 Keys to Smart Profit Growth: Treat Your Online Strategy as a Balancing Act, Not a Pricing Play
by Susan Lee and Fan Oswald-Chen

Where Should the Pricing Function Report Into?
by Stephan Liozu

Decoy Pricing
by Anirban Sengupta
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   Faster, more accessible internet and mobile shopping capabilities are forcing retailers and suppliers to expand from traditional brick-and-mortar locations by adding online shopping channels. Retailers and suppliers who remain too closely tied to the traditional world risk responding too slowly or too simplistically to online trends. Those who embrace the online world too quickly risk alienating consumers who are not ready to adopt new practices. The transition requires balance, as this article explains.

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   In this article, the author explores the concept of Decoy Pricing, a method of pricing where the seller offers at least three products, and where two of them have a similar or equal price. This strategy makes people compare the options with similar prices, and as a result sales of the most attractive choice will increase. The author uses examples from Apple, LinkedIn, *The Economist* and other industry examples to demonstrate the effectiveness of this tactic.
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High-speed internet connections and mobile devices make it easier than ever for consumers to purchase goods and services quickly and conveniently. These tremendous opportunities have begun to change how consumers make judgments about value and price when they decide whether to buy online or in a store.

Retailers and suppliers who remain too closely tied to the traditional bricks-and-mortar world risk responding too slowly or too simplistically to these trends. Retailers and suppliers who embrace the online world too quickly risk alienating consumers who are not ready to adopt new practices and keep up with the trends. This begs a vitally important question: what do consumers themselves really want?

This paper combines recent experience with fresh insights from a survey of over 1,000 consumers in order to answer that question. It will describe how overall value in choosing a channel (offline vs. online) is a balance among convenience, information, and price. Your success in this emerging “multichannel” world depends on how well you understand that balance and use it to your advantage.

Pricing strategies for online business have seemed to share one central assumption since the dawn of the internet age: prices online should be lower than prices you see in stores, or at worst equal to them. This assumption rests on the belief that an online business should have lower costs. An online business does not require a fancy storefront on expensive real estate, nor does it require a sales team. Lower costs should mean lower prices for consumers, right?

The flaw in this assumption, however, is that it ignores value and gives too much weight to cost alone. Buying a product online can offer consumers big advantages over buying the same product in a bricks-and-mortar store. Consumers can enjoy 24/7 availability, a wider selection, the convenience of ordering from anywhere, and the time savings because you don’t need to walk or drive to a bricks-and-mortar store, browse it on foot, wait to see if they have your model or size, and then wait in line to check out.

Taking these valuable advantages together, you could make the argument that some products should be more expensive online than in stores.

Over the last year, the pricing community has surveyed consumers, retailers, and suppliers to understand what they think about price and value, and how aligned those views are. Recently, a comprehensive survey of over 1,000 US consumers was conducted to understand – in greater depth – why they go online, why they still shop in stores, what could lure them back to stores, and how that differs across 13 popular categories. These categories ranged from the vanguard categories of e-commerce (books, music/entertainment, and consumer electronics) to core staple products such as health and beauty, laundry and cleaning products, and food.

The study revealed that consumers’ decision-making on where to shop has a level of sophistication and nuance that renders a “price price price” strategy simplistic at best, and dangerous and destructive at worst. Digging deeper into the minds of consumers, the analysis and interpretation of the survey data led to six provocative insights which hold true for most or all of the categories examined. They should help retailers and suppliers start to understand how to achieve balance across convenience, information, and price when they develop their online strategies, especially if they still have a legacy business in bricks-and-mortar.

- “Convenience” motivates online shoppers just as much as “lower prices” do
- The more consumers shop online, the less price sensitive they become
- Habit and immediacy are food and grocery’s biggest lines of defense against a consumer shift to e-commerce
- Suppliers should capitalize on the unlimited online “shelf space” to sell niche products that appeal to smaller consumer segments
• Lower prices won’t bring people back into traditional stores
• “Showrooming” is a legitimate risk to retailers, who should respond with better service, not with aggressive discounts

These insights have profound implications for retailers, suppliers, and even for investors, who need to decide which business models to back. In this paper, we have decided to focus on how managers at consumer packaged goods (CPG) companies can benefit from this fresh “voice of the consumer” research.

CPG managers should keep these six insights in mind when they develop their pack-price and channel strategies, especially when they need to weigh opportunities to work more closely with online retailers and integrate them into their overall go-to-market strategy.

As we elaborate on each insight, we will rely on data from just four of the categories examined in the study with consumers: health and beauty; hobbies (toys and sporting goods); consumer electronics; and clothing. The insights will help provide not only CPG managers, but managers in general, with more confidence and leverage as they negotiate the terms and conditions.

**Insight #1: “Convenience” motivates online shoppers just as much as “lower prices” do**

Obviously price plays a factor in almost all shopping decisions, and yes, sometimes it plays the decisive role. But when is pricing — especially lower prices — the best solution to win over more consumers and achieve your financial and commercial goals? Survey data shows that even if price helps explain why they go online, factors such as convenience (24/7 shopping, better selection, a pleasant and simple shopping experience) keep them coming back again and again rather than making a trip to the bricks-and-mortar store.

