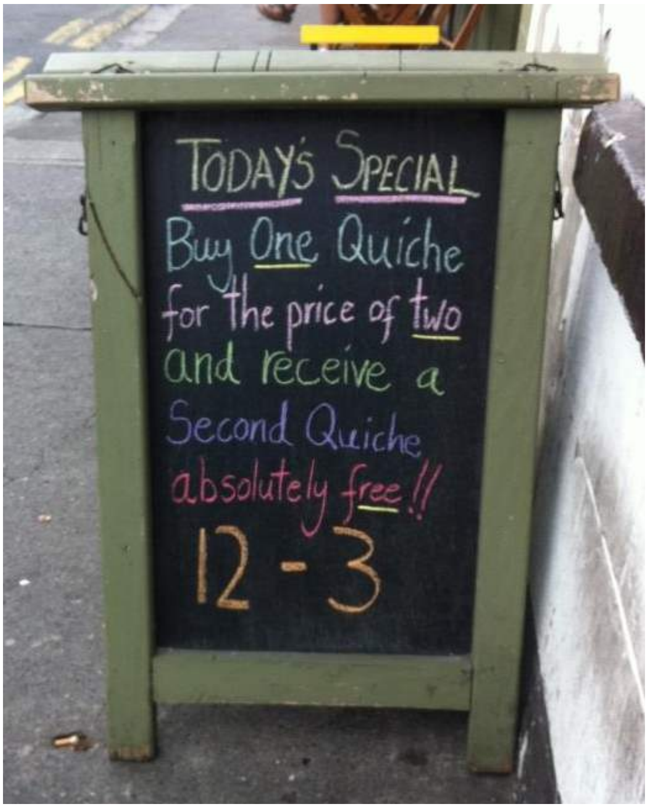
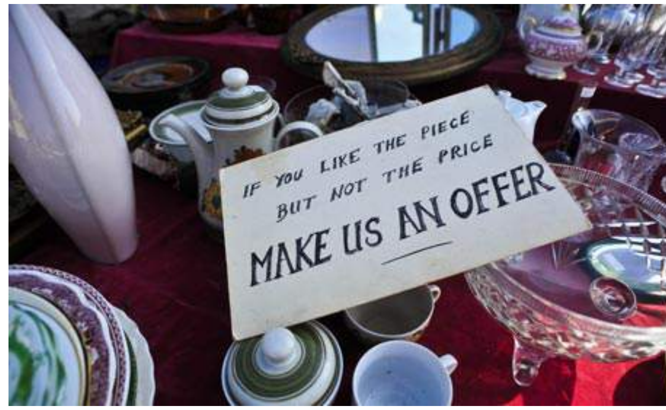
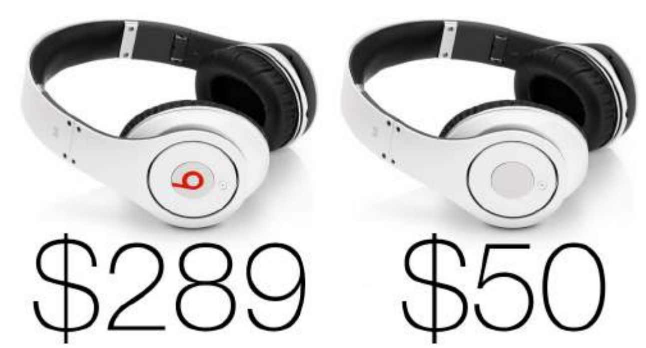
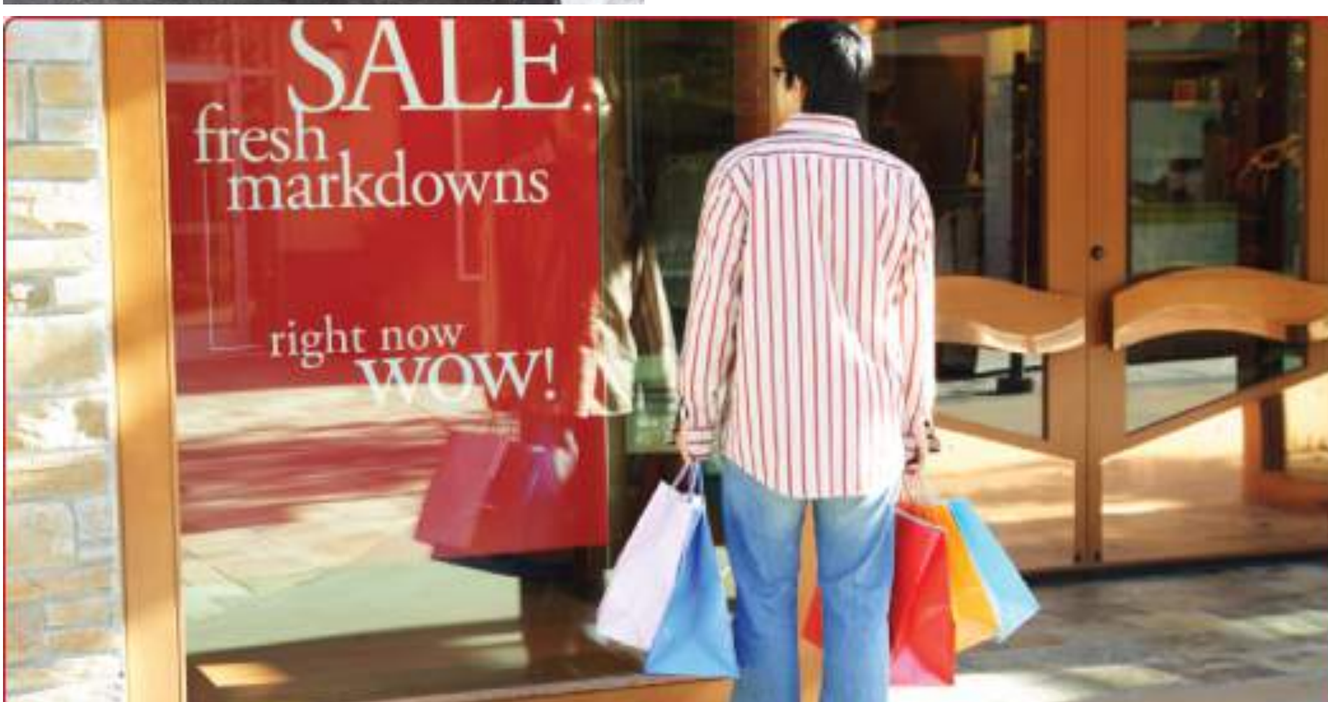
At What Price?:
Pricing Strategies & Brand Perception







