The So What from BCG Podcast

The Price Is Not Always Right

Jean-Manuel Izaret

GEORGIE FROST: An effective pricing strategy is one of the most important aspects in driving business growth. It can define the value of products, shape relationships with customers, and have the highest impact on improving profit. And yet, of all the revenue levers in business, it's arguably one of the most undervalued and overlooked. Whether you're a new business or an established player, implementing the right pricing strategy requires a deep knowledge of your company, your customers, and the market. But get it right and you could set your business up for long-term success. I'm Georgie Frost, and this is *The So What from BCG*.

JEAN-MANUEL IZARET: It starts with three really simple questions. The first question is, how do you create and share value with your customers? The second is, what game do you play? And the third one is, depending on the game and how much value you have to share, then design a pricing model and a pricing strategy that will allow you to leverage your competitive advantage and get the right outcome in the market.

GEORGIE: Today I'm talking to Jean-Manuel Izaret, known as JMI, who leads BCG's Marketing, Sales & Pricing practice globally and is the author of *Game Changer*, the book about pricing strategy.

JEAN-MANUEL: Many people think about pricing as just setting the price and setting it high or setting it low, and pricing strategy is high, low, or sometimes high-low for retail environments that sets the price at different points in time for different promotions. In reality, when you think about the pricing model, which is the decisions you made before you set the price, you could create completely new business by just selling something in a different way.

For instance, if you sell a car, by the car, it seems like obvious, how would you sell it differently? You're in the auto business. But if you sell the car by the day, you're in the car rental business, and that's a very different business. But now you can even sell the car by the ride. In the ride-sharing business you have an entire new market where you bring drivers together with customers when they need, in order to all come back from a concert.

And so the pricing model is really enabling, in the case of ride-sharing, new use cases that were not easy to put in place before. It was hard to have a lot of taxi cabs be ready to go at the end of a concert, and people were frustrated, and that's a good answer.

GEORGIE: But there are also negatives for that. You talk about ride-sharing, this is how pricing can be very controversial, is dynamic pricing, and we saw that in the London terror attacks when prices of those ride-hailing apps went up. So actually that could damage one's business and society and your trust in that company.

JEAN-MANUEL: Which is a great illustration about how important pricing could be. Which is, on one hand, everything in the market, it could be a really great thing, and it could be a really bad thing. And so dynamic pricing on the one hand has a set of advantages that allow to balance the markets and to provide services that otherwise would not be available. But in times of crisis, if you are in the desert and you find one guy ready to sell you a bottle of water and says, "You need to give your life savings in order for me to give you the water because I'm going to save your life." You're like, "No, this is cheating. This is not fair."

We all have a sense about pricing where 20 to 30% more to bring supply in balance with a high demand, everybody tends to understand this is a great thing. If instead you bring the price to ten times what it used to be, then everybody's really upset because why can you charge me more? What was the logic? Just because you're lucky to have this bottle of water in the desert and you want to sell it to me?

GEORGIE: Just explain to me what's the difference between pricing and pricing strategy.

JEAN-MANUEL: Pricing strategy are all the decisions you made before you even set a price, and they are mostly decisions about how will that price vary. For instance, dynamic pricing is a decision you make that the price will vary over time depending on supply and demand. You can make other decisions.

On the train and so on, you have a set of tariffs that allow seniors and students, for instance, to have discounts. So the pricing strategy is to decide that for categories of people, older folks in retirement and students for instance, you want to have a lower price. You could decide to price differently depending on the time of the day. You could decide to price based on a number of criteria, and that's pricing strategy.

GEORGIE: Where should pricing come in the chain of your products?

JEAN-MANUEL: Pricing should come really early on when you're thinking about your product, its value proposition, and how it's going to be useful to people. That's the right time to design your right pricing strategy. If you first design your product and then come at the end and say, "What's the right price for this?" there's a chance you will have missed something.

I remember working for a software company that asked us that two months before the launch: What should be the price of their product? We looked at what they were doing and the product was used very differently for two populations. There were people developing a set of applications, if you wish, for others, and you had users. They wanted to have the same price points for everybody, and it was wrong.

They should have developed the software with two types of software, a software for the developers and the people who are going to put the app together and a piece of software that's just connecting to the apps and for the user, and the price should have been different. But because they had only one app for everybody, then they missed the opportunity to differentiate the prices and have the right pricing strategy that has both penetration for getting as many users as you can, but also enough margin extraction to pay for people who get a lot of value from having users use the apps.

GEORGIE: Is there a danger though that it could go the other way, that if you introduce pricing too early or too significantly at the start it could be a situation of some might argue the tail wagging the dog?

JEAN-MANUEL: I am not saying that is the only thing you should consider up front, just forget about everything.

GEORGIE: [laughs] It’s all price.

