

Airline manufacturing analysts predict a demand of approximately 34,000 new commercial aircraft over the next 20 years. The most fruitful subset (68%) of the entire commercial fleet market rests in the 100 to 149 seat capacity segment. With Bombardier inching at the heels of the big two and commercial airlines demanding more efficient airplanes, how will the market landscape adjust and distribute the market share up for grabs?

The Bombardier CS100 and CS300 are roughly priced at list around $65 and $75 million, respectively, which falls almost 18% below the list price of the Airbus A320 and 5% below the list price of the Boeing 737-800. The value proposition delivered by the CSeries aircraft in comparison to market competitors is demonstrated in figure 1.

Bombardier CSeries aircraft is positioned as value advantaged in the commercial airplane manufacturing market space. Since the CSeries offerings deliver superior value to customers relative to competitors at lower list prices, Bombardier's go-to-market pricing strategy is consistent with a penetration pricing methodology. Bombardier's aggressive entry tactics for the CSeries aircraft offers a credible threat to existing Boeing and Airbus revenue.

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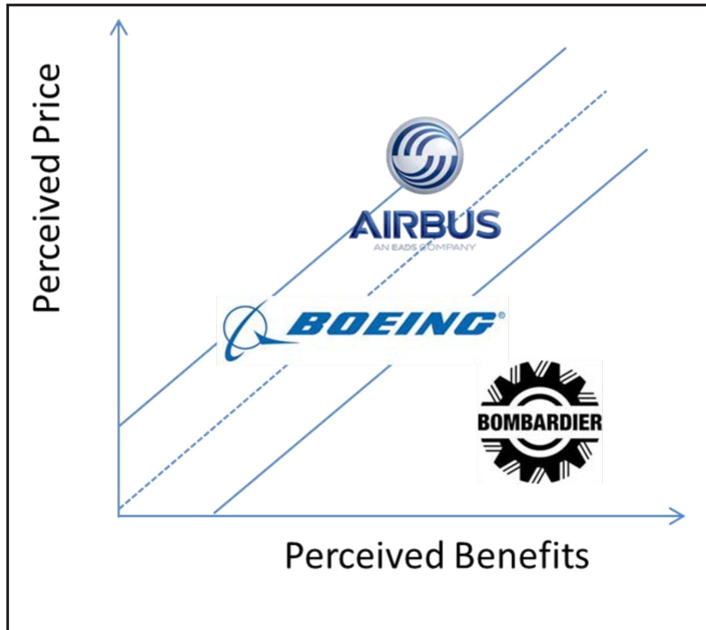
Figure 1: Bombardier's Value Proposition



With over 382 commitments for CSeries aircraft from customers including Korean Air, Luxair, and airBaltic, Bombardier proves it is serious about delivering cost-effective airplanes to consumers seeking better margins. Rick Erickson, an independent aviation analyst, speaks of the Bombardier CSeries, "Once it's up in the air and they start proving the plane's cost-benefit — they're arguing, 20% fuel savings — I think we're going to see airlines fairly quickly start moving towards the aircraft." The resilience of the air transportation market even in economic downturns, estimated 5% annual growth in world passenger air travel for the next 20 years, and passenger airlines seeking operating cost cuts, yields promising futures for airline manufacturers.

The pertinent question at hand is this: how will the dominant market powers, Boeing and Airbus, respond to a fringe firm encroaching on their market share and revenue? Will the larger relative market cap companies, Boeing and Airbus, choose "predatory" tactics to combat such advances by Bombardier? And by what means will Boeing and Airbus approach this market invasion?

Several countering techniques could be employed to mitigate market share loss including price concessions to meet the competition, volume and customer loyalty discounts, or other promotional incentives. The incumbents need to decide which method will allow for acceptable market share loss with respect to reasonable margin deterioration. Figure 2 shows the decision events and outcomes associated with employing a price-to-meet-competition strategy.

Figure 2 explores a *possible* distribution of revenue over the next 20 years between one dominant player, Airbus, and the entrant, Bombardier (accounting for Boeing's revenue). It is estimated that $2 trillion worth of value exists in the 100 – 149 seat, single-aisle passenger plane market from 2012 – 2031. The subsequent statistics are founded on plausible expectations of Bombardier's market growth strategy. Assuming that Bombardier effectively executes its 50% market-revenue capture, the following conjectures will rest.

