

PRICING ON PURPOSE

A helpful guide to aligning pricing strategies
to long-term organizational vision and goals



The price is right... or is it?

If God has gifted us with a special skill and we use that skill to earn a profit, we should embrace it as living *for* God, not as competing *with* God. How we earn that profit determines whether it is God-honoring, self-serving, or ill-advised.

Pricing of products and services can dramatically impact the bottom line in any organization, of any size, and in any industry. It is a defining factor for our businesses' overall viability and capacity to serve people well. We all want to realize our full potential for competitive differentiation and profitability. But a one-size-fits-all approach to pricing fails to exert critical thinking or create a high-performing business. As leaders, we spend time developing and investing in our long-term organizational goals; achieving them requires aligning our pricing strategies with those visions.

The Price We Pay

As Christian capitalists interested in building a well-served customer base, we remember that God’s Word is clear that we are to use honest weights, measures, and scales in our pricing strategies (Prov. 11:1, 16:8, 16:11, 20:23).¹ The Bible has much to say on business, transactions, profit, and earnings!

New Testament scholar Wayne Grudem suggests that profit results from providing something useful for others. Such profit should reflect the value of our time, skill, and risk.²

In our attempts to love God and pursue profit, we should consider these factors:



CONSCIENCE

Given our added value, is what we are charging fair for our customers and us?

INDUSTRY

Have we justified our actions to support an industry-accepted practice?

HONESTY

Which factors are we conveniently ignoring?

CUSTOMER CIRCUMSTANCES

What customer factors should affect what we charge?³

1 “Love of God vs. the Pursuit of Profit,” in Just Decisions (n.p.: Theology of Work), accessed June 2018, <https://www.theologyofwork.org/book/just-decisions/part-two-7-dilemmas-christians-face-at-work/chapter-6-love-of-god-vs.-the-pursuit-of-profit>.

2 Grudem’s biblical argument is based on Gen.1:28, the parable of the talents in Matt. 25:14-30, and the parable of the minas in Luke 19:13.

3 “Love of God vs. the Pursuit of Profit”

But Money is the Root of All Evil, Right?

“No one can serve two masters, for either he will hate the one and love the other, or he will be devoted to the one and despise the other. You cannot serve God and money.”

Matthew 6:24

As Christians in business seeking to “serve only one master,” many times we inappropriately apply Jesus’s warning on the idolatry of money to our business operations. This can skew our perception of business profitability. Fear of idolizing money can tempt us to let our prices fall to the market’s lowest level. Ironically, neglect of pricing excellence could actually be considered sinful mismanagement. However, a diligent and strategic approach to pricing is obedient and pleasing to the Lord.

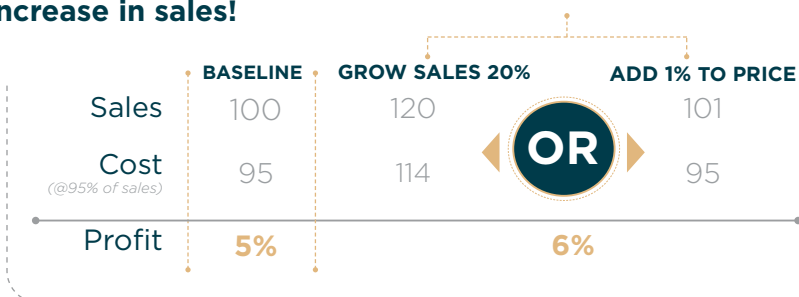
Smarter, Not Harder

While some of us may fear making incremental price adjustments, the sales and margin growth with even small adjustments can yield surprising results.

In fact, for a typical business currently generating 5% net pretax profit on sales, a price increase of 1% produces the same profit impact as a 20% increase in sales!

In this scenario, every 1% price increase drops straight to the bottom line as net profit.

YOU CAN EITHER



Right Side Up

When evaluating our capacity for some loss while right-sizing our pricing, the Pricing Elasticity Table below demonstrates the percentage drop in sales that can be sustained to maintain the same gross profit after a price increase.

