

OPTIMIZE YOUR
PRICING WITH
RESEARCH



OPTIMIZE YOUR PRICING WITH RESEARCH

Pricing decisions are some of the most important a company will make, and—unless you operate in a regulated market—you have some latitude in setting price. At first blush, it seems like the processes for pricing a new product and adjusting price amid changing competitive conditions are fairly straightforward. In the case of pricing a new product, you add up your costs and overhead rate, then add a reasonable profit margin. In the case of adjusting price in a competitive market, you look at the competition's price points, then set your price just below, equal to, or above, depending on your need to generate immediate sales, improve market share, or maintain a certain brand identity.

These two strategies are attractive in their simplicity, but are they the best ways to price your products? Consider some of the potential consequences for making pricing decisions in those one-dimensional ways:

- ▶ The overall market or a key customer segment is not likely to buy at the price you need to charge based on costs plus margin
- ▶ Customers or prospects are willing to pay more than you decided to charge, so you end up leaving money on the table
- ▶ You gain considerable sales by going out with a lower price, but you also create a product identity as the low cost/low quality option
- ▶ Matching the competition reduces your profitability because the competitors have an established customer base
- ▶ Your product is highly visible or frequently shopped and compared, so you cannot charge more without providing a point of difference that is valued
- ▶ The volume you can sell at the price you chose will not support profitability



Pricing impacts many aspects of your business, including profitability, market share, brand preference, competitive position, marketing, and brand identity. Properly pricing your product or service should often include relevant market research to guide your final decisions. Research is especially helpful for pricing decisions when your initiative falls into one of the following scenarios.

SCENARIO 1

Introducing a completely new category of product or service to a market

- ▶ Will buyers prefer it over the product or service they currently use?
- ▶ Do they trust it to deliver its promised performance?
- ▶ Do buyers have obstacles within their organizations to implementing, using, or allocating budget for this?
- ▶ What would they expect to pay or be willing to pay for it?
- ▶ Do they want all the features you offer, or do they prefer a stripped-down version?
- ▶ How much value do they assign to your brand versus other brands, and how important is brand for this purchase?
- ▶ Are there differences in price expectations among different groups of potential buyers, especially in early adopters?

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SCENARIO 2

Adding an improved product or product extension to your existing line

In addition to the questions in the first scenario that apply to your situation, you should also consider these issues:

- ▶ Will this new product or service create incremental revenue, or will it cannibalize some of your existing sales?
- ▶ Does the pricing level enhance, reflect, or diminish your brand identity?
- ▶ Will the new offering attract a new type of customer and expand your customer base?
- ▶ Will it create issues with any of your current customers?





In addition to these three scenarios, companies may often review pricing if they start to see changes in sales, customer retention, or competitor growth.

SCENARIO 3

Bringing your products or services to a new industry, geographic region, or customer niche when the market has existing competitors offering a similar product

In this third scenario, most of the earlier questions mentioned in the first case apply, but you should also reflect on the following:

- ▶ Where do you need to price your product to promote the market position you seek?
- ▶ What happens if your competitors copy your offering or your price?
- ▶ Are there combinations of features/benefits/price that will allow you to establish a foot in the market that you can build on?
- ▶ What issues or unmet needs do buyers have with your competition's current offerings?

RESEARCH TOOLS THAT PROVIDE INSIGHT ON PRICE



There are two types of research you can conduct: **primary and secondary**. Primary research is information gathered through self-conducted methods such as an interview, survey, or group discussion. Secondary research is information gathered from previous studies or data compiled by other entities.

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SECONDARY RESEARCH

It can be enormously beneficial to start your investigation with secondary research that includes information on products or services in your target market. The types of data to collect might include features, benefits, customization options, delivery options, pricing, discounts or rebates, and sales patterns. Anything that can help you map out the competitive landscape and understand current pricing practices is valuable. Places to find this information often include:

- ▶ Competitor websites and marketing materials
- ▶ Conversations with dealers or distributors
- ▶ In-store scans of products and pricing
- ▶ Industry association reports and publications
- ▶ Business data resources
- ▶ Annual reports



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PRIMARY RESEARCH

Depending on the industry or the competitor, all pricing information may not be transparent and accessible via secondary research. In these cases, primary research conducted with the customers or buyers of the product can provide rich pricing data.