Presumably, if Bombardier were to stay out of the market, Airbus and Boeing would split the revenue spoils and receive approximately $1 trillion each. If Bombardier enters the market as expected and supplies abundant CSeries airplanes, Airbus has options to maintain its current price level or offer price discounts to meet competition.

The resilience of the air transportation market even in economic downturns, estimated 5% annual growth in world passenger air travel for the next 20 years, and passenger airlines seeking operating cost cuts, yields promising futures for airline manufacturers.

If Airbus does not change its pricing strategy for the current A320 aircraft:

- The market will realize that its aircraft are value disadvantaged.
- It will potentially lose $500 billion, realizing $500 billion in revenue.
- Given Boeing making a decision similar to Airbus', Bombardier stands to bank $1 trillion.
- Boeing would take the remainder of the available market revenue.

If Airbus grants price concessions to be more competitive or rectifies its price-to-value alignment:

- Bombadier will earn approximately $750 billion.
- Airbus and Boeing (again, assuming comparable strategy decisions) split the rest of the market, each receiving $750 billion.

Employing a price-to-meet-competition strategy, Airbus would more than likely experience some revenue bleed-out, but would avoid losing half its revenue to Bombardier. Bombardier's market-growth rate would be partially thwarted by such discounting tactics employed by Airbus.

The outcome of this market entry scenario can be derived through backward induction. Airbus would choose to cut its price if faced with entry from Bombardier to salvage potentially drastic revenue loss. Bombardier evaluating its potential revenue gain would choose to

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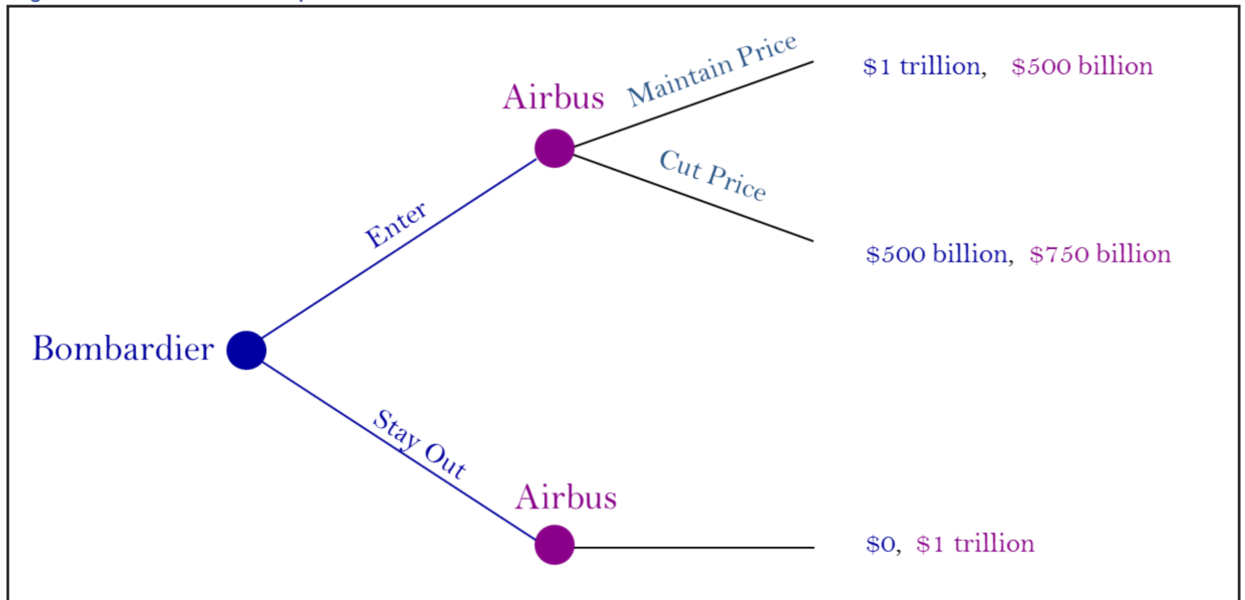
enter the market due to $1 trillion (Enter) exceeding $0 (Stay out).