EXAMPLE:

If a company budgets off of a **20% profit margin** and **they raise their prices by 10%**, they could lose a third of their sales and still maintain the same profit margin!



TARGET GROSS MARGIN

%	10	15	20	25	30	35	40	45	50	55	60
2	16.7%	11.8%	9.1%	7.4%	6.3%	5.4%	4.8%	4.3%	3.8%	3.5%	3.2%
3	23.1%	16.7%	13.0%	10.7%	9.1%	7.9%	7.0%	6.3%	5.7%	5.2%	4.8%
4	28.6%	21.1%	16.7%	13.8%	11.8%	10.3%	9.1%	8.2%	7.4%	6.8%	6.3%
5	33.3%	25.0%	20.0%	16.7%	14.3%	12.5%	11.1%	10.0%	9.1%	8.3%	7.7%
8	44.4%	34.8%	28.6%	24.2%	21.1%	18.6%	16.7%	15.1%	13.8%	12.7%	11.8%
10	50.0%	40.0%	33.3%	28.6%	25.0%	22.2%	20.0%	18.2%	16.7%	15.4%	14.3%
15	60.0%	50.0%	42.9%	37.5%	33.3%	30.0%	27.3%	25.0%	32.1%	21.4%	20.0%
20	66.7%	57.1%	50.0%	44.4%	40.0%	36.4%	33.3%	30.8%	28.6%	26.7%	25.0%
25	71.4%	62.5%	55.6%	50.0%	45.5%	41.7%	38.5%	35.7%	33.3%	31.3%	29.4%
30	75.0%	66.7%	60.0%	54.5%	50.0%	46.2%	42.9%	40.0%	37.5%	35.3%	33.3%

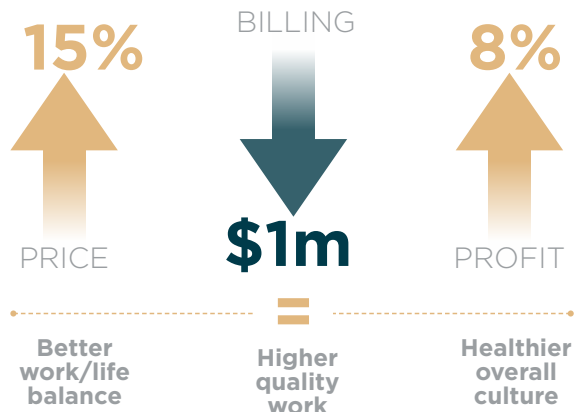
PRICE INCREASE

C12 Member Case Study: Crafting a New Model

Frank is a true craftsman in the custom kitchen and bath trade. Customers loved the projects his company designed, produced, and installed. They reflected a level of personalized design, quality, and care that exceeded customer expectations, but they were priced at rates similar to those of other contractors who lacked such distinctive performance. Although the company scaled with the production and delivery of several simultaneous projects, the company's profitability was modest. And with no upfront cost for sharing his expertise, Frank even sometimes lost contracts while his designs were executed by less capable contractors. Frank knew his approach of bidding jobs based on simply marking up labor and materials was no longer effective. Unfortunately, by only reacting to prevailing street pricing and terms, Frank had allowed other builders and homeowners to define his business model. **He had built himself a job instead of a sustainable company that could afford to reinvest in serving his clients with the excellence he desired.**

Considering his unique capability, Frank radically revised his pricing approach to reclaim his market position. He announced he would design for an upfront fee, which he would reimburse to customers that awarded his company the entire project. Frank recognized that some customers wanted a custom kitchen and bath design, while others simply wanted factory-made cabinets delivered and installed. He raised his prices 15% to eliminate the distraction of commodity work.

