Whitepaper
Growth Through Pricing

GROWTH THROUGH PRICING

xeinadin

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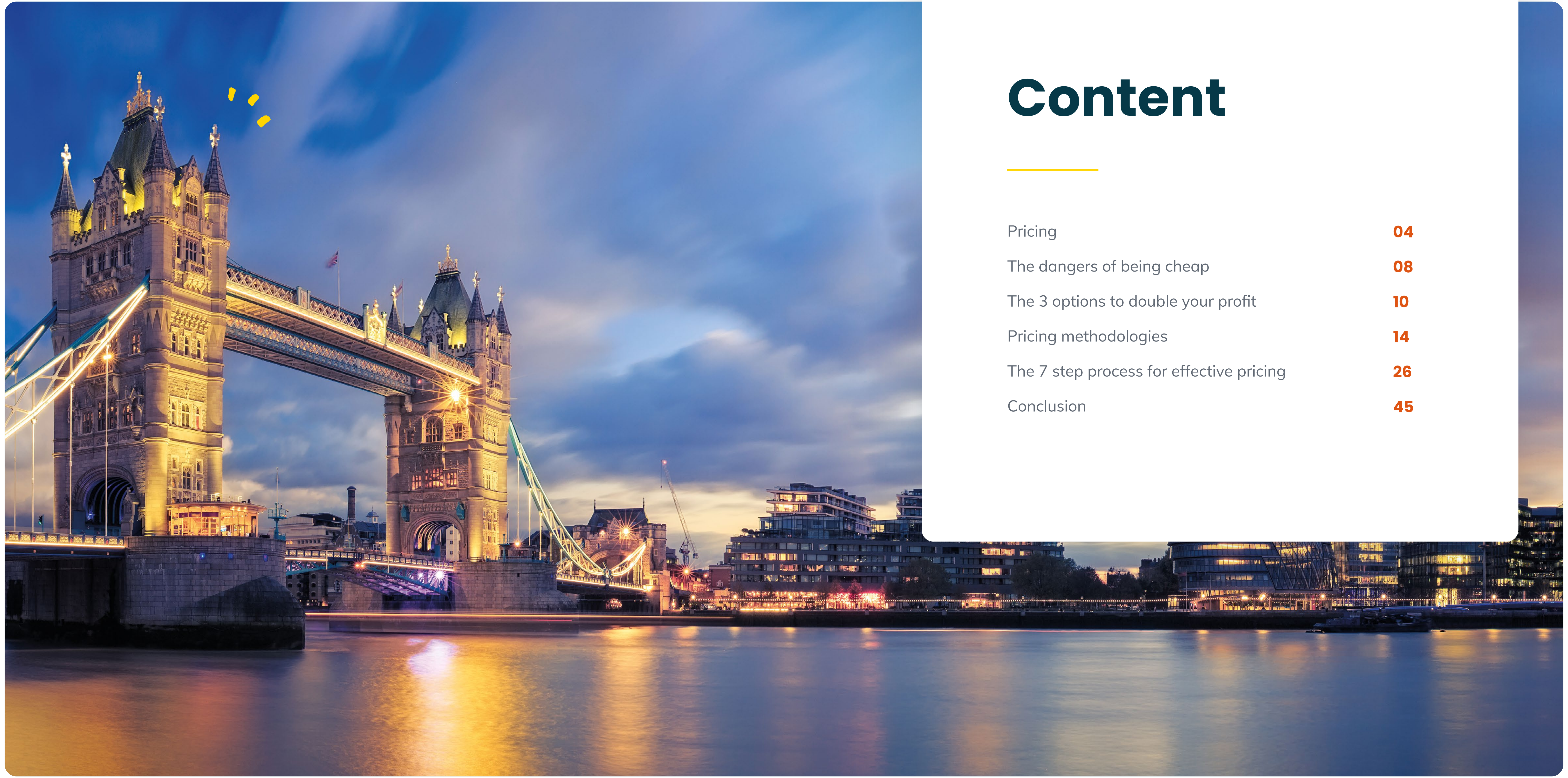
Summary

This whitepaper gives you the keys to greater profits in one short read. It's rare that small changes can make dramatic differences to the bottom line, but pricing can have a multiplier effect like no other lever.

Read on and we'll show you why this is true, and give you strategies to set prices that will not just make you more profitable – they'll make your customers happier too.



Content

Pricing

Of all the levers in your control, none has a greater effect on your improving profits than pricing. In this paper we aim to help you make the most of what many business gurus have identified as a widely untapped profit stream.

Of course, we understand that you'll have strong preconceptions borne of experience in this area – we can almost feel your eyeballs rolling away. But we urge you to keep reading and keep an open mind until the end of this paper. In other words, bear with us. After all, there is no other area of your business where small changes can have such a dramatic effect. In fact, a McKinsey study of the Global 1200 found that a mere 1% rise in prices (if demand stays the same) could increase profits by an average of 8%.

> Price is what you pay.
> Value is what you get.
>
> *Warren Buffett*
>
> American business magnate

And unfortunately, it cuts both ways – a 1% price cut will result in a corresponding drop in profits.

But the convenient truth is that customers' minds don't work in the way that your instinct tells you they do. Don't believe us? Well let us explain...

Price, in isolation, is a relatively meaningless figure.

The human mind can't process absolute figures – we're conditioned to focus on differences, contrasts and changes. Customers subconsciously look for other clues to contextualise cost – clues about what they actually get for their money - and this works to your advantage.

Remember – only one player in each market can be the cheapest (and it's a very precarious position to be in). Everyone else relies on differentiations of value and the most important point to remember is, there are no rules. Value is a highly personal and emotional abstraction. It doesn't follow logic, or science – it's all about what feels right. Is an Aston Martin seven times better than a Mondeo? Will an Armani suit last ten times longer than a Marks and Spencer one? See what we mean? It's been proven time and time again that companies who understand full value pricing achieve superior results.

So if you can follow the practices of the most successful companies and find a way to make your pricing strategy work better for you, you'll do more to grow your business than you will through any other strategy. And we firmly believe that this whitepaper will help you to do so...

The dangers of being cheap – how elastic is your demand?

Selling on cheapness is dangerous. Customers (and prospective customers) are likely to confuse it with low quality. And if that's all they expect of you, it gives you nowhere else to go. You're trapped in the bargain basement, going round and round in endless revolutions unless you can find a way to break out.

However, the sensitivity of your customers to price change is known as "price elasticity". It's a common fear among business owners that demand for their product or service is "elastic" – i.e. price hikes will cause customers to walk. This fear is more often than not unfounded. If you'd decided on a certain car that cost £50,000 and when you got to the showroom the price card showed £50,500, would you walk away? If the price of your favourite beer went up from £4.00 to £4.40, would you switch to one you didn't like as much? Well, we can say with quite a degree of confidence that your loyal customers have more respect for your product than what they see on the price tag, or they'd have deserted you as soon as a cheaper offer came along anyway. Which means you have some price inelasticity to work with.

> "The moment you make a mistake in pricing, you're eating into your reputation or your profits."

Katharine Paine
News Group

What else can you do?

The 3 options to double your profit:

1

Cut costs

Not as easy as it seems. To double your profits you'll need to make some pretty deep cuts – as much as 20%. You may find that some fixed costs can't be cut at all. Cutting variable costs by this much would have a deleterious impact on the quality of your product or service. And cutting wages by 20%? That would be a brave call.

So while we'd always recommend keeping a tight rein on costs, using it as the main tool to boost profit is a poor strategy.

