

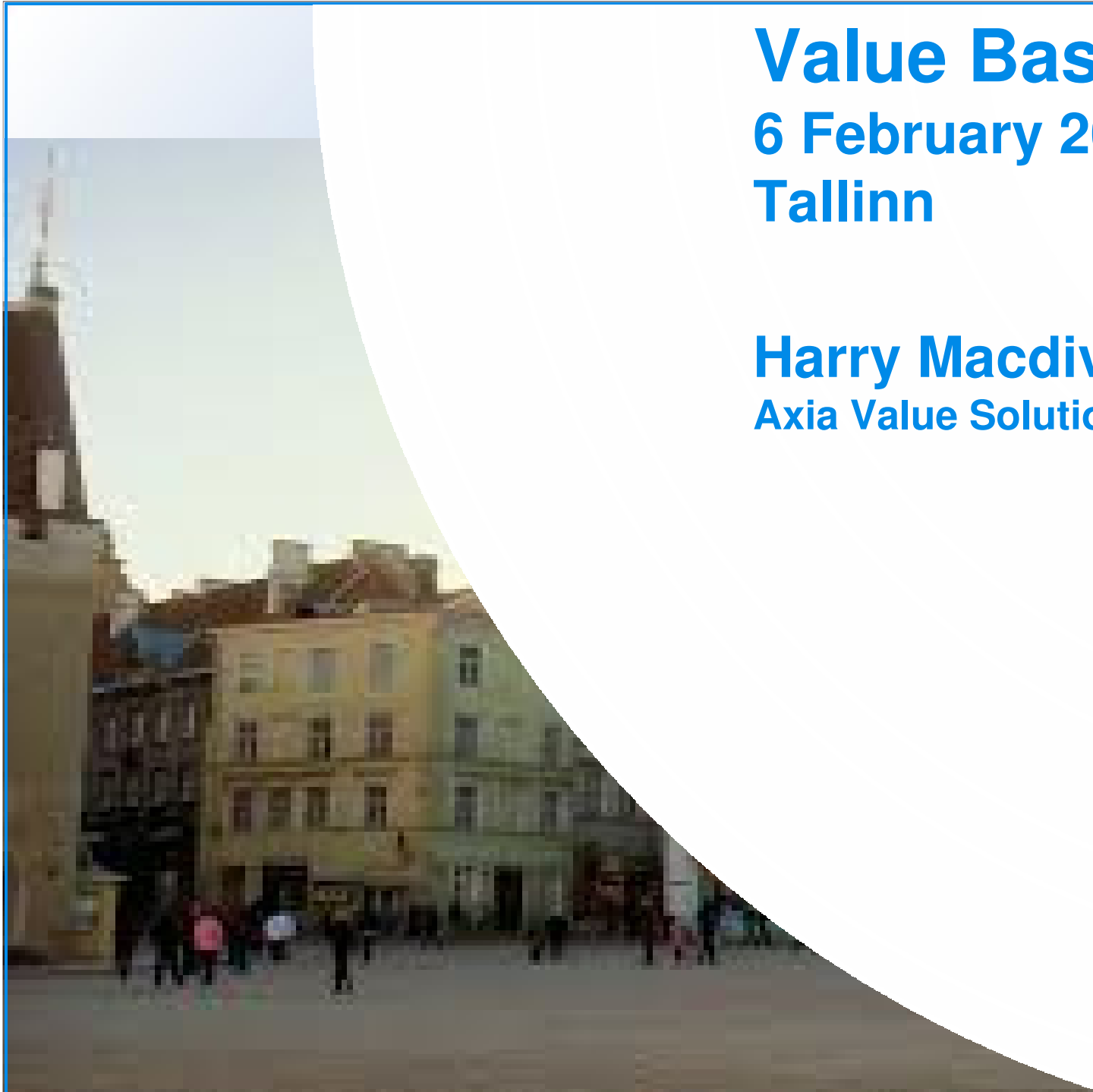
Value Based Pricing

6 February 2013

Tallinn

Harry Macdivitt

Axia Value Solutions



What we will look at...

- Conventional Pricing Methods – Pros and Cons
- What is Value?
- What is Value Based Pricing?
- What companies use Value Based Pricing?
- Value Based Pricing – A Journey or a Destination?

Conventional Pricing Methods

Cost Based

Based on our costs

**Competition
Based**

Based on competitors' prices

**Market
Based**

*Based on what we think the
market will accept*

"OOTA"

Based entirely on a guess

€

Cost-Based Price Structure

€50

Margin/Mark-up

€75

Variable Costs

€80

Fixed Costs



Critique of Cost Based Pricing

+	-
Easy to calculate	largely ignores the role of consumers and competitors
Minimal information requirements	Ignores opportunity costs
Easy to administer	Uses historical accounting costs - not replacement value
Tends to stabilize markets - insulated from demand variations and competitive factors	Includes sunk costs rather than just incremental costs
Should insure seller against unpredictable, or unexpected later costs	Contractors may not focus on performance because the cost is always covered by the client
Fair and transparent	Uses “normal” or “standard” output level to allocate fixed costs