Over a six-month period



Understanding Pricing Dynamics

Too many companies establish prices by default, using historical habits, cost-plus formulas, industry practices, loose delegation, competitive situations, and customer requests. A recent survey of 1,700 companies⁴ by Bain & Company shows that large capability gaps exist in price structure, sales incentives, use of tools and tracking, and structuring cross-functional pricing teams. **Top performers were identified by increased market share, positive pricing decisions, and regular price increases. They exceeded their peers in three capabilities:**

PERCENTAGE OF RESPONDENTS WHO 'STRONGLY AGREE' OR 'AGREE'

THE BEST

The rest

Our pricing strategy maximizes returns at customer and product levels

76%

41%

Our incentives encourage prudent pricing

80%

42%

Our sales force has the right tools and data

77%

40%

*Among the companies that excel in all three areas, 78% are considered top performers. **Would your business fall among the “best” or the “rest”?***

The Most Important Part of Price is the Value

A customer's experience with us generally involves **three dimensions:**



Most customers aren't price-sensitive as much as they are value-conscious. When asked about the notion that “price rules the world,” Procter & Gamble CEO Alan George Lafley responded, “It's value that rules the world....”

⁴Ron Kermisch and David Burns, “Is Pricing Killing Your Profits?” Bain & Company, June 7, 2018, <https://www.bain.com/insights/is-pricing-killing-your-profits>.

... There's an awful lot of evidence across an awful lot of categories that consumers will pay more for better design, better performance, better value, and better experiences."⁵

Providing a product or service of great value requires a great investment. The price a customer is willing to pay is always a reflection of the perceived value of the product or service in the customer's eyes. This principle, also referred to as "willingness to pay," is not objective, but subjective, based on "value drivers" and "purchase factors" that are not all equally important.

Setting a value-based price requires understanding our customers' value drivers. Taking the time to engage and profile our customers helps us understand their expectations and justify a healthy price for our products or services.



"The bitterness of poor quality remains long after the sweetness of low price is forgotten."

- BENJAMIN FRANKLIN

Quantifying the intangibles of the customer's total experience—all the service, support, interactions, and communications involved in an offering—is much harder than making an offering faster, cheaper, or more durable. But if we adopt modern survey techniques and statistical analysis to quantify these elements, we can learn what customers truly value and which aspects of an offering merit investment.

Value and price will always have an interesting reciprocal relationship. Identifying our target customers' value drivers and setting corresponding prices unlocks opportunities for us to offer even greater value to our customers and our employees. Remember, the three drivers behind a successful pricing strategy are: **create value, quantify that value, and communicate that value** to customers.

Intelligently applying these principles and practices will open doors for new business and increase our average pricing and profitability.

Harvard Business School's B2B model of the **Elements of Value Pyramid**⁶ organizes 40 distinct kinds of value (motivations for buying and using products and services) that B2B offerings provide customers. The most objective value is at the base of the five-level pyramid. Value subjectiveness increases as you go up the diagram.

INSPIRATIONAL VALUE

PURPOSE



Vision



Hope



Social responsibility

INDIVIDUAL VALUE

CAREER



Network expansion



Marketability



Reputational assurance

PERSONAL



Design & aesthetics



Growth & development



Reduced anxiety



Fun & perks

EASE OF DOING BUSINESS VALUE

PRODUCTIVITY



Time savings



Reduced effort

ACCESS



Availability

RELATIONSHIP



Responsiveness



Expertise



Decreased hassles



Information



Transparency



Variety



Commitment



Stability



Cultural fit



Organization



Simplification



Connection



Integration



Configurability



Risk reduction



Reach



Flexibility



Component Quality

OPERATIONAL

STRATEGIC

FUNCTIONAL VALUE

ECONOMIC



Improved top line



Cost reduction



Product quality

PERFORMANCE



Scalability



Innovation

TABLE STAKES



Meeting specifications



Acceptable price



Regulatory compliance



Ethical standards

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FROM "THE B2B ELEMENTS OF VALUE," BY ERIC ALMQUIST ET AL., MARCH-APRIL 2018

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⁶ Eric Almquist, Jamie Cleghorn, Lori Sherer, "The B2B Elements of Value," *Harvard Business Journal*, March–April (2018): 72-81. Note: Table stakes were not included in the analysis, because they are prerequisites for being in business, not areas for differentiation.

