Using Value Pricing to Launch Fighter Line Products in Emerging Economies

A commonly adopted stance to enter Low Cost Emerging Economies is thru a 'Fighter Line' of products. Value Mapping can not only help you determine what 'Prices' can be charged in those markets but also to determine upper & lower limits as 'Cost Target' for your Product teams as well as set realistic Margin expectations for your Finance organization, as the author explains. Vishal Gupta, APJ is Pricing Manager at Schneider Electric. He can be reached at vishal2.gupta@schneider-electric.com.

"Over the past 10 years the BRIC economies contributed over a third of world GDP growth. By 2020, we expect the BRIC economies to account for a third of the global economy and contribute about 49% of global GDP growth." – GS Global ECS Research[1]

No Multi National can afford to ignore these growth areas today. But what is the biggest challenge these global organizations face when they decide to serve a market like India or China?

- Local competition
- Low cost substitutes
- Direct price comparisons between global brands & the home-grown smaller brands
- Inability to penetrate the market because of higher prices

Once they face these challenges, there is an inevitable pressure for pricing downwards to increase market share. Down that path is nothing but an irreparable damage not only to your profitability, but also to the brand, market and the industry as a whole. Pricing downwards is easy; it's the uphill road which makes you sweat.

There is a lot of text on various strategies which can be adopted to counter the low cost competition. Of course one size doesn't fit all; still one of the more generally adopted stances is to launch a "Fighter Line" of products (under the same brand or a new brand). If your organization is among those that are focused on entering Low Cost markets via a 'Fighter Line' of products, read on. What I am going to discuss here is how to use the concepts of "Value Mapping" not only to 'price' your product but also arrive at the min-max limits which can serve as 'Cost Targets' to make a profitable proposition for your business. Let's not shy away from the fact that if you are entering an emerging economy through a low-cost product; ability to serve 'Maximum Value' while maintaining 'Low Costs' is the single most important thing. This is also going to help you be realistic in your 'Gross Margin' expectations, because sometimes organizations do make the mistake of having similar margin expectations from "Low Cost" countries what they are able to make in developed economies.

Value Mapping for 'Fighter Line'

Value drivers for a 'Fighter Line' of products can be quite different compared to values customers seek in a developed economy, and they can be surprising at times as well. When we did a survey for few of our products vis-à-vis competition, we came to know that our Home and SMB Customers put enormous value to the extra number of 'plug sockets' we put in our UPS (Uninterrupted Power Supply) which allows more electronic products to be connected to a UPS at any given point of time. Now, competitor products do have enough sockets if somebody is plugging in only the desktop peripherals but Indian customers use the same sockets to plug in their mobile chargers, Ipads, Ipods etc., the reason being frequent fluctuation of power which is dangerous and at times fatal for the battery life of electronic products. This is a need we were serving without realizing ourselves.