Price

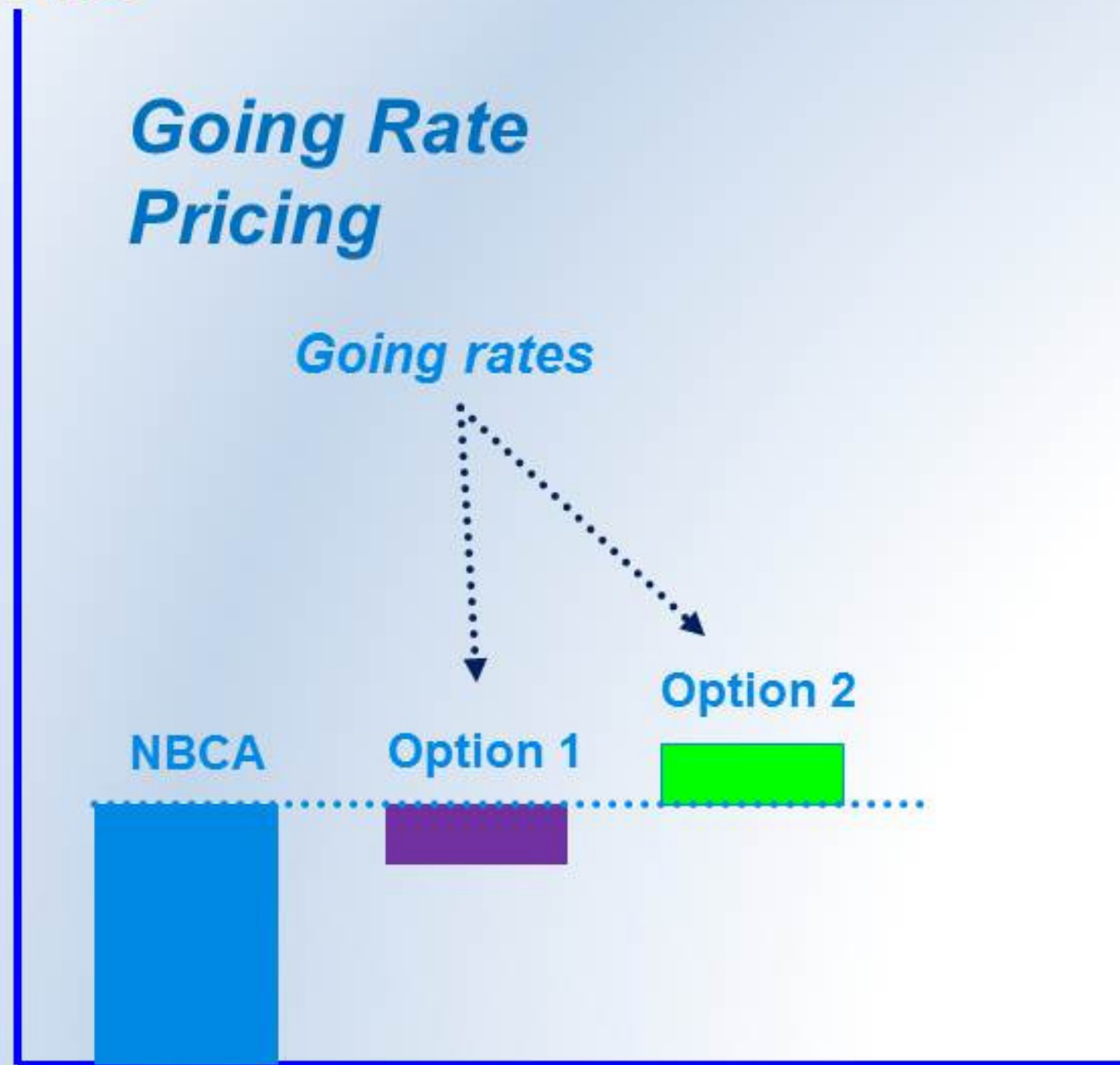
Going Rate Pricing

Going rates

NBCA

Option 1

Option 2

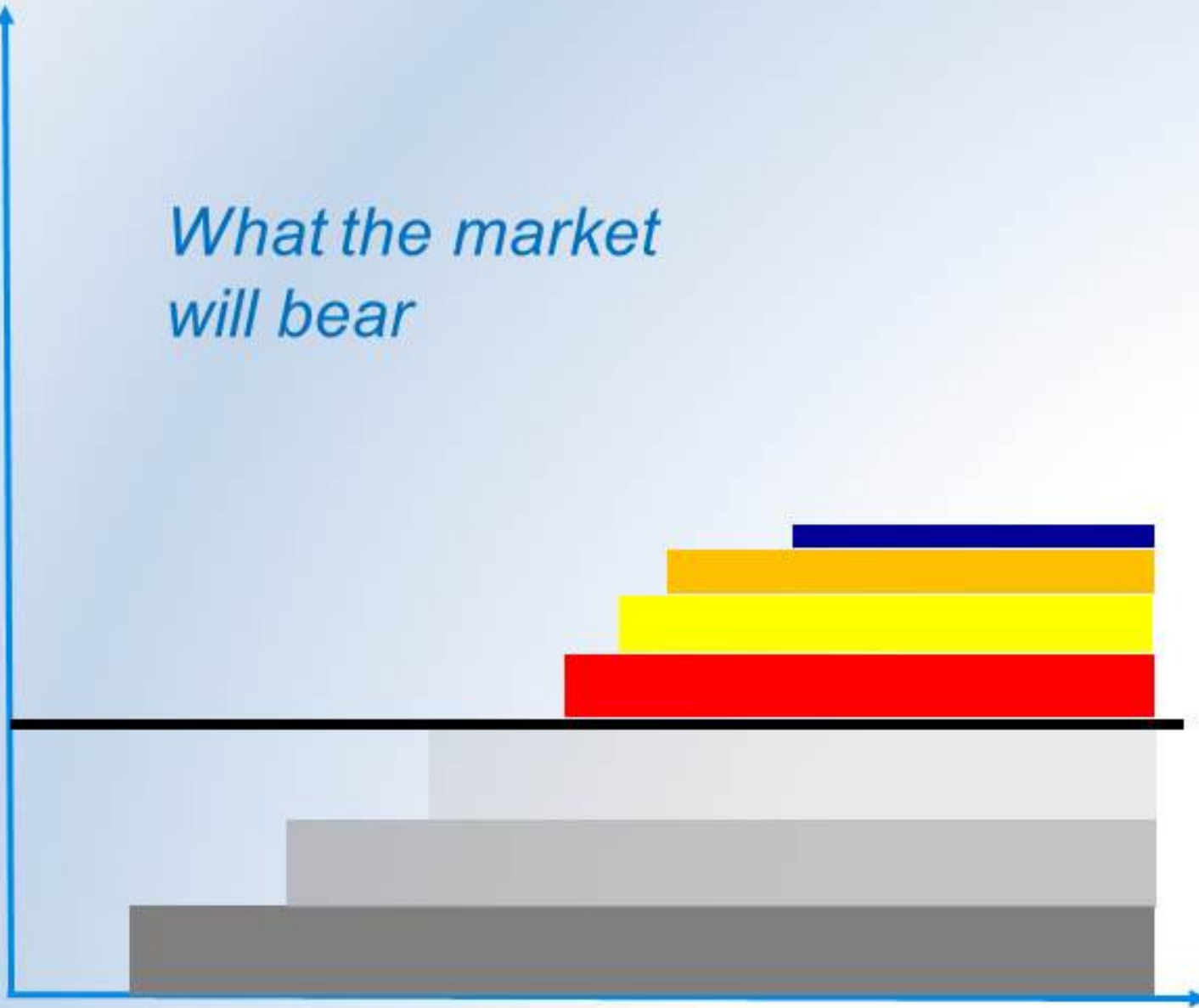


Critique of Competition-Based Pricing

+	-
Competitive data are generally available in the public domain.	The available data may be wrong, out of date or irrelevant.
Relatively easy to position our product	Positioning may not take account of different segmental priorities
Permits focus on the purchase decision attributes	These may not be the right attributes
Maintains market stability.	...at the cost of conservative pricing.
Guarantees we will win some share of the market	Suggests that there are few differences between competitors
Enables us to collect the price and specification data	Encouraging point by point comparisons on price and specification.
	Does not take into account economic elements of value-in-use.
	Completely ignores psychological or emotional qualities of our offer.

£WTP

*What the market
will bear*



