SPAIN

VALUE PRICING: HOW MARKET RESEARCH CAN HELP COMPANIES WALK THE TIGHTROPE

Legendary investor Warren Buffet, the chairman and CEO of Berkshire Hathaway, once said he sees pricing power as the most important decision when evaluating a business. According to him, “if you’ve got the power to raise prices without losing business to a competitor, youw’ve got a very good business. And if you have to have a prayer session before raising the price by 10%, then you’ve got a terrible business.”

Pricing is indeed one of the most important levers to increase profitability and can have a direct impact on a company’s market competitiveness and overall health. As an example, for a product with a 10% contribution margin, a 1% price improvement can boost bottom-line profits by 10%.

However, most companies are afraid of increasing prices. In fact, when they see competitors making a price cut, most businesses tend to immediately follow suit for fear of losing customers.

So why so many companies still struggle to maintain a strong position in this area?

This is because measuring customers’ willingness to pay and designing a value-based pricing strategy are not easy tasks. They require meticulous preparation, specialist skills, precise calculations and support from experienced professionals to avoid disastrous (and often irreversible) outcomes for the business.

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How Can Companies Determine Value?

Value can be subjective and vary widely across customer segments. This is largely because the value derived from a product or service can be linked to intangible factors such as brand reputation, customer experience and emotional connections.

This makes it difficult to quantify the specific benefits customers derive from a product or service and how price points are perceived.

While internal data is the most reliable source of information for that purpose, it comes with several challenges:

- **Lack of historical data or not enough historical price variations:** To determine price elasticity, companies must be able to measure customer reactions to different price points. However, it might be the case that the price of the products or services offered has not changed over time, or that the changes have been accompanied by modifications in the product itself, which makes customer reactions difficult to measure.
- **Too much noise:** When measuring price elasticity through internal data, companies need to be able to isolate price as the main driver for decisions. This can be complex as price changes may coincide with competitor actions or ongoing promotions that affect the product or service being investigated. Macroeconomic aspects that influence sales, such as high inflation, can also create additional data challenges.
- **Difficulty allocating price changes to specific items or products:** In businesses with high numbers of products and multiple promotions, it is hard to establish a precise baseline (how much volume is driven by promotions and how much would be sold regardless) or understand cannibalization (the impact promoted products have on the sales of other products). Sometimes promotional costs are accounted for by a single concept and cannot be allocated to individual products. Obviously, managing all this data for multiple items can be a high-effort exercise.
- **A/B Testing complexity:** Apart from the obvious implementation efforts, especially if they require changes in the product, achieving statistical significance in A/B testing[1] requires an adequate sample size. Some businesses may struggle to collect a sufficiently large sample. Brand image can also be affected by constant price changes.

Using market data and research to inform pricing decisions

In order to overcome these issues and achieve an effective pricing strategy, the use of market data or market research is essential. We identify the following main advantages of external data/research in pricing decisions.

Advantages

- **Isolation:** Experiments or tests in a market research environment allow businesses to control the environment and, thus, the main driver for customer decisions. As such, experiments can be designed to isolate customer reactions to the price of a certain product or service.

1. A/B testing is a method used to compare two versions of something to see which one performs better, in this case could be the same product with different prices.

- **Speed:** Tests can be conducted in just a few weeks, or even days, without the implementation effort that product A/B testing would require and without requiring any traffic to sales channels.
- **Flexibility:** Market research does not require implementation efforts and allows companies to perform a wide range of tests while being able to adapt price points, benefits or frames iteratively. The access to results in real time and the ease of processing them are also advantages.
- **Combination of methods:** Market research is not an exact science. Therefore, it is important to combine methodologies to achieve the most accurate results. There are different methods depending on the objective of the pricing research, including identifying pricing psychological thresholds, willingness to pay for different attributes and purchase intention for different price levels.

It is important to note that market research requires a prior segmentation of target customers. This will allow businesses to segment customers based on contextual factors other than demographics, something that could be challenging with internal data alone. For example, initial questions can profile customers based on whether they have an immediate need or on their attitudes towards the product. As context heavily influences decisions, the data that can be extracted from this exercise can be much more relevant.

Methodologies

Different methodologies can be used to capture pricing insights through surveys:

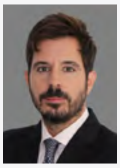
- **Van Westendorp:** Developed by Peter Van Westendorp in the early 1970s, this technique involves asking survey respondents a series of questions related to their perceptions of a product's price. Based on their responses, a range of acceptable prices and price sensitivity can be determined.
- **Gabor-Granger:** Developed in the 1960s by Clive Granger and André Gabor, the technique involves asking survey respondents about the likelihood that they would buy an item based on its price.
- **Conjoint:** Based on the work in the 1960s by psychologists and statisticians Luce and Tukey and complemented later with the studies on discrete choice methods from econometrics, the conjoint methodology identifies the individual aspects that influence the customer's decision, weighing the benefits against the trade-offs. This is especially relevant in products with several attributes where the value is linked more to certain attributes.
- **Max-Diff:** also referred to as the Best-Worst method, it is a survey technique that involves participants selecting the most favorable ('Best') and the least favorable ('Worst') options from a provided set. By incorporating this approach into a well-designed experiment, companies can effectively establish a relative ranking for each option.
- **Turf Analysis:** This technique is used to identify the optimal combination of products or services that will maximize reach within a target audience. It is able to help configure the benefits of a certain product to maximize reach while limiting costs.

Conclusions

As the most powerful profit lever, pricing has an immediate impact on revenues and overall business performance. However, adjusting prices can be scary and not an easy task, especially if companies want to be precise. Raising prices is like walking on a tightrope — a delicate balancing act where one misstep could lead to a dangerous fall, risking both profits and customer loyalty.

Transactional data is the most reliable source of information to understand customer willingness to pay and adjust product benefits and price levels. However, accessing and processing it has many challenges. Because of this, pricing market research techniques can be an effective tool to design products and services that capture more value from customers.

KEY CONTACTS



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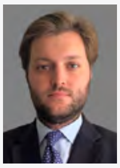

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