As an example, we (Vernon Research Group) were contacted by an international company that was considering moving into a new geographic market in the U.S. They wanted to obtain pricing information on the competitors operating in that market and wondered if it made sense for our team to call into those competitors' offices and obtain their pricing. None of it was available online.

We considered their objectives and recommended they have us conduct a survey with homeowners who had purchased these services within the last six months. The survey allowed us to gather authentic and full pricing data for various types of services packages, as well as for

different types of payment schedules. We also gathered satisfaction and brand awareness data. The results helped the company identify where they would need to be priced to enter the market and succeed, which allowed them to decide if the move made financial sense.

In addition to identifying competitor pricing, **it is critical to know what value people have for your product or service and what they are willing to pay for it.**

When you want to find out what people will pay, there are four common, proven approaches using primary research. We will look at the benefits and drawbacks of each, then provide an example of the typical research output. Carefully consider the advantages and limitations of each method before you decide which tools will be most beneficial to you.

OPTION 1:

MONADIC (SINGLE) PRICE TESTING



This approach to price testing is best used when you have a strong understanding of price perceptions in the market, if you are repricing an existing product, and/or if you are pricing a product extension.

Monadic simply means showing a single price to one group of research participants. The simplest form of monadic testing is to present the product or service at different price points to different parts of your sample. If you wanted to test five price points, you would need five sub-groups of the same and sufficient size. It would also be critical that these groups not differ in key demographics that could influence their price response. One of the five price points is randomly presented, and the respondent is asked if they would buy at that price.

MONADIC (SINGLE) PRICE TESTING

Here is how the question and the output might look: If you were looking at a retirement community residence and it included two bedrooms, a kitchen, an open-concept living area, two full baths, a patio, and covered parking, how likely are you to buy this unit for \$300K?

You would then ask the same question to the other four groups, only changing "\$300K" to \$350K, \$400K, \$450K and \$500K. Below is an example of what the output from this exercise could look like.



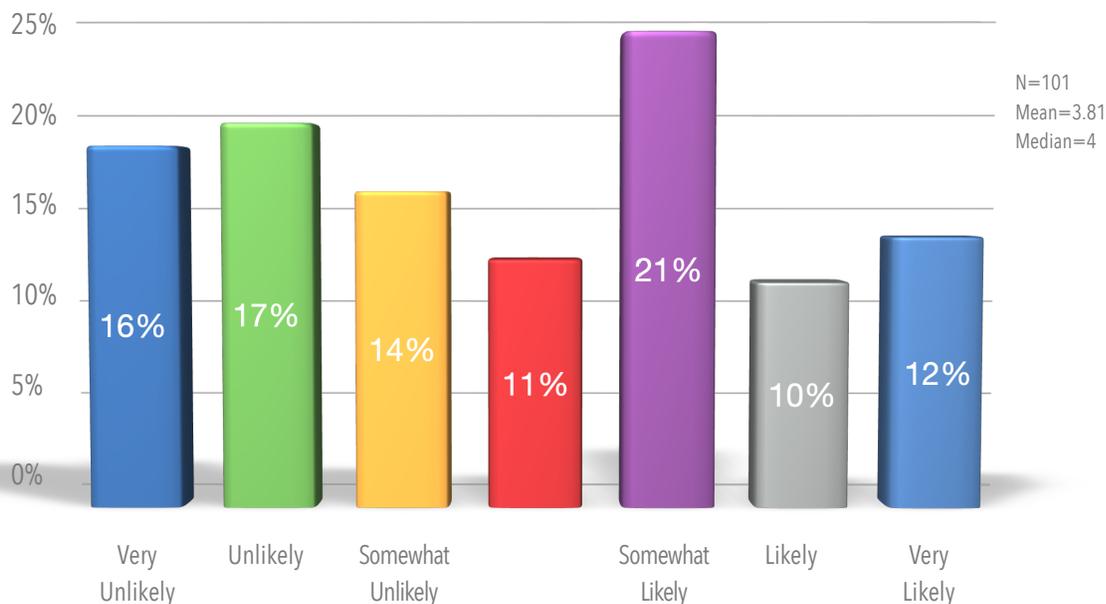
A variation on monadic testing is the **Gabor Granger method**. Developed in the 1960s, this method is used to find the highest price people are willing to pay. The Gabor Granger method goes a step further than the residence example. If the answer is "definitely" or "probably" for the purchase question, then the survey presents the next highest price point. If the response is "definitely not" or "probably not", then the survey presents the next lowest price point. This process continues until the highest acceptable price point is identified for each respondent. Once you have their answers, you can produce a demand chart.

