Price Elasticity Analysis: A Wasted Effort

If you're a private equity firm trying to ascertain the price elasticity of your target company's offerings, STOP! You're about to waste time and resources. The question you should be asking is "How do we make price inelastic?" To understand why, let's look at these contrasting views of price elasticity.

Contrasting Views
Those who attempt to 'discover' or 'predict' price elasticity, whether they realize it or not:

- View price elasticity as a living, breathing entity that can be measured, but not controlled.
- Adapt their operations to the volume/price relationship identified in the analysis.
- Subject themselves to constant re-evaluation of their pricing based on what competitors and the economy are doing.
- Adapt to 'the market' instead of leading it.

Eventually most firms employing this approach come to the realization that finding *the* right price/volume mix is as rare as a Sasquatch sighting. Even with this realization, they either continue to expend huge amounts of time, energy and money in hopes of achieving that elusive goal or defer to industry pricing.

Let's contrast that with a strategy in which our goal is to make the price of our offerings inelastic - that demand doesn't change regardless how high our prices go. Before you decide that I'm a candidate for a padded cell, consider this:

- There are many commodity products, but few commodity businesses. In other words it's rare to find a product to which we can't add value in some form.
- Buyers have demonstrated a willingness to pay for value. Mercedes owners pay more than 7.5 times the lowest priced Chevrolet. Early adopters pay 3 to 4 times the mass market and 12 to 13 times as much as late adopters.
- Buyers appear to be price conscious *because our marketing messages focus their attention on price*. Our ads become a self-fulfilling prophecy.

Making Price Inelastic
How do we make our prices inelastic? We need to be able to:

- Quantify the value we provide. Most businesses tell their customers why their offerings are superior, but few can quantify that value - convert the value to dollars and cents.
- Discover ways in which our and our competitors' offerings fail to meet the market's needs (better yet, their desires), then meet them.
- Communicate our value in ways that our competitors don't. Merely being able to quantify value distinguishes us from our competitors.
- Talk about the results our offerings afford instead of what we do.

- Make our offerings a scarce resource. Despite the fact that there are other products out there that are similar, providing intangibles that customers value that they can't get elsewhere make our offerings scarce.
- Position our offerings in ways that take buyers from the "Yes/No" decision-making process to "Which of these" decisions.

Quantify value
The key is to create such a compelling value proposition that buyers don't care about the price. Here's how one company did it.

The company provides ergonomic lifting equipment to manufacturers. They buy the core unit, then customize the gripping mechanisms to meet their customers needs. Their value proposition is 'leveraging the power of man physically and fiscally.'

With that focus they're able to craft formulae to quantify the value of the:

- *Productivity improvements from moving more product, more quickly.*
- *Worker's compensation premium savings from fewer injuries.*
- *Avoiding the costly mistakes and productivity losses that occur when a worker is filling in for an injured colleague.*
- *Improved morale through fewer workplace injuries.*
- *Lower administrative costs associated with fewer injuries and less regulatory oversight.*

You get the picture. Eventually the value proposition becomes so compelling the buyer says "I get it. How do we get started?"

I'm sure that some of you are thinking "We do that, but we still get push back on our price." That brings us to the second step in making our price inelastic - communicating value.

Communicating value
There are typically four reasons why buyers push back on price:

1. They're price buyers; price is the most important criteria in their buying decision.
2. They can't see any advantage to using your offering over a competitor's offering.
3. They see the advantages of your offering, but don't know how to quantify the value.
4. They want reassurance that the value you're touting is there.

<u>Price buyers</u>
If the buyer is truly a price buyer, then you need to look for other markets. Price buyers are never satisfied - they never feel like they got a good deal. They're also the least loyal buyers you'll encounter, the next low price and they're gone. Other than that they're wonderful people.

Fortunately price buyers only represent about 15% of any market. If your experience is different, then I'd suggest that you're fishing in the wrong pond.

<u>No advantage</u>
When buyers don't see an advantage to your offerings it's because you haven't communicated it effectively or the buyer doesn't value what you have to offer. We already have an example of how to communicate your offering's advantages in the ergonomic equipment example above.

Here's an example that demonstrates the futility of trying to sell to a buyer who doesn't value what you have to offer. I was buying a new car. For me a car simply needs to get me from point A to point B reliably.

I had visited one dealer and found a car that met my needs, but didn't want to make a purchase without seeing what else was available. The second dealer had one that had a moon roof and alloy wheels. When asked what I was willing to spend for this car, I shot the dealer the same price I was offered for the car without those amenities. When asked "What about the moon roof and alloy wheels?" My response "They have no value to me."

The moral of the story is "Buyers determine what is or is not valuable to them." Our marketing campaigns need to acknowledge that reality. We need to craft marketing messages that attract buyers who value what we have to offer enough to pay premium prices to get it. A great marketing message allows the reader, listener or viewer to, within 30 seconds, decide "Yes, I want to know more." or "This isn't for me."

By the way, I got the moon roof and alloy wheels at my price. Shame on the dealer for not training it's sale force more effectively.

<u>Unquantified value</u>
We've already discussed the importance and seen an example of how to quantify value. I won't belabor the point here.

<u>Reassurance</u>
Buyers ask for price concessions as a way to affirm value. Even if you've done all of the above well, you're going to get push back on price. Why? The buyer is testing you to see whether or not *you* believe what you're saying.

Let's assume that you've done everything right and you're a hair's breadth away from closing the deal. The buyer pushes back on price. If you offer a concession, what's the buyer likely to do? Ask for another concession, right? Why? Because you just told them that there's something wrong with the offering - something that they haven't uncovered or some reason that the value isn't as great as what you just told them.

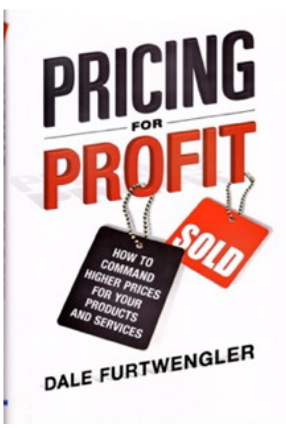
Contrast that with the reaction you get, as a seller, when you say, “We’ve discussed all the advantages our offering affords and, together, we’ve quantified that value. You know that the price is less than the value you’re getting. If it doesn’t fit your budget I understand; we, all, have budgets within which we have to live. Let’s explore some alternatives for you.”

You’ve told the buyer - the price if fair and firm. Buyers gain confidence and a great deal of satisfaction from their buying decisions when you stand firm on your pricing. You’re also forcing them to make conscious decisions about what they value.

If the salesperson at the auto dealership had used the script above - had offered an alternative to fit my budget, he’d have forced me to make a conscious decision about whether or not the moon roof and alloy wheels were worth the money versus whatever alternative he proposed.

Compelling value
With all of these wonderful tools for creating compelling value propositions, does it make sense to invest your time, energy and resources in attempts to ‘discover’ or ‘predict’ the elasticity of price? Personally, I prefer to control the elasticity of price instead of allowing it to control me.

Give me a call and, together, we’ll make price INELASTIC for your offerings.



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