

Marketing and Pricing Strategies for C-ECO Business Model

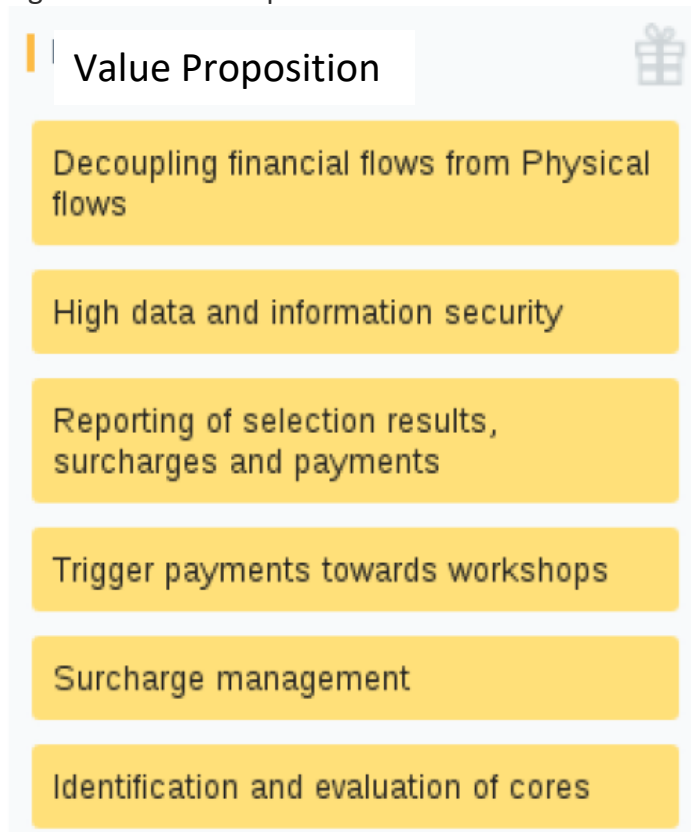
1. Introduction

The main goal of this report is to propose marketing and pricing strategies for the implementation of the Circular Business Model developed for the automotive sector to be used by C-ECO during the demonstration stage. The Business Model was developed for a specific customer segment – the independent aftermarket wholesalers.

The implementation of a Business Model (BM) requires a marketing strategy aligned with its components, to deal with value creation and capture. The marketing strategy should set the direction of the business and starts from the value proposition - how the product benefits customers and how it is unique in face to competitors. Having the value proposal to the consumer always in mind allows that the marketing strategy fits with what the company wants the customer to experience.

This means that the Marketing strategy for C-ECO starts from the value proposition presented in figure 1:

Figure 1 – Value Proposition for C-ECO Demonstrator Circular BM



The marketing strategy is operationalized in a marketing plan. This operationalization revolves around the tactics that are in line with the remaining

components of the BM. The most usual way of do this is by considering the marketing mix in terms of the 5 Ps: Product, Price, Place, Promotion and People. The plan will then describe the most effectively ways to promote the business and share the company's unique value proposition. This plan explains how the will show customers the value of its products or services and how to persuade customers to make a purchase.

In the case of the implementation of the C-ECO circular Business Model, it is possible to assert that pricing and promotion will assume a central role in the marketing plan, since they foster major challenges for the success to the new BM. Pricing and Promotion are related: If the company is capable of efficiently communicate the distinctive characteristics of its value proposition it can lower price sensitivity and charge a higher price to the consumer.

It is possible to relate these two elements of the marketing mix to the element of the BM Canvas:

- Pricing is related to Revenue Stream and is vital for the profitability and financial sustainability of the business. Pricing options made by the company will answer to questions like: for which aspects of the value proposition are customers really willing to pay? How much will they be willing to pay? How would they prefer to pay?
- Promotion is fundamental to clarify the customer's benefit and related to Channels (namely by contributing to raising awareness among customers about the company's products and by helping customers evaluate a company's value proposition) and Customer Relationships (namely in terms of customer acquisition and retention).

The following sections of the report will discuss the pricing and promotion strategies and tactics aligned with the circular BM developed for the C-ECO demonstrator. The relevant academic and practitioners literature is taken into account, as well as the information collected during the RECIPSS project activities (e.g. workshops, interviews) will also be considered, in order to present the more appropriate solutions for this case.

Finally it is important to stress that the work presented in this report reflects the fact that we are in the presence of a B2B business model, which impact on the analysis carried out and on the proposals arising therefrom.