More Value, Greater Loyalty, Better Prices

Excelling at multiple elements of value strongly correlates with higher customer loyalty. In fact, they have a nearly one-to-one statistical relationship. Product quality, expertise, and responsiveness emerged as the elements with the strongest impact on customer loyalty, while cost reduction ranked only 27th!⁷ Understanding the specific drivers in our respective markets is only the first step in the process of achieving value-based pricing.

The 5 C's of Value:⁸



Comprehend value to customers

(i.e., understand segment-based value drivers)



Create value for customers

(i.e., create/deliver segment-based value solutions)



Communicate the value you create

(i.e., tell them up front and reinforce it later)



Convince target customers to pay for value

(must profile/know your customers to do this)



Capture value for customers

(with strategic and disciplined pricing based on value, not cost)

If we can't communicate our value, our teams can't maximize it and capture it with our prices. By ignoring what drives customer value, we give the customer the upper hand in negotiations, resulting in lower pricing and profits.

⁷ Ibid.

⁸ Adapted from T.T. Nagle and J.E. Hogan, *The Strategy and Tactics of Pricing*, 4th ed. (Upper Saddle River: Pearson-Prentice Hall, 2006).

Pricing the value we offer can be determined by the following formula:

$$\text{reference value} + \text{differentiation value} = \text{VALUE}$$

Reference value is determined by the closest perceived alternatives (our own products or services, direct competitors, indirect competitors, and delayed decisions). **Differentiation value** is the value of your product's attributes that exceed the reference value, taking into consideration competitive offerings, the actual worth of our unique benefits, and the costs of customers switching.⁹

Make a Move

If you want to make a shift to value based pricing, refer to this helpful flowchart as you and your team discuss implementation.

Moving from Cost-Plus to Value-Based Pricing

Basic Cost-Plus Pricing

- Improve quality of costing data
- Use incremental costing in pricing decisions
- Target % margin instead of % markup
- Use price to control utilization of bottlenecked resources

Better Market-Driven Pricing

- Base prices on:
 - Qualitative indicators of value
 - Competitor price levels
- Adjust cost multipliers based on perceived value
- Use out-of-pocket to define low end of price range

Pricing to Value

- Must understand offering cost and revenue impacts for the customer
- Capitalize on differentiation relative to the competition
- Own fair market share

Price Setting Process

Preliminary Segment Pricing

Set baseline prices based on value assessment and strategic objectives.

KEY QUESTIONS:

- ? *How much of the differential value should be captured for each segment?*
- ? *How should I anticipate and consider competitor response to potential prices?*
- ? *How should I adjust segment prices to account for different price sensitivities among segments?*

Optimization

Refine preliminary prices with iterative process, balancing trade-offs between price, cost, and market response.

KEY QUESTIONS:

- ? *What tradeoffs should I make between long-term strategic objectives and short-term market responses to price changes?*
- ? *What types of analytical techniques are best suited to my product and market conditions?*
- ? *How can I estimate customer response to potential price changes?*

Implementation

Set final prices and ensure acceptance among customers and the organization through effective change management approach.

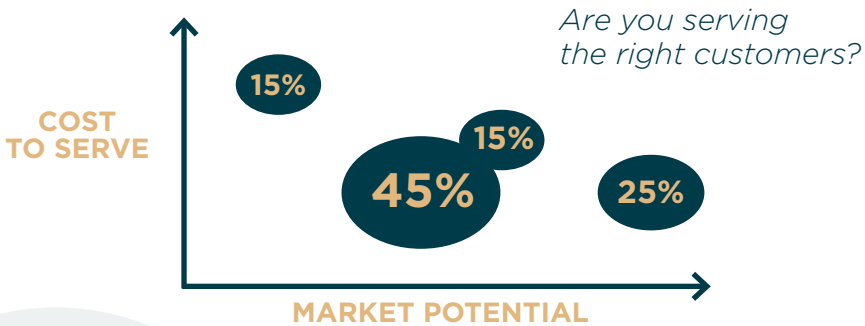
KEY QUESTIONS:

- ? *How do I get sales force to buy in to the new prices and empower them to execute effectively?*
- ? *What's the best approach for communicating price changes to customers?*
- ? *What's the best approach for raising prices on undervalued products?*

⁹Phil Montgomery, "Economic Value to the Customer (EVC) Determines Price," LinkedIn.com, July 5, 2014, <https://www.linkedin.com/pulse/20140705191201-1315848-economic-value-to-the-customer-etc-determines-price/>.

