

DYNAMIC PRICING: Everything Old is New Again

Back before the Industrial Revolution, haggling and auctioning were the rule of the marketplace. Today, the Information Revolution is having another look at dynamic pricing as a

key driver of global eMarketplaces.

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While dynamic pricing is being heralded as the pricing model of the future, it is actually significantly older than fixed pricing. Prior to the Industrial Revolution, our society was comprised of isolated communities that were generally immobile and agrarian. As a result, people took their livestock, crafts and produce to the local market where they could barter or sell their goods and

services – and haggle over pricing. Haggling is one form of dynamic pricing that takes place between a single buyer and a single seller.

Then the auction format evolved, where a seller could engage multiple buyers who competed to buy the seller's goods and services. The earliest known auctions occurred in 500 B.C. in Babylon, where women were auctioned off as brides.

The Basics of Dynamic Pricing

Dynamic pricing encompasses the following broad categories: haggling, auctions, reverse auctions and exchanges. Within these broad categories there is a further classification by type. For example English, Yankee, Dutch, Vickrey and

Japanese are some of the types of auctions and reverse auctions you might encounter. These auction types broadly define the rules of engagement, such as how bids are placed, who wins and how much they pay. These auction types are further defined by the parameters of the specific auction, including timing constraints, bidding and clearing rules, permissions and information disclosure, to name a few.

Auctions

There are several kinds of auctions on the Internet. All of these can be conducted as forward or reverse auctions.


- ◆ English auction – starts the bidding at the lowest acceptable price and asks for successively higher bids until the auction is closed. The highest bidder wins.
- ◆ Dutch auction – the bidding for one or a group of like items starts at a high price and is progressively lowered until buyers have bid on all the items.
- ◆ Vickrey auction – like an English auction, except that the second-highest bidder wins. This is to avoid “bidder’s remorse.”
- ◆ Japanese auction – begins at a low price and increases at a fixed amount. Bidders drop out at each increase until the last winning bidder remains.
- ◆ Sealed bid auction – each bidder makes a single, secret bid and the highest bidder wins once all bids have been received. Since no bidder can see the other bids, sealed bid auctions do not drive the price up through competitive bidding.

Reverse auctions

In a reverse auction, a single buyer posts a description of needed goods or services on an eMarketplace for multiple sellers to bid on. This eliminates the request for quotation process.

Exchanges

An exchange is sometimes used to describe a marketplace that brings buyers and sellers together for the purpose of transacting sales. It also can be defined as a specific bid/ask environment that matches buyers and sellers having the requirements in real time, for example, the NASDAQ exchange for trading over-the-counter stocks.



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But, just as you needn’t understand all of the rules of various forms of football – NFL, CFL, Arena, Australian Rules, etc. – to play a little flag football, you needn’t become an expert in all of the various aspects of dynamic pricing to participate in it. You only need to understand the rules of the particular eMarketplaces in which you participate.

The best way to develop a familiarity with dynamic pricing is to read the rules at the eMarketplaces that best suit your specific needs, and then observe a few auctions. You’ll soon develop a reasonable level of comfort and expertise. And before you know it you’ll be an active participant, either buying or selling.

In the meantime, here’s a look at some of the various kinds of marketplaces you may encounter:

Negotiation

This is the simplest form of dynamic pricing, also called bargaining and haggling. Negotiation takes place when one buyer and one seller intend to do

Division of labor

The Industrial Revolution, which began in England around 1760, ushered in an era characterized by the division of labor into distinct roles within an organization. This ultimately led to the creation of geographically distributed sales forces. It soon became obvious that dynamic pricing was not scalable in this environment. The problem with dynamic pricing is that in order to ensure that each transaction is profitable at the agreed upon price, the seller must understand the underlying material, labor, transportation and other costs for each product. It was very difficult to distribute the cost information, a portion of which is often variable, along with profitability guidelines to a geographically distributed sales force.

