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The Art of New Product Pricing

CAN'T DECIDE OPTIMAL PRICING FOR NEW B2B PRODUCTS? YOUR CUSTOMERS MIGHT HAVE ANSWERS

Truth be told, many B2B suppliers guess the price for their new products. If they guess too high, their customers let them know by refusing to buy. What if they price too low? Well, those customers hate to nit-pick. They will overlook the mistake and let it go this time. Some suppliers don't realise how underpriced they are until they try to rationalise products and find customers willing to pay much, much more.

How do you price new – not existing – products? Since our work involves strictly on new product development, we have enough firsthand knowledge on this. We think it's a crime to optimise pricing after years of giving away value. Why not enjoy great margins from the very beginning, for the entire product life?

Customers will help you set prices before – but not after — you launch your new product. No need to raise eyebrows. Customers want you to develop innovative new products that deliver value to them. So they'll give you insights early on to make this happen. If you're clever about it, these same insights allow you to establish optimal pricing. But once your new product is launched, the pricing insight window usually closes.

We are talking about customer-focused pricing, and not supplier-focused or competitor-focused pricing. Supplier-focused pricing is often called cost-plus pricing. Any correlation between cost-plus pricing and optimal pricing is purely coincidental. It's like using your birthdate to pick lottery numbers: convenient but rarely correct.

Competitor-focused pricing puts the emphasis on unit — rupees per kg or per litre — not on value created. It's useful only for me-too and incremental new products. Hopefully, your new product will deliver significant new value beyond competitors' products. If so, competitor-focused pricing is helpful only in understanding customers' initial price reaction.

Meanwhile, customer-focused pricing is an "outside-in" approach that requires more work by the supplier. It is also the only way to consistently maximise the value you capture with new products.

So how do you get customers in your target market segment to help you set optimal product pricing? You have two options: Either ask customers for pricing decisions or understand customers' decision making.

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With the "ask-for-decisions" approach, you might use Van Westendorp, Pairwise Comparison, Conjoint/Trade-off Analysis, etc. You would ask prospects to make pricing decisions and analyse these responses to set prices. For the "understand-decision-making" approach, you would use Voice-of-Customer (VOC) and observational methods to essentially "enter the world" of your customers. You'd build an internal capability for replicating customers' decision making.

Which method should you use? It really depends on your market. The "more B2B" your market is, the more you should lean toward the second approach – understanding how your customers make decisions.

A few years ago, we developed the B2B Index to measure "how B2B" a supplier's market is. It involves measuring and indexing customers' Knowledge, Interest, Objectivity and Concentration (number of customers in the market). For example, if you sell hydraulic hose to earth-moving equipment producers, your market has a high B2B Index. Those Caterpillar engineers are knowledgeable, interested in your innovations, objective – using economic decision making – and there aren't many earth-moving equipment makers.

Selling garden hose to homeowners is B2C, representing a very low B2B Index. But what about water hose used by cement companies to clean mixers and other equipments? This is still a B2B market, but with a lower B2B Index than hydraulic hose for earth-moving equipment.

What is needed is a New Product Blueprinting, based on the "understand-decision-making" pricing approach. The higher the B2B Index, the more important this is for you. Those Caterpillar engineers are both willing and able to help you design a better product, so you can "enter their world" at an astonishing depth. There are few customers in the bulldozer market, and if you depend on Van Westendorp survey, good luck getting straight answers out of them.

> *Suppliers that understand how customers make decisions — pricing or otherwise — have an important competitive advantage*

The real world is a lot different. Our clients – all of whom are B2B – use New Product Blueprinting first to understand their customers' world. Then, if they have a lower B2B index – especially one driven by thousands of customers – they may use the "ask-for-decisions" approach.

There's a science to the "understand-decision-making" approach, which includes five steps.

• Diverge to all outcomes.
Independent research by Tony Ulwick (What Customers Want) indicates customers have 50 to 150 outcomes for every job they take your product to do. Many suppliers start with their own solutions before understanding the full range of possible outcomes they could address. Big mistake, since this severely limits the value they can deliver.

• Converge to value-added outcomes.
The only outcomes customers might pay more for are those that score high in importance and low in current satisfaction. Anything else you deliver will either cause your customers to yawn, or will give them "me-too" leverage to beat down supplier pricing.

• Use advanced observation.
With the right skills, B2B suppliers can use customer tours to learn how to create more value and gather economic data to quantitatively predict the financial impact on customers. The unique AMUSE methodology is useful to find ways to Accelerate activities, Minimize activity input, Upgrade activity output, Simplify transitions between activities and Eliminate activities altogether.

• Conduct side-by-side testing.
Do customers pay more for value? Not really – only for value beyond their next best alternative. Most suppliers do a terrible job of quantitatively understanding what these next best alternatives are. New Product Blueprinting methodology combines external customer interviews with internal side-by-side competitive testing to provide insights.

• Create value calculator.
The first four steps are necessary, but not sufficient to set optimal new product pricing. You must pull it all together in a value calculator that allows you to predict and communicate the value your new product will deliver. You must do both, because your price ceiling isn't set by the value you deliver. It's set by your customers' perception of the value you deliver.

A word of caution: If you find it helpful to perform Van Westendorp or Trade-off Analysis, be sure to complete all steps first. The supplier that understands how customers make decisions – pricing or otherwise – has an important competitive advantage. If you're going to design a new car engine, it's not enough to understand all those lights and dials on the dashboard. You've got to get under the hood.

Finally, remember you may need to relook at pricing several times in your product development process. You'll need increasingly accurate pricing estimates as you move through your stage-and-gate process, "perfecting" your pricing prior to launch.

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