
by Paul Hunt

Pricing products and services is an area often shrouded with mystique. One manager we spoke to recently likened it to "throwing darts at a spinning dartboard...blindfolded".

Getting the price right is not only challenging because it directly impacts volume, but also because it has the highest leverage on profitability. To illustrate, if price is increased by $1 \%$ price for the average FP500 firm, while keeping costs and volume constant, profit increases approximately $12 \%$. Making the right pricing decision is imperative, but how do you do it?

Pricing decisions can become significantly more manageable when supported with effective pricing research. The key to it, like with any research, is designing it right and executing it effectively. In this article, the first of a series on pricing research, we put forth a framework, entitled the "5 Cardinal Rules of Pricing Research", that will help your company make those critical pricing decisions, but also make you more effective in providing the answers.

## Rule \#1: The Buying Process is Critical

Understanding the who, what, why, when, where and how your customers make their purchasing decision is an essential element of designing effective pricing research. Reflecting this buying process in the design however, is not always an easy task. In our experience, it is one of the most significant challenges facing researchers and is also one of the leading causes of poor research.

We will illustrate the importance of capturing the buying process into the design with an example. A plumbing products manufacturer was measuring
the price elasticity of its flagship product. They used a survey to gather statistically significant information. The result of the study revealed an extremely high elasticity for the product. Analysis of the effect on volume due to a recent price increase indicated that the elasticity was significantly lower than the research indicated. The research was deemed inappropriate for decision-making purposes.

In follow-up customer research, plumbers indicated that they purchased the product only once a year, primarily when it wore out from use. This "buying window" also coincided with the plumbers' busiest season, where they had
are they buying

- Frequency of purchase - how often
- Key decision maker - who
- Length of the buying process - for how long


## Rule \#2: Not all tools are created equally

Generally, there are a number of common methods for collecting pricing data. No two methods are exactly alike and no one method can be used all the time. The key is to match the data collection method to the pricing problem you are seeking input into. A description and comparison of the methods follow in the table below:

|  | Customer <br> Surveys |  | Price <br> Experiments | Historical <br> Market Data | Quasi- <br> Quantitative |
| :--- | :---: | :---: | :---: | :---: | :---: |
| Pricing Issues | New Product <br> Pricing | Price Elasticity, Price/ <br> Value Relationship | Price Increases, Product- <br> Line Pricing, <br> Optimization Point | Price Elasticity, <br> Price Increases | Innovative New <br> Product Pricing |
| Cost | M | M-H | H | L-M | L |
| Accuracy | L-M | M-H | M | L-M | L-M |
| Segmentation | L-M | H | L-M | M | L-M |
| Time Frame | $2-4$ weeks | $4-8$ weeks | $6-12$ weeks | $1-4$ weeks | $1-4$ weeks |

no time to shop around. As a result, they were actually quite price insensitive.

The market researchers realized that they hadn't understood this buying process and thus, did not effectively incorporate it into the design, which resulted in the plumbers focusing more on price than they would have in a real purchasing situation.

To avoid getting back poor pricing information, focus on capturing some of the following elements of the buying process into the research design:

- The buying occasion - when and why


## Rule \#3: Understand how your customers perceive price

Price often plays a highly emotional role in the customer's buying decision. When price is too high, customers experience "sticker shock", and either walk away to another supplier or wait until the price comes down in order to purchase. On the other hand, a high price can sometimes signal a prestigious image, where the customer is filled with a sense of exclusivity and belonging, and is willing to pay premium prices. In both cases, prices are perceived as high, but the cus-
tomer's reaction to each is quite different. Therefore, understanding how your customers think of price in the context of their purchase is critical to effective pricing research design.

There are several psychological issues around price to keep in mind when designing research. One such concept is known as price prominence.

Price prominence refers to the customer's level of price awareness and the visibility of price within their buying decision. For example, a paint manufacturer was measuring price elasticity by presenting consumers with several competitive brands and varying their price over a number of buying scenarios (See diagram 1 below).

Diagram 1

| Brand A | Brand B |
| :--- | :--- |



Price Elasticity of Brand $\mathrm{A}=\mathbf{- 3 . 0}$
DIAGRAM 1
Preliminary results came back with a price elasticity of -3.0 , which seemed high relative to industry standards. The researchers had a hunch that something else might be in play, so they went back to field but this time reduced the font size of the price card to see what would happen. What they found was that the product's price elasticity dropped by half. (See diagram 2 below)

Diagram 2

| Brand A | Brand B |
| :---: | :---: |
| $\$ 25.95$ | $\$ 22.95$ |
| Price Elasticity of Brand $\mathbf{A}=\mathbf{- 1 . 5}$ <br> DIAGRAM 2 |  |

The reason for this was that paint retailers didn't tend to display pricing in-store, except for promotions. As a result, both the consumer's price awareness and the price visibility in the buying process were low. By pre-
senting prices in the smaller font, they were able to mimic how prices are perceived in an actual buying situation. This allowed the researchers to hone their results and make a pricing decision with greater accuracy.

## Rule \#4: Use Research to sell price, not just set price

Once the pricing research is complete and a decision has been made, the onus often shifts to the salesforce to execute the decision. The problem that many organizations run into is that they use the research to make a pricing decision, but don't share that information with the salesforce to help them successfully execute that decision. As the members of your organization closest to the customer, equipping the salesforce with as much information as possible makes considerable sense.

Educating the salesforce with findings from the pricing research provides four key benefits. First, it facilitates buyin to the pricing decision at the start. Second, it allows for pricing objections and concerns to be heard and dealt with as an organization. Third, it empowers the salesforce with the confidence to sell the price, because the research can contribute to the development of selling story based on facts. Lastly, the market research department demonstrates its high value within the organization, by not only providing the information necessary to make the right decision, but by working within the organization to apply the information so that the decision can be executed successfully.

## Rule \#5: Segmentation means deciding who you won't do business with

Price segmentation is often utilized to identify which group of customers are the "best" customers to serve. Although these customers are targeted specifically, many companies can't resist the temptation to sell the product or service to the whole market anyway in order to grab volume. What ultimately happens, is that the company gets dragged down by serving the unprofitable "cherry pickers" at the expense of their profitable "core customers". To illustrate, a financial services firm conducted a prof-
itability analysis by customer and found that $20 \%$ of their customers contributed to $80 \%$ of their profits, however they were losing money on $10 \%$ of their customers that were being serviced most. Does it make sense to serve those customers if they are not going to be profitable? Price segmentation is a means of directing you to the segments that are not worthwhile to serve.

For instance, a health product manufacturer introduced a new product to the market and undertook research to identify the optimal price. Although, the new product had the strongest value proposition in the market, the research reported an optimal price well below expectations. On deeper inspection, price segmentation revealed that five distinct market segments existed and that one segment, comprising over 75\% of the market, was willing to pay significantly more than the other segments. By focusing its resources on selling to this highly profitable segment at the expense of the others, it was able not only to command premium prices, but also cut costs by reducing the resources allotted to this product. The product is now the market leader and has surpassed the company's profit forecast for the last three years.

## Summary

By applying this framework to each and every pricing initiative, you will help enhance your company's pricing decisions by providing accurate and actionable information. Better decisions will lead to a competitive advantage, and you will have enabled your company to make the high leverage of pricing work in its favour.

Tune in next month in which we continue our article series on key topics in pricing research.

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