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Finance & Pricing Strategy

5. Pricing analytics and methods - Tutorial

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Economic Value to Consumers (EVC)

- Economic value to the customer is simply the purchase price that customers should be willing to pay for your product, given the price they are currently paying for the reference product and the added functionality and diminished costs provided by your product.

EVC formula:

$$\text{EVC} = \underbrace{\text{Reference Price}}_{p_{\text{main competitor}}} + \underbrace{\text{Differentiation Value}}_{V_{\text{you}} - V_{\text{main competitor}}}$$

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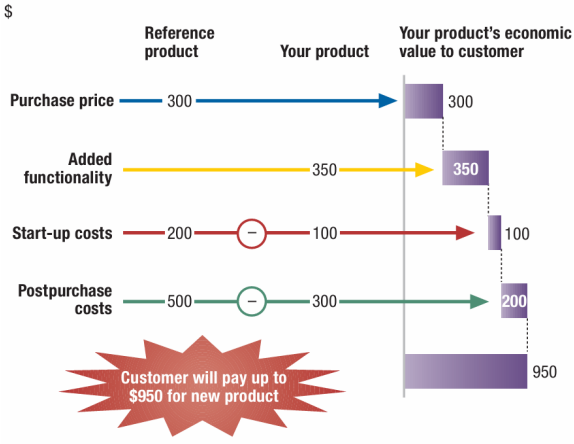
- Consumer's utility from your product: $V_{\text{you}} - p_{\text{you}}$.
- Consumer's utility from best alternative: $V_{\text{main competitor}} - p_{\text{main competitor}}$.

$\longrightarrow$ Consumer buys your product if $V_{\text{you}} - p_{\text{you}} \geq V_{\text{main competitor}} - p_{\text{main competitor}}$, meaning there is a theoretical upper bound to the price you can charge:

$$p_{\text{you}} \leq p_{\text{main competitor}} + \underbrace{V_{\text{you}} - V_{\text{main competitor}}}_{\text{differentiation value}} = \text{EVC}.$$

Economic value to the customer



You are a social media influencer with 1 million followers trying to decide how much to charge for a single post...

- Your closest competitor has 0.5 million followers;
- Charges $7,000 per post;
- Estimate the EVC.

	Competitor	**You**
Followers	500,000	1,000,000
% of followers who see ad	15%	10%
% who engage	1.60%	2.20%
% who buy	25%	25%
# sold to followers	?	?
Sales per customer	£200.00	£200.00
Brand's gross margin	30%	30%
Brand's gross profit	?	?
Competitor's price	£7,000.00	

Economic Value to Consumers (EVC) vs. Willingness To Pay (WTP)

	Economic Value to Consumers	Willingness to Pay
Definition	Total theoretical benefit or utility derived from a product.	Maximum price a consumer is willing to pay.
Nature	Objective calculation based on product benefits and cost savings.	Subjective valuation influenced by individual circumstances.
Determinants	Product's total value proposition compared to alternatives.	Information about all value/attributes that your product provides, perceptions, market factors, consumer's financial constraints.
Pricing Implication	Sets an upper bound on the value a product can deliver. Highest price the firm should reasonably charge for the product.	Determines the feasible price point for sales.

14 Factors That Can Impact Willingness to Pay

1. Income
2. Geography
3. Weather
4. Age
5. Gender
6. Brand Loyalty
7. Service Levels
8. Advertising
9. Competing Products
10. Expectations
11. Legality
12. Packaging
13. Environmental/Social Impact
14. Necessity

You work in the pricing division of Bosch. During your lunch break, a colleague from the sales team, Marine, tells you that according to sales data from leading retailers, your latest cordless vacuum cleaner, Bosch Serie 6 Unlimited, is not doing so well. In fact, they mention that the following three competing vacuum cleaners have much better sales:

1. SHARK DuoClean AZ950
2. Dyson V8
3. Miele Blizzard CX1.

Marine asks you if the price of Serie 6 Unlimited might be too high. Currently, the suggested retail price is £329.99.

Price-Elasticity of Demand and Demand Curve

- **Elastic goods**: highly responsive to price changes, substitutable goods, like clothes, some cereal,… luxury/non-essential goods, like restaurants, diamonds,…
- **Inelastic goods** are those whose demand stays relatively stable in the event of price changes, e.g., tube, gasoline, medications,…

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$$\text{e} = \frac{\text{Change in Sales}(\%)}{\text{Change in Price}(\%)} = \frac{\Delta\text{Sales}(\%)}{\Delta\text{Price}(\%)}$$

- If $|\text{e}| > 1$, demand is elastic: 1% increase in price leads to more than 1% decease in demand.
- If $|\text{e}| < 1$, demand is inelastic: 1% increase in price leads to less than 1% decease in demand.

Goods with Elastic Demand

In general. goods with elastic demand are luxury items or have a many substitutes

Goods with Inelastic Demand

In general. goods with inelastic demand are necessIties or have few or no substitutes

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Thank you.
Questions?