

# Practical Pricing Tips for Driving Profitable Growth

David Mok

# Speaker Biography

**David Mok** manages the worldwide retail pricing team for Seagate's \$1B branded storage solutions business. At Seagate, he helped turned a barely profitable situation into a strong and sustainable gross profit business within a year. During this time, the retail channel business posted the highest profit in Seagate's six-year branded solutions history.

Prior to Seagate, David was at Xilinx where he led transformational pricing efforts, deployed pricing software, architected the company's global pricing model, and developed pricing strategies across a broad spectrum of semiconductor products for a \$2B business. He also managed the communications segment marketing team and led value-based pricing efforts using solutions. He was a product manager for an advanced platform system-on-chip semiconductor product family. David teaches a pricing course at the University of California, Berkeley and has been speaking professionally on the subject of pricing at various conferences throughout the country. David began his career as a naval officer aboard an attack submarine where he conducted missions vital to the national security of the United States.

# Retail Business Accomplishments

5      % GM - 2 plus years ago

3      # of quarters to improvements

25    % GM - at the height of our financials

# The Power of One

McKinsey Study: Across the Fortune 2000, on average, 1% improvement in price translated to 11% improvement in operating profit

1% Improvement in	Increase in Operating Profit
Inventory	2.7%
Units	3.7%
COGS	7.3%
Price	11.0%

# Agenda

- Review some simple pricing rules to help you manage your business more profitably
- Concept applies whether you are selling widgets, software, services or whether you are in B2B or B2C channels
- Most importantly, let's have fun talking price tonight

# Why are Diamonds More Expensive than Coal and Water?



No Functional  
Value



Labor intensive to  
mine, like diamonds



Critical to Life

# Three Approaches to Price Setting and Two Theories of Value

- Competition Driven Pricing
  - Your Price = Competitor's Price
- Cost-Plus Pricing
  - Labor Theory of Value  
Product → Cost → Price → Value → Customers
- Value-Based Pricing
  - Subjective Theory of Value  
Customers → Value → Price → Cost → Product

## **Rule #1**

**If the value is not clear, your  
price will always be too high  
(Value Justifies your Price)**



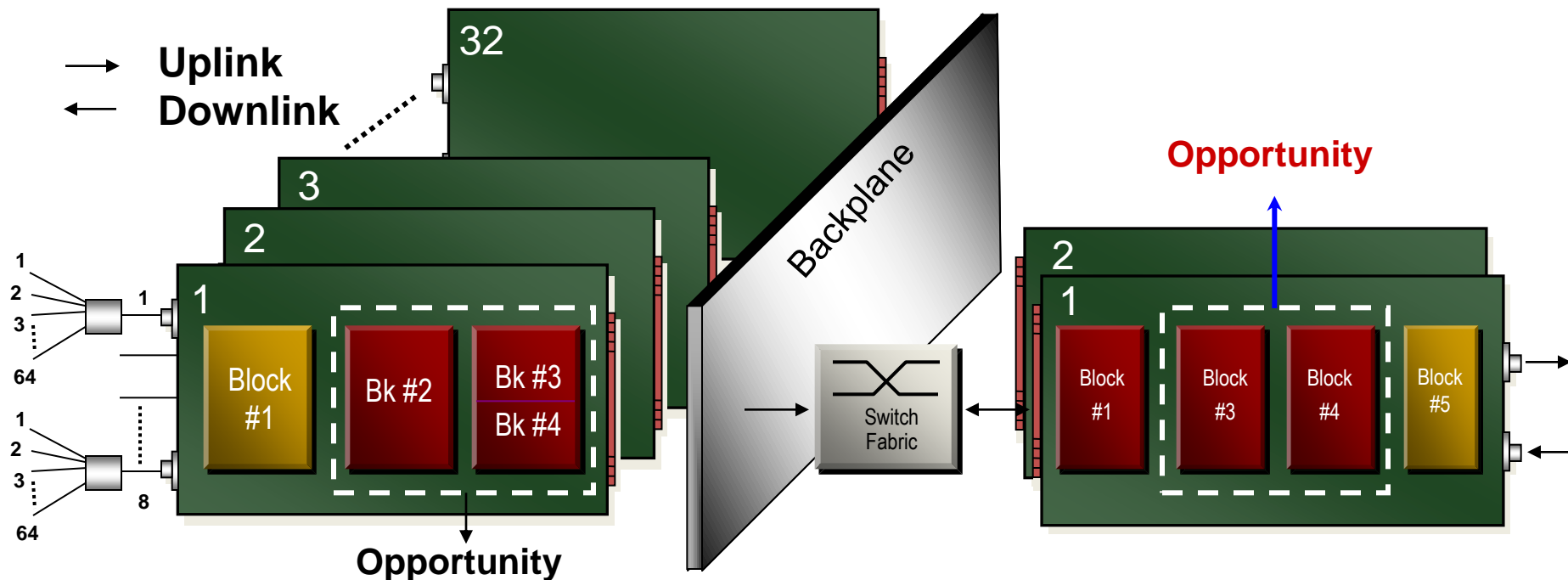
# What is Value?

“Value is defined as the perceived worth in monetary units of the set of **economic**, **functional**, and **psychological** benefits received by the customer in exchange for the price paid for a product offering taking into consideration available competitive offerings and price.”

*- James Anderson, Dipak Jain, and Pradeep Chintagunta. “Journal of Business-to-Business Marketing”*

# Case Study: Wired Communications

- Customer developing flexible communications equipment
  - Your competition = another Chip vendor (competitor's account)
  - Customer building a solution in attempt to displace incumbent
- Competing Chip vendor priced at \$125 per unit
- **What would you do?**



# Integration of Surrounding Building Blocks Reduces System BOM by \$5 Million

- Integrate Surrounding Functional Blocks
  - ➔ Less Number of Chips
  - ➔ Reduced System BOM

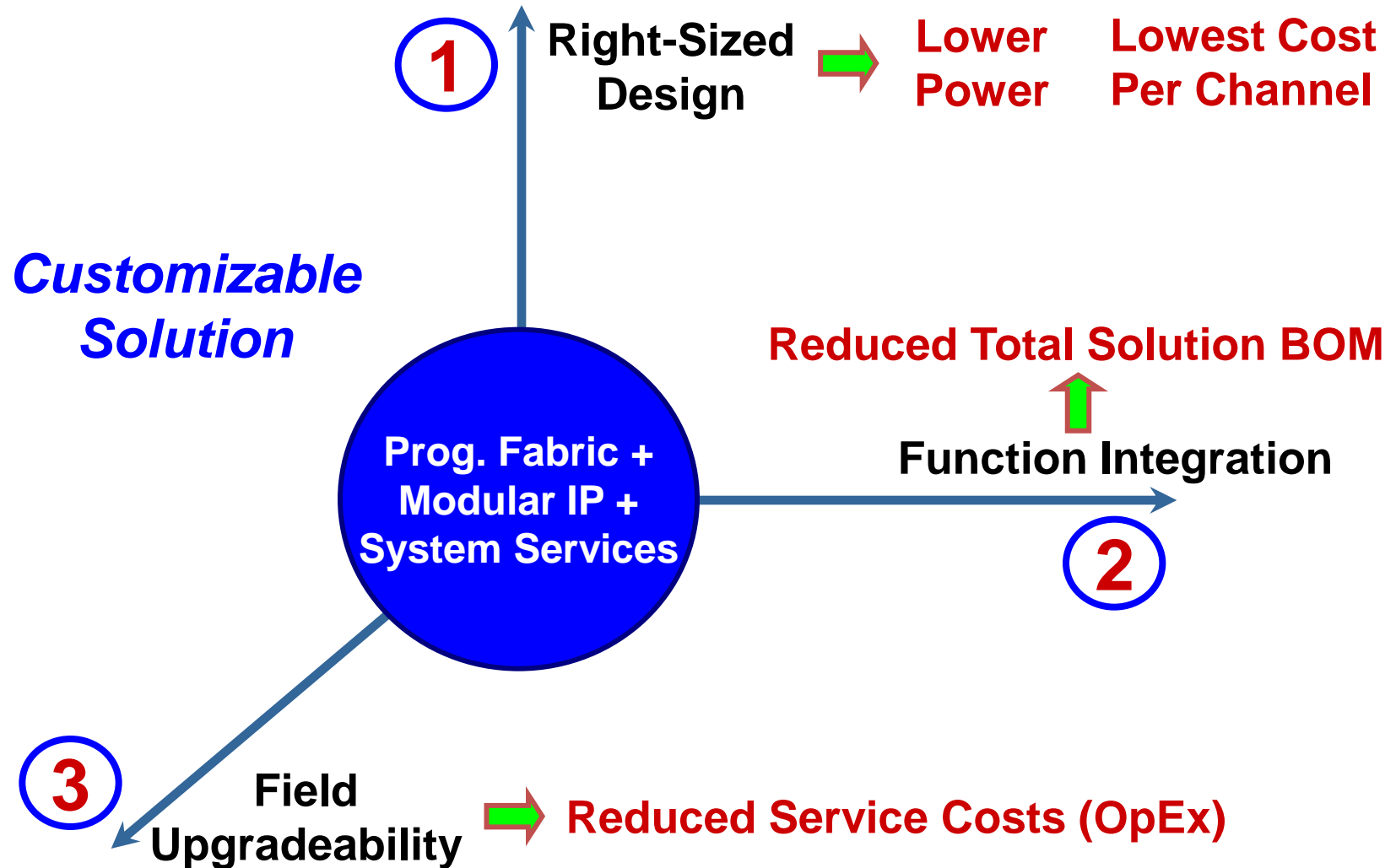
Functional Blocks	Competitive Solution	Price	Our Solution	Price
Ingress Processing	20G Standard Chip	\$250	Programmable Chip + IP	\$210
Egress Processing	20G Standard Chip	\$250	Programmable Chip + IP	\$210
Control Function	Programmable Chip	\$125	Programmable Chip	\$180
Control Function	Programmable Chip	\$125	Not Required	\$0
Num of Boards / System		16		16
Life Cycle System Forecast		2,000		2,000
Total Life Cycle BOM		\$24 M		\$19 M

# Field Upgradeability Reduces Service Costs by \$8 Million

- Programmable Chip Online Field Upgradeability
  - ➔ Eliminates Replacement of Boards
  - ➔ Eliminates Truck Rollouts and Service Calls

