

Setting Prices Based on Customer Input: A Fool's Errand?

Well, maybe. If it's not done right. Common wisdom suggests that the last person you should ask about price is a prospective customer. And there's some truth to that. How can you expect objectivity from a person who benefits greatly from a low price for your goods or services? Unfortunately, you sometimes have no choice; you can try many other tactics but you may find it advantageous to talk to some carefully chosen customers before completing your pricing study.

Baseline Tactics

First, let's look at some essential tactics that need not rely on customer input. You can set your price based upon your costs; this is useful only to set a "floor" price to meet margin objectives independent of market influences. If there are several directly competitive products or services available in your market, the prices of those offerings will obviously constrain your pricing choice; the degree of constraint will naturally depend upon your competitive position in the market.

Beyond these basic tactics, you will definitely need to gather customer input (1) if you're bringing significant incremental value to users in a competitive market, or (2) if you're bringing a truly unique product or service to any market. So let's now focus on some customer-guided tactics.

Value

Value-based pricing attempts to determine a user's *perception* of the economic value of an offering's benefits in comparison to the offering's price. One can also attempt to guide the user's perception by disclosing a value model as part of the research process. The best approach is to define the offering's benefits, then allow the user to quantify those benefits in economic terms. Ideally, you then set the price at some level below consolidated perceived value.

Value-based pricing deserves to be an important component of most pricing studies. After describing your offering, you ask prospective users to quantify the offering's assumed benefits in both operational and economic terms. This is an imperfect process because few users can accurately quantify the benefits in real time without actual experiences with the offering. But this is a step in the right direction when combined with your own knowledge of likely product usage, i.e. your knowledge of your customer's business.

Unfortunately, value-based pricing has an inherent weakness: Respondents often know that a pricing study is being performed and can, therefore, attempt to unfairly influence your price-setting.

Comparables

Every product or service offering is explicitly or implicitly compared to similar offerings by customers or users. This is often the most powerful influence on customer attitudes and their inclinations to buy.

Prospective customers are likely to have certain perceptions of the prices of various existing products or services they believe to be *similar* to your own. You can ask prospective customers to identify those "similar" offerings and have them compare those offerings to yours. A review of your consolidated findings allows you to set some comparables-based benchmarks.

This approach to pricing analysis can be considered a "sanity test" by prospective users. It is by no means a sophisticated, analytical approach. But it will position your offering in the prospect's mind -- if you do nothing to alter that perception.

Sensitivity

Ultimately, a customer's real views will be known at the point of sale. Price sensitivity studies commonly involve direct customer inquiries in the course of a research process that precedes the sales process. The best approach, in our view, consists of four simple questions, part of the so-called Van Westendorp approach:

- What price is so low that you would question the product's quality?
- What is the highest price at which the product would still be a bargain?
- What is the price at which the product is starting to get expensive?
- What is the price at which the product becomes too expensive to consider buying?

Your findings can be combined to set an "optimized" price to achieve acceptable projected volume and revenue. There are, however, two offsetting deficiencies. On the one hand, respondents know that a pricing study is being performed and can, therefore, attempt to influence price-setting in their favor; you might choose to adjust your pricing upward. On the other hand, customers typically are not really willing to spend as much as they say in a pricing survey.

You can include price-sensitivity content in your study by asking appropriate direct pricing questions of prospective users, preferably at the end of each interaction. The resulting data can be valuable in combination with the results of value-based and comparables-based pricing analysis.

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