Remember: Not All Customers Are Created Equal

While the concept of offering different pricing for different customers may upend historically fundamental beliefs, it introduces a profitable strategy known as “customer centrality.” When we are expected to develop a long-range plan for generating profitable revenue growth, based on a unique brand, we can proportionally invest in our customers with the most potential value. Customer centrality identifies customers who matter most and dedicates disproportionate amounts of resources to understand what those customers want.¹⁰ Focusing on our customers as individuals enables us to serve them as they want to be served.



“Not all customers deserve your company’s best efforts. And despite what that tired old adage says, the customer is most definitely not always right. Because in the world of customer centrality, there are good customers... and then there is everybody else.”¹¹

- PETER FADER

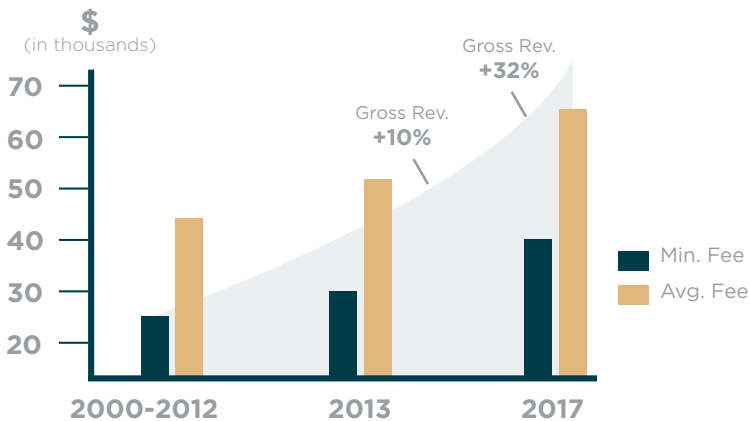
¹⁰ Peter Fader, *Customer Centrality: Focus on the Right Customers for Strategic Advantage* (Philadelphia: Wharton Digital Press, 2011).

¹¹ Ibid.

C12 Member Case Study: The Right Margin Fuels Mission!

In 2016, Steve Hayes, senior partner at The Human Capital Group, was facing the tension of restructuring the strategy of his executive search firm while still honoring its mission “to serve one another through love.” In their first 12 years of business, the group’s minimum fee was very low compared to that of their competitors. They raised their minimum fee for the first time in 2013, which reflected positively in their average fee. Even so, the company was losing money on lower-level searches, which earned low to no margin. With the risk of offending or losing existing and prospective customers that he wanted to serve, Steve was hesitant to commit to another increase to their minimum fee. But with his C12 group walking alongside him through this tough decision, Steve realized that margin fuels mission and overcame his fear. The company committed to a dramatic increase to their minimum fee, which in turn increased the threshold of their target customer.

Although Steve lost a handful of customers, he embraced the blessed assurance from Job 1:21, “The Lord gave, and the Lord has taken away; blessed be the name of the Lord.” Steve’s stewardship was met by new and more profitable customers: **“I had to learn to say ‘no’ to the good, so I could say ‘yes’ to the great!”** Steve’s team is now confidently pursuing work with target customers and producing 30% higher return for the same amount of work. His team is no longer hindered by pridefully thinking they could serve everyone or fear they might lose some revenue streams. Serving fewer customers at a higher price point has provided the opportunity for greater focus and quality.