When asked why they plan to increase their online purchasing in the next 12 months, buyers of consumer electronics cited lower prices (64% of respondents), 24/7 shopping (61%), and an enjoyable shopping experience (57%) as the their top three motivations. The more telling fact, however, lies in the flipside of those data. Over one third of people who buy consumer electronics online — and who furthermore plan to buy even more over the next 12 months — did not cite lower prices as one of their primary motivations, even when they saw the option explicitly listed in the survey and knew they could provide one or more answers.

Against that backdrop, it seems unwise to place a huge bet on price cuts, whether outright or in the guise of a “price-matching” program, under which a retailer promises to match a competitor’s lower price if the consumer brings it to their attention. The challenge for a retailer is to rethink the role of the store and its inherent advantages to capture a consumer’s attention and close a sale. Keeping everything constant and slashing prices to make yourself appear to be a more attractive destination is not a recipe for success. The demise of the German home improvement chain Praktiker — famous for its “20% off of everything in the store” discount programs — demonstrates this clearly. Praktiker filed for bankruptcy in July 2013.

**Insight #2: The more consumers shop online, the less price sensitive they become**

Consumers see so many diverse advantages in shopping online that we wonder why retailers and their suppliers emphasize price as much as they do. Giving price too much weight in the balance of convenience, information, and price will drain extra dollars out of the product category with lower prices. This is especially damaging when the majority of the most active online shoppers are not looking for them.

In other words, the more consumers shop online, the less emphasis they place on “lower prices” in their decision-making.

We grouped the respondents into three segments according to how often and how intensively they shop online, regardless of the category. This “high-medium-low” split yielded additional insights which challenge the simplistic belief that “lower prices” is the key to success in online retail.

As mentioned above, when asked why they plan to increase their buying of consumer electronics products online, some 64% of respondents cited “lower prices” as a key motivation. But if we look at the heaviest online shoppers, the percentage of respondents drops to 59% and leaves pricing fourth on their list of factors, behind the online shopping experience (66%), 24/7 shopping (63%) and free shipping (61%).

Survey data shows that even if price helps explain why they go online, factors such as convenience (24/7 shopping, better selection, a pleasant and simple shopping experience) keep them coming back again and again rather than making a trip to the bricks-and-mortar store.

These differences may seem slight in consumer electronics. But they are more pronounced in other categories, even in a vanguard category such as books.

When the survey posed the same questions to consumers who plan to buy more clothing online in the next 12 months, we saw an even sharper pattern. Overall, 24/7 shopping was the main motivation (68% of respondents), followed by lower prices at 55%. But if we focus just on the heaviest online shoppers, “lower prices” drops to 6th place on their list, ranking behind 24/7 shopping and several convenience factors such as better shopping experience, better selection, and the fact that the site “remembers” the consumer. For the health and beauty category, “lower prices” ranked 9th among the top motivations behind why the heaviest online shoppers plan to buy more online in the next 12 months.

Against these data — which come directly from consumers them-
It seems that the purchase of staple products has become a health-and-beauty products online. The reason that a large segment of consumers buy these staple products — food, laundry and cleaning products, and health and beauty products — in bricks-and-mortar stores is that they have always bought them in bricks-and-mortar stores. Each category is part of the regular shopping trip, and collectively they form the raison d'être for a regular shopping trip.

Of those four staple categories, health and beauty is the one most actively purchased online, by far. The appeal of lower prices online clearly played a role in consumers’ decision to start buying this category online, but it was neither the primary factor nor the reason they keep buying online.

When asked why they plan to increase their buying in a certain category in the coming 12 months, the power of “better selection” as a motivator remained robust. At least 40% of all respondents cited it as a motivating factor in buying more clothing, toys and sporting goods, with “better selection” the third most important motivation.

The reason why e-commerce offers “better selection” is obvious. In theory, shelf space is unlimited in the online world, but it remains a scarce and highly-sought-after resource in traditional stores. This offers managers an opportunity to take advantage of their segmentations and adjust their portfolio assortments and pricing to serve smaller segments better and also bring niche products to market when their velocity or volume might not warrant a precious slot on the shelf of a traditional store.

The challenge for managers arises, however, when we weigh the data above against consumers’ answers to the question of what would bring them back to traditional stores. For the four categories we are highlighting in this summary, “better selection” was among the top three factors cited by respondents in all cases, and it was the number one factor for buyers of clothing and toys and sporting goods.

This makes finding the optimal portfolio assortment and pricing across all channels a tougher balancing act. Online retailers also want popular or more mainstream products, too, and not tale of two segments. The consumers who still buy in stores cite habit and immediacy as their two biggest drivers. Some 49% of respondents who buy in stores said they do so because it is part of their regular shopping trip, while 40% of respondents like being able to get the product immediately.

We conclude that those two factors will make migration of staple products to the world of e-commerce will be slow and tricky. First, a large number of people still have the traditional shopping trip as an ingrained habit. Second, the effort to get a consumer to abandon that habit and buy online will become harder and harder with every incremental consumer. Why? The traditional stores have a full arsenal of tactics to help them fight back successfully, or at least keep the trip habit attractive. These include coupons as well as a pleasant all-around shopping experience. Even the social aspects of going to the store remain important to roughly 20% of buyers of various staple categories.