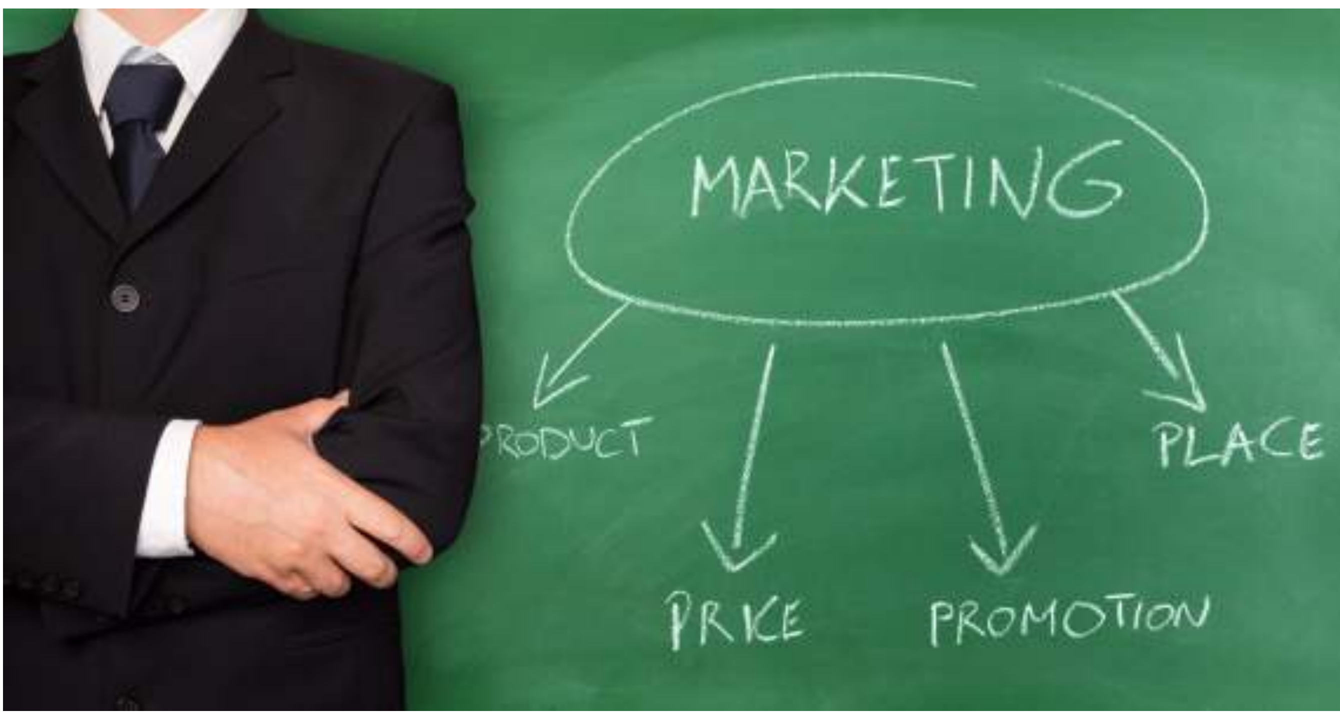


The most important thing about a point of view is to have one.

There are a handful of famous marketing models taught in schools and used in business. These include the unique selling proposition, product life cycles and a customer's lifetime value. They help businesses focus and organize information to assist in strategy and decision-making. If there were a vote (and it would be a very nerdy contest) I am confident the Four Ps would win for most recognizable.

The Four Ps endures because it is both simple and complex (and has a catchy name). It remains relevant some fifty years after being introduced by E.J. McCarthy. That was a time when the maturing marketing profession was trying to inject rigor, process and some science into how to attract customers. It was this type of strategic thinking that allowed marketers to lead the decision-making in product, promotion, place, and specifically, price for their organizations but that is no longer the case.

Today too many organizations miss the opportunities that pricing presents. This is important given the influence it has on the perception of a brand. This paper examines pricing mistakes and successful strategies. It also questions the lack of pricing curriculum in business schools and calls for Chief Marketing Officers to regain control of pricing in their organizations or at least gain parity with their finance colleagues. It starts where all marketing should with an examination of human behavior.



Pricing & Consumer Behavior

We are irrational beings and our illogical behavior is liberally demonstrated in the buying process. If a company were to price goods and services strictly from a rational point of view they would either leave money on the table or have very few customers. That is because so little of what is taught in business conforms to how people buy.

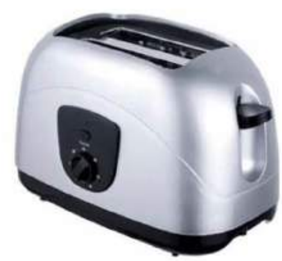
According to Derek Thompson's tremendous article on consumers and math in The Atlantic, "consumers don't know what the heck anything should cost, so we rely on parts of our brains that aren't strictly quantitative. Second: Although humans spend in numbered dollars, we make decisions based on clues and half-thinking that amount to innumeracy." Thankfully and ironically, our irrational behavior is somewhat predictable. Here are a few interesting examples of our crazy ways.