The outcome of the game delivered is a (Enter, Cut Price) outcome. Of course this analysis is purely speculative, but has grounds based on best-observed pricing practices. More robust studies would explore multiple decision trees encompassing both incumbents and the entrant, account for probabilistic choice, and move-order significance.

Other means of observing market interaction in the aviation manufacturing market would prove useful in providing further insights on expected incumbents' actions. Needless to say, Airbus and Boeing's key line of revenue and primary source of growth going forward is at stake.

Figure 2: Price to Meet Competition Decision Tree



Without strategic pricing direction and market execution by the dominant firms, the current duopolistic market may be a thing of the past.

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Why Good-Better-Best Prices Are So Effective

When most managers think about pricing, they harken back to their days of Economics 101: a rote downward sloping demand curve and an asterisked point labeled "perfect price." However, many companies have begun offering good-better-best pricing so that, instead of creating missed pricing opportunities with a single price, they can capitalize on a downward sloping demand curve by appealing to more consumer groups. 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 Profit to Profit and Grow. This article originally appeared on the Harvard Business Review web site at HBR.org.

SeaWorld Entertainment Inc., operator of theme parks including SeaWorld and Busch Gardens, recently filed for an initial public offering (IPO). Best known for its aquatic shows featuring Shamu the killer whale, SeaWorld's IPO filing specifies that a key future growth strategy will be to "expand in-park per capita spending through new and enhanced offerings...by providing our guests additional and enhanced offerings at various price points."

So the next time you visit SeaWorld, be prepared to choose amongst an array of admission options ranging from Shamu (good = lower price), Shamu-Plus (better = higher price), and Shamu-Premium (best = highest price).

When most managers think about pricing, they harken back to their days of Economics 101: a rote downward sloping demand curve and an asterisked point labeled "perfect price." At this optimal price, elasticity is such that it does not make sense to raise price (because the extra per unit profit is overshadowed by lost sales) nor discount (because increased sales don't compensate for lower profit margin). If you rely on the approach suggested by this graph, pricing has traditionally been thought of as a simple search for one perfect price.

If your company views pricing in this manner, it's not making the most of this powerful bottom-line enhancing strategy. First, a key challenge is few of us have actually seen a demand curve for our product — let alone an asterisked price point. But more importantly, even if you can determine your product's perfect price, you end up in what I call a "Pricing Catch-22": no matter what price you set, you'll inevitably create missed profit opportunities. Some people would have paid more, while others would have purchased if only the price had been lower.

The way to break out of this Pricing Catch-22 is to offer good-better-best prices. Instead of creating missed pricing opportunities with a single price, this multi-price versioning strategy empowers you to capitalize on a downward sloping demand curve. Having an array of price points — low to high — allows customers to choose which price works best for them. At a gourmet restaurant, for instance, dining high rollers (those at the top of the demand curve) opt to dine at the chef's-table (best) while those on a budget (a newly married young couple celebrating an anniversary, for example) arrive before 6:30 PM for the early-bird menu (good).

By allowing customers to select the experience that works best for them, companies benefit by reaping higher margins from some customers relative to others. Just as important, they also grow their business by serving budget minded customers (with good versions); early-bird diners would probably not come if this discounted option is not available.

Another benefit of good-better-best is customers are more comfortable with this pricing strategy. Few of us take well to ultimatums, which is exactly what offering a single price is: "Here's the price, take it or leave it." In contrast, good-better-best is accommodating: "If the price is too high, consider our good version" or "You may appreciate the features of our best option."

When this strategy is implemented, it's often surprising how many customers choose the best version and its bottom line effect.

In 2007, for instance, Southwest rolled out its Business Select ticket version. For $10 to $30 above the normal ticket price, customers received additional amenities — chief of which is priority boarding. In its first year, I estimate this best version increased Southwest's revenue by $100 million and operating profit by 10%. In addition to reaping higher margins from high-end flyers, Business Select also generated growth by targeting new customers. I, for instance, rarely flew Southwest due to its no-assigned-seat policy. But since Business Select reduces this seating free-for-all, I now fly Southwest more.

If your company believes that pricing strategy is simply the search for a perfect price, it's missing out on significant profit opportunities. Customers are better served and profits are enhanced by serving new customers as well as reaping higher margins.