To understand Value Based Pricing we first have to understand value...

What is Value?



So - What is Value?

In groups, come up with
a definition of value.

Start your definition
“Value is...”



Answers managers in other companies have given...

what the customer perceives
as adding value to his
business and increases our
returns and margins

to provide your customer with
anything he/she appreciates
(now there's an opportunity!!!)

a mystery

the things we do over and
above competition creating
a profit – $1 + 1 = 3$

when you deliver something
more than the customer
expected

creating the perception in the
customer's mind that he needs
our product more or better
than competitor's.

Value? Let's look at Water...

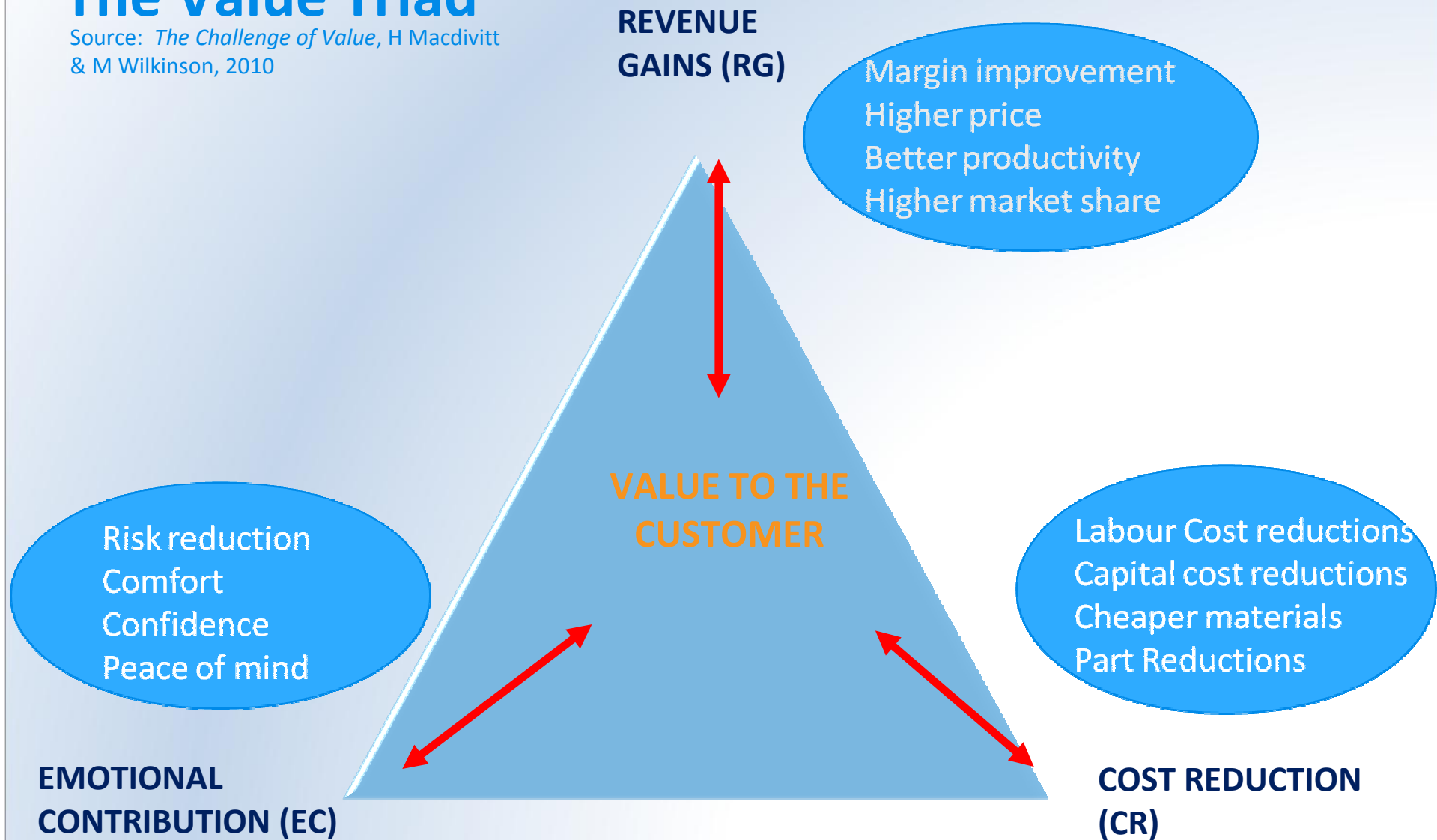


€0.05/
litre



The Value Triad[©]

Source: *The Challenge of Value*, H Macdivitt
& M Wilkinson, 2010






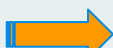
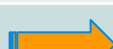
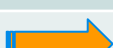


What is a Value Driver?