2. Pricing strategies and tactics

Let us start by introducing the concept of pricing strategy as the "quantification of the perceived value that the firm creates for its customers. From a supply side perspective, pricing is a strategic and tactical expression of how the firm wishes to

compete to generate revenues and, in light of its business model, realizes a profit.” (Lancioni, Schau and Smith, 2005: 123).

Price is a fundamental part of marketing, fact that is recognized for a long time (Borden, 1964). Among the marketing mix variables, price is the only one that has a direct effect on the company's revenue – that is, price is a revenue-creating variable, namely for the case of B2B (Pitt et al., 2001, LaPlaca, 1997). Price setting is therefore an important capability to achieve business success. Despite the acknowledgment of this fact, pricing strategy is an underexplored topic of little in B2B marketing research and practice (Hinterhuber, 2004; Kienzler& Kowalkowski, 2014).

The BM literature presents several revenue stream origins and pricing mechanisms. Of particular relevance is the classification proposed by Osterwalder & Pigneur (2010), presented in table 1.

Table 1 – Origin of Revenue Streams and Price Mechanisms

Revenue stream origin	
Asset selling	Revenue comes from selling ownership rights to a physical product
Usage fee	The level of use of a particular service creates the revenue stream: the more a service is used, the more the customer pays.
Subscription fee	Revenue derives from selling continuous access to a service: the customer pays a monthly/yearly amount in exchange for access to service during the period.
Lending/Renting/Leasing fee	Revenue is created by temporarily granting the customer the exclusive right to use a particular asset for a fixed period in return for a fee.
Licensing fee	Giving customers permission to use protected intellectual property in exchange for a licensing fee generates the revenue stream.
Brokerage fee	Revenue Stream derives from an intermediation service performed on behalf of two or more parties.
Advertising fee	Revenue Stream results from fees for advertising a particular product, service, or brand.
Pricing Mechanism	
Fixed Menu Pricing	Predefined prices are based on static variables: <ul style="list-style-type: none"> - List price: Fixed prices for individual products, services or value proposition feature; - Product feature dependent: Price depends on the number or quality of value proposition features; - Customer segment dependent Price depends on the type and characteristic of a customer segment; - Volume dependent Price as a function of the quantity purchased.
Dynamic Pricing	Prices change based on market conditions: <ul style="list-style-type: none"> - Negotiation (bargaining): Price is negotiated between

	<p>two or more partners. Negotiation power and/or negotiation skills will influence the price;</p> <ul style="list-style-type: none"> - Yield management: Price depends on inventory and time of purchase; - Real-time-market Price is established dynamically based on supply and demand; - Auctions: Price is determined by outcome of competitive bidding.
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Source: Osterwalder & Pigneur (2010)

For new products or services, as is the case of the RECiPSS ICT Platform for Automotive Aftermarket, optimal price strategy is usually driven by the product sales curve along the product life cycle (Krishnan et al., 1999). When introducing a new product or service in the market, traditional advice of marketers usually revolves around two different strategies: penetration pricing and skimming. In the first, companies set the price of new products low right from the beginning of the life cycle, to preclude competition and "penetrate" the market, gaining market share quickly. In the second, new products are priced high at launch and then progressively lowered, to "skim the cream" (Hinterhuber, 2004). However, other alternatives can be used to attract customers, including discounting and rebates, price bundling, and psychological or "odd-number" pricing to appeal to customers (Pitt et al., 2001).

Price setting decisions are affected by three factors: competition, costs and customers' price sensitivity. Accordingly, although companies can use different approaches to price setting that vary across industries and countries, it is possible to recognize three main methods to determine selling prices, according to the factor that is central in the analysis: cost-based pricing, competition-based pricing or customer value-based pricing (Hinterhuber & Liozu, 2012).

Cost-based pricing is primarily driven by the objective of getting a specific return on investment or markup on costs and relies on accounting data. Examples of cost-based pricing are cost-plus pricing, target return pricing, markup pricing or break-even pricing.

Competition-based pricing draws on competitive price levels or on anticipated or observed actions of actual or potential competitors to set appropriate price levels. The use of this approach is based on the idea that price is one of the most important purchase criteria for customers. However, evidence shows that customers are frequently unaware of prices paid (Hinterhuber, 2016) and that, even when they are more aware of prices and more price sensitive, as is the case of business markets, other purchase factors price is usually not the most important customers are more sensitive to other aspects – such as services, convenience, expertise, speed, quality, customization or total costs of ownership – may have a higher-importance than the price (Avila et al., 1993; Ulaga & Eggert, 2006). Additionally, the use of competition-based pricing can exacerbate the risk of price wars between competitors.

