

Week 2 Value-based Pricing Module Introduction

Value-based Pricing

In this module...

- Pricing to demand curves
- Practical applications
 - Price piano
 - Price ladder
 - Incentive curves
- Customer value drivers in a B2B context
- Value-based price setting for new products
- Price elasticity: Intersection of economics and customer value

By the end of this module you'll be able to...

- Relate willingness to pay to the demand curve
- Use price to meet demand as much as possible
- Calculate the right price in line with willingness to pay
 - Price piano
 - Price ladder
 - Incentive curves

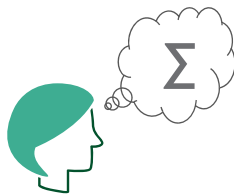
#5

Price to demand curve

(Thomas)

How do you price to the demand curve?

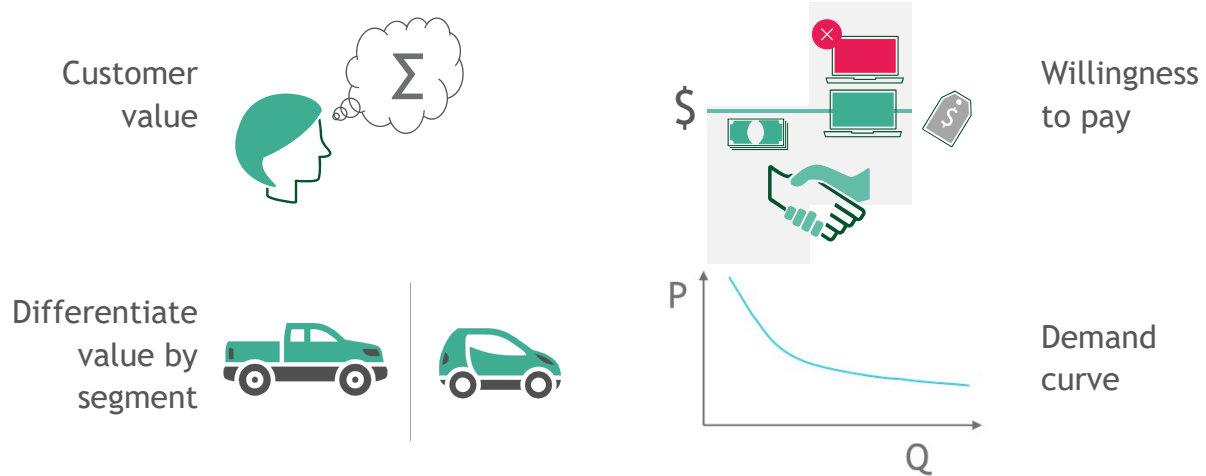
Customer
value



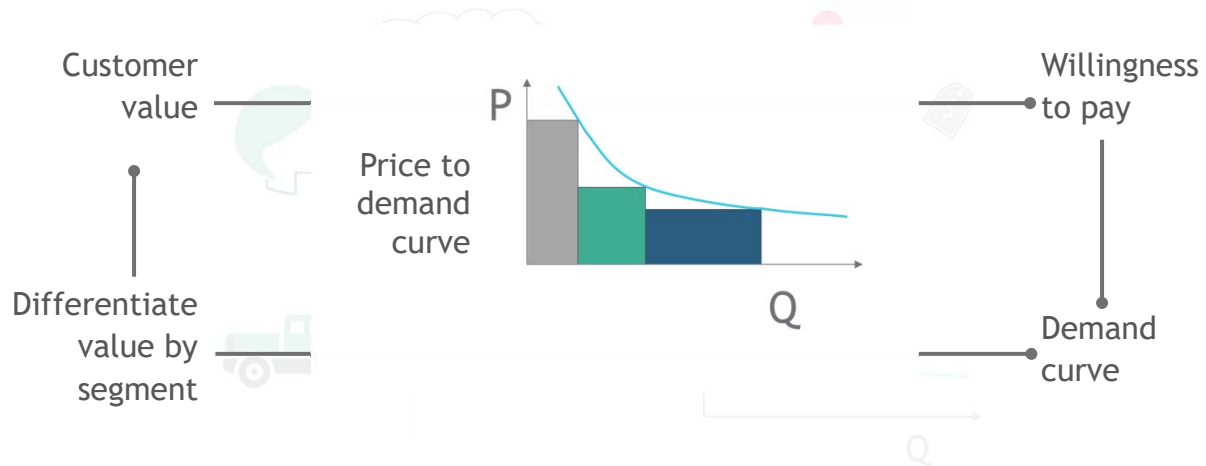
Differentiate
value by
segment



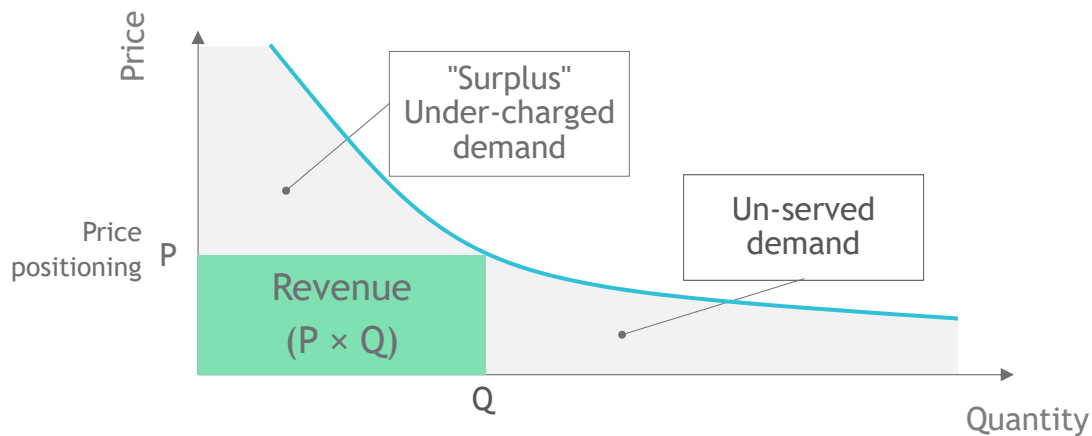
How do you price to the demand curve?



