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Topic: Market Research – Pricing

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Taking the Uncertainty out of Pricing Decisions

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In today's uncertain economy and highly competitive environment, the importance of getting your company's pricing strategy right has never been greater. If you set price too low you could miss out on considerable potential revenues; if you set it too high you risk alienating customers and losing business to competitors.

However, pricing is also one of the most challenging topics to research. Often the price at which customers *say* they will buy bears little relationship to their actual behaviour in the marketplace. Pricing is an emotionally charged area, even in the B2B environment and sensitivity to price can be driven by a whole range of influencers, from market conditions and competitor activity to perceived value of the brand and the decision-maker's personal attitudes, needs and desires. It is difficult to predict with any certainty what a customer will do until they actually put their hand in their pocket.

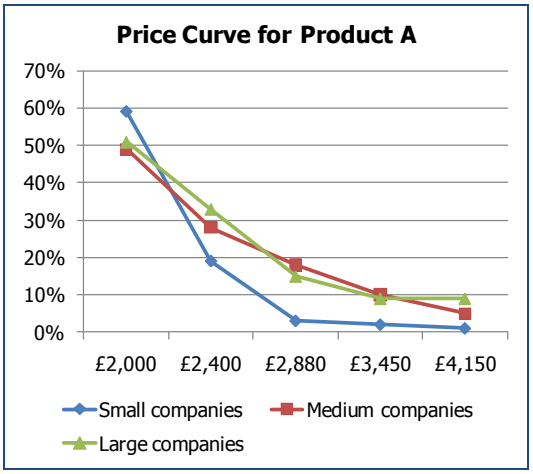
Business Advantage offers a range of different tools designed to take some of the uncertainty out of pricing decisions. These methods can be used to understand the optimal pricing levels for your products and services. They can also be used to identify the elasticity of demand for a product or service and to establish where customers would welcome an improvement in your offerings, and what premium they would pay for those improvements.

The expectations of your customers and channel partners are one of the key factors influencing price setting. Research can help you understand what price—or range of prices—is acceptable to them. One of the most straightforward methods of measuring price sensitivity is the Gabor Granger technique which simply involves asking people whether they would purchase a product at a given price; the price is varied until it reaches the level at which the customer would no longer buy the item. Having identified the optimum price for each individual, we then work out the expected level of demand for each price point and plot these in a price curve.

The following example is from a recent survey we conducted on the price of CAD software to investigate the effect of wide variations in price by channel on customers' willingness to buy. As can be seen, the price curve for smaller companies is distinctly

different from those of larger ones.

Figure 1: Gabor Granger Price Curve



To measure the relationship between changes in price and changes in demand volume we calculated the price elasticity of demand using the following formula:

% Increase in demand / (- % decrease in price) = price elasticity of demand

For example, if quantity demanded increases by 20% as a result of a 10% decrease in price, the price elasticity of demand would be 20% / (-10%) = -2. The average elasticity of demand for a product or service is the mean change from price point to price point. The larger the value (generally negative) the more price sensitive the item. Moreover, when comparing different customer segments, the one with more negative average elasticity is more sensitive. In our example above we can see that the purchase interest of small companies has a steeper drop-off as price increases, and the following elasticity scores confirm that they are indeed the most sensitive to price changes.

Figure 2: Price Elasticity of Demand

	Average Elasticity Score
Small companies	**-2.5**
Medium companies	-0.55
Large companies	-0.54

In another example, taken from a five-country research study measuring the price elasticity of a potential new low end, wide format, 'all-in-one' printer, otherwise known as a multi-functional printer (MFP), two concepts were presented in turn to respondents. Initially they were asked to react to the 'printer only' concept with an associated price and then asked to consider the concept developed as a MFP, and to:

- Give their expectation of its price as a MFP
- Rate their likelihood to purchase the MFP at five given price points in local currency (presented at random)

The data was then used to build pricing curves with regard to propensity to purchase as shown in the table below:

