



Scoring Birdies Instead of Bogies Generate a Positive ROI from Pricing Research

By Paul Hunt & Greg Thomas

In our combined 30 years as pricing strategy consultants, we have never noticed such a strong focus on pricing as we are currently experiencing. It was already an expanding discipline, but with the economy now in the dumps, it is attracting even more attention.

There is good reason for that. During normal economic times, a 1% pricing improvement typically delivers about a 12.5% improvement in profit, but that assumes you are making a bottom line profit of 8% (profit/sales). However, during a recession, the pricing improvement can jump to 20 to 25% or more, if your profit drops to 4% or 5% of sales, as it has on average for companies during the recessions in the early '90s and earlier this decade.

Now, more than ever, companies must manage pricing prudently and effectively. To help them do so, many new tools have emerged. Companies are developing their own sophisticated pricing tools and some of the software firms are developing "on demand" versions of their software that are affordable for smaller companies

Another important pricing enabler is market research. By combining the appropriate research method with technology, statistics, and economics, companies can do something that has historically never been possible—create powerful price/volume forecasting models.



There is a catch though, as using the research method does not guarantee the accuracy of the model. In other words, just because you have a golf club, it doesn't make you a PGA professional. With pricing models, as in golf, it doesn't take much to land "out of bounds."

A case in point: The following chart shows the impact of raising the price of a product 10% when the price elasticity is assumed to be either -0.8, -1.0 or -1.2. [Price elasticity is a ratio of the percent change in volume divided by the percent change in price.] The effect on the bottom line is dramatic, ranging anywhere from a modest 4% increase to a substantial gain of +36%. Like golf, being just a little off can make a big difference to the outcome.

Continued on page 2

Inside...

Scoring Birdies Instead of Bogies	1
PPS Orlando Fall Conference	3
News & Events	4

Impact of Incorrect Price Elasticity

Elasticity	Base	Scenarios		
		-0.8	-1	-1.2
Price	\$10.00	\$11.00	\$11.00	\$11.00
Unit Volume (m)	10.0	9.2	9.0	8.8
Revenue (m)	\$100.00	\$101.20	\$99.00	\$96.80
Cost	\$90.00	\$87.60	\$87.00	\$86.40
Contribution (m)	\$10.00	\$13.60	\$12.00	\$10.40
Impact		36%	20%	4%

But do these erratic results mean that pricing research is a fool's game that can never be accurate? On the contrary, our experience has shown that conducting pricing research is an excellent idea 90% of the time. In the other 10% of cases, the product or buying process is so complex that it renders traditional quantitative methods ineffective.

There is plenty of evidence to prove that pricing research can be highly accurate when designed and managed well.

For example, one CPG company executed a pricing research study and used the data to influence the retail channel to adjust prices. One of the retailers did not believe the results, and ran a six-month in-store test in 100 U.S. stores to "prove" that the research results were incorrect. Instead, the test validated the research results completely and unequivocally.

Why is pricing so sensitive? How does it differ from other methods of research? The key difference is that pricing research reverses the goals of traditional research. Most market research focuses on identifying what the customer wants (e.g., new product development), how he or she buys (U&A), or how satisfied he or she is (Customer Satisfaction). Pricing, on the other hand, focuses on how much the customer will give. Customers are happy to tell you what they want, but they typically don't want to tell you what they are willing to pay. That is why direct questioning is so ineffective in the area of pricing.

Therefore, we try to live by different design rules. Here are two of the most important ones:

1. Select the correct pricing research tool. For example, one study of a liqueur showed high elasticity. However, the company had powerful historic evidence to suggest that consumers were price-insensitive. It turned out that the research was incorrect. The study had used BPTO (Brand Price Tradeoff Analysis), a method that asks respondents to indicate their commitment to a product as the price is steadily increased. Consumers quickly figured out that showing a low level of commitment would probably get them lower prices for their favourite liqueur, and so they overstated their price sensitivity.

There are many different approaches to pricing research, and many of them are ineffective. The following Table

summarizes our view of "The Good, the Bad, and the Ugly" when it comes to collecting data.

