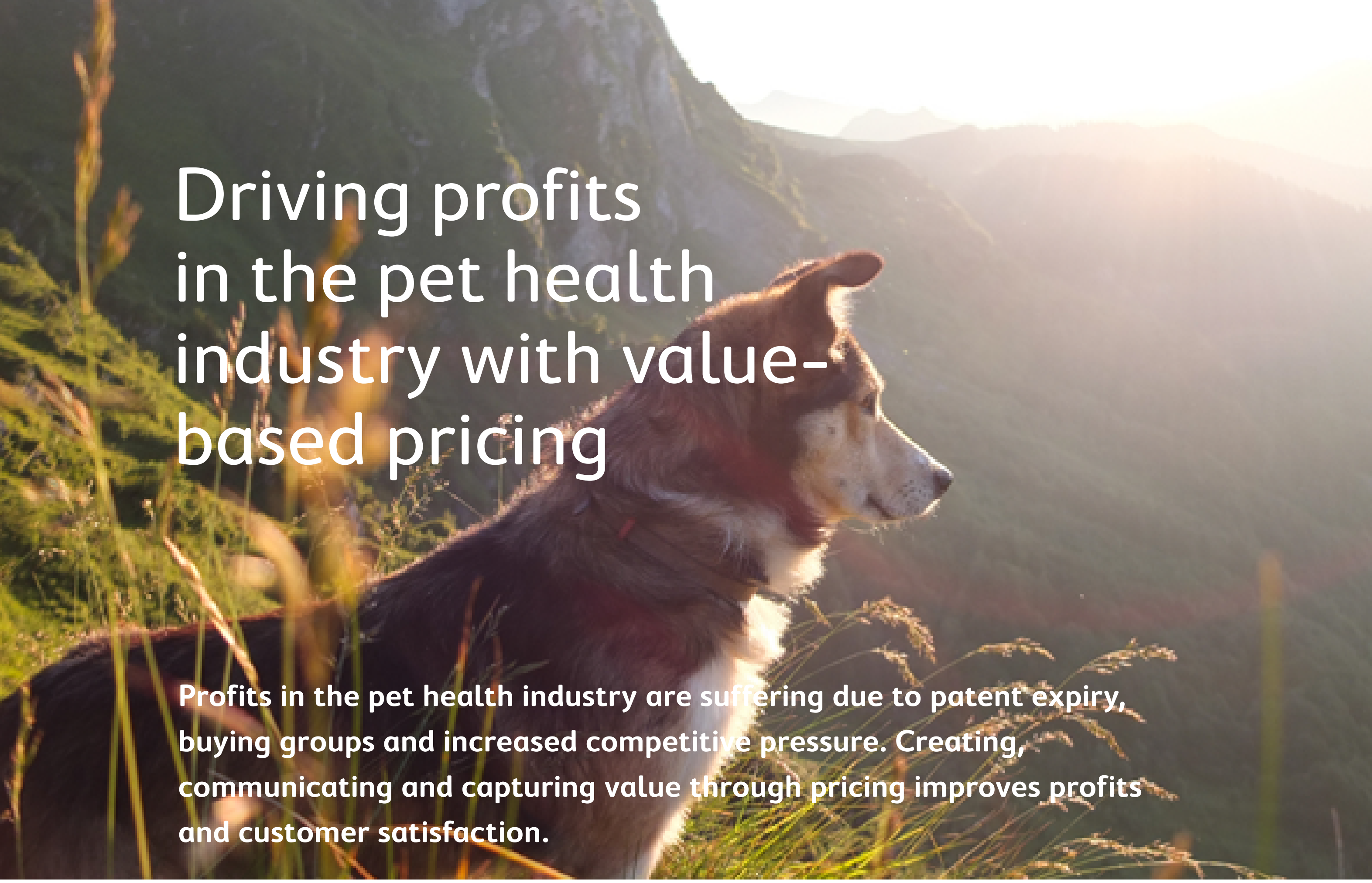
Marketing

Profits in the pet health industry are suffering due to patent expiry, buying groups and increased competitive pressure. Pet health companies can drive profits by tackling pricing – in five steps.



