

Interview with Hermann Simon, the author of "THE CONFESSIONS OF THE PRICING MAN".

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1. Please name five main pricing trends in the Western World. And give examples.

Simon: 1. Digitization and E-commerce have a strong influence on pricing. E-Commerce is heavily attacking traditional retailers. 2. We see more transitions from one- to multidimensional pricing, e.g. Amazon Prime. 3. New pricing models are introduced (e.g. pay as you go, pay what you want, Freemium). 4. Globalization plays a key role. It's not just cheaper, but also more differentiation. 5. Price wars have become more frequent. 59% of companies worldwide are engaged in some kind of price war. These five trends are interrelated.

2. Please name three main trends of the consumer behavior. How do they affect the prices and the companies? Give examples.

Simon: First, there is the increased price transparency created by the Internet. Airline, hotel, tourism prices are immediately visible and comparable to the consumer. Consumers pay more attention to the balance of price and value they get. Then, very important, psychological insights allow to control consumer behavior more effectively, very important in banking.

3. Analysts say that after the crisis ends, the consumers will keep crisis habits: they will search for discounts and low prices. What should companies do not to scare off the clients and to improve profits?

Simon: Of course, the consumer learns from crises. During crises many switch to cheaper alternatives and find that their quality is okay. The crisis has certainly helped hard discounters like Aldi and Lidl. Consumers expect that discounts granted during the crisis will continue later on. Companies should consider that. What they do in the crisis may have long-term unwarranted consequences. That's one reason why I recommend to be very cautious with open price discounts during the crisis. I prefer natural discounts. And it is often better to accept a volume decline rather than a price decline during the crisis.

4. In Russia there's a popular strategy: every month a company announces some kind of a special offer or a promotion for the clients (discounts, two for the price of one, etc.). Is this strategy reasonable? How often should such special offers happen so that the clients don't get used to them and think: "If I don't buy this month, I can buy the next month when there's a special offer"? Please give examples.

Simon: Regular discounts are dangerous because they educate the customer towards the behavior you just described. Why should you pay a higher price today if you can expect to get a lower price next week (assumed you do not urgently need the product today)? Discounts should be irregular in terms of frequency, duration and magnitude. The vendor should maintain a degree of uncertainty. This is especially true for products which can be stored, e.g. detergents.

5. How do you recommend to announce a special offer and not to offend the client? For example, one Russian fitness-club sends a message: “Only today you can buy the card for 90 RUB per day” or “Only today the price for a month is 2700 RUB”. But if you calculate the annual cost, the price is the same. In other words there is no discount.

Simon: This is, of course, cheating. Very risky for your reputation. If you pretend to offer a discount, but actually this is not the case, somebody will detect it. The cheating can appear in the press or on the internet and ruin your reputation. I would say this kind of announcement is stupid, even if it works temporarily.

6. How to define the maximum and the minimum discounts?

Simon: The minimum discount is defined by the consumers' perception. There is a famous law in psychophysics, the so-called Weber-Fechner-law. Applied to pricing it would say that the minimum discount should be proportional to the absolute price. A 1%-discount on a 100 Rubel item would mean a discount of 1 Rubel and not achieve much. The same percentage on a 1000 Rubel product would be 10 Rubels and also not be very effective. A 20% discount on the 100 Rubel-item would bring the price to 80 Rubels and probably move sales volume. The same is true if you offer a product usually priced at 1000 for 800 Rubels. The maximum discount is limited by your marginal costs. Normally a company should not sell a product below its marginal costs.

7. Which categories of products you should never experiment with and just set the fixed price? Why? And which you should definitely experiment with? Why?

Simon: Don't experiment with the price of luxury products. If you cut the price you will ruin the image and annoy former buyers. Price volatility is the enemy of a stable long-term image. On the internet you can run price experiments at low costs. That is a very interesting new arena. I think consumer electronics are a category where price experiments make a lot of sense – unless you are Apple.

8. The methods that you explain in your book – are they prevalent in the Western world? Are they used by the majority of companies or only by a few “driving forces”?