2

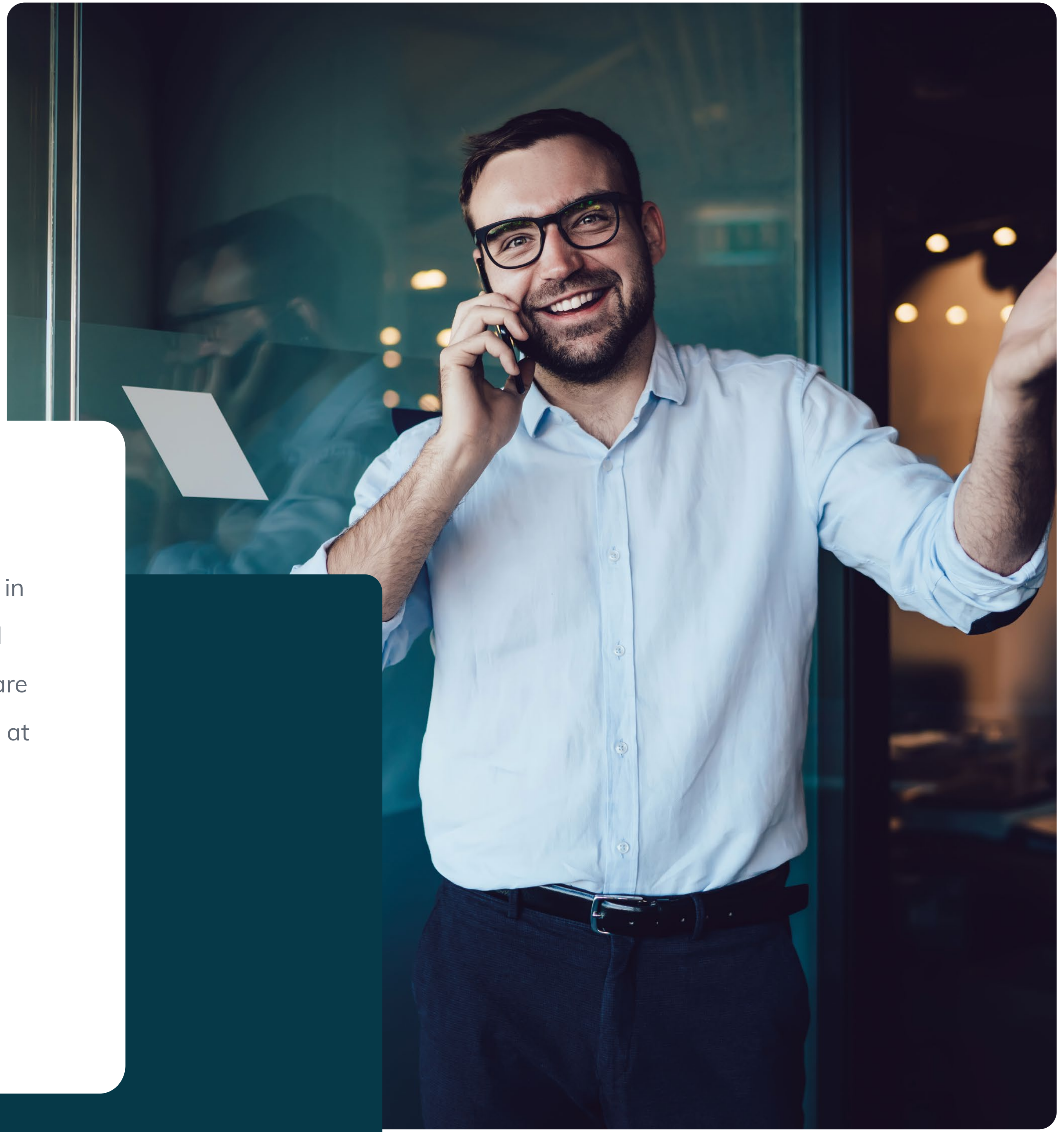
Increase sales

Again, this involves big changes. To double annual profit, you'd need to raise turnover by a third. This means bringing in a third more customers than you have now, or cross-selling (or upselling) a third more to existing customers – which, in a mature business, would require a miracle or two. Of course, increasing customers and sales should be a central part of your gameplan, but this alone is unlikely to double your profits.

3

Increase prices

By far the simplest option. Just a 20% increase in prices will result in twice the annual profit. And what's more, any new customers you bring in are worth a 33.33% net profit rather than the 20% at current prices.



Still not convinced?

How much do you really know about how customers reach their buying decisions?

Never be afraid of customers and prospects saying, “That seems a bit expensive”. If you’re not hearing this from time to time, you’re not valuing your own product or service as your customers do, which means you’re too cheap. As we mentioned above, the majority of people don’t really buy on price. They may say they do, but as the legendary advertising man David Ogilvy said,

> Consumers don’t think how they feel. They don’t say what they think and they don’t do what they say.
>
> *David Oglivy*

So while they might grumble that price is the most important factor (nobody likes paying more than they have to) it’s unlikely to be the deal breaker.

A small number may very well buy on price, but when you take into account the Pareto Principle – 80% of your sales come from 20% of your customers – is it really worth courting these tyre-kickers? They can’t afford you, they don’t value you and they’re often the hardest to get payments from.

Isn’t it far better to a) work on attracting those who are prepared to pay for what they want? And b) use price queries as an opportunity to explain the value you offer to those who can’t clearly see it. It’s a great chance to learn what value you need to add and how to explain it to the customer or prospect.

> Customers buy on price because they can’t find extraordinary quality, convenience, or value
>
> *Warren Greshes*
>
> Supercharged Selling

Pricing Methodologies

Cost-plus pricing

The simplest method. Exactly as it says – you work out what it costs you to make your product and then you add a bit to mark up the profit. There are several weaknesses to this approach:

1. It doesn't consider how much your customer is actually willing to pay
2. It doesn't consider what your competitors are charging (although this in itself is not the end of the world)
3. It's only a target rate of return – and because you rarely calculate all your costs fully it doesn't always achieve your desired goal

So cost plus pricing isn't suitable for most types of business – especially those where the value you're providing is much higher than the production cost (such as consultancy, software or SaaS providers). If your costs are uniform across your industry, you'll need a more competitive or market-based strategy.

The strengths of Competitor-based pricing:

1

Simplicity

It takes relatively little research – just a glance at your direct competitors will enable you to implement a reasonable competitor based pricing strategy. However, it gets more difficult when your products can't easily be compared.