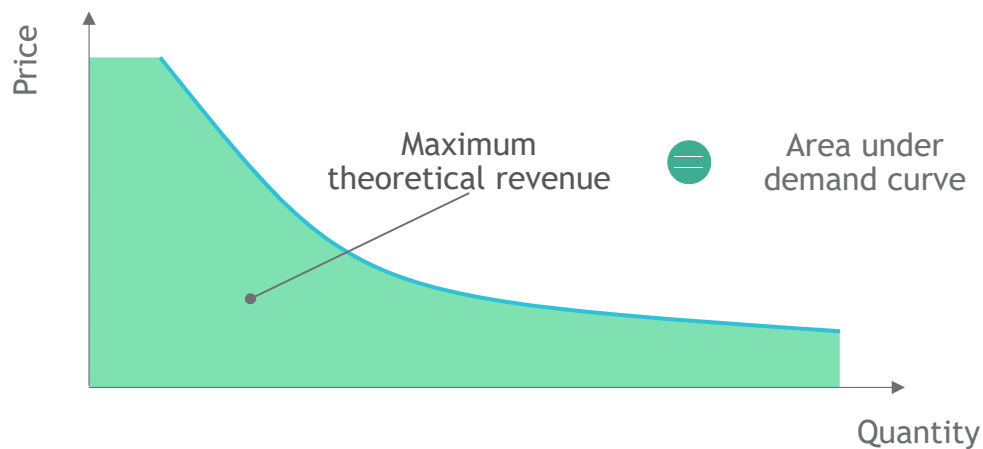
How do you price to the demand curve?



Demand curve - revenue with single offering



Demand curve - maximum theoretical revenue

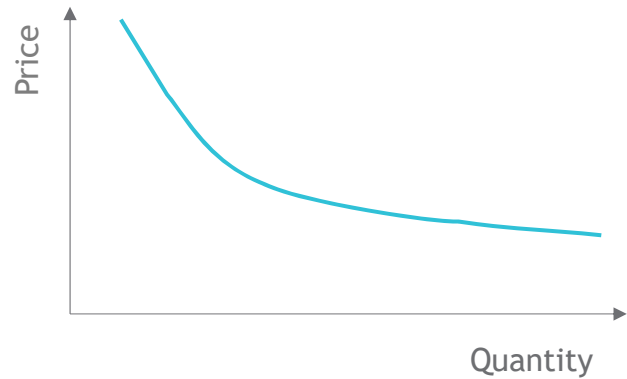


Price to demand curve by selling to multiple customer segments



Objective

Maximize value extraction by tracing the demand curve closely

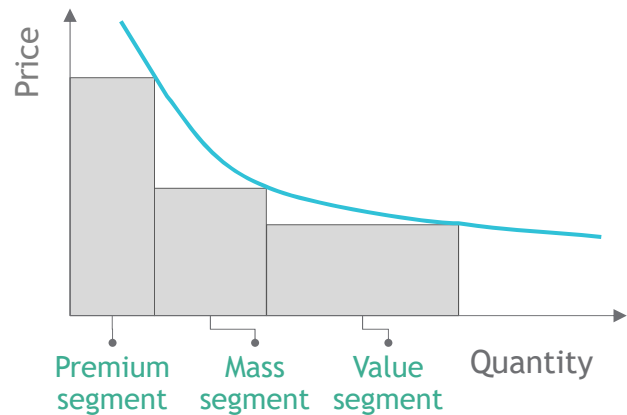


Price to demand curve by selling to multiple customer segments



Objective

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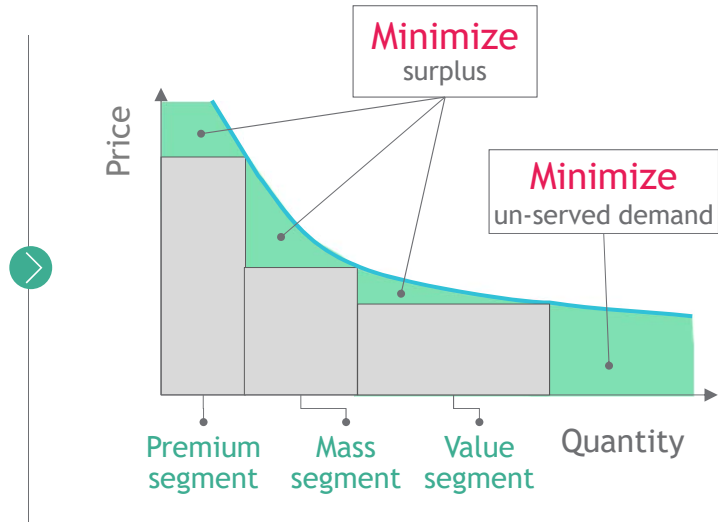


Price to demand curve by selling to multiple customer segments



Objective

Maximize value extraction by tracing the demand curve closely



How many customer segments should you serve?

Better question:
What does it take to serve a customer segment?

How many customer segments should you serve?

Better question:

What does it take to serve a customer segment?

Deep customer understanding

- Differentiate customer value equations
- Identify segments
- Articulate winning value proposition

How many customer segments should you serve?

Better question:

What does it take to serve a customer segment?

Deep customer understanding

- Differentiate customer value equations
- Identify segments
- Articulate winning value proposition



Capabilities and assets

- ... to deliver the value proposition

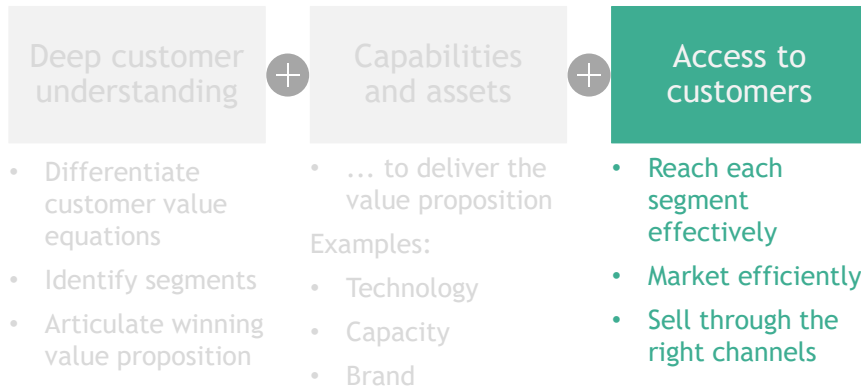
Examples:

- Technology
- Capacity
- Brand

How many customer segments should you serve?

Better question:

What does it take to serve a customer segment?



How many customer segments should you serve?

Better question:

What does it take to serve a customer segment?

