

## The price is right – is it?

Why is our son quite happy to part with \$250.00 for a pair of Oakley sunglasses? Why is the same hotel room half the price at the weekend than it is during the week? Why does the price of a litre of petrol vary by 10 cents and more over the course of a single day? Is there a single formula that can explain all the vagaries of pricing?

We believe there is and the equation is:

$$P \leq \text{COPV}$$

Where for a customer to buy your product the **Price (P)** must be *equal to* or *less than* the **Customer's Own Perceived Value (COPV)**.

When we conduct a Customer Feedback Survey, by definition, we are talking to people who *at the time of purchase* followed this equation.

But contrary to popularly held belief, when we ask respondents to rate the importance that they attach to price, it rarely rates in the top half of the attributes measured.

“That can't be true” – I sense many of you thinking – “that's all the customer is ever interested in”. There is, however, a rational explanation. So often, the **Customer's Own Perceived Value** does not significantly differ between the various offers and if that is the case, why would anyone pay more for a product or service that he or she perceives to be equal in value to competitive offers. In contrast, our son regards Oakley's as anything but “just another brand of sunglasses” - they are both “different “ *and* “better”.

While “price” invariably rates in the bottom half of the importance hierarchy, the absolute rating for price varies significantly depending on the nature of the product. Price will receive a higher rating if the following conditions apply:

- Customers' perception of product differentiation is low - eg - petrol
- The product represents a significant percentage of total costs – eg - electricity for an aluminium smelter.
- The purchase is a repeat purchase – eg - raw materials/component parts.
- The purchase is a necessity – eg – insurance
- Competition among suppliers is intense – eg – take away pizzas
- Small number of powerful purchasers – eg – supermarket chains
- Low risk to the buyer as a consequence of poor performance – eg – paperclips
- Competition is international – eg - whitegoods

The higher the rating for Price, the harder it is for suppliers to obtain a premium and thus the band of market prices from the lowest to the highest is narrow.

In contrast, the rating for “Price” will be lower if –

Customers’ perception of product differentiation is high – eg – fashion clothing

The customers’ risks associated with poor performance are high – eg – IT systems

The purchase is a discretionary purchase – eg – set of golf clubs

The purchase is infrequent or one-off – eg – furniture

Large number of independent buyers – eg – all dentists

Less competition among suppliers – eg – plastic surgeons

Competition is local – eg – freight costs are proportionately high

If the above market conditions predominate the band of market prices between the lowest and the highest will be broad.

It would be rare indeed for a product to meet in full either set of criteria. Nevertheless, every product will lean towards one or the other and an understanding of your product from the customers’ perspective should enable you to determine the key drivers of your business’ profitability. Is it margins; is it sales revenue; is it fixed costs; is it variable costs?

bpi’s Customer Feedback Surveys also demonstrate a clear linkage between the importance of price and price competitiveness. When the feedback suggests that the price is perceived by a significant number of customers to be uncompetitive, it follows that our universal pricing formula is no longer in equilibrium. Instead of **Price** being *equal to or less than* the **COPV**, **Price** is now *greater than* the **COPV**.

What action is taken to bring the two sides of the equation back into equilibrium depends on the product’s importance rating.

If its Importance rating is high and the market band of Prices is narrow, then Price will be the key point of focus. For instance, if Shell and BP each have a service station on opposite sides of the road, then their prices for Regular Unleaded petrol would have to move in unison. For low differential products, customers assess the competitiveness of the price by reference to the competition’s prices – and that’s very easy to do with petrol.

In contrast, for a supplier of a product with a relatively low importance rating operating in a broad pricing band market, customers will gauge the competitiveness of the Pricing by comparing it to the value delivered.

So the remedial actions to bring both sides of the equation back into equilibrium are diametrically opposite.

High importance, narrow price bands – focus on Price (**P**).

Low importance, broad price bands – focus on customer value (**COPV**)

The old adage that the quality will be remembered long after the price is forgotten is as true today as it ever was. The challenge facing suppliers of high importance, narrow price band products in particular is that often the potential points of differentiation are related to the service components not to the product itself. The veracity of the claims made on such attributes as Supply Reliability, On-time Delivery, Short Lead-times and Customer or Technical Service can only be gauged and valued by the customer *after* the customer has committed to the sale. So unless the supplier can build a reputation that is acknowledged and valued by the prospective customer in the pre-sale period, price will have a higher importance rating prior to the sale than after.

Understanding the dynamics of pricing from the customer's perspective is crucial management data and bpi's feedback surveys can help you acquire it.

**Graham Haines**  
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