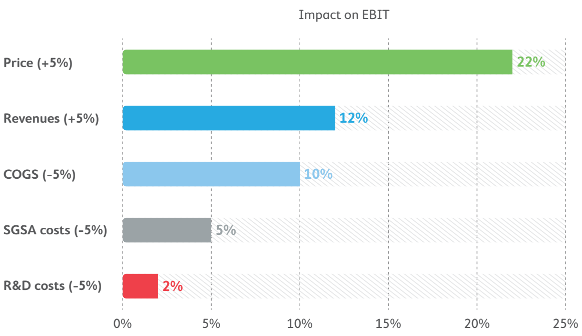
Driving profits in the pet health industry with value-based pricing

Profits in the pet health industry are suffering due to patent expiry, buying groups and increased competitive pressure. Creating, communicating and capturing value through pricing improves profits and customer satisfaction.

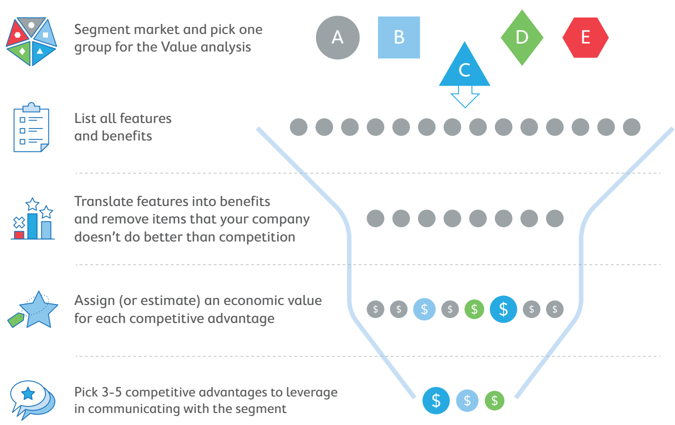
Pricing is the key profit driver

Pricing is the lever with the highest impact on profitability. Research done on a sample of Fortune 500 companies shows that a 5% increase in price improves EBIT by 22%, while increasing sales or decreasing cost of goods sold by 5% only improves profitability by 12% and 10% respectively (Hinterhuber, 2004).

Pet health companies can drive profits by tackling pricing. More specifically, pricing based on customer value ensures that company and customer interests are aligned.



The impact of pricing on profitability (EBIT)

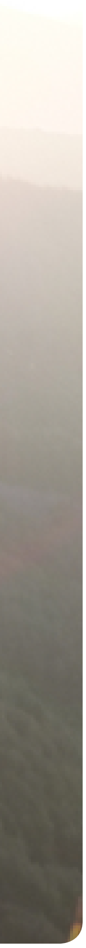


Five steps to jump-start a company's value-based pricing

The value-based pricing approach

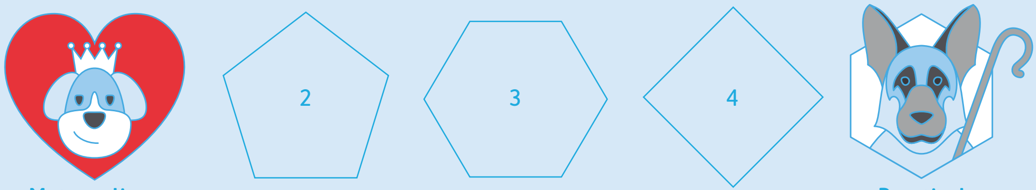
Step 1: Segment markets intelligently

Segmentation is tricky, but understanding customers lies at the heart of value-based pricing. Segmentation should go beyond technical or demographic criteria: the best segmentation approach is a needs-based segmentation.



Business case – dog food company (Germany)

The following two segments were identified for the German market:



Metropolitan in-house pet lovers

Practical shepherds

'Metropolitan in-house pet lovers' and 'Practical shepherds' – the former is made up of true dog lovers who spend significant amounts of money on their pets; the latter are professionals who like their dogs but also see them as business resources.

In the light of this segmentation, the company changed the way it presented, packaged and priced the product. 'Metropolitan in-house pet lovers' were very interested in food quality controls, while 'Practical shepherds' were keen on nutritional facts to ensure that their dogs have enough energy for the tough job of herding sheep, while minimising visits to veterinary clinics. Using this segmented approach to understand the needs of different kinds of pet owners allowed the company to introduce new products and to increase the prices of currently underpriced products. It also helped them to avoid getting into price wars, as price becomes less of an issue if customers feel that products really meet their ultimate goals and needs.

The segmentation process may require dozens of one-on-one customer interviews, focus group interviews and a conjoint analysis, but it pays big dividends: it allows a company to offer a series of differentiated products to different segments of customers at different price points.