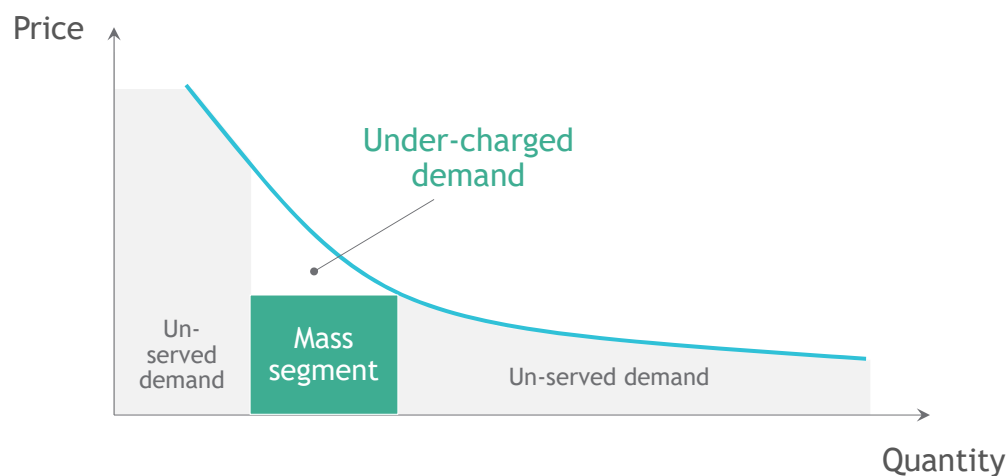


How many customer segments should you serve?

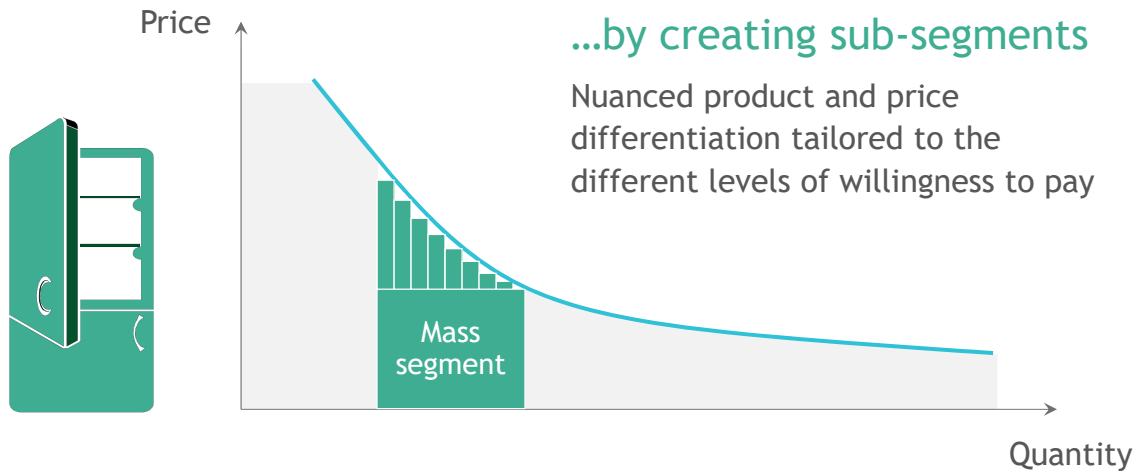


As many segments as you can effectively serve profitably!

Even within a segment, there is room to optimize...

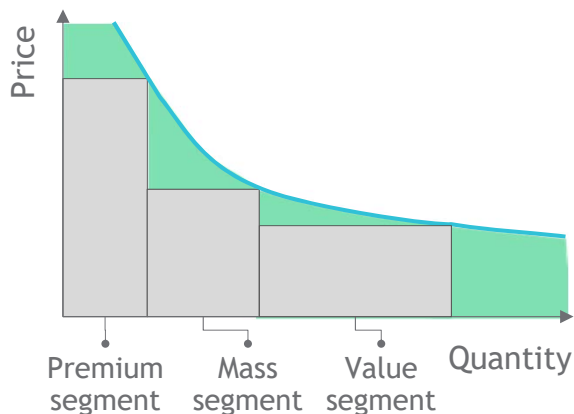


Even within a segment, there is room to optimize...

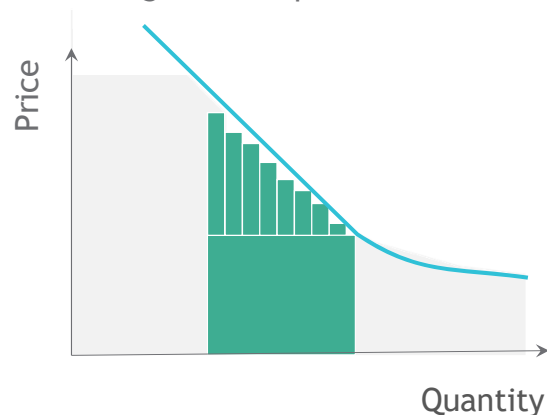


Create segments first, then use sub-segments to price to demand curve

1 Create distinct customer segments



2 Identify sub-segments within segments to price to WTP



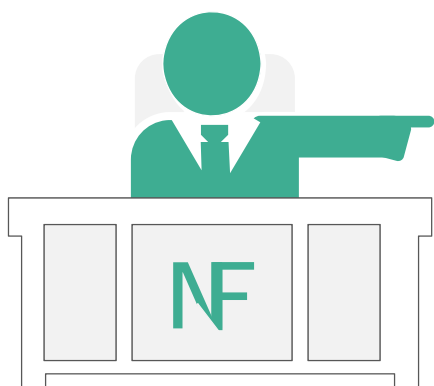
#7a

Application: Pricing to demand curve (Thomas)

A discussion with the CEO of NewFood



A discussion with the CEO of NewFood



- Fast food chain
- 1,000 stores, \$800M sales
- Primary product: Hot dogs
- Two product lines
 - Traditional (~60%)
 - Organic (~40%)
- Two direct competitors
 - "Frankies"
 - "Dawg Day"

Pricing experts rely on these three techniques

Someday, you will too.



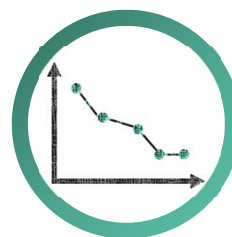
Price Piano

Understand "hot" price points in the market



Price ladder

Systematically differentiate products and prices



Incentive curve

Optimize package sizes and price per use

Pricing experts rely on these three techniques

Someday, you will too.