No Discount Please

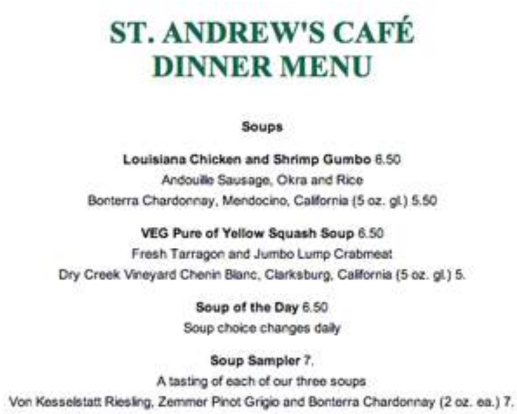
A report from GroupM Next shows that 45% of customers would leave a store to buy a product online if they found it at a 2.5% discount while comparison shopping on their mobile device. This number climbs with ever higher discounts. A 5% discount would have 60% of customers leave while 87% would exit the store for a 20% discount. All of which appears highly rational except that 1 in 10 shoppers said they would complete the purchase in store regardless of any discount.

We Trade Up

Kent Monroe of the University of Illinois has offered up a curious lesson in pricing and behavior. Consider a company that makes two versions of the same toaster. One is packaged and presented more stylishly than the basic offer. The basic one is $22.95 and the other $28.95. As one would expect the lower priced version is selling better but at a lower profit. Enter a competitor with their own toaster that is essentially the same but much fancier and is priced at $38.95. Monroe says the $28.95 toaster becomes the best-seller for the original company, "The point is that economic theory says that can't happen. But it does."



Derek Thompson may know why this goes on, “One explanation for why this tactic works is that people like stories or justifications. Since it's terribly hard to know the true value of things, we need narratives to explain our decisions to ourselves. Price differences give us a story and a motive.” So because there is a toaster priced at $38.95 we feel great buying the $28.95 version even though there is one $6 cheaper our irrational minds tells us we still got a deal.



ST. ANDREW'S CAFÉ
DINNER MENU

Soups

Louisiana Chicken and Shrimp Gumbo 6.50
Andouille Sausage, Okra and Rice
Bonterra Chardonnay, Mendocino, California (5 oz. gl.) 5.50

VEG Pure of Yellow Squash Soup 6.50
Fresh Tarragon and Jumbo Lump Crabmeat
Dry Creek Vineyard Chenin Blanc, Clarksburg, California (5 oz. gl.) 5.

Soup of the Day 6.50
Soup choice changes daily

Soup Sampler 7.
A tasting of each of our three soups
Von Kesselstatt Riesling, Zemmer Pinot Grigio and Bonterra Chardonnay (2 oz. ea.) 7.

The Dreaded “$” Symbol

Researchers at Cornell University did a fun experiment at St. Andrew’s Café by printing three variations to the same menu. The first listed the items with a dollar sign in front of the numerals; the second removed the dollar sign; and the third spelled out the word "dollar" with the price. When the prices were listed with “$” or the spelled out “dollar”, customers spent less and spent more when the dollar sign was absent.

So Well-Trained

All of us have been taught to recognize and accept three universal pricing approaches. The first is called anchor pricing and it is the generally accepted price for a good or service in a given industry. We each keep an anchor price for different products in our heads and use them as points of reference when shopping. It may be $2 for a soft drink, $1,000 for a computer, and $30,000 for a car.

We did not set those prices. We have been conditioned to accept them as reasonable and “fair” by the market. Every industry has their anchor prices and they become entrenched in our minds but just because they are called ‘anchors’ does not mean they are static. They are a reference point and forces move them up or down. I have not been a beer drinker for two decades but occasionally stock up for guests. Because I purchase beer infrequently, the price I have anchored in my mind is twenty-years old so every time I buy the cost is a shocker (it makes me pour myself a double vodka).

Apple demonstrated an interesting anchor strategy with the iPhone. At release they were priced from $499 to $599 setting the anchor point for the smartphone market. Two months later they dropped the price by $200. Consumers reacted to this discount and purchased en masse. Then when the iPhone 3G came out at $199, Apple sold one million phones in three days. This satisfied a dual business strategy of gaining a significant customer base at a decent margin while controlling the anchor pricing of the entire category.

The second conditioning we undergo is bump pricing. This concept is used widely in real estate and vehicles. Basically, the price set puts the brand in a certain category related to perceived value. You may search for a new home on a website that offers price ranges such as $350,000 to $400,000. This is great for a quick reference to match our budgets and price sensitivity. As consumers our expectations regarding features, benefits, and value change with each category. If we are bumped up a category our expectations grow often irrationally because we evaluate if the brand fits our personal values and beliefs.

The third way we are trained to react to brand pricing is through the charm price which accomplishes two things. First, it is in line with the anchor price so consumers evaluate it as fair. Say it is a microwave and the anchor price is approximately $80 so a leading supplier prices it at $79.99. That penny is powerful. The assessed value is $80.00 but we instantly equate it as a deal in the $70 to $79 range. If the supplier had chosen $80.99 we may have bypassed that microwave without even a consideration. Such is the effect of charm pricing.

This is supported by a study from the University of Chicago who monitored margarine pricing at a local grocery store chain. When the price dropped from 89 cents to 71 cents, sales went up 65%. Then when the price fell to 69 cents, sales jumped by an incredible 222%.

These examples show that pricing is a curious mix of art and science. The art is understanding behavior while the science is finding a fair price for both consumer and brand. It is not about manipulation or tricks. It is about transparency and thinking in terms of relationships not transactions.

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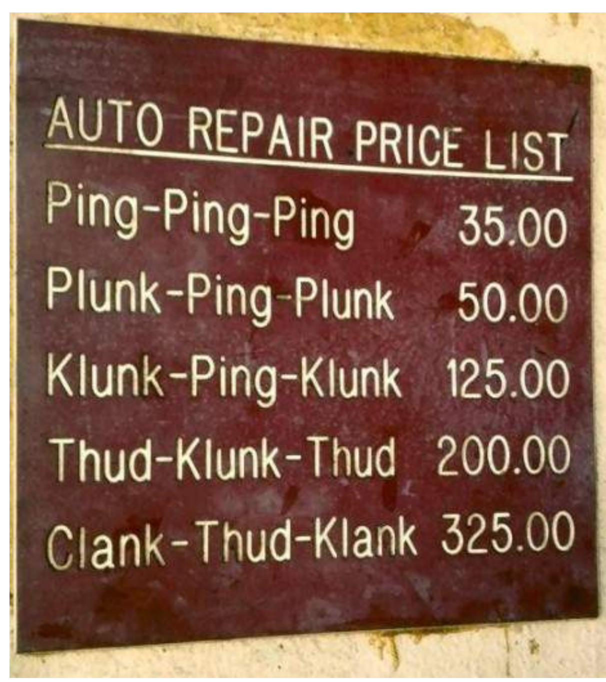


Pricing and Brand Perception

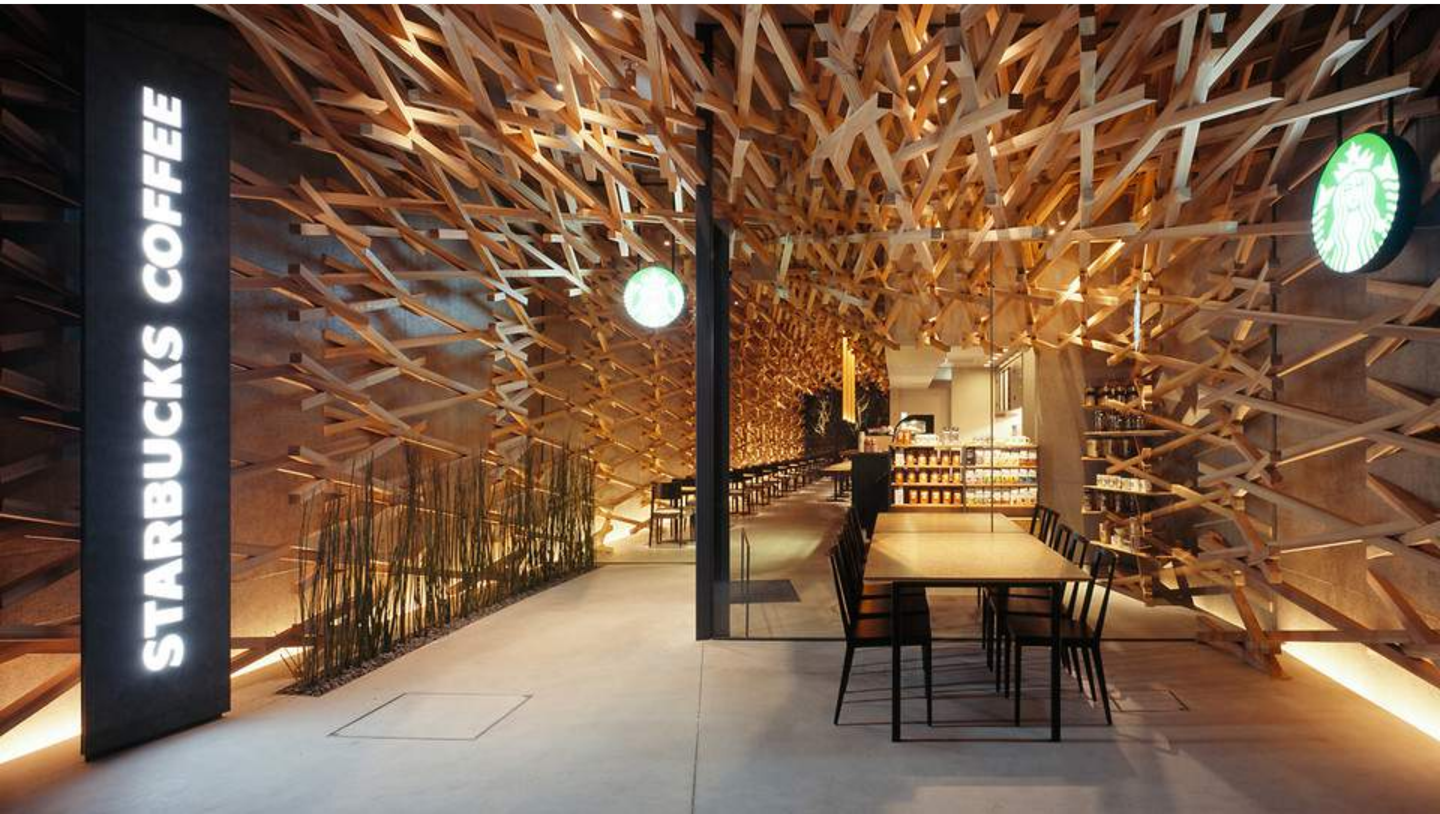
When you step into your friendly neighborhood electronics store and view a wall full of flat screen TVs what is your first thought? Most likely, your trained brain computes a rapid assessment. You review quality, price, aesthetics, size, features and, of course, brand. Incredibly you make an initial assessment of what TV is for you using all these inputs in mere seconds.

This is one of the chief reasons why branding exists and that is to help sort through the variables involved in any purchase. Brands are invested with tangible and intangible associations meant to help guide a decision. All of us are now equipped to delineate the differences and value between brands whether it be cars, chewing gum, or running shoes.

Adam Davidson's highly relatable blog in The New York Times titled, *Making Choices in the Age of Information Overload* asks, "How does anyone really know that they've picked the right baby formula, soda or car? They don't, and manufacturers know that. That's why our economy is filled with highly promoted branding campaigns that, however superficial or annoying, can be enormously helpful guides."

Pricing has huge impact on how consumers view and categorize a brand. In fact, brands generally communicate a clear anchor price. We know that a Starbucks coffee is more expensive than the vast range of alternatives, like Apple, it sets the premium anchor pricing for its category. While we consumers are irrational we are not entirely unbalanced. We patronize Starbucks and willingly pay more for a commodity product because of the brand association. Starbucks has thrived despite having prices that are at odds with the industry.