Customer value-based pricing is focused on demand aspects (namely the willingness to pay and price elasticity). The final selling price depends on the perceived customer value of the product and therefore it is necessary to gain a deep understanding of customer needs, of customer perceptions of value, of price elasticity and of customers' willingness to pay.

Nowadays, it is recognized that traditional strategies based on cost and competition methods, which still predominate, have an inferior performance in terms sales and profits (Hinterhuber, 2016, Liozu & Hinterhuber, 2013). In fact, there is evidence that value-based pricing is the only pricing approach positively linked to profitability (Hinterhuber, 2016) and that firms that used value-based pricing – considered as an innovation in price setting – significantly outperform their competitors (Hinterhuber & Liozu, 2014). This strategy is also in line with the philosophy of the Business Model Approach – which revolves around value creation and delivery to the customer that needs to be captured by the company. For these reasons, value-based pricing should be considered to develop the pricing strategy behind the implementation of C-ECO circular BM. C-ECO is striving to understand and create customer value, and should use this as the main basis for pricing the new service and capture the value it creates.

In order to guide companies in developing a customer value-based pricing strategy Hinterhuber & Liozu (2014) provide a very useful roadmap, depicted in figure 2.

Figure 2 – A roadmap for using customer value-based pricing

Element	No innovation in pricing	Roadmap for innovation in pricing						
		Good-better-best market segmentation	Needs-based market segmentation	Pay-for-performance pricing	Pricing to drive market expansion	New metrics	Zero as a special price	Participative pricing
Strategy	Cost or competition-based pricing							
Tactics	Discounting	Revenue management	Contingent pricing	Bundling	Individualized pricing	Flat fees	Creative discounting	Psychological pricing
Organization	No pricing team	Dedicated pricing function	Centralization of the pricing function	CEOs as pricing champions	Confidence	Company-wide pricing capabilities	Change management	Pricing experiments: Pricing as learning

Source: Hinterhuber & Liozu (2014)

In terms of strategy, there are several ideas in the roadmap that can be applied to price setting in the context of C-ECO circular BM:

- move from a one-size-fits-all pricing to multiple price and value configurations reflecting differences in value creation for different customers. This offers customers different price points in order to address large variations in customers' willingness to pay, price sensitivity and need

for support. Therefore instead of having a single price policy, the company can design a pricing policy based on several price points to address a broad range of customers. This means that there will be an entry point (low price) and a premium point (higher price). Examples for three price points: basic, plus and premium; basic, silver and gold.

- use needs-based market segmentation for pricing decisions. This allows the company to simultaneously offer a multitude of products or services in the several price points with close to zero cannibalization. The several product or service options are directed towards clearly distinct needs of well-defined customers. This enables to address the specific and complex needs of the customers. In the case of the C-ECO circular BM this idea can be used, since the value proposition rests in several services that and be target at clearly distinct needs of the customers.
- use pay-for-performance pricing, where the supplier is paid depending on performance outcomes determined conjointly with the customer. For this is necessary to be very careful in the choice of KPIs to focus on in creating a compensation structure. Performance-based pricing can be costly, largely because monitoring is intensive. This option would be complex but possible option to implement in the case of C-ECO BM (at least before the demonstration phase). For instance, one of the KPI could be related to the reduction of "lost surcharges".
- use pricing to drive market expansion. Prices are set according to key customer segments willingness to pay and then the company works backward to determine suitable costs. In this case prices are the drivers of costs.
- develop new price metrics, resulting from the alignment between the price and the customer goals and preferences.
- use zero as special price, namely in freemium-based approaches, where basic/standardize versions are free and advanced/customized versions are sold. Freemium can be an effective customer acquisition strategy, but there are huge challenges in pushing a customer up to a premium tier, namely in terms in-depth knowledge about customer behavior and incentives.
- use participative pricing, where customers take an active role in pricing, using ICT, for instance by submitting a bid price above an unknown threshold or by pay what the want based on product assessment and fairness.