A value driver is any factor which, when acted upon within a business, leads to an enhancement of competitive advantage

Value Drivers

Customers want to know how we can help them...

Examples of Value Drivers		Nature of driver
Get to market faster		Economic, Emotional
Eliminate “hassle”		Emotional, Economic
Eliminate costs		Economic, Emotional
Reduce their anxiety		Emotional, Economic
Enhance operational efficiency		Economic, Emotional
Remove conflict		Emotional, Economic
Improve customer retention		Economic, Emotional
Achieve greater peace of mind		Emotional, Economic

...and they will select us if we can demonstrate convincingly how we can do these things for them

What is Value Based Pricing?

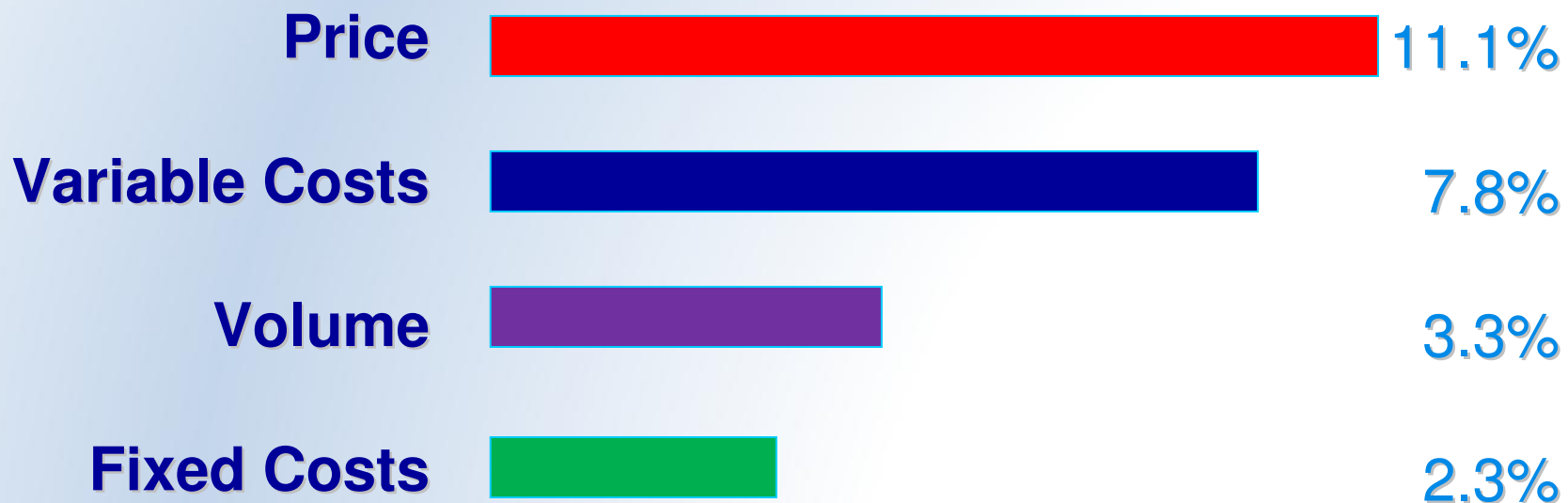
Why bother?

Comparison of Profit Levers

In a study of over 2000 companies price had the most significant impact on operating profits.

1% improvement in ...

operating profit improvement of...





If a Martian asked me “What is Value Based Pricing?”

This is what I would tell him...

“Value Based Pricing is a pricing method where we would work out the total benefit to the customer of our product or service...and then base our price on the benefit the customer receives.”

Value Based Pricing is based entirely on customer value – the benefits and advantages we can bring to the customer that he really cares about, and that no other supplier can match.

So – we must understand the customer deeply – more deeply than our competitors.

And arguably even more deeply than the customer himself!

***Some industries
that are now
using VBP...***

Automotive suppliers
Automotive manufacturers
Energy Consultants
Logistics companies
Biotechnology manufacture
Legal services
Engineering
Mobile telecommunications
Chemicals
Medical devices and supplies
Telecoms network providers
Power generation
Travel consultants
Legal firms

**Value Based Price =
Reference Price + Net Revenue Gains + Net Cost Reductions**

Reference Price

Price of product, service or method your customer would use if your product was not available (Next Best Competitive Alternative)