Understanding the local usage behavior and specific customer

Figure 1: Existing Market Players

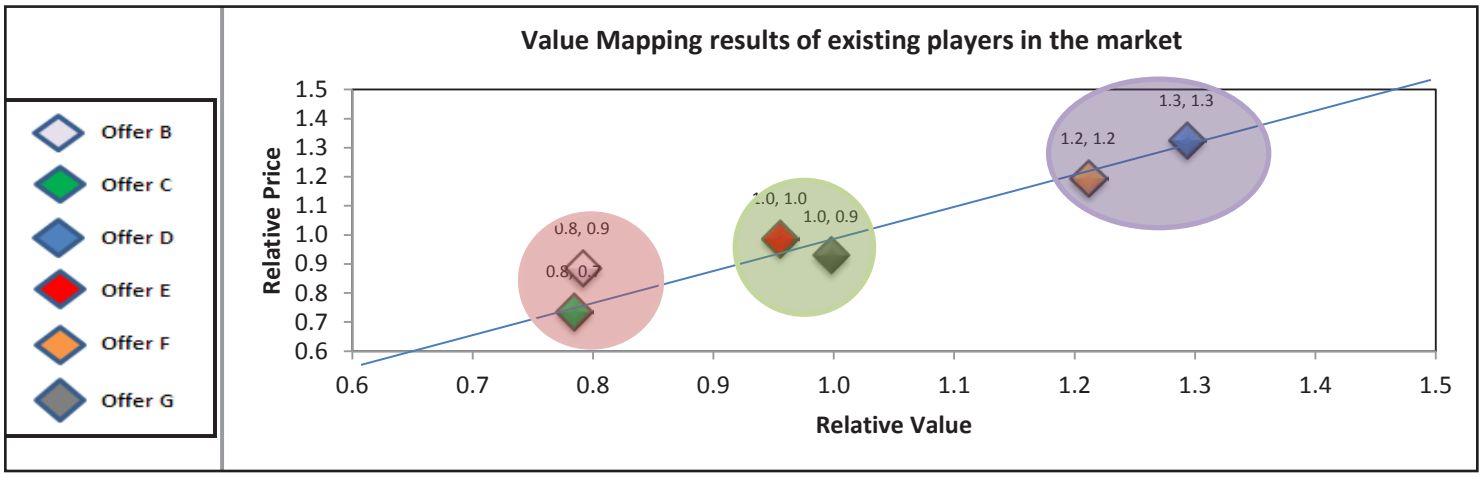
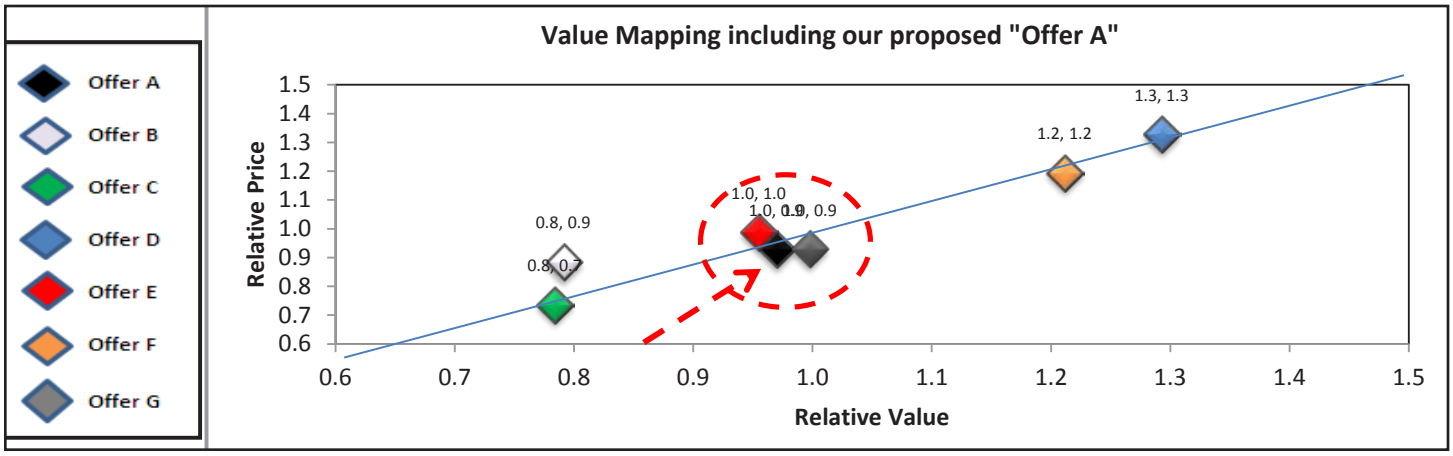


Figure 2: Market View with 'Offer A'



needs and then arriving at the 'Value Drivers' is of prime importance. Again, the 'rural' and 'urban' usages of the same product can be quite different as well. Primary and secondary surveys through market research experts are one of the key methodologies to arrive not only at the 'Value Drivers' but also at specific competitor rankings. The scope of discussion here assumes the following example where 'Value Drivers' have been determined and competitor rankings etc. have been done. We have the 'Price Value Map' ready in front of us to be exploited.

In the example on the previous page there are six different 'offers' in the market. For the sake of simplicity let's assume two players each fall in each of the groups as defined below in three different colors. The Value Map below is a relatively idealistic market scenario where the three groups are surviving happily at a comfortable price gap from each other. Each group is addressing the needs of a specific 'customer segment' (doesn't necessarily mean they belong to different competitive brands though). For instance, the 'purple' group is serving the least price sensitive customer segment that vouches for highest quality and best brand whereas the 'red' group is serving the most price sensitive customer segment.

Now, we are supposedly the new entrants in the market and wish to launch an "Offer A". Since it's our 'Fighter Line' we would like to position it somewhere in the 'green' group, which by the way has the highest market share in this particular product range.

Let's say we start with few iterations and decide internally with all stakeholders to settle for a 'price' which would correspond to our offer in the market to look like this → The black dot in figure 2 represents our 'Offer A' (this assumes that Value Drivers for the Offer A have been taken care of by way of our Go-To Market, Quality, Branding, etc).

