



Value-Based Pricing

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There is a widespread understanding in marketing area that the company should be viewed not only through the prism of the products they create, and the benefits that provides to its customers.

Robert J. Dolan and John T. Gourville have defined marketing as a process where the company has made the value for selected customers (Principles of Pricing, 2005).

The marketing process is related to value creation, value delivering and value keeping (Figure 1).

Creation of value for the customers is made via:

- Creation of product which satisfied customers needs and wishes,
- Creation of communication program which transfer product's value to the customers,
- Selection of the best distribution program for product delivering to customers,
- Development of pricing program which on the one hand creates an incentive for customers to buy product, on the other hand is an incentive for company to sell this product.

The company has made expenses with realization of the first three components of the marketing mix regarding value creation for the customers. The price is the only component which created revenue for the company. As a result, the company has created revenue which is used for future value creation.

Don Sexton has examined the marketing as a management of perceived value (Trump University, 2010, p. 39).

Priority connection of marketing with the value for the customer, and in particular the perceived value of the product by the customer, requires a new look at the price as an element of the marketing mix.

There are two main pricing approaches in the marketing literature: Cost-Based Pricing and Value-Based Pricing.

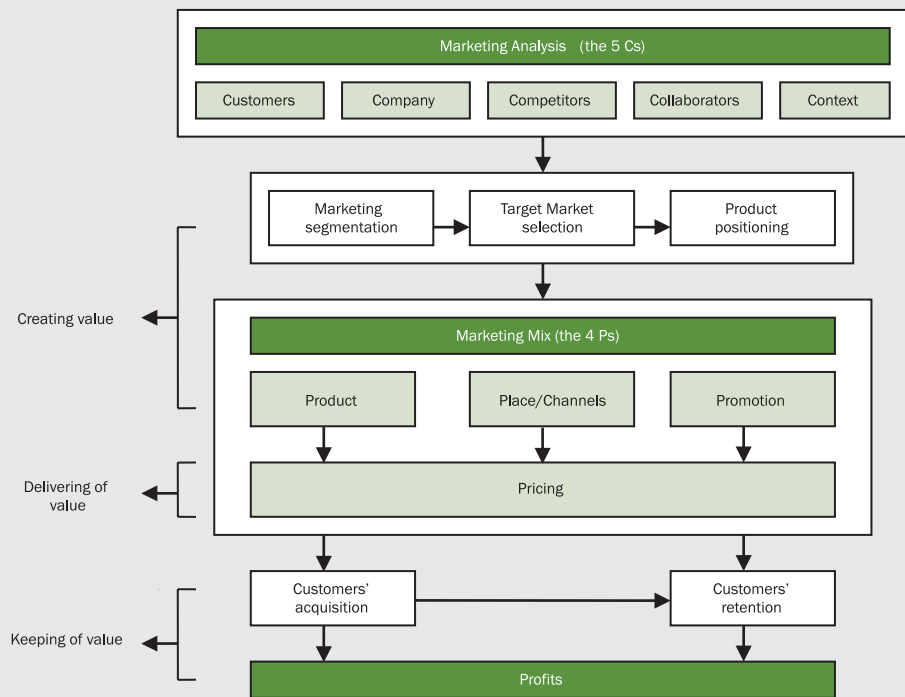
COST-BASED PRICING

Company has created good products via cost-based pricing. To the cost of production of these products add a certain amount of profit and determine the price. After that, the company has created a perception among customers that the product is worth the money and corresponds

Abstract: The main aim of the paper is to present the value-based pricing. Therefore, the comparison between two approaches of pricing is made – cost-based pricing and value-based pricing. The “Price sensitively meter” is presented. The other topic of the paper is the perceived value – meaning of the perceived value, the components of perceived value, the determination of perceived value and the increasing of perceived value. In addition, the best company strategies in matrix “value-cost” are outlined.

Keywords: value-based pricing, value for the customer, perceived value

FIGURE 1. Marketing Process



SOURCE: The diagram is adapted based on similar representations developed over the years by Harvard Business School

to customers' needs (Figure 2.1). If the price is really high, the company should decrease revenue to realize planned sales.