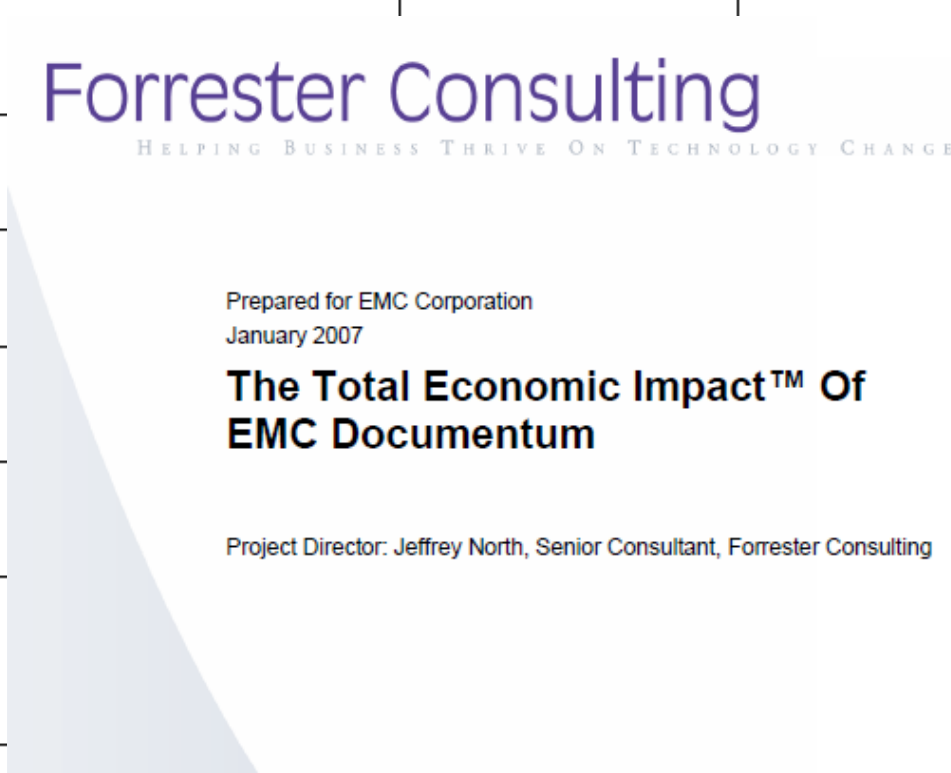
Parameters	Assumptions	Competitor	Our Solution
Customer Equipment Revenue		\$1B	\$1B
Service Revenue	20% of Revenue	\$200M	\$200M
Cost of Services	50% of Service Revenue	\$100M	\$100M
Field Upgrade Costs (BOM + Services)	33% of Total Services	\$33M	\$0
R&D Efforts (Design & Verification)		\$150K	\$150K
Probability of Field Upgrades	25%		
Cost of Field Upgrades		\$8,287,500	\$37,500

# We Priced it at \$210 and Won a \$50M Program with 3 Key Benefits that Resonated with the Customer



# Other Examples

# Economic Impact of EMC Documentum

Summary Financial Results	Original Estimate	Risk-Adjusted
ROI	 <p><b>Forrester Consulting</b>  <small>HELPING BUSINESS THRIVE ON TECHNOLOGY CHANGE</small></p> <p>Prepared for EMC Corporation  January 2007</p> <p><b>The Total Economic Impact™ Of  EMC Documentum</b></p> <p>Project Director: Jeffrey North, Senior Consultant, Forrester Consulting</p>	
Payback period (years)		
Total costs (PV)		
Total benefits (PV)		
Total (NPV)		
Internal Rate of Return (IRR)		

# What Customers Buy

Don't sell me *things*. Sell me ideals, feelings, self-respect, home life, and happiness.

- Michale LeBoeuf, PhD, Author

Don't sell me clothes

Sell me a sharp appearance, style, and attractiveness

Don't sell me toys

Sell my children happy moments

Don't sell me computers

Sell me the pleasure and profits of the miracles of modern technology



# MICHELIN. BECAUSE SO MUCH IS RIDING ON YOUR TIRES.



Michelin is guided by a single overriding concept: tires are the most important pieces of equipment you can put on your car.

Therefore, making the best tires, regardless of cost, is an obsession with us.

That is why we make our own steel for our steel-belted radials. Why we take so long to develop and test each tire model.

That is also why Michelins perform as well as they perform.

And last as long as they last. And why they cost more.

Though you may find, as many Michelin buyers do, they end up costing less to own in the long run.



**MICHELIN**

# Raise Your Hand if Willing to Pay \$99.99



Other Seagate  
backup drives  
available at:

\$69.99

&

\$59.99

# The Other Backup Drives

\$69.99



\$59.99



# Let's Take Another Poll

\$99.99



## FreeAgent Replica

- One click
- Backs up everything continuously

\$69.99



## FreeAgent Go

- Schedule with software

\$59.99



## Expansion

- Manual backup



# Packaging and Merchandising

## Communicate your Value



# Front Box Messaging – Proof Point Testing

*No technical jargon, testing proof points/icons for highest response rates*

- **Multi-PC Home Storage**
  - Continuous File Protection/Access
  - PC/Mac, Notebooks, Netbooks
  - Mobility, Smart Phones
- **Five Minute Set-Up**
- **Wireless Attached Storage**
  - Easiest Set-Up / User Interface
- **Media Sharing/Streaming**
  - Music, Video, photos through out the home
- **Easy Expansion/Archive**
  - Easily Grow Storage Needs

Wireless messaging, icons,  
images will be prominent  
(being tested)

David Mok



Concept Packaging



**Wireless Storage for Every PC  
in the Home**



# Back/Side Box Messaging – Proof Point Testing

*Highlight ease of use, wireless storage benefits and use cases*

- Hassle Free Set-Up
- Print Server
- 'Set it & Forget it'
- Continuous Backup Protection for all PCs
- Remote Access
- Time Machine Compatible
- Expandable storage
- Easy storage archiving



**Seagate** 

**FreeAgent GoFlex Home**  
NETWORK STORAGE SYSTEM  
SYSTÈME DE STOCKAGE RÉSEAU

**Easy to setup! Facile à installer!**

**Inside the Box**

- GoFlex Home network storage system
- CD with Backup and encryption software for 2 computers per home (additional add-on user licenses sold separately)
- NTFS driver for Mac pre-installed on drive
- 4GB (2 meter) RJ45 cable
- Power supply
- Quick start guide
- 2-year limited warranty



**Seagate** 

**FreeAgent GoFlex Home**  
NETWORK STORAGE SYSTEM  
SYSTÈME DE STOCKAGE RÉSEAU

**Automatically and continuously back up files and folders on every computer in the home – Time Machine® software compatible.**

- Share a USB printer with all computers in the home
- Simple set up takes just minutes
- Access files stored at home over the Internet from anywhere in the world
- Increase storage capacity with USB drives or upgrade the main integrated storage with a GoFlex™ Desk drive

**De forme automatique y compris copie de sécurité de fichiers et dossiers en tous ordinateurs en cas - Time Machine® de logiciel compatible.**

- Partager une imprimante USB avec tous les ordinateurs en cas
- Simple jeu prend place à quelques minutes
- Accéder aux fichiers stockés à la maison sur Internet de n'importe où dans le monde
- Accroître la capacité de stockage avec des disques USB ou mettre à jour la mémoire centrale intégrée à un lecteur GoFlex™ bureau

**Automatically and continuously back up backup de fichiers et dossiers en tous ordinateurs en cas - Time Machine® de logiciel compatible.**

- Partager une imprimante USB avec tous les ordinateurs en cas
- Simple jeu prend place à quelques minutes
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- Accroître la capacité de stockage avec des disques USB ou mettre à jour la mémoire centrale intégrée à un lecteur GoFlex™ bureau

**Power**  
Alimentation

**Desktop adapter**  
Adaptateur de bureau

**USB 2.0**

**Inside the Box**

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- NTFS driver for Mac pre-installed on drive
- 4GB (2 meter) RJ45 cable
- Power supply
- Quick start guide
- 2-year limited warranty

**Contenu de la boîte**

- Système de stockage réseau GoFlex™ Home
- CD avec logiciel de sauvegarde et de cryptage pour 2 ordinateurs par foyer (plus de add-on utilisateurs de licences vendues séparément)
- Pilote NTFS pour Mac préinstallé sur le disque
- Câble USB 2.0 de 2 m
- Cordon d'alimentation
- Guide de démarrage rapide
- Garantie limitée de 2 ans

**Connect FreeAgent GoFlex™ Home to your wireless router to access it from any computer on your network.**

**Connectez FreeAgent GoFlex™ Accueil à votre routeur sans fil d'accéder depuis n'importe quel ordinateur sur votre réseau.**

**Mac** **Windows** **Linux** **FreeAgent GoFlex**

Concept Packaging

# Software – Are you Buying Bits & Bytes?



In 1999 Sage's accounting software is ugly, slow, and hard to use.

Yet 40,000 people call Sage help line everyday and is the dominant accounting software in the U.K.



