VIEWPOINT

Pricing Is Not an Afterthought

Leading Strategies for Pricing Early in the Product Development Process

BY JAMES WEAVER

There's a leading luxury car maker that performs an average of 100 more safety tests than those performed on a non-luxury car. They successfully sell the car in the market for $280,000. A well-known online retailer has one of the cheapest and most popular e-readers in the market at $79. So what is common between these two firms with winning products at different ends of the pricing spectrum?

Both companies have given extensive thought to value and pricing during the early stage of the product development process. For the luxury car maker, price and customer willingness-to-pay helps to define a strong product concept that flows through the subsequent phases. The high value proposition in turn helps to command a high price.

On the other hand, an early pricing discussion on the e-reader helped the retailer create a robust product concept and a new product strategy – low priced products with a built-in feature to generate additional revenue streams by also being a live advertisement platform. Companies that incorporate pricing strategy early on are more likely to maximize the revenue potential and value of their products.

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3 Pitfalls that Lead to Pricing Problems

Companies typically invest in pricing and value management strategies late in the product development lifecycle, in the period just before product launch. This trend is driven by three common issues:

1. ***Incremental development mindset***
   For many companies, product development means adding a new feature to an existing product. While incremental development has its place, when pricing these products, companies often default to cost-based pricing. But manufacturing cost and incremental customer value generated by the improvement cannot necessarily define the optimal price.
2. ***Lack of clear value positioning***
   When companies think beyond incremental product development, they often feel as though new product pricing is risky and uncertain. After all, how should you price something that has never been sold before? Companies often rely solely upon anecdotes, gut feel and emotion to set price rather than incorporating value analytics.
3. ***Limited understanding of pricing impact***
   There is a general lack of understanding around the importance of the right price for new products. Companies are comfortable making significant changes to a product's price point after launch, once they "see how the market reacts." This inconsistency generates confusion among customers and across the industry as to the true value of an offering. For any business, price is the most powerful profit driver, and pricing mistakes can have long-lasting consequences.

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Leading Practices in New Product Pricing

Do any of these common pitfalls sound like things your company does? Don't worry – here are three practices that leading companies have utilized effectively.

1. ***Build price and value alignment early***
   Companies have maximum leverage to shape the long-term profitability of a product during the early stages of the development lifecycle, where cost of making changes is very low and freedom to build a compelling value proposition is very high.

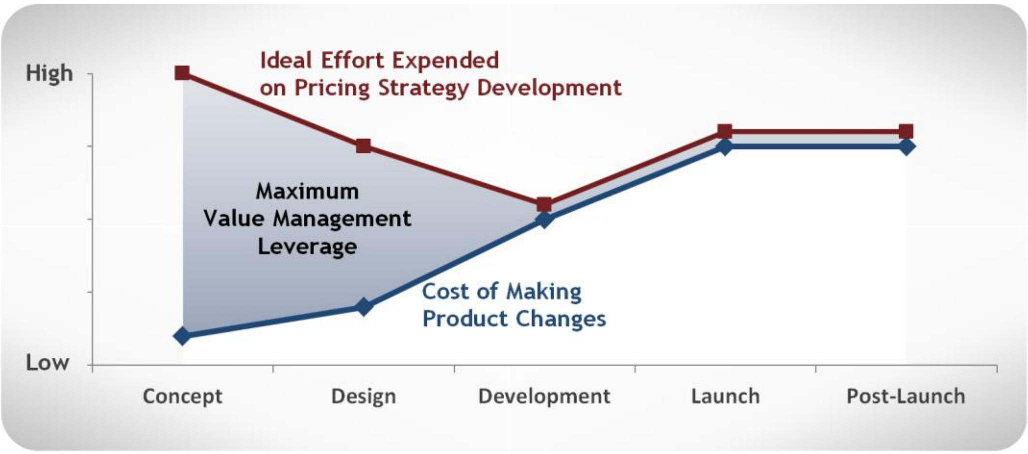

Figure 1: Effort Expended on Value Management vs. Cost of Making Product Changes

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2. ***Utilize value analytics to calibrate market positioning***
   Price products based on the value delivered to the customer versus the next best alternative. This not only meets the needs of specific customer segments and competitive positions, but also ensures that the firm is designing and delivering the right level of value for the cost and return thresholds.

   There are two fundamental types of value analytics used by leading companies: Economic Value Bridges and Value Mapping.