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App Prices: A Few Pennies More Wouldn't Hurt

The app market continues to boom heading into 2013. Over 700,000 of the 'little-programmes-that-do-stuff' have been sold – and that's just in Apple's AppStore where an unbelievable 30 billion apps have been downloaded. It's high time to focus on users: How do they handle apps? How much are they willing to pay? A recent study gives some answers - and advice - for app providers. Annette Ehrhardt is media expert and Senior Director at Simon-Kucher & Partners. She's the author of two current app studies (usage behaviour and willingness to pay of app users; AppStore price model and price level analysis). Study results are available upon request. She can be reached at Annette.Ehrhardt@simon-kucher.com.

Be it smartphone or tablet app, for over 80 percent of users, downloading apps is commonplace. Instead of daily app shop visits, many users surf the store once or twice a month - very thoroughly - then download several apps at once. This downloading behaviour has normalised over the past year: 48 percent of respondents report that they haven't changed how much they download. Forty percent, however, (significantly) increased their downloading, obviously more comfortable with their new gadgets. Download behaviour is expected to remain stable in forthcoming years.

Download behaviour is most heavily influenced by three factors; top app listings, app prices, and family and friends recommendations. These factors form two-thirds of the reasons why users download. Other factors, such as classic advertising, have minimal impact. Apps are essentially typical Internet 2.0 products: peer endorsement and constantly updated listings tell users what's "in". And, let's not forget, price is a natural barrier in download decisions.

Ninety percent of users downloaded apps from the four categories of games, news, productivity (life's daily little helpers) or social networks, and half of respondents already paid for an app. Whether it's a free download or an app purchase, respondents own more games apps than those from other categories - but use each games app less frequently. More games apps are downloaded for experimentation, while in other categories, users are satisfied with downloading only a few apps. News is followed, for example, using just one or two favourite apps; and to communicate with friends, two social network apps are ample.

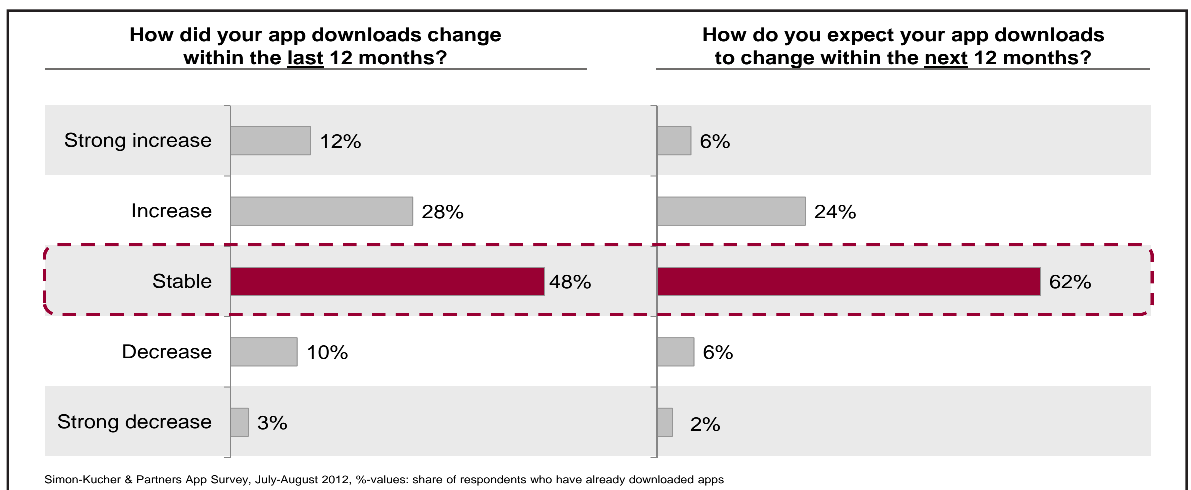
How much is an app worth?

Only 23 percent of respondents say they would never pay out for an app. In contrast, two-thirds would be willing to pay over one pound; 20 percent would even be open to paying over five Great Britain Pounds (GBP) - if the value lives up to the price. App developers shouldn't be overly concerned; 45 percent of respondents feel that app prices are affordable for the value they offer. In other words, users feel they're getting value for money.