What they did is redefine the very product offered. The physical locations communicate a different sensibility, ambiance by refreshingly inviting people to stay as long as they want. They want customers to participate in a culture of coffee creating a clubby feel. Trained personnel are friendly, helpful and knowledgeable. The food tends to be of higher quality in variety, substance and packaging. Starbucks has created their own language which is now treated with some levity. All of this allowed them to set a new anchor price for coffee. Howard Schultz may have taken a lesson from Henry Ford who said, "The man who will use his skill and constructive imagination to see how much he can give for a dollar instead of how little he can give for a dollar is bound to succeed."



Eric Casaburi, founder of Retro Fitness, an 80’s themed fitness franchise has his own spin on this approach. Mr. Casaburi notes that “there is a pricing vertical in almost every industry: high end, intermediate which is the worst place to be, especially now, and low cost.” Curiously, he chose to price monthly membership at $19.99 when most charge between $39.99 and $49.99. The next twist is the quality of experience offered.

Mr. Casaburi has found that prospective members often say, "Hold on. You have better treadmills, better TVs, iPod integration, movies, a smoothie bar, great personal trainers. What's the catch?” He can answer that there is no catch and it is not because he has chosen to operate at a lower margin.

The entrepreneur explains, “As a gym owner I want you to come to my gym five times a week, because when you're there you might want a smoothie, tanning sessions, clothing, time with a personal trainer. If you're just sitting at home paying your membership we can't sell you anything. And eventually you'll stop paying your membership because you're not getting anything out of it. We want members in the gym every day. One, that means they love working out and love our facilities. They'll be long-term customers. Two, that gives us the opportunity to meet even more of their needs.”

The pricing is transparent at Retro Gyms and so is the business strategy of lifting revenue and margins through value-added services and products. Most importantly, the business has created a unique offer with a loyal following of franchisees and customers. By wanting people in their gyms versus the industry norm of selling and not caring if they ever show again up, Mr. Casaburi has demonstrated that what he can give for a dollar is a sound strategy.

Regardless of the industry or business situation, I instruct clients to think about three things when pricing:

The Effect of Price on Quality Perception

The Effect of Brand on Quality Perception

The Effect of Quality & Price on Brand Perception

These are intertwined and extremely valuable. I am currently using them as part of a framework for assessing the viability of a store brand product extension. Previously, I applied it in the premium casual shoe market with success. Interestingly, it looks like Wendy’s went through a recent exercise similar in approach but broader in scale.

Wendy’s has announced massive changes to their business and brand strategies including pricing. In March 2013 they rolled out a revamped logo across all packaging, advertising, crew uniforms, restaurant signage, menu-boards and websites. Craig Bahner, the restaurant’s Chief Marketing Officer, knows that in order to enact real change at the company and to get more people through their doors they need to address pricing. This is because Wendy’s had confused their market.

In order to enact real change at the company and to get more people through their doors Wendy's needs to address pricing as a vital aspect of the new business and brand strategies.

Bahner states, "There's a very clear need to have a price-value level. We recognize that and we're working on both the premium and the value end of the price spectrum. On the premium end we're growing market share in premium burgers and chicken sandwiches and in our salads line. And then when we look at the price-value segment, there are a couple of sub-segments there. One is a price consumer for whom 99¢ is the key price point, and we're trying to hit that. We're working on a program that gets our system aligned on a number of items at 99¢ so the consumer can have a meal at that price point. Put three 99¢ items together and still have that consistent, quality meal. Then there's a segment focused on price-value and it's about what I pay as well as about what I get."

Wendy's and Bahner have recognized that anchor prices are changing in quick service restaurants and customers like flexibility of choice and product bundling. That does not allow for a simple shift in prices. They need a system to deliver on the 99¢ price point. That takes menu changes, kitchen refits, packaging, training, advertising, and consistency of delivery. Like any major decision, pricing has ramifications in so many areas. It also proves that pricing is no easy task and will always be a critical factor in how consumers view brands.

Pricing Strategies

So what is a fair price? How do companies get their pricing strategies right? How can we use human behavior to help? These are universal and never-ending questions. To best illustrate, here are a few examples of how pricing can go wrong or right.

NetNixed

When Netflix announced a 60% price hike along with a spinning off of its DVD and streaming businesses the result was a million lost subscribers and a beating on Wall Street. This change of fortune resulted from Netflix's inability to renew a streaming rights deal with Starz for the Disney and Sony catalogue of movies and TV. Starz was negotiating for ten times as much and Netflix balked. It was calculated that if 70% of Netflix's subscriber base stayed paying the 60% increase it would equate to 12% revenue growth. It is a tough category with Hulu, Amazon, and HBO offering similar services making it analogous to an airline having good routes, or in this case, great content priced fairly.

Sky High

I am continually boggled by the price of flying. I contend that no economy flight in my home country of Canada should be anymore than $500 and that includes Vancouver to Halifax. This is my own anchor pricing based on the value of the experience. So it is amazing to me to be on a flight and find out someone in the seat next to me paid half of what I did.