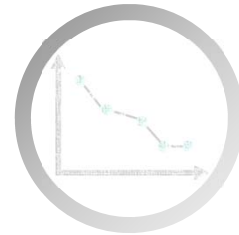
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Price ladder

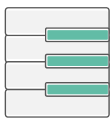
Systematically differentiate products and prices



Incentive curve

Optimize package sizes and price per use

1 Determine price range



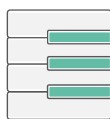
Price Piano

Framework to understand a market, identify opportunities, and discover "hot" price points



\$2.00 - 2.49
\$2.50 - 2.99
\$3.00 - 3.49
\$3.50 - 3.99
\$4.00 - 4.49
\$4.50 - 4.99
\$5.00 - 5.49
\$5.50 - 5.99

2 Map product line-up



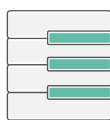
Price Piano

Framework to understand a market, identify opportunities, and discover "hot" price points



	NewFood	
	Traditional	Organic
\$2.00 - 2.49		
\$2.50 - 2.99	\$2.59 \$2.99	\$2.99
\$3.00 - 3.49		\$3.49
\$3.50 - 3.99		\$3.99
\$4.00 - 4.49		\$4.49
\$4.50 - 4.99	\$4.59 \$4.99	
\$5.00 - 5.49		
\$5.50 - 5.99		

3 Map competitor line-up



Price Piano

Framework to understand a market, identify opportunities, and discover "hot" price points



	NewFood	Frankies	Dawg Day
	Traditional	Organic	
\$2.00 - 2.49			
\$2.50 - 2.99	\$2.59 \$2.99	\$2.99	\$2.99
\$3.00 - 3.49		\$3.49	\$3.24
\$3.50 - 3.99		\$3.99	\$3.99
\$4.00 - 4.49		\$4.49	\$4.24
\$4.50 - 4.99	\$4.59 \$4.99		
\$5.00 - 5.49			
\$5.50 - 5.99			

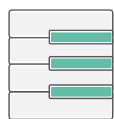
4 Find the “hot” price points

	NewFood		Frankies	Dawg Day
	Traditional	Organic		
\$2.00 - 2.49				
\$2.50 - 2.99	\$2.59 \$2.99	\$2.99	\$2.99	\$2.99 \$3.24
\$3.00 - 3.49		\$3.49		
\$3.50 - 3.99		\$3.99	\$3.99	\$3.99
\$4.00 - 4.49		\$4.49		\$4.24
\$4.50 - 4.99	\$4.59 \$4.99		\$4.99	\$4.99
\$5.00 - 5.49				
\$5.50 - 5.99				

5 Find the open price points

	NewFood		Frankies	Dawg Day	
	Traditional	Organic			
\$2.00 - 2.49					
\$2.50 - 2.99	\$2.59 \$2.99	\$2.99	\$2.99	\$2.99	\$2.99
\$3.00 - 3.49		\$3.49		\$3.24	
\$3.50 - 3.99		\$3.99	\$3.99	\$3.99	\$3.99
\$4.00 - 4.49		\$4.49		\$4.24	
\$4.50 - 4.99	\$4.59 \$4.99		\$4.99		\$4.99
\$5.00 - 5.49					
\$5.50 - 5.99					

6 Map prices by channels

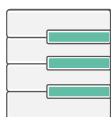


Price Piano

Higher prices at
POI locations



	Frankies	
	Regular location	POI location
\$2.00 - 2.49	+ \$0.50	
\$2.50 - 2.99		\$2.99
\$3.00 - 3.49		\$3.49
\$3.50 - 3.99	\$3.99	
\$4.00 - 4.49		\$4.49
\$4.50 - 4.99	\$4.99	
\$5.00 - 5.49		\$5.49
\$5.50 - 5.99		



Price pianos are about "hot" price points and opportunities

Understand the market

What are the "hot" price points?



Are there open price points?



Do "hot" price points vary across
channels or major retailers?



Identify opportunities

Does our product line-up cover
them?

Could we occupy them?

Are we varying our prices
accordingly?

#7b

Price Ladder (FINALLY PRETTY) (Thomas)

Price ladders are about product and price differentiation



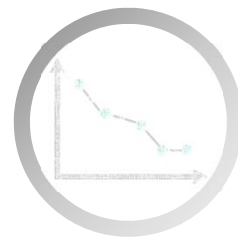
Price Piano

Understand "hot" price points in the market



Price ladder

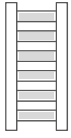
Systematically differentiate products and prices



Incentive curve

Optimize package sizes and price per use

1 Plot product line-up

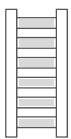


Price ladder

A way to identify the steps between price points and assess if the steps are too wide or too steep

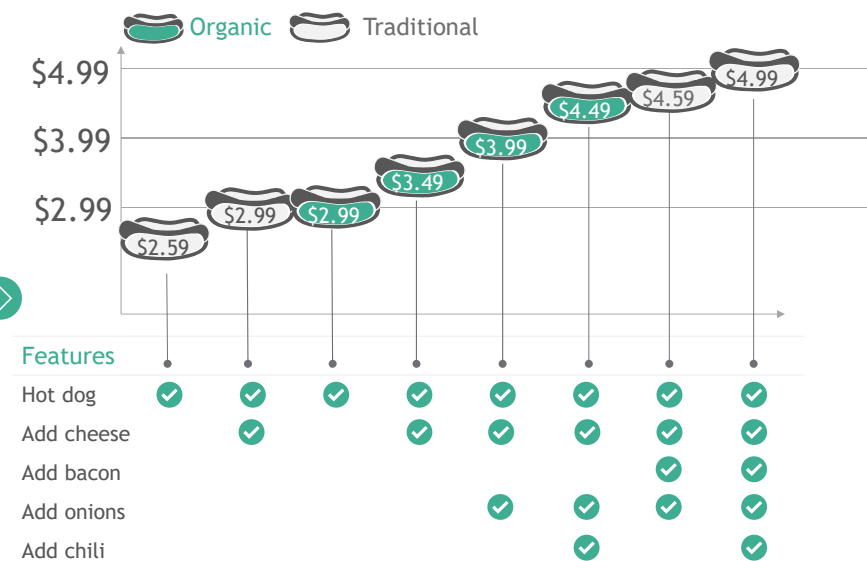


2 Map features of each product

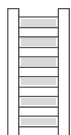


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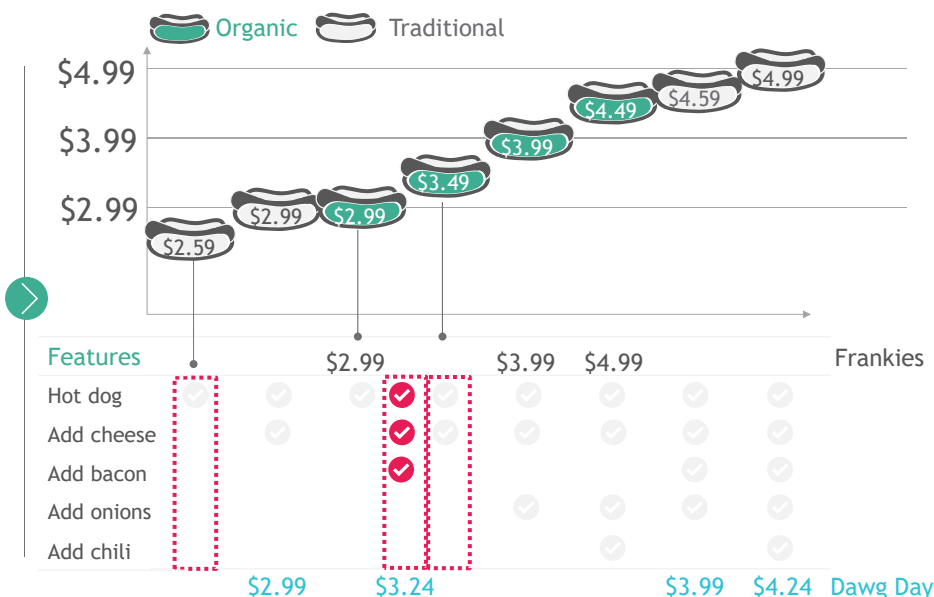


