

Original Paper

On the Future of Pricing

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Abstract

Price is the most effective profit driver. In recent years we have seen a wave of innovations in pricing driven by technology. The internet, big data, and artificial intelligence enable the implementation of complex price structures, individualized pricing, ongoing time-based adjustments and performance-based pricing. Prices are increasingly expanding into areas such as the environment, traffic, social services and education. Pricing such services may be politically expedient but can lead to social tensions.

Keywords

pricing, profit, value, price differentiation

1. Introduction

Pricing has seen more innovations in the last 20 years than in the previous 2,000 years. The primary reason lies in technology. The discrepancy between fundamental idea and practical implementation can be illustrated by the example of Socrates. He said, “Happiness does not arise from possession, but from the use of a product.” Socrates can thus be seen as the father of the sharing economy, in which people relinquish ownership of a car or a scooter and merely use these objects. The increasing spread of the sharing economy through companies like Uber or AirBnB is transforming entire industries. Why wasn't this revolutionary Socratic idea implemented earlier? The answer is obvious. The transaction costs of sharing were too high before the advent of the Internet. Selling a scooter for 2,000 euros requires a single transaction. Shared use in minute doses requires thousands of transactions at minimal amounts, which are only economically feasible if the transaction process is extremely cost-efficient. In addition, there is the need to bring together a critical mass of demanders and suppliers. Neither of these is conceivable without the Internet.

What can we learn from these experiences about the future of pricing? I am convinced that we are on

the verge of another wave of innovations, involving numerous tools and sub-areas.

2. Action Fields of Pricing

2.1 Better Quantification of Value-to-Customer

The core of pricing is value-to-customer. This value must be quantified, because this is the only way to optimize price, which is by definition a quantitative parameter. Great progress has already been made with methods such as conjoint measurement. Measurement methods will continue to improve, leading to more valid and differentiated quantifications of value-to-customer

2.2 Advance of Complex Pricing Systems

Is a price too high or too low? This frequently asked question is naïve. A better question would be whether a pricing system is optimal. How do we differentiate prices? Should products and prices be bundled? Is dynamic pricing, where prices are continuously adjusted, effective? Instead of a one-dimensional price, should we have a multi-dimensional price scheme? Instead of a sales model, a subscription model? Do customers prefer pay-per-use to flat-rates? Is it possible to charge performance-based prices? Is a time-based price better than a per haircut price at the hair salon? There are an infinite number of variations, but you need a lot more data to optimize them.

2.3 Big Data and Artificial Intelligence

As a young pricing researcher in the 1970s, I was starved for data. Today, we are drowning in data. But data alone is not information. Traditional approaches, such as using econometrics, fail to exploit the possibilities of analysis. This is where Artificial Intelligence (AI) comes in. At Simon-Kucher, we have used AI and huge amounts of data to discover price effects that we would never have come up with “manually.” One example is the impact of Bundesliga matches on consumers’ willingness to pay. The individualization of prices will also benefit from AI.

2.4 Price and Shareholder Value

In most models, price is considered in the short term. What is the impact of a given price on profit? This relationship can be estimated more reliably than before because of improved methods and data. In contrast, research on the relationship between price and shareholder value, i.e., market capitalization, is in its infancy. I expect that this field will receive significantly more attention.

2.5 Expansion of Prices

It seems that prices are inexorably expanding and moving into areas that traditionally went without prices. These increasingly include education, transportation, the environment, parts of the health sector, other public services. These expansions of price contain potential for social tension. In exchange for a higher price, does one get faster lanes on roads or reserved parking spaces? Do people receive preferential treatment for higher prices, such as at airport security checkpoints? Can only the wealthy afford environmentally harmful behavior? Economically such systems make a lot of sense, both financially and in terms of control. Politically, they are explosive.

3. Result

The topic of pricing remains exciting and we will see a wave of innovations in the coming years. Artificial intelligence, sensor technology, blockchain, smart contracts and—in the more distant future - quantum computing will lead to pricing methods we have no idea about today.

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