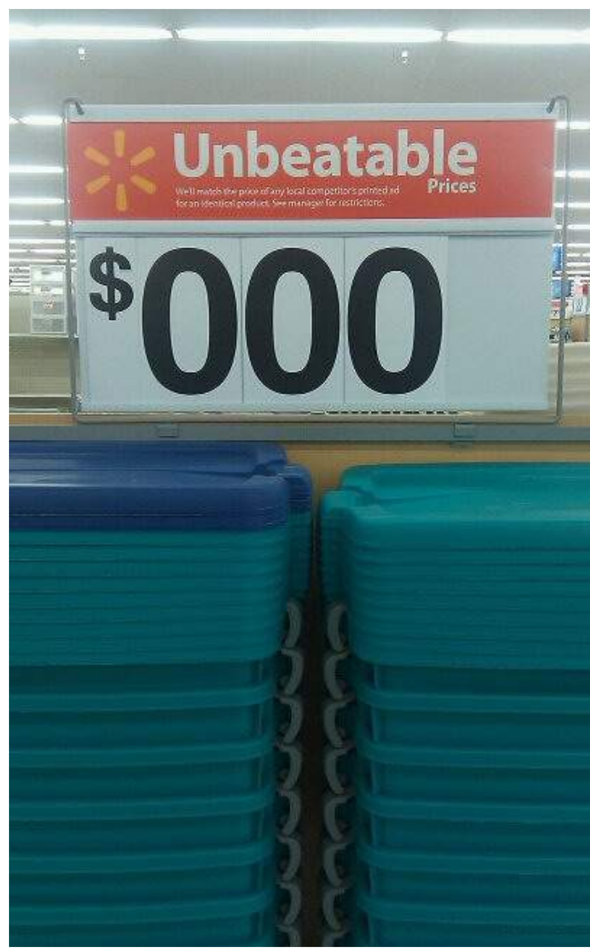
Much of this is attributed to what the airlines are selling which is a perishable product. Hotels operate on the same principal. Once the door closes on a plane with empty seats or a room goes empty overnight, that revenue is lost forever. Fruits and vegetables may get marked down as they approach expiration as does clothing from last season but airline seats go up because consumers attach 'last minute' value to travel. The seats on an airplane may be all going to the same destination but they are not the same product so they will not be the same price. A ticket sold a month in advance has a different value than a ticket sold a day before.

This creates incredible complexity for airlines. If you take into account the number of flights every day, the various price levels, advance sales, and the resulting changes as the day of flight approaches, a single airline can be managing millions of prices on the market at any given time. No wonder the consumer is confused.

Walmart was Adrift

The famous retailer lost its way in strategy and pricing by trying to appeal to everyone. It left its roots to cater to a more affluent clientele and in so doing lost it's anchor pricing. It did so by clearing promotional merchandise out and reducing assortments to make stores more visually appealing and easier to shop. Consumer Edge Research tracked more than 1,200 shoppers beginning in August, 2012 and households with incomes over $100,000 were defecting from the store in record numbers. It was not only the affluent. Shoppers with household incomes over $40,000 were even more dissatisfied.

Walmart had to change tacks. Advertising Age reported, "In ads breaking next month, Walmart will highlight its decades-old everyday low pricing by poking fun at the high-low strategies of competitors offering discounts on select products. The chain will also highlight its policy of matching competitors' advertised prices, a guarantee it's always had but hasn't talked about much in recent years."

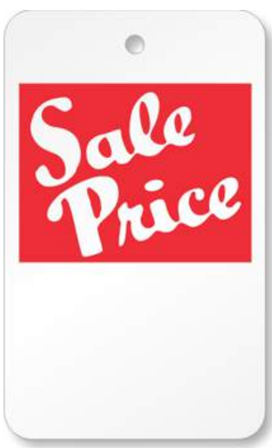


Many Pennies
JC Penny has been reporting poor performance for some time and CEO, Ron Johnson has expressed some frustration, "I don't know that we're giving up customers. Our customer is clearly buying less with fewer visits in the short term, but we want to earn her back, earn him back."

In 2012 JC Penny invested heavily in an advertising campaign for their new pricing strategy. It is a three tier approach: everyday prices; monthlong values; and best prices, beginning on the first and third Friday of every month. The strategy cuts back promotions to 12 a year from a mind boggling 590. Yet, it has not worked based on almost any measure: traffic, conversion, spend. The only thing that has gone up are negative comments in social media mostly about the removal of coupons.

Jonathan Salem Baskin of Advertising Age succinctly points out the paradox between Walmart and JC Penny pricing, "'Low' is a synonym for 'Fair' in a way that 'Sale' isn't, since promoting sale pricing is all but an admission that regular prices are higher than they should be."

An Approach to Consider
So clearly price is a pivot point of business success often representing the first and final criteria for a purchase decision. Yet, the mechanisms for setting price seem archaic or muddled. These tend to be the favored ways:



Cost-plus Pricing: Professor Kent Monroe believes that consumers and businesspeople assume that price has everything to do with cost which is wrong, "You have to know the cost so that you can understand the profitability implications of price but not for the purpose of setting price." As Daniiel Nimer says, "The purpose of pricing is not to recover cost but to capture the value of the product in the mind of the customer."

Competitor Pricing: this is such an obvious 'me-too' strategy and one that really allows for an abdication of responsibility. What competitors do is important but pricing should be informed more by customers than competitors. If your offer is at parity then so should be your price, if so, it means you have to work on creating additional product and service value and articulating tangible differentiation.

Historic Pricing: when has past performance ever been an entirely accurate barometer for the future? Once again, it can be part of the analysis but is not the driver.

Price/Value Analysis: this is the closest approach to determining a "fair" price that helps build a brand's image and grow its value. "Price is what you pay. Value is what you get.", according to Warren Buffett.

Each of these approaches are ingredients for effective pricing. Companies must balance their own unique cost structure and profitability targets with customer perceptions of value and competitors' moves. When I work with clients, I ask them what do you have that is truly unique and who needs or wants it? That usually kicks off an examination of differentiation and value that produces a compelling story and leads to more accurate pricing.

I also advocate using a very simple tactic to find out how much customers are willing to pay. Simply ask them. This is tremendous input into both pricing accuracy and brand relevance. It is valuable to know what customers and prospects think. These lines of inquiry are beneficial:

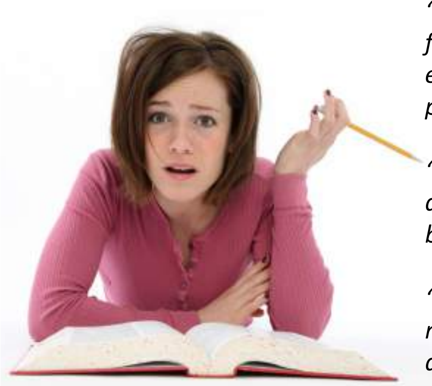
Rival brands in your customer's consideration set and why?
Is your pricing transparent, understood and fair?
Are there any additional features or benefits that should you offer?
How do they interact with your brand (channels of communication)?
Is your price a true reflection of your brand's value?