# When you buy Sage, you are not just buying Software, you are buying . . .

- **Reassurance:** when the tax laws change, the software will get updated too
- **Familiarity:** if you buy Sage, odds are that your accountant will already be able to use it
- **Support:** if you don't understand some of the accounting codes or procedures you need, then you can phone somebody for help

**The reason Sage is so dominant in the UK is because Sage understands exactly what their product is - You need to do the same**

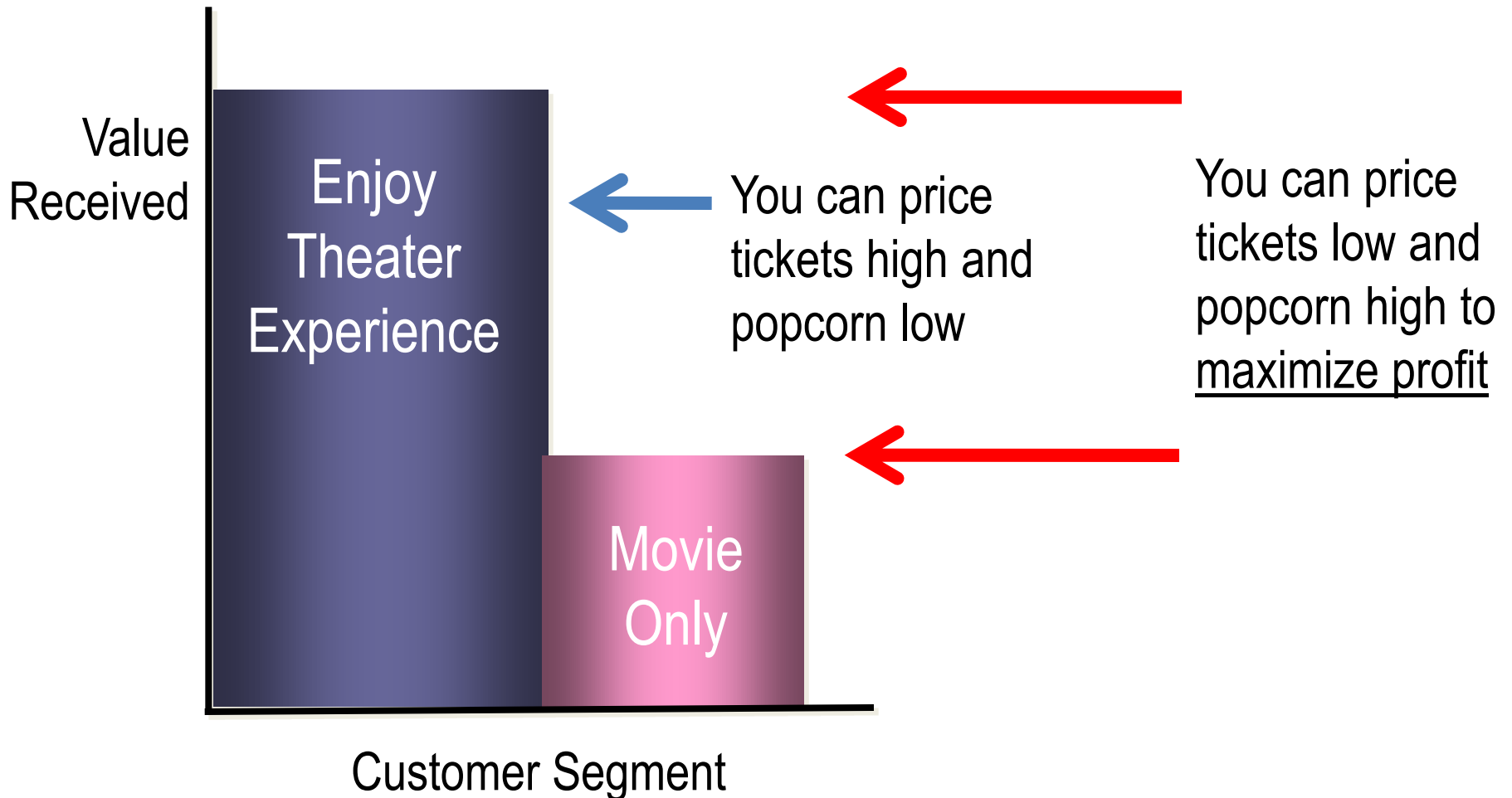
# Once you've Determined what your Product is, you need to Consider its Value to your Customers

- Traditional value metric: Per processor, Per Seat, or Per Something Else
- With this approach, firms are ensuring their solutions will be viewed as a commodity
  - Ask yourself this: *Can anyone tell the difference between kilowatts of power provided from two different utilities?*
  - IBM: *“Don't worry so much about the underlying technology, let's come to an agreement on results, and we'll charge you a fair price”*
- In software, customers are no longer buying “applications”; they are buying process capabilities that can quickly produce bottom-line results

# Why is Movie Popcorn so Expensive?



# It's Why You Price Segment: Different Customers Have Different Uses (Value) for Your Products



# What is your Enterprise Pricing Metric?

- Key is not to price what the technology does, but to price what the customers do with the technology
  - Flexible on-demand provisioning: *Very appealing to cyclical business. Consider catalogers during Christmas season – want flexibility of adding database, logistics, and billing application capacity in sync with their cash cycles to better control margins and capital investment*
- Firms need to break out of the narrow “computing as a utility” mindset and bundle basic services with more advanced services and deliver complete solutions

Winning Formula: Provide solutions to customers' problems with the right technology *and* delivery methods

- Customers want required functionality and access by individuals who need it (Product Dimension)
  - Deliver needed functions; minimize unwanted overhead
  - Provide the right access
- Customers want straightforward charges and payments (Contract Dimension)
  - Charges tied to usage
  - Payments tied to need
- When this happens the business transaction gets less costly and more profitable for both sides

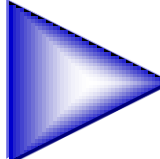
**Rule #2**  
**Offer Trade-Off Scenarios**  
**(“Give-Get”), Not Concessions**  
**(Trade Value for Price)**

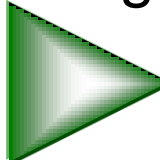
# Does This Sound Familiar?

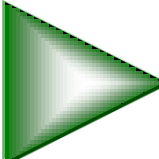
## (Positional Bargaining)

Seller: \$500 

Seller: \$450 

Seller: \$400 

Buyer: \$350 

Buyer: \$300 

*You can't expect customers to pay for value unless You have a price structure that aligns with value*

Agreement? 



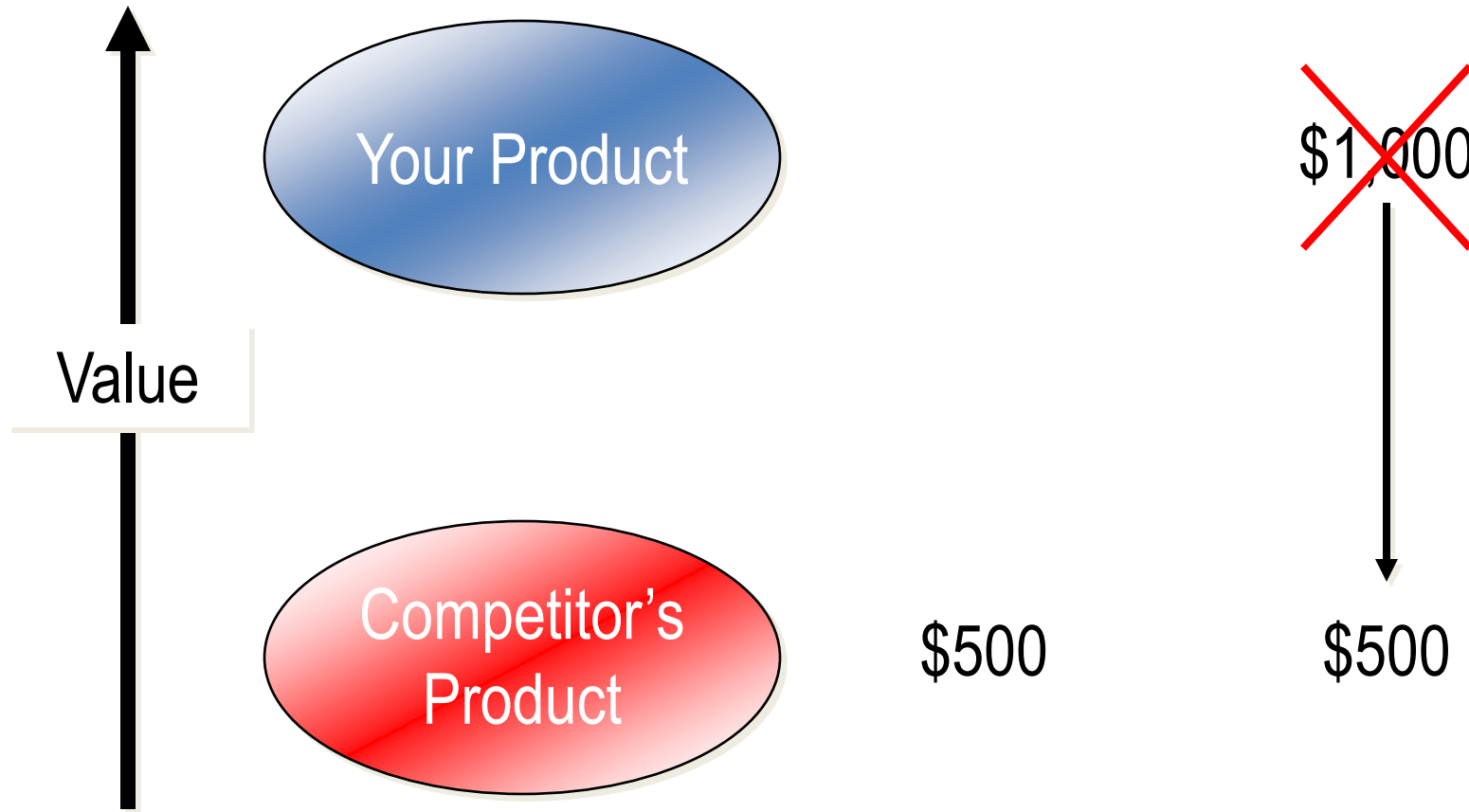
# Case Study: Mobile Backhaul

- Customer's in-production equipment is facing component end of life and needed to replace it
  - Our competition = another chip vendor
  - Customer willing to pay for proof of concept before deciding
- Proof of concept
  - Our Price: \$100K
  - Customize turnkey IP
  - Customer defined tester
  - Customer defined interface
  - Implemented on customer board passing through scarce telecom board