VALUE-BASED PRICING

The value for the customer is the main factor which defines the pricing policy. The conduct of research is recommendable to find out the main product benefits

for customers, the customers' needs and attitudes towards the price level of the product. After that, the company has made internal extrapolation and analyses to identify whether it is recommendable to offer the product and to define expected cost and revenue. (Figure 2-2).

Value based pricing is not related to the launch of the product and after the definition of the product price, the marketing specialists should conduct market analyses to define the price and after that is the

FIGURE 2.1. Cost-Based Pricing



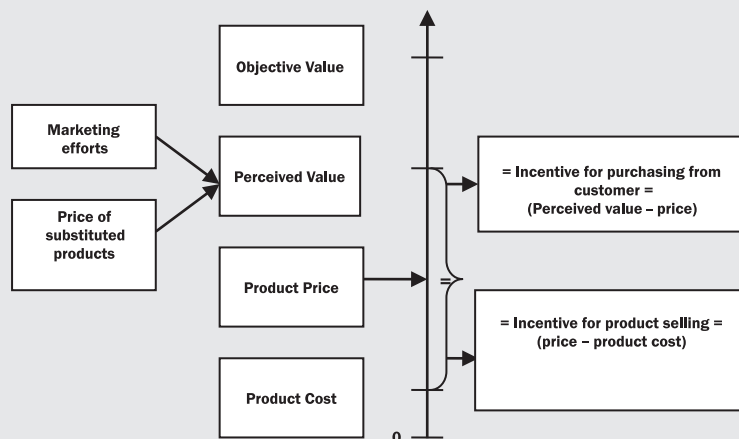
SOURCE: Nagle, T., Hogan, J., *The Strategy and Tactics of Pricing*, 4th Edition, p. 5

FIGURE 2.2. Value Based Pricing



SOURCE: Nagle T., Hogan J., *The Strategy and Tactics of Pricing*, 4th Edition, p. 5

FIGURE 3. Price sensitively meter



SOURCE: *What is marketing?* Harvard Business School Press, p. 152

product launch. The price is defined during the creation of other components of marketing.

The margin between upper limit (the value of the product for the customers) and lower limit (cost for production) is the main area for the conduct of the two type of price policies from the marketing specialists.

The „Price sensitively meter” is shown in Figure 3, where all factors which are important are included and should be taken into consideration in terms of definition for the most appropriate price level of product.

The following factors should be taken into consideration when optimal price is calculated:

- Value of the product for the customers,
- Marketing actions of the company to identify customers’ value,

- Price of the same products,
- Real Value of the product

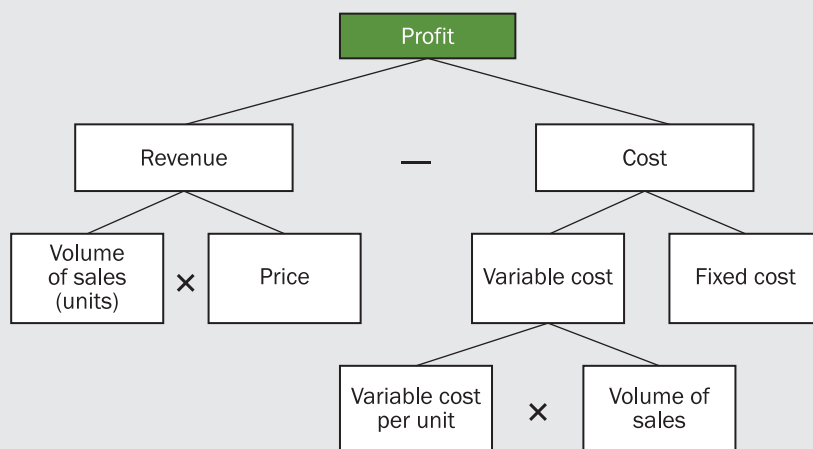
It is recommendable to make a differentiation between objective and perceived value of the product when the pricing is based on value for the customer.

