Fifty Shades of Pricing

When the world was less standardized and more of an open market (say before 1861 when John Wanamaker introduced the price tag in Philadelphia), it was the norm for tradespeople to await the buyer's first offer and then negotiate up. However, the subsequent swing towards an almost unified approach to stated price shifted negotiation power considerably over to the seller. Should we be seeking a more balanced approach? Raymond Augustin is a recognized thought leader, specializing in pricing strategy. He has an active interest in the research of the psychology of price and pricing motivations. He can be reached at raymond.augustin@miami.edu.

by Raymond Augustin

The typical price negotiation begins with the seller stipulating an asking price. It is a very rare occasion when a prospective buyer is invited to make an offer. In fact, this is so unnatural in our experience that it creates a sense that "no matter what the offer is, the buyer is going to be taken." However, this was not always the case. When the world was less standardized and more of an open market (say before 1861 when John Wanamaker introduced the price tag in Philadelphia), it was the norm for tradespeople to await the buyer's first offer and then negotiate up.

The swing towards an almost unified approach to stated price is a topic best suited to another time, but this move shifted negotiation power considerably over to the seller. Even in a fair negotiation the scales are never in a state of equilibrium. One side always has more weight, which gives rise to the phrases "buyers" or "sellers" markets.

The practice of Standard Retail Pricing further changed the dynamic. The **misleading** use of the word *standard* gave illusion to an often-impenetrable wall of consistency. It also made it easier to appease the negotiating buyer by appearing to be equitable, as in "This is the standard price and it would not be fair to our other customers..." Of course, this was a lie and, to avoid being forced to concede to this, wholesalers and retailers came up with things like *spends, discounts, multi-purchase, surplus*, etc. – an endless and continuously growing modality to justify the 'fairness' of not selling at standard price.

Though this was a benefit to the seller, it was not as pernicious as some, if not most, of the current pricing models. Until recently, the standard approach was to price a profit (fair or not) above the cost of production/effort/labor plus capital. The newer models, mostly software or capital SaaS type solutions with lower production costs and specifically lower fixed to variable cause ratio, have now embarked on value-based pricing, as seen in Figure 1.

Like all its predecessors, it sounds like something beneficial to the customer, but it is only a way to charge more. Value-based pricing enables a vendor to charge a totally different price from one customer to another based on the vendor's choice on how to standardize the recognition of value that their product may provide.

The seller will use proxy measures like number of users, number of beds/seats/tables, number of visitors/tickets, number of employees, etc. The choice of their proxy measure tends to sow confusion (while claiming the opposite) and is strongly inclined towards providing the opportunity for overspending. One cannot blame the seller for trying to make more profit and credit the mercantile mirage that the pricing is fairer.

There is an urgent need to return to a more symmetrical relationship between buyer and seller.

To tip the scales even further, vendors, manufacturers of hardware, publishers of software, and professional service providers have benefited greatly from an overweight of information flowing in their direction. Their professional sales teams are now made of up of individuals that are both technically competent and endowed with good business acuity.

On the *customer* side, the application or engineering team understands what is required and what has to be specified and the purchasing team understands their contractual and organizational requirements. However, there is no visibility or understanding of the pricing nor of the nuance of that sales ecosystem.

Here are some typical purchase team behaviors with respect to price:

1. Accept pricing as is.
2. Negotiate towards a budget.
3. Negotiate based on starting at X% lower and we will meet in the middle.
4. Negotiate based on time.

All of these are immature efforts that the sales team has already built into their sales strategy. These are crude efforts based on antiquated negotiating techniques that are entrenched in an information asymmetrical intercourse. Instead of repeating the standard scripts and expecting different results, what is required is better understanding of the true cost, the profit margins, relevant financial metrics, and other motivational pressures that are in play. ❖

Figure 1