2

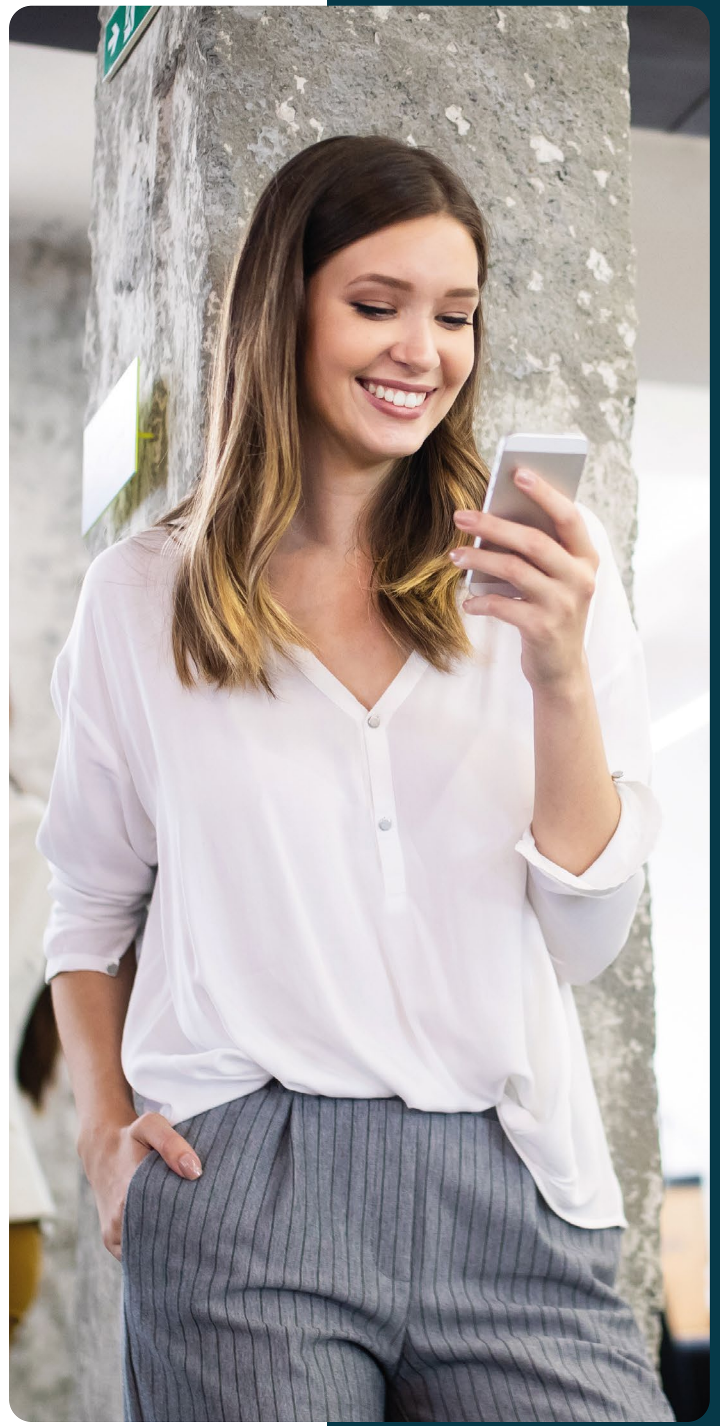
Low risk

It's hard to mess up. As long as you have a good idea of your product's quality, target audience and cost of production, it's a good bet that if it's working for your competitors, it'll work for you. At least in industries like retail, where you have millions of customers and

3

Relative accuracy

plentiful data on market price and market share, competitor-based pricing will generally get you to the right price. However, it's not so useful in industries which don't have this luxury.

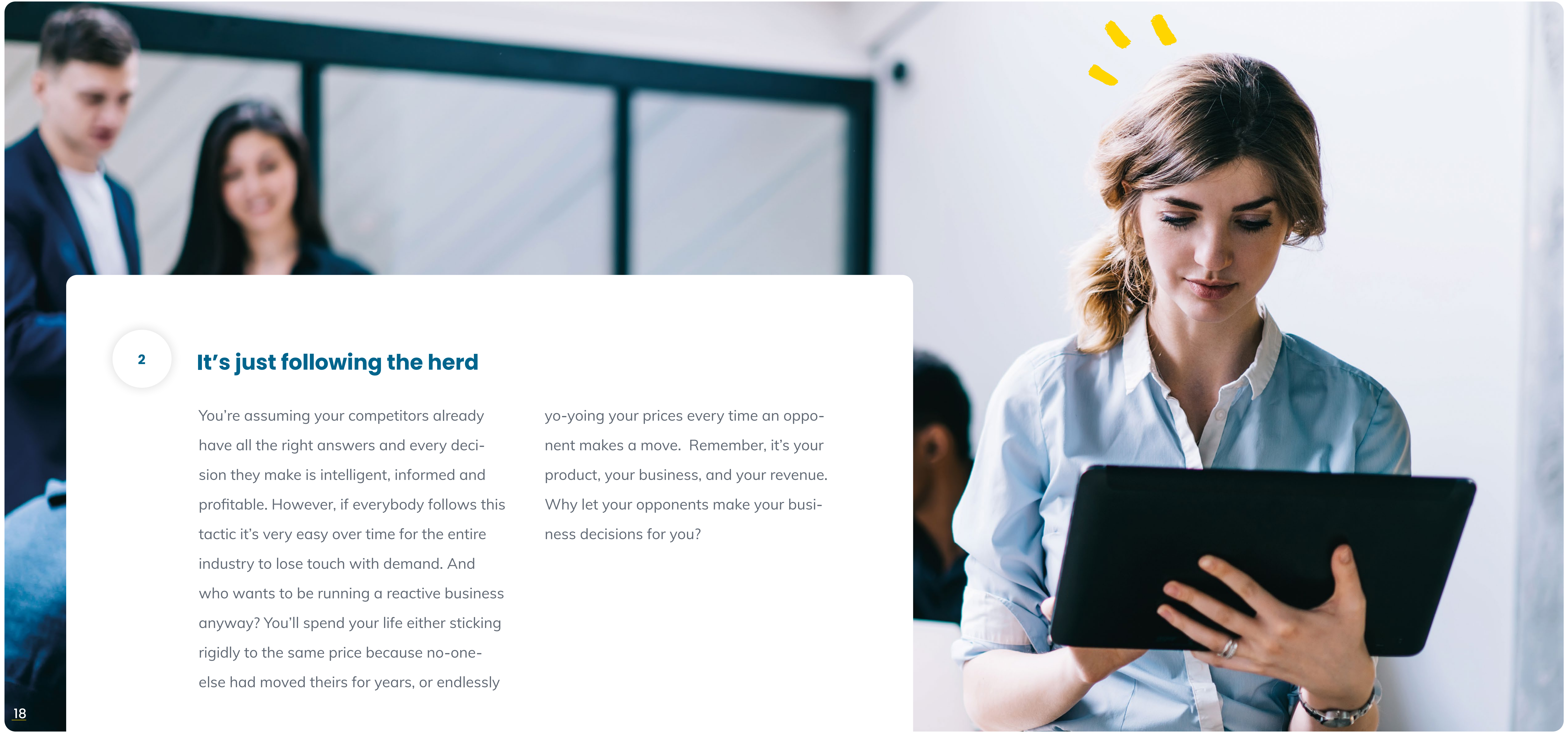


The weaknesses of Competitor - based pricing:

1

It leads to missed opportunities

Like Cost-plus, it doesn't take customer value into consideration. Just copying your market's numbers can lead to a lot of wrong prices and lost profits, even if you do think you're doing well. With a bit of extra work on the pricing front, you can maximise revenue and profits.