The Art of Pricing

It takes creativity and commitment to clearly define, communicate, and price multiple offerings instead of adopting a single-price approach. However, there are many mutually advantageous opportunities for extending price differentials to particular consumers. Depending on the product or service you offer, you can be strategic with how you apply customization based on different dimensions. **Here are some examples:**

Discounts:



BUNDLING

selling the main product or service at a discount with an attractive add-on at a higher margin

VOLUME

leveraging costs per transaction (e.g., sales and overhead)

FREQUENT BUYERS/PARTNERS

setting up repeat customers for easy ordering/payment/service

PAYMENT TERM INCENTIVES

(e.g., upfront payment or multiple installments)

CLASS

(e.g., seniors, students, first-time buyers, widows)

DISCOUNTED/EXCESS INVENTORY ITEMS

(e.g., seasonal promotions, prior models)

Buyer Preferences:



DELIVERY

(e.g., web purchase/dropship vs. showroom consultation/premium delivery)

SERVICE PACKAGE

(e.g., basic or lifetime satisfaction warranty)

A,B,C OFFER

gives consumers choices that usually lead to them wanting the premium offer. The price of the better version will look more attractive and can be raised slightly, which would not be possible without the anchor of the highest price; therefore, it has the greatest impact on financial results (i.e., silver/gold/platinum, L/XL/XXL, good/better/best)

TIME OF PURCHASE

(e.g., peak vs. off-peak times, normal hours vs. after hours)

Consumer Psychology:



IMAGE/QUALITY INFERENCE

because consumers tend to believe that higher priced goods are more valuable, increase the image of product performance (e.g., expensive cologne).

PRICE ENDINGS

this is more important in B2C markets where the psychology is to sell something for \$300 at a price of \$299. Psychological prices ending in 9, 95, 98, or 99 cause customers to feel like they are getting a better deal than the whole dollar price.

Value Enhancements:



IMPROVE CHANNEL DELIVERABLES

(e.g., warranty quality or guarantee, or customer support)

SELLING PROPOSITION

a unique proposition that includes something no one else has. Some companies trademark their differentiators.

CUSTOMIZATION

increase the degree of customization your customers have with your offering(s).

Price Leadership

Consider the difference between price gouging and smart profit. Diligence in the way we approach pricing means overcoming the idea that anything above 10% markup is gouging or taking advantage of customers.

Pricing according to the value we provide is considered good stewardship, particularly if it helps us manage the demand for our products and services, deliver greater excellence, provide a flourishing work environment, and advance mission sustainably.

Further Bible Study on Loving God and Pursuing Profit

“But seek first the kingdom of God and his righteousness . . .” **Matt. 6:33**

“Whatever you do, work heartily, as for the Lord and not for men . . .” **Col. 3:23**

“Better is a little with righteousness than great revenues with injustice.” **Prov. 16:8**

“A good name is to be chosen rather than great riches, and favor is better than silver or gold.” **Prov. 22:1**

“O Lord, who shall sojourn in your tent? Who shall dwell on your holy hill? He who walks blamelessly and does what is right and speaks truth in his heart; who does not slander with his tongue and does no evil to his neighbor, nor takes up a reproach against his friend.” **Ps. 15:1-3**

“So whatever you wish that others would do to you, do also to them, for this is the Law and the Prophets.” **Matt. 7:12**

“. . . You shall love your neighbor as yourself.” **Matt. 22:39**

“A false balance is an abomination to the Lord, but a just weight is his delight.” **Prov. 11:1**

“A just balance and scales are the Lord’s; all the weights in the bag are his work.” **Prov. 16:11**

“Unequal weights and unequal measures are both alike an abomination to the Lord.” **Prov. 20:10**

“Unequal weights are an abomination to the Lord, and false scales are not good.” **Prov. 20:23**

“Hear this, you who trample on the needy and bring the poor of the land to an end, saying, “When will the new moon be over, that we may sell grain? And the Sabbath, that we may offer wheat for sale, that we may make the ephah small and the shekel great and deal deceitfully with false balances, that we may buy the poor for silver and the needy for a pair of sandals and sell the chaff of the wheat?” **Amos 8:4-6**

Results Matter.

