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Pricing strategies

The price is wrong

Clever companies are finding new ways to boost prices. But most firms are still getting it wrong

FOR a glimpse of today's pricing wars, try booking an air ticket on Expedia, a travel website. Recently, a ticket from Toronto to San Francisco on Expedia's Canadian website was listed for around $750. On the American site, the same trip cost about half as much. But do not try to use your Canadian credit card to buy the cheaper seat—the American website won't take foreign plastic. Your American office would have to buy it and post it to you.

That is a minor inconvenience, compared with the other restrictions that have plagued travellers, such as minimum-stay requirements and massive premiums for flexibility. Airlines and hotels, with their fancy "yield-management" systems, have long led the way in sorting customers into categories, based on their willingness to pay. But now, thanks to downward pressure on prices, other industries, from retailers to chemicals, are catching on and trying to become as sharp at varying their prices as the airlines.

The trick is to do it without annoying customers. Most bosses assume they can change prices often and with little effort. But, says Mark Bergen, a professor at the University of Minnesota, this ignores the costs of management time, as well as the risk of alienating some customers while soothing others. Once a bad price is established, he says, it can be devilish to fix.

Mr Bergen argues in a recent article* that chief executives need to pay more attention to pricing. He sees a need to go beyond today's tactics, and to invest in "pricing capital"—including better computer systems as well as price-savvy managers. These may be hard to find. Few business schools teach pricing as a discipline; instead, they see it as a branch of marketing. He cites Polaroid, which went bust last year largely because it failed to price its digital-photography products properly.

Contrast that with the American subsidiary of Roche, a Swiss drug company. One of its top managers, Ron Andrews, arrived to find prices set deal by deal, with wide latitude given to the company's salesmen. He introduced software for every salesman's laptop computer to provide instant—and profitable—price quotes in the field. The hard bit, of course, is to get the salesmen on board. To help, he created a new post of director of pricing strategy.

Raising prices is likely to remain tough even as the world economy rebounds. Inflation is likely to remain low in rich countries, for several reasons. Globalisation has increased the number of competitors. The Internet has made it easier for buyers to shop around and to compare prices. The euro has made prices more transparent in Europe, even if consumers worry that retailers have used its introduction to mark up their goods (see box on next page). And big buyers, such as Wal-Mart, are squeezing ever more from their suppliers. The days of annual (upward) revisions to price lists look to be over.

And yet most bosses still worry more about their costs than about the prices they charge. One survey found that managers spent less than 10% of their time on pricing. Henry Vogel of the Boston Consulting Group likes to remind clients that raising prices by 1% can boost profits by up to four times as much as a 1% cut in overheads and fixed costs.

Today's managers, unlike those emerging from previous recessions, have no end of fancy technology to help them. Supermarket chains, for example, can quickly and easily track customers' "elasticity"—how their buying habits change in response to a price rise or a discount. But although firms can now measure this sort of thing in a more sophisticated way, basic rules of thumb are still the most common way of setting price.

A popular—and rather crude—technique is hidden or "stealth" increases. Mr Vogel points to car companies, which may charge extra for features such as anti-lock brakes and passenger-side airbags, instead of offering them as standard features. A slightly more subtle approach is to offer a huge menu of margin-enhancing financing schemes. Give your customer plenty of choices, and he will struggle to find the deal with the cheapest price.

Better organisation has helped some consumer-goods companies to set prices. Martin Smith of Whirlpool, an American white-goods maker, says his company overhauled its pricing two years ago by thinking of prices themselves as a product, much like a dishwasher. Despite the recession, when steep price cuts looked like the only way to go, Whirlpool last year reduced the frequency of its discounts, which it says are costly to communicate to salespeople, and can confuse customers if they are changed too often.

Industrial markets are even more demanding. Dow Chemical, operating in the ▸▸

*Pricing as a Strategic Capability. MIT Sloan Management Review. Spring 2002. Shantanu Dutta, Mark Bergen, Daniel Levy, Mark Ritson and Mark Zbaracki