User attitudes about app prices are one thing, but actual app spending is another. Users' most expensive apps average around two GBP. The highest purchase, however, tops 70 GBP. On average, respondents pay one to two GBP per app.

Sixty percent of respondents could imagine making an in-app purchase - and a good one-third had already downloaded one or more freemium apps. Freemium apps were often a free trial that turned into a paid/free basic version, complemented by a paid premium version. Ad-sponsored apps, in which users view ads during usage, are also widespread.

Figure 1: Download Behaviour in The Last and Next Twelve Months



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Willingness to pay and ideal price per app category

To determine the ideal app price, respondents indicated whether they would download a real app (Angry Birds, The Times, Voice Assistant, WhatsApp) at several suggested price points (between zero and 6.49 GBP). Unsurprisingly, willingness to pay for apps drops as the price rises. What's most interesting is how it drops. At 65 pence, approximately 85 percent would buy Angry Birds, but only 70 percent would buy The Times or WhatsApp. At a price of 1.59 GBP, the gap widens further: around 70 percent would buy Angry Birds or Voice Assistant, but only 50 percent would pay this price for The Times or WhatsApp. 10-20 percent would still be willing to pay for these apps at 6.49 GBP.

App providers must pay attention to this decision making process. Depending on how many paying customers are gained per price point, revenues will fall or rise. Multiply the tested prices of each app with the share of buyers according to the study, and Angry Birds and WhatsApp would provide the highest revenue at a price of 1.59 GBP. The Voice Assistant, in contrast, would maximise revenues at a dearer 6.49 GBP price tag. With The Times app, a price of 3.19 or 6.49 GBP wouldn't make a difference in revenue, but these prices would of course have considerable impact on downloads.

This example illustrates the tricky situation app providers face: on one hand, they must ensure that their apps are in the highest possible rankings of the top download charts. This is their primary way to ensure their apps get downloaded and endorsed by users. That's why low/no price may seem the optimum solution, but, on the other hand, providers won't survive without earnings. Therefore, revenue must remain in focus and that's where it may pay off to sell apps for a higher price to fewer users.

Freemium models offer a good solution, as they kill two birds with one stone: A free trial phase or basic version - combined with a paid version later – enables users to try apps for free. This way, high rankings in top download lists can become a reality. For those users prepared to pay for apps, the paid version is an attractive offer – and providers are able to clinch the needed earnings.

