Strategic Pricing – a Part of Company’s Strategy

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Abstract: In our days few managers think strategically about pricing, and few companies proactively manage their business to create the condition that foster more profitable pricing. Sometimes pricing decisions are made without reference to the company’s broad strategic choices – whom to target, what offer, through which distribution channel, based on what competitive position.

This paper focuses on price as an important strategic tool for companies, revealing the practical conditions for strategic pricing, and bring the discussion forward between tactical and strategic pricing. Furthermore the article will focus on price as a part of the company strategy.

Keywords: strategic pricing, proactive pricings

1 Introduction

Pricing is one of the key elements of marketing, although it is only a part of the marketing-mix it is critical in achieving desired outcomes and specific marketing objectives [1]. Pricing helps to differentiate in the marketplace and obtain customer satisfaction. Furthermore, is the most important communication tool for a product addressed to the audience, the customer.

In practice pricing has multiple levels of implementation. At the highest level is strategic pricing, which takes into account long-term profit objectives of the organization. The next layer is tactical pricing, which optimizes price, taking into account short-term market dynamics, including demand shifts and competitive effects. The lowest layer is execution level, where stock dynamics and inventory and supply management have there well defined role [2].

Nowadays the need to focus on pricing as a strategy based on the overall company strategy is going to become more acute in companies life. Nonetheless, most of the companies never adopt strategic pricing because it requires leadership, interdisciplinary skills and the execution of strategic decisions.
But, companies that price by instinct are more likely than ever to fall behind competitors, no matter how good their products and services are [3].

Adopted correctly pricing can become a powerful strategic tool if it is understood in the context of the company or the product market environment. In order to achieve specific goals, such as maximizing sales and profit or driving penetration an entering company in a new market needs to behave differently than a new company entering an already existing market or an existing company entering existing market. Not giving enough attention to understand this dynamic seriously limits the options available to companies and undermines the ability to use pricing as a strategic tool.

1.1 Strategic Pricing versus Reactive Pricing

‘Pricing is a bit like the weather. People complain about it, they worry about it, and in the end, they feel there is not much they can do about it [4].’ But, unlike the weather pricing can be controlled, can be manage to become an efficient tool in companies hand.

Approaching pricing from a reactive point of view is meaning that pricing decisions are made in reaction to a pricing problem, whereas proactive pricing is planned to exploit an opportunity. In the first case the company analyses the immediate impact of decisions on profitability, in the second case also considers how the reaction of customers or competitors might change the picture. The difference between the two pricing methods is the difference between reacting to market conditions, and proactively managing them1.

First of all strategic pricing requires the management of the company to take responsibility for establishing a coherent set of pricing policies and procedures, consistent with its strategic goals for the company [5]. Only after reasonable pricing objectives are developed and made an objective of business strategy it is possible to select target markets, create product and service bundles, develop promotional messages that communicate value, and design price structures that will maximize customer’s willingness to pay.

Whereas, price setting is one tactical decision in sales effort, the day-to-day management of pricing strategy is the coordination of multiple activities to achieve a common objective. While strategic pricing decisions can lead to long term competitive advantage, tactical pricing often yields bigger and an immediate pay-off, it is the guerilla maneuvering to achieve the day’s victory.

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Tactical pricing can be very helpful for a company in his daily decision making process, it will help to:

- shift the mix of orders toward more profitable products
- reduce the amount of money left on the table in winning situations
- gain share by selectively cutting price with specific customers
- doing so will not lead to a price war.
- appear to exert upward pressure on industry prices in order to misdirect and confuse competitors.

On the other hand tactical pricing requires close attention to three key elements: price level, timing, and method of communication. Determining the price level, gives a clear understanding to companies where they stand not just in relation with competitors, but also in relation with customer’s price sensitivity and price visibility. Timing price changes can also be as important for companies as the changes themselves. A simple tactic of lagging competitors in announcing price increases can produce the perception of the company among customers of being the most customer-responsive.

The method of communication of price increases or price decreases has a high importance, regarding the fact that price reduction that are widely announced can produce a competitive downward price spiral.

Successful pricing depends on much more than simply selecting the right price level, it means that the process for setting price levels must also be proactive. If managers think about pricing only when they must set a price, they can control only the price level. If they are concerning about capturing value as the primary objective, they can expand their ability to set prices profitably by controlling much more than the price level [6].

Pricing strategically involves managing customer’s expectations to induce them to pay for the value they receive, pricing strategy involves managing everything that raises willingness to pay closer to the value received [7].

Pricing must occur in the context of a pricing process that is proactive in order to optimize long-term profitability. Proactive pricing strategy must be a part of a marketing strategy that is value-based. A long-term competitive positioning that is profit driven, rather then driven by sales or market share, must guide the value based marketing strategy. Figure 1 illustrates the multiple levels of pricing strategy, where success within each circle is limited by the successful execution of the ones surrounding it.

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2 Robert A. Garda: Tactical Pricing, Global Marketing, 1992, number 3, p. 3
1.1.1 Practical Conditions for Strategic Pricing

For most companies strategic pricing requires more than a change in attitude, it requires a change in when, how and who makes pricing decisions. For instance strategic pricing requires anticipating price levels before beginning product development.

Perhaps most important, strategic pricing requires a new relationship between marketing and finance. Strategic pricing should be the interface between those two sciences. It involves finding a balance between the customer’s desire to obtain good value and the firm’s need to cover costs and earn profit. Furthermore, has to be the coordination of interrelated marketing, competitive and financial decisions to set prices profitably. Regrettably, the pricing policy at most companies is characterized more by conflicts than by balance between those subjects.

We can fairly ask then: who owns pricing? Sales? Marketing department? Product Management? Finance? All of them have an opinion and all only see one piece of the puzzle. After all, someone needs to own the value and pricing functions someone who can be held accountable for creating and capturing value across the entire range of customers. If we consider how much executive attention the cost accounting and purchasing functions receive in most organizations, with the appearance of a new title, chief purchasing officer shouldn’t the pricing function get the same level of executive commitment, attention and resources as a function designed to control cost? – raise the questions Ronald J. Baker [8].

In order to set prices profitably and to reflect value to the customer prices must be set by those best able to anticipate that value, probably marketing and sales managers. However, their effort will not generate sustainable profit unless constrained by appropriate financial objectives. Financial managers instead of attempting to cover costs they must learn how costs change with changes in sales and must use the knowledge to develop appropriate incentives and constraints for marketing and sales to achieve their objective successfully.

Another approach to strategic pricing is that the company pricing strategy should be seen in relation to developments in the company variables, internal ones (capital strength, competencies, organizational conditions, efficiency of the work force) as well as external ones (customers, competitors, the technological development). Torben Hansen proposes that a company external and internal variables and the pricing strategy should be analyzed based on four approaches. These four approaches we can see in the table below:

| Table 1 |
| A general framework for systematic strategic pricing⁴ |

<table>
<thead>
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<th>Consequences of a chosen company price strategy</th>
<th>Changes in internal variables</th>
<th>Changes in external variables</th>
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<td>Type I analysis</td>
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In type I analysis, changes in the company’s internal variables are viewed as a consequence of the pricing strategy, e.g. changes in the company’s capital resulting from a low pricing strategy. In type two, changes in the company’s external variables are viewed as a consequence of the pricing strategy; competitors may initiate extensive price reductions as a reaction to a company’s low pricing strategy. With type one and two analysis, the company’s choice of pricing strategy is thus viewed as cause and the influence on the internal and external variables as

effect. In contrast in type three and four analysis, possible changes in the internal and external variables are viewed as cause and the consequences for the company’s choice of pricing strategy as effect. A type three analysis could provide the result that new company competencies have effected a technological leap, which enables the company to improve the durability of its products. If customers emphasize durability, this could result in the company changing a chosen low pricing strategy [9].

J. D. Richards, John Reynolds and Matt Hammerstein have defined the organizational conditions for developing an integrated strategic pricing capability which will yield dramatic improvements in financial as well as organizational performance. First of all companies have to gain talent through training programs to broaden and deepen technical pricing expertise and knowledge of company overall strategy. The next step should be the so called strategic management process, to be formed a new pricing management team who would report to the executive committee, and take the responsibility for debating alternative pricing strategies, ensuring the decisions are consistent with the company’s strategy. The following element of the mode, roles and decision rights consists of the assumed responsibility of the formed pricing management team over decision rights on pricing, rather than leaving pricing decisions to individuals much lower in organization, overdelegating decisions regarding prices.

Abdicating responsibility for pricing to the sales or to the distribution channel for instance it means giving up the responsibility for the strategic direction of the whole company.

Information and technology – should be very carefully selected, companies need timely, dynamic decision support information, combined with a deep understanding of customer attitude and behavior. The revenue optimization systems which are adapted from earlier systems developed for airline and hotel industries are not capable to replace management judgment and therefore should not be the sole basis for decision, they can help only with tactical, short term decisions. Last but not least companies need a change in their mindset and culture. A core group of managers with the expertise needed to develop pricing decisions that would be grounded in not only the company’s own economics, but also competitor and market realities.

The adoption of this model will generate new behaviors in the company life:

- pricing will be based on strategic intent, not on profit targets
- prices will be set proactively not reactively
- pricing changes will be agreed quickly and based on an evolving fact base
- pricing decisions will be consequential and transparent, inducing a virtuous circle of performance [10].
Conclusions

In organizations pricing is one of the most complex strategic activities. Pricing strategy involves establishing cross-functional objectives and synergistic goals to create an organization that can profitably produce and capture value. Nowadays for many companies, pricing is still a collection of short term activities rather than a business discipline and an embedded core competency.

Despite of his advantages tactical pricing must not dominate companies overall pricing strategy, there have to be room for the future perspective, for long-term profitability, namely for strategic pricing.

And when it is adopted strategic pricing should not be about shifting authority, rather about providing an efficient robust process and methodology that helps the company to understand and articulate the components necessary for strategic pricing decisions integrated in the company’s overall strategic goal.

References


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5 J. D. Richards, John Reynolds, Matt Hammerstein: The Neglected Art of Strategic Pricing: Lessons From Retail Banking, Marakon Associates, p. 3