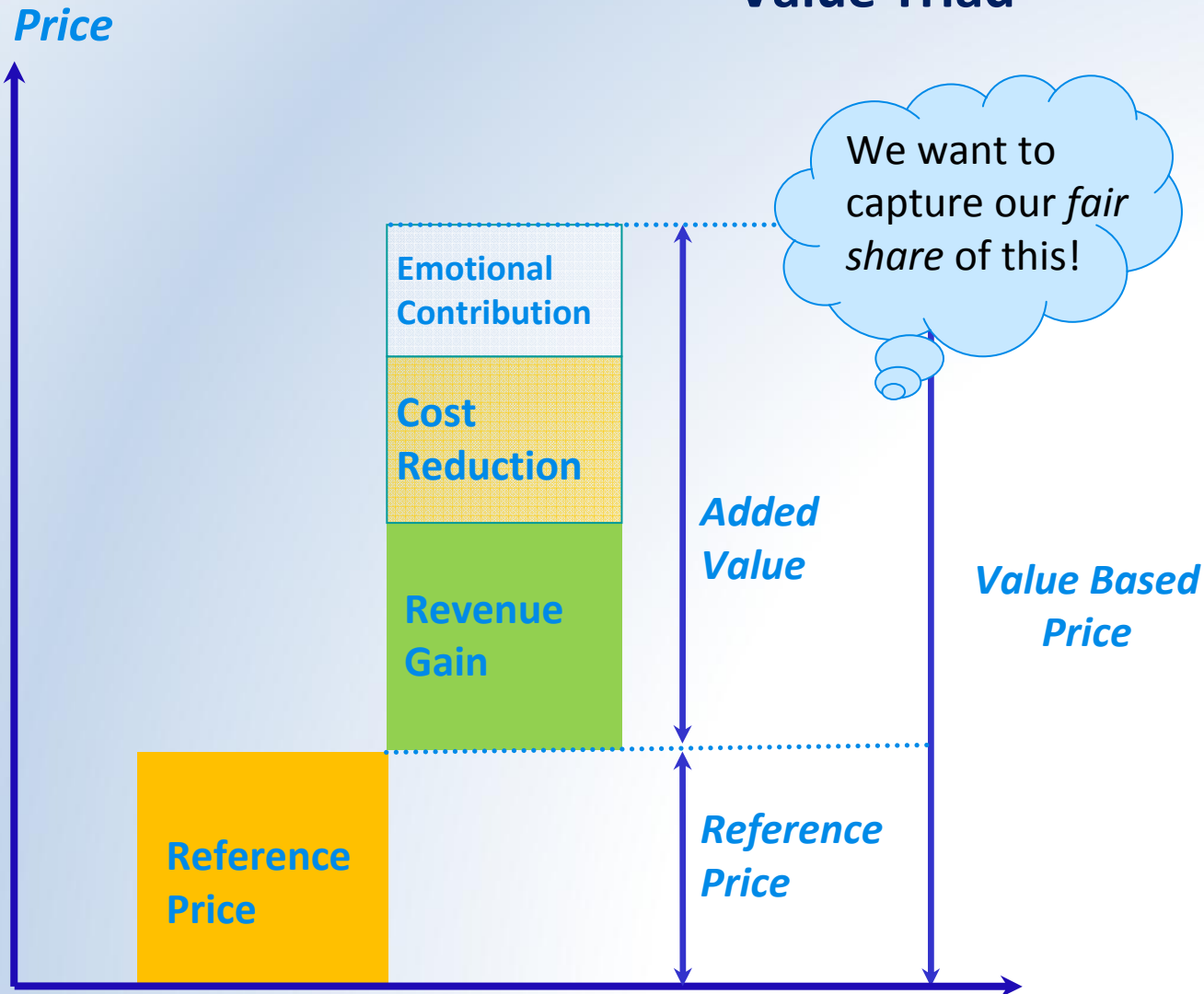
Revenue Increases (net)

Any gains in sales or productivity arising directly from the use of your product or service compared to the reference

Cost Savings (net)

Reductions in costs arising directly from the use of your product or service compared to the reference

Structuring the VBP using the Value Triad[©]