Simon: There are big differences across industries. In terms of price professionalism the pharmaceutical industry is leading. Premium automobile producers, airlines, telecommunications companies are also quite sophisticated. Larger firms apply more and better pricing methodologies than mid-sized companies. Sectors like retail or tourism are often involved in price wars, which is rather stupid. Media also lag behind. In the internet we see a lot of pricing heterogeneity, some are very good, others amateurish.

9. There are lots of manufacturers among our readers. They sell their products not to the ultimate consumer but to other businesses. What pricing strategy should they choose? Please give examples.

Simon: Indeed, the vast majority of transactions, about 75%, are B2B, not B2C. And in practically all B2B-transactions prices are negotiated. Therefore, negotiation skills play a key role. The most important aspect is that the vendor understands the value he offers to the customer. The Romans in their Latin language had the same word for price and value, namely “pretium”. This is the core of the pricing challenge in general, and especially in B2B with complex underlying processes. This does not preclude that the vendor must also understand the final customer.

10. What kind of special offers and promotions should manufacturers make for their clients? How often? Examples?

Simon: There are dozens of variants of special offers and promotions: simple price cuts, product bundles, cash back, quantity discounts, multi-person (family) offers, offers for special and many others. There can be no general rule how, when, and how often to apply them. But all promotions have one thing in common: they work only if they are effectively communicated. Smart communication can work wonders. In one case we renamed a hitherto unpopular flatrate product of the German Railroad Corporation (Deutsche Bahn) and put it under the umbrella of the well-known BahnCard-concept. In spite of a price increase sales volume quadrupled.

11. What kind of marketing is optimal for the manufacturers? How should they promote their products? Please give examples.

Simon: I am convinced that value-to-customer always was, is, and will be the key. Hard discounters like IKEA, Aldi, Lidl or Ryanair are not successful, because they are cheap. They are successful because they combine an acceptable and consistent quality with a very aggressive price. If they offered shabby, unacceptable quality the low price alone would not help them. Under this perspective good marketing means creating, communicating and offering value-to-customer at a competitive price.

12. Judging from your experience: do the companies working in different countries really adapt their pricing strategies for each country? For example, in one country the price is charged for the use of tires and in another country – for the tires. What does the decision depend on? Why it's not wise to act in the same way in every country? Or is it?

Simon: Price determinants like distribution channels, competitive positions, intensity of competition, consumer behavior, retail structures strongly differ across countries. Therefore, a uniform price across countries is almost never optimal. In the same vein, the internet and globalization force companies to align their prices. Our solution is an "international price corridor" which partially adjusts to the market differences and in the same time prevents gray or parallel imports.

13. What's the task of CEO in the product promotion?

Simon: To set clear objectives, install a systematic approach and create a culture which subdues overly aggressive behavior.

14. Please name five mistakes that companies make when setting prices.

Simon: Waging price wars, pure cost plus pricing, not knowing the value to customer, abstention from price differentiation, sloppy implementation.

15. What kinds of price labels attract the customers most? What numbers? Perhaps you've conducted experiments with the label colors? Which colors draw the customers' attention?

Simon: Actually we don't know that much about these effects. Research results are spurious and contradictory. The most popular practice of odd prices, which means prices ending just below round number, e.g. 9,90, sometimes works, sometimes it doesn't. Red is a color which draws attention and signals discounts. But too much red is dangerous. I would not use yellow to communicate discounts. But you should also take into account the color of the company's logo – some colors match, others don't.

16. When does the high price strategy work? Please give examples of how the companies explained their high prices to the clients.

Simon: High prices work if a company is successful in creating and communicating a superior value. Apple's i-phone is a convincing case. It's price is about three times the price of an average smart phone, but still the product achieved huge sales numbers. In recent years Apple took about 80% of the smartphone industry profit. Porsche is another case. Even during the crisis it kept its prices high. It is the most profitable company in the automotive market (in terms of profit margin).

17. How to create a boom for the products? Are there any successful examples?

Simon: The keyword is innovation. But let's be honest. 75% of all innovations according to a Simon-Kucher global study don't meet the expectations. The challenge is to integrate technology and customer needs. That's really difficult. And there remains always an element of luck.

18. Is it wise to ask the clients about the product prices? Wouldn't they perceive this as a weakness – as if the company doesn't know what to do?