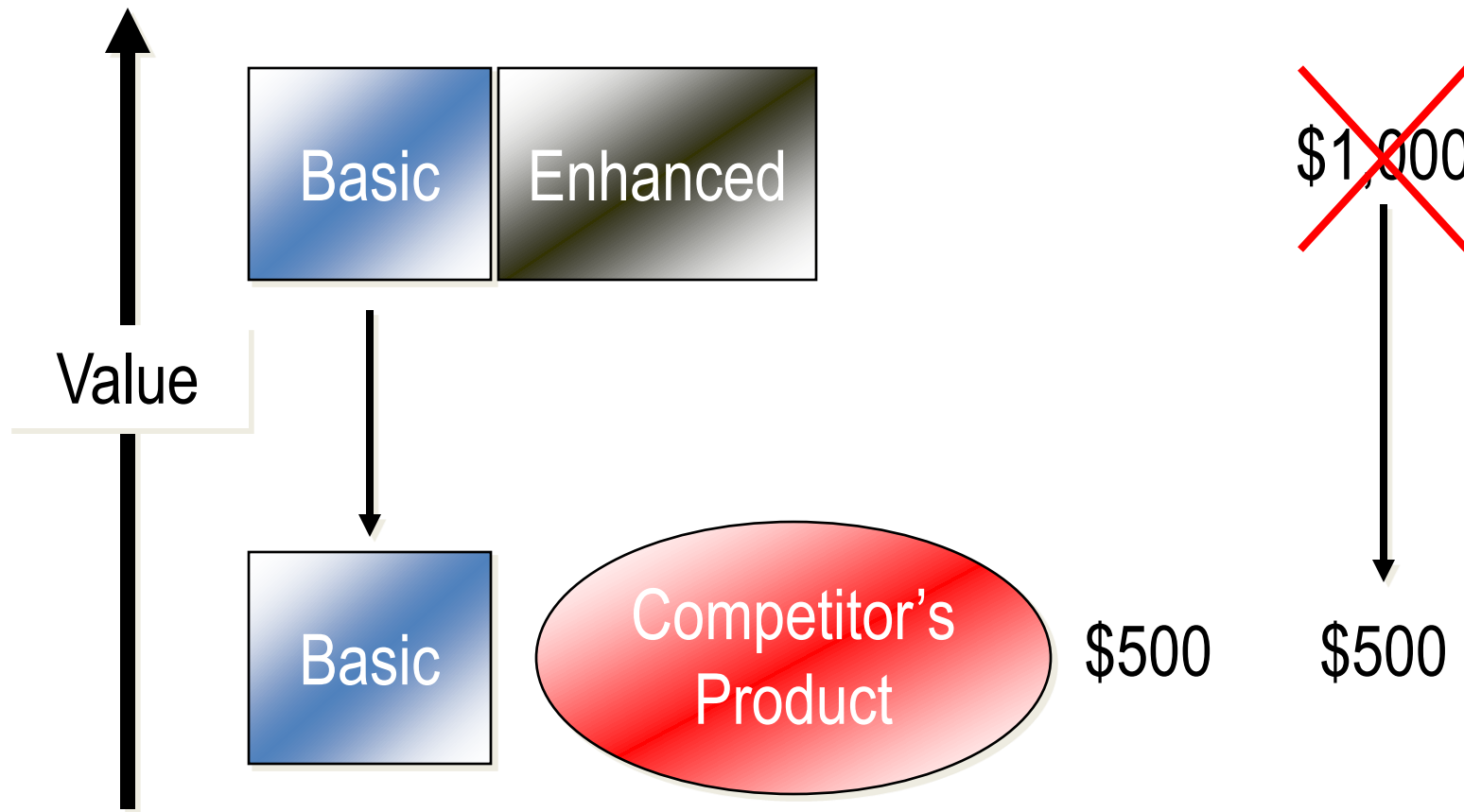


Customer offering to pay \$25K or we won't move on to next step

# Positional Bargaining gives away what Differentiates your Product and Drives the Discussion to Solely on Price

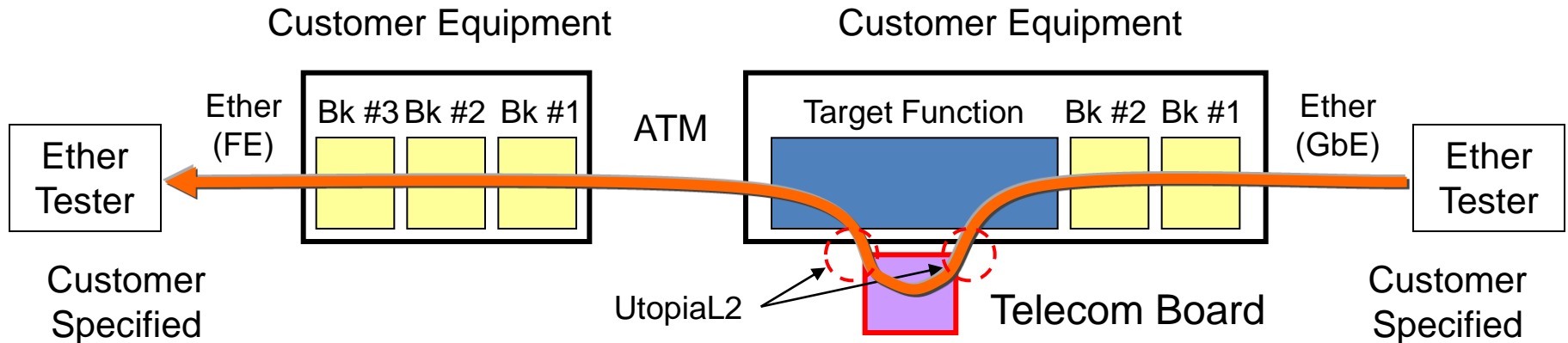


# Instead, Offer the Customer Alternatives and Force the Discussion to Value by Trading Off Value for Price

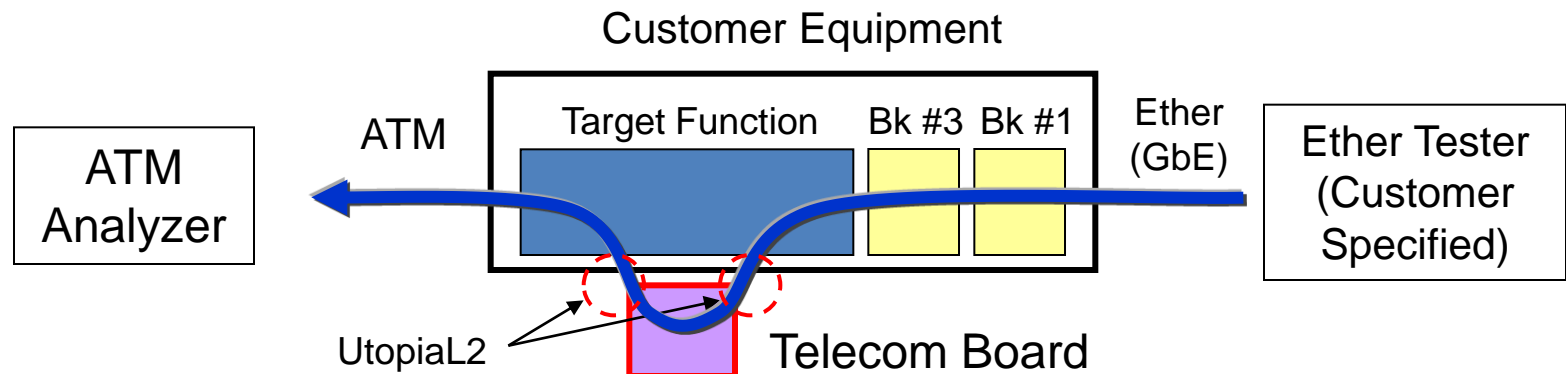


# Proof of Concept - Enhanced Option

## (1) To check data path

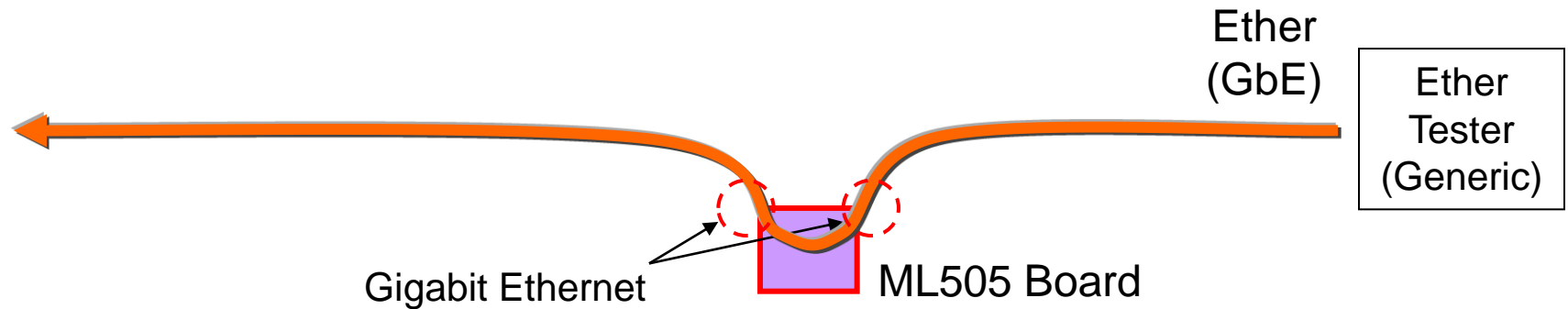


## (2) To check Shaping Function

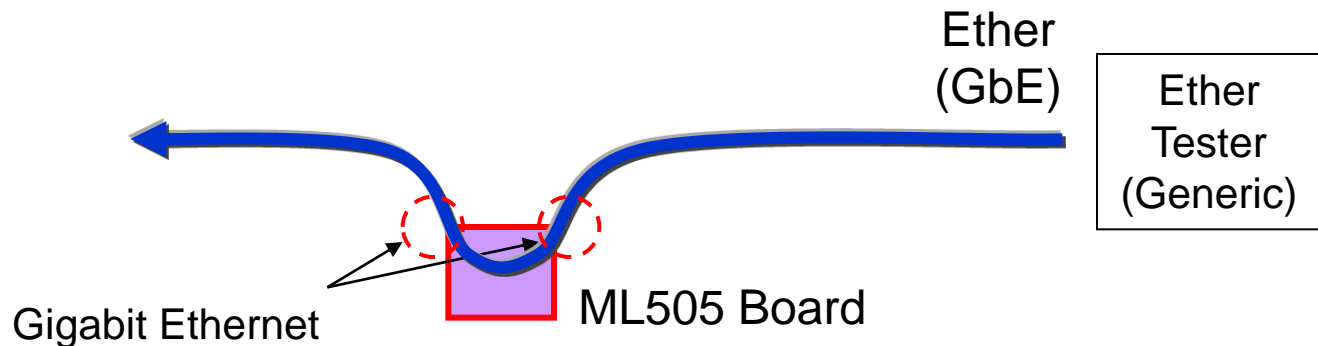


# Proof of Concept - Basic Option

## (1) To check data path



## (2) To check Shaping Function



# The Customer Selected the Basic Option and We Protected our Higher Value Offer

- Customer wanted an extensive proof of concept, but was not willing to pay \$100K and offered paying \$25K
- Sales asked that we drop our price and with past behavior we would have (or even gave it away)
- Instead we stripped down our offering and countered with a proof of concept that was good enough for \$25K
  - We forced trading off value for price
  - We protected our higher value offer
  - We reduced our effort and costs
- We proceeded to the next round of discussions

