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Marco Bertini (mbertini@london.edu) is an assistant professor of marketing at London Business School.

Luc Wathieu (luc.wathieu@esmt.org) is the associate dean of faculty at the European School of Management and Technology, where he holds the Ferrero Chair in International Marketing.

RE

Surprisingly, your best tool for getting people to see beyond price may be the price itself. *by Marco Bertini and Luc Wathieu*

How to Stop Customers from Fixating on Price

A

t a consumer products company we're familiar with, no one on the senior team would ever refer to the company's products as "commodities."

Managers there know what the competition has to offer, and they know their goods are different. They can name the distinctive features and explain their value—and they can tell you how much they've spent on innovation to keep that edge.

The problem is, their customers don't seem to have gotten the memo. Faced with the many options available to them on store shelves, they behave as though only one factor matters in the buying decision: price. They treat the company's products as commodities.

It's a hard problem to overcome, and hardly limited to this company. Many, perhaps most, markets

today are mature enough to feature intense price-based competition. The constant undercutting to capture customers sometimes spurs efficiency gains, but more often it damages brand equity and erodes profit margins. To make matters worse, customers in these markets develop low expectations and grow disengaged: They fixate on price and lose interest in marketing communications and all but the most radical innovations. (See the sidebar “The Commoditized Customer.”)

It is still possible, however, to jolt customers into considering the value of your offering in terms of quality and personal relevance. To persuade them that they have a meaningful decision to make, you can—paradoxically—use the last thing you want to be decisive: the price.

Our research suggests that four pricing moves in particular can diminish the salience of price in a transaction. You can change the basis of your pricing structure, as Goodyear did when it priced tires according to how many miles they would last. You can stimulate curiosity with willful overpricing, as Burt’s Bees does with its natural beauty products. You can partition a price into components to make customers notice a key benefit, as IKEA does by charging separately for a table’s top and legs, alerting people to its

useful modularity. Or you can put the same price tag on a range of options, causing customers to weigh their preferences, as Swatch did when it uniformly charged \$40 for any watch design. What these strategies have in common, we’ve discovered, is the close link between pricing and customer attention—a link that has not previously been explored by marketing scholars, and one with significant implications for businesses.

STRATEGY 1

Use Price Structure to Clarify Your Advantage

The first way to use pricing to diminish price sensitivity is to make it call attention to the value your product or service delivers, and ideally to the one dimension that most meaningfully differentiates it from those of competitors. To achieve this you must revise your pricing structure (the basis on which you price your various offerings). Goodyear’s problem for a long time was that customers were unwilling to pay a premium for the innovations the company introduced to extend tread life. Without a clear reference price for tires, buyers experienced sticker shock and gravitated to the lowest price. Goodyear solved that problem by pricing its various models on the basis of how many miles they could be expected to last rather than their engineering complexity; this highlighted the advantage of those innovations for customers and taught them a new way to compare offerings that was perfectly aligned with the company’s value proposition.

We begin with the idea of revisiting pricing structure because it is so often neglected. When managers worry about pricing, they typically focus on determining the optimal price point for a given product. Drawing on market testing or research techniques ranging from simple surveys to full-scale conjoint analyses, they work diligently to discover just how much demand would be generated at different prices under different support conditions (for example, with or without advertising or merchandising budgets) and from which customer segments. Meanwhile, they fail to examine the larger framework in which such questions reside.

Yet the benefits of restructuring pricing to align with value have been proved many times. In the world of industrial explosives, Orica escaped commoditization with “broken rock” pricing that charged customers according to the fragmentation of the rocks extracted rather than the amount of ex-

The Commoditized Customer

When has a product category been commoditized? Most managers and business scholars will tell you it’s when competing products are indistinguishable in terms of tangible features and capabilities. But our research shows that commoditization is as much a psychological state as a physical one. A commoditized market is one in which buyers display rampant skepticism, routinized behaviors, minimal expectations, and a strong preference for swift and effortless transactions regardless of product differentiation.