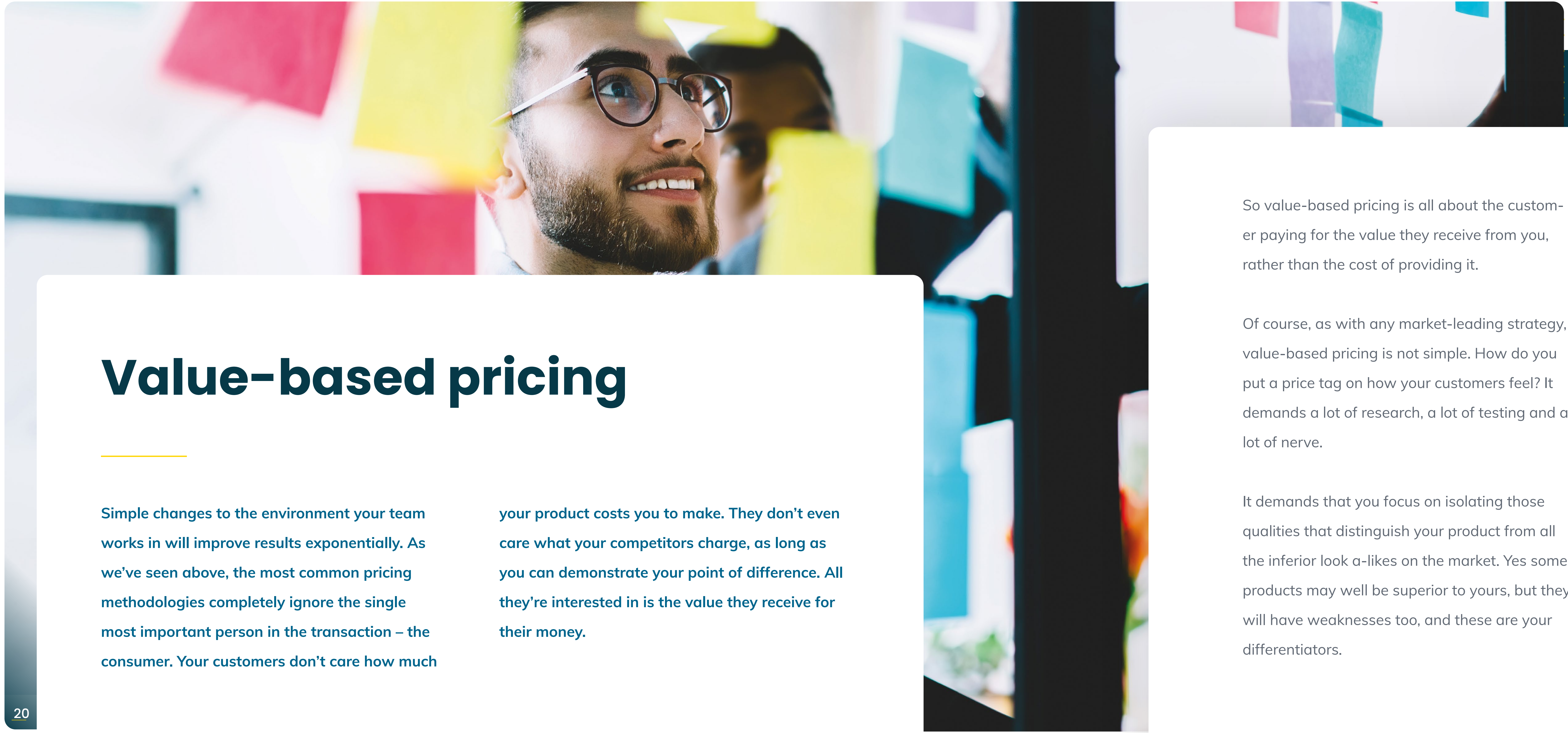
2 It’s just following the herd

You’re assuming your competitors already have all the right answers and every decision they make is intelligent, informed and profitable. However, if everybody follows this tactic it’s very easy over time for the entire industry to lose touch with demand. And who wants to be running a reactive business anyway? You’ll spend your life either sticking rigidly to the same price because no-one-else had moved theirs for years, or endlessly yo-yoing your prices every time an opponent makes a move. Remember, it’s your product, your business, and your revenue. Why let your opponents make your business decisions for you?

3 It’s short term thinking

In most industries, the widespread lowering of prices (even though many customers would be willing to pay more) trigger customer doubts about quality – which can become a self-fulfilling prophecy as skinny profit margins and lower revenue tighten the coils around production costs.

This area of your business is too crucial to adopt a “set it and forget it” mentality. The pricing process demands proper reviewing of the data analysis constant attention - so if you’re only watching the other players, you’re ignoring too many other variables.



Value-based pricing

Simple changes to the environment your team works in will improve results exponentially. As we've seen above, the most common pricing methodologies completely ignore the single most important person in the transaction – the consumer. Your customers don't care how much your product costs you to make. They don't even care what your competitors charge, as long as you can demonstrate your point of difference. All they're interested in is the value they receive for their money.

So value-based pricing is all about the customer paying for the value they receive from you, rather than the cost of providing it.

Of course, as with any market-leading strategy, value-based pricing is not simple. How do you put a price tag on how your customers feel? It demands a lot of research, a lot of testing and a lot of nerve.

It demands that you focus on isolating those qualities that distinguish your product from all the inferior look a-likes on the market. Yes some products may well be superior to yours, but they will have weaknesses too, and these are your differentiators.

You'll need to analyse customer data, understand the relative value to customers of different features and carry out a review of competitor products. You'll need a clear understanding of what other options your customers are faced with and their journey to making a purchase.

But you'll find all that work is worthwhile because it puts you in the driving seat.

The strengths of value based pricing:

1

It pays back on the work you put in

The research you do gives you a bank of valuable data that is not available to your competitors, and leads you directly to profit-generating. In other words, get it right and value-based pricing helps you generate the most profit.

A deeper understanding of the three spheres – what your customer wants, how your product/service fills that need and what your competitor offers to counter your own offering - will help you understand the strengths and weaknesses of your product, and what improvements you can make. In addition, it will help point you to the custom-ers that are actively looking for your solution and push you to tailor products and features driven by consumer demand. This in turn raises perceived value, enabling you to charge a higher price.

2

It helps you develop better products/services and even higher profits.

3

It increases customer loyalty.

Just bringing customers into the discussion of value, courting their opinions and preferences will naturally lead you to a more customer-focused offering. This can be the difference between one-off passing trade and loyal customers who connect with your brand and are willing to pay the price you ask because they believe it gives them full value.

The weaknesses of value based pricing:

1

It takes time and resources

Granted, it's a lot more bother than totting up your costs, Googling the competition or picking a number out of thin air. But trust us, finding the perceived value to customers and charging accordingly is literally its own reward.

You can never be 100% accurate – but you can get close enough

2

It's not an exact science.

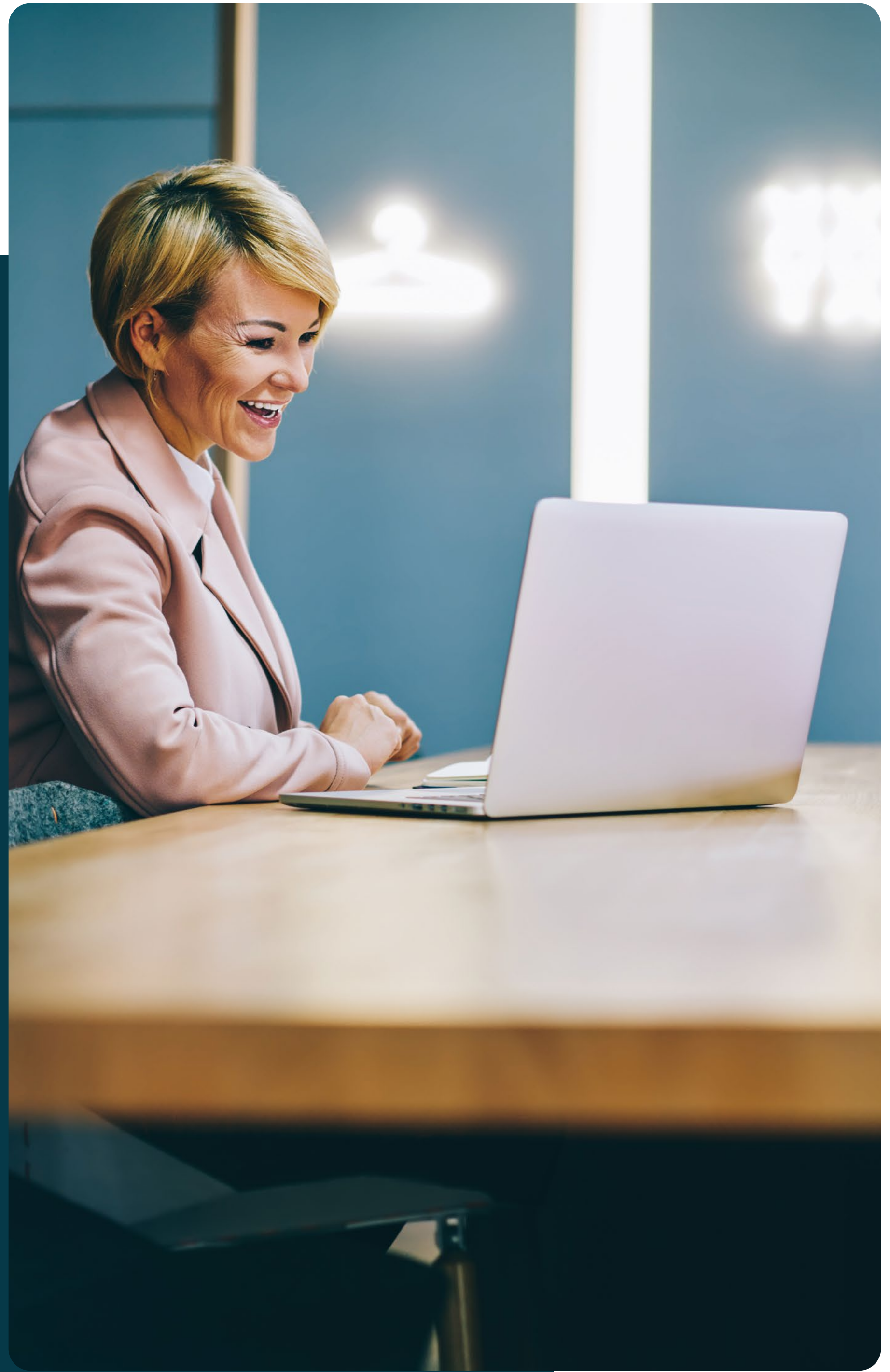
to make a big difference. If you can find the customers who are willing to pay, and charge the amount they're willing to pay – taking into account different customer personas, regions and offers – your business quickly becomes a lot more sustainable, in multiple ways. Even businesses which historically rely on cost-plus or competitor-based pricing can benefit from this method – look at how modern supermarkets target different customers' price sensitivities with value, mid-range and premium product ranges. If you're not in this game, you're leaving money on the table.