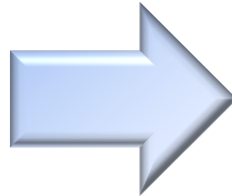
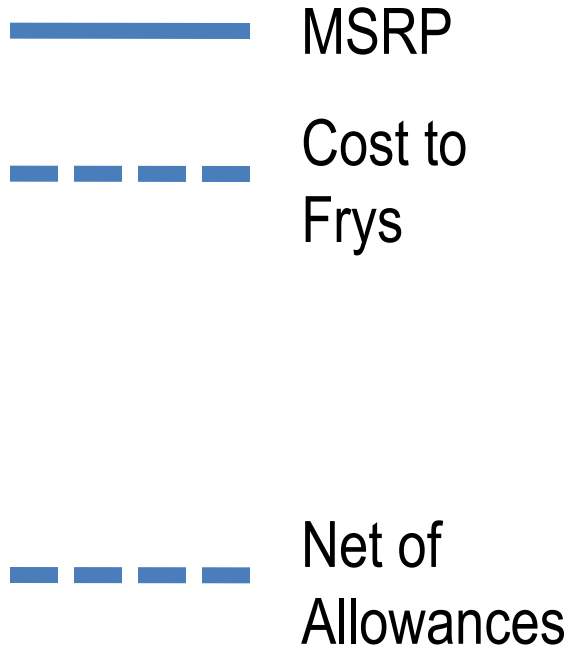


- Account was bleeding profit 3 years ago
- What would you do?
  - You sell electronic widgets or software
  - Fry's is saying your prices are not competitive
  - Holding out on placing orders
  - Your phone is ringing off the hook
  - Sales wants lower prices or they are escalating

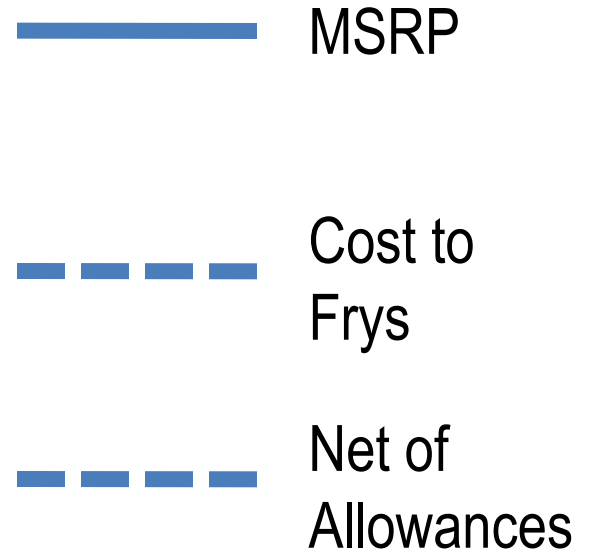


# Now a Profitable Business

## Before



## After





## **Rule #3**

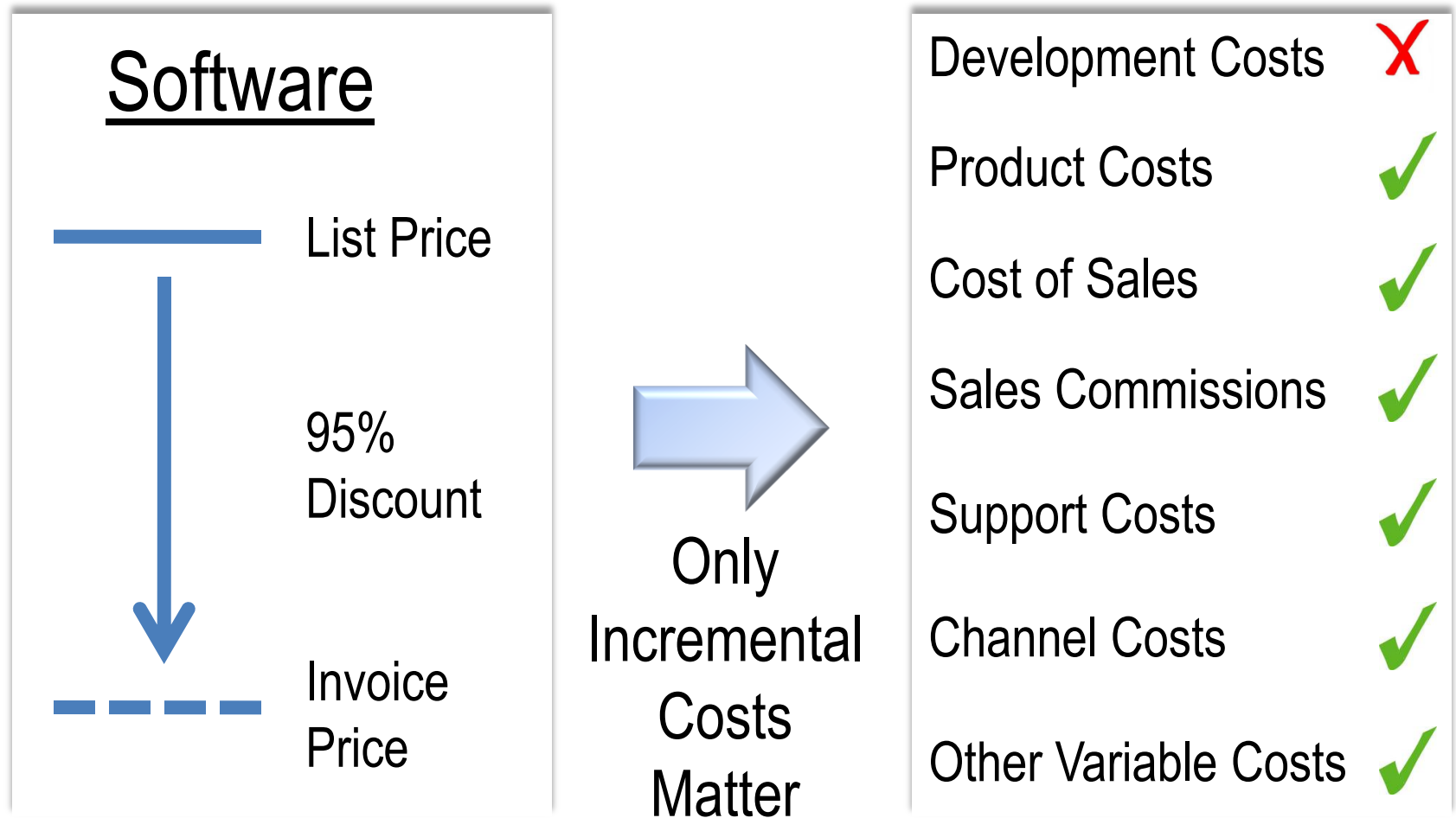
**Knowing When to Fold is as  
Important as Knowing When to Hold  
(Know when to be Desperate)**

# What Happens If You . . .

Cut Prices By . . .	5%	25%
% Volume Change (Breakeven Revenue)	5%	33%
% Volume Change (Breakeven Gross Profit)	20%	500%

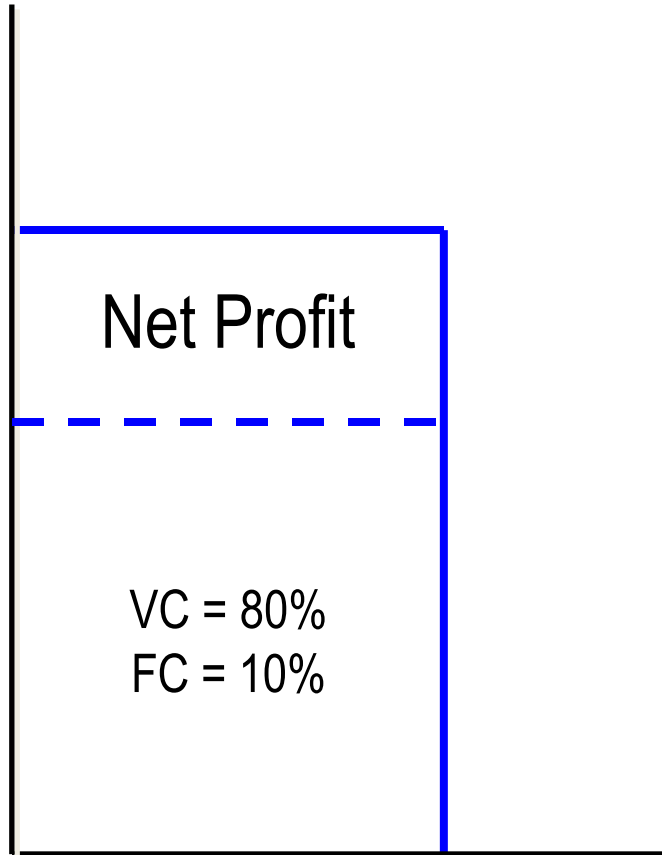
Note: Assume 30% GM and no distributor margin