Figure 2: **Factors Influencing App Downloads**

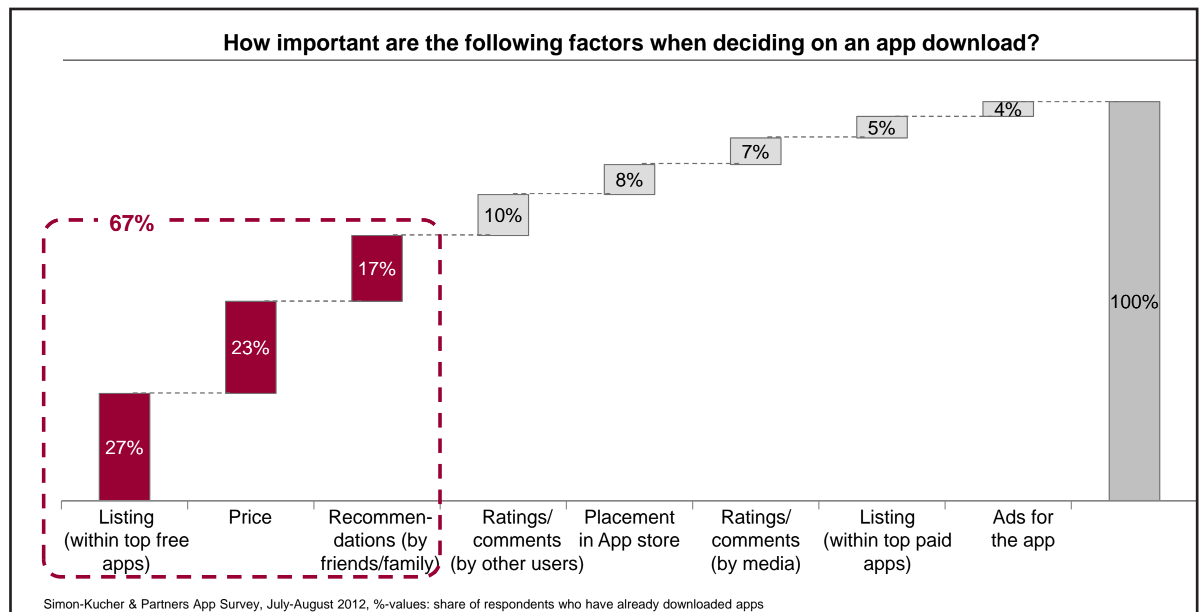

Figure 3: App Usage Per Category

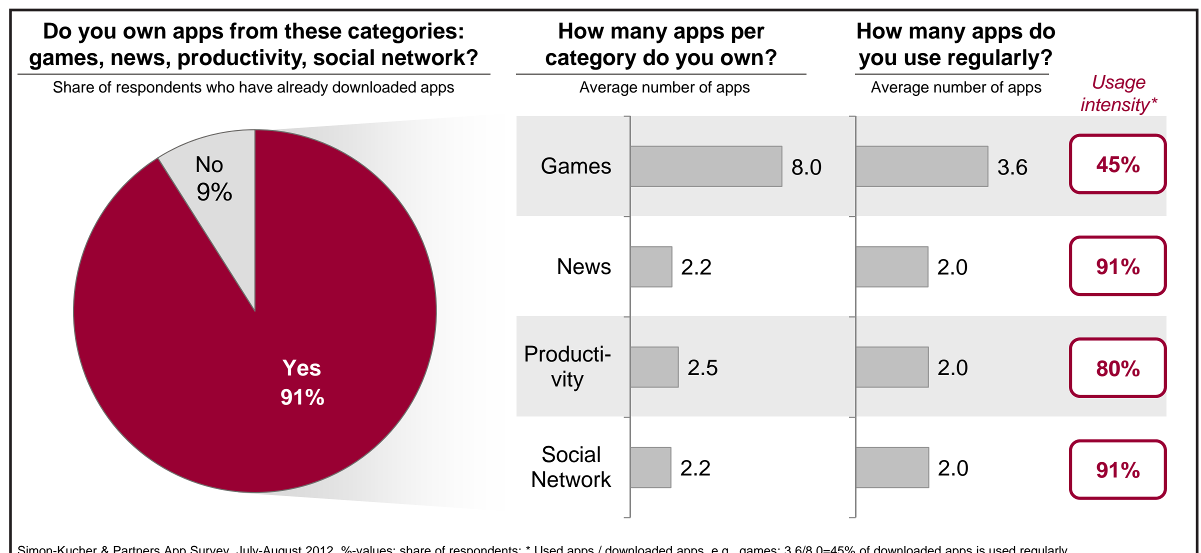

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Figure 4: Most Expensive Apps Ever Purchased and the Average Spending Per App

