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RIEKHOF ON PRICING No 49

Strategic Pricing for Spare Parts: Reviewing the Price Architecture

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Imagine picking up your company car after a service appointment. You glance at the invoice (if it isn't sent directly to the internal "Company Vehicles" department) and notice that, in addition to labor hours, a longer list of spare parts is itemized.

Have you ever wondered whether these parts must be genuine BMW or Mercedes components, if an original Bosch part instead would be acceptable, whether it could be a dealer's own brand that meets OEM standards, or even a used part for expensive parts?

Fig. 1: Spare Parts need a pricing strategy on it's own.

Strategic Pricing for Spare Parts

Some years ago, in a project for an international commercial vehicle manufacturer, we reviewed the pricing strategy for spare parts and services. We also empirically examined the pricing strategies of key competitors.

One of the key findings was that a leading competitor had implemented a clear strategic focus on spare parts. We found

- a consistent pricing strategy
- a universal price leadership for spare parts and service offerings
- a regional differentiation of these spare part prices
- distinct price variations for hourly service rates.

It is evident that these insights led to adjustments in our client's pricing strategy.

Creating a Thoughtful Price Architecture for Spare Parts

Not every spare part possesses unique characteristics. Some spare parts are quite simple, so they are often under price pressure, others are more unique and technically more complicated. Therefore, we suggest to categorize spare parts using pricing related categories, and establish a pricing strategy for each of these categories.

In an international industrial goods conglomerate's Power Plant Division, they differentiate between:

- Standard Parts
- Purchased Parts
- Engineered Parts
- USP Parts.

These categories lead to significantly differentiated pricing strategies. It is evident that competition is higher for standard and purchased parts, whereas greater pricing flexibility exists for proprietary parts. Employing distinct pricing strategies in these categories ensures competitiveness even for interchangeable standard parts.