3 Include competitors

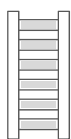


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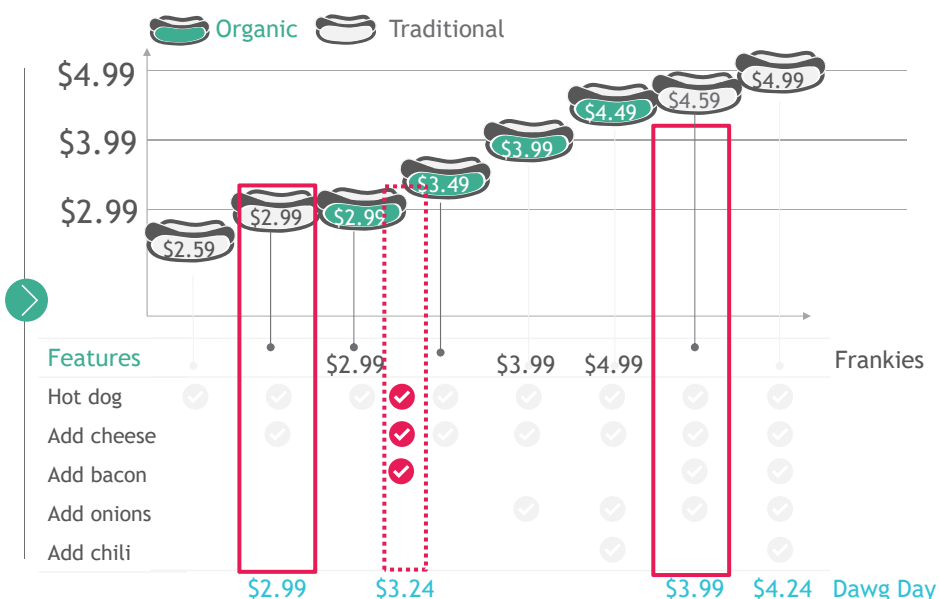


4 Analyze the price ladder

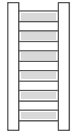


Price ladder

Look for a big price or feature gap

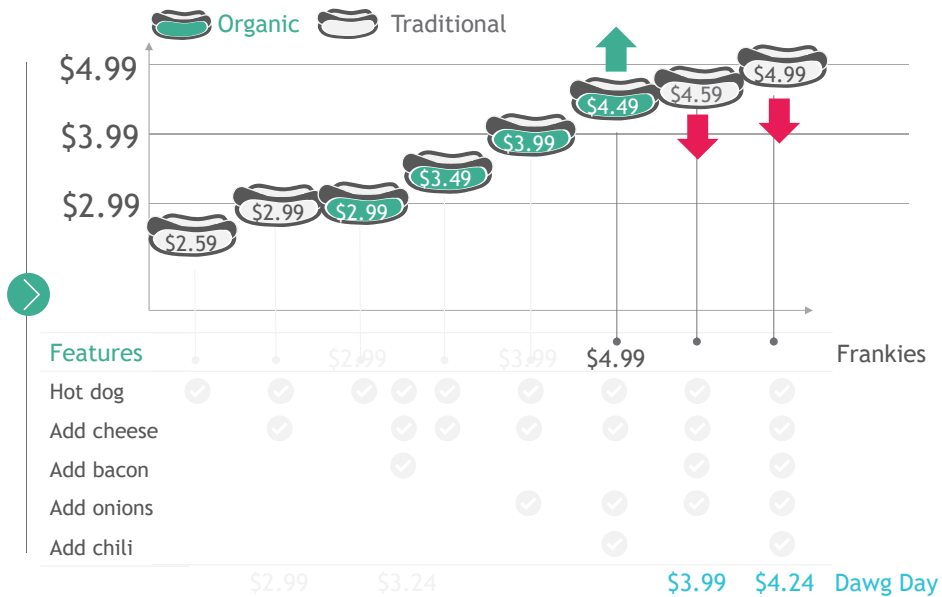


4 Analyze the price ladder

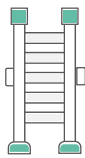


Price ladder

Look for re-price opportunities

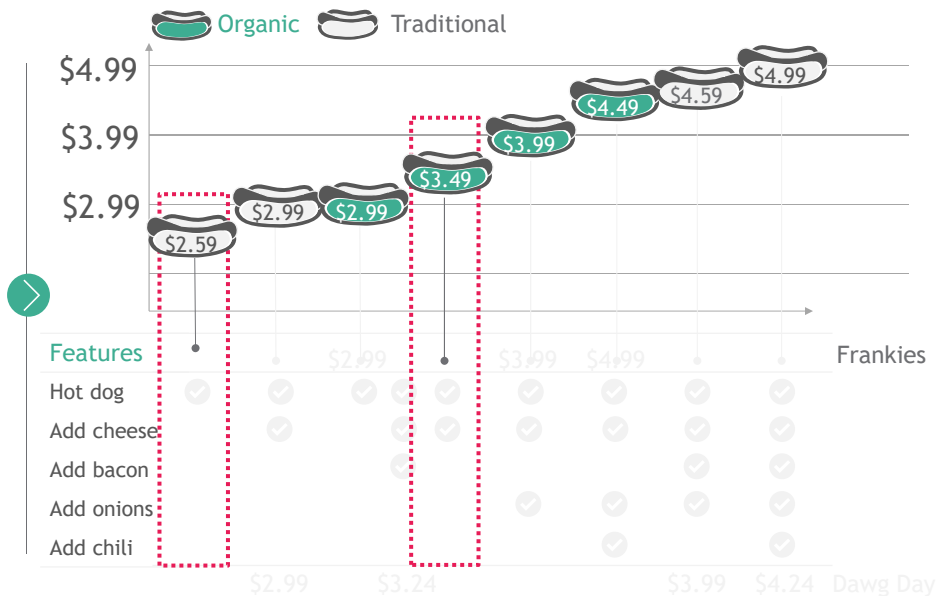


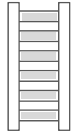
4 Analyze the price ladder



Price ladder

Defend the unique positions





Price ladders are about product and price differentiation

Understand the market

What's the relationship between features and price?