Rule 1 - The Good, the Bad and the Ugly



THE GOOD	THE BAD	THE UGLY
<ul style="list-style-type: none"> <input type="checkbox"/> Discrete Choice <input type="checkbox"/> Multivariate Regression Analysis <input type="checkbox"/> In-Market Tests <input type="checkbox"/> Price Value Mapping <input type="checkbox"/> Monadic Testing <input type="checkbox"/> Defection Analysis <input type="checkbox"/> Financial Value Measurement <input type="checkbox"/> STEP 	<ul style="list-style-type: none"> <input checked="" type="checkbox"/> Van Westendorp (Price Sensitivity Meter) <input checked="" type="checkbox"/> Price Laddering <input checked="" type="checkbox"/> Full Profile Conjoint Analysis (rating & sorting) 	<ul style="list-style-type: none"> <input checked="" type="checkbox"/> Direct Questioning <input checked="" type="checkbox"/> Brand Price Tradeoff Analysis (BPTO)

2. Only do quantitative pricing research when you can effectively re-create the buying experience/process. The design must be realistic and consistent with the buyer's actual buying process. If you ask someone to engage in a simulated purchasing exercise and you don't re-create the experience to actually reflect how he or she buys, then you can almost be certain that the results will be misleading. For example, we recently conducted research in the denim category. We realized that an online study would not work because, to fully understand the product's value, people had to touch/feel the product, and even try it on if they wanted to. However, in other consumer categories, touch and feel are less important. Take, for example, credit-card selection. Brand, rewards, security, interest rate, etc., are all attributes that can be effectively assessed over the Web.

Assuming the research can be designed in a way that is likely to yield accurate results, the next step is to ensure that it has, in fact, done so. That's why quality assurance is critical with pricing research.

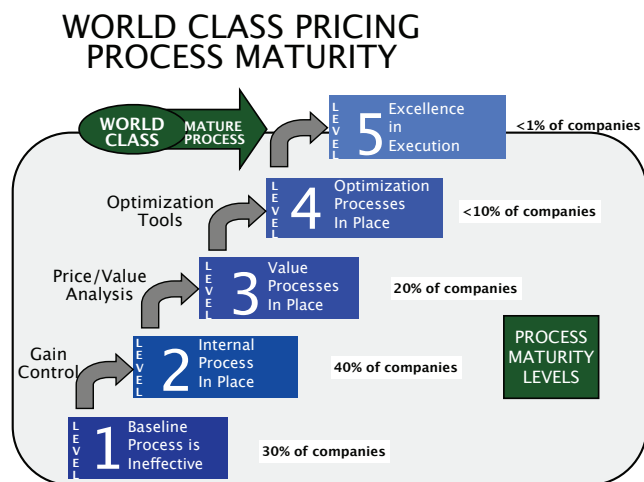
How do you know if you have a predictive model? You can never be 100% sure until you have actually tested it in the marketplace, but there are a number of ways in which you can reduce the risk of the model being inaccurate. One of the specific QA techniques we have developed measures the actual consumer choice share versus the predicted share. This process can reveal significant gaps between the model and the choices made by consumers. Often, the gaps are caused by a product crossing pricing thresholds where a "tipping point" in consumer demand has occurred. Models do not necessarily capture consumers' irrational behavior, but this insight can be critical to the client's pricing decision.

The final, and most important, step is to ensure the research makes an impact. Too often, pricing research is relegated to the marketing team and does not make it out to the sales team, or the organization does not have the pricing management processes required to ensure the successful execution of a new pricing strategy.

Continued on page 3

Not getting sales teams involved is a mistake. The sales force has to communicate the price/value proposition of the company, and sharing the pricing research with them is a critical step in building their confidence in the overall pricing strategy.

If a company does not have its internal pricing management processes (i.e., price change execution, discounting, and trade spend management) in order, it will have only a limited ability to successfully apply and leverage the consumer insight provided by the pricing research. From our experience, this is the case for approximately 70% of companies (see World Class Pricing™ Process Maturity Table below). To generate a positive ROI from pricing research, a company really should be operating at Level 3 on the World Class Pricing™ Process Maturity scale.



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Firms that are world-class pricers involve the sales, finance, research, marketing, and, more and more, the internal pricing teams in the development and application of pricing research.

While there are risks in doing pricing research, companies who use the appropriate methods and tools, and get the different functional areas—especially sales—engaged will score birdies instead of bogies.

This article was first published in Canada's leading Market Research magazine, VUE.

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PPS Orlando Fall Conference Pricing 2.0 Keynote Highlights

By Paul Hunt

I am glad to report that the Professional Pricing Society's 20th Annual Fall Conference in Orlando, Florida, on October 22nd and 23rd was a huge success, with more than 500 delegates in attendance.