Thousands of faith-driven, results-minded CEOs and executives meet in forums monthly to encourage and challenge one another to make better decisions, avoid costly mistakes, and create solid plans for business growth, all while striving to create eternal impact far beyond the bottom line.

**Be a part of a local C12 Forum,
visit joinC12.com**



Pricing Diligence Assessment Companion Tool



Assessing Your Strategy

It may be easy to rationalize or justify our current pricing approach due to our unique industry and/or competitive circumstances.

However, poor pricing habits can lead to distorted business models and value propositions that don't match the reality customers perceive.

This quick assessment can help to reveal ways you can be more diligent in your pricing strategy.

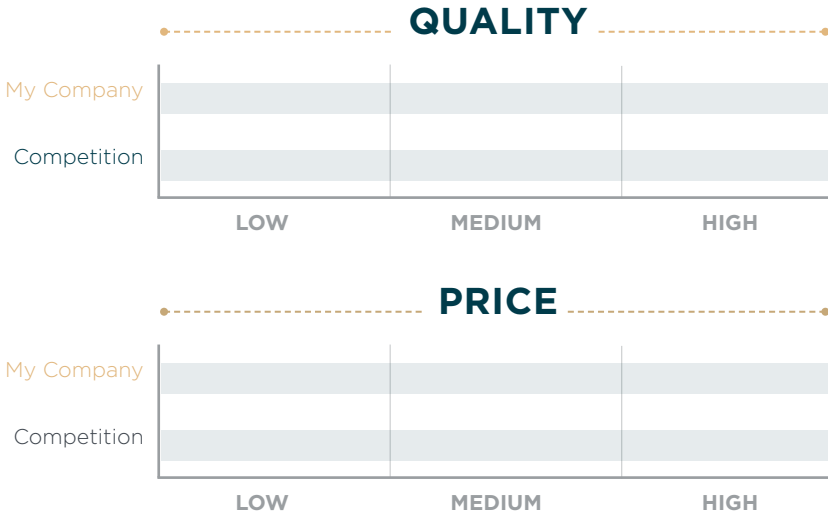


"You're really not in business to make a profit, but you're in business to render a service that is so good that people are willing to pay a profit in recognition of what you're doing for them."

- STANLEY MARCUS
Former CEO, Neiman-
Marcus

1st

Using the two scales below, shade in how you rate your company's current quality and price relative to your competition.



2nd

Next, circle where this positions your company on the Quality/ Price Matrix below.

QUALITY

High	Low Price/High Quality UNDERPRICED	Med. Price/High Quality IDEAL FOR PENETRATION	High Price/High Quality PREMIUM
Med.	Low Price/Med. Quality REAL BARGIN	Med. Price/Med. Quality AVERAGE	High Price/Med. Quality OVERPRICED
Low	Low Price/Low Quality CHEAP	Med. Price/Low Quality UNHAPPY CUSTOMER	High Price/Low Quality SELL & RUN
	Low	Med.	High

PRICE

Pricing Diligence Assessment Companion Tool

If you've concluded you need a price adjustment to align better with your value proposition, you may also be asking yourself how this will impact volume requirements. Performing a breakeven analysis determines the volume you would need to sell to break even should you raise or lower your price. **This exercise will require knowing how much variable margin is built into your product or service.**

3rd

Variable Margin

	EXAMPLE	WORK IT OUT
Current Sales Price	\$ 100	\$
Variable Unit Cost	\$ 20	\$
Variable Margin	\$ 80	\$

Today's Margin Dollars

	EXAMPLE	WORK IT OUT
Today's Unit Sales Volume	# 10,000	#
Today's Variable Margin	\$ 80	\$
Today's Var. Mar. Dollars	\$ 800,000	\$

Price-Reduced Variable Margin

	EXAMPLE	WORK IT OUT
Reduced Sales Price	\$ 90	\$
Variable Unit Cost	\$ 20	\$
Price Reduced Var. Mar.	\$ 70	\$

