



## Value-Based Pricing: the key to success

An Advanced Pricing Logic White Paper

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# CHALLENGE

There are many pricing strategies and all have their time and place in a product's lifecycle. But the strategy used to the greatest effect, that consistently drops the most profit to the bottom line is value-based pricing. Understanding it is the key to pricing success.

## RULES OF PRICING

There are two basic, yet highly powerful rules in pricing and these rules form a foundation for sound price decision-making. Understanding them helps to organize your approach to pricing from a scientific value-based position. Coined by iconic pricing practitioner Ron Baker, the first and second laws of pricing are:

- all pricing is contextual
- value is subjective

## RULE #1 - PRICING IS CONTEXTUAL

If you have two similar soaps on offer, one being "premium" and the other being "standard", the standard one outsells the premium one. Why? Because it is less expensive and the value proposition suggests that it is just as functional as the more expensive one. In the context of a choice between two items, most consumers opt for the one that offers the best value – in this case it is the lower priced one. If a new brand of soap is introduced, and priced above the previously highest priced soap, it becomes an "ultra-luxury" soap. The price of the middle soap choice is increased slightly, but still becomes the alpha, because pricing psychology indicates that a majority of people will gravitate toward the middle offering when there's a choice of *good-better-best*. Recognizing there are three choices presents a powerful pricing opportunity.

## RULE #2 - VALUE IS SUBJECTIVE

What is considered value depends on the product, the organization, the culture, the country, etc. The basis for your pricing decisions become a balance between enterprise, departmental and marketplace expectations. There often can be conflicting internal pricing goals. The CFO requires higher profits, Marketing would prefer promotional discounts, Sales needs pricing flexibility and the CEO wants answers he can deliver in the board room; the list of goals is never ending. The object in sound pricing policy is to find the place in the pricing sphere that will resonate with the marketplace and at the same time satisfy the business requirements for higher profits and revenues.

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## VISIBLE VALUE DRIVERS™

A value driver™ can be anything that is identifiable by you and/or your customers that can convey true value. Examples include product features, unique capabilities, convenience and any other "visible" unique assets and

propositions. When maximizing revenue and profit, those assets are crucial to the value proposition.

## ABSTRACT VALUE DRIVERS™

There are other less obvious value drivers™ which are equally important. These have a direct effect on the ability to gain revenue and profit. Examples of these include in-stock ratio, margin-to-price analytics, supplier performance and other measurable metrics. The importance of abstract value drivers™ cannot be overstated as each one affects the overall health of the enterprise. Pricing excellence through actionable interpretation of value drivers™ can have a tremendously positive effect throughout the organization.

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## PRICE-ELASTICITY

All products have a price “band” with high and low values. Marketing efforts, margin and supply chain performance can have a profound effect on the elasticity of price. Value drivers™, both internal and external, will determine how *stretchy* the price band truly is.

## POWERFUL INDIRECT INCENTIVES

There are many ways to enhance an offering without sacrificing price. How does a firm convey value without cheapening their product? Often times, companies will offer global incentives to buy from them versus a competitor. Incentives are an abstract way to offer value. For example, providing a free freight incentive if the customer spends over a particular dollar amount. An in-store incentive would be loyalty points. These incentives

are used over and over because they work. This means products can be priced slightly higher (known as skimming) and they will sell more because of the abstract incentives.

## THREE MAIN INGREDIENTS

According to Thomas Nagle and John Hogan, both highly respected thought leaders in the pricing field with decades of experience, the main ingredients found in nearly all successful pricing strategies are:

- a value based strategy
- a proactive approach to pricing
- a desire for higher profit driving every pricing strategy

These three timeless considerations form the basis of a successful pricing initiative and today’s price leaders employ these strategies to great effect. In their landmark book “The Strategies and Tactics of Pricing”, Nagle and Holden illustrate one example after another of how value based pricing should be the ultimate goal in any organization.

## WHAT DOES IT MEAN?

Warren Buffet said, “Price is what you pay, value is what you get.” Put another way, value is what builds the price. Implementing value-based pricing is the surest way to monetize that value and the best way to make sure you’re not leaving money on the table. Value-based pricing provides the greatest revenue and margin potential.

## ABOUT THE AUTHOR



Dave Leonard is the CEO of Advanced Pricing Logic. He has over 30 years of executive management experience in multi-channel retail, distribution, manufacturing, and catalog

merchandising. Mr. Leonard has extensive experience in the area of technology analytics as it relates to price optimization for the mass marketer, inventory control and optimization, purchasing optimization, and consumer pricing psychology.

## ABOUT APL

At Advanced Pricing Logic we are dedicated to designing innovative analytic software that makes our customers more profitable. Our software transforms data into insight and provides the platform to turn insight into action. Designed by business professionals, our software follows three guiding principles: encapsulate world class analytics, enable customers to take sound action through easy to use applications and ensure ROI less than a year after purchase.