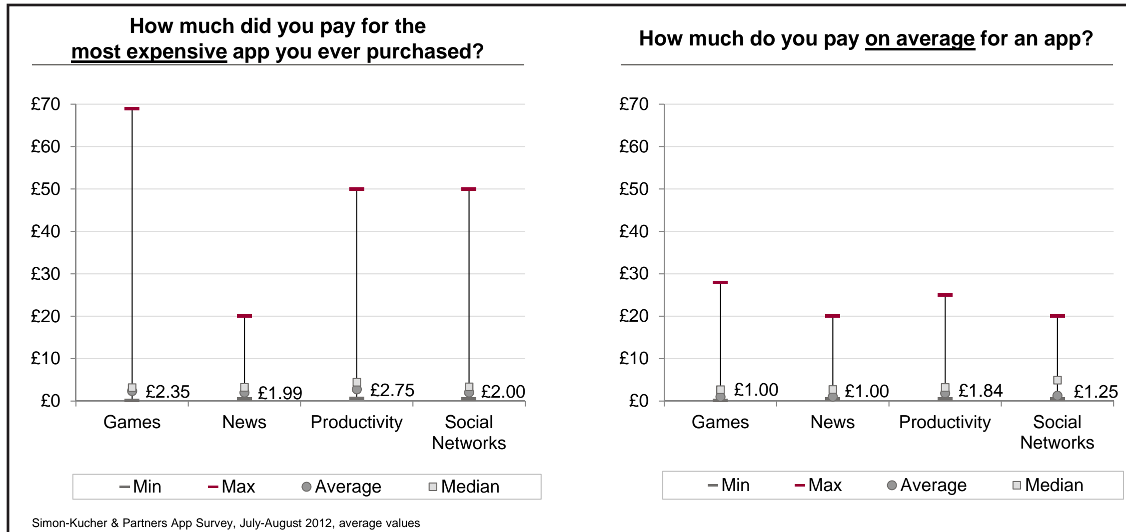


Figure 5: Willingness To Pay Per Category For Various Prices

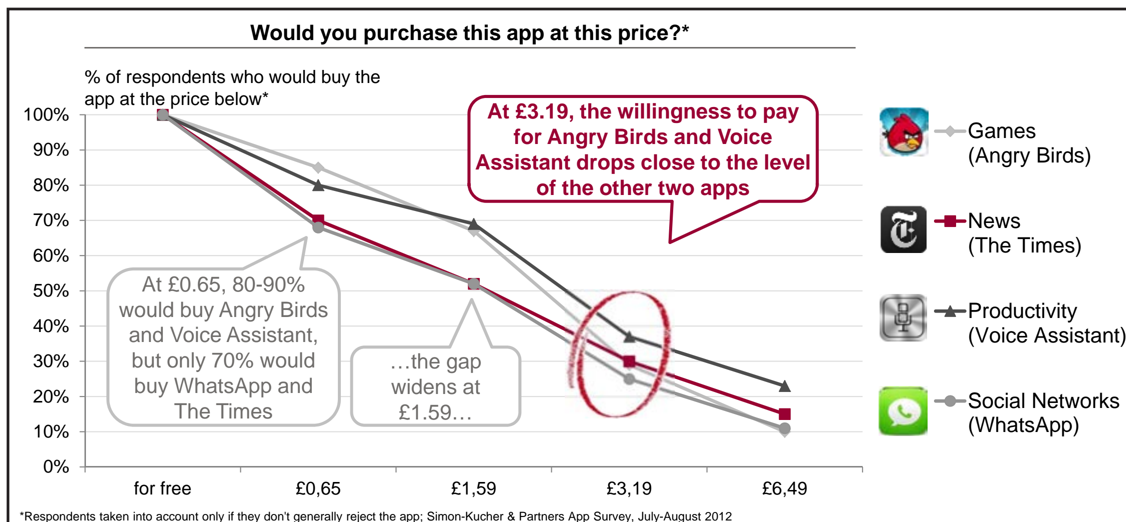
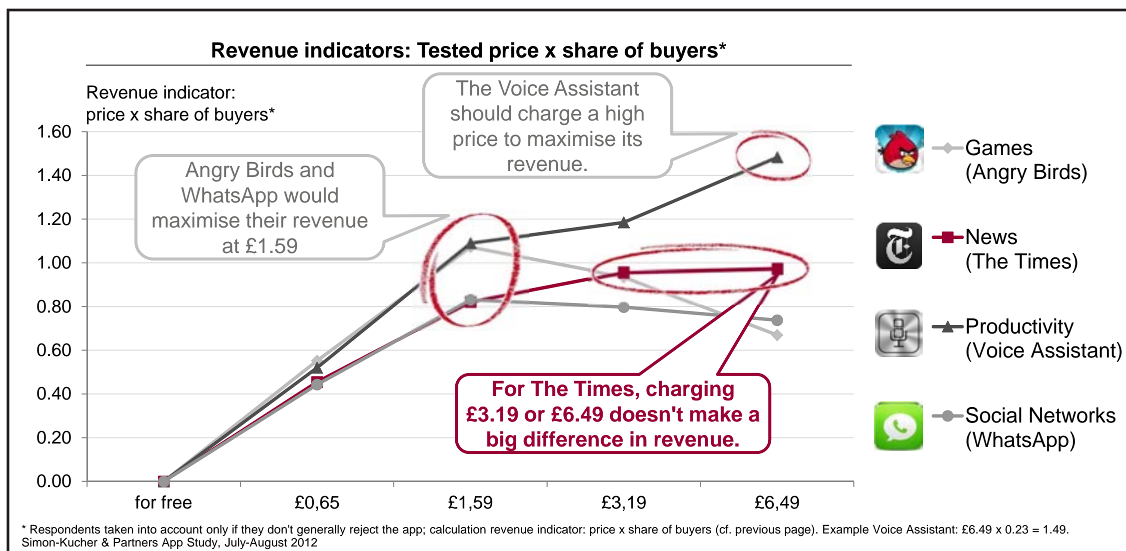