The key, therefore, to escaping commodity status is not what you do to your product—it’s what you do to your customer. You must find a way to reengage a buyer

who is past caring. Commoditized customers choose on the basis of price because they have become convinced that the options available are equally palatable and the minor differences among them are not worth investigating. They have lost the habit of asking “Which of these suits me best?”

That’s why turning the tide is so difficult. Fresh rounds of innovation go unnoticed, and better-formulated marketing messages don’t get through. This will remain true until you make consumers sit up and take notice. The best way to do that, we’ve discovered, is to take the one thing they’re focused on—the price of your offering—and alter it in a surprising or challenging way.

Idea in Brief

In mature markets, heavy competition has a commoditizing effect, and customers become increasingly fixated on price.

When marketers refer to “commoditization,” they typically mean diminishing differences among offerings. But it’s also a psychological state: Consumers fall into a mind-set that makes them less receptive to innovation or marketing campaigns.

Paradoxically, one of the most important levers managers can use to revive consumer interest is price. The authors describe four pricing moves that can call attention to how an offering is different—and why it deserves to fetch a premium.

Constant price undercutting can damage brand equity and erode profit margins. Meanwhile, customers develop low expectations and become disengaged.

plosives spent. General Electric changed its airline-engine pricing to deliver “power by the hour.” Embrex (now Pfizer Poultry Health) offered poultry breeders inoculations “by the egg”—aligning pricing with the value breeders seek from healthier animals. All these companies realize that pricing based on units sold does little to set them apart from the competition. In fact, it promotes price comparison by establishing a simple common denominator that customers seize on. Alternatively, telling customers that they will be charged according to the value delivered suggests that they reassess their preferences in line with that value and sends a powerful message that the seller stands behind its offering.

Sometimes one seller’s price restructuring can revolutionize an industry. Consider Norwich Union (now part of Aviva), a UK-based insurer, which changed how it charged for car insurance. Traditionally, a policy’s annual premium is based on the insurer’s actuarial analysis of the risk presented by a given driver. The price is intended to cover the projected costs of claims plus a markup dictated by the competitive environment and the financial objectives set by top management. Norwich Union’s innovation was to do away with annual premiums and begin charging per mile driven. Even more surprising, the company installed sophisticated tracking devices in policyholders’ vehicles, allowing it to monitor their driving behavior—and to charge higher rates under conditions of elevated risk. Thus a policyholder who drove more miles at night, or neglected to wear a seat belt or use turn signals, would pay more than one with safer driving habits.

Norwich Union discontinued its offering when it became clear that its tracking devices were too intrusive for the tastes of customers in the UK, but its pay-as-you-drive innovation has since been taken up by other insurers around the world (including Progressive in the United States). The power of this pricing approach is that it causes customers to stop and think. Rather than mindlessly choosing on the basis of the lowest quote they can find, they are forced to consider the purchase in light of their own unique behavior—and in the process they come to appreciate the argument for use-based insurance.

For the company there are several other effects: The first is that riskier drivers, who are always the most costly to serve, migrate to competing insurance companies. The second is that having obtained the data to find patterns in driving behavior and claims, the company can refine its risk profiling, increasing its competitive advantage on an important dimension. The third is that pay-as-you-drive insurance induces many customers to alter their driving behavior, thereby reducing the likelihood of accidents—an outcome of obvious benefit to both sides of the transaction.

What all the examples above have in common is that a pricing change compelled customers to pay attention to a certain form of value. The key to succeeding with this strategy is to vary price according to what’s most distinctive about your offering rather than the makeup of the product or service itself. This will take your offering out of head-to-head price competition and allow it to compete on the personal relevance to customers of the value it provides.

Managers might argue that any radical change in pricing structure is virtually impossible in hyper-competitive markets where every player sets prices using the same metric and every customer has significant experience paying in a certain way. Although we're sympathetic to this concern, our experience suggests that the benefits far outweigh the obstacles along the way.

