The PRICING ADVISOR
A Professional Pricing Society Publication

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How to Avoid Being Just Another Commodity

In this article, the author gives examples of pricing strategies that will help pricers circumvent these commoditization traps and capture the price that awards a product's value. Paul Hunt is the president of Pricing Solutions and a frequent PPS contributor, instructor and presenter. He can be reached at phunt@pricingsolutions.com. Paul will be leading a workshop on "Building a High Impact Pricing Strategy" at the 23rd Annual PPS Spring Conference in Chicago on May 9. He also writes a pricing column that appears monthly in the Financial Post (www.financialpost.com).

Marketing professionals work hard to bring innovative new products to market, but often the customers' procurement department figures out ways to commoditize the product thus negating the pricing power that you expect to get out of an innovation. The result is poor profit margins and less investment in innovation — not an acceptable formula for long term success. This trend is prompting some marketers to find ways to make sure they capture a price that rewards the value they have created. Here are a few examples:

1. Pay per use. Pay per use is common for services and subscription based products. In recent years, it has been introduced as a new pricing model for hard goods.

• A manufacturer of aircraft components developed a tire that would last longer than anything else on the market. Despite being a premium product, customers had a difficult time accepting the premium price. The manufacturer regrouped and set the pricing strategy based on the key benefit: increased number of landings. Instead of buying a set of tires, customers would pay for each landing they achieved with the new tires. The lower per-use price appealed to customers and generated higher revenues than the manufacturer forecasted with its original pricing strategy.

• In healthcare, large capital investments for equipment are necessary but difficult with tight budgets. A medical device manufacturer developed a new delivery system for anesthesia and introduced a pay-per-procedure model. Hospitals would essentially "rent" the equipment and pay for each time the device was used. The pricing model was a huge shift in thinking for the healthcare industry but made it easier to adopt this device because they didn't have to budget for a large capital expenditure.

Pay Per Use is an effective strategy when the customer doesn't want to make a large capital investment and the manufacturer can generate recurring revenue from frequent product use.

2. Pricing based on Cost-Benefit Analysis. Cost-Benefit analysis is a regular exercise for procurement departments evaluating between product offers. It can also be an effective exercise for a Pricing Manager to do when setting prices.

• A medical equipment manufacturer developed a new line of hospital beds. Based on specifications, these beds did not appear to be different than existing beds but they were twice the price. The manufacturer knew its new line of beds had advantages over the competition so it invested in a cost-benefit analysis. With the results, the manufacturer was able to show that its beds reduced workplace injuries, therefore reducing time off and worker compensation costs. The savings made up for the premium price of the bed and sales took off.

Proving to your customers the long term savings that can be achieved with an investment up front can drive success.

3. Pay what you want. This strategy has gotten a lot of press, but the results have been fairly dismal…..except in a few very unique situations. Instead of the marketing team selling the value of the product and setting the price, the customer determines the value and pays accordingly.

• The band Radiohead released its last album as a digital download and listed the price as "up to you." The strategy generated publicity and interest in the album. However, *Rolling Stone* reported that while the album was popular, most fans decided *Free* was the best price for the digital download.

• Even organizations and individuals that are reliant on Pay What you Want have made some modifications to try and increase what they receive.

An example: I was at a "Busker" fest (e.g. street performers) recently. It was very interesting watching them implement their pricing strategies. After they finished their act they pointed out what made them unique and the value that they brought: "Where else can you get to see world class entertainment like this and not have to pay a substantial price? I am only asking you for a minimum donation of $5!" I used to give $1 and feel good about it…..not any longer! In speaking to a few of the buskers they have found that the donation size has gone up….more than enough to offset any loss in the number of donations!

"Pay What You Want" is necessary in some situations (e.g. not-for-profit, busking, etc.) but even they are setting reference prices to push their constituents to "dig a little deeper." And when it comes to consumer goods, "Pay What You Want" will bring out the spendthrift in all of us.

Be sure you are not letting yourself be commoditized. Remember, when it comes to pricing it is just as important to have the right pricing model as it is to have the right price.