MONADIC (SINGLE) PRICE TESTING

You can have other variations on monadic testing. The following example is from a study where we presented increasing price levels for internet service, but each price level also included a change in the upload/download speeds. Additionally, we asked participants if they perceived that package as similar to others available on the market and collected data on their current internet plan. The combination of all these data points allowed us to pinpoint ideal pricing based on the research.

Likelihood of Looking into Offer 25 Mbps x 5 Mbps at \$149/mo

There was a wide spread in likelihood of looking into this offer.



Q25: How likely would you be to look into this offer further?

Limitations to Monadic Testing

The drawbacks of this approach are that you need a very large sample to test individual prices in sub-groups and you can only test one iteration of your product or service instead of variations of it. It also does not measure the likelihood of a respondent buying the product at the tested price unless you ask a follow-up question.



OPTION 2:

SEQUENTIAL MONADIC PRICING

This approach works best when you have a strong idea of price perceptions in the market, if you are repricing a product, and/or if you are pricing a product extension.

It has the advantage of asking the same pricing questions to all the research participants in your sample. You do not need to worry about demographic differences between sub-groups the way you do with the basic monadic model.

This approach asks respondents to evaluate each price point one at a time. This is sometimes called tiered pricing or price laddering. The price points can be presented from high to low or vice versa.

Here is an example of this approach we used in a survey for a health insurance carrier testing a new type of plan. Instead of testing a price, we tested a premium discount. This was more realistic because the premium price level varied by company and plan (family, employee/spouse, or individual).

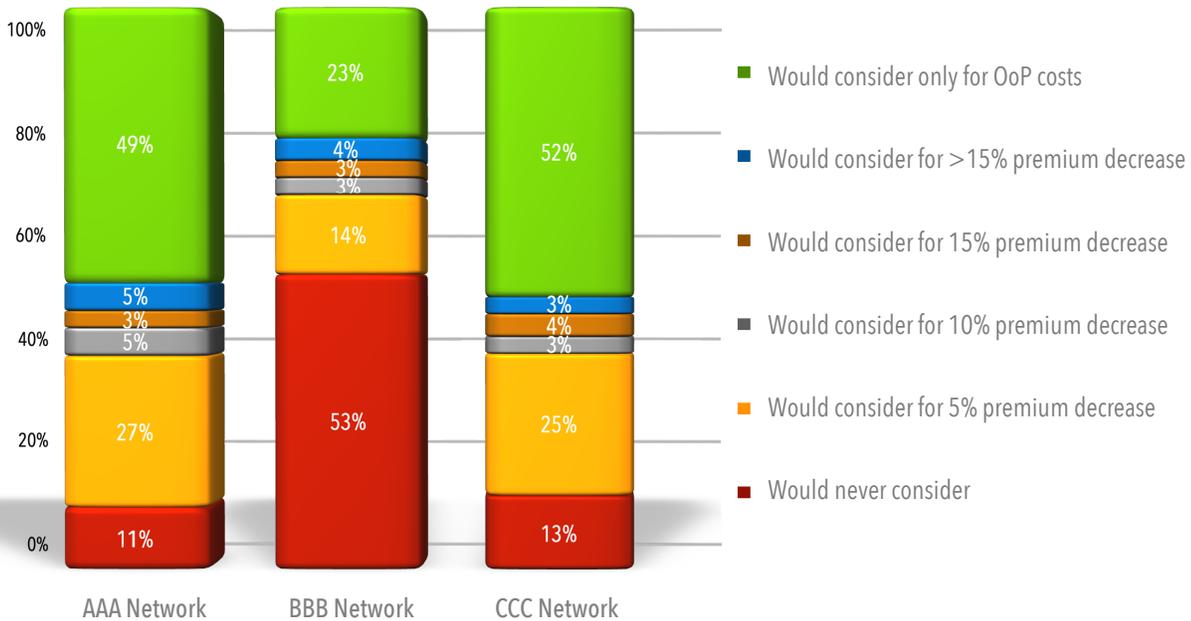
How likely would you be to consider a (type of) network if it resulted in a 5% lower premium?

We then tested 10%, 15%, and >15% discounts if they were not likely to consider the smaller discount(s).

SEQUENTIAL MONADIC PRICING

Insurance Plan

Respondents were significantly less likely to consider a BBB network. Consideration of AAA and CCC networks was virtually indistinguishable.



Limitations to Sequential Monadic Testing

Two disadvantages to sequential testing are that (1) it can become boring for the participant if too many price levels are tested, and (2) it is possible for previously shown prices to bias the appeal of subsequent ones. It also does not measure the likelihood of a respondent buying the product at the tested price unless you ask a follow-up question.



OPTION 3

VAN WESTENDORP'S PRICE SENSITIVITY METER

This method can be useful when you are introducing a new technology or product to a market or when you are taking an existing product to a new market. It is helpful when you have concerns about how pricing may fit in with or affect your brand identity, or when you have uncertainty about acceptable price ranges.

The van Westendorp method takes a nuanced approach to asking a potential buyer about price by approaching it in four different ways. The questions ask at which price the product would be:

1. So cheap its quality is doubted?
2. A bargain (or good value) for the money?
3. Getting expensive but you would still consider?
4. So expensive it wouldn't be considered?

The benefits of using the van Westendorp approach include:

- ▶ It is easy to implement in a survey
- ▶ It is easy for research participants to answer
- ▶ The analysis is simple
- ▶ The resulting graph is easy to understand
- ▶ It is a strong tool for a new product in the market because it ensures you do not underprice

VAN WESTENDORP'S PRICE SENSITIVITY METER

The analysis of these responses can then identify a range of acceptable prices. There are four main outputs from this research tool:

1. **Point of Marginal Cheapness.** This identifies the lower price limit. It is at the intersection of the "cheap" and "somewhat expensive" curves, where price starts to convey poor quality.
2. **Optimal Price Point.** This is where the curve for "too expensive" and "too cheap" intersect. Buying resistance is lowest at this point.
3. **Indifference Price Point.** This is where the curves for "expensive but worth considering" and "a bargain" intersect. This is similar to the median of the price - equal amounts of people find the price expensive or cheap.
4. **Point of Marginal Expensiveness.** This is where the curves for "a bargain" and "too expensive" intersect. Above this point, buyers are not likely to buy the product.

The acceptable price range from this analysis would be between the points of marginal cheapness and marginal expensiveness.

The optimal price point is around \$1,000.



At what price would the new wireless device be a bargain, expensive, too expensive and too cheap for the money?