What price gaps exist between competitors in the market?

What's the relationship between price and cost?



Identify opportunities

Does our internal view of relative value match the market?

Do we have steps in our price ladder that are too wide or too steep?

Can we price better to customer value?

#7c

Incentive curve (Thomas)

Incentive curves optimize package sizes and price per use



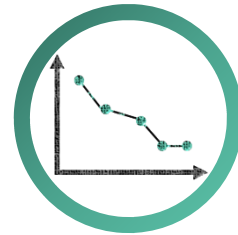
Price Piano

Understand "hot" price points in the market



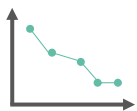
Price ladder

Systematically differentiate products and prices



Incentive curve

Optimize package sizes and price per use



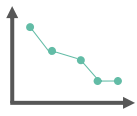
Incentive curve - quick recap

Price/unit

Examples for units:

- Grams/ounces
- Liters/gallons
- Count





Incentive curve - quick recap

Potato chips vs. Toilet paper

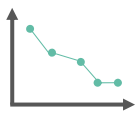
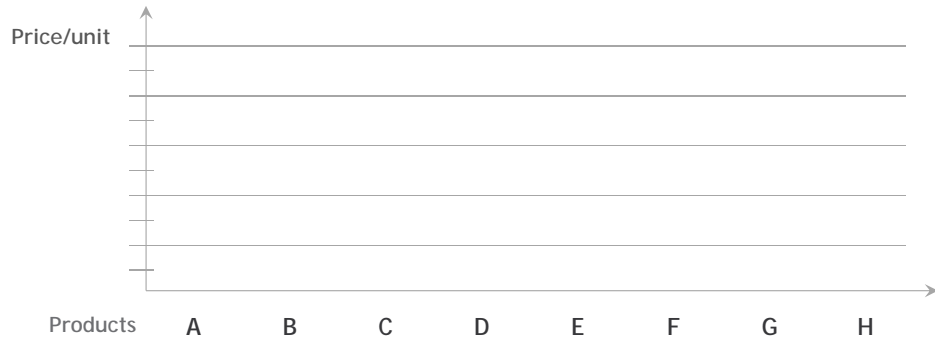
Price/unit

Potato chips:

- Grams / ounces

Toilet paper:

- Count of rolls



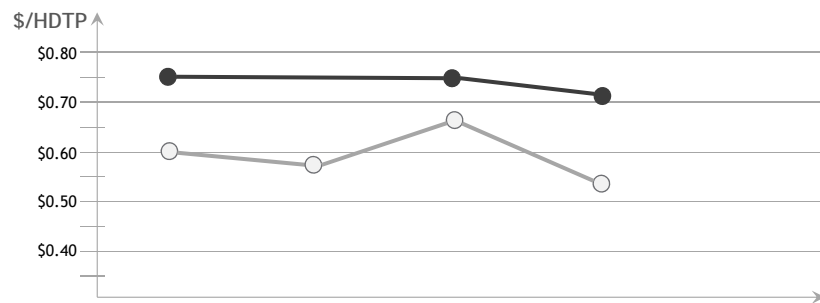
Incentive curve for Organic hot dogs

Hot Dog Taste Points

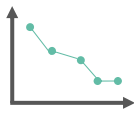
Consumer scoring of taste



- 1 - very bad
- ...
- 10 - excellent



Products	E Organic	F Organic	G Organic	H Organic
Price \$	2.99	3.49	3.99	4.99
HDTP	5	6	6	8
\$/HDTP	0.60	0.58	0.67	0.56



Incentive curves are about package size and price per use

Understand the market

What is the impact of package size on usage?



What are appropriate target slopes between sizes to maximize profitability?



Where are price/unit relationships out of place in the market?



Identify opportunities

Can we drive incremental usage through larger package size?

Can we introduce incentive curves ... or adjust their slope ... to optimize profitability?

#8

Customer Value Drivers in a B2B Context

(Thomas)

How would you price this laptop
in line with customer value?



Consumers



Businesses

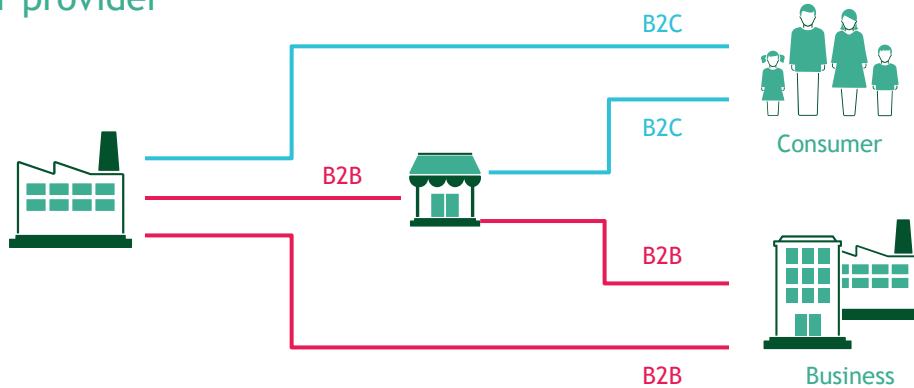


Difference between B2B vs. B2C

Manufacturer
or provider

Re-seller

End-user



Consumers



Businesses



$$\text{Customer value} = \sum_{\text{all } i} \text{Value-drivers}_i$$

Consumers and businesses have very different value drivers

Value drivers are different B2C vs. B2B

$$\text{Customer value} = \sum_{\text{all } i} \text{Value-drivers}_i$$

B2C

- Technical ...
- Functional ...
- Emotional ...

Needs to work
Experiences
Satisfaction

Importance



B2B

Needs to meet specs
Outcomes
Reassurance

How businesses think about your price

"Your price" is "their cost"

- B2B customers have desire to maximize surplus (i.e. benefits - cost)
- Investment mindset ... expecting adequate returns
- Total cost of ownership considered for durables
- Ease of doing business important

What do B2B customers really want?

Success as business

- Achieve competitive advantage
- Drive growth in top and bottom line
- Deliver adequate capital returns



How does your offering contribute
to these goals?

