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Launch Pad

Pricing impacts success in NPD

Experts discuss pricing strategies at Florida PRICEX conference

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Most new product developers are familiar with the four P's of marketing: product, price, place (distribution), and promotion. Today, greater attention is being paid to the pricing component. Visions *Launch Editor Mark Hart reports on highlights from the PRICEX conference, an annual event that celebrates excellence through the impact of pricing.*

Who should have responsibility for pricing a new product? Will sales representatives be predisposed to make decisions that lower prices to close deals? Will marketing specialists advocate campaigns to increase product share? Will the finance department insist on increasing margins? Will executives offer special discounts to ensure that quarterly targets are met? What factors impact pricing in the distribution channel? Does the product manager have sufficient influence to set the pricing strategy?

The PRICEX conference provided companywide inspiration to guide organizations to profitable pricing strategies and tactics. The Pricing Institute's 20th anniversary of PRICEX was held in Key Biscayne, Fla., June 25-27, 2007. The Institute for International Research (IIR) (*www.iirusa.com*) produces the PRICEX conference.

Why a pricing strategy is important

Typically, customers strive to buy what they need at the lowest possible price. Because price is easy to change, a salesperson's first instinct may be to drop prices to close sales. Does the salesperson's decision support system-level goals? Without a pricing strategy, too many decisions are sub-optimized. A company's pricing strategy specifies the comprehensive way it measures, captures, and retains value.

During his presentation, the conference's chairman, Mike Marn, Director of Pricing Services at McKinsey & Company, described some of the factors that contribute to price decreases. These include:

- Tougher, more sophisticated buyers
- Customer and channel consolidation
- Rise of discount resellers and distributors
- Excess supplier industry capacity
- Worldwide sourcing
- Open book costing
- Leaner and meaner competitors
- Growing price/cost transparency

If your company is an S&P 500 company with an average profit and loss structure, what would be the result of decreasing prices by one percent? Marn summarized by saying that a one percent price decrease is likely to result in a nine percent decrease in profits. For comparison, survey results show that a one percent price decrease impacts profits more than a one percent decrease in variable costs, volume, or fixed costs.

An important question is, "What pricing strategy will enable you to increase prices by one percent?" According to the McKinsey data, a one percent price increase is likely to result in an 11 percent increase in profits.

According to Marn, "The imperative for the pricer is to redouble efforts to create and communicate benefit positions." For developers, it requires more than completing the engineering tasks and assigning a price. To be very effective, developers should identify the attributes that contribute to value and prioritize their activities to ensure that these features are implemented. This process may require contributions from many disciplines including engineering, marketing, training, support, packaging, branding, and pricing. In addition, communication strategies should be identified and tested for use in activities such as advertising and public relations campaigns. The results derived from preliminary testing are used to refine the development activities and deliverables. At product launch, the appropriate pricing strategy is a reward for a superior product.

> "Pricing is evolving into its own discipline."

Insights from the hotel business

In his "Integrating Pricing into Revenue Management (RM)" presentation, Steve Pinchuk, Corporate Vice President of Revenue Management at Harrah's Entertainment, listed a few factors that impact profitability in the hotel business. These include:

- *The hotel room itself.* A room is a perishable product. An empty room produces no revenue. The lost revenue is not recoverable.
- *Variable pricing.* Flexible pricing is common and accepted and/or expected by guests.
- *Improved profits.* More money is made when displacement costs are minimized.
- *Additional purchases.* Hotel guests make contributions to profitability through the purchase of additional products and services.

In the hotel business, displacement concepts are important because rooms are a constrained resource; there are a finite number of rooms available per night. There is a negative impact on profits when too many $200-per-night guests displace other guests who would have been willing to pay $500 per night for the same rooms. In addition, some guests are more likely to purchase additional items, such as meals or entertainment packages, that contribute to profits. Ideally, these high-revenue-opportunity guests should be identified and given priority for rooms at the hotel.

Pinchuk's team is composed of 20 revenue managers and computer systems that dynamically set prices for 25,000 hotel rooms each day. Rooms are not provided on a first-come-first-served basis. Rooms are awarded using a rigorous analysis to determine the combination of customers, from price-conscious bargain hunters to high-value patrons seeking a resort experience, in order to maximize revenue each day.