   Economic Value Bridges are most effective when the value proposition can be defined economically, in terms of reduced cost of ownership, increased sales productivity, greater asset utilization, etc.

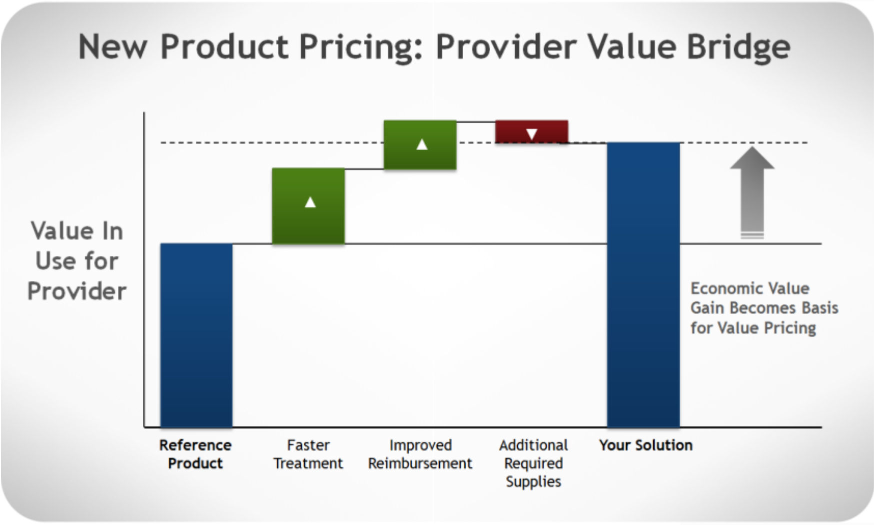

Figure 2: Economic Value Bridge

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Value Mapping is used to depict the landscape of competitive offerings against two axes – price and perceived benefits – when product differentials are more perceptual and qualitative.

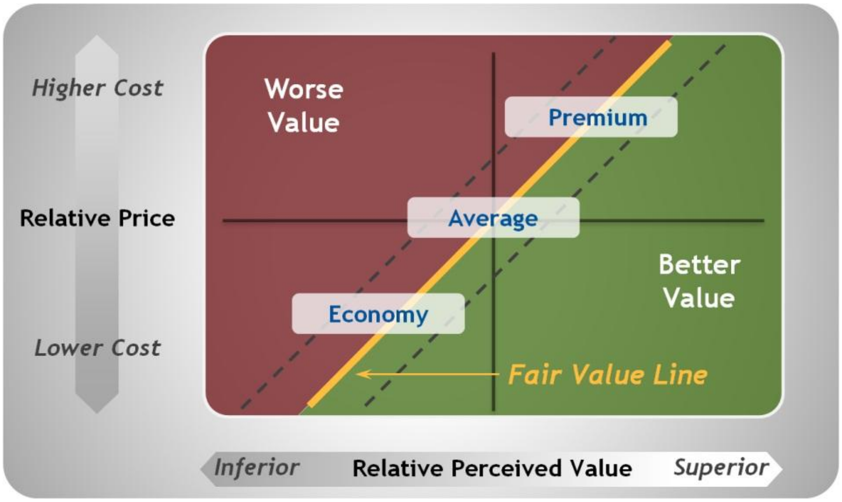

Figure 3: Value Mapping

When unfavorable cost variations arise during development, leading practitioners resist the impulse to let the target price drift and remain committed to a justifiable value proposition.

3. ***Treat target price as a design requirement***
   By collaborating internally for early alignment on the value story, supported with solid value analytics, companies establish a clear target price and performance specifications for the product development stage. When unfavorable cost variations arise during development, leading practitioners resist the impulse to let the target price drift and remain committed to a justifiable value proposition.

Getting Started with a Better Pricing Strategy

Here are our suggestions for embarking on an initiative to improve new product pricing:

- Start with a team of the most analytical product managers, with input from product marketing and finance, who can compare the effort needed on value management with the cost of making product changes
- Select a few pilot projects from the development pipeline and utilize these strategies to build price and value alignment early, and then compare results with conventional pricing strategies to get management buy-in

Take the guess work out of pricing by incorporating value discussions early in the new product development process, including value analytics and sticking to the price/value decision throughout the process. Whether your product is luxury or economy, having a plan to create and capture more value will increase the chances of market success.

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