# Let's Start with Which Costs Matter

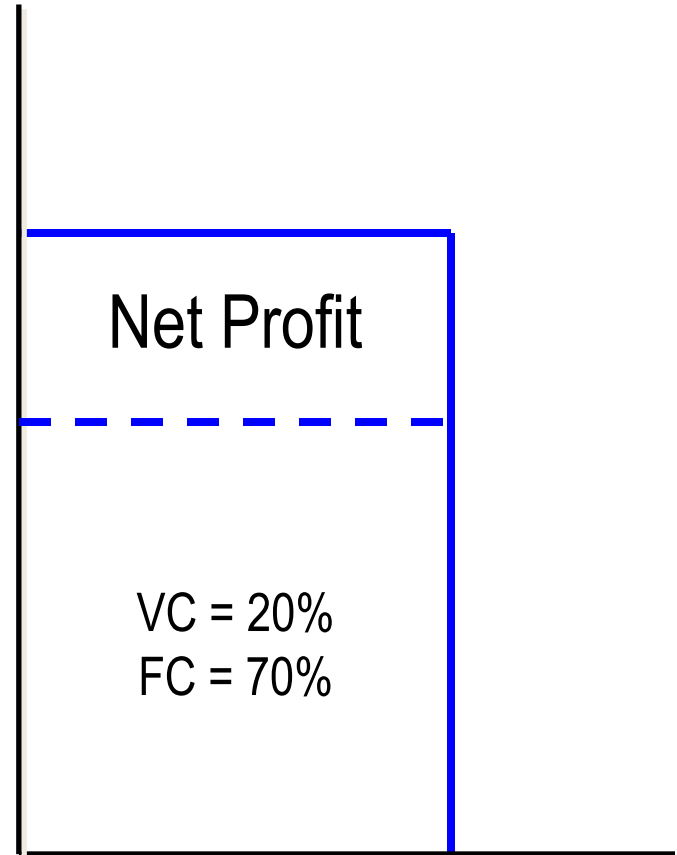


# Two Products, Equal Net Profit

Product 1

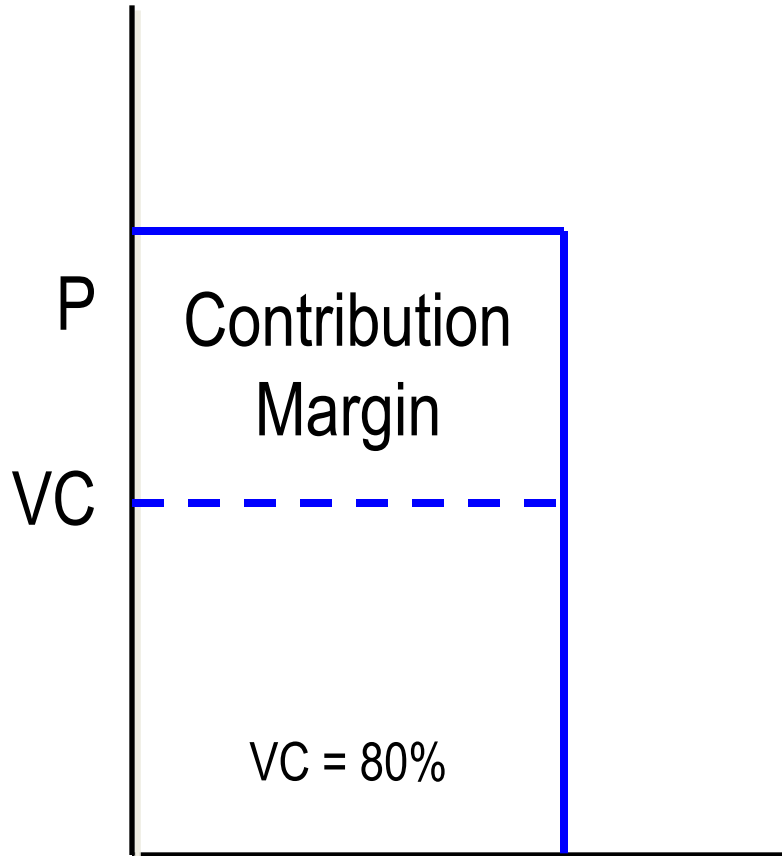


Product 2

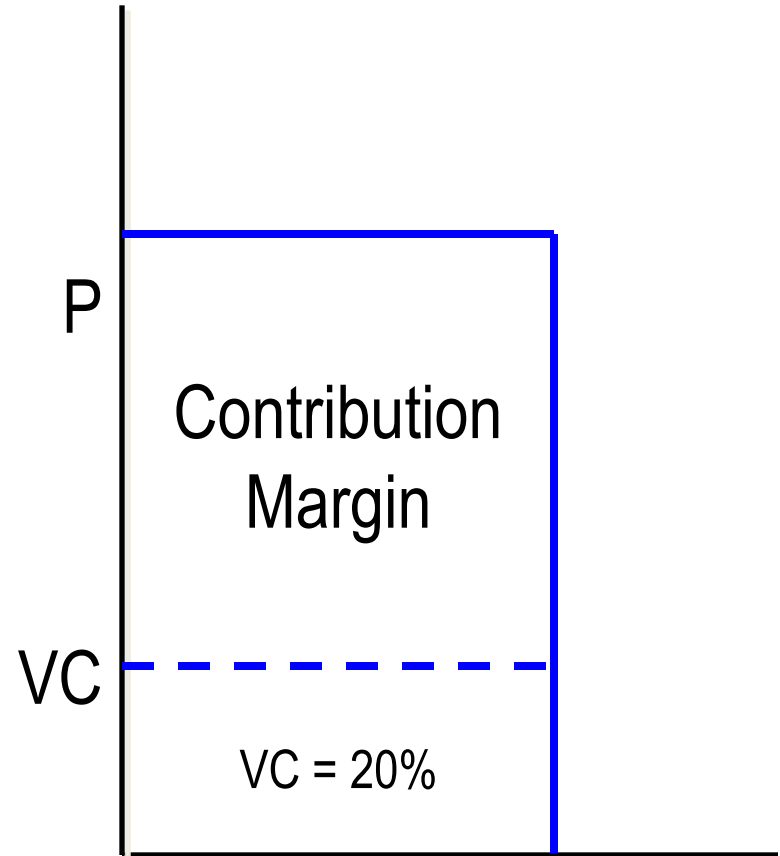


# Two Products, Diff Contribution Margin

Product 1

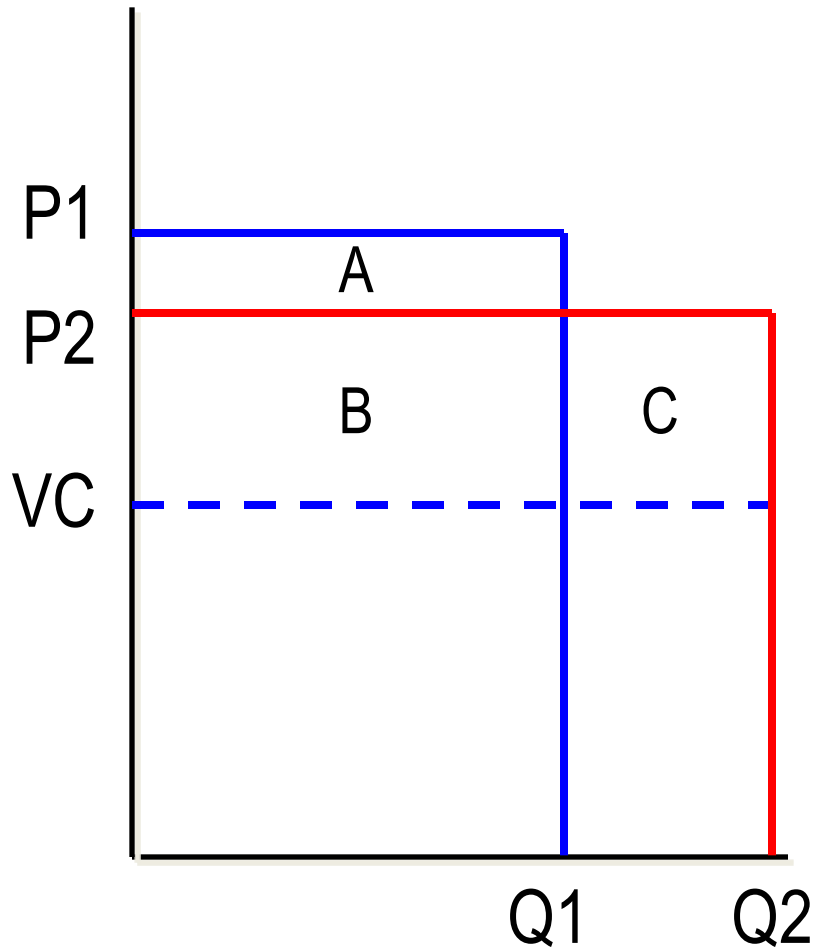


Product 2

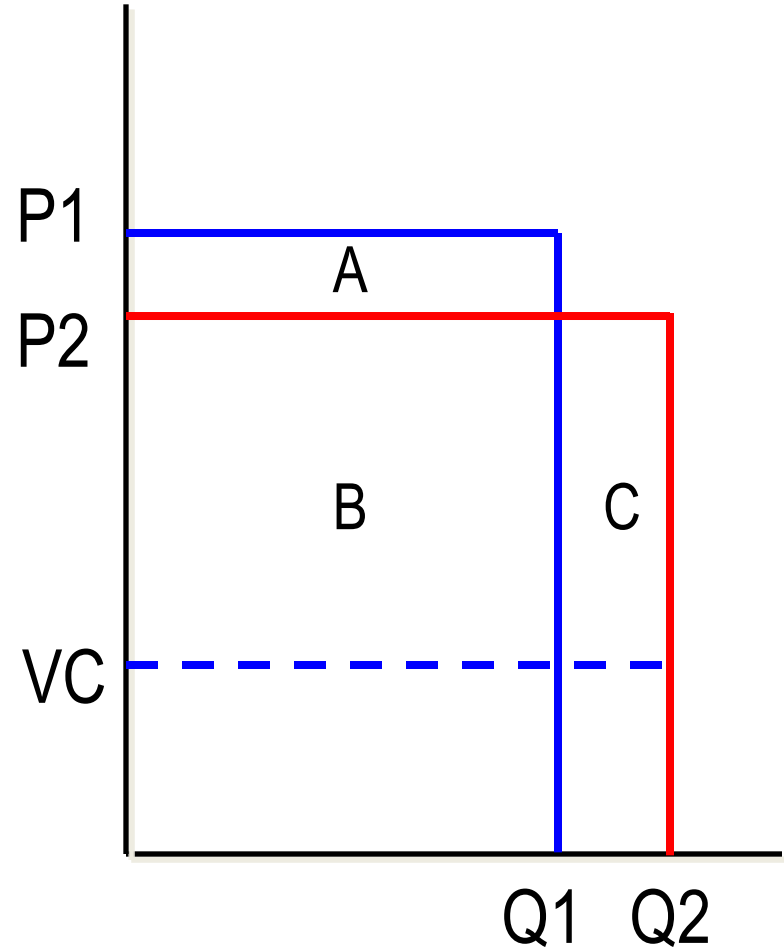


# Drop Price 10%: Higher Volume Demand Needed for Lower CM Product to Breakeven

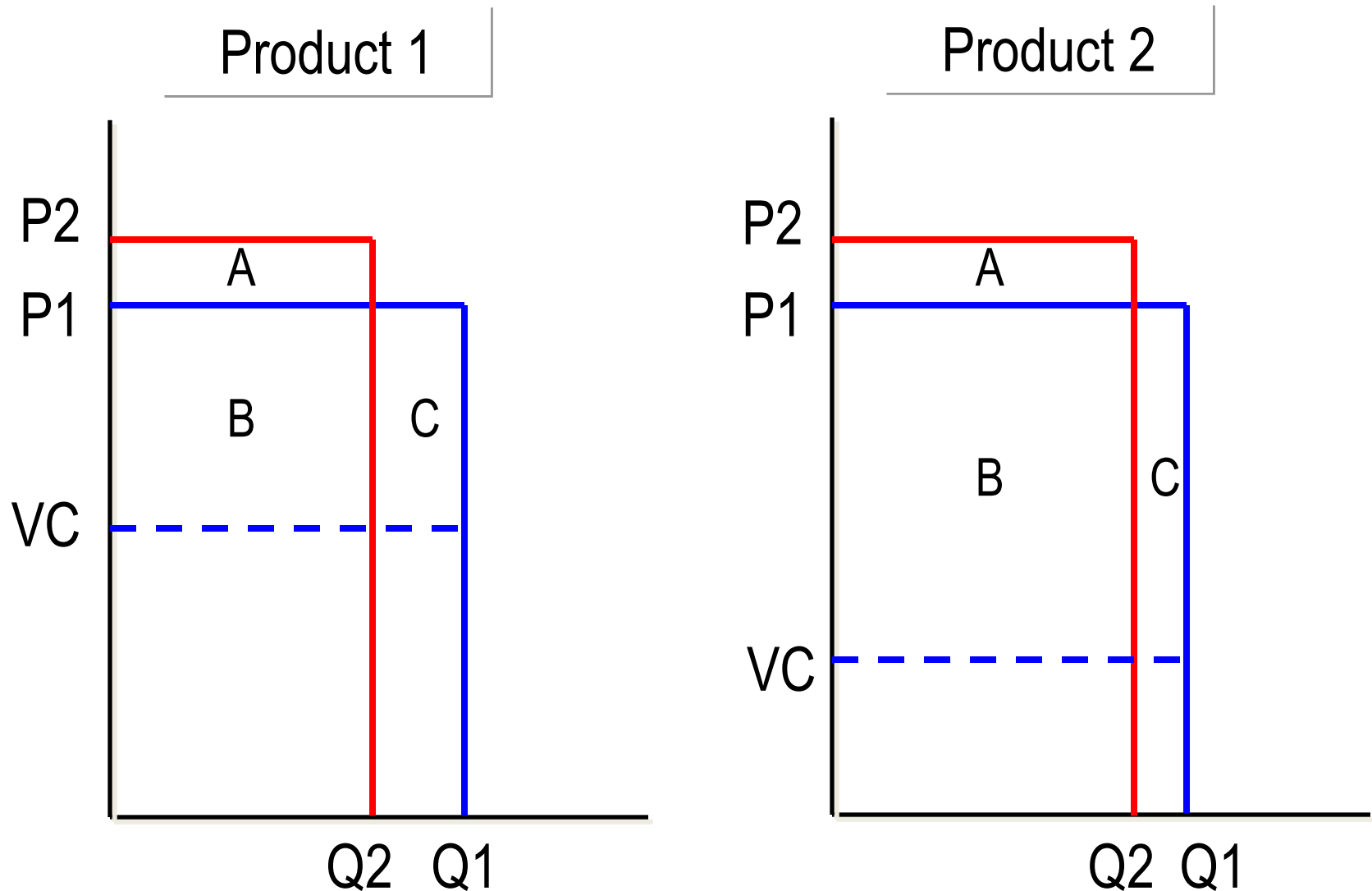
Product 1



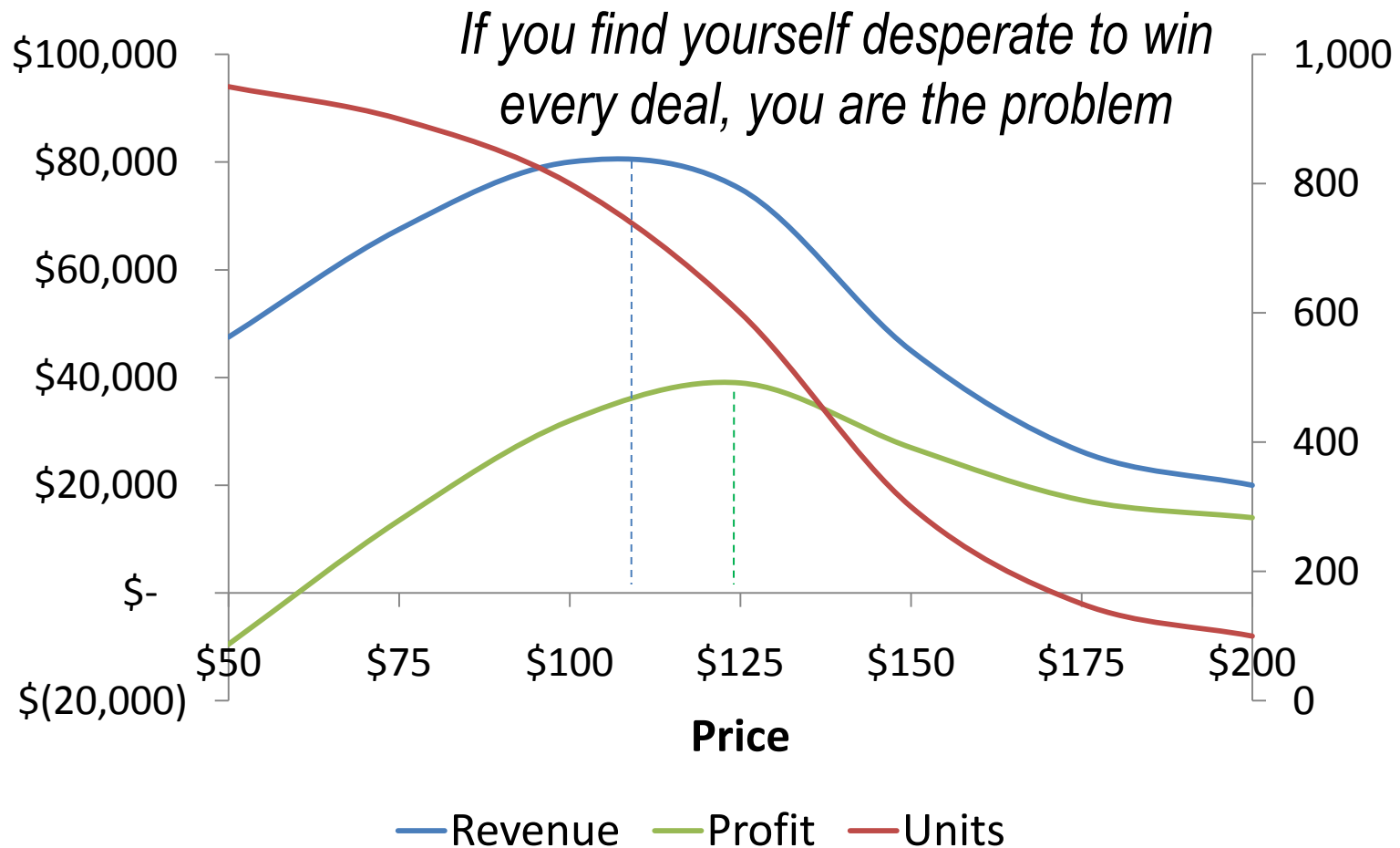
Product 2



# Raise Price 10%: Higher Volume Loss Needed for Lower CM Product to Breakeven



# You Have to Decide on Priority of Revenue, Profit, and Units

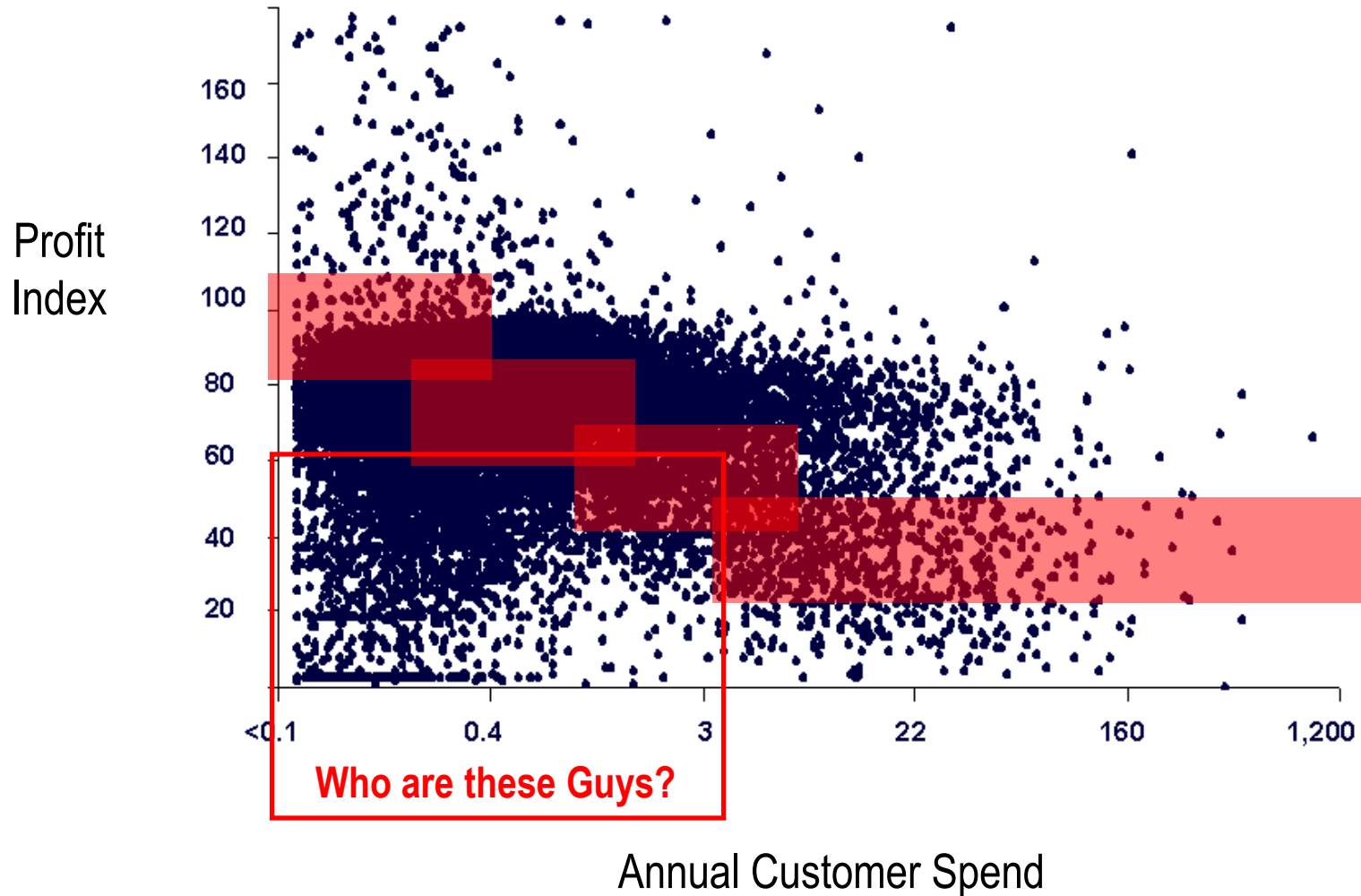




# **Rule #4**

## **Get Control of Your Discounting with Rules of Engagement**

# Do Your Discounts Make Sense?



# Ask Yourself the Following . . .

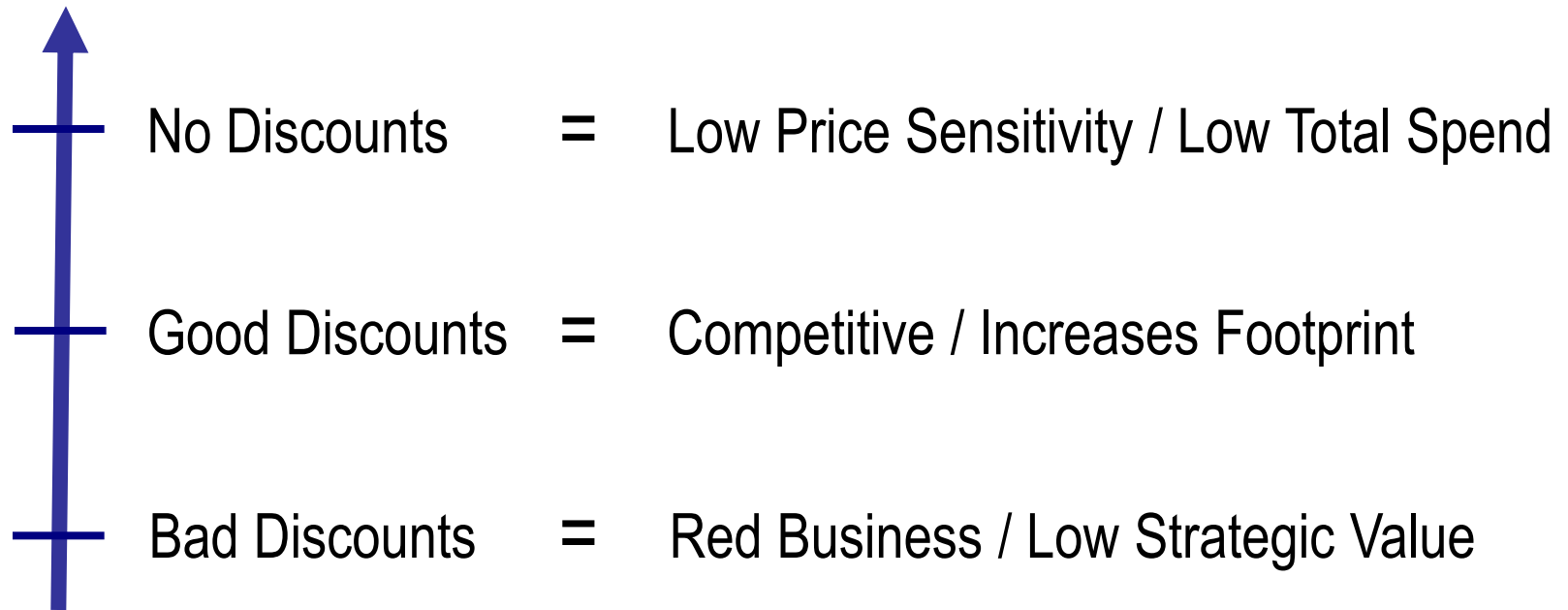
- Are discount dollars being invested in customer segments and product categories that provide the greatest strategic value to the company?
- Do discount levels vary widely, beyond what can be attributed to differences in deal size?
- Are discounts fairly consistent over time or do they rise sharply at quarter end?
- Is excessive discounting a widespread, relatively uniform problem in the company?