Fig. 2: Some spare parts are more valuable than others

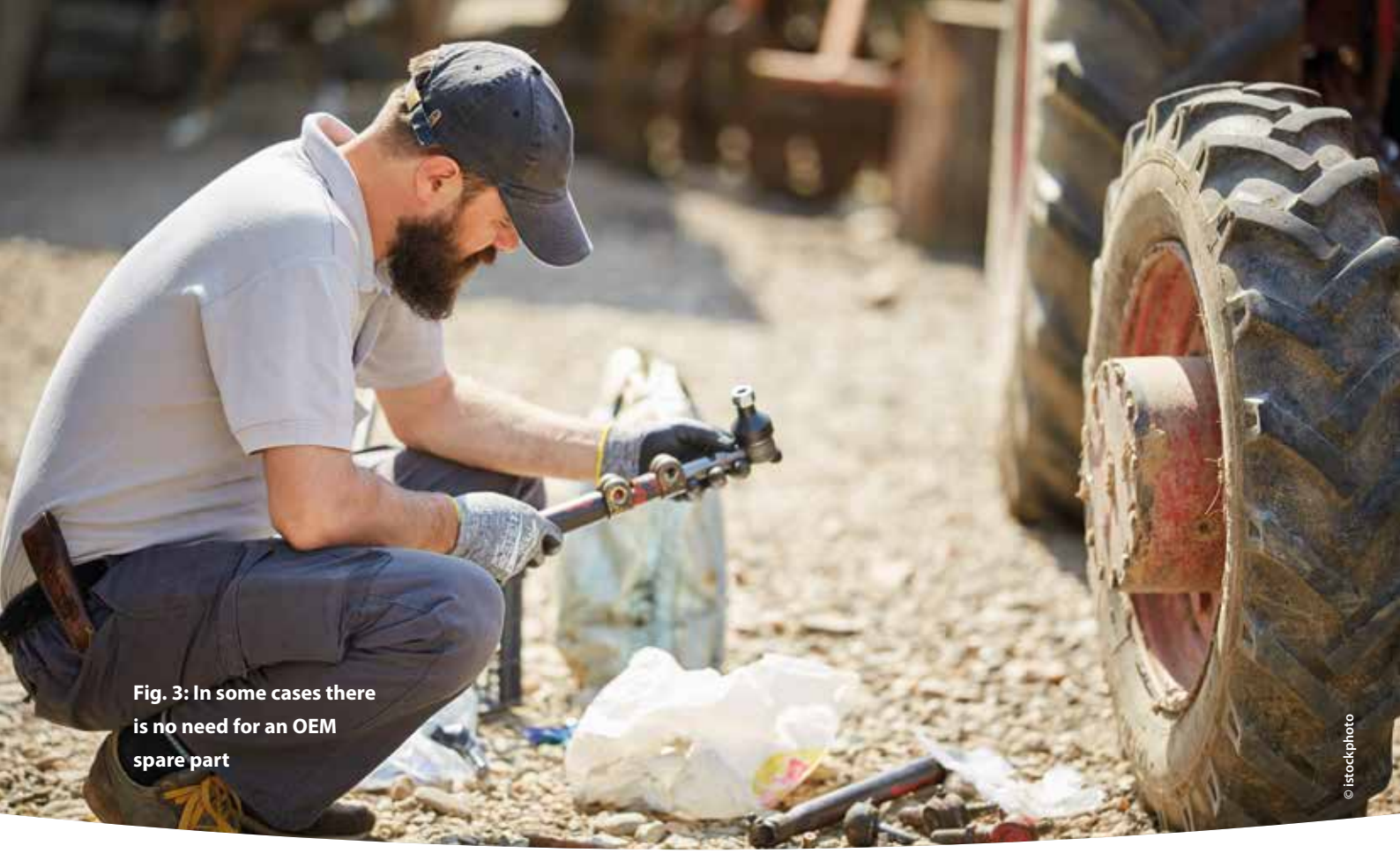

Fig. 3: In some cases there is no need for an OEM spare part

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Manufacturers of Spare Parts as Price Drivers

Consider the product complexity of a commercial vehicle spare parts dealer. They may stock millions of parts, including:

- Original parts from the OEM (Original Equipment Manufacturer, e.g. Mercedes)
- Original parts from OES (Original Equipment Supplier, e.g. Bosch)
- Parts under their own brand, often marketed as meeting OES standards (e.g. Granit Parts)
- Unbranded imported parts.

A clear pricing architecture is essential here, with prices decreasing significantly from top to bottom according to these categories.

Aligning Spare Part Pricing with Base Products

Another criterion for setting spare part prices is the base product for which they are intended. For instance, brake discs for an Audi A8 are more expensive than those for an A3. This is not solely due to technical differences but also varying cost calculations.

Pricing spare parts for highly complex chemical industry manufacturing equipment differs from pricing parts for a factory's roll-up door.

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Fig. 4: If the product in question is expensive the spart parts might follow

Frequency and Complexity of Repairs as Pricing Criteria

It is evident that fleet managers at large logistics companies pay close attention to prices for wiper blades, sets of tires, or brake discs for their 38-ton trucks – these are frequently procured and easily comparable spare parts. In contrast, digital control units may involve different pricing dynamics, offering more flexibility for OEMs.

High-Tech Spare Parts at Bugatti

An extreme example of spare part pricing was presented by Frank Goetzke, one of the chief developers at Bugatti, during his presentation at our Goettingen Marketing Day of the Private University of Applied Sciences Goettingen. He showed us 3D-printed titanium brake calipers for the Bugatti Chiron and produced an impressive video showcasing the process. (Please consider YouTube's data protection regulations when viewing: (https://www.youtube.com/watch?v=x_r5oXQ4B8U)).

He implemented a consistent pricing strategy for spare parts: a set of titanium brake calipers for retrofitting is offered at €270,000. Whether this price includes installation is beyond my knowledge, but these titanium calipers make the Bugatti "significantly" lighter.

„In several industries, spare parts are an extremely important profit driver. In order to defend your business against copycats you should better develop a longterm spare part pricing strategy."

Prof. Dr. Hans-Christian Riekhof

Considering Customer Contracts in Spare Part Pricing

Not only does the strategic categorization and evaluation of individual spare parts play a role in pricing, but the customer side should also be considered in your pricing strategy. For instance, list prices for spare parts may offer discounts for specific customer groups when multi-year contracts with fixed purchase quantities are established.

Conversely, customer demand for rapid spare part delivery can be taken into consideration. Availability can be a component of spare part pricing, such as:

- A 24-hour delivery guarantee
- Twice-daily deliveries of spare parts (e.g. for service centers)
- Worldwide spare part delivery within 3 days
- Consignment inventory at the customer's key locations.

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Fig. 5: Availability of spare parts can be a key value driver

Spare parts: a significant contribution to overall profits in several industries

To sum up, spare parts pricing deserves its own defined pricing strategy. In some industries, spare parts contribute significantly to overall profits. Depending on technical complexity and lifespan, spare parts can sometimes generate more revenue than the original product. The dimensions outlined in this newsletter should be considered when developing a price architecture for spare parts.

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Prof. Dr. Hans-Christian Riekhof is founder and shareholder of UNICconsult (www.unicconsult.com). Until 2022, he was Professor of International Marketing at the PFH Private University of Applied Sciences Goettingen. He is author and editor of several books on Strategy, Marketing, Management Development, and Retail Business.

He was Director of Marketing at the Otto Group Hamburg, and he was Head of a Business Division at Beiersdorf AG.

For more than 20 years he is conducting empirical studies on strategic and operational pricing, and he is consulting international corporations as well as Mittelstand companies.

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