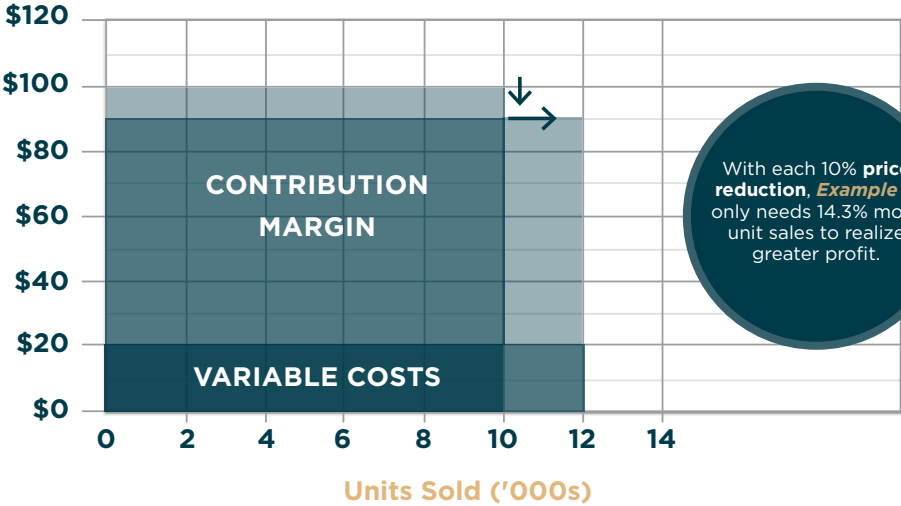
Breakeven Volume with Price Reduction

	EXAMPLE	WORK IT OUT
Today's Var Mar Dollars	\$ 800,000	\$
Divided by		
Price Reduced Var. Mar.	\$ 70	\$
Breakeven Unit Sales	# 11,429	#
Percent Increase	14.3%	

These two diagrams are examples that demonstrate how you can use the breakeven exercise to inform your pricing decisions.¹²

EXAMPLE A: High Variable Margin

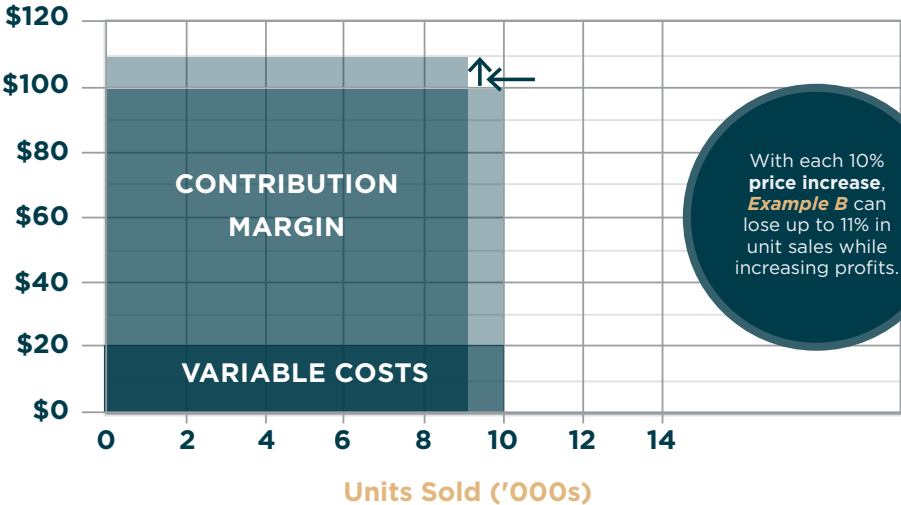
Is 10% price reduction a good idea?



With each 10% price reduction, **Example A** only needs 14.3% more unit sales to realize greater profit.

EXAMPLE B: High Variable Margin

Is 10% price increase a good idea?



With each 10% price increase, **Example B** can lose up to 11% in unit sales while increasing profits.

¹² Art Saxby and Pete Hayes, *The Growth Gears: Using a Market-Based Framework to Drive Business Success* (Charleston, SC: Advantage, 2016).