Figure 6: Revenue Indicator Per Category At Various Prices



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Spring Is A Time For Pricing 'Commitments'

Last year pricing made the headlines on several occasions. In this article, the author reviews several critical pricing mistakes made in 2012 and presents three pricing commitments (not resolutions) that your company should add to your spring cleaning list to make certain pricing doesn't fall by the wayside in 2013. Paul Hunt is the president of Pricing Solutions and a frequent PPS contributor, instructor and presenter. He can be reached at phunt@pricingsolutions.com. He also writes a pricing column that appears monthly in the Financial Post (www.financialpost.com).

Spring is a time of renewal — in nature, but also in business. It's an ideal time to revisit old practices, assess their efficacy and commit to refreshing what might not be helping the long-term interests of your business, including pricing policies and strategies.

Last year pricing made the headlines on several occasions. From Bank of America to Netflix and perhaps the most famous example, J.C. Penney, there's a lot to be learned from the past year in pricing. To make certain pricing doesn't fall by the wayside in 2013, here are three pricing commitments (not resolutions) your company should add to its spring cleaning list.

1. Stop making reactive pricing decisions

Highly reactive pricing decisions increase the likelihood that your organization will become a price taker. **When pricing is just a means of satisfying short-term objectives, you may find yourself constantly under pressure to offer deep discounts or risk lost deals and unhappy customers.** It's characteristic of a company stuck at Level 1 or 'fire fighting' – a company just setting out on the road to world-class pricing.

So in 2013 make pricing a *journey*, not a destination. A journey requires planning. First you must decide where you're going (set pricing targets). Then it's important to determine how you'll get there (develop a pricing strategy). Constantly monitor performance indicators to determine where adjustments need to be made, and when faced with obstacles and roadblocks, don't lose sight of that strategy. After all, the targets, processes and feedback loops are only as effective as you are proactive.

2. Never underestimate your customers

If one size doesn't fit all, neither does one price. It's essential you understand your company's value proposition in the eyes of different customer groups. Pricing segmentation is truly the backbone of pricing strategy and there are varied approaches — segment by product usage, order urgency or growth potential for starters. Use those groupings to identify high- and low-margin orders and consequently where true growth opportunities lie.

Can we really remember the last year in pricing without mentioning J.C. Penney? The company is an example of what can happen when customers are misunderstood or segments are treated uniformly. In 2012, the retailer put an end to its popular in-store sales and promotional coupons. Instead, the company introduced a three-tier pricing program of everyday prices, monthly values and best prices. It sounds great in theory, but "fair and square" aside, J.C. Penney shoppers felt alienated and confused, and the retailer ended the year -28% in sales during peak season.

3. Stop compromising on value

It can feel like a vicious cycle if salespeople and employees aren't committed — or worse yet, don't see the value in committing — to pricing. After all, pricing performance demands accountability. Be aware of your sales team feeling frustrated, constrained or even burdened by unrealistic sales targets. When it comes to negotiating with customers over price, salespeople must have a clearly defined degree of variation. Although saying no can be difficult, it puts the focus squarely on your value-added offerings.

Consider the alternative: in 2012 there was an explosion of price-match guarantees, causing sales at many brick-and-mortar stores like Best Buy and Barnes & Noble to suffer (although some have shown signs of rebounding). Consider Best Buy for a moment. The company lost sight of what differentiated itself from competitors. With a decline in value-added programs like worry-free repairs and buy-back trade-in programs, no wonder price became the sole differentiator. It's worth re-emphasizing — stop compromising on your company's value.

Just remember, when it comes to pricing improvements don't think of it the same way you do your resolutions to eat healthier. This spring, focus on pricing as an effective leveraging tool for company profitability and you will see measurable results in 2013.