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Advertising's slow road to value-based pricing

Posted on [January 23, 2013](#) by [Jon Manning](#)

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This post is by Jon Manning, Founder & Principal Consultant at [Sans Prix](#), a management consulting firm that helps companies monetise the value of their products and services with smarter, value-based pricing strategies.

As a pricing consultant, I am frequently asked by companies from all sorts of industries to assist them in a move to Value-Based Pricing (VBP). These companies tend to be acting proactively and initiate the move to Value-Based Pricing themselves. So what is Value-Based Pricing and why do companies initiate the move?

Value-Based Pricing is where a company monetises part or all of the economic value it creates for its customers. The economic value is created by the vendors' products and services either increasing the client's revenue, reducing their costs or minimising their risks. These three sources of value are not necessarily mutually exclusive: some products can increase revenue and reduce costs, for example.



One of the most commonly cited reasons by companies for shifting to Value-Based Pricing is that their customers don't buy from them because of what it costs the vendor to provide the product or service purchased. They buy from them because of the value they receive. If the research is to be believed, then the 70% – 80% of companies that resort to cost-plus pricing are pricing on a dimension that their customers just don't care about.

To put it another way, cost-plus pricing (like billing by the hour) is based on inputs, while Value-Based Pricing is based on outputs.

Value-Based Pricing requires vendors to have a knowledge and understanding of their customers' value-chain and their value creation process, and this is achieved via long-term, sustainable relationships, rather than the odd transaction here and there.

As a result, Value-Based Pricing is more holistic than alternative methodologies. It enables companies selling goods to monetise the services involved in the provision of such goods, while enabling service companies to shift their focus to the provision of solutions.

The majority of companies I work with want to move to Value-Based Pricing so

they can become the “price maker” in their industry, and reap the rewards that go with wearing that crown. Such a move also helps differentiate them, particularly in industries that are being commoditised or disrupted.

Which brings me to the advertising industry, which is one of two major industries where customers are demanding a shift to Value-Based Pricing because the industry itself is refusing to go there (the other industry is Professional Services, such as Lawyers, Accountants and the like).

“On 20th April 2009, Coca-Cola said it would adopt a “value-based” compensation system for the advertisers that do work for its 400 brands. Rather than paying advertising agencies for hours worked, Coke will pay for results achieved”

The Economist, 14th May 2009

The situation where customers demand Value-Based Pricing is not one you want forced onto you. It will catch you off-guard and force you to make mistakes that come with not planning ahead and being reactive to customer needs. You will be a commoditised “price taker”, constantly beaten up by powerful procurement managers.

Perhaps more worryingly, there is a huge risk of polarisation across the advertising industry. Those that can provide value-based advertising solutions to customers will command premium pricing.

And for everybody else, there’s “*commoditisation hell*”.

What are your experiences with cost-plus vs value-based pricing? Leave a comment with your thoughts.

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About Jon Manning

Jon Manning is Founder & Principal Consultant at [Sans Prix](#), a management consulting firm that helps companies monetise the value of their products and services with smarter, value-based pricing strategies. Jon is also the entrepreneurial mastermind behind [Pricing Prophets](#), the worlds first and only online pricing advisory service where companies can ask a panel of global pricing experts and thought-leaders what price to charge for a product or service, and why.

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