Working out what price to charge

There's no right or wrong way to do it. All customers are different and will value things differently. But we can guarantee one thing - if you only have one price for your product or service, it's the wrong price. It's either

a) too expensive for some and they won't pay for it, or
b) too cheap for others and they would have paid more

In short, value is a personal and emotional interpretation based on the facts available. So find out what each customer wants and charge what it's worth to them.



The 7 step process for effective pricing

Step 1
Formulate a price discrimination strategy

By now it will be obvious. The most important first step is to **ask your customers.**

What would they have bought if they hadn't bought your product or service. That tells you who your real competitors are. Next, choose one of these competitors and do the value-based buying maths for yourself. How much does your product or service cost? How much does your competitor's cost? What are the differences? Be brutally honest here - list all the areas where your competitor is

superior. Then list all the ways that your offering is better.

What value would you put on these differences if you were a customer? Ignore what you know about production or market costs. Add the value of your differences and subtract the value of your competitor's differences.

Next, **analyse your total reachable market.**
Yes, customer data is immensely valuable in setting prices - but it's a skewed sample. Existing customers have already shown their willingness to buy from you.

To determine an accurate price point for acquiring new customers, you'll need to do a bit of market research across the whole market to gain an understanding of what the people you'd like to sell to would be willing to pay.

Added-value differentiators

Here are some other tools you could use to develop a price discrimination strategy:

- Offering trade-ins
- Timing - peak v standby
- Bundling – e.g. a la carte v table d'hote
- Channel pricing – e.g. Internet vs instore
- Concessions – e.g. adult v OAP
- Chaser systems
- Online auctions
- Creating different versions - premium v economy
- Menu pricing

This process is the cornerstone of your pricing strategy. Don't rush it. Devote some time to thinking how could this work in your business...

Step 2
Add more value

Remember - Value is the perceived gap between benefits (intangible plus tangible) and price.

Tangible benefits are the "real" selling points built into the product or service itself – AWS brakes, British-made, free delivery, etc. Intangible benefits are how your customer feels about the product as a whole. Of course, what those benefits are will depend on the product or service you are offering.

For example - coffee shops sell coffee at a considerably higher price than cafes and fast food outlets, and this reflects the experience of being in a coffee shop. Diced carrots cost a lot more than whole carrots, but the time saved to the customer makes it absolutely worth it. Don't underestimate these intangible benefits.

It's a good idea to get your team together to brainstorm current or potential tangible benefits of your product or service. If you can test it on a focus group of customers (even by email) so much the better. There may be benefits that you just take for granted and will be made plain by a fresh pair of eyes.

Step 3
Communicate your value

Remember we're often so close to our product we don't see how to make it stand out and look different. Look at ways you can make your product look more valuable.

Here are some techniques you can use...

- Cost of not buying it – the current pain
- Opportunity cost of not buying it – the result you won't get
- Cost of comparable solutions
- Cost of everyday solutions
- Cost of doing it yourself – the value of your time
- Compare against your biggest value product – Top Down Pricing
- Contrast with future price – a pre-launch offer
- Emotional cost – how good does it feel to have your product/service?

Remember to focus on the benefits to the customer – it's easy to fall into the trap of describing features. Remember, the customer isn't looking to buy a 1/4in drill bit – he just wants a 1/4in hole! Tell him why your hole is smoother, cleaner, faster.

In particular, consider

- The Overt Benefit
- The Dramatic Difference
- The Reason to Believe

Step 4
Establish your payment terms

This is something we often forget when pricing. We put it off till later and it never gets done. Making sure you get paid and on your terms is absolutely key to your pricing strategy.

After all - if you're paid late or not at all, it costs you time and effort to chase the debt. This obviously erodes or eradicates your gain.

So make sure you agree your payment terms up front - at the point when your prospect or customer wants to buy from you. This is when you have most leverage. Leave it until after you've delivered the goods or services and you've nothing to bargain with.

We can recommend several businesses that offer simple, low-cost DirectDebit solutions for businesses which the banks will not deal with directly. Please speak to us if you'd like to know more.

And do be bold - don't hide your payment terms in the small print on the back of an invoice – your customer is highly unlikely to read it and will decide that his payment terms are the ones which suit him or those he usually pays. Make sure:

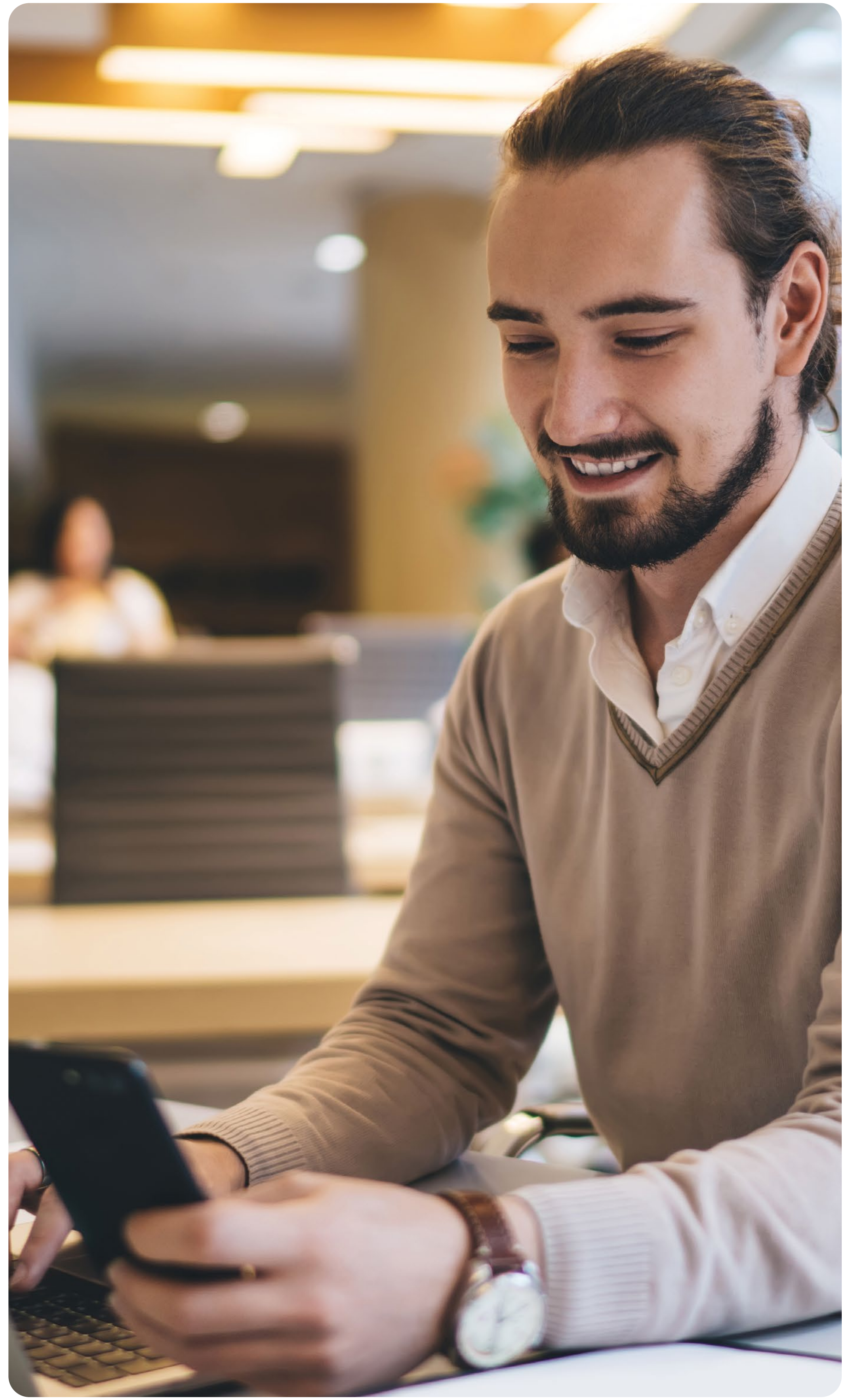
- it's obvious,
- it's agreed, and
- wherever possible, it's collected by DD and in advance.

Step 5
Formulate your price and link it to value

When you've formulated your price, tell the customer what they are getting for their money to link the price to value

For example:
- 100% cashmere
- Slow-roasted using the finest Colombian beans
- A glass and a half of full cream milk
- Award-winning design
- Old family recipe
- 0-60 in 3.1 seconds

You see? You can use any key point to underline the value in your price. You just need to decipher what it is your client values most.



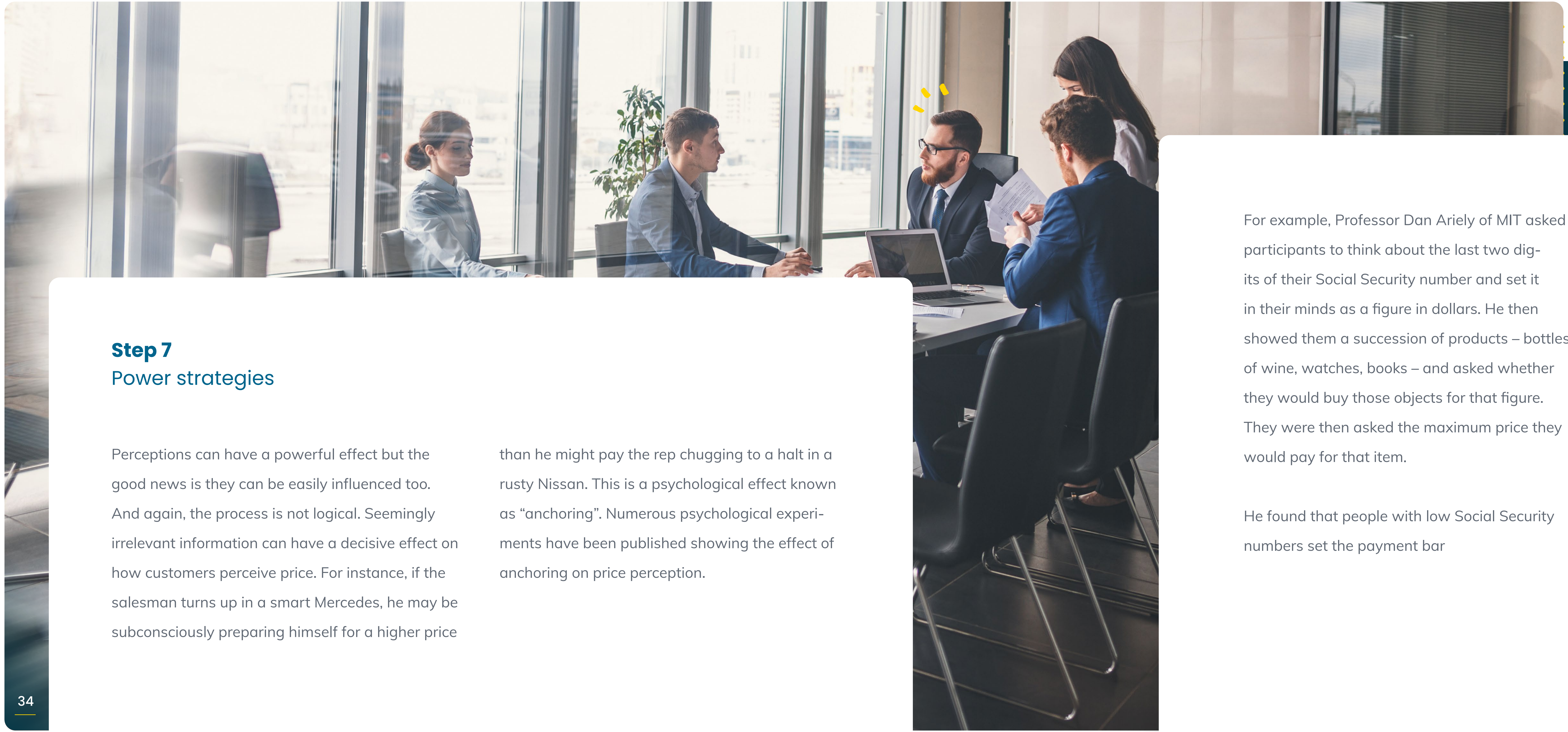
Step 6
Make your price seem as small as possible

Examples of techniques to make the price of a product or service seem smaller:

- Chunk it down into an amount paid a month, a week or a day – e.g. Apple advertise a 27-inch iMac by comparing the payments to less than a cup of coffee a day.
- Cars are often advertised by showing the cost under HP or PCP based on either the amount they pay each month, or the total of the deposit + monthly payments - and they ignore the final payment as the customer has the option to hand the car back at this point.
- Washing powder manufacturers state on the pack how many washes it will give you.
- Use prices ending in 9 – research shows that more sales are generated from products sold with a price ending in a 9 than a cheaper product doesn't end in 9 e.g. £35 against £39
- Use words to frame the cost and make it sound less e.g. – a £9 fee vs. a small £9 fee?
- Research has shown that people perceive simple-looking numbers to be smaller. This technique is often used in expensive restaurants where, for example, prices will simply be written as 18.

To illustrate this point, which feels smaller ?

1. **£1,500.00**
2. **1,500.00**
3. **1,500**
4. **1500**



Step 7
Power strategies

Perceptions can have a powerful effect but the good news is they can be easily influenced too. And again, the process is not logical. Seemingly irrelevant information can have a decisive effect on how customers perceive price. For instance, if the salesman turns up in a smart Mercedes, he may be subconsciously preparing himself for a higher price than he might pay the rep chugging to a halt in a rusty Nissan. This is a psychological effect known as "anchoring". Numerous psychological experiments have been published showing the effect of anchoring on price perception.