The birth of MSRP

In response, the pricing function became centralized. Sales forces were provided with standard pricing, from which they typically had little or no ability to deviate. In addition, the development of sales channels further complicated the pricing issue because manufacturers tried to avoid the negative effects of price competition by their various channels. By establishing a Manufacturers Suggested Retail Price (MSRP), manufacturers were able to manage these problems. They could determine a reasonable “standard” price in an effort to validate their wholesale prices, and also avoid the negative impact of unfettered price competition across their various sales and distribution channels.

As the number of mass-produced goods increased, so did the preva-

lence of fixed or static pricing. During this time in our history, dynamic pricing became relegated to the auctioning of one-of-a-kind goods like art; antiques; livestock; some agricultural goods, like tobacco; as well as used, overstocked or refurbished products.

Today, however, dynamic pricing is on the ascendance, particularly on the Internet. This is based primarily

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on three simple factors enabled by the Net: liquidity, centralized control of pricing, and reduced barriers to entry.

Liquidity

Liquidity is defined as an environment that brings together a large number of buyers and sellers actively engaged in transacting business, and it is critical to dynamic pricing. Its value can be distilled down to a simple question: If you were trying to sell something via an auction format, would you want to have two potential buyers or ten million? Clearly, the larger the number of buyers, the more opportunity to maximize your sale price.

The Internet, through its sheer number of users, is the ultimate infrastructure for developing liquidity. In fact, the number of people who scour local garage sales for gems that they subsequently resell on eBay for



several times more than they paid, also demonstrates the value of liquidity. The garage sale has only a limited number of visitors because of the constraint of having to physically visit the sale during limited hours. eBay, on the other hand, caters to millions of users around the world and around the clock, who



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compete for these one-of-a-kind gems.

Because of the value of liquidity, Internet auctions also enjoy increasing returns. In other words, buyers attract sellers, who in turn attract more buyers, feeding a virtuous cycle of growth. This favors large auction sites. However, depending on the targeted appeal of the goods you are buying or selling, you may find that vertical eMarketplaces provide superior liquidity. While the vertical eMarketplaces may not offer the quantity of either goods or buyers, depending on your perspective, they may provide the quality of goods and buyers necessary to create a liquid market.

Centralized price control

The second factor enabled by the

Internet is centralized control of pricing. As described earlier, the inability to distribute cost, value and pricing information to a geographically distributed sales force was one of the primary factors behind the creation of fixed pricing. However, the Internet's reach enables a single individual to manage several global auctions, reverse auctions, exchanges or even haggling, simultaneously. This ability to centralize the price determination with the individual or individuals who have sufficient knowledge to ensure that the transactions are profitable, greatly improves the value of dynamic pricing. Now companies can engage in dynamic pricing without fearing that their sales people, who lack sufficient cost information, may enter into unprofitable deals.

Reduced barriers to entry

The Internet has also lowered the traditional barriers to entry by companies who wish to exploit dynamic pricing. Almost all companies find themselves with excess goods at some point – typically in the form of excess inventory, refurbished products or used furniture and equipment. However, companies often do not know the value of these goods. In the physical world, the process of assembling an ad hoc market that leverages dynamic pricing – to establish the market value for these goods – is both cost prohibitive and a distraction from the company's core business. As a result, the typical course of action is to sell the entire collection to a liquidator, who resells these same items, utilizing dynamic pricing, to maximize their value.

The spread between what liquid-

ators pay for these goods and the amount they command in auctions has made the liquidation business quite lucrative. Now, however, companies can easily auction these goods themselves through a number of horizontal or vertical eMarketplaces using various forms of dynamic pricing.



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These eMarketplaces dramatically lower the traditional barriers encountered by companies because they provide a liquid exchange with a steady flow of buyers and sellers. And, listing products for sale is quite easy. As a result, more and more companies are taking this do-it-yourself approach to liquidating excess inventory, refurbished products and used furniture and equipment.