With the above plotting, we have a 'price' at which we can enter the market and expect to increase our share of wallet in the mid-market. Let's say this particular market positioning corresponds to an end customer price of $100. Now that we have arrived at a justified 'price', we are all set to play with the three set of variables.

The three variables: Price, Cost and Gross Margin

We just know what 'price' might be acceptable in the market. What we do not know is if that 'price' is a feasible proposition for our business goals. We have three variables to play with 'price', 'cost' and expected 'gross margin' (GM). We start with exploiting different combinations of the three variables and try to arrive at an optimized solution by keeping any two variables fixed but changing the third at any given point of time.

(In the following figures, Green Colored Items are fixed at one specific number and Yellow Colored Item is the one which is calculated.)

Figure 3: Cost Build Up (Price, GM Fixed)

Cost Build UP (Price, Margin Fixed)		
End Customer Price	$	100
Partner to End Customer	$	100
Partner Margin		7.0%
Distributor to Partner	$	93
Distributor Margin		4.0%
Freight + SCM alloca		2.0%
Contingency		2.0%
Required GM%		27.5%
Landed Cost Should be	$	60

Figure 4: Price Build Up (Cost, GM Fixed)

Price Build UP (Cost, Margin Fixed)		
End Customer Price	$	118
Partner to End Customer	$	118
Partner Margin		7.0%
Distributor to Partner	$	110
Distributor Margin		4.0%
Freight + SCM alloca		2.0%
Contingency		2.0%
Required GM%		27.5%
Landed Cost is	$	71

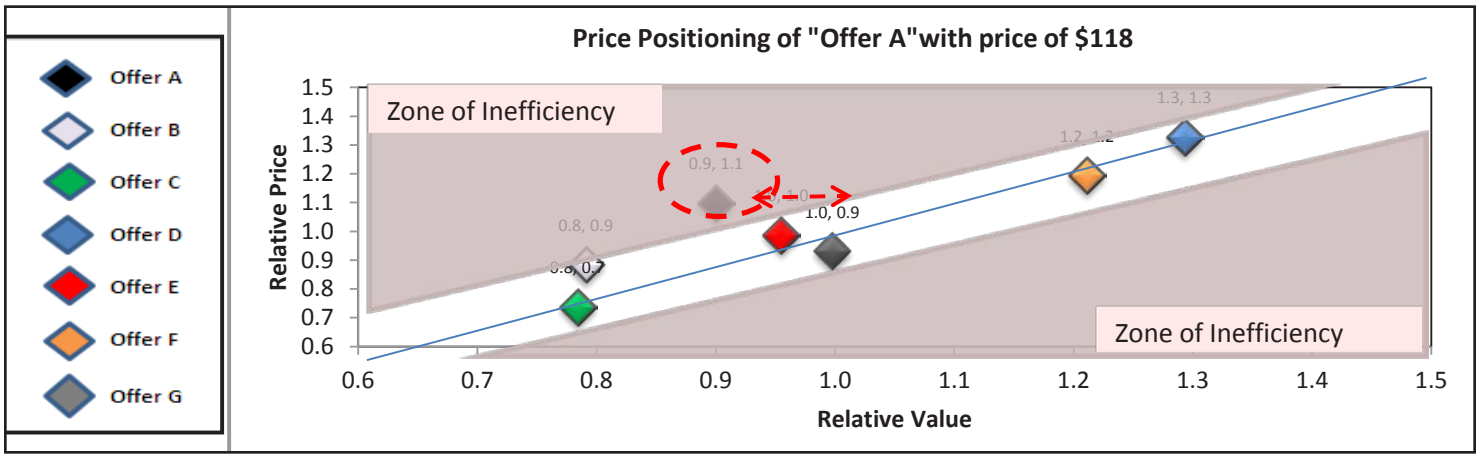
Step 1 – Price Fixed, Gross Margins Fixed, Cost Variable

In this first step, we allocate an expected GM target from the 'Fighter Line' of business and work backwards to arrive at what our 'costs' should be if we wish to sell the product in the market at the price which we calculated from the Value Mapping exercise.

Through a few assumptions and approximations, we know that if we wish to sell the 'Fighter Line' to the end customer through a Distributor-Partner route at $100 ($100 is the 'price' which was calculated in Figure 2) and we wish to have 27.5% GM then it is imperative for us to create the product within $60 (the line items like freight, SCM, distributor margins, etc., are indicative and would certainly change depending on your business).