Insight #4: Suppliers should capitalize on the unlimited online “shelf space” to sell products that appeal to smaller consumer segments

The ability to obtain a “better selection” clearly motivates consumers to go online. It is an even stronger motivator in their decisions to increase their online purchasing.

When asked why they plan to increase their buying in a certain category online, buyers of health and beauty products cited 24/7 shopping and lower prices equally strongly (17% of respondents), with better product selection ranking third at 13%. The same pattern held true for buyers of clothing and buyers for toys and sporting goods, with “better selection” the third most important motivation.

The ability to obtain a “better selection” clearly motivates consumers to go online. It is an even stronger motivator in their decisions to increase their online purchasing.

When asked why they plan to increase their buying in a certain category in the coming 12 months, the power of “better selection” as a motivator remained robust. At least 40% of all respondents cited it as a motivating factor in buying more clothing, toys and sporting goods, and consumer electronics, and “better selection” was tied with “lower prices” (each at 47%) for buyers of health and beauty products.

The reason why e-commerce offers “better selection” is obvious. In theory, shelf space is unlimited in the online world, but it remains a scarce and highly-sought-after resource in traditional stores. This offers managers an opportunity to take advantage of their segmentations and adjust their portfolio assortments and pricing to serve smaller segments better and also bring niche products to market when their velocity or volume might not warrant a precious slot on the shelf of a traditional store.

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This makes finding the optimal portfolio assortment and pricing across all channels a tougher balancing act. Online retailers also want popular or more mainstream products, too, and not
just the specialty ones aimed at the smaller segments. A CPG manager faces a risk of intensified channel conflicts if he or she improves the online assortment at the expense of what is available in the traditional store. Ideally, we recommend that managers strive for online and in-store portfolio assortments online that are complementary.

That requires an even deeper understanding of shopper behavior in the individual channels for your category. That understanding was always important; now it is critical to finding the right assortment and pricing. The growth of online retail means that a supplier can now use pack-size, price, and other instruments to tailor their offerings even more sharply to reach segments both large and small, while mitigating the risk of channel conflict. This is especially true in categories such as health and beauty and toys and sporting goods, where the breadth and depth of brands, variants, and bundles is much greater than in the staple categories.

**Insight #5: Lower prices won’t bring people back into traditional stores**

We, the authors, have traditionally argued vigorously against price cuts which don’t have a proven, achievable, and sustainable upside or which create the risk of a price war. We’ve based this stance on a variety of arguments, ranging from the theoretical to the long-term strategic to the purely financial. This study added one more key pillar to the point of view: lower prices in most categories will not entice consumers to return to traditional stores, once they have begun shopping online regularly.

This is especially true for categories such as consumer electronics and toys and sports equipment. When offered a scenario in which a traditional store offered prices on consumer electronics that were lower than online prices, only a mere 9% of respondents who buy that category online frequently said that incentive would get them to buy in a bricks-and-mortar store again. For toys and sports equipment, the figure was just 11%. For clothing, the figure was 16%.

When we look at the most active online shoppers, we can almost declare “game over” on the idea of lower prices in consumer electronics and hobbies. The percentage of respondents who would see lower prices as something that would lure them back to a traditional store was 7% for consumer electronics and 6% for toys and sports goods.

This indicates that buyers of consumer electronics and other categories abandon stores for a variety of reasons. Price is important, but it is not the whole story.

Gift cards, coupons, and other incentives are more effective than lower prices in keeping people in stores. We suspect that gift cards work because they serve as a restricted form of currency. The consumer has money to spend, but no longer have a say in where they spend it.

**Insights #6: “Showrooming” is a legitimate risk to retailers, who should respond with better service, not with aggressive discounts**

High involvement categories such as consumer electronics, clothing, and to a lesser degree furniture are indeed susceptible to “showrooming,” which means consumers use the traditional stores to gather information and narrow their choice set, then make their actual purchases online.

Several questions in the study touched on this tendency, including directly-stated choices on where consumers would shop for a new product, the degree to which they need help from a “live” sales associate, and the degree to which they need to see, touch, feel, or test the product before purchasing it. The higher the scores across all three categories, the greater we feel the tendency is for consumers to “showroom” that category.

In addition to segmenting the respondents by online shopping activity (high/medium/low), we also grouped them into three categories based on their choice of channel to buy a new product: those committed to doing their research and making their purchase in a store; those committed to doing their research and making their purchase online; and those who are undecided.

These “undecided” consumers are the current battleground for traditional and online retailers. They have yet to “vote” on a channel. Both types of retailers have a chance to sway them.

Based on the survey responses, it appears that the majority of those undecided consumers plan to showroom in some form, either by doing their research or confirming their choice in a store, but then making the actual purchase online. This phenomenon held true – with a few exceptions – for the most active online shoppers as well as the least active ones. It was most pronounced in the hobby category (toys and sporting goods). Between 70% and 78% of “undecided” respondents expressed the intent to showroom the category (depending on their general online shopping frequency).

We can appreciate the strong temptation to cut prices or “price match” in such a situation. But in light of the other four key insights from our study, we would ask retailers and especially their suppliers to take a step back and weigh that decision against the other motivations and habits that consumers expressed in our study.

In some cases, a more aggressive push into e-commerce makes sense. In others, patterns in consumer behavior call for caution and prudence. In either case, we warn against placing too much emphasis on having lower prices online.
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Where Should the Pricing Function Report Into?

In this article, the author examines common questions that arise for pricers around reporting lines and which department pricing should report to. He also explains how, as the pricing function gains success and credibility within an organization, reporting lines gradually become irrelevant. Author Stephan Liozu, Ph.D., CPP, (www.stephanliozu.com) is the Founder of Value Innoruption Advisors and specializes in disruptive approaches in innovation and value management. He earned a PhD in Management from Case Western Reserve University and can be reached at sliozu@case.edu. He conducts numerous pricing research studies both independently and in partnership with Professional Pricing Society.

Some questions about pricing never go away. One very good question is: “Where should the pricing function report into?” Although not much has been written about the subject in either academic or practitioners’ papers historically, recently, Tim Smith wrote a very interesting piece on who should control pricing in an organization.1 Granted, control of pricing and pricing reporting lines are quite different topics but Tim made some very important points. I encourage you to read his position paper published in the September 2013 issue of Pricing Advisor.

I am writing this short essay to shed some light on the reporting question and to, hopefully, generate some exciting exchanges during pricing meetings and conference discussions.

Trends in Reporting Lines
Every year, Professional Pricing Society conducts a year-end survey. In this survey, they gather over 1000 responses from pricing professionals related to salary levels, promotion and advancement, and their reporting line in their organization. Looking at the results of the past four surveys, and over time, reporting trends for the pricing function emerged.

Here is what we can conclude from the trending information:

1. Marketing and finance are the most common reporting lines for pricing with over 50% of the responses. This is not surprising considering the pricing maturity of PPS members and supporters.

Figure 1: Pricing Reporting Line 2009 - 2013 (PPS Year-End Survey)
2. Marketing and product development also represent 41% of the reporting lines in 2013 supporting that pricing is an integral part of the marketing construct. Let me say it loud and clear: pricing is part of the marketing construct.

3. The share of pricing teams reporting to senior management is slowly shrinking from 25% in 2009 to 18% in 2013. Perhaps, as pricing becomes more accepted in organizations, there is less of a need to make it report to senior management. Chances are that smaller organizations might have more of a need to report to top managers.

4. Surprisingly enough, pricing does not seem to report much into the Information Technology function (IT). When it is the case, pricing becomes a support function for pricing technologies being deployed to optimize pricing decisions.

5. Over the past five years, the proportion of pricing professionals reporting into sales has remained stable at 12%. I might argue that all participating enterprises might have a dedicated pricing team which generally will not report into the “evil empire.” I conjecture that, if we conducted a survey among firms with no formal dedicated pricing teams, the pricing responsibility would most likely fall under sales or sales leadership (to be confirmed).

It Depends

The fact of the matter is that they is no clear answer to this very existential question. My position is that there are no right or wrong answers. The best answer is “it depends.” It depends on a multiple of factors including but not limited to the following ones:

Your current organizational architecture for pricing-related activities: If business and financial analysis teams currently report to the finance organization, it might be hard to move the pricing reporting line away from finance. The reality is that, if you are assembling a new pricing organization, you might have to leave the accountability and responsibility where it currently is. Pricing responsibility might be fragmented but someone is currently conducting some form of analytics and “controlling” on pricing decisions.

Your pricing maturity level: In some firms, pricing might exist as a discipline but not yet as a function. In firms with greater pricing maturity, the reporting line might fall under marketing, finance, and business analysis/analytics. That makes a lot of sense. If your firm moves from a decentralized to a center-led organizational design for pricing, the pricing team will most likely report into a process function such as marketing or commercial excellence. My recommendation at the beginning of the pricing journey is to embed the pricing team with a respected and powerful team. If pricing is a brand new discipline to an organization, it will already face enough headwinds both internally and externally. Do not add additional complexity.

Your organizational culture: Culture might be the greatest influencer of where pricing reports into. If your firm has a strong cost or manufacturing culture, I would recommend that pricing report into finance. On the contrary, if your culture is customer-focused and market-based, then pricing should report into marketing or sales operations. Remember what Peter Drucker famously said: “culture eats strategy for breakfast.” My recommendation is to gauge the primary orientation of your culture (cost, competition or customer) and to match the reporting lines to this orientation.

The importance of pricing in the strategic agenda: When a firm’s strategic agenda includes pricing as a core priority, chances are the reporting line will be very close to the C-suite and will most likely be into finance or marketing. When this happens, it immediately raises the visibility of the pricing function and the performance expectations. I recently conducted a change management workshop and one of the participants reported directly the CEO. That change occurred after the CEO got frustrated with the lack of progress with pricing programs. There are pluses and minuses to this and we will discuss them later in the paper.

The background and emphasis of top leaders: You might be surprised but the background and emphasis of your top leaders, including your CEO, will influence reporting lines. A CEO coming from manufacturing or finance will place pricing under finance, IT or Six Sigma for example. A CEO who moved up the ranks of marketing or sales will integrate the pricing function within the commercial or marketing organization. So ask the right question about the background of your top leaders and what they pay attention to. When the CEO changes, so does his or her emphasis. That might trigger a change of reporting lines.

Who runs the show in your organization? That is another crucial question. In any organization, there are formal power lines and informal ones. A C-suite is a very political environment where top guns lobby for power and influence. It is important to find out who has the ears of the CEO. Who calls the shots and makes things happen. That will influence the reporting lines as well. So if your organization is finance-dominated because the heir-apparent is the CFO, then pricing should report into finance. Things will get done there. If sales calls the shots in the C-suite, having pricing in the marketing organization might be a waste of time.

So you get my point. All of these factors influence the reporting line of the pricing function. That is why there is no right or wrong answer to the reporting line question. This is also why there are no silver bullets. In addition, reporting lines will change over time. Organizational design change on a regular basis based on strategic moves, with new leaders coming in and others leaving the organization, and with new businesses entering the portfolio. The pricing team might be reporting into the marketing organization today and then moving into a process role a couple of years later. Things are dynamic and fluid in the field of pricing. That is why I highly recommend that pricing professionals learn about the science of change management so that they can better navigate the power dynamics of their organization.

Pros and Cons of Reporting Lines

In case you are asked the question internally (where the pricing team should report into?), I propose pros and cons of the most common reporting lines for pricing: marketing, finance, sales, IT, and CEO/top management. I recognize that I am missing the analysis for the product development function but I am taking the position that product development can be considered a marketing function.

Reporting into marketing offers a lot of pros. The biggest one be-
Cons

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ing the access to market information to feed into the price setting process. Since pricing is part of the marketing construct through the 4P’s, it is also more logical to include pricing strategies in the overall marketing strategies.

However, very often the marketing function might only include packaging and marketing communications. Also the marketing function might be viewed as lacking analytical capabilities or as being too qualitative in nature.

Reporting within the finance organization offers real advantage to pricing professionals. They are embedded in a powerful and well respected organization and have access to all financial information. The fit with the analytical requirements is great. On the other hand, working within finance might strongly influence the type of pricing strategies that are selected for the business and might lead to pricing being considered as a tactical function.

In my experience when pricing reports into the sales organization, it might be perceived as too biased towards customers. Additionally, most sales leaders have not received advanced pricing training which might limit the development of the organization’s pricing capabilities. But working within sales accelerates the pricing decision-making process thus creating competitive advantage. The sales team is close to the market and able to give quick feedback on pricing strategies and tactics. In some industries, speed is essential.

Most pricing teams reporting into the IT organizations tend to be focused on deploying and supporting advanced pricing systems and analytical tools. Pricing strategies are rarely designed and executed within the IT organization. So the pricing team might be separated between an IT pricing team and an operational pricing team with separate reporting lines. One of the key reasons for this is that the IT function is far removed from business operations and have very little knowledge about customer activities and market segments.

Finally reporting into the office of the CEO or another top executive might strongly increase the visibility of the pricing function especially when pricing is a strategic priority. Things might get done faster and resources might be allocated with greater urgency. The pricing team might also be able to pull support from the CEO to accelerate some of the most difficult change management activities. But reporting to the top might create some tensions with the rest of the organization especially with teams that are most impacted with the pricing changes.

The most dangerous reaction might be a general passive aggressiveness within teams and a need for compliance because of the specific reporting lines and not because people are sold on the project. The pricing team might also suffer from the style of the CEO or top leader they report into. A top executive with micro-managing tendencies might greatly complicate pricing projects and might introduce additional workload that brings little value to the organization. So reporting to the top leader might work for a while but I generally do not recommend it.

Figure 3

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<tr>
<td>Closeness to the market for more dynamic pricing</td>
<td>Often not represented in the C-suite as a dedicated function</td>
</tr>
<tr>
<td>Speed of response to competitive pricing moves</td>
<td>High level of fragmentation in the organization</td>
</tr>
<tr>
<td>Access to customer knowledge, data, and pricing history</td>
<td>Lack of overall knowledge &amp; capabilities in pricing</td>
</tr>
<tr>
<td>Ownership of pricing would facilitate required changes</td>
<td>Often resistant to progressive value &amp; pricing changes</td>
</tr>
<tr>
<td>Greater adaptability to regional cultural differences in pricing</td>
<td>Tactical/clerical approach to pricing limits strategic pricing</td>
</tr>
<tr>
<td>IT</td>
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<tr>
<td>High ownership of the data &amp; pricing systems</td>
<td>Lack of overall knowledge &amp; capabilities in pricing</td>
</tr>
<tr>
<td>Ability to customize pricing solutions to support business operations</td>
<td>Very little knowledge about customer &amp; commercial process</td>
</tr>
<tr>
<td>Experience in designing &amp; deploying technology solutions</td>
<td>Often not represented in the C-suite as a dedicated function</td>
</tr>
<tr>
<td>Technical &amp; analytical skills in pricing systems</td>
<td>Often works in silo &amp; too process oriented</td>
</tr>
<tr>
<td>Excellent relationship with pricing vendors</td>
<td>Distance from key business decision-makers in the organization</td>
</tr>
<tr>
<td>CEO/President</td>
<td></td>
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<tr>
<td>High visibility of the pricing function</td>
<td>Limited amount of attention received due to time constraints</td>
</tr>
<tr>
<td>Pricing becomes a priority for the organization</td>
<td>Pricing projects might get done for compliance only</td>
</tr>
<tr>
<td>CEO championing of pricing accelerates organizational change</td>
<td>Political tensions leading to non transparent pricing actions</td>
</tr>
<tr>
<td>Greater strategic approach to pricing &amp; value management</td>
<td>Confusion in the C-suite about who owns the pricing function</td>
</tr>
<tr>
<td>Strong message sent to the market about the importance of pricing</td>
<td>Background &amp; style of the CEO might influence outcome</td>
</tr>
</tbody>
</table>
What Matters in the End?
Because “it depends” is not the answer everyone likes to hear, my recommendation is to choose between marketing or finance. These are the best choices and they are supported by the PPS year-end surveys. Reporting lines do matter, as you have read earlier, as they might shape the types of strategies that are deployed, the access to resources and power, and the respect the pricing team might receive from the rest of the organization. Reporting lines matter at the beginning of the pricing journey when pricing professionals are establishing their presence and credibility. They matter from a change management perspective to get projects launched and put quickly on the right track. However, once the pricing journey and the related programs are well on their way and pricing teams have demonstrated their value, reporting lines start to matter less. And that is a good position to be in.

What really matters in the end are the following organizational factors:

1. **Culture**: Can the pricing team shape the pricing culture of an entire organization regardless of where it reports into? Establishing a strong pricing culture with a corporate culture is the end game for a pricing team. At that point, pricing is accepted as a discipline, respected as a function, and adopted as both an art and a science. The main purpose of this position paper is to shed some light on the question of the reporting of the pricing team. When pricing folks ask me that question, I usually try to probe what is behind the question. Is it a lack of respect or credibility? Is it that they are facing a change in reporting lines in their business? Is it insecurity or lack of conviction to convince their superior that pricing is what they should invest into? For all of us, the question of reporting lines is an important one. But I conjecture that once a pricing team is established with a track record of success, it should not matter. I would argue that pricing professionals should focus more time and attention on measuring and tracking their impact and selling internally their contribution to the business. With success comes credibility and stature in the organization. Reporting lines then become irrelevant.

2. **Coalition**: As change agents, can pricing professionals bring together a powerful coalition of business professionals to deploy pricing projects and make the necessary pricing changes internally and externally? With the hard-earned respect from the organization, pricing teams can demonstrate the power of cross-functional team work to reach consensus on strategic pricing decisions. Established pricing teams can build a coalition of the willing whether they report here or there. The greater the credibility of your pricing organization, the more irrelevant the discussion of reporting lines becomes. So if, as a well-established pricing team, you are involved in reporting line discussion, you might have to ask yourself existential questions: Did we achieve our commitment? Are you bringing the right level of value to the organization? Are we credible as a team vis-à-vis other functions?

3. **Collaboration**: In a culture of collaboration, reporting lines and silos disappear. Then it really does not matter where pricing reports into. Collaboration and alignment are critical conditions for the success of a pricing transformations. Without both, progress is not made and full success is not reached. Best-in-class organizations understand this concept and set up cross-functional pricing councils to manage pricing activities collaboratively.

4. **Communication**: With a strong coalition and a culture of collaboration, the communication of relevant information to make the right pricing decision is fluid and unbiased. The information entering the organization through many touch points are quickly communicated to the right pricing experts. Sales, marketing, and finance teams share cost, competitive and customer-related information to increase pricing success.

5. **Credibility**: With track record of success, pricing teams earn credibility within their organizations. Then the pricing function finds its natural place in the organization. Success erases barriers, doubts and resistance to change. The greater the credibility of your pricing organization, the more irrelevant the discussion of reporting lines becomes. What Matters in the End?

References

Choosing the right partner is the elementary key to success.

Pricing power can increase ROS by 2 to 4 pts. Yet it remains an elusive goal for the majority of companies. Simon-Kucher has the insights, experience and approaches to help you take the mystery out of pricing. Even the greatest minds need a partner at their side.

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For a free chapter
In this article, the author explores the concept of Decoy Pricing, a method of pricing where the seller offers at least three products, and where two of them have a similar or equal price. This strategy makes people compare the options with similar prices, and as a result sales of the most attractive choice will increase. The author uses examples from Apple, LinkedIn, *The Economist* and other industry examples to demonstrate the effectiveness of this tactic. Anirban Sengupta works as a pricing manager at Cypress Semiconductor. He holds a BE in Electrical Engineering from National Institute of Technology, India and an MBA in Marketing from Symbiosis Centre for Management and Human Resource Development (SCMHRD), Pune, India. He can be reached at gupt@cypress.com.

About a month back a colleague of mine called for some advice. He was planning to buy LinkedIn’s Job Seeker service and wanted my help in choosing a plan. Even though I regularly use LinkedIn for networking purposes, I had never before looked at the premium package plans. As I began studying the different options, I suddenly felt that there was a peculiarity. I kept the page open, gazing at the ticks and numbers, but somehow what I saw didn’t leave me comfortable (see figure 1).

As a pricing guy, I always thought the customer who buys more gets a better price (per unit), or, at worst, expects the same value. In this case that very premise seemed contradicted. The guy who chose the “Job Seeker” plan paid INR400 more than the guy who chose “Job Seeker Basic” plan and in exchange got 5 “InMail Messages”. In other words, this guy paid INR80 for every InMail Message (per month). Is that expensive or is it a good deal? It was difficult to evaluate. Then I looked at the “Job Seeker Plus” offer. This plan offered 5 more InMail Messages (for a total of 10), and charged the user INR2,400. This implied that for the five additional messages the user effectively paid INR200 per message. What is LinkedIn up to? Why is the guy who is paying the most (INR2400 for Job Seeker Plus) being charged the most per message (INR140 per message if I took the “Job Seeker Basic” as a reference)?

At first I thought in terms of the value of an InMail Message. Are five InMail Messages a month not enough to land a new job? Does research show that on average a candidate needs to send eight such messages to get a job through LinkedIn? Somehow none of these thought trains made sense beyond a point. I kept wondering whether it was impossible to land a job through LinkedIn.
The storage memory type in iPhone is Flash. The average memory prices by density as per Digikey are as follows in figure 3.

<table>
<thead>
<tr>
<th>Row Labels</th>
<th>Average of Unit Price (USD)</th>
<th>Count on Digi-Key Part Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>16G (1G x 16)</td>
<td>$21.31</td>
<td>8</td>
</tr>
<tr>
<td>16G (2G x 8)</td>
<td>$18.63</td>
<td>91</td>
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<td>32G (4G x 8)</td>
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<td>78</td>
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<td>66</td>
</tr>
<tr>
<td>Grand Total</td>
<td>$33.99</td>
<td>243</td>
</tr>
</tbody>
</table>

So the cost of migrating from 16GB to 32GB is $15, while the cost of migrating from 32GB to 64GB is $23. In both cases the customer pays $100 more. Please note the prices considered are for unit buy. For production buy (given iPhone volumes) the cost/unit would be at most one tenth that of the prices shown above. Thus the cost difference between 16GB and 64GB is not expected to be more than $3.8. The price difference is $200. So it’s evident why it makes sense for Apple to sell more of 64GB phones while cannibalizing 16GB sales.

In the case of LinkedIn the cost difference would be even more miniscule (if even non-zero). I decided to wind up my research by running an experiment myself. The experiment was simple. I created the following Facebook post:

(A social experiment) Given a choice which option would you buy?

Outside the laboratory, in the big bad real world, LinkedIn was doing exactly the same thing to my friend (and many other social job seekers). Of course they are not alone. Apple is doing the same in their own way (see figure 2).

The snapshot from the iPhone 5S page demonstrates how the price changes for the three models. The models differ on only one parameter: storage memory.

For 16GB to 32GB the price goes up by $100. In other words, Apple is charging $6.25 per extra GB. From 16GB to 64GB the price goes up by $200. In other words Apple is charging $4.17 per extra GB. Not to mention for migrating your buying decision from 32GB to 64GB you are paying $3.13 per GB. From 16GB to 64GB the price goes up by $100. In other words Apple is charging $6.25 per extra GB.

To understand how the price changes for the three models.

Dan Ariely, in his book *Predictably Irrational: The Hidden Forces That Shape Our Decisions*, first brought the Decoy effect in pricing to public attention. In the book he mentions the case of The Economist. The magazine created the following offers for student subscribers:

**Option A** – A subscription to the online version of their magazine for $59 a year.

**Option B** – A subscription to the print version of their magazine for $125 a year (without access to the online version).

**Option C** – A subscription to both the online version and the print version for $125 a year.

100 students were provided the offer and asked which option they would choose. The survey findings showed that 84% of the students went for option C while 16% of the students went for option A. Of course nobody chose option B!

However a control experiment was done whereby the students were provided only 2 options: A and C. The control experiment result showed that 68% students went for option A and 32% went for Option C.

I am not mentioning here what advice I ended up giving my friend. What goes without mentioning however is the fact that I kept studying the “LinkedIn strategy” for quite some time thereafter. That was when I was hit upon by one of the most beautifully imperfect pricing strategies: decoy pricing. In fact I felt slightly embarrassed by the fact that despite being in the profession of pricing, I had never known about this strategy before.

I was not using the in-mail services! I felt it was not. However my friend needed advice and needed it quickly. “Go for Job-seeker,” seemed the most politically correct answer. That way he would not have to pinch his pocket too much by buying the overpriced in-mail facility (that’s how I classified the Job-seeker plus plan) and at the same time he wasn’t running the risk of not choosing in-mail service at all. But the question remained – was in-mail required at all?

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The snapshot from the iPhone 5S page demonstrates how the price changes for the three models. The models differ on only one parameter: storage memory.
1. Unlimited kebab platter -> Rs.500 ($8)
2. Unlimited kebab platter + 2 drinks (vodka-based cocktail OR virgin mojito) -> Rs. 1000 ($16)
3. Unlimited kebab platter + 3 drinks (vodka-based cocktail OR virgin mojito) -> Rs. 1500 ($24)

Rules
Just state your choice (e.g. #3) as the comment. No further explanation required.

I then posted the same on various Facebook groups that I am a member of. In some groups I posted only option 1 and 2.

The results were as follows in figure 4.

<table>
<thead>
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<th>Figure 4</th>
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<tr>
<td>Response</td>
</tr>
<tr>
<td>1</td>
</tr>
<tr>
<td>2</td>
</tr>
<tr>
<td>3</td>
</tr>
<tr>
<td>TOTAL</td>
</tr>
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It was evident that Option 3 (the imperfect one) caused a shift of response from 1 to 2.

The pricing strategies of Apple and LinkedIn explain how decoy pricing leads to a customer upgrading on choice. Next, we will examine how as a seller one can take advantage of the decoy effect to book more profit.

To begin with we have to understand that any customer is likely to “fall for” a decoy if at the time of buy he is executing a mental trade-off. The root cause of the trade-off is economic—he is exchanging money for a product and/or a service. He understands that to garner more benefits he has to pay more. At the same time he also understands that he has a limit with respect to budget. Thus begins the trade-off: Which features do I choose to maximize the benefits at the minimum price?

To initiate trade-off thinking, the seller needs to offer multiple immediate choices. Just like The Economist does. The snapshot from the India subscription page of The Economist puts the user face to face with the following two choices in figure 5.

The subscriber begins to decide which offer suits him better: the print or the digital. He must be going through multiple trains of thought but is unlikely to be thinking about the price, since both the offers cost the same and he knows that he is going to pay INR80.

Now let’s take a look at the rest of the page (see figure 6).

All of a sudden the previous two offers begin to look expensive in the face of the third choice. Let’s explore why. Individually the print subscription and the digital subscription have their own set of benefits and limitations. However, if purchased together, the customer doesn’t need to do any trade-off. Since individually each cost INR 80, a customer is likely to justify that to avoid trade-offs she must shell out INR160. Then comes the third offer: buy both at INR 96. This third offer is likely to get interpreted as a discount of INR 54 and hence appreciated as the best value offer. If the same appreciation leads to a sale (of the combo package) then the seller emerges victorious, as he has made the customer pay more than what was budgeted!

Another point to be noted here: an additional digital subscriber doesn’t add on to any variable cost to the company. Thus effectively INR 16 is additional profit.

On the other hand, if the offer were INR 96 for two print subscriptions, then it would not be a profit initiative but instead a desperate discounting tactic to pull up the top line (a print edition has substantial variable cost).

Even in the case of LinkedIn and Apple explained, the additional features cost the sellers little or nothing more.

Hence the first major target a of decoy pricing strategy: earning more without spending more.
To achieve the same the following steps are advisable:

1. Identify the features that your product is offering.
2. List out the features that can be fluctuated without change in variable cost.
3. Create multiple offerings based on fluctuations of the features to build your portfolio.
4. Plant the decoy.

From my understanding I would classify price decoys in the following categories:


A similar strategy can be adopted by phone makers and other electronics firms to sell insurance deals:

- Price of Phone = $200
- Price of Insurance = $20
- Price of Phone + Insurance = $205

The customer is likely to consider the third offer as a “good deal.” In the absence of the third choice to buy or not to buy, insurance would be the question in his mind.

2. Stepwise: We saw this in the case of the iPhone. The variable feature was the storage memory. The customer paid less per unit of memory if she bought the more expensive phone. Increasing storage memory in the phones did not cost Apple much, and hence the profit on 64GB phone is higher than the profit on 16GB phone.

A recapitulation of the price list:

- 16GB – $199
- 32GB -$299
- 64GB – $399

Here the 16GB price was in fact the planted decoy to make the customer migrate to 32GB or 64GB. There was no trade-off ruled out in this case, however the customer was upgraded to the “next step.”

A similar strategy can be adopted by most web-based applications and services. LinkedIn is doing it already with respect to the “job-seeker” accounts. It’s time for the dating and matrimony sites to take the same route. Most dating and matrimony sites segment membership plans, member-ship plans based on number of made connections.

An example is shown in figure 7.

We could plant here a decoy in the name of “Plan C.” Let’s consider two possibilities for Plan C (see figure 8).

If Plan C1 is published then it is likely to push prospects to Plan A. Between Plan A and Plan C1 the connections increase by 5, but the cost goes up by $10. Plan A appears more reasonable in comparison to Plan C1. In this case Plan B would not be a part of the consideration.

If Plan C2 is published, there is high probability that Plan B would be chosen for the same reason as explained above. Thus from profit point of view it makes more sense to launch Plan C2.

Going back to the basics: The decoy mimics one of the plans and highlights that plan as a better choice.

Apart from segmentation there is another important factor that determines whether a decoy pricing strategy is feasible: can the buyer negotiate with the pricer? If yes, most likely decoy pricing is a no-go.

In the B2B environment, in most cases the purchaser can influence the pricing by negotiating directly with the supplier. Hence it is unlikely that decoy pricing (or in fact any form of psychological pricing) will work.

However, an exception to this would be with respect to web pricing. When a buyer is buying components through the web without any contact with the supplier’s sales personnel, the buying pattern is similar to that in a B2C environment. Thus when it comes to selling B2B products via the web, there is a scope of innovation with respect to pricing. A proposal would be to experiment with different volume break web prices (see figure 9).

Decoy pricing as a strategy could be explored to increase revenue through web sales in the B2B environment.