



# Prevent profits slip sliding away by mastering the science of pricing...

Do you ever wonder how much more profit you're missing out on by ignoring the science of pricing?

Lost profits is a business banana-skin to avoid.

And when you know a 1% increase in price can deliver an 11% profit improvement, it's time to check out the power of profitable pricing.

## What matters most...

Like most business owners you want to achieve three things:

1. Happy customers who come back for more and recommend others
2. Healthy business profits
3. Capital value growth for your business

The way you price your products and services has a massive impact on all three.

So you'd be passing up on three big business wins if you let these pricing insights slip away.

## Can +1% really deliver 11% profit increase?

Two studies by McKinsey & Co and A.T. Kearny (both global consulting firms) - suggest that pricing has a bigger influence over your profits than reducing costs or increasing sales volumes.

	McKinsey	Kearny
Reduce fixed costs by 1%	+2.7% profit	+1.5% profit
Increase volume by 1%	+3.7% profit	+2.5% profit
Reduce variable costs by 1%	+7.3% profit	+4.6% profit
Increase price by 1%	+11% profit	+7.1% profit



Just think - what impact could better pricing have on your bottom line profits?

## In a nutshell

Pricing is too important to ignore or treat lightly.

Build your pricing toolkit around top-down pricing options and you tap into windfall profits for your business.

## You, me, everybody, we all want to choose...

In the 17th Century, Thomas Hobson rented horses to Cambridge University students. The students were offered just one horse - take it or leave it. And so was coined the phrase 'Hobson's Choice'.

We resist 'Hobson's Choice' because of a deep-rooted psychological need we all have to feel a sense of control. 'Hobson's Choice' removes our sense of control.

Knowing this, why would you want to offer a buyer just one price?

Providing your buyers with well-thought-out pricing options puts you in successful company:

**TripAdvisor Apple EasyJet**

Even if you already use tiered pricing options, like these companies do, there's more to price options than meets the eye.

Mastering the art and science of pricing options can seriously boost your business profits.

## Here's a proven solution for your business...

Use top-down tiered pricing options and bring a barrow-load of pricing insights to radically improve your business profits.

## Compared to what?

Have you ever, after a bracing wintery run or bike ride, stepped into your shower that's set at your normal shower temperature?

It feels ridiculously hot. It's the same temperature as normal, but you're much colder, so it feels much hotter.

Humans are tuned to changes in temperature, not absolute temperature. The same can be said for assessing weights – you know which is heavier but not what it weighs.

And the same relativity applies to prices. This relativity is important.

## Comparing prices works

Ever wondered why sale prices work so well? It's not because they are cheap, but because they are cheap relative to the full price.

Offer only one price to a buyer and you make it difficult for them to assess the value, as they can't compare prices.

The thing is, they will compare prices anyway – with a competitive offer, or a previous purchase. Offer one price and you run the risk of losing out to your competition.

Provide options and you give buyers a reference point. This relative reference makes it easier for them to make a decision in your favour – you also put them in control. You win twice.

## The personal appeal of your price...

How good are you at second-guessing the price an individual buyer will pay?

Offer one price and you have one guess, one chance to get it right. Offer three prices and your odds improve, don't they?

Go to the downloadable tools and check out the Apple pricing page for the 21 inch iMac. You'll see how they provide you with three options. Check out the Apple website and see how your choices are managed all the way through to purchase.

Offering price options makes sense because different people pay different prices. Improve your odds of success by offering options. Thanks to pricing options, you win again!

## Choose your options very carefully...

Getting your price options wrong can severely reduce sales income.

For example:

What would you pay for a glass of beer? Would you go for the premium option or the standard option?

Here are the results of a test carried out by two university professors and reported in William Poundstone's landmark book on pricing (see next page).


In the first test 4 out of 5 people chose the premium beer option (at £2.50) and produced £236 for every 100 buyers.



Wheel of fortune as a pricing anchor almost always works...

		
Price	£1.80	£2.50
Buyers	20	80
<b>Sales</b>	<b>£36</b>	<b>£200</b>

3-tier pricing should help improve profitability so a third option was offered – a lower priced option:

			
Price	£1.60	£1.80	£2.50
Buyers	0	80	20
<b>Sales</b>	<b>£0</b>	<b>£144</b>	<b>£50</b>

See how the cheaper option reduces revenues by 18% to £194?