Simon: It is certainly wise to investigate the clients value perception and their willingness to pay. But not in a direct, obvious way, e.g. by asking questions like "what should be charge for this product" or "how much would you pay?" Today we have very sophisticated, computer assisted

questioning technologies. The whole family of conjoint measurement methods allows us to answer these questions without the unwarranted side on consumer behavior. Simulation models allow us to predict market shares and profits quite reliably.

19. How to communicate the product/service value to the buyer? Please give examples of failures and success.

Simon: To successfully communicate the value-to-customer there must be a real value. Cases where the value is created solely through communication are rare. Segway, the scooter on which you can drive upright, is a classical failure case. The communication was superb. This revolutionary innovation got a lot of attention. But the initial price of around \$ 5000 was far too high. Segway announced that they would sell 250 000 units in the first five years. The actual sales number was 30 000, almost 90% below target. When Audi introduced the Q7 they did excellent communication, but set the price at 55 000 Euros too low. The demand in the first year far exceeded the capacity. Thus, they couldn't deliver and consumers were dissatisfied.

20. If competitors cut their prices, should I follow them? Or perhaps it's better to raise prices?

Simon: First, you should think before you act. The question can only be answered if you understand both your customers and your competitors. Is the competition's price cut a temporary move, for instance to clear stocks, to sell out an old model, or is it longer term? How do your customers react to possible price moves? And you have to think one step further: if you cut the price will the competition do another price cut and you induce a downward price spiral? This is a very complex game theoretic situation. Simple answers are dangerous.

21. How often is it recommended to reconsider prices during a crisis?

Simon: you should always observe your prices – and competitive prices. But in times of high volatility being vigilant is even more important. A crisis almost always means higher volatility. But the same is

true for a period of rapid market growth with new entrants etc. Thus my general recommendation is: the more volatile a market is the more frequently you should reconsider prices.

22. What do you think about the coupon-websites? Do you believe they are successful? Are there many coupon-websites in the western countries?

Simon: Coupon-websites are part of the shift from classical to digital media. They can be much better targeted to specific groups whereas coupons distributed through newspapers or magazines are not very effective in this regard. In Germany, kaufda.de (this means buyhere) is quite successful. Some time ago it was acquired by Springer (the publisher of Germany's Bild tabloid) which shows that large players are interested in this method.

23. How often should ordinary companies (not major players) sell on coupon websites?

Simon: The answer requires two "ifs". If the competition is selling on coupons all the time, it is difficult to refrain from this practice. You may have to follow suit. The same is true if consumers are "absolutely" used to get these coupons. If the two "ifs" do not apply you should rather use coupons intermittently. If you do it permanently you are likely to destroy your price image and price level in the long term. Another important aspect is how many of your customers do actually use internet coupons. If the number is limited then these coupons may be an effective tool for market segmentation and price differentiation.

24. Do the western companies use any new methods to motivate the sellers? Please give examples.

Simon: There are lots of new tools. Mueller, one of Germany's leading drugstore chains, prints a 3% coupon on the sales slip, to be applied to the next purchase. Not so young, but still a great innovation is the BahnCard of the German Railroad. You can buy variants of this card which give you for the duration of one year 25, 50 or 100% discounts on every ticket purchase. More than 5 million people own this card today. "Pay per use" is gaining. Michelin introduced a truck tyre which is not sold but priced per kilometer driven. We also see a radical novelty, namely negative prices, where the buyer gets money for buying a product. Examples are electric power, interest rates and special offers, e.g. by Commerzbank which pays 50 Euros to a new customer.

25. Please give two or three advices to the Russian executives - how should they act in 2017?

Simon: My first advice is that you must check very carefully the role of price. If demand is low or goes down (e.g. due to a crisis) it does not necessarily mean that you should cut the price or give higher discounts. If people are not buying because of perceived higher uncertainty, price is very ineffective to increase demand. In the worst case you end up with lower prices and lower demand, a real disaster. My second advice: customer groups are typically very differently affected by crises. This provides an opportunity for a more pronounced and new price differentiation. Third advice: I am a big fan of natural discounts instead of cash discounts. Give the customer who asks for a lower price or demands a discount a little more of the product. This has two advantages. First it prevents the destruction of your accustomed price level. And second it means more volume, thus more work for your people. And often customer like it.