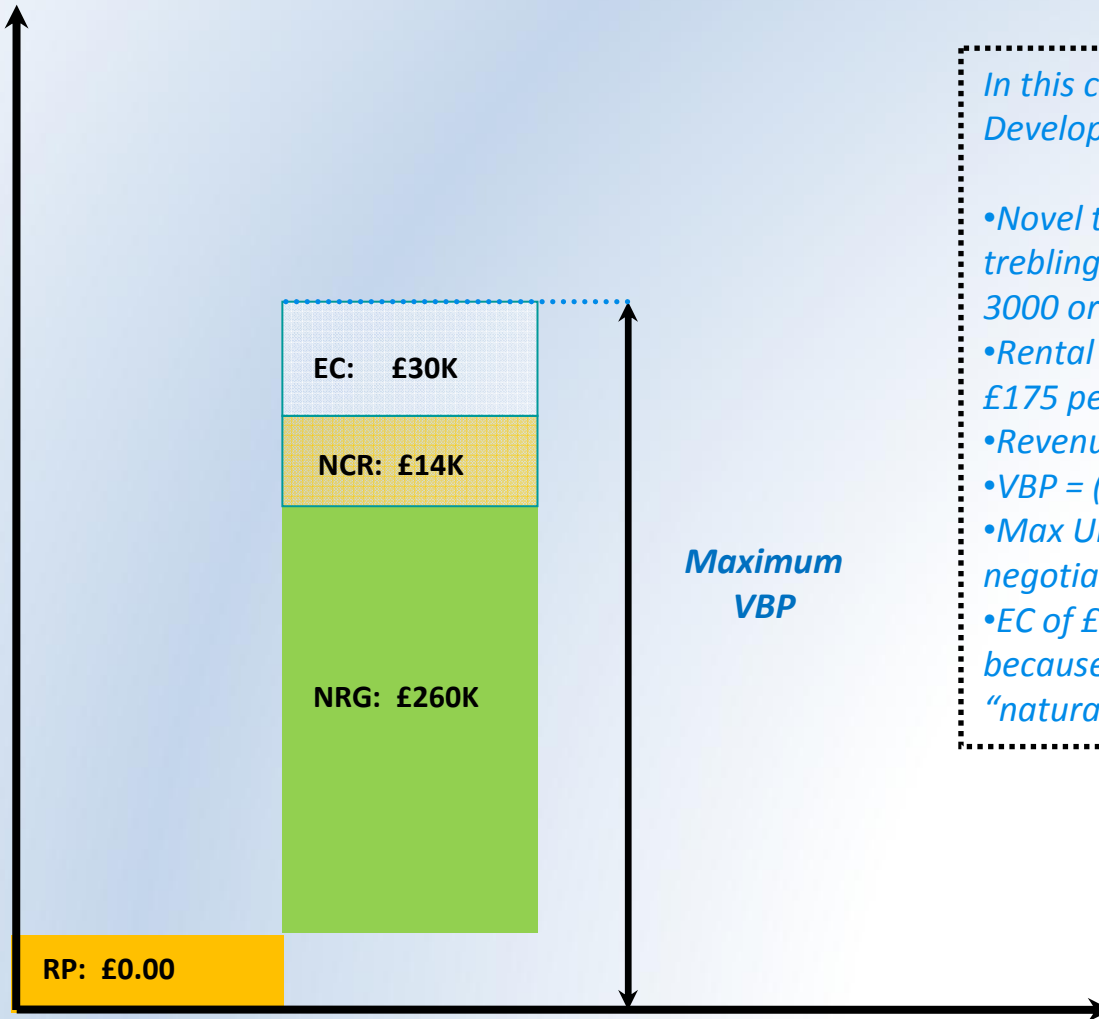
Simple Example

	Competitor Machine	Our Machine	Our Added Value	
Price	€100000			
Revenue	€250,000	€300,000	€50,000	Better performance leads to <i>revenue gain</i>
Costs:				
Fuel	€75,000	€68,000	€7,000	9.3% less fuel
Spare Parts	€35,000	€30,000	€5,000	14.3% fewer spare parts
Maintenance Labour	€60,000	€34,000	€26,000	43.3% less maintenance
Total Added Value			€88,000	Fuel + Spare Parts + Maintenance
Maximum VB Price*			€188,000	

Structuring the VBP

Business Services

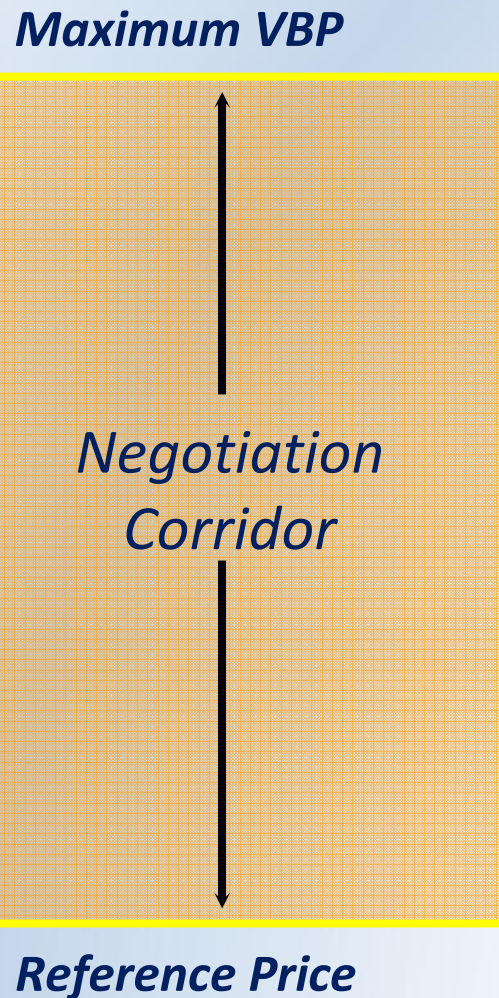
Price



In this case the **scenario** is a 12-month Business Development option for the operator.

- Novel technology permitted doubling or trebling of unit coverage (1500 per 10 weeks to 3000 or even 4500).
- Rental price per unit to operator's customer - £175 per annum (£3.40 per week).
- Revenue gain £260,000 (doubling scenario)
- $VBP = (£260K + £14K + £30K)/1500$
- Max Unit VBP on this schedule \approx £200, negotiable on corridor.
- EC of £30k accepted by major operator because of reduced hassle, more flexibility and "natural plants".

Negotiation Corridor



- Understand as fully as possible the customer/client context
- Collect evidence to support revenue and productivity improvements
- Collect evidence to support cost reduction claims
- Think through which intangible benefits are relevant
- Use Value Triad[®] elements to support important assertions