Objective value for the customer is the measure of the benefits that the product provides, regardless of whether the customer is aware of them or not.

Perceived value is that the customer believes that its product provides, i.e. realized benefits. The perceived value represents the maximum price that the customer is willing to pay for the product (Dolan, R., Simon, H., 2006).

The marketing efforts should be focused on actions related to removing the gap between objective and

FIGURE 4. Factors, defining the profit



SOURCE: Dolan R., Simon, H., 1996, p. 25

perceived value of the product. Therefore, the other elements of marketing mix should be used actively – product, distribution and promotion.

The price level of competitors' products is the other component which has influence on the perceived value of the product. If the company A developed a product which has a big objective value for customers and the value is realized by the customers, they would be ready to pay a higher price for the product possession. If the company B launched the same product at a lower price, perceived value of product A would decrease to the price level of product offered by company B.

The company has found out the factors which could boost the sales of products the same as the customers have looked for real benefits from the product consumption. The company should define the appropriate price level (to cover made cost), which will give the company the opportunity to continue the sales of product and to realize profit (Figure 6).

The pricing is a compromise between how much of the difference between perceived value (ceiling price) and production costs per unit of product (floor price), the company will retain the form of margins and how will the customer in the form of incentive for making a purchase.

While the company is aware of the cost of producing the product and the prices of competitors and substitutes are in front of her eyes, then determining the perceived value is a real challenge for marketing specialists.

The perceived value should not be considered an abstract definition. The perceived value is manageable similar to the cost. The marketing specialists should make the following steps to manage the perceived value of the product: detailed examination, measuring, analyzing, evaluation of the perceived value and finding ways for added value creation.

What is necessary to be taken into consideration regarding perceived value?

1. Perceived value is not the real sales price; it is the highest price which customers are ready to pay,
2. The perceived price is the overall evaluation of the customers regarding the product,
3. The perceived value is defined by the customers' needs and wishes and the evaluation of the product based on the comparison of all competitors' products on the market,
4. The perceived value correlates with customers needs and priorities which are dynamic,
5. The perceived value could be measured ,

6. The perceived value is manageable via better knowledge and insight for customers, competition, main target groups, core target, other elements of marketing mix, etc,
7. The highest the perceived value is, the highest the sales will be, profit, cash flow of the company generated via the product.

DEFENDING THE PERCEIVED VALUE

Four components have defined the perceived value:

1. The main provided benefits,
2. The real performance of benefits in the product and the competitors' products,
3. The different benefits of the product and competitors' products perceived by the customer,
4. The importance of each of those benefits for the customer.

These components have different performance which is predefined by the type of product and profile of the customers

Perceived value could be measured via four different methodologies (Trump Unibersity, 2010, p. 40):

1. Direct customer response,
2. Indirect customer response,
3. Value-in-use,
4. Subjective estimation.

DIRECT CUSTOMER RESPONSE

In most of the cases companies have realized direct marketing research among potential customers to understand their perceptions. Direct questions are used for understanding customers' opinion related to the intention to buy the product and the price which they are willing to pay for it. Market research is the first step towards market understanding but it is recommendable to be taken into consideration that customers declare intention for product purchasing which is not related with real money spending for product.

Direct marketing research has delivered important information for the market, especially when customers have given honest answers. It is recommendable to take into account that customers have given lower price level when they are asked directly "How much are you willing to pay for the product?"

Another way to register customers' reactions toward product is the "price experiment". Instead of a

direct question for the price level of the product, different concepts for the price level of the product could be tested. As a result, different levels of sales and analysis of customer's behavior related to the perceived value of the product could be planned.

INDIRECT CUSTOMER RESPONSE

The company could use "the compromises model" for measuring the perceived value of the products. One example of the price for a room in a hotel will be used to show how the model works. (Table1)¹. The hotel managers have offered the price for one night 80 euro (without breakfast) and 90 euro (with breakfast). The managers would like to understand whether the perceived value is correlated with the hotel's popularity.

