PRICE & PREJUDICE

How smarter pricing delivers more for less

An OC&C Insight

OC&C Strategy Consultants

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PERCEPTIONS OF VALUE

Retailers invest huge amounts of effort and money in price changes, often with little return. In our experience retailers in general do not pay sufficient attention to what drives the customer's perception of their price position.

As a result investments go unnoticed by the customer and create no benefit for the retailer.

This Strategic Insight argues that through taking a customer perspective price perception can be improved, often with little need for overall investment. Our key messages are:

Price and customer's perception of price are different—it is price perception that is important.

This is good news as it costs less to improve price perception than reduce prices—this is a big opportunity!

There are a number of proven weapons retailers can deploy to manage price perception effectively:

- Target price investment on perception-driving products and categories
- Don't create a product mix (or a store environment) that appears expensive to customers (even if like-for-like the prices are good value)
- Create clear signalling and communication of value position

Through developing a good understanding of what drives customers' price perceptions these weapons can be deployed with maximum impact.

PRICE MOVES SHOULD BE ASSESSED IN TERMS OF THEIR IMPACT ON PRICE PERCEPTION

PERCEPTION VS REALITY? NO CONTEST

Price matters: perceived price matters more

It is price perception that drives customer behaviour, without improving this any other improvements to pricing are worthless.

In France for example, as a result of the Loi Galland in many retail sectors, prices are very similar between competitors. However in our experience customers' perceptions of retailers are very different despite very similar overall prices.

Case study—How to waste your investment in price:

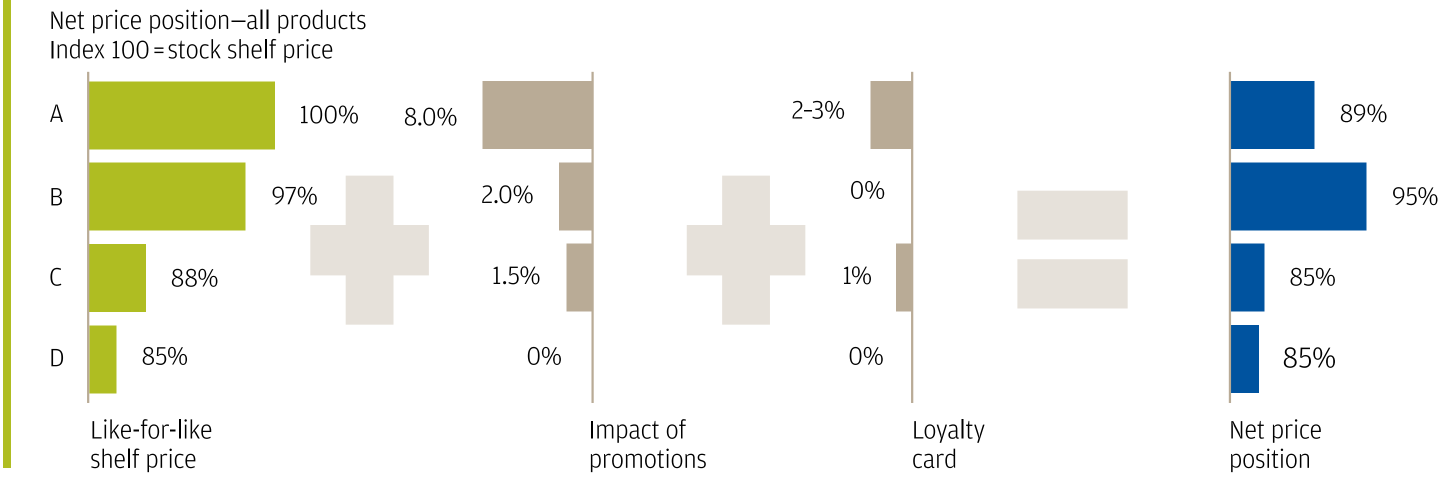
In this (real but disguised) case retailer A is delivering a net price to its customers which is lower than retailer B. However in this case the customer perception is that retailer B is significantly cheaper.

The reason for this discrepancy is that retailer A is delivering this price through promotions and loyalty card discounts, which are not being fully valued by the customer. Retailer B has cheaper like-for-like shelf price (particularly on some prominent items) and reinforces this with aggressive value-led advertising.

Hence Retailer A appears to be wasting money that could be better reinvested in other elements of price, or back into margin!

In our view, pricing moves should always aim to deliver maximum improvement in price perception (not price position) for minimum investment.

Headline price vs delivered price



THE POWER OF PERCEPTION

It's a lot cheaper to change perception; it works better too

The good news is that price perception is often cheaper to influence than price itself.

OC&C recently undertook work with a multi-category retailer who had a significant price perception deficit—which was driving customers to shop elsewhere. Our recommendations resulted in a significant change to the way price was represented:

- Re-mixed categories with greater emphasis on 'value for money' products
- Clear and understandable price promise (promising value that was already there!)
- Increased investment in key perception-driving categories—largely made up for through price increases elsewhere
- Significant increases in marketing highlighting the value available

The net result of these changes was an increase of five percent at the operating profit line through increased volumes with no overall investment in margin. The key in this case was to implement a package of coordinated measures to change overall price perception.