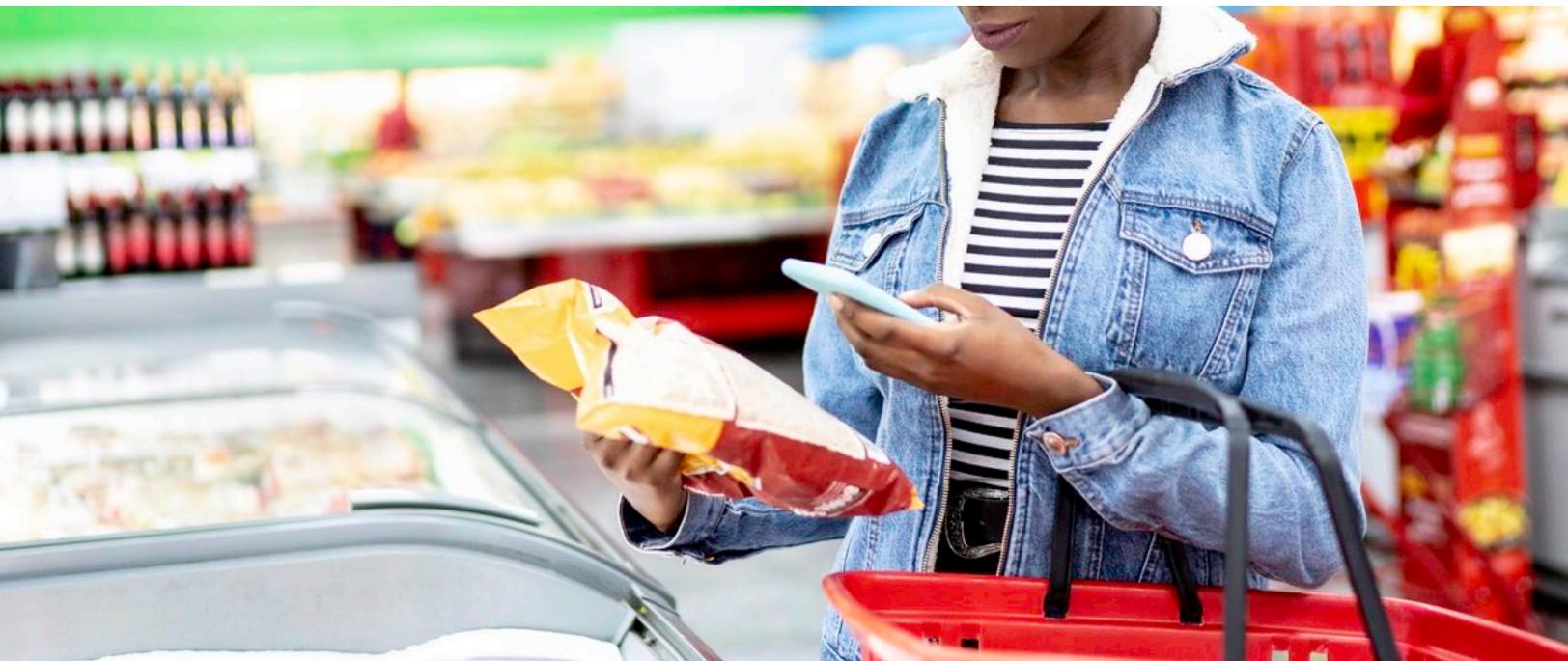
VAN WESTENDORP'S PRICE SENSITIVITY METER

Limitations to the Price Sensitivity Meter

The two main drawbacks to the Price Sensitivity Meter are that (1) it does not measure the respondents' likelihood to consider or buy the product at that price, and (2) the characteristics of the product or service offering are not taken into account when judging the price.

The value that a person ascribes to various features and benefits does impact the cost a buyer is willing to pay, and the van Westendorp approach does not directly or indirectly measure this. If you use only this method to gather data on pricing, make sure you thoroughly explain the features and benefits offered before asking any actual pricing questions. When applicable, a diagram or video of the offering can be exceedingly helpful.

In our experience, the van Westendorp model is best used to get an initial read on how much buyers are willing to pay. It is also helpful when used alongside other methods that deliver other pricing input, providing a fuller understanding of price issues and opportunities.



OPTION 4:

CONJOINT ANALYSIS

Conjoint analysis is different from the other pricing research tools we have discussed in that it gathers comprehensive data that allows you to look at the complex interplay between price, product features, competitive products, and brand. Developed in the 1960s, this approach continues to be updated and has been rigorously researched and tested by marketing experts and academics.

This approach is often used when trying to determine which combination(s) of features and benefits to take to market, as well as at which price point(s). It can be extremely helpful to companies operating in highly competitive industries, considering entering a new market, introducing a new product line, or testing potential product ideas.

A conjoint choice exercise simulates the product selection process that happens in real life by asking respondents to review multiple product bundles. These bundles present various combinations of features, benefits, price levels, and sometimes brand. Respondents view these bundles on multiple screens, making a preferred choice each time. This indirect way of capturing price is more realistic and reliable than directly asking respondents as in the monadic approach. Respondents in a conjoint choice exercise are assigning value in their mind to features and benefits and trading off between what they value and what they are willing to pay – just as they do when making a real purchase.



CONJOINT ANALYSIS

Here is a screenshot from an example conjoint study that shows what a respondent may see in the bundles part of the choice exercise (note: it has been simplified; most conjoint exercises have many features and variations).

Golf Study

If you were considering buying golf balls for your next outing and these were the only alternatives, which would you choose?

(1 of 8)

Brand:	Magnum Force, by Durango	High-Flyer Pro, by Smith and Forester	Eclipse+, by Golfers, Inc.	
Performance:	Drives 10 yards farther than the average ball	Drives 5 yards farther than the average ball	Drives 10 yards farther than the average ball	NONE: I wouldn't choose any of these.
Price:	\$4.99 for package of 3 balls	\$10.99 for package of 3 balls	\$8.99 for package of 3 balls	
	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

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There are three types of conjoint exercises you can employ. **The first** is the traditional choice-based conjoint, where respondents see multiple screens of product bundles and make choices, as in the Golf Study example.

A second type is the adaptive choice-based model, wherein respondents build their own ideal product bundle first, then those preferences are taken into account as the survey presents the bundle choices, which continue to adapt as the respondent goes through the exercise, narrowing in on their selections and preferences.

CONJOINT ANALYSIS

This is what a survey respondent might see in the build-your-own exercise:

Please select the grand piano you'd be most likely to purchase. For each feature, select your preferred level.

(The base price for a 6-foot instrument is \$7,000.)

Select Feature	Cost for Feature
<input type="radio"/> Yamaha (+ \$8,000) <input type="radio"/> Knabe (+ \$2,000) <input checked="" type="radio"/> Bechstein (+ \$10,000) <input type="radio"/> Samick (+ \$2,000) <input type="radio"/> Bosendorfer (+ \$18,000) <input type="radio"/> Estonia (+ \$5,000)	\$ 10,000
<input type="radio"/> 6-foot Length <input checked="" type="radio"/> 6.5-foot Length (+ \$5,000) <input type="radio"/> 7.0-foot Length (+ \$11,000) <input type="radio"/> 7.5-foot Length (+ \$18,000)	\$ 5,000
<input checked="" type="radio"/> High Gloss Black Finish <input type="radio"/> Flat Black Finish <input type="radio"/> Wood Grain Finish <input type="radio"/> White Finish	\$ 0
<input checked="" type="radio"/> Standard Bench <input type="radio"/> Concert Bench <input type="radio"/> Standard + Concert Bench (+ \$250)	\$ 0
<input checked="" type="radio"/> Square Legs <input type="radio"/> Rounded Legs	\$ 0
Total	\$ 22,000

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CONJOINT ANALYSIS

The **third type** of conjoint exercise is menu-based, wherein respondents choose options from a menu that typically includes standard bundles with several a la carte options. It is best suited to products or services that are highly customizable, such as ordering from a restaurant menu, picking financial services or insurance options, or selecting a car.



To give you an idea of the difference between a conjoint exercise and simpler pricing research tools, let's revisit the example we provided for the monadic testing approach. In that approach, we asked different respondents to rate their likelihood of buying a 2-bedroom condo in a retirement community at different price points. "If you were looking at a retirement community residence and it included two bedrooms, a kitchen, an open-concept living area, two full baths, a patio, and covered parking, how likely are you to buy this unit for \$300K?"

To test this same product in an adaptive conjoint choice exercise, respondents would first make selections for how many bedrooms they wanted, type of kitchen, number of bathrooms, type of parking, etc. When they make each choice, they can see how it affects the price of the condo, and they are allowed to adjust their choices to keep the total price consistent with what they want to spend. Later, screens would show respondents different combinations of condo features based on their preferences, adjusting pricing up and down, and ask the respondent to choose the bundle that best fits their needs.

CONJOINT ANALYSIS

Output from Conjoint Studies

The pricing piece of conjoint studies is mostly in the market simulator output and, in the case of adaptive choice-based conjoint, the results of the build-your-own exercise. The build-your-own output provides the ideal bundle with price overall and the percentages of the sample that were willing to buy at different price levels. The results can be cut by buyer segments if desired.

