

Profitable Strategies #6 Pricing by Value

Most businesses exist to create economic value, whether by lower costs, higher performance, or niche delivery. However, this is not always supported by an effective value pricing approach.

The key to pricing by value is to understand the alternative choices that customers have when choosing to buy, and assessing the relative value of each to them. A differentiated alternative will be worth more to those who *actually value that level of differentiation* than those who don't. It is essential to match the packages offered to the customers seeking it.

A Value-Based Approach to Segmenting Customers

A supplier needs to understand the needs and procurement mind-set of different types of customers in order to know the best way to pitch and the most appropriate pricing.

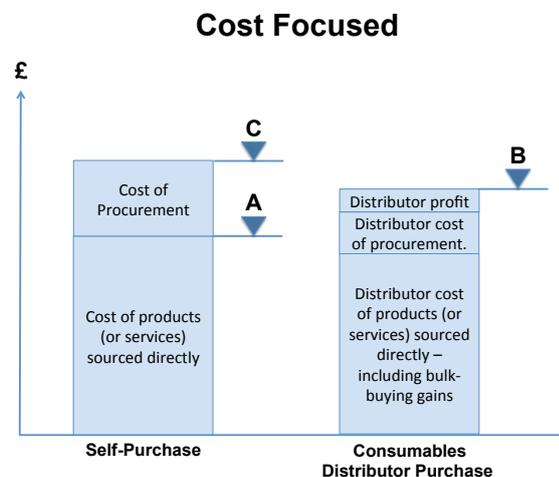
So, for example, a business providing consumables to niche market customers adds value by being able to buy in bulk and making it easy for to order on-line products sourced for their specific needs. The customer's reasonable alternative to buying from the consumables supplier is to source the products directly, or go to another supplier.

The customers have three different 'mind-sets' to buying: cost focused; cost-avoidance focused; and value focused.

Cost Focused Mind-Set

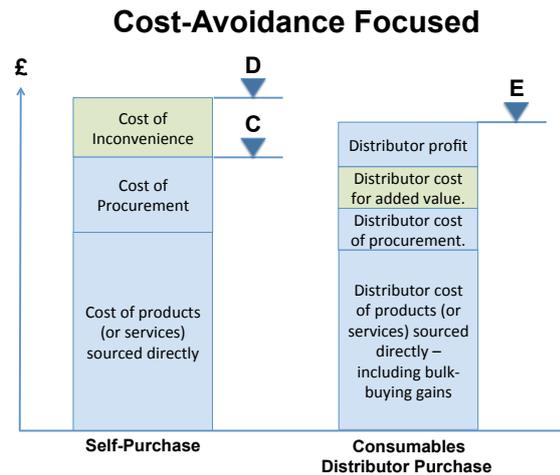
Cost focused customers look first at the price. The most naïve of them may compare the supplier's prices at B with the cost of purchasing them directly at price A, neglecting the cost of procurement. In order to win the business, the supplier's key task is to demonstrate to the customer

the substantial additional cost (total C) in sourcing the products directly, making buying from the supplier at price B the best alternative.



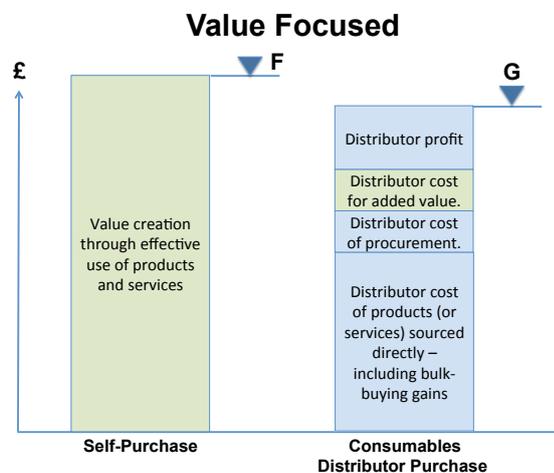
Cost-Avoidance Focused Mind-Set

Other customers are more open to valuing operational benefits. For example, delivering the product in double-quick time can help to remedy expensive mistakes. The pitch to these customers must be about how the added-value benefits of better responsiveness will enable downtime to be reduced, and so costs avoided. The key is to provide worked examples that show how these costs are avoided. This benefit justifies a higher price, at price E, because of the costs saved elsewhere.



Value Focused Mind-Set

Value-focused customers are most ready to account for the value created, rather than just costs (which is 'safer'). Pricing the products for them means understanding how they will be used, how they add value, and therefore what specific value added services are required for the



customers to succeed. This usually means researching customers' needs and operations to create appropriate solutions, together with compelling communication demonstrating how those needs are being met, and how the commensurate price G is the best value for money.

Differential Pricing

Ultimately, trying to be all things to all customers means giving away all your value-added services at the lowest price. It is essential to recognize that different groups of customers need different approaches, prices, and packages of value-added services.

Staffan Engstrom