A PACKAGE OF COORDINATED MEASURES CAN TRANSFORM OVERALL PRICE PERCEPTION

CHOOSE YOUR WEAPONS

Numerous weapons are available to manage price perception

There are a number of proven weapons retailers can deploy to manage price perception effectively

'Price' is complicated and is delivered and communicated to the customer using multiple mechanisms. The impact of each mechanism on customers' perception is different; hence the importance of targeting investment where 'bang for buck' is greatest.

Target price 'investments' where they have impact

It sounds obvious to say but price investments should be focused on price sensitive categories and products: ones that drive price perception and are disproportionately purchased by price-seeking (but nevertheless profitable) customers. In some areas it is not worth investing in price; for example even in the highly price competitive area of food retail it is not worth price matching in fresh categories like behind-the-counter deli, where customers find direct comparisons difficult.

Even though promotions typically do not drive customer perception as much as on shelf prices, they remain a key part of managing price perception. Often promotions are regarded as a way to get supplier funding and hence do not punch their weight in driving customers' perception. This focus on supplier funding obscures customer perspective. If the promotions are targeted at delivering price reductions selectively to price-sensitive customers, the impact can be huge.

Keep product and category mix consistent with value position

We have worked with a number of clients investing significant sums in price matching competitors, only to find their price perception remains worse than competitors'. Often this is because while they are matching products on a like-for-like basis they are still offering a more expensive mix of products overall. The overall mix is biasing the customer perception.

In UK grocery for example, Asda has considerably lower price perception than Tesco, despite the two being within a whisker in like-for-like price. A major driver of this is Tesco's higher price product mix driving higher price perception. This does not mean retailers need to stack their shelves with cheap product; a few prominently displayed value lines can go a long way.

Tell customers about your value

Communicating your price position is critical. Too often price promises are confusing (and not believed) and great value is hidden on the shelf where customers don't notice. Price promises are often very powerful, however in many cases neither understood nor believed even when true!

The important point is to understand where customers' perception is worse than reality and tell them about it. Highlight value where it is important to your customers.

A FEW 'VALUE PRODUCTS' PROMINENTLY DISPLAYED BEATS CUTTING PRICE ACROSS THE BOARD ANY DAY

I, THE CUSTOMER

Step one is simple: think like a customer

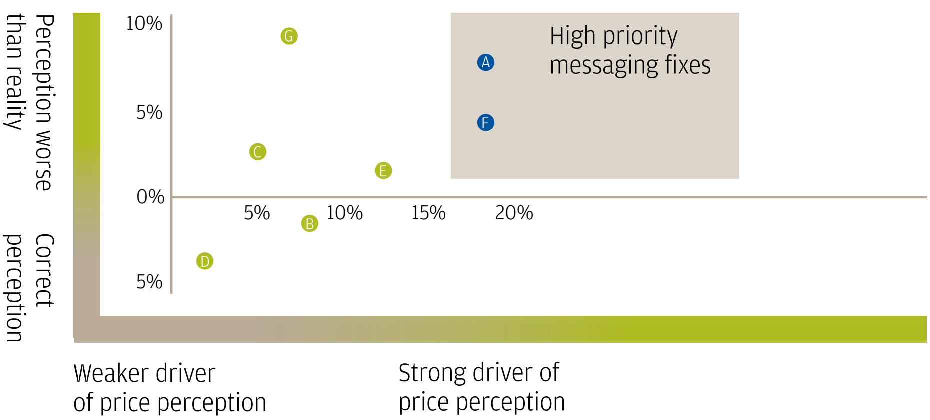
The key to effective pricing strategy is to understand what drives customers' perception and invest in products and categories that are important to driving this. Then tell customers about it.

In an example in catering we discovered the high price of a cup of coffee was critical to creating adverse perception. When we looked at competitor best practice we saw they had invested in lower priced coffee, and had posters communicating this. It was a small investment, but drove significant perception benefit.

Exhibit 2 shows how through taking a customer perspective investments in relative price position can be improved. The exhibit shows the importance of a category to driving overall price perception and how customers currently perceive that category (versus reality).

In this case categories A and F are both important to driving price perception and are categories where customers think the retailer is worse than reality. These represented a clear case for increased signalling of the strong price position, a cheap and quick win!

Exhibit 2.
Derived importance of price vs price perception % indexed to competition



SHORT TERM SUCCESS, ENDURING HEALTH

An understanding of price perception enables short term success for sales and enduring health for the brand

Failing to get fair value for pricing in today's unforgiving market can be expensive. In our experience there are three common pitfalls that need to be avoided:

- Flip-flopping on price confuses the customer; decide what your position is and execute it consistently
- Piecemeal solutions are expensive and often have little impact; a coordinated programme is required
- Assuming you know the answer without finding out what drives the customers perceptions

SUCCESSFUL PRICING DELIVERS IMPORTANT, EVEN VITAL, RESULTS. OC&C CAN OFFER CRUCIAL GUIDANCE ON WHAT TO DO – AND WHAT TO AVOID.

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