For example, Professor Dan Ariely of MIT asked participants to think about the last two digits of their Social Security number and set it in their minds as a figure in dollars. He then showed them a succession of products – bottles of wine, watches, books – and asked whether they would buy those objects for that figure. They were then asked the maximum price they would pay for that item.

He found that people with low Social Security numbers set the payment bar lower than those with high numbers. In other words, their (totally irrelevant) Social Security number acted as an anchor for the value they put on the products.

Like so...

Last two digits of Social Security Number	Average Bid
00-19	$16.09
20-39	$26.82
40-59	$29.27
60-79	$34.55
80-99	$55.64

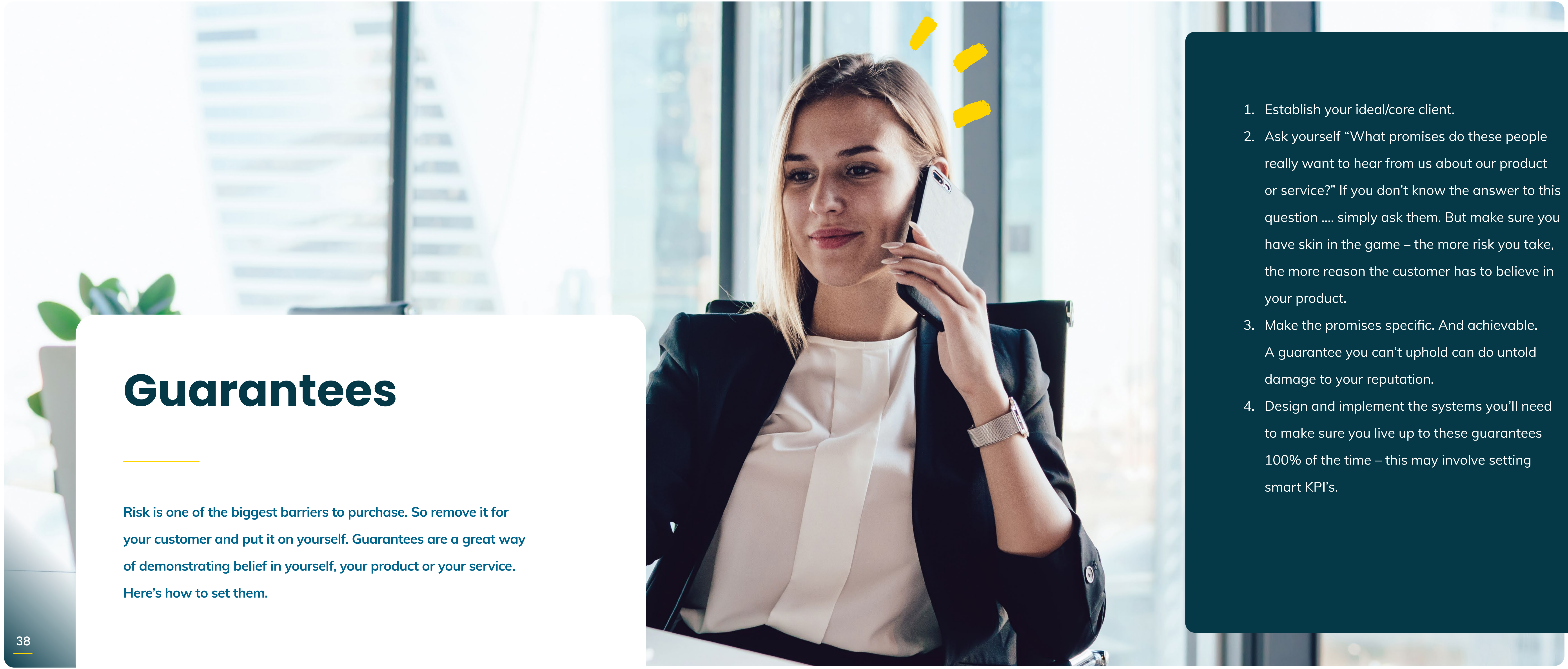
Average bids for a wireless keyboard varied depending on the first hypothetical price (equal with the last two digits of their SSN) that people had been asked to consider. Those whose SSN ended in low numbers tended to make lower bids than people whose SSN ended in high numbers.

This is just one of many studies that clearly demonstrates people's gratuitous tendency to rely on previously-seen information to anchor future estimates, even when those anchors have little relevance to the decision being made.

Many industries use this technique. Tailors often employ top-down pricing when selling suits – showing the most expensive suit first to anchor the customer's thinking at a higher value before showing the suits he actually wants to sell.

Hubolt advertise a million-dollar watch, made of white gold and encrusted with diamonds. It's totally impractical as a watch – but they have no intention of selling it anyway. Its sole purpose is to make their $60,000 watches look great value in comparison to the Million Dollar anchor.

And while this process defies logic, it's totally predictable and applicable in many situations. Try it yourself.



Guarantees

Risk is one of the biggest barriers to purchase. So remove it for your customer and put it on yourself. Guarantees are a great way of demonstrating belief in yourself, your product or your service. Here's how to set them.

1. Establish your ideal/core client.
2. Ask yourself "What promises do these people really want to hear from us about our product or service?" If you don't know the answer to this question .... simply ask them. But make sure you have skin in the game – the more risk you take, the more reason the customer has to believe in your product.
3. Make the promises specific. And achievable. A guarantee you can't uphold can do untold damage to your reputation.
4. Design and implement the systems you'll need to make sure you live up to these guarantees 100% of the time – this may involve setting smart KPI's.

You might choose to offer pricing options based on the level of guarantee you offer:

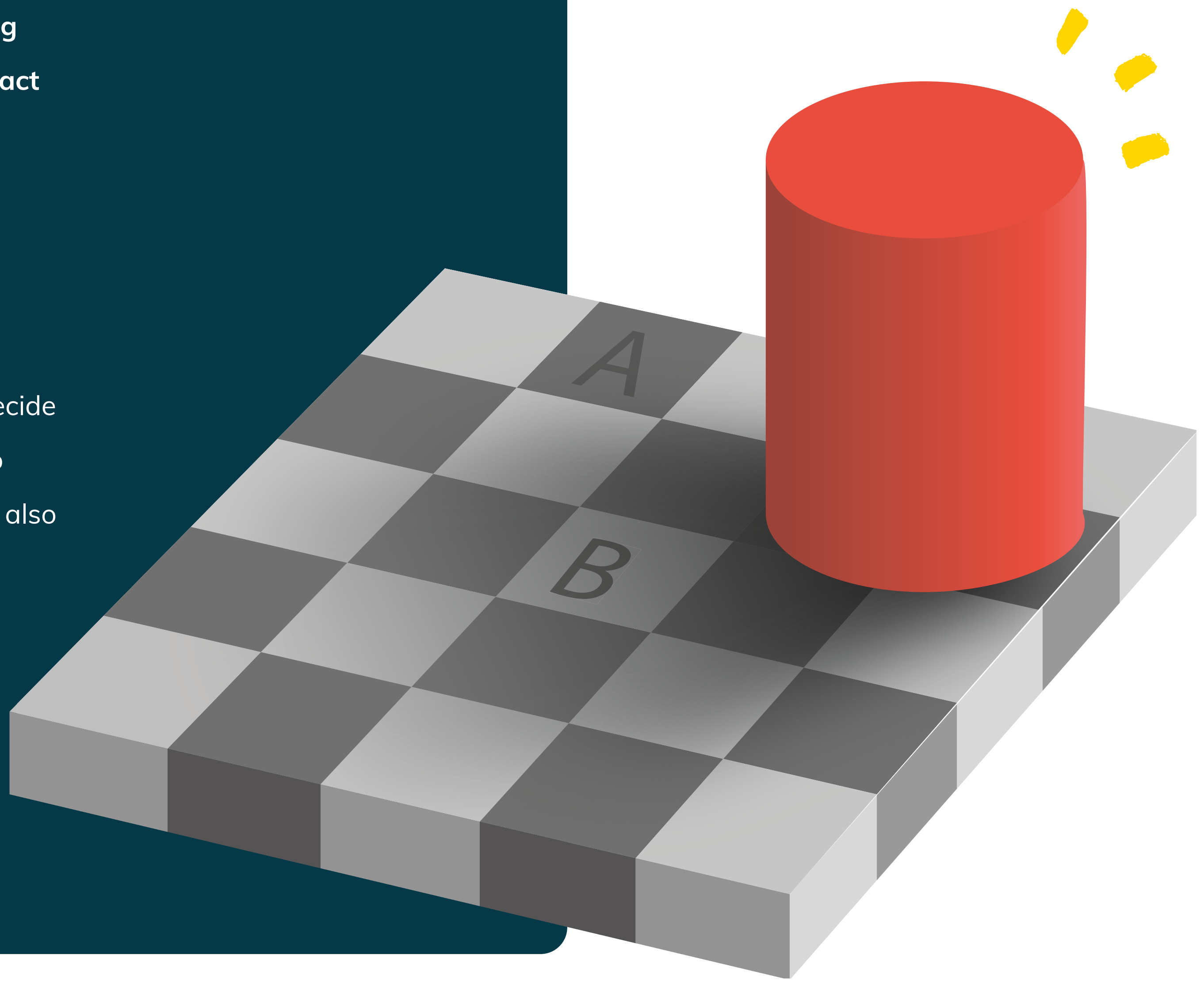
- No guarantee: lower price as the buyer is taking the risk
- Full guarantee: premium price as the seller is taking the risk
- Partial guarantee: mid-price as risk is shared