JEAN-MANUEL: [laughs] Yeah, just think about the price and think only about the price and you're done. No, absolutely, you have many things you need to consider when you design a new product. Who are the target segments? How are they going to use the products? What are you competing against? But all these questions are very tied together to defining your pricing strategy.

It is the right time when you think about all of these factors to also think about what's the strategy of your pricing. The exact price might come months later when you are really closer to the end, but the structure of your pricing should be decided up front when you decide what you offer to the market.

GEORGIE: And it's not just one size fits all, one strategy, boom, and you're done, is there? There's a few to choose from, so how do you pick the right one for your business?

JEAN-MANUEL: That's why we wrote this book, *Game Changer*, is because not only do we want to help people think about pricing as strategy and not just numbers, but we also want to share with them that we think there are seven different pricing games. The same way when you play ball, you don't say, "Oh, I'm playing basketball and soccer."

Everybody knows the rules and the strategy are very different between these two games. You have different pricing games, and you need to play these games differently in order to succeed. And so it's very important for a business to know what game they're in, to pick the right game for them because sometimes they might have a choice between one or two games, and then to play it well.

GEORGIE: Now, obviously we've only got a short podcast, but as much as you can just high-level overview of an example of how that would work, what sort of different games are available and why one game might be more suited to one company and another to another company?

JEAN-MANUEL: Right. Think about a company in the construction business. Every project costs very differently. You cannot have the same price for every project. The price is going to be based on the cost of each of the projects, and so it tends to be a cost-plus pricing model. But when you go and walk into a retail store, everybody pays the same price and you don't have a price that is different per person.

Which is the example of the cost where everybody who builds a house, it's a slightly different house, it's a slightly different price. You don't necessarily think about how a different pricing game that is, but the logic about how you set the price if you are in the cost game versus if you in what we call the uniform game, which is everybody pays the same price, which is the solution in retail, is a very different one.

We talked earlier about dynamic pricing. That's an entirely completely different game. We all know that Apple and others can play what we call the value game because they have products that are really valuable at the high end where there's not that many competitors, and that's another entirely different pricing game.

I think it's really important to distinguish this game because very often when we talk to companies, some leaders are asking, "Oh, I'd like to price this way." Well, if you're in the construction business, it's harder to price value the same way Apple does. If you have a very unique value proposition and unique way to build houses with a new technology, maybe you can do this, but if you build it with concrete and wood, the same way everybody else does, well it's going to be harder to do that.

And so understanding what game you play gives you a clear roadmap about what kind of strategy is going to be the most successful for you. And it's important for companies to know that.

GEORGIE: Sometimes it might be very obvious, I imagine, as to what strategy to choose for your business. I mean you said earlier that actually there might be a time when you need to decide between one or the other. What sort of questions should you be asking yourself?

JEAN-MANUEL: There are two games that often are confused with each other. One we call the custom game, and the other one we call the choice game. It's really important for companies to understand how to play one or the other. The custom game is a game where you give a different price to every single customer and you customize the offer for them.

You customize not only the price, but you customize the product. You usually have relatively few competitors in this market. And this is what you do when you sell trucks. For instance, every truck is different from each other, and every fleet will buy slightly different trucks and you customize the deal. In the B2B space, you tend to play the custom game.

Many companies, in playing the custom game, ask to do bundling, and they like to do bundles. It sounds great, but bundles require you to be in a different game that we call the choice game, because when you offer bundles, you can't offer 1,000 bundles. You have to offer three, four, five, six bundles, but not 1,000. And so you need to simplify your offer. You need to simplify and lower the range of discounting that you have to offer clear choices.

In the custom game, customers can ask whatever they want at the best price possible. In the choice game, you offer customers a few choices that are really clear at different prices. All the companies in the SaaS world, software players, tend to offer what we call good, better, best choices. You don't have

1,000 choices, you have three, four, five, ten choices, and this is a different game.

GEORGIE: Where are businesses getting it wrong the most, you see?

JEAN-MANUEL: People are getting it wrong very often by trying to play a game that they're not well-equipped to play. And so I gave the example of trying to play the value game, which requires you to have a unique value proposition. If you don't have a unique value proposition, you're not going to be able to play that. Bundling has been a very successful strategy for airlines in the dynamic pricing world.

It is not the right strategy in what I call the B2B custom game I just talked about earlier. And so when people want to implement bundling because they read somewhere or someone told them, "Bundling can be really effective," if they don't understand the characteristics of the game they're playing, they're going to misleadingly think they could do that. You could spend six months, nine months trying to implement something that ultimately is not going to be successful. That's wasted resources and that's not right.

GEORGIE: Companies will inevitably take risks with their pricing strategies. How can you mitigate those risks but still make sure that it does what you need it to for your business?