This is a good start for the product design and costing teams as they have a target 'cost' to look at. We provide the inputs to

Figure 5: Price Positioning with New Price for Offer A



these concerned teams and allow them to come back with a design which fits the bill. Wouldn't it be nice if life was so simple? Let us assume that our Product Design teams came back with a minimum cost of $71 for the particular 'Fighter Line' they have designed.

Step 2 – Cost Fixed, Gross Margin Fixed, Price Variable

Now that we have a starting estimated 'cost' from the product design team, let us fix the cost variable and stick to our GM expectation to calculate what 'price' this particular combination allows us to be able to sell in the market. Note in this step we are still trying to meet the GM expectations of the company and evaluating our competitiveness in the market with the new 'price'.

So we have a $118 price tag set to our product. Let us use this new price tag and go back for a moment to the Value Mapping in Figure 2 to explore where we would be "Price Positioned" with this new price tag.

Clearly, if we wish to sell with this new price of $118, we might just be entering the zone of inefficiency and run the risk of being perceived higher priced. One of possible alternatives is to increase the value of our product so as to move it towards the 'Fair Value Band' and be positioned towards the higher end of the middle group (remember it has to be closer to the middle group and should not threaten the 'offers' in the upper group as the whole idea is to launch a 'Fighter Line').

The last step of this three step process is to explore the achievable GM with the draft 'cost' that the product teams have provided for the particular design and the justified 'price' we have calculated to be present in the middle group.

Price Fixed, Cost Fixed, Gross Margin Variable – Step 3

So now we know that the expected 'costs' are $71 and the justified 'price' at which we want to sell in the market is $100. Let us see our margins in case we decide to keep these two variables fixed.

The above calculation shows that we would be making 14.8% GM against our expected 27.5%. If this is feasible to the business, then we are all set to enter the market with the already obtained costs and the calculated prices.

However, before that decision is made, it is quite imperative that the above three steps are visited 'iteratively' and multiple scenarios are generated for comparative analysis.

Sometimes it's a challenge for a multinational whose focus has traditionally been on quality and brand to suddenly switch gears and focus on frugal engineering, cost specific products. Since

Figure 6: Margin Build Up (Price, Cost Fixed)

Margin Build UP (Price, Cost Fixed)		
End Customer Price	$	100
Partner to End Customer	$	100
Partner Margin		8.0%
Distributor to Partner	$	92
Distributor Margin		4.0%
Freight + SCM alloca		2.0%
Contingency		2.0%
GM% will be		14.8%
Landed Cost is	$	71