Would a more expensive 'premium plus' option work any better?

			
Price	£1.80	£2.50	£3.40
Buyers	5	85	10
<b>Sales</b>	<b>£9</b>	<b>£213</b>	<b>£34</b>

Revenues up 8% from the original 2-option offer (£236) to £255.

Getting your price options right can severely increase sales and profits.

How do you construct your tiered pricing options? NB Managing and planning numbers is what we do. So if you want to do some work on your pricing why not call us to give you a sanity check or some help?

## Mind-blowing power of pricing anchors...

Anchoring is profoundly important to pricing for profit. Here's why...

When a goose chick hatches from its egg it associates the first moving object it sees as mother goose.

Consider the chick that anchors itself to

the farmyard Land Rover (the first moving object it sees) – it's a wildlife cameraman's dream. Those close-up camera shots of flying geese on natural history TV programmes are geese flying to keep up with 'Mum' driving along at 30mph!

The same principle, **anchoring**, applies to pricing your products.

## ...try the wheel of fortune

Nobel prize winners on this subject, Tversky and Kahneman, rigged a carnival-style wheel of fortune to show only a '10' or a '65'.

Let's say you're playing and the number wheel shows up as 65.

Now answer question 1: *Do you think the percentage of African countries in the UN is above or below this number?*

Then answer question 2: *What do you think is the percentage of African countries in the UN?*

Before you read on - what's your estimate?

Tversky and Kahneman recorded the estimates of people playing this game. The average estimate of people who saw the wheel show 65 was 45%; the average estimate of subjects who saw the wheel show 10 was 25%.

These gentlemen proved that being exposed to a high number then anchors our response to the next (pricing) judgment we make.

Can you now see how important top-down pricing tiers then become? And how bottom-up pricing can undermine the prices you want buyers to pay?

Be very careful how you introduce pricing and how you want buyers anchoring themselves.

I wonder what would happen to Starbucks' profits if they adopted top-down rather than bottom-up 3-tier pricing? (you'll find an example Starbucks' price list in the download tools).

**NB** Try the ping pong game in the downloadable tools for a bit of fun with this concept and you'll prove to yourself, and the group you work with, the power of anchoring.

## TIME TO DISAGREE

**“Pricing cannot work in isolation. There’s more at play than simply adding 1% and watching profits increase.”**

Couldn’t agree more. Thomas Edison thought the same:

*“The secret of staying afloat in business is to create something people are willing to pay for.”*

Yes, you have to create your ‘something’ and you have to get people to pay, and make a profit.

But how much will they pay? Applying the science of pricing is worthy of your attention because it influences what people will pay (even if your ‘something’ stays the same).

Please don’t take our word for it - test and measure one or more of the ideas here, or ideas you’ll find in the downloadable tools from the URL link on the next page.

It pays to assume that your current pricing process could work better and deliver greater profits. So test an alternative way of pricing. When you find a pricing model that delivers greater profitability, it’s time to adopt it wholeheartedly. And then test again to find an even more profitable pricing model.

**“Being clever with pricing feels unfair on our customers!”**

You’re right to consider fairness when pricing. Violate your customers’ view of fairness and you’ll soon be fighting to stay in business.

Like Amazon fell foul of customer reaction when it was discovered they were selling

DVDs at higher prices to people living in ‘wealthier’ locations.

You manage fairness when you’re seen to deliver genuine and relevant value at the price options you offer. A hidden benefit of pricing options is the transparent fairness it gives buyers at different price points.

**“The price is the price. People will pay it or they won’t pay it, I can’t influence them.”**

The thing is, the way you present your price does influence your buyers. The earlier beer exercise and the wheel of fortune anchoring exercise prove this.

What’s certain is, if you present your price clumsily, without care, and without following the science, you will sell less. You’ll probably sell less at lower prices too. And so your profits will be much lower than they could be.

All you need to do is take the science of pricing seriously. Then take testing pricing seriously to find ways to sell more at higher prices. Like Apple do, like Starbucks do and like the airlines do.

### Tell me more

We hope you’re now inspired to dig deeper into the science of pricing.

William Poundstone has done a brilliant job of pulling together some of the best science about pricing. It’s a book every business owner and manager should read and start testing the insights.

You’ll also find some quick and easy examples, exercises and insights in the downloadable tools – simply go to the link listed on the next page.



## Use the Business Bitesize Support Tools And Resources

to help you make the most of this edition of Business Bitesize – go here: [www.businessbitesize.com/aa\\_chartered\\_accountants](http://www.businessbitesize.com/aa_chartered_accountants) to download these

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# 4 helping hands for you...

Mastering the science of pricing and applying it to your business is a source of far greater profits. McKinsey, the global consulting firm, suggest pricing has a bigger impact on your profits than anything else.

Every business owner who is serious about profit growth should be equally serious about the science of pricing.

To start with...

- 1. Collect 3-tier pricing examples**
- 2. Build a ‘pretend’ tiered pricing offer for your business**
- 3. Test and measure with real-life buyers**
- 4. Keep testing. Make price testing something your business does regularly**

## ULTIMATE ARGUMENT:

**“How do I know that using 3-tier pricing options will make my business more profit?”**

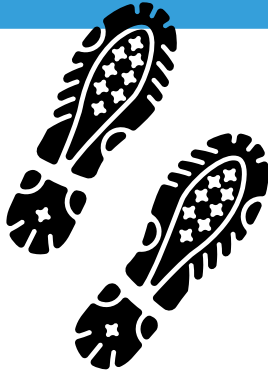
When you take pricing options seriously you’ll stutter and stall making it work. This is normal; just like learning to drive a car.

But only when you start testing customer response to different pricing options will you discover which options deliver the best profits for you and your business.

**STOP** offering one price and taking a sense of control away from your buyers.

**START** giving your buyers top-down, 3-tier pricing options, so they feel in control and are more likely to buy from you.





## Your next steps:

Most businesses manage costs carefully.

Most businesses manage sales and productivity carefully too.

Too few businesses manage pricing with enough care and attention.

Follow the readily available science of pricing and you'll steer your business towards healthier profits.

## Start by being serious about well-thought-out, top-down, pricing options:

Top-down pricing options tap into the control buyers want to feel.

Top-down pricing options apply the science of anchoring.

Top-down pricing options increase the likelihood of a buyer choosing you because they can make value comparisons.

## More tools and information for you:

As well as the four steps on this page, use the insights, stories and tools by downloading the supporting resources.

# Prevent profits slip sliding away by mastering the science of pricing...

If a 1% price increase results in a profit improvement of 11% (as a McKinsey study suggests) then it pays to know more about how to price your goods and services, don't you think?

But where to start?

### 1. Start collecting 3-tier pricing examples in your industry or related industries

You'll find several examples of pricing options being used in the downloadable tools section at the URL link below. Start collecting your own examples and learn how other businesses make the science of pricing pay off for their business.

### 2. Build a 'pretend' 3-tier pricing offer for your business

There's no harm creating one or two different pricing tiers for your business. It will prompt you to work out different ways of 'bundling' or 'scaling' your offers to reflect value across your 3 pricing tiers. Then you can...

### 3. Test and measure with real life buyers

Why not test the power of your 'pretend' tiered pricing?

Asking people 'what they'd choose if they were buying' is an academic test. Only when you ask people to choose an option in real-life will you know how well your pricing options work, and whether they're profitable for your business.

### 4. When your price testing delivers a more profitable pricing process, spread it across your business and cash in

### 5. Make testing pricing improvements something you and your business does every year or every quarter or every month!

**For ideas and inspiration on these five valuable insights and more, please visit the tools in the link below.**

**YOUR SUPPORT TOOLS ARE HERE:** Go to the link below and you'll find a selection of practical support tools to help you work out how to test and measure different pricing processes and work out which ones will increase your profits.



**Find the support tools to help you here - [www.businessbitesize.com/aa\\_chartered\\_accountants](http://www.businessbitesize.com/aa_chartered_accountants)**

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