JEAN-MANUEL: You need to have a really keen understanding of your customers and what really matters to them. For example, if you say, "I'm a bank and most of my customers are loyal customers, they don't change bank very often." And there's an example of that. They had lost some profits and wanted to increase their margins, and they were going to charge for the debit cards, something they had never charged before. Basically there was revolt from their customers because the logic they used is, "Hey, we are not making as much money, we decided that we should charge you for something we haven't charged you for before." With no change in value, no story about why this is justified, just like, "We think we can."

The market came back and says, "No, you shouldn't. We don't think it's right." And that's the good thing about the market forces we have in societies is, and that was enabled by... It was the beginning of social media impact on pricing because there is a woman who started to say she thought it was not right. Within two days, I think, thousands of people agreed with her that it was not right. It took a month and a half, I think something like this, they just came back and says, "No, we won't do this. Sorry, it was a mistake."

That doesn't mean that if they had a really special card and a value proposition that was worth it they couldn't have charged for this. They just didn't have the right value prop where compared to the alternatives people would say, "Yeah, it's worth it."

GEORGIE: Is there a blueprint that businesses can follow when designing a pricing strategy?

JEAN-MANUEL: It starts with three really simple questions. The first question is, how do you create and share value with your customers? The second is, what game do you play and what game should you play? And the third one is, depending on the game and how much value you have to share, then design a pricing model and a pricing strategy that will allow you to leverage your competitive advantage and get the right outcome in the market.

GEORGIE: We've been in difficult times over the last few years economically speaking, but history will tell us that, hopefully, a wave will come. How can pricing help you surf that wave?

JEAN-MANUEL: Let's qualify a bit the difficulties that we've had over the past few years and where we are now and where we can go. We had the COVID crisis and people were isolated. Pricing has helped us in some ways already by giving tips to drivers in order to support them and support restaurants when we knew they would go bankrupt because we couldn't go to restaurants anymore.

Now, as these practices that were established during the pandemic have persisted, people have felt bad about the swivel when suddenly you have this terminal that is turned in front of you and you have to pay a tip at your orthodontist, and you're like, "Well, that's not right. This has gone too far."

And this is a good example of society needs to bring prices into balance. It was the right thing to do to tip people generously during the crisis in order to keep the businesses open. It's not right that when you have no service whatsoever that you give a tip in addition to the price. The market is balancing right now.

Now, how should pricing help us in the future? There's one big change that is coming our way, which is GenAI. There's one fundamental question with these super smart algorithms that can talk to us and help us resolve a number of problems scientifically or in our daily lives, how are we going to price that? It's a topic for many of the companies that are thinking about this. There is a really high cost to running these models, therefore there needs to be some price to some use of GenAI.

But if you price it too high, you might actually not have enough deployments of the solutions as they should. So it's going to be a real challenge to price this right in the market. And as always, the same way it was for the internet, it's going to be a combination of different pricing model that people will try. Right now you're having the market price per token versus price per user versus free... Companies will need to determine how they price GenAI offers, and if they do it right, they can be very successful.

GEORGIE: We spoke about how getting the right pricing strategy can set your business up for long-term success, but that doesn't mean you've set up one pricing strategy and then you rest on your laurels for the next 50 years and just watch the money roll in. I assume this is something you need to be looking at a lot.

JEAN-MANUEL: You need to be looking at regularly, but if you change your strategy in general every two weeks, you probably have the wrong strategy. Let's take the example of salesforce.com. Their pricing model was a key component of their new offer and their success. That carried them for more than a decade, almost 20 years now.

At this stage in the development of Salesforce, they are in a place where they have bought a number of companies, MuleSoft, Slack, Tableau, that are related to their core business but not exactly the same as their core business. And right now they got to this situation where they're selling hundreds of products with different pricing strategy and different pricing basis.

And so it's probably time for them to rethink their pricing strategy and how they can essentially offer the simplest way for their customers to buy their product and consume all of these products together. Microsoft had to go through a similar change. When Satya Nadella came on board and decided that cloud and mobile was first, he changed the pricing strategy of Microsoft in order to be successful, and that has served them well. It's not the only thing he's changed, but it was part of the change that was done at the time.

GEORGIE: What are your key takeouts of our conversation?

JEAN-MANUEL: The first takeout is think about decisions you made before you set prices, think about your pricing structure and your pricing strategy. Number two, think about how much value you should share with customers, not just how high your prices should be. Sometimes if you share more value and leave a little bit more money on the table, more people come to your table, and you have more long-term success than you would have otherwise. And then pricing is quite complicated. We've made it simple for you. Read the book, I'm sure you'll have a number of stories that will apply to you.

GEORGIE: JMI, thank you so much, and thank you for listening. If you like what you heard, and would like to order a copy of JMI’s book on pricing, *Game Changer*, we’ve included a link in the shownotes. We'd also love to know your thoughts. To get in contact, leave us a message at thesowhat@bcg.com. And if you liked this podcast, why not hit subscribe and leave a rating wherever you found us? It helps other people find us too.