■ Allegheny Marketing Group ■

Seeds...

Issue Number 7

*This issue of Seeds… covers a relatively new research technique called **Conjoint Analysis**. It is becoming a popular research methodology in the industrial market. This issue also continues our practice of increasing the awareness of our readers that pricing is a marketing activity of extreme importance. Skillful price management is the quickest way to improve the bottom line.*

Pricing

The Allegheny Marketing Group conducts market research to measure price sensitivity. Competing in markets with low price sensitivity is a high priority with many marketing managers. However, even in price sensitive markets, there are methods that make products/services less susceptible to low price competitors.

According to Tom Nagle, author of "The Strategy and Tactics of Pricing", there are 9 factors affecting price sensitivity. Mr. Nagle mentions:

The Sunk Investment Effect
The greater the sunk investment, the less price sensitive products used as a result of the investment are.

The Shared Cost Effect
When costs of a purchase are shared, in part or whole, by someone else, the price becomes less sensitive.

The Substitute Awareness Effect
High awareness of alternate products/services causes higher price sensitivity.

The Total Expenditures Effect
When the expenditure is small relative to the total purchase package, the buyer becomes less price sensitive.

The Price-Quality Effect
The greater the consequences of poor quality, the less price sensitivity. (Provided higher prices signal higher quality.)

The Inventory Effect
If a buyer can hold inventories, the buyer becomes more price sensitive.

The Unique Value Effect
Buyers place high value on unique attributes and are willing to pay premium prices.

The Difficult Comparison Effect
Products that cannot be compared prior to purchase are normally less price sensitive.

The End-Benefit Effect
If the buyer's product is price sensitive, the buyer's purchase will be price sensitive.

It is likely only a few of these factors would apply to a specific business. Based on the Allegheny Marketing Group's studies, we have found the following to be most applicable and under the control of marketing executives.

Difficult Comparison Effect-	Companies selling to distributors carrying multiple competing product lines will likely see a higher degree of price sensitivity. On nearly all transactions, the distributor can make a direct comparison of suppliers' prices.
Total Expenditures Effect -	Companies having the ability to sell in small quantities can often decrease price sensitivity. The total expenditure for each transaction is less, making the buyer less sensitive.
End-Benefit Effect -	Companies selling to OEM's who have a product differentiation strategy will normally see less pricing pressure. Promoting products to those OEM's who focus on larger incremental increases in value for small incremental price increase is a sure winner.
Sunk Investment Effect -	Companies selling replacement parts or product upgrades normally see less price sensitivity. Strategies that include product add-ons at future dates are often successful and very profitable.

Market Research

Marketing executives frequently ask The Allegheny Marketing Group to help determine whether customers would rather buy product "x" with a low price, short warranty period and minimal product features or product "y" with a high price, longer warranty period and multiple product features. The answer "it depends" is generally not acceptable to our clients, but it is the way their customers think and buy. A relatively new industrial research methodology, called **Conjoint** or **Trade-Off Analysis**, is the technique needed to determine just what "it depends" means.

Conjoint Analysis is an analytical tool that quantifies how much buyers value product or service features and how much they are willing to pay for the value. This analysis reveals the buyer's true decision-making process and can unravel how the buyer would trade more of one product attribute for another.

The results of Conjoint Analysis can be a powerful marketing tool in the hands of experienced marketers. Unlike many other research methodologies, this analysis predicts behavior based on multiple "what if" scenarios.

The following examples have been used in our Conjoint research.

1. What will happen to our market penetration if we increase prices by 3%, 6%, 10% or 15%? (Without changing any product features.)

2. If we introduce this new product at $6.00 with a 3-year warranty and a 10-year life, what effect will it have on our total sales and on our other industrial products?

3. Our product margins are declining due to price deterioration in the market. What if we decreased prices 8% and eliminated two of our less valued features (that cost us 7%)? Would our total product margins increase and if so, by how much?

4. What if our major competitor comes out with the product they have been showing selected customers? What is likely to happen to our market share? (Unless we make a retaliating move.)