In terms of tactics, there are also several concepts in the roadmap that can be applied to price setting in the context of C-ECO circular BM:

- use revenue management tactic by varying price levels and bookable capacities conjointly to optimize profitability. This tactic can only be applied in industries characterized by the following features: fluctuating demand, existence of different customer segments, fixed and perishable capacity, high fixed costs, low variable costs, and predictable demand.
- use contingent pricing, by selling the product or service at a low price if it is not possible to get a higher price offer during a specified period.

- use bundling—that is, selling packages of two or more products or services. This tactic can lead to a growth of profits, by letting companies to appropriate a larger share of customer surplus, if there are differences in customers' relative valuation of single components. This tactic is relevant for C-ECO circular BM, since the value proposition includes several complementary services that can be bundled in different packages. The packages can be based on different services and/or in different levels of services. Different packages can then have different prices.
- use individualized pricing, that is charge substantially different prices for identical products or services, based on individual customer data collected through information systems.
- use flat fees, that is fixed fees that allow customers unlimited consumption. Evidence shows that customers usually end up paying more with a flat fee than with a conventional pay-per-use plan, yet their satisfaction is higher.
- use creative discounting: 1) Non-linear pricing, whereby prices develop non-linearly with product volume. This can be used in some of the services offered by C-ECO, namely in pricing the ERP connection to the interface; 2) steadily decreasing discounts, whereby discounts are gradually phased out instead of an immediate abolition of discounts under hi-lo pricing; 3) Bonus packs, whereby volume can be used to imply savings. 4) Innovative discount presentation, amplifying perceived savings through the presentation format (e.g. "pay only 60% of the regular price" instead of "get 40% off"). 5) Cross-market discounts, whereby companies use their strong position in one market to increase sales in other unconnected area. 6) Participative discounts, whereby specific actions on the part of customers (e.g. referrals and minimum purchase requirements) lead to reduced prices.
- use psychological pricing to construct customers preferences and willingness to pay, namely: 1) advertised reference prices; 2) 9 endings since there is abundant evidence that customers perceive prices ending in 9 as lower than they actually are and associate 9 endings with special offers; 3) compromise effect, by giving intermediate, rather than extreme, options in a choice set, because customers are averse to extreme options (it is possible to increase the likelihood that customers buy a premium product by adding a super-premium product to their offer); 4) decoy effect, that is include an option which consumers would presumably avoid, in order to drive customers to choose the premium version: compared to the decoy, the most expensive option looks cheap (e. g. Apple uses memory size to influence customer perception such that the most expensive product appears underpriced) (Hinterhuber, 2016).

Customer value-based pricing approach has a major drawback: the data on customer preferences, willingness to pay, price elasticity and size of different market segments are usually hard to find and interpret (Hinterhuber & Liozu, 2012). In the case of the implementation of the C-ECO BM, using the demonstration phase to collect the relevant data could mitigate this disadvantage.

Additionally, companies need to be aware of the risk of being in a situation where they have to manage many price points, since it is possible to take value and use to every single customer/product combination (Hinterhuber & Liozu, 2012).

In order to understand the sources of economic value of a product or service to customers it is necessary to conduct an economic value analysis. Only then is it possible to avoid flawed pricing decisions, namely pricing truly innovative products far too low (Hinterhuber, 2004).

Among the data that is usually used by marketers to price setting is the willingness to pay, depicting the inherent, albeit unobservable, property of goods or services, which should be measured – by assigning monetary values to specific attributes - using a conjoint analysis and other approaches (Auty, 1995; Voelckner, 2006). In conjoint analysis, customers are presented with a set of options in terms of price-quality of product/service and are asked to indicate the one they prefer.

However, this approach may be considered passive and there is evidence showing that some leading companies do not take this road. They do not see willingness to pay as something that is inherent in a product or service, but something that can be actively managed and influenced using consumer psychology, namely using the decoy effect (Hinterhuber, 2016).

3. Promotion strategy

Traditionally, in industrial businesses undervalue promotion and rely heavily on their sales forces, and personal selling, namely through face-to-face presentation to prospective buyers (Hellman, 2005).

The promotion strategy is vital in order to increase the demand for a product or service, by informing, persuading, or reminding the customers of the value of the product or service, to influence their opinion or elicit a response. In B2B business promotion should have a more central place in the marketing mix, going beyond price cuts and discounts and creating extra value for customers, building brand equity, improving profits, and permanently increasing sales (Hellman, 2005).

It is a mistake to assume that customers will immediately recognize and pay for a truly innovative and superior solution (Hinterhuber & Liozu, 2012). To develop an effective promotion strategy B2B it is necessary to understand the customer and to master all aspects of the value proposition.

