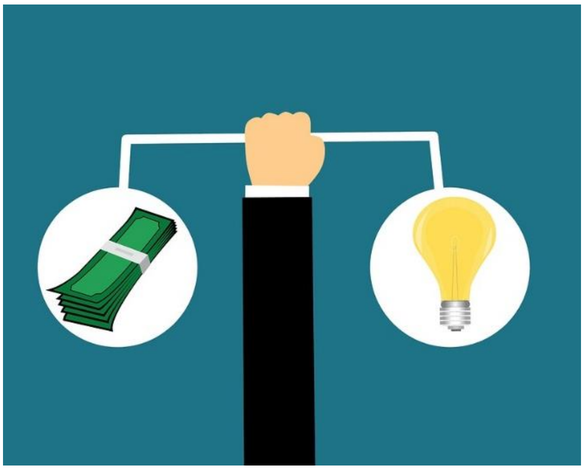
On pricing



Pricing is one of the few topics that have the power to instantly spark debate. Whether it is the right price for the latest gadget ("How much did you pay for it? Really?) or the B-2-B pricing strategy that is set for products or services ("Our prices are higher because we offer premium products").

Funnily enough, the company pricing strategy often seems to be gone with the wind nowadays. I recently experienced the case where a premium product was offered at price-levels below the lowest competition. Why was this done? Was it the inability of the sales manager to explain the product value, lack of knowledge, missing customer proximity or desperation?

I believe that companies often misinterpret customer signals and actions. In addition, pressure on sales quotas seems to weigh higher than pressure on margins.

So, let me do away with some common myths:

1. **Customers base their buying decision on price.** Wrong, there are many other factors that play a role. Need some examples? How about payment terms, delivery time, response time, warranty terms, technical support, ease of doing business, breadth of product portfolio, company reputation, personal sympathy and, yes, product quality. These factors are even more pronounced if you have a more educated buyer sitting on the other side of the table.

2. **Customer behavior is difficult to predict:** Wrong again. The truth is that some customer behavior is quite typical and easy to predict (never accept the first offer) while others are changing with the situation. A customer who was guided by low prices may accept higher prices if the delivery time turns out to be critical for him. A loyal customer may challenge you for rebates if a new person gets into the procurement position. This also means that sellers need to adjust their behavior and learn to understand the customer's situation. More on this below.

3. **Customers can easily replace suppliers:** This is certainly not true as a generic rule. Qualifying new suppliers, vetting them and getting them through the compliance process has substantial costs and potential risks. In fact, the buyer may even be scrutinized if the product he bought fails prematurely or does not meet the user requirements.

So where am I going with all of this? Clearly away from a standardized pricing concept towards the value-based pricing approach. Granted that value-based pricing means that you need to do your homework. You need to understand the buyer's current situation and state of mind. You will need to brush out applicable customer benefits and you will also need to understand competition. Maybe the best lessons learnt in this regard come from traders at a bazaar. By virtue of experience they are able to weigh the people passing by and instantly call the right price or shall I rather say adjust the price tag according to the price-elasticity of the demand side. This is also a reason why a Coke at the Himalaya base camp is priced at around 5 USD. At that time and place alternatives are limited…

I would also like to come back to the pricing strategy from a different angle. At times where you see yourself drawn into a price war it may even make sense to keep your cool and allow your competitor to win. Consider this in particular if the whole equation doesn't work out i.e. that the whole sales (incl. after-sales services) is unattractive. I learned this lesson while working in the ATM industry. A Kazakh bank was tendering a substantial number of ATMs but insisting on the low benchmark service fee for the capital city Almaty. As this rate was unsustainable in the vast, difficult to access, rural areas of Kazakhstan my senior colleague decided to lose this deal intentionally. Thus, the competition won and lost at the same time. As they continued to struggle with the project their focus soon shifted away to other markets much to my colleagues liking – and expectation.

So, is there something like a “fair price” after all? Well, yes and no. It’s simply the price that gets accepted by a buyer and a seller under the given circumstances. Nothing more than that.

While we often talk about the ever-growing buyer’s power, I recommend not to underestimate the seller’s power, too. In any case, a seller should price his products smartly and shouldn’t be afraid to walk away, if this is the right thing to do.

For further information please also refer to my post “On Negotiations”.