#9a

Value-based price setting for a new product: Steps 1 & 2

(Thomas)

Value-based pricing more thorough
than cost-plus pricing

Price setting approaches



Five steps to set value-based prices for new products

- 1 Define target customer segment
- 2 Identify next best alternative
- 3 Identify the customer's value drivers
- 4 Quantify value drivers to find the indifference price point
- 5 Use the indifference price point to set the price



1 Define target customer segment

Know your customer



Jane
Typical home
user

- Watching movies in 3D
- Large enough screen size
- Appealing brand

Her usage requires fewer
technical benefits

1 Define target customer segment

Know your customer



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Her usage requires fewer technical benefits



Raj
IT Director

- Security
- Durability
- Processing power
- Storage capacity

Needs technical specs to maximize user productivity

1 Define target customer segment

Know your customer



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Typical home
user

- Watching movies in 3D
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Her usage requires fewer technical benefits



Raj
IT Director

- Security
- Durability
- Processing power
- Storage capacity

Needs technical specs to maximize user productivity



Activities to analyze markets

- Store visits
- Customer interviews
- Competitive mapping
- Quantitative surveys

1 Define target customer segment

Know your customer



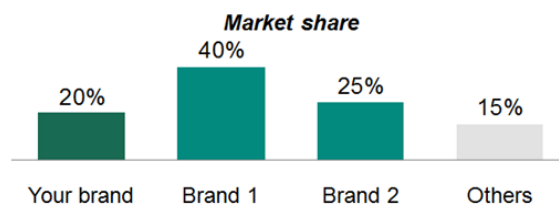
Jane
Typical home user

- Watching movies in 3D
- Large enough screen size
- Appealing brand

Her usage requires fewer technical benefits

Know your competitors

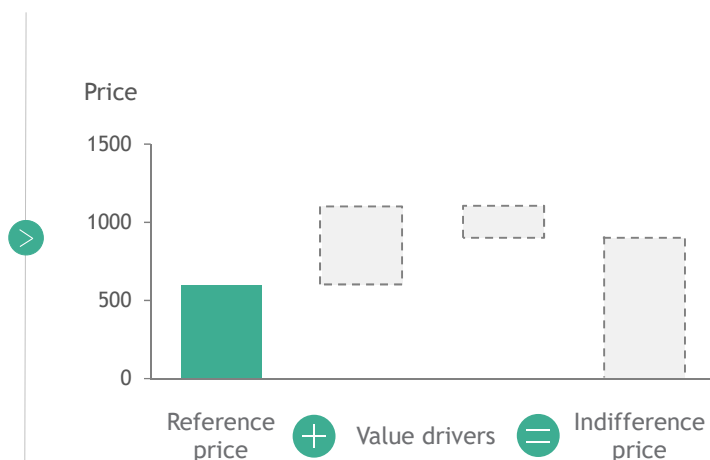
What other brands and product offerings compete for Jane's business?



2 Identify next best alternative

What is the next best alternative?

- Customers looking to buy a product usually have a specific product in mind: the next best alternative
- The price of this product represents the reference price





2 Identify next best alternative

Compare products with similar defining features

- Relevant for your target customer segment
- Compare key features with competing products
- Try to anchor to the market leader







		
Brand	Your brand	Brand 1
Market share	20%	40%
Processor	Dual-core 2.5 GHz	Dual-core 2.5 GHz
Hard drive	512 GB	512 GB
RAM	4 GB	4 GB
Screen size	15"	13"
Movie conversion	1 hour	1 hour
HD video editing	50% faster	50% faster
Blu-ray in 3D	Yes	No

2 Identify next best alternative

For products with market leading features

- Reference price points **NOT AVAILABLE** without directly comparable products
- Build the target customer's next best alternative by combining products and services which provide the exact same value
- Aggregate prices of individual elements to "build" price



	
Your laptop 2TB	Competitor laptop 1TB
How much would it cost the customer to build up to 2TB storage using add-on products?	
Competitor 1TB \$700	<div>  </div> <div> External USB drive 1TB \$75 </div> <div>  </div> <div> Next best alternative \$775 </div>

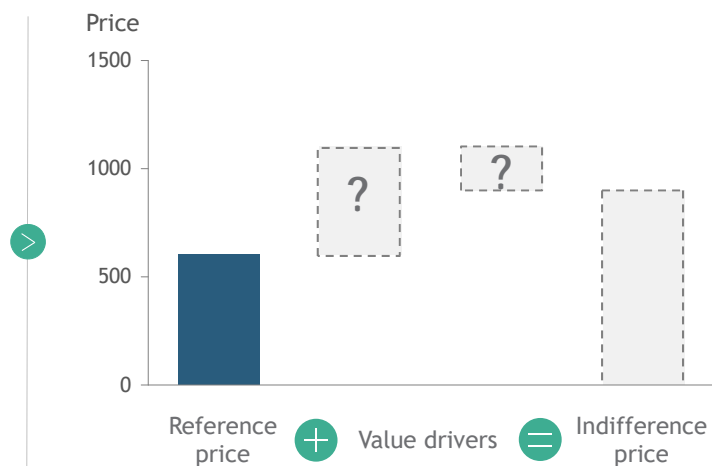
#9b

Value-based price setting for a new product: Steps 3 - 5 (Thomas)

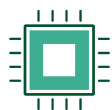
3 Identify value drivers to find the indifference price point

Customer benefit equals
sum of value drivers

Value drivers measure the
value customers associate
with each product feature



3 Identify value drivers to find the indifference price point

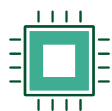


Technical

Product features that provide technical benefits. Connect to functional and emotional benefits

Product value drivers	<ul style="list-style-type: none"> • Size • Capacity • Performance
Non-product value drivers	<ul style="list-style-type: none"> • Warranty duration

3 Identify value drivers to find the indifference price point



Technical

Product features that provide technical benefits. Connect to functional and emotional benefits

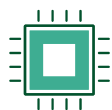


Functional

How the customer **experiences product** during purchase, set-up, usage

Product value drivers	<ul style="list-style-type: none"> • Size • Capacity • Performance 	<ul style="list-style-type: none"> • Ease of use • Breadth of functions
Non-product value drivers	<ul style="list-style-type: none"> • Warranty duration 	<ul style="list-style-type: none"> • Delivery speed • Customer service • Value-added services

3 Identify value drivers to find the indifference price point



Technical

Product features that provide technical benefits. Connect to functional and emotional benefits



Functional

How the customer **experiences product** during purchase, set-up, usage



Emotional

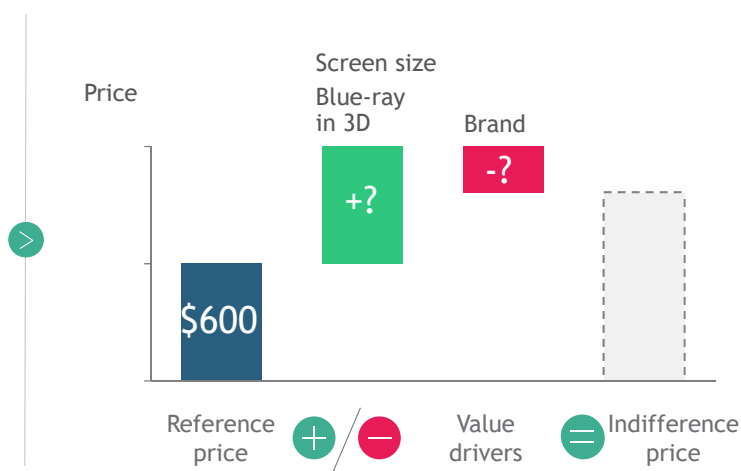
How the customer **feels about product** based on his brand perception, its reputation, and their personal experience

Product value drivers	<ul style="list-style-type: none"> • Size • Capacity • Performance 	<ul style="list-style-type: none"> • Ease of use • Breadth of functions 	<ul style="list-style-type: none"> • Brand • Design
Non-product value drivers	<ul style="list-style-type: none"> • Warranty duration 	<ul style="list-style-type: none"> • Delivery speed • Customer service • Value-added services 	<ul style="list-style-type: none"> • Courtesy • Trust

3 Identify value drivers to find the indifference price point

How well do we meet Jane's needs?

Value drivers can have both positive and negative impacts

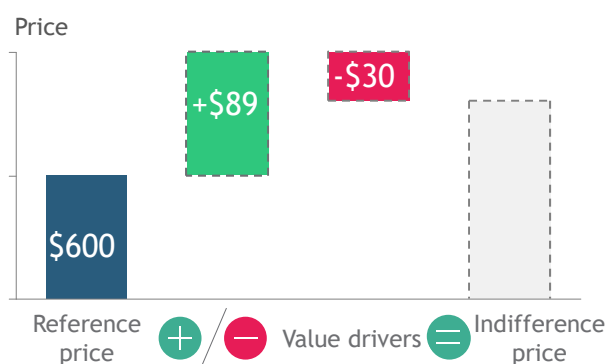


4 Quantify value drivers to find the indifference price point

Three main quantification methods

- Economic value estimate
- Intrinsic value analysis
- Conjoint analysis

Product features	Monetary value
Screen Size	\$25
Blue-ray in 3D	\$64
Brand	\$-30

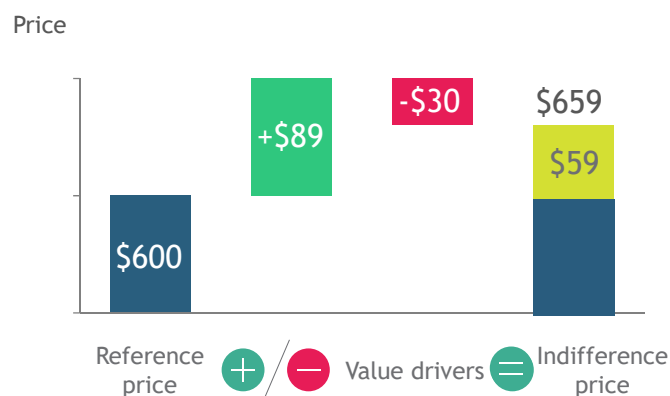


4 Quantify value drivers to find the indifference price point

Indifference price

Price at which Jane would be indifferent whether she buys our product or her next best alternative

Product features	Monetary value
Screen Size	\$25
Blue-ray in 3D	\$64
Brand	\$-30



5 Use the indifference price point to set the price

Justifiable price range

Range above product cost and indifference price



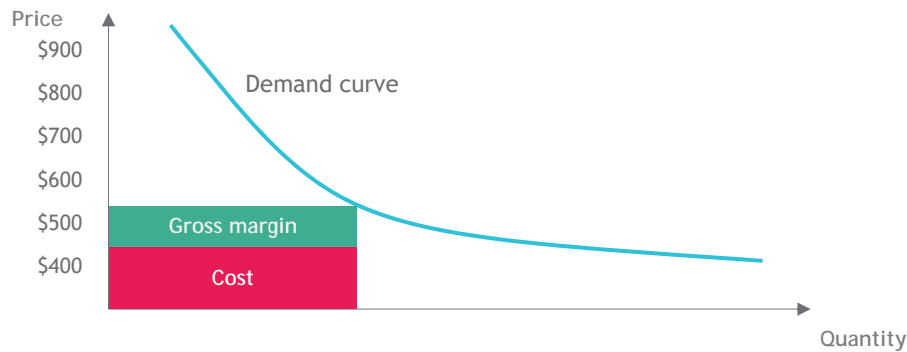
5 Use the indifference price point to set the price



5 Use the indifference price point to set the price

Calculate gross margin for each price point

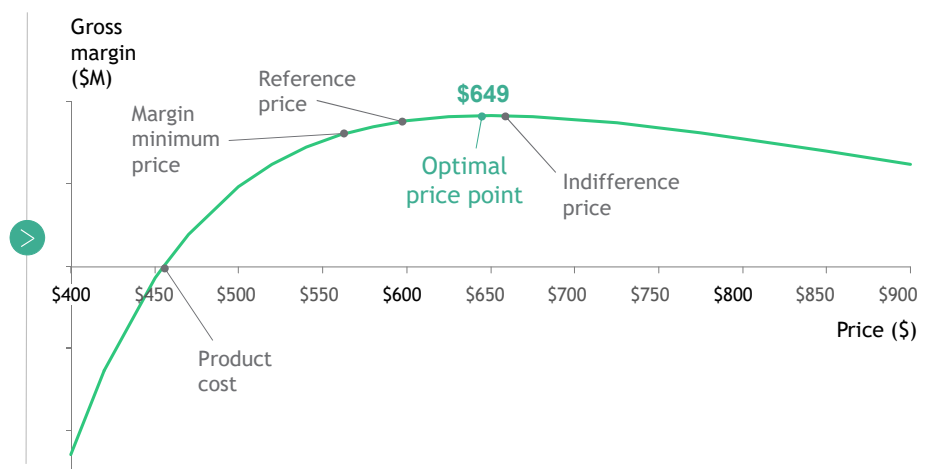
Leveraging demand curve



5 Use the indifference price point to set the price

Profit parabola
will lead to
optimal price

Plot gross
margins for each
price point and
find maximum



Value-based price setting - closing remarks

In the real world, pricing decisions always consider all three lenses

- Customer value
- Economic
- Competitive



Value-based Pricing Takeaways

Now you can...

- Relate willingness to pay to the demand curve
- Use price to meet demand as much as possible
- Calculate the right price in line with willingness to pay
 - Price piano
 - Price ladder
 - Incentive curves