TABLE 1. Limited choice of method - an example of hotel

Ranking of the hotels	Type of hotel	With breakfast	Price for one night in euro
5	Popular	Yes	90
7	Not popular	Yes	90
6	Popular	No	90
8	Not popular	No	90
1	Popular	Yes	80
3	Not popular	Yes	80
2	Popular	No	80
4	Not popular	No	80

The customer could choose different options via ranking them regarding the following criteria: price per night, popularity of the hotel and breakfast. This is related to the decision whether a customer should make a compromise with something. To define the first choice: room with 80 euro with breakfast and popular hotel.



If the price is the most important thing, the customer should make a compromise with the breakfast or the hotel's popularity. If the customer wants the popular hotel, the compromise with breakfast or low-

er price should be made. If the free of charge breakfast is the most important thing, the customer should make a compromise with the price per night or the hotel's popularity.

The customer should make a decision for some benefits; this method is more reliable compared with the direct customer response.

VALUE-IN-USE

The "Value-in-use" approach defines product value given to customer as a difference between costs related to usage of new/company's product and old/competitor's product. It is recommendable to be used when there is one and the same perception towards products and possibility for measuring perceived value. It is not workable when the purchase intention is made based on emotional factors and perceived value is not measurable (reputation of trademark).

SUBJECTIVE ESTIMATION

The subjective estimation of the product perceived value could be used when company does not have budget for market research and special software for data analyzing.

The subjective evaluations are based on information gathered via: conversation with the customers, testing of the customers reactions towards different price levels, research of competitors' prices, analyzing of product strength and weakness compared with competitors' products, etc.

INCREASING OF PERCEIVED VALUE

There are some approaches to increase the perceived value of the product:

1. Added of benefits and their communication to the customers,
2. Added of benefits and boost customers to use them,
3. Persuade customers with the product's benefits,
4. Added services which could have influence and are important for the customer choice,
5. Improve the quality of concrete benefit,
6. Change of benefits meaning,
7. Build brand based on basic benefits;
8. Increase the positive influence of the brand

¹ The example is adapted based on Trump University, Marketing 101 How to Use the Most Powerful Ideas in Marketing to Get More Customers and Keep Them, Published by John Wiley & Sons, Inc, 2010, p. 43

FIGURE 5. Matrix „value-cost”

High		*	*
Medium			*
Low			
	High	Medium	Low

Cost

* *wining positioning*

SOURCE: A. Guide – Strategic Theme Analysis, The Arrow Group, Ltd., New York, 2008.

The main areas of company completion are based on value or cost. On the figure 12 are shown the posi-

tioning of the companies regarding their price policy in the “value-cost” matrix.

The winning strategies are situated in the top right corner

- High perceived value and low cost for production and realization,
- High perceived value and average cost for production and realization,
- Average perceived value and low cost for production and realization.

The best option is high perceived value and low cost for production and realization. This situation pre-defines the triumph over competitors in both cases: strategy of high or low prices. Small number of companies could realize at the same time high perceived value and low cost for production and realization, so that the other two strategies could be defined as successful too.

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Rezime

Određivanje cena zasnovano na vrednosti

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Osnovni cilj rada je predstavljanje metoda određivanja cena baziranog na vrednosti. U tom smislu, u radu su upoređena dva osnovna pristupa u određivanju cena – određivanje cena zasnovano na troškovima i određivanje cena zasnovano na vrednosti. U radu je predstavljena i tehnika „Price Sensitivity Meter“ za određivanje preferencija potrošača u pogledu cene. Druga tematska oblast u radu odnosi se na model percipirane vrednosti i obuhvata

određivanje pojma, konstitutivne komponente percipirane vrednosti, načine za njeno određivanje i povećanje. Dodatno su u radu prezentovane i najbolje strategije za određivanje cena na osnovu percipirane vrednosti za potrošače koje primenjuju vodeće svetske kompanije.

Ključne reči: određivanje cena zasnovano na vrednosti, vrednost za potrošača, percipirana vrednost

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