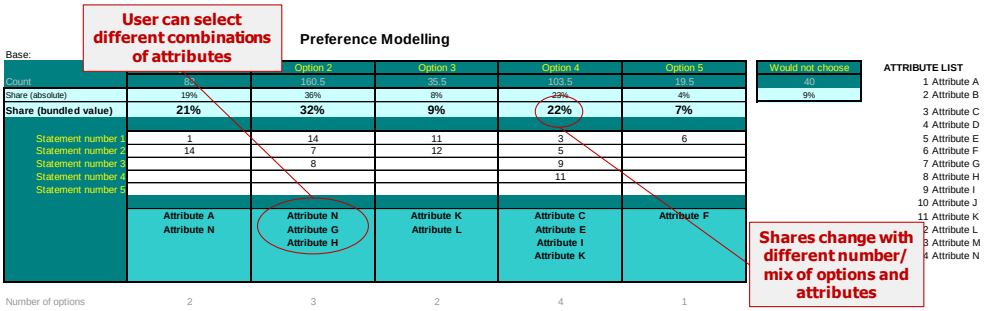
Propensity to purchase (mean scores)

While tools such as Gabor Granger provide a good indication of 'willingness to pay,' there are other more sophisticated pricing research methodologies that allow greater flexibility and reliability in decision-making. Recent developments in computing power and state-of-the-art software have led to increasingly sophisticated models that can be used in a range of situations that were not previously possible. Conjoint Analysis and other multivariate techniques simulate the choices or trade-offs between different price points, product attributes, brands, etc. that customers make in reality when making a purchase decision. We would recommend using these tools when:

- determining the optimum combination of features and price of new concepts
- uncovering real or hidden drivers to purchase which may not be apparent to customers themselves
- simulating realistic choice or purchase situations, especially the trade-off that people make between various features and functions

One particular advantage of these more sophisticated choice-based techniques is the ability to perform 'what-if' simulations: users can see the impact of different market events—price changes, new launches, new claims—and identify winners and losers under various scenarios. An example of such a model is seen below in Figure 3. As different numbers and/or combination of attributes is input for each product option, the share of customer preference changes accordingly, thus allowing the marketing team to design a product with the potential to capture optimum market share.

Figure 3: Share of Preference Model



Getting your own pricing right is certainly important, but sometimes it also pays to understand the wider market environment, notably what the competition is doing in terms of pricing. This is where the expertise of our Competitor Intelligence Team comes into play. Using a combination of desk research and personal interviews, they seek out information from a wide range of sources to piece together a comprehensive picture of a company's pricing strategy.

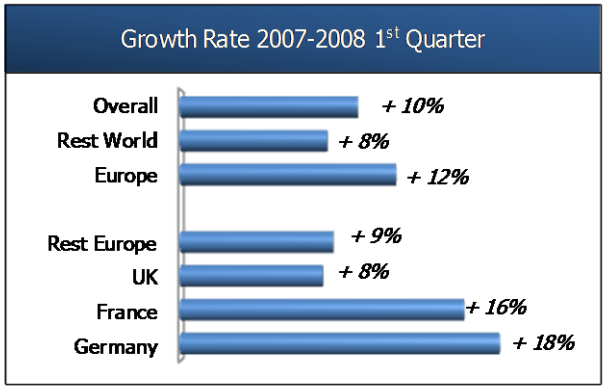
In one such study we were able to provide a detailed overview of a certain CAD software developer's prices—list, trade and street price, margins and discounts. The research utilised a variety of published secondary sources. Posing as potential customers we also discretely interviewed key stakeholders in order to validate our findings.

Figure 4: Pricing of Competitor CAD Solutions

	List Price	Margin for Resellers	Trade Price	Discount	Street Price
Standard Version	€5,050	45% - 50%	€2,780	10%	€ 4,550
Professional Version	€6,744	45% - 50%	€3,709	20%	€ 5,400
Premium Version	€8,225	45% - 50%	€4,542	20%	€ 6,580

From this we were able to extrapolate accurate estimates of the company's revenue stream and sales projections:

Figure 5: Projected Growth Rate in Competitor's CAD Sales



We understand that pricing decisions are extremely complex, involving consideration of a multitude of factors, both internal and external. Yet these decisions can have important consequences for your organisation. Whatever pricing issues you face, Business Advantage has a range of research techniques specifically designed to address the particular needs of your company. We can help you to make better decisions when:

- Determining the optimum combination of product attributes and price
- Estimating potential sales and market share
- Striving for competitive advantage
- Managing risk in a fluctuating market environment.

For more information on Business Advantage's Pricing Research services see our website.

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