

Pricing strategies and the perceptions that drive them

D. Kirk Eddleman
Weatherford, TX

In order to survive, let alone grow, a practice has to attract and retain loyal customers. A loyal customer is one who has a positive attitude about the practice, who buys frequently and who recommends the practice to friends and colleges. It costs more to acquire new customers than to retain current customers. This means loyal customers generate more profits each year they are retained. Given that successful practices typically see 80% of their income come from just 20% of their customers, it is vital that we learn to focus on customer loyalty especially with our top customers.

One of the three key determinates of customer loyalty is the total cost of using a practice's products or services. Customers will buy from the practice they see as offering the highest perceived value. Customer perceived value, or CPV, is the difference between the customers' perceived benefit derived from using a company's product or service and the total costs of purchasing that product or service. Therefore, pricing and other financial techniques can play a significant role in the customer's perceived value and, ultimately, are a key factor in practice profitability.

What is customer loyalty?

The "loyalty effect" is a powerful profit generator because loyal customers spend more, refer others, and cost less to serve. A loyal customer is one who has a positive attitude about the practice, who buys frequently and who recommends the practice to friends and colleges. Customer loyalty is about attracting the right customers and getting them to buy, buy often and bring you even more customers. Businesses with loyal customers grow, on average more than twice as fast as the industry average. In fact, the probability of selling a product or service to loyal clients is much higher, 60% to 70%, compared to former client, 20% to 40%, and only 5% to 20% for a prospective client. Often, veterinary practices will spend more of their time, energy and money on attracting new clients than on client loyalty programs. It's time for a paradigm shift. Our focus needs to be more on retaining customers rather than acquiring new ones.

Drivers of client loyalty

In order to focus on loyalty we must understand what drives it. Customers will buy from the practices they see as offering the highest perceived value. The CPV is the difference between the customer's evaluation of all the benefits and all the costs of an offering and the perceived alternatives.

$$\text{CPV} = \text{Total Perceived Benefit} - \text{Total Cost}$$

The total customer value is the perceived monetary value of the bundle of economic, functional, and psychological benefits the customer expect from a given product or service. Total customer cost is the total costs the customer expect to incur in evaluating, obtaining and using, a given product or service. Several factors can influence the customer's perceived value of a service. These include:

- Attitude - about the brand, quality and customer focus
- Brand image - such industry leader, trustworthy, innovative
- Customer experiences - perceived quality, purchasing process, supportive, caring staff, and service provided
- Perceived value - of the product or service received

Notice that the first three have nothing to do with price. Price is important but it is not the main thing that impact the customer perceived value. Emotions play a much bigger role than price or even quality. Yet, traditional customer loyalty programs have focused almost exclusively on lowering the price in the form of discounts.

Pricing strategies for customer loyalty in veterinary medicine

It is important to remember that while discounts have a high value for most customers (everyone loves to save money) they alone do not create loyalty. Discounts attract bargain hunters who are easily lured away from the practice by someone offering a better discount. Remember customer loyalty cannot be bought. It must be earned over time with good value for the money, superior products or services and the integrity of the practice. This means long-term loyalty must be developed at the emotional level. It must also be noted that giving a discount is giving away pure profit with no certainty that there will be an increase in volume to compensate for the discount given. Therefore, smart practice managers will use more sophisticated pricing methods that make customers earn discounts rather than simply giving them away. Discounts should be used to reward customers and to direct their behavior. To achieve this there are several pricing strategies we can employ. The ones most commonly used in veterinary medicine described below:

1. **Multi-step quantity discounts** - This strategy offers increasing discounts at higher purchase levels. As the purchased quantity increases, the discount is also increased progressively. This encourages increased purchases, as the next discount level is easily attainable. However, because the discount starts lower and increases as the quantity increases the average discount given is lower than the current discount.
2. **Multi-product pricing** - There are two types of discounts in this category. The first is “tie-in sales” is where a strongly discounted sale of the main product/service is linked to a longer-term agreement to purchase complimentary products or services. The main product may even be sold as a loss leader. With this strategy a regular stream of income is offset the discounted product or service. This means the loyalty effect is very strong although additional action will be required at the end of the agreement. The second type, “price/product bundling,” combines products and services that are generally sold separately. The bundle is sold at a significant discount versus the sum of the prices for the individual products.
3. **Multi-person discounts** - With this strategy a discount is not offered to the main buyer but to an additional buyer if their purchases are tied together. Here the loyalty program is aimed at the additional participants as well as the main purchaser. This creates a price advantage for the entire group. Multi-person discounts are used for revenue maximization and are ideal for companies/industries with low variable cost and high fixed costs such as veterinary medicine.
4. **The two-part tariff** - a mixture of an up-front flat payment and subsequent discounts spread out over a fixed period of time.

Each of these will be discussed in detail in the presentation with several examples of each for discussion purposes.

Determining price (how to properly set fees)

Before implementing any discount program it is critical a manager understands their cost of providing a good or service. The remainder of this presentation will focus on determining the total cost of providing goods and services and then setting fees based upon the actual cost plus a reasonable profit margin. This portion of talk is an interactive session designed to help veterinarians and practice managers better understand the true cost of doing business. We will use a hypothetical income statement to determine the direct variable and fixed costs that must be calculated when setting fees. In addition, we will apply these concepts to set fees both professional service and product fees common in almost any veterinary practice.

Summary

The ultimate goal of any customer loyalty program or pricing strategy is to maximize profits. In order to implement the right strategy in-depth analysis is needed. Rather than cutting into profits by simply discounting this thorough preparation will be rewarded with higher profits and more loyal customers. Value-oriented customer loyalty programs will help establish emotional relationships between the practice and the customer to create long-term loyalty.