These are just a few of the qualitative questions that yield amazing insights that will influence your business, brand and pricing strategies.

You Cannot Put a Price On Education

These pricing approaches need to be taught in post-secondary education. Yet, there are precious few specific pricing courses offered in business schools. The subject is overwhelmingly treated as sub-topic if at all. In one leading business school's MBA curriculum I found pricing buried in a New Product Development course as one of eight areas that would be covered. In another well-regarded school's executive MBA pricing as a topic could only be found in the market research section.

The few dedicated pricing course descriptions send a very obvious signal. Here are three currently offered by leading colleges and universities:



"This course is designed to teach students how to price goods and services by providing a framework for understanding pricing strategies and tactics. Topics covered include economic value analysis, price elasticities, price customization, pricing complementary products, pricing in platform markets and anticipating competitive price responses."

"Managerial Economics focuses on real-world management decisions and market analysis. Product pricing, profit maximization, optimal production, and market structure-based strategic pricing are included."

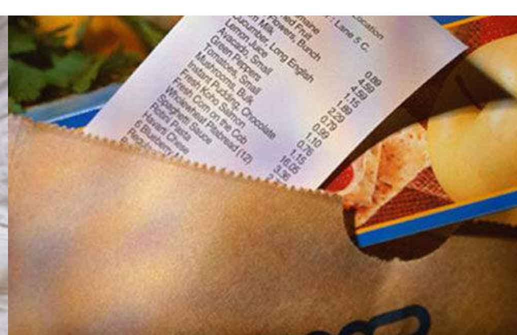
"This course focuses on pricing strategy and tactics from both theoretical and applied managerial contexts. Substantial content of the course concentrates on how firms attempt to capture value, as well as profits, in the revenues that they generate. Additional focus will be made on pricing dynamics and the reaction to and by competitors at the firm and product level."

Each of these schools should engage their English faculty to help clean up the management mumbo-jumbo. The important observation is that none of these courses mention marketing or consumer behavior.

This may stem from the fact that the professors who teach pricing tend to hail from backgrounds in economics, accounting, and auditing. I did find a very bright light in a professor at a leading European school who is an expert in the area of pricing and revenue management and "Her recent work in behavioral operations explores how firms should manage these decisions in response to realistic, but not necessarily rational consumer behavior." I look forward to her research.

I have had the pleasure of guest lecturing and speaking at over thirty post-secondary institutions and advise on curriculum in branding and marketing. One of my goals is to make the case that pricing needs to be core curriculum, that pricing involves consumer behavior, and the professors who teach it must possess both practical marketing and finance experience. This is an important step in arming future managers and leaders with an incredibly important business competency and professional skill.

On a side note I have been pleased to find that many business schools are emphasizing some very necessary capabilities including presentation skills (voice projection, eye contact, audience management), business etiquette, interviewing and note taking, along with persuasive speaking and writing. These are not soft skills they are basic building blocks for effective business leaders. Hopefully schools will get as progressive with pricing curriculum.



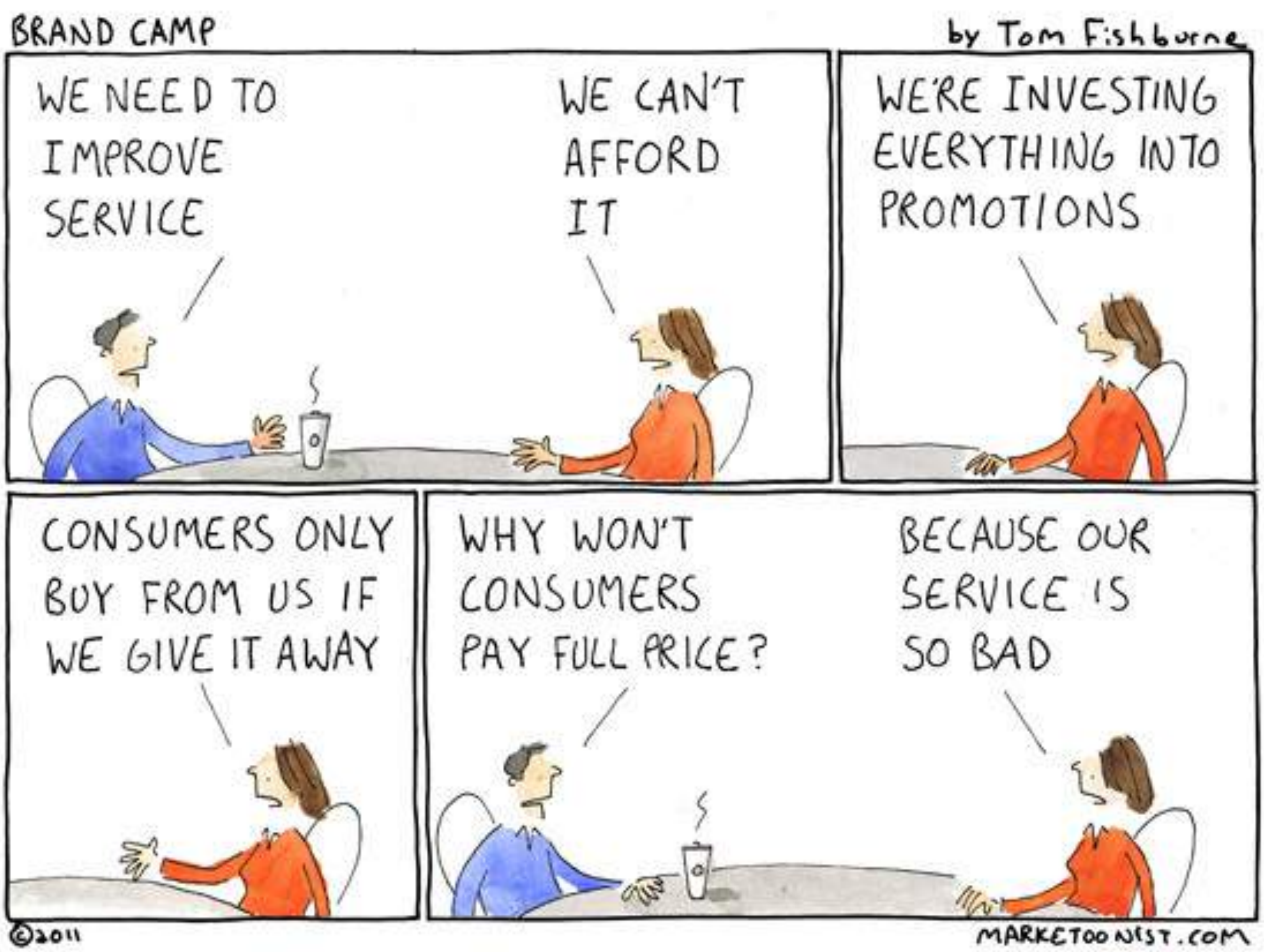
CMO Where are You?