Comparing the Methods

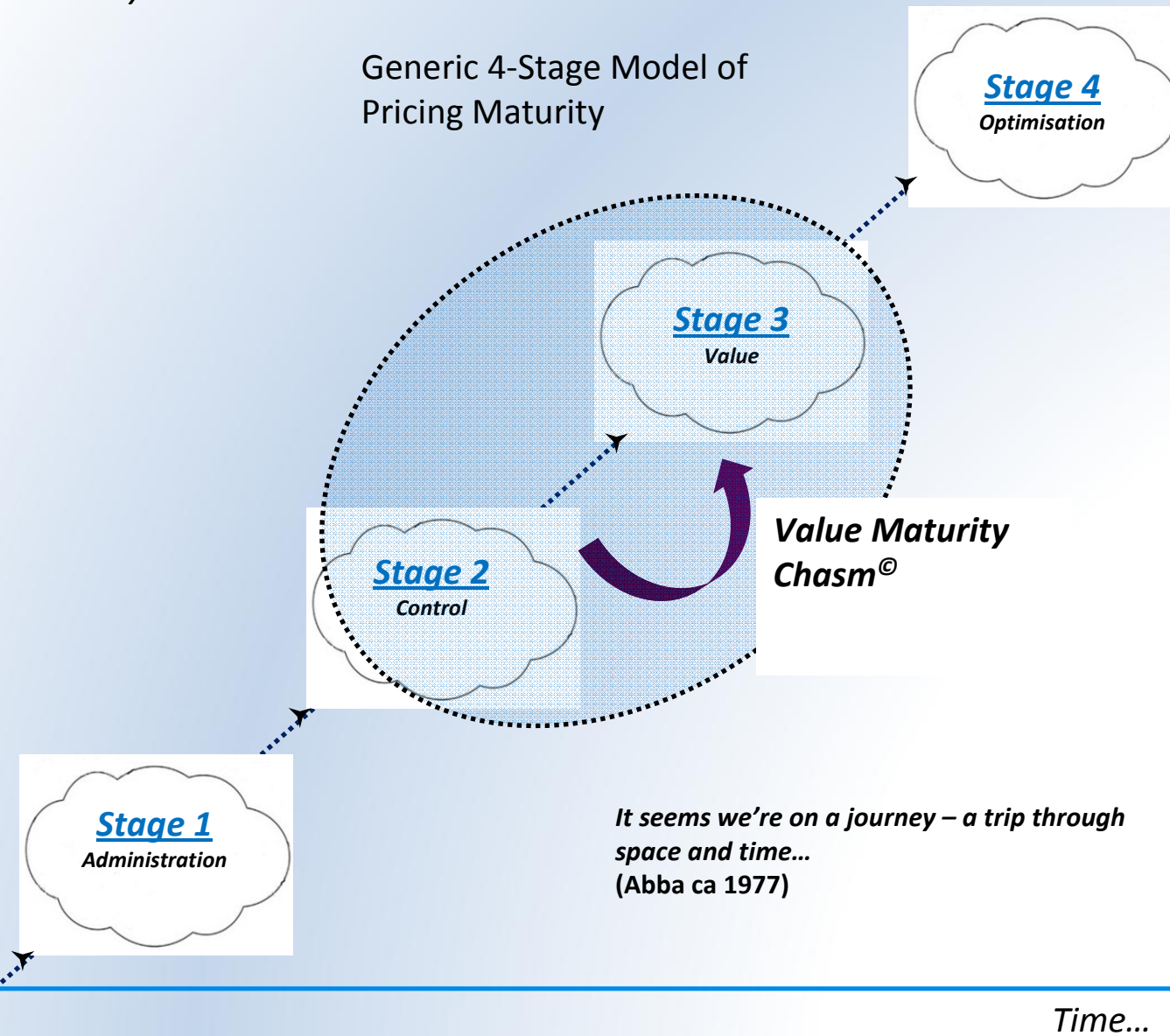
	<i>Competition Based</i>	<i>Cost Based</i>	<i>Value Based</i>
<i>Focus</i>	Competitors' price levels	Internal costs	Win-Win
<i>Encourages</i>	Pursuit of market share – not profit	Formula based approach	Cooperation and partnership and deep customer knowledge
<i>Customer relationships</i>	Ignored	Ignored	Central to all transactions
<i>Reward for innovation</i>	None	None or even negative	High and sustainable returns
<i>Selling efforts</i>	Minimal	Minimal	Consultancy and solutions based
<i>Inducement to buy</i>	Discounting	Discounting	Demonstrable economic advantages
<i>Value capture</i>	None	Minimal	Complete, or as well as your salespeople can negotiate

Value Based Pricing

The Journey or the Destination?

Pricing
Maturity...

Generic 4-Stage Model of Pricing Maturity



Global Lubricants

Key Factor	Issues for Attention
Change Drivers	<ul style="list-style-type: none"> • Recent takeovers made the company truly global • Need to drive up margin • “Customer Intimacy” the key corporate strategy • Segmentation project highlighted need for change • Value orientation seen as next step on the journey
Current Methods	<ul style="list-style-type: none"> • Issued price list basis for negotiation • Cost plus and discounting • Sales team technical specialists and order takers • Limited understanding of customer value
Customer Value	<ul style="list-style-type: none"> • Products and services perceived to be good value but not cheap • Value given away by discounting as the primary business winning tool • Pricing Project underway

Global Lubricants ...*continued*

Key Factor	Issues for Attention
Changes Required	<ul style="list-style-type: none"> • Senior management, product management and marketing all bought in and supportive • Salespeople generally open and “persuadable!” • Sales highly technical and product focussed - greater customer focus required • Positioned as a corporate initiative • Case studies being built demonstrating value impacts internally and externally
Apprehension	<ul style="list-style-type: none"> • Level of sales management buy-in varies country to country • Some apprehension that it is just a means of raising prices • Extensive and expensive VBS training recently completed and must deliver demonstrable margin improvements
Implementation	<ul style="list-style-type: none"> • From a European start-out, now global • Real strategic support, and a structured communication programme • Cultural change requirement recognised and supported • Customer segmentation helping to target value customers