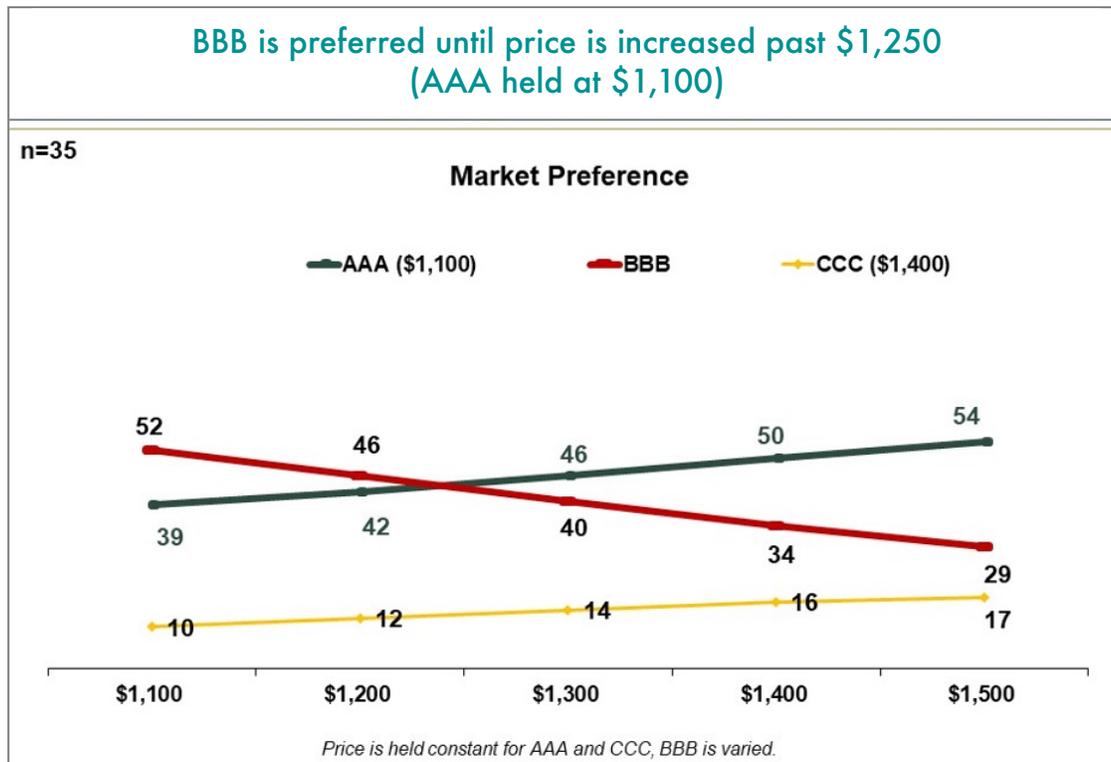
The market simulation allows you to use the conjoint exercise data to model buyer preferences and generate "What if?" scenarios, mixing and matching different features to build your own product. You can compare market share preference levels for multiple product configurations in a competitive set. You can compare new products under consideration against your existing product line. In each case, preference shares are calculated for all product profiles that you create in your custom marketplace. You can see how consumer interest changes when you vary pricing and product options.

Here is a simple example of a setup and output from the market simulator from one of our studies.

Preferences & Pricing **Market Simulation 5**

Brand	Valve position feedback	Manual override	Housing material	Power supply	Delivery lead-time	Price
AAA	% of span feedback	Manual	Aluminum	Battery	5-week	\$1,100
BBB	Open/close	Manual	Aluminum	Battery	5-week	Varies
CCC	Open/close	Manual	Aluminum	Battery	5-week	\$1,400

CONJOINT ANALYSIS



In addition to pricing levels, conjoint studies provide the following valuable information:

- ▶ The relative importance of price to other factors, which typically include brand and product/service features and benefits
- ▶ The utility value for the product as price changes

All of these results can be segmented if you have enough sample. Below is a graph of the utility value of price cut by industry, showing that the healthcare industry is much more sensitive to pricing than the other three industries for this client's software services.

CONJOINT ANALYSIS

Utility Values – by Industry Total Price

The healthcare industry had significantly less preference as price increased. The other industries, which had more respondents and are more reliable, had similar results as each other.



Limitations of Conjoint

While conjoint analysis is powerful and considered a benchmark by many researchers, there are drawbacks to the approach, as well as many times when it simply does not make sense. Conjoint requires specialized software and professional expertise to both properly execute and analyze. It makes surveys noticeably longer, restricting the number of other questions you can ask without provoking respondent fatigue. You need reliable competitor information to set up accurate simulations. Finally, there are some products or services that are too customizable for even menu-based conjoint to be a good fit. As a result of these requirements, conjoint analysis projects are often more costly to undertake. When it makes sense, however, conjoint analysis is the most accurate way to research price.

PRICING IS A CONTINUOUS STRATEGY



While you want to get initial pricing right – not overpricing or underpricing – it is just as important to monitor your prices and profitability on an ongoing basis. Make sure you are building in activities for your sales, marketing, and analytics staff that gather data and insights relevant to pricing. Key areas of focus should include getting feedback from your customers, watching industry trends, and monitoring your competition's moves.

If you would like expert guidance on the appropriate market research for your pricing decisions, we invite you to contact us.

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