As a keynote, I spoke about, "Pricing 2.0 - The Next Generation of Pricing Management". The presentation was well received, so I thought I would share some of the highlights.

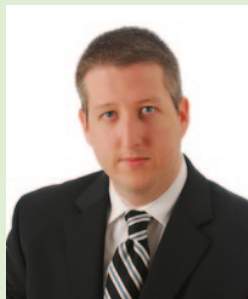
My belief is that many companies have reached Level 2 of our World Class Pricing™ framework (see table at left) and that moving to Levels 3-4 is where the next big migration will be. However, to do so is not easy and to achieve this pricing level, leaders must do three things:

1. Become the Chief Storyteller - Achieving Level 3 requires gaining the resources necessary to get the job done and ensure senior executive support. Becoming the Chief Storyteller means that the Pricing team must communicate the successes achieved in a coherent and consistent way to gain visibility for Pricing. Also they must identify the opportunities that exist and highlight those in a compelling way.

2. Bring the Outside Inside – Level 3 is all about the practical application of value-based pricing. The only way to get there is to bring the "Outside Inside", which means that Pricing must get involved in the area of customer research, and ensure that useful customer insights into Pricing are obtained to reach better value-based pricing decisions.

3. Break down the Silos – At level 3, Pricing is seen as a partner to pricing success rather than a barrier to making sales. Breaking down the Silos means that pricing must find ways to create and gain the trust and cooperation of the Sales, Marketing and Finance functions regarding the overall direction of pricing strategies and tactics.

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Pricing Management Update

Graham Woodhouse has recently joined Pricing Solutions as a Consultant focusing on pricing management and strategy. Prior to joining Pricing Solutions, Graham was the National Pricing Manager for a large multinational express and logistics organization. Graham played a key role in managing and developing the pricing practices for an organization with annual sales in excess of \$4 million. Graham is a CMA (Certified Management Accountant).

To reach Graham, please call him at 1-416-943-0505, x 138 or email at gwoodhouse@pricingsolutions.com

NEWS & EVENTS

WEBINARS

January 21 – “Pricing 2.0 – The Next Generation of Pricing Management” with Paul Hunt, President, Pricing Solutions. For Professional Pricing Society members only. Visit www.pricingsolutions.com for more information.

PRICING MANAGERS FORUM

Pantages Hotel, Toronto

January 22 - “Attaining World Class Pricing (Levels 3 & 4) Through Pricing Research”. Contact Jim Saunders, jsaunders@pricingsolutions.com, for more information.

FRENCH PRICING CLUB BREAKFAST MEETINGS

Pôle Universitaire Léonard De Vinci, Paris

January 29 - “Bottom line Pricing: Capture the Full Value of your Pricing Initiatives”, One Day Conference. Contact Loic Le Corre, llecorre@pricingsolutions.com, for more information.

Pricing Solutions University of Guelph Term Paper Award Winners

Every year Pricing Solutions sponsors a term paper writing competition for the Pricing Management course at the University of Guelph. Pricing Solutions awards \$500 to the student that produces an innovative term paper that includes designing a pricing research project and an empirical analysis of the data they collect.

Dr. Vinay Kanetkar, who teaches the course, is a professor at the University of Guelph and developed one of the first undergraduate marketing courses in Canada that specifically focuses on Pricing. The Pricing Management course is now a core curriculum course for all Marketing students at the university. Dr. Kanetkar is also now Pricing Solutions’ Chief Pricing Scientist and has collaborated with the company for over 12 years on hundreds of projects.

Greg Thomas, Leader, Pricing Research Practice, at Pricing Solutions, conducts a number of case studies each year in Dr. Kanetkar’s course and selects the winning term paper. The winners for the past two terms are:

Spring 2009 - Jutta Jakob & Kristina Svirga, “Price Elasticity of Consumer Demand for Organic Produce”.

Winter 2008 - Tyler Hummel, “Variable Pricing Systems in the NBA”.



Pricing Solutions University of Guelph Term Paper Award winners, Kristina Svirga (left) and Tyler Hummel (right) with Dr. Vinay Kanetkar, Professor, University of Guelph, and Chief Pricing Scientist, Pricing Solutions.

Visit www.pricingsolutions.com for an update on all events

New Phone Number for North American Office

Please note that effective immediately, Pricing Solutions new North American (Toronto) office number will be: 1-416-943-0505. All extension numbers and our fax number will remain the same. Please update your records. Thank you.



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