

OPTIMISING YOUR MARGIN IN TURBULENT TIMES



FAIR'S FAIR

Everyone has their own favourite version of the story but here's mine. Pablo Picasso was once sketching in a park when a fan sheepishly approached him. *"Sorry to bother you Mr. Picasso"* asks the nervous fan *"but I'm a great admirer of your work and would be honoured if you could sketch a picture of me"*. Picasso obliges and in thirty seconds and one pencil stroke has completed a sketch which he hands to his admirer. *"It's perfect!"* she exclaims. To which Picasso responds, *"that will be five thousand dollars"*. *"Five thousand!"* exclaimed the fan this time less impressed *"but it only took you thirty seconds to draw!"*. *"No my friend"* said Picasso *"it took me forty years"*.

This is a story of fair value. Picasso values his work highly as it has taken years of training and dedication to get to the point where he can create it. He wants to be recompensed for the sacrifices he made and his unique talent. The buyer on the other hand sees only the output and, nice as it may be, fails to see how thirty seconds of any man's time can be worth five thousand dollars. In this case it's unlikely a deal will be done as the gulf between the two parties is so vast. The same conflict exists to this day with pricing a key challenge for the modern marketer who is searching to find a point at which both sales volumes and revenues can be maximised. Not easy. But not impossible.

KEY DRIVERS OF PERCEIVED VALUE

Tomes have been written about pricing theory. Millions of man hours spent pondering how prices are and should be set. And the conclusion? Price is determined by one thing - what people are willing to pay. This in turn is a function of several considerations about the product or service related to supply and demand:

- How essential is it to the buyer?
- How much does the buyer value its benefits?
- How much budget does the buyer have to purchase it?
- To what extent is the buyer able or willing to shop around?
- How much competition is there for the buyer's business?
- How much are different suppliers charging for it?
- How motivated is the seller to part with his goods or services?

Businesses are eternally searching for the optimum price point. A point not too high and not too low. A point where they're not charging less than customers can comfortably bear and at the same time not pricing themselves out of the market. In B2B environments the seller's predicament is further confused by the fact that competitive price benchmarks are often unavailable. How then does one find this optimum point? Most rely on guesswork and because of this either miss out on profit by charging too little or charge so much that they miss out on volumes which would offset any margin reduction. If only they knew Mr. Van Westendorp.

THE VAN WESTENDORP MODEL

Imagine how it would transform your business if you knew where the optimum price point was. If you could rest assured that you were charging a price which customers saw as fair yet maximised your profits. Research can make this a reality.

A Dutch statistician called Peter Van Westendorp had a theory which went something like this. The price that can be charged for a product runs on a spectrum which is bound at two ends. At the lower end is a point below which the price is so cheap that buyers will walk away as they question the quality. At the upper end is the point above which buyers will walk away as they feel the price is unfairly or unaffordably high. Somewhere in between these two extremes is the point at which both seller and buyer are happy. A point where the deal is fair. Being a pragmatist Van Westendorp then set about devising a way to find this point. His conclusion was, and this has since been widely validated, that by asking four simple questions to a sample of potential buyers the optimum price can be determined.

- At what price would you consider this product to be so expensive that you would not consider buying it?
- At what price would you say the product was starting to get expensive and you would need to give some thought to buying it?
- At what price would you consider the product to represent good value for money?
- At what price would you consider this product to be so cheap that you would question the quality?

Take the answers, run them through Van Westendorp's formula and out pops the optimum price point. Admittedly it's more complex than that but work with a good research agency and they'll deal with the tough stuff whilst you focus on other aspects of your business. Let me show you what I mean.

VAN WESTENDORP IN ACTION

Representing more than 750 mobile network operators globally, the GSM Association (GSMA) is the leading trade body for the telecoms industry. One of the core benefits the GSMA offers members is access to exclusive insights through a series of topical reports.

Working with the GSMA, Circle produced the 'Global Mobile Services' report. Based on a major programme of interviews across 15 countries, the report explores demand for various mobile services. Not only that, using the Van Westendorp technique the report also reveals the optimum price point for these services which has in turn enabled operators to refine their pricing models. For example, the optimum price for a five minute TV broadcast should be...well, you'll need to buy the report to find that out (take a look: http://www.gsmworld.com/ms_report/index.shtml).

So, research which makes use of statistics like Van Westendorp is undoubtedly powerful. And it doesn't stop with price. Conjoint analysis can reveal the ideal product in terms of features and benefits. Derived importance analysis can reveal the one or two key behaviours which truly drive customer satisfaction. Association mapping can identify ownership of brand attributes relative to competitors. Priceless.



Andrew Dalglish has specialised in B2B research for close to a decade. Over this time he has helped inform the thinking of clients such as Ericsson and Fujitsu across a diverse range of business issues including brand positioning, product development and customer satisfaction.

Andrew holds an Honours degree in Psychology from Aberdeen University, an MSc in Marketing from Strathclyde University and the MRS Diploma. He is a member of the Market Research Society and ESOMAR.