STRATEGY 2

Willfully Overprice to Stimulate Curiosity

Ever wonder why Apple computers are always priced at a premium and, more important, how the company can sustain both this premium and strong customer goodwill in the face of increased competition and tough economic times? Or perhaps you're familiar with SKF, the leading global supplier of bearings, which continues to command a 30% to 40% premium despite stagnant industry growth and the entry of several low-cost alternatives from emerging-market competitors. Both cases demonstrate the thought-provoking effect of moderate overpricing—that is, setting prices higher than what customers normally intend to pay.

The logic behind willful overpricing is at once intuitive and counterintuitive. Imagine that you are in the market for a GPS device, and that many models are available from various manufacturers, all priced at about \$200. Thanks to that clustering of options, you are mentally prepared to part with an approximate amount of cash: \$200. Now suppose you come across a model at your local electronic goods store that costs \$300. How do you react?

If you think like the customers in recent studies we conducted, you don't automatically dismiss the higher-priced model. Rather, you're motivated to take a closer look: Perhaps added features justify that price—features you haven't considered but might in fact care about. Thus the manufacturer has produced exactly the response it needs to compete in an intensely price-conscious market.

In one experiment we asked graduate students to examine two differentiated supermarket products: organic lettuce and free-trade coffee. Through prior testing we had discovered that the students would be willing to pay a premium of 20% at most for these products. But when we priced the items at an 80% premium, they recalled nearly twice as much product information, which enabled them to cite more arguments in favor of buying the products. The overpricing also evoked a more passionate response to the products (which we measured by asking participants how relevant organic foods and free-trade harvesting were to their lives), which led to a willingness to pay much more than they originally intended. By contrast, people who were exposed to a premium close to their price expectations (10%) or one that was outlandishly high (190%) simply acted according to their pretested inclination, without giving much thought to their choice.

The implication is that for every purchase decision, there's a price range above what potential customers say they are willing to pay that will provoke them to ask, "Do I need this benefit or not?" rather than the usual (and damaging) "What is the cheapest option in the store?" Yet managers often respond to price competition by slashing prices to a point where important decisions about added functionality or benefits become no-brainers—which precipitates commoditization. This was the effect that Goodyear and other tire makers faced: As they kept lowering prices, their race to the bottom made consumers less sensitive to differences in safety and other aspects.

In a mature market where prices have already entered a damaging downward spiral, willful overpricing can help to reverse the trend. Starbucks took a beverage that many establishments served almost free and put a price on it above \$3. Millions of cups of coffee later, it's clear that the premium was paid neither because the customer base was too affluent to care nor because the quality was that much higher. What Starbucks did, quite deliberately, was set a price point that made people rethink the importance of a coffee break in their lives.

Willful Overpricing Can Make Customers Pay Attention

In one experiment, graduate students were asked to examine differentiated supermarket products.

WHEN THE PRICE PREMIUM WAS...	10%	50%–80%	190%–250%
Recall of label information was...	DECENT	EXCELLENT	MINIMAL
Sense of personal relevance was...	NOTICED	PRONOUNCED	NOTICED
Willingness to pay was...	MODERATE	GREATEST	MODERATE+

The Perils of Price Discounting

Burt's Bees pulled off a similar feat by charging premiums of 80% to 100% over nonnatural personal-care brands, changing the views of a mass market that had seemed determined to pay the lowest amount possible for lip balms and shampoos. Burt's Bees' prices shocked consumers but prompted them to wonder what could possibly make the company's offerings so special. The answer—that they are made with natural ingredients by a socially responsible organization—began to matter. The company's sales grew annually by nearly 30% and its valuation quadrupled from 2003 to 2007.

Understanding the effect of willful overpricing may help managers to price truly innovative offerings without trepidation. Consider the case of KONