

EXIT for Success Series

Brought to you by Tom Long, Solid Oak Consulting, LLC

A BizMACH Affiliate

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POSITION FOR TRANSITION

More on Integrated Pricing Strategies

First, a review of progress on this issue thus far. We now understand that customers buy for different reasons. By assuming all customers are only interested in the lowest price, we risk making decisions that could cripple, if not destroy, the future prospects for our companies. Remember there are four buyer motivations:

- Price
- Value
- Convenience
- Relationship

Every company has a different mix of buyer-types and it is critical that we understand who buys from us and why.

Previously, we discussed substitute products and pricing strategies. Substitute products are defined as those that adversely affect sales of competing products. For example, the gas station that offers three grades of gasoline captures the "price" conscious buyers with the low end regular option, but at the expense of selling that same customer the higher margin Special or Premium blends. By offering substitute product/service options, companies are better able to segment their buyers by motivation. This critical information leads to new pricing strategy options for the "value, relationship and convenience" motivated buyers.

Complementary Product Pricing

Complementary products/services are those that benefit from the purchase of other complementary products/services. They arise for one of two reasons: (1) the products are used together in producing satisfaction (*an example might be popcorn and a movie - some people believe that popcorn increases the pleasure of the movie experience*); or (2) the products are most efficiently purchased together (*an example might be a person who travels to another supermarket to take advantage of an advertised special and purchases other items out of convenience*).

In today's marketing, many consultants are reviewing their client's product/service set to determine if either a complementary or substitute product/service strategy exists. This usually happens



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Competitive advantage is the key to revitalizing your company's growth and profitability. Call me if you'd like a free consult and to learn how BizMACH can grow your company and increase its value.

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when a company offers several products and services, but may not realize there is a correlation between or amongst them.

Remember, the goal of a sound pricing strategy is to create Competitive Advantage. True Competitive Advantage is recognized only when the results show an increased average purchase per customer or the addition or increase in revenue from a new or existing buyer segment.

In some cases it can pay to price a complementary product as a loss leader (below the actual cost) in order to attract customers to the rest of the product set. Or, you might try bundling complementary products at one price wherein the overall gross margin loss is 20% but the actual gross profit in dollars per sale is 8% higher. For example, a gas station offers \$5 off each oil change with every 20-gallon fill-up, or an office supplier offers color copiers at 10% below cost with a three-year service contract, which includes paper, ink and supplies as opposed to the original one-year contract.

Complementary pricing strategies do not necessarily have to occur at the same time. Pharmaceutical companies often sell drugs to teaching hospitals at significant discounts because the doctors that are training there will be more likely to prescribe those drugs later. Rock concerts purposely sell tickets below market to encourage attendance by those fans that are more likely to drive CD sales later. Many companies like Epson, Lexmark and HP offer low-end \$99 color printers, which is probably below the cost to manufacture them. However, the replacement ink cartridges sell for \$30 and higher and on average provide for fewer copies per cartridge. The printer is a loss leader to support high margin ink cartridges.

Changing the Buyer's Reference Point

If the goal in establishing a complementary pricing strategy is to create a competitive advantage that will result in improved bottom line results, then by differentiation at the reference point, many companies can gain advantage that catches the competition flat-footed. A buyer's reference point is the key basis of comparison amongst purchase options.

For example, in the office copier market, assume that the price of the copier is the reference point that most purchasers use when comparing options. To keep things simple, assume service contracts are similar across all competitors. Now, suppose one company creates multiple service contract alternatives enabling them to adjust the price per copier based on the service contract offered. In effect, the service contract selection governs the overall gross margin per sale. This company can now beat every competitors' price for the same copier by adjusting the service contract option. To further confuse the competition, assume this company modifies its marketing to include a "cost per copy" validation under each of its copier/contract options. While the competition is still selling on overall copier price, this company has developed a secondary reference point that validates their complementary pricing strategy and forces the competition to retreat and reset their reference points and pricing.

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Coming in the Next Issue

Growth Through
Acquisition for the
Smaller Company

Conclusion

Even the most mature industries can establish new competitive advantage through pricing strategies. It should be noted, however; that a mistake in implementation can be costly and some changes are difficult to erase. Research and proper evaluation of the results is the key.

At BizMACH, we specialize in assisting mature industry companies achieve renewed competitive advantage and increase the underlying salable value of the firm.

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