Pinchuk's team has plans to enhance Harrah's systems so that bundled products can be created live based on Customer Relationship Management (CRM) data. The goal is to set prices based on individual analysis and not just by the market segment. This capability will enable prices to be driven by revenue opportunity and not just displacement.

Other insights

Mark Chussil, the founder of Advanced Competitive Strategies, Inc., enrolled attendees in a Top Pricer Tournament that was implemented as a business war game. He defined pricing strategy as "the high-level principles that guide your pricing and related decisions." Chussil declared, "We can recognize pricing excellence by looking at the outcomes of pricing decisions tested against a suitable measure of success."

J.D. Spangler of Sara Lee Corp. provided insights about how he developed a pricing culture within his company. Spangler, who heads the Price and Promotion Management Group at Sara Lee, said, "Pricing is evolving into its own discipline, and companies that build this capability stand to gain a competitive advantage." He reported that he built internal support for pricing discipline in his company by publicizing success stories. In hindsight, he acknowledged that he had underestimated the amount of internal training required to change the culture surrounding pricing within Sara Lee. Without a comprehensive pricing strategy, groups such as sales, marketing, and finance made different pricing decisions because of unique perceptions about their goals. Recently Spangler's group provided help developing a pricing position in response to a dramatic increase in the price of wheat, a major ingredient for their products.

During the "Pricing and Revenue Management in Multi-Family Housing Lessons From an 'Alternative' Industry" presentation, two executives from the pricing and management area of Archstone-Smith, an apartment investment and operations company, shared pricing advice. According to Donald Davidoff, Group Vice President, and Montgomery Blair, Assistant Vice President, their list of critical success factors included a CEO-level commitment to support the initiative. Their advice also included, "Don't let perfection be the enemy." When their system was being developed, there were complaints that their system was not perfect. To this criticism, Davidoff replied, "What you have now is better than what you had before, and the system is getting better." His data show that since the company's pricing system went live in late 2001, the company has achieved better results.

Dr. Reed Holden, founder of Holden Advisors and Associate Professor at Columbia University, was this year's winner of the Dan Nimer Award. According to the IIR web site, "The award is bestowed upon a pricing professional who has helped advance the field through demonstrated original thinking, challenging the status quo, and contributions to the body of pricing knowledge through publications and/or presentations of pricing ideas in public forums."

Dr. Holden urged senior managers to consider the following guidelines:

Price for profits and leverage, and create value; innovate for growth (he discourages using price to compensate for a lack of innovation); and manage value, not price.

Holden also provided advice on maintaining profitability in a low-margin market. He asked the probing question, "If you gave a discount, what did you get?" The desired answer is: "Something of great value."

During PRICEX, both presenters and attendees shared examples of what they considered good "value." These examples included:

- *Locking a customer into your platform.* For example, a customer's decision to standardize with your solution ensures that he will continue to invest in compatible products and services for many years.
- *Avoiding a price war.*
- *Bundling products.* For example, your primary product may be sold with a discount, but the overall profitability of the sale will be improved by the inclusion of accessories and support agreements that have higher profit margins.
- *Quantifiable data.* These data can be used to calculate the value of your offering. For example, if you claim that your product saves time, is your customer willing to share detailed before and after data? Is your customer willing to participate in conference presentations that highlight your product? Is this customer willing to allow you to use his site for demonstrations?

Presentations by PDMA members

PDMA members gave three presentations. Ruedi Klein, Product Portfolio Manager from Alcatel-Lucent, discussed "Pricing in the Telecom Equipment Industry—Practices and Challenges." G. Scott Erickson, Associate Professor and Chair, Marketing & Law, School of Business, Ithaca College, explored "Pricing and Trade Secrets: Developing a Strategy for Sharing and Protecting Pricing Information." My presentation focused on integrating pricing into new product development.

> "Companies that build this pricing capability stand to gain a competitive advantage."

Pricing imperatives

PRICEX sessions confirmed that product prices are becoming more transparent. For new products that are competitively differentiated, pricing strategies should be based on value. Klein noted that "pricing discipline in many low-margin businesses is the most important lever on new product profitability." The alternatives include cost-plus-markup models, fragmented discounting policies, and price wars.

Erickson summarized his experience at PRICEX by saying, "Pricing is of interest in new product and process development because it effectively incorporates your overall strategy, your cost structure, short-term tactics, and other factors. Get it right, and your introduction is that much closer to success. Get it wrong, and you might not get another chance."

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