Step 2: List features and benefits in main market segments

This task requires a brainstorming session among marketing, sales and product managers. For a pharmaceutical company relevant features are waiting times, efficacy, safety, compatibility, ease of use, relationships with veterinarians and opinion leaders, and so on.

Step 3: Identify competitive advantages in main market segments

A company needs to identify features and benefits that outperform the competing offer, while removing the rest. Being as good as a competitor is not an incentive for customers to choose your product.

Features must also be translated into benefits. It is the company's duty to do so: customers cannot be expected to undertake the exercise themselves.

Competitive advantages are the building blocks, the foundation, of value-based pricing. This pricing approach is essentially all about quantifying the key differences between competitors in economic, customer-specific value.

Benefits vs Features

Think of a car manufacturer: a feature of a new car may be a cutting-edge engine. But this means very little for many consumers and that is why car manufacturers translate the feature into relevant metrics for them. Even better: they communicate the same feature to different segments using different benefits!

The great engine becomes a time performance expressed in 0-60mph (or 0-100kmh) to appeal to thrill-seeking drivers, or a yearly fuel-saving measure to appeal to families. Even if both segments are interested in the same car – with the same engine – they value different benefits.

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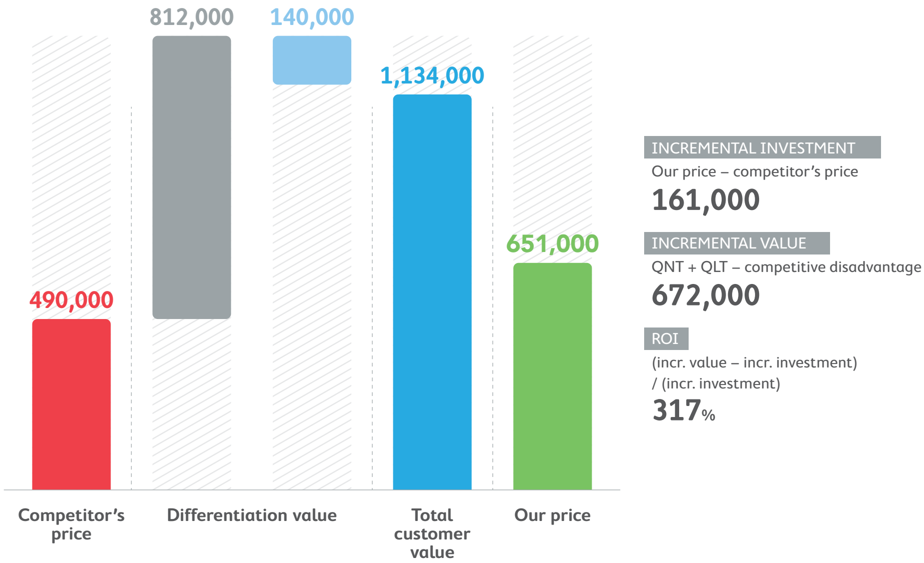

Value documentation for the customer – IT solutions provider explaining a 30+% price premium (€651,000/$743,000 vs €490,000/$559,000) over the closest competitor

Step 4: Calculate the economic value of competitive advantages to consumers
Many companies struggle with this step. Identifying features is easy, but identifying benefits requires understanding segments and segment-specific needs, and quantifying value is the high art, the craft, that allows the best companies to put a price on value (Hinterhuber, 2017).

There are a variety of approaches for translating features into benefits, and benefits into customer-specific economic value. Hinterhuber & Partners has developed the VQT (the Value Quantification Tool) that helps quantify customer-specific value across virtually all industries.

Step 5: Communicate the three to five differentiating factors that provide the biggest bottom line impact on the consumer
About 80% of the economic value that differentiates an offering from the competition can be summarised in three to five benefits. They may be segment-specific, but usually one or two competitive advantages are common to all segments. These are the ones to leverage in company communication, sales pitches and on the front of the product label.

Art, craft and science

Value-based pricing is about putting the customer at the centre of the pricing process in order to drive both customer satisfaction and profits. This pricing approach is a science, a craft and an art.

A science, as it is based on robust, scientific research into customers; a craft that can be learnt as companies implementing value-based pricing get better at it by doing, learning and experimenting; an art, because each company needs to find its own, unique way to create, communicate, deliver and price for value.

References:

Hinterhuber, A. (2004). Towards value-based pricing – an integrative framework for decision making. Industrial Marketing Management, 33(8), 765-778.
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