In industrial marketing and in situations where the service component is important, as in the case of C-ECO BM, personal relationships with qualified sales personnel are detrimental to attract and maintain customers. Building long-term relationships with customers can create significant switching costs, namely if there is investment in an information infrastructure that allows in-depth customer knowledge (customer

preferences, tastes, and purchase histories are stored electronically) (Hinterhuber, 2004).

Promotion has an increased importance if the company is using a Customer value-based pricing approach. In this case, there is a need to educate customers and communicate to them the uniqueness and value of the product or service before linking price to value (Hinterhuber & Liozu, 2012). Customers must first recognize value in order to be willing to pay for value rather than base their purchase decision solely on price. In fact, nowadays, marketers recognize that customer willingness to pay depends only on customer perceptions of value (Hinterhuber, 2016).

In this context, communicating value to the customer is the most important task in industrial selling (Hinterhuber & Snelgrove, 2012). To do it successfully, it is necessary to determine the value of each benefit for the customer. The launch campaign should stress the benefits - solid communication of the beneficial aspects of the value proposition. (Hinterhuber & Liozu, 2012). Companies also need to quantify the value that is being offered to the customer (incremental value provided to the customer by the unique aspects of the company value proposition), to document the incremental value, and to clearly communicate that value (Hinterhuber, 2016). In B2B markets, without number supporting the claim of superiority or uniqueness the customer will not take the offer seriously (Anderson et al, 2006).

An effective communication expresses a deep understanding of the customer's business priorities. This means that suppliers' sales force should not try to communicate all elements of their value proposition to the prospective client but focus on the one or two points of difference that deliver, and whose improvement will continue to deliver, the greatest value to that specific customer (Anderson et al, 2006).

Promotion can be used to reduce customers' price sensitivity by emphasize the unique value brought by the company value proposition (unique value effect). The goal is to communicate "unique" features that customers will pay for despite the existence of lower priced alternatives (Nagle & Holden, 2017).

4. Pricing and Promotion: Recommendations for C-ECO Circular Business Model

Drawing on the insights presented in the previous sections, we present the following recommendations to:

1. Use a fix menu pricing.
2. Use a usage fee for the identification and selection of cores - continuing the practice currently in force for this service.

3. Use a brokerage fee, in the form of a commission per transaction, for the transactions in the core market (namely core transactions between wholesalers and between wholesalers and core brokers to avoid the lost of surcharges).
4. Use a subscription fee for the remaining services. Two tactics are possible:
 - 4.1. adopting creative discounting and non-linear pricing, for example, when pricing the ERP connection to the interface by level of use of the service – namely considering the number of customers (workshops) of each wholesaler – design a system where the average monthly/annual fees per customer drop with the number of the wholesaler’s customers.
 - 4.2 adopting bundling and multiple price points dependent on the service (the price depends on the number or quality of value proposition features). In establishing the price point use psychological pricing tactics, namely decoy, 9 endings and compromise effect. The later tactics suggests having at least three price points with corresponding levels of service, since customers are averse to extreme options.
For example:

	Basic	Plus	Premium
Reporting	Standard reporting for core evaluation	Customized reporting for core evaluation	Customized reporting for core evaluation + Reporting on payments
ERP connection to the interface	-	Until XX customers	No limit
Surcharge Management	Standard	Rule customization	Rule customization
Payment facilitation services	-	Until XX payments	No limit
Access to clearing house	See offers	See offers + Filter offers	See offers + Filter offers + Insert offers

5. Use a **free-trial** - “try before you buy” experience. This is an effective customer acquisition tactic for new products or services. It will give a potential customer a taste of the value C-ECO is creating and will help to overcome customer resistance to paying a service that he does not know. After the free trial experimental period (e.g. 3 months) convert free users to paying customers. The free-trial period could be combined with a steadily

decreasing discount tactics, where the price increases gradually until the “normal” price is achieved.

6. Quantify the customer benefits in relevant dimension during the demonstration phase and subsequently use this information to develop an effective customer value-based pricing approach. During demonstration relevant KPIs can be identified, tested and quantified, in order to be used in price setting. This will enable to further refine prospective customer value models, create value case histories, and get numbers on cost savings and incremental profits produced, therefore enhancing the credibility of the offering’s value.
7. Do not neglect promotion. Value proposition and pricing are not enough to attract and retain customers.

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