Ripe

Welcome to enrich, Ripe Strategic's newsletter

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How much is too much?

It doesn't matter whether you're selling movies or movie stars, bread or caviar, what matters is the buyer's perception of whether you are charging too much or too little. That's why a pricing strategy and price positioning needs to rely heavily on consumer (or customer) **research**.

Among the many techniques for understanding consumer perceptions, one we find brings a particularly useful perspective to pricing is Van Westendorp's Price Sensitivity Meter (PSM). It provides a fundamental understanding of how price ranges and levels work. The key to using the PSM is to integrate it with consumer research, by asking four key questions alongside images and concept statements about your product and competitor products.

The four key questions are...

- At what price is the product expensive?
- At what price is the product cheap?
- At what price is the product too expensive to be afforded?
- At what price is the product too cheap to trust?

Finding the acceptable price range

The principle behind the PSM is that we all have a price range we find acceptable for a particular product or brand. Say, for example, we are buying a 50g tin of Beluga caviar. £350 we might think ridiculously expensive. But a tin costing £150 we might consider too cheap to be of good quality. Whereas if the price tag on our caviar is between £225 and £275, it may fall in our "acceptable" range.

The PSM graphically illustrates where the intersections are; i.e. where "too cheap" and "not a bargain" intersect as the cheapeast point, and "too expensive" and "not expensive" intersect as the highest point. If we were the seller of the Beluga caviar, these intersections – lying at £225 and £275 respectively - would give us a good starting point for our pricing strategy, including the pricing "sweet spot" or range of acceptable prices.

In other words, the PSM tells us the price at which most consumers would be willing to pay for the product and for competitor products. From this we can start to see the relative positioning and then establish our prices based on the relativities of real world pricing and the findings of the PSM.

Netflix: the perils of not getting to grips with your value equation

When Netflix customers found they faced a 69% price hike – the second increase in 12 months – there was uproar. Netflix operates a film rental business in North America similar to the UK's LoveFilm. The change in pricing policy involved separating a previously combined service for unlimited DVDs and unlimited streaming of films. Users wanting to continue with both services had previously paid $9.99 a month. Now they would pay $15.98. Over 30,000 comments were posted on Netflix's Facebook page within a day of the announcement. Here are 3 typical examples...

" I cancelled my Blockbuster online membership to switch to Netflix. Now, I'm going to have to pay more money than I paid at Blockbuster. You took away the very edge you had in the market!"

"Netflix isn't adding any new content to go along with this price hike. To say 'our service today is worth 50% more than it cost yesterday' is awfully brash when that service hasn't changed a lick."

"As of next month I will not be a NETFLIX CUSTOMER any longer. This is outrageous. I do not need your service and will not be renewing it! YOU ARE PROBABLY GOING TO LOSE A LOT OF CUSTOMERS."

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There are 2 reasons Netflix may have taken the decision they did:
1. The company has become a victim of its own success. Watching movies at home is much easier than it was (particularly if you're tech-savvy enough to connect your computer to your fancy wide screen TV). And as more people watched streamed films, Netflix's licensing fees rose. Added to which, film distributors have negotiated a higher fee for streamed movies than for DVDs.

2. Maybe Netflix is restructuring its business model and trying to switch more customers from DVDs to streaming. Although streaming content means a higher fee, it's likely to involve lower fixed and variable costs than sending DVDs through the mail.

So where did it all go wrong?
Whatever the reasons for the price increase, it seems a heavy-handed approach. Netflix's major mistake was in not managing the value proposition effectively from the outset. In other words, they didn't set the price of the bundled package in line with the benefits. Customers perceived the Netflix offering as better value than competitor brands such as Blockbuster, and they won market share as a result. By the time Netflix came to realise the value of the different elements of the bundled service, it was too late - their customers had become used to their amazing deal. The benefit was already devalued – the package was perceived as standard rather than beneficial.

Splitting the once bundled service and charging a higher price was always going to be a difficult proposition to get right. The second failure by Netflix was in implementing the change. No extra value was offered or communicated for the extra cost. As the Facebook user quoted above pointed out, "that service hasn't changed a lick". As it is, if those 30,000 Facebook users who posted on day one are anything to go by, Netflix will lose market share to competitors. The licensing fee will have to be supported by a smaller number of users or from an impact to profits (or a combination of both). It's a high price to pay for not getting to grips with your **value equation**.

Daily bread – not so essential after all?

There's a habit among manufactures of commodity and essential items of increasing their own prices in step with any upward trend in market prices. Their assumption is that they can do this without endangering their market share. However, a recent **article** on the gathering of data for inflation statistics in New Zealand suggests that commodity manufacturers may be wise to look out for behavioural changes in the wider market, when thinking about price increases.

What the inflation researchers found was that sales of flour were increasing steeply. In fact, between 2007 and 2010 they'd nearly doubled, going from $38m NZD to $63m NZD. This was attributed to the increasing use of bread-makers in the home. And it seems that the rise (pardon the pun) in the popularity of bread-making machines happened as a result of the sharp increase in the price of bread and other foodstuffs. **Consumers** had begun voting with their yeast and making their own bread. This means bakeries can't count on the essential nature of bread to guarantee that their products will sustain a price increase without losing volume - consumers are finding that the benefit of having a loaf baked for them is no longer as convenient or, some would argue, as tasty.

When considering a price increase, it's worthwhile gauging not just what impact it will have on consumer behaviour within the category, but also what will happen to the category itself. And whether the price increase will make it more likely that a wider change is brought about.

Wise Words

Customers are very tuned in to pricing.
If you increase your prices and then offer a discount soon after the rise comes into effect, they will expect you do to the same next time, and will act accordingly.

History has a huge impact on your pricing options, making it difficult to fundamentally change your price position effectively. Heavy discounting lowers product perception in the long term while pricing a product at a more premium level requires significant brand repositioning.

Want to discuss your pricing issue with an expert?
We'd be delighted to hear from you. Our contact details are below.

Kaye Coleman

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