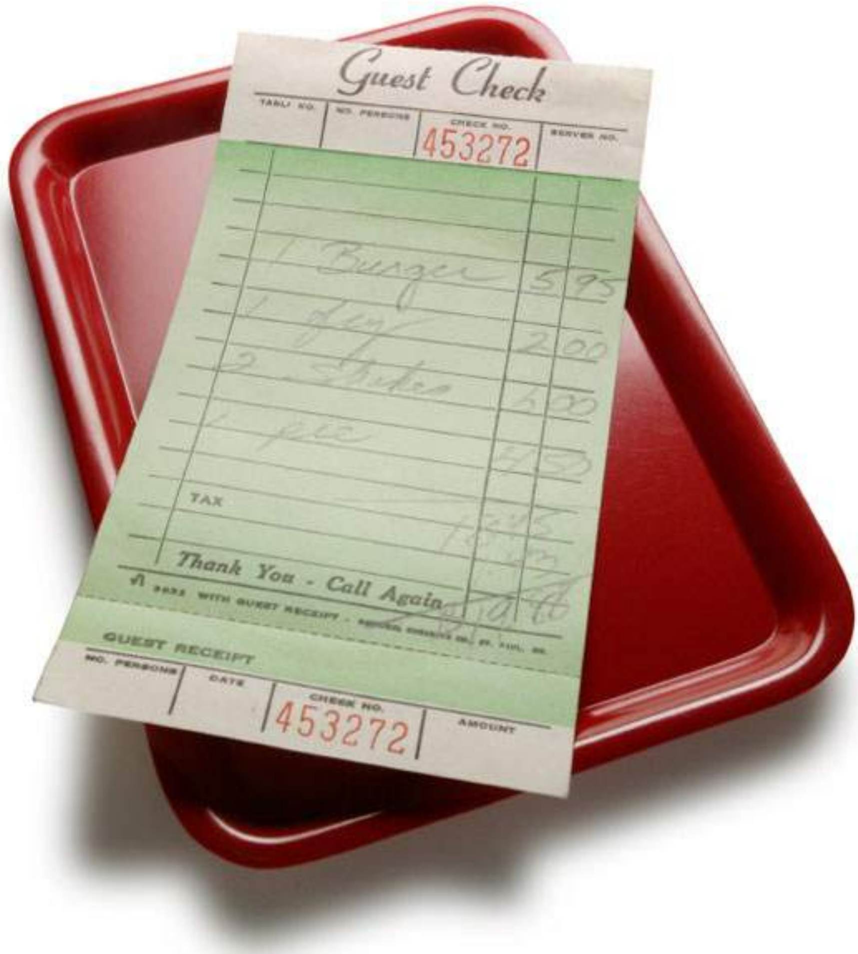
The Chief Marketing Officer role has been heavily scrutinized since its relatively recent inception. Tenure has been short, performance questionable, and overall value in doubt. This is largely because the job has been exceedingly touchy-feely. One article in Forbes even suggested that a Chief Marketing Officer is actually five roles: brand shaman, change agent, field marshal, strategic consigliere, and culture curator. I am not sure what any of that means but it is far from tangible.

The most effective Chief Marking Officers I have worked with have oversight or decision-making parity in their organizations for each of the Four Ps. Yet the vast majority are relegated to basic execution. In too many cases the Chief Marketing Officer's primary function is overseeing the production and delivery of marketing communications. To be truly strategic and valuable these marketing leaders need to set the agenda for product, promotion, place and price.

Even though price remains the most significant criteria in decisions to purchase there are additional considerations. A McKinsey retailing study shows that consumers also factor in experience, trust, assortment, return policies, and loyalty programs. This means that brands can and should leverage all the variables that influence consumer behavior.

It makes sense that Chief Marketing Officers are the ones to pull this all together. If the most senior marketing professional in an organization does not have a lead hand in pricing, then they might as well be satisfied with art directing brochures, writing the CEO's speeches, and reviewing visitor statistics to the company website.





Wrapping Up

Clearly, pricing is critical to business. McKinsey has reported that 80 to 90% of all poorly chosen prices are because they are too low. It turns out that charging just 1% less than the optimal price could mean giving up 8% potential operating profit. Keeping an eye on pricing can often yield price increases of 2 to 4 percentage points or more. Over the long-term this may represent 15 to 25% of a typical company's total profits according to the consultancy. Even before the financials comes in pricing will have had significant influence on a brand's perception and image.

My work on pricing has produced a startling insight and that is so many executives forget that they are also consumers. As a result, I have witnessed scores of businesses make decisions that are not in the best interests of their customers. David Ogilvy had it right when he said, "The consumer isn't a moron; she is your wife. You insult her intelligence if you assume that a mere slogan and a few vapid adjectives will persuade her to buy anything. She wants all the information you can give her."

Consumers discern a great deal of information from your pricing. By seeing how much you can give for a dollar, you establish a powerful way to create additional value. That means focusing on creating long-term relationships, not short-term transactions. Each customer is different and they appreciate flexibility without confusion. All of which requires transparency in your pricing. So remember, if you need an entire advertising campaign to explain your pricing strategy then you need a new pricing strategy.

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