Finding a balance

Given the fact that the Internet greatly simplifies the use of dynamic pricing, the next logical question is whether the pricing pendulum will swing back toward dynamic pricing as the dominant pricing mecha-

nism. The answer to this question varies depending on whom you ask.

Clearly, the use of dynamic pricing is becoming more prevalent in the B2B eCommerce market. But static pricing also has its own advantages. For example, buyers who purchase goods on a repetitive basis, or who choose to use a preferred vendor, may prefer the stability of static contract pricing. As a result, it is reasonable to assume that B2B eCommerce will reach a state where dynamic and static pricing achieve some level of equilibrium.

Is dynamic pricing for you?

If you wish to buy or sell goods that have a high degree of price uncertainty, or that are perishable, then dynamic pricing is an excellent option. For example, you might wish to sell airline tickets for seats that will otherwise go unfilled. These are perishable, because when the plane leaves the gate, the value of that seat goes to zero. As a result, an airline might choose to implement a multi-winner Yankee auction. In this format the price for all remaining seats drops over time, while buyers try to get the lowest prices before all of the seats are sold, or the plane departs from the gate. Balancing these factors as you try to “win” the auction can spark a sense of competition and excitement.

Dynamic pricing pointers

Before jumping into the exciting world of dynamic pricing, do the necessary research to find the eMarketplaces that provide you with the best combination of liquidity, rules and costs.

When evaluating liquidity,

remember to focus on it as it applies to the goods and services of interest to you. For example, eBay may have 10,000,000 participants, but if the 20 people in the world who might be interested in buying your used metal stamping machine for \$250,000 aren't on eBay, then eBay isn't the right eMarketplace for you.


Also, as with selling anything over the Internet, it is critical that the description of the goods or services

be very rich. Unlike the physical world, in cyberspace the potential buyer cannot inspect the goods they wish to buy. So, if you provide only minimal descriptive data, buyers will either refrain from bidding, or bid very low prices.

For example, if I were auctioning a car, and the only description is "car," people would have to assume that it was a broken down junker, possibly a non-functional '72 AMC Pacer with 250,000 miles.

In reality the car could be a brand new top-of-the-line Mercedes. The richer your data, the better your chances of selling the item, unless of course you are selling a broken-down '72 Pacer with 250,000 miles. Then you might want to stick with the description "car". Obviously, richness of content is critical to maximizing both price and buyer satisfaction.

Obviously, dynamic pricing is enjoying a resurgence due to the growth of the Internet. While it might seem intimidating at first – so many categories, types and parameters involved – it is actually easy to learn the rules of dynamic pricing at the eMarketplaces that suit your needs.

Once you start down the learning curve, you quickly will find yourself not only benefiting financially from dynamic pricing, you will also find it to be quite entertaining. 

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PAYMENT ON SHIP

One of the challenges of electronic commerce has been the fact that most companies who do business online, still have to perform credit checks the old fashioned way.

However, that soon will be a thing of the past.

In June, VeriSign, Inc., the leading provider of Internet trust services; Ariba, Inc.; and financial services giant, American Express, announced a strategic relationship to provide a secure payment infrastructure for American Express' Pay On Ship procurement card system.

Under the terms of the alliance, Ariba will integrate VeriSign's B2B payment connectivity services with the Ariba Commerce Services Network (CSN) to process American Express payments, reducing the costly extra steps and manual processes in the authorization, settlement and reconciliation process.

"Companies are embracing B2B eCommerce as a means to significantly lower costs and widen their trading networks," says Mac Schuessler, vice president of E-Payment for American Express Corporate Services. "Through this integrated ePurchasing and payment solution, companies will now have the confidence to migrate key business processes, such as ordering, invoicing, payment and settlement over the Internet."

To deliver an integrated payment solution, the companies said they will create a new cXML standard that will allow communication between systems of different companies as well as provide greater protection of eCommerce charge card transactions. The new standard will utilize VeriSign's "XML Pay" schema, a flexible multi-purpose protocol.

The American Express Pay on Ship product will be available from Ariba by late summer.

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