

## Pricing Communications—Comic Insights

BLONDIE | YOUNG & LEBRUN



*Blondie* demonstrates how the description of your price has a significant impact on the perception in the mind of the customer.



*The Wizard of Id* proves again that at times, price by itself is part of the value delivered to customers.

## List Price: Still Useful? – Maybe Not!

The concept of list prices is pervasive in most retail and many industrial businesses. However, the consumer electronics business is a good example of where list prices have begun to lose all credibility and usefulness for most customers and retailers. The manufacturers of virtually all consumer products establish list prices which are set to be the absolute ceiling price for any transactions at the highest end retail outlets. Most retailers for consumer electronics items now try to advertise themselves as discounters who can sell the product at a significant reduction to list price. The Internet now has enabled people to see through list price to identify the “street price” at a wide variety of outlets. This gives consumers far more power to negotiate.

Although some economists believe that the use of list prices and deep discounts creates a win-win situation, it appears that in many markets this practice is transferring power both to the consumer and potentially to competitors. It transfers power to consumers because once they recognize that a retailer or manufacturer will discount from list, their natural tendency is to ask for larger discounts as the first step in the negotiation. The list price approach also transfers power to competitors because it enables them to track the percentage discount from list price a manufacturer (or competitive retailer) is willing to sell products. These data give a competitor a good benchmark with which to judge how to beat their competitors on price.

## Kmart's Pricing Woes: Trying to Use Price Alone to Gain Share

There were many articles trying to diagnose how Kmart got into trouble so rapidly. *Business Week* identified that one of the major bad decisions made by Kmart's leadership was a pricing decision. During 2001 Kmart decided that they would change their pricing strategy from a slight premium to prices at Wal-Mart to a strategy of matching Wal-Mart on the price of 30,000 basic items. This move didn't work because Wal-Mart had two important capabilities. The first was a lower cost structure than Kmart. The second was the ability to easily lower prices to maintain their strategic price differential versus competition. As a result, Kmart volume did not increase but Kmart's margins dropped while Wal-Mart was able to sustain their margins due to their aggressive and industry leading low cost structure.

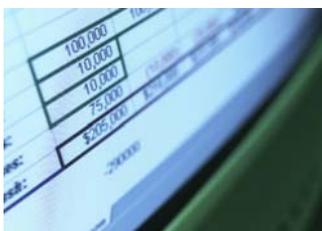
It is interesting to try to assess the logic in Kmart's pricing strategy. They had significant success in building traffic in their stores through the use of name brand products and special branded products such as Martha Stewart, Sesame Street and Route 66. Kmart used the attractiveness of these special brands to build traffic in their stores, calculating that customers would buy the necessities, even at a slight price premium to Wal-Mart, in order to avoid the extra time and effort (switching costs) necessary to go to Wal-Mart instead of just picking up the items as they walked down the Kmart aisles.

The pricing lessons from Kmart are: (1) Price is the easiest competitive move to match—and price cuts rarely result in share gains; (2) Switching costs can be used to capture both volume and price; (3) Pricing must be an integrated part of overall strategy—not used in isolation.

## Does Price By Itself Have Value? You Can Bet On It.

Freeware (free software) is fading away as developers find it easier to sell a product at a price than to give it away. This same lesson has been learned not only in the software business, but by many industrial companies who are now shifting from a practice of giving away samples of their products to setting a price for the samples, in order to better communicate the value that the samples, and the technical service that accompanies those samples, is really providing to their customers.

Astute marketers always apply a price to samples; however, they may not actually collect the price if they want to ensure that their customers use those samples a part of the design of their new products. This technique often gets the best of both worlds by linking the value of the production item to the price of the sample and ensuring that current costs or budgets don't stand in the way of getting samples designed into the customer's product.



## Doctors' Fees—Expanded Service With Appropriate Price

Some physicians have recognized that they can offer services which will not be paid for by third party payers but will be paid for by certain customer segments. These physicians have decided to charge their patients a fee in return for 24-7 availability on a counseling basis. They are willing to provide patients with instant access on a 24-7 basis and virtually no waiting time for appointments in return for fees that range from \$1500 to \$20,000 per year. They also have recognized that they can charge a fee for providing higher levels of personal service during appointments, including monogrammed robes, heated towel racks and marble showers in their offices.

The implication of this trend in medicine is applicable across many consumer and business services. It is the renewed recognition that buyers will pay for services as long as the benefits they receive and perceive exceed the price that they pay. This also demonstrates that consumers, as well as industrial businesses, are willing to pay for the risk reduction provided by a guarantee of future capacity, whether it's manufacturing capacity or medical capacity.



MFL's consulting practice focuses on helping our clients build margins and volume by capturing their fair share of the value they deliver to their customers. We have found that pricing, while often managed in isolation, can be a powerful and integrating lever to drive a necessary shift in mindset and capability.

It is not enough to simply create value for customers. That value must be understood, communicated and recognized by the customer in order to capture your fair share of the value you deliver in your price. To accomplish this, an organization should understand and deliver benefits that help their customers be successful in their markets (be market-focused). At the same time, applying a market-focused approach to pricing can capture your fair share of that value while slowing or preventing the commoditization of your offerings from the inevitable pressures of changing customer buying practices and aggressive competitors.

Although it is easy to talk about, creating a market-focused culture in a business is very challenging. And, converting that mindset and understanding into a valuable set of customer offerings and an appropriate approach to pricing can be equally challenging. Our extensive McKinsey & Company experience, combined with our general management experience has enabled us to develop approaches that help our clients sustainably improve their profits and growth by successfully meeting these challenges.

Elliot Ross  
Dave Nuechterlein

## Pricing Communications: Know Your Audience(s)

eBay is a very good example of pricing a communication that focuses on several different audiences at the same time. eBay has raised its fees for transactions on its website. In some cases, they more than doubled the amount that sellers will be required to pay the Internet auctioneer. Their announcement was designed to accomplish several goals. First, they wanted to increase their price and margin for services that they provide in a unique manner and along a number of dimensions. They increased the minimum price for listing a car or auctioning items, as well as increased the variable price for auction items. They explained to their customers (sellers on their site) that the purpose of the higher prices was to help eBay fund improvements in the technical reliability of its site and its customer ser-

vice. The magnitude of these price increases, which ranged from 20% to 100%, seems to be a low risk move for eBay, given 2 things: they have a dominant share position and past price increases have not caused them to lose customers.

The second audience for this price communication was stock market analysts and investors. eBay timed the announcement of the price increase to coincide with the announcement of a successful quarter, where their revenue increased over 64% and they were able to report a profit. As a result, analysts not only felt positive about the recent sales and earnings report, but had confidence that the price increases would help continue the revenue growth at a profitable level.

The MFL Group  
2000 Auburn Dr., Suite 300  
Beachwood, Ohio 44122  
Phone: 216-514-3022  
Email: ebr@mfl.com, djn@mfl.com  
Web: www.mfl.com