Context

Don't underestimate the influence of the setting and context in which you operate, and its impact on the perception of value.

Consider this optical illusion:

The colours on squares A and B are exactly the same. It's the context that causes the mind to decide what shade of grey it is - not the object itself. So context has a huge effect on perceptions. And it also colours our thoughts on value.



Another example:

In Bargain Booze you may find a fairly standard recent bottle of cabernet sauvignon for £4.99. You may find a very similar bottle in a mid-range supermarket for £7.99. In an upmarket specialist wine shop this bottle in a box with a different label, with tasting notes could be sold for £9.99.

In a restaurant, it could easily cost you £20.

The product is essentially the same. The label may be slightly different – but the fundamental difference is the context in which the bottle is sold. In each case, the customer will be inclined to believe he is getting good value.

Success Story

Here is a success story from a business who has improved profits by implementing their own pricing strategies.

Success story

Driving John Delany Motors Forward

As a new business owner, Brittany wanted to grow her business with a new brand and to create a pricing strategy that effectively communicated who they were to new and existing customers.

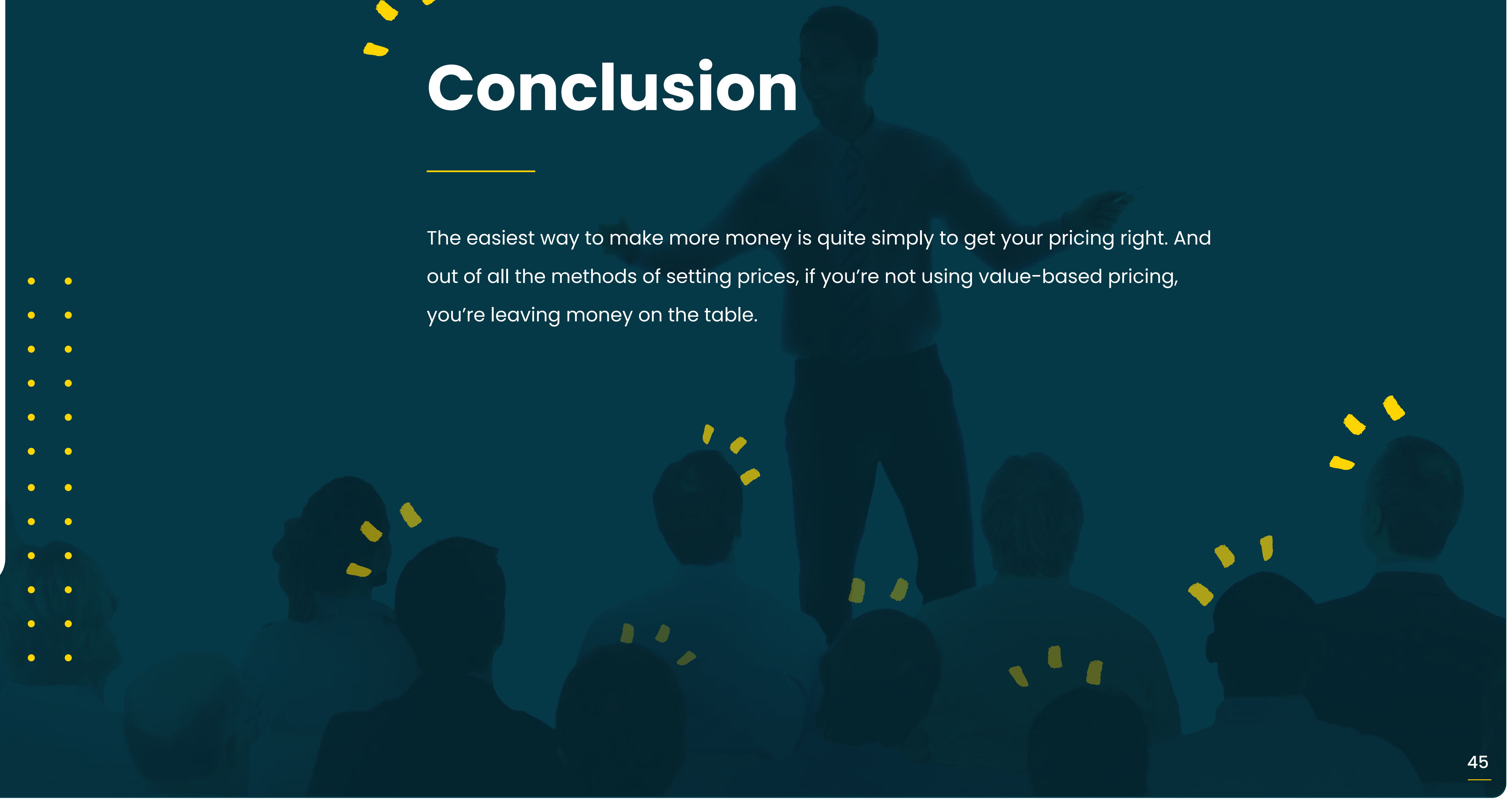
Brittany set goals and introduced KPIs with monthly management meetings so they are focusing on what matters most. She soon recognised that she was trying to do too many day-to-day roles within the business and needed to focus on growing the business. Brittany restructured the office roles and recruited a Marketing Manager to enable herself and her team to focus on what they do best. By introducing annual appraisals, team satisfaction surveys and regular communications she understands how her team tick and how to best support them.

Brittany has introduced a new pricing structure and new ways to support and communicate with their customers which has increased turnover and customer happiness overall. They are continuing to develop their brand and enhance the support they offer their customers to further grow the business.

> Working with Xeinadin has allowed me to take time out of my business to focus on making improvements, implement changes and create growth. Setting goals and tracking these using KPIs has made a very positive impact on my business.

Brittany Delany

Business Owner, John Delany Motors.



Conclusion

The easiest way to make more money is quite simply to get your pricing right. And out of all the methods of setting prices, if you're not using value-based pricing, you're leaving money on the table.

Notes

Notes

xeinadin

We are XEINADIN

Have you been inspired by this whitepaper?

Get in touch and talk to our experts about how we can help grow your business.

hello@xeinadin.com