Figure 7: One window view with all constraints

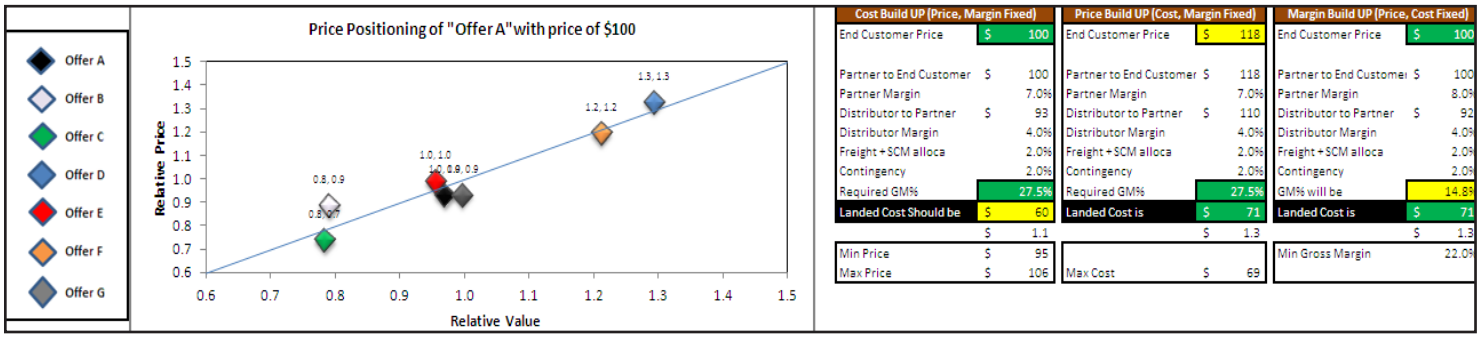
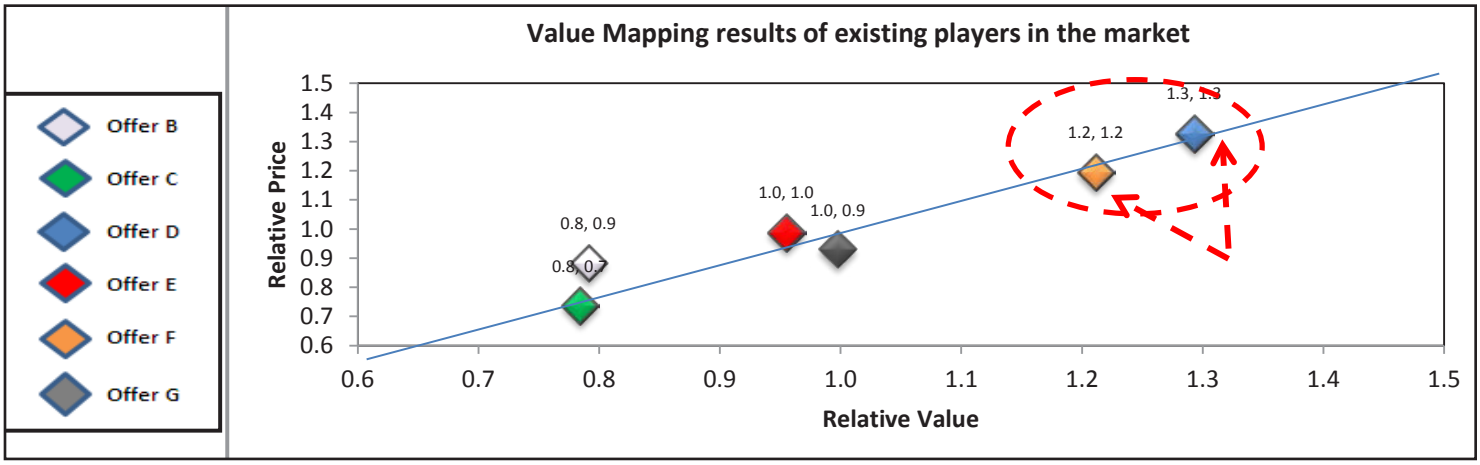


Figure 8: Premier Line of product



we are still at the stage of planning and designing the product, intuitively we can use 'Value Pricing' concepts to define the min-max limits for 'price', and most importantly defining max limits for 'cost' beyond which the whole 'Fighter Line' case does not make business sense. These limits serve as guidance to all the different stakeholders involved in this process which include but are not limited to Product Design teams, Business Development, Pricing, Strategy, Sales and Finance etc. and help Senior Management make an informed decision.

Defining min-max limits for 'price' is independent of other two variables as this is more inclined towards what the market and customer is ready to pay to us. We can use price positioning in Figure 5 to determine what are the 'limits' for 'price' (for the particular set of 'values' we are delivering) post which we start entering the Zone of Inefficiency on either side of the 'Fair Value Band'.

Defining max limit for 'costs' is one of the most important criteria to be met by the product design teams. What we consider as the maximum possible cost of the product is an outcome of the maximum price we calculated above and minimum gross margins the organization is willing to make to have a sustainable business proposition.

We can have a single window view to iteratively stretch each of the variables and identify the most feasible combination of all the three constraints put together.

Maintaining two Product Lines

If you are a multinational entering the emerging economies not only restricting yourself to the 'Fighter Line' of products but have plans to launch/maintain the 'Premier Line' of existing products, it is imperative that you include those product as a future competitor in the Value Maps.

The added benefit it brings to the table is you would have one more dimension to play with. Assuming your Premier Line is higher priced and perceived higher in terms of features and capabilities, it would certainly lie on the top end of the spectrum.

This gives us an additional dimension to explore: increasing / decreasing prices on the 'Premier Line' and hence maintaining a visible as well as healthy gap between the two product lines so as to minimize cannibalization. Under no circumstances would we like our 'Premier Line' customers to move to the 'Fighter Line' either because it is priced very close or both the product lines addresses 'almost' all the customer pain-points with equal efficiency. Maintaining a healthy gap price-wise and visible differences value-wise between the premier line and fighter line of products should give the maximum returns.

Conclusion

Value Pricing concepts are best applied when designed for new products as you have multiple levers to pull at and multiple stakeholders who can influence the end result. We as integral parts of the worldwide pricing community are focused on making Value Pricing a success (2) and moving away as much as possible from traditional Cost Plus / Competition Based approaches.