The "what if" scenarios can go on endlessly with the simulations available from the Conjoint software programs.

The key to a successful Conjoint Analysis study is the careful selection of product attributes (including price) and quantifiable levels for each attribute. An example, such as a decision of which VCR to buy, explains the need for picking attributes and attribute levels that are realistic.

Attributes	Brand Name	Price	Number of Heads/Sound Quality	Channel Programming Capability	Tamper Proof Child Lock
Levels	Magnavox	$150	2 with Hi-Fi	Manual	Has child lock
	GE	$200	2 without Hi-Fi	On-Screen	No child Lock
	Gold Star	$250	4 with Hi-Fi	Voice	--
	Sharp	$300	4 without Hi-Fi	--	--
	Samsung	$350	--	--	--
	Sony	$400	--	--	--

Market Research - *continued*

These attributes and their levels are entered into a pre-programmed computer disk interview. Respondents are asked a number of forced choice questions about each attribute and attribute level on the computer disk. Based on their individual responses, selected attribute levels are eliminated until a manageable set of finite "products" are chosen that the respondent would consider ("product" meaning a single set of levels for each attribute). These product combinations are then displayed on the computer screen and the respondent is asked to indicate their preferences as shown below.

Paired Comparison Question
VCRs

Which Would You Prefer?

Type a number from the scale below to best indicate your preference:

Samsung 2 Heads with Hi-Fi Has Child Lock $200	Magnavox 4 Heads without Hi-Fi No Child Lock $250

Strongly Prefer Left   1- - -2- - -3- - -4- - -5- - -6- - -7- - -8- - - 9   Strongly Prefer Right

The respondent is asked to repeat these preferences for a large number of other paired choice combinations. The computer program then runs a regression analysis and determines values for each attribute and attribute level. These values are calculated using a simulation package that determines a share of preference for each "product" ("product" defined by a single set of attribute levels.) By running different simulations, the "what if" scenarios previously discussed are played out.

The applications of **Conjoint Analysis** are numerous –

- Aids in product development efforts
- Assists product managers in product portfolio planning
- Helps determine price-volume trade-offs
- Aids in value-selling efforts
- Establishes strategic positions of competitor's products
- Provides different market segmentation possibilities

Conjoint Analysis is a tool every marketing executive should consider having in their tool box. It is a technique easily transferable in-house and can be an ongoing process.

Marketing Thoughts

Al Ries and Jack Trout published a book in 1993 dedicated to the elimination of myths and misconceptions about the marketing process, entitled "*The 22 Immutable Laws of Marketing*". In upcoming issues of *Seeds…*, we will explore these laws in detail.

Calling upon forty-plus years of marketing expertise, Ries and Trout have identified what they call the definitive rules that govern the world of marketing. By combining a wide-ranging historical overview with a keen eye toward the future, the authors have brought to light 22 tools and techniques for the international marketplace. They are:

1. ***The Law of Leadership***
2. ***The Law of Category***
3. ***The Law of the Mind***
4. ***The Law of Perception***
5. ***The Law of Focus***
6. ***The Law of Exclusivity***
7. ***The Law of the Ladder***
8. ***The Law of Duality***
9. ***The Law of the Opposite***
10. ***The Law of Division***
11. ***The Law of Perspective***
12. ***The Law of Line Extension***
13. ***The Law of Sacrifice***
14. ***The Law of Attributes***
15. ***The Law of Candor***
16. ***The Law of Singularity***
17. ***The Law of Unpredictability***
18. ***The Law of Success***
19. ***The Law of Failure***
20. ***The Law of Hype***
21. ***The Law of Acceleration***
22. ***The Law of Resources***

The Law of Leadership: It's better to be first than it is to be better.

Who was the first person to break the 4-minute mile? Who currently holds the world record for the mile? More people will recognize Roger Bannister as the first person than will know who the current world record holder is. The same analogy holds true in many product categories. High brand name awareness often goes to the first product introduced.

Creating a category where you can be first will maintain market leadership for long periods of time (until a new category is created).

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