# Eliminating Unnecessary Discounts will Improve Profit Significantly

- If you want to stop any habit (unnecessary discounting), you've got to replace it with something
- First, recognize how bad the discounting is
- Once you realize how much money you're leaving on the table in your negotiations, develop some rules for when you will and won't discount
- Start with something like your smallest highest-value accounts and write those rules in stone
- Notice the results. See, you didn't lose as many customers as you thought you would

# Key to Rules of Engagement is Start with Something Easy

- Something that everyone can understand and will agree that it's the next step and you can put some teeth into it



## **Rule #5**

**New Products need a Context  
Without it, Customers cannot  
Evaluate a Price**

# Where's the Value?



**What are they Selling?**

# Typical Approach to Pricing Innovation

- Most of these products were developed by technicians
  - Scientists, Engineers, and Geeks
- They have typically been priced in one of two ways
  - Cost Plus
  - Based on the price of something similar
- These approaches lead to pricing disasters
  - Setting too low or high a price



# Pricing Unique New Products

- Pricing a unique new product requires thinking about value in unique new ways
- Pricing a unique new product with no direct comparators is a challenging task
- Unlike pricing new products in developed markets, a unique new product has no direct points of reference
- Understanding the critical issues, and processes, required to link the price with the value of the product is essential if you are to avoid pricing mistakes



A price needs a context – this is call a  
**ValueFrame**

Without it, a customer can't evaluate a  
price, and you will have trouble getting it

***Identifying and using the  
proper ValueFrame is the  
marketer's primary job***

# That's the Value!

- ▶ Do I have COPD?
- ▶ Should my COPD be treated?
- ▶ Is SPIRIVA right for me?
- ▶ How can I get the best results from SPIRIVA?

Receive free COPD resources.

To get expert information on managing COPD, [CLICK HERE](#) ▶

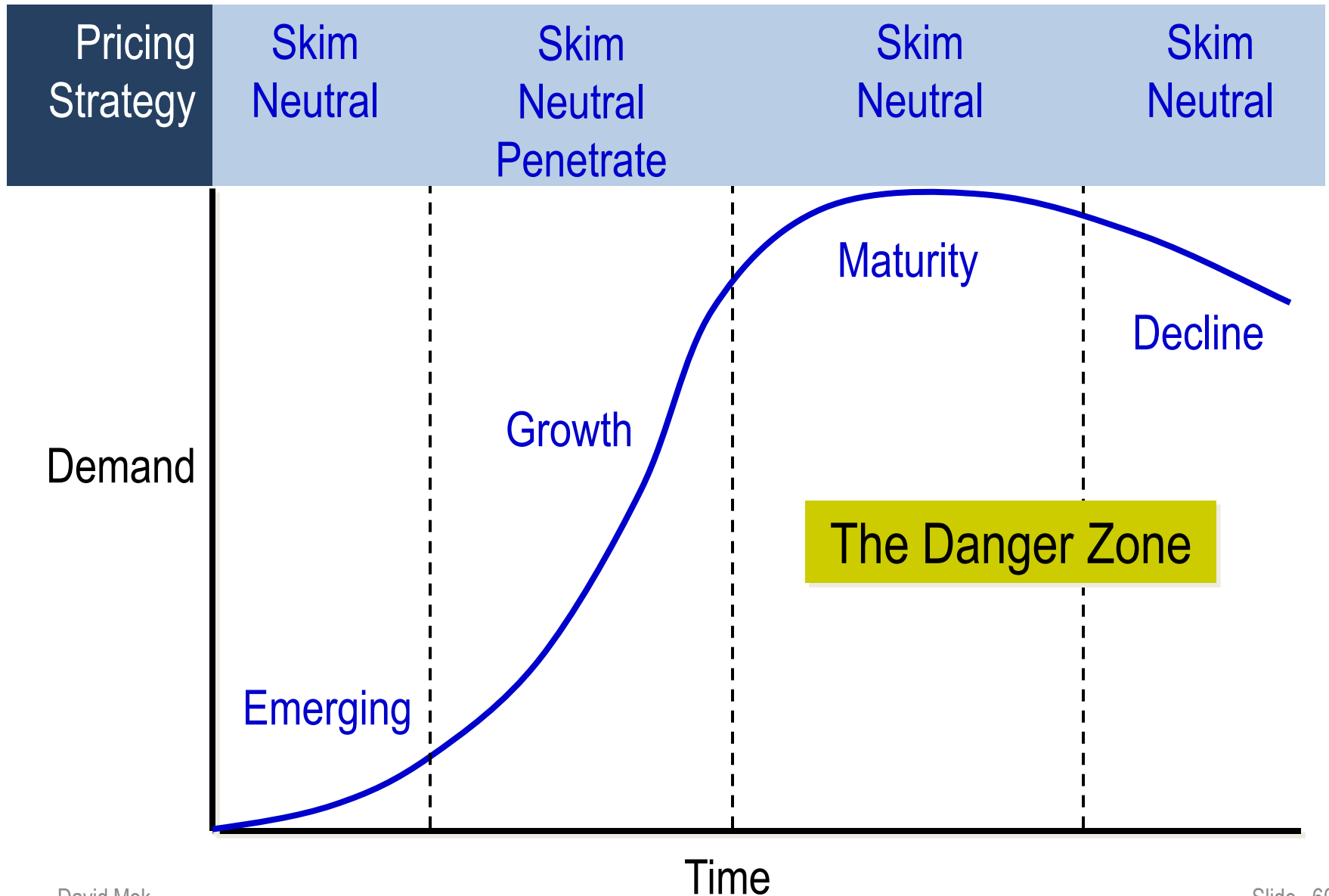
SPIRIVA is an inhaled maintenance prescription treatment for breathing problems associated with COPD (chronic obstructive pulmonary disease). COPD is a lung condition that includes chronic bronchitis, emphysema, or both.

Taking SPIRIVA once a day can help you breathe better all day, every day. And it's not a steroid.



BREATHING BETTER MAY  
LEAD TO THE BACK NINE

# Consider Where in the Market Lifecycle



# Summary

- Rule 1: Value justifies the price
- Rule 2: Trade value for price
- Rule 3: Know when to be desperate
- Rule 4: Get control of your discounting with rules of engagement
- Rule 5: New products need a context, without it, customers cannot evaluate a price