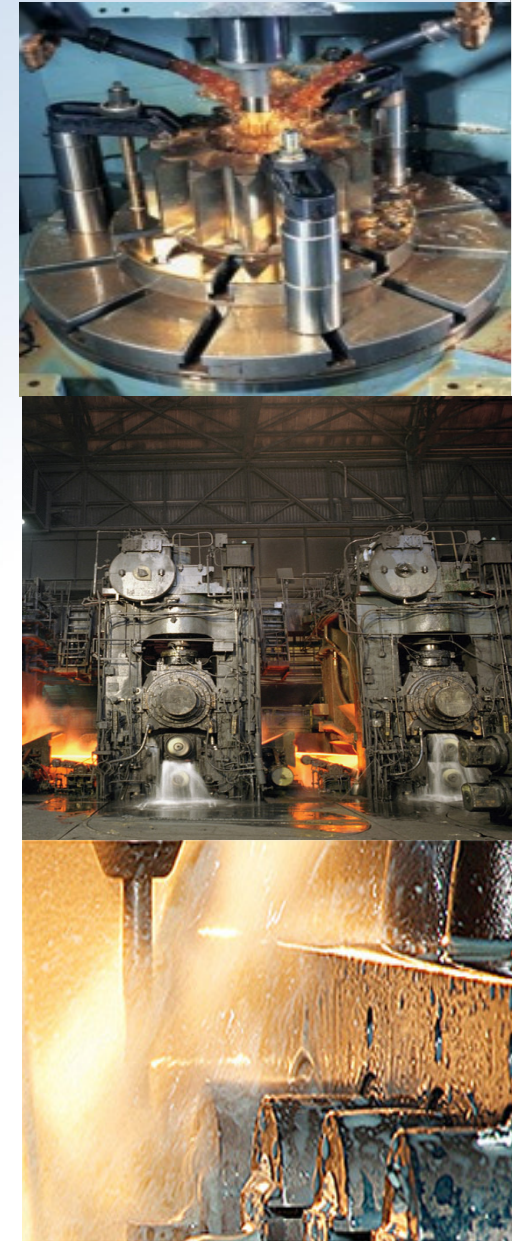
Global Lubricants

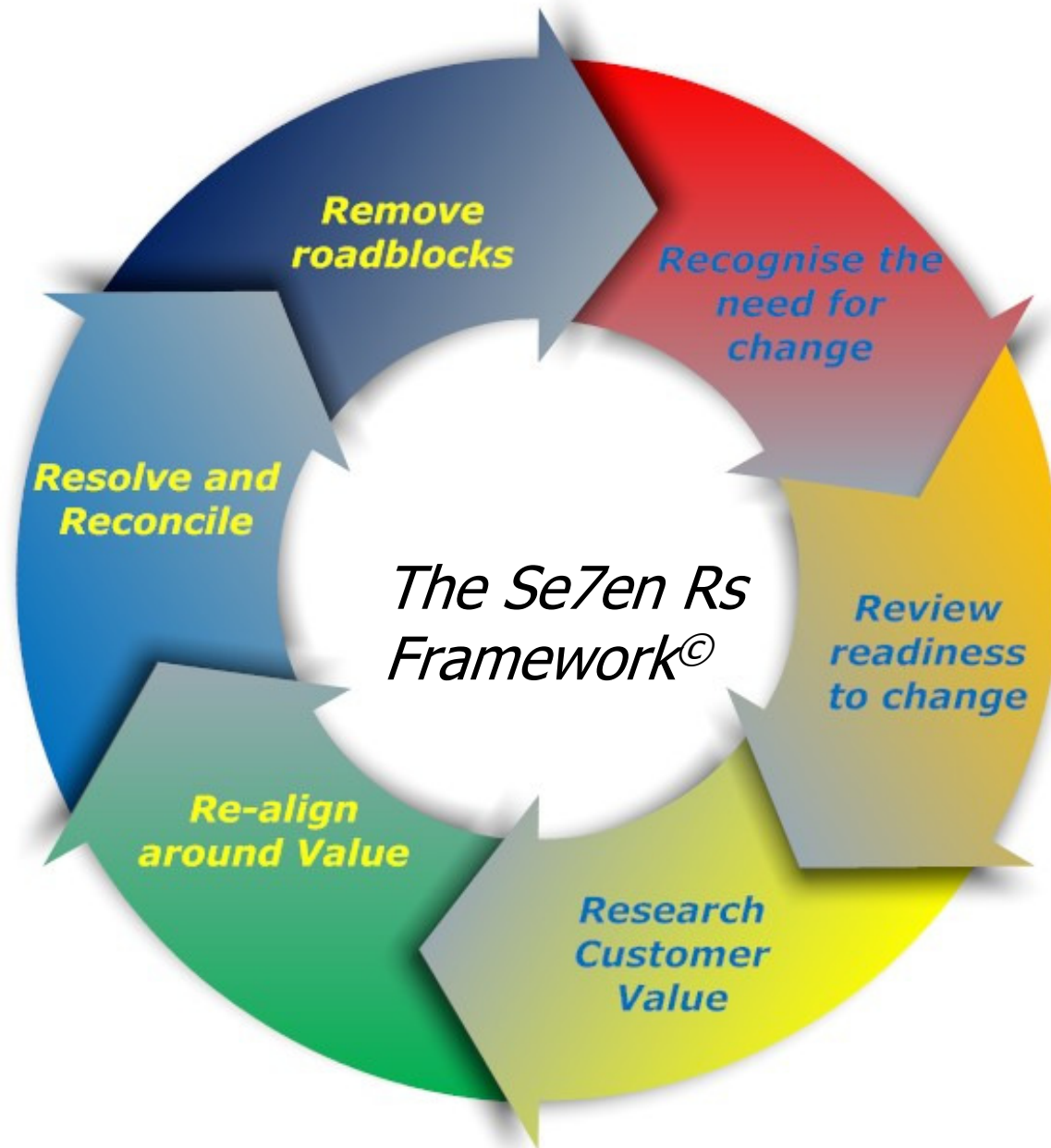
Tips...

- Communication is key
- The process is strongly supported by senior management
- Value forms the core of sales and pricing discussions
- There is a simple PI - margin improvement

Traps...

- Don't rush the process
- Remaining focussed on value and not returning to the "discount default" can be tough
- Some sales people will "get" value quickly, others will struggle - so tailor your training and support





*And don't forget to
Reward everyone who
has contributed to the
success of the project!*



- Conventional pricing methods like cost-based and competition based approaches still work, and work adequately, for many companies;
- These methods are less satisfactory when significantly greater differential value is created for the customer;
- Value based pricing methods capture more completely the value created and benefit both vendor and customer economically and emotionally;
- For this reason many industries are exploring value based pricing approaches – or have fully adopted these methods;
- Implementing Value Based Pricing in your organisation should be considered a strategic initiative - and should be given enough time to work.

Any questions?

Thank you for your
attention!

Harry Macdivitt
can be
contacted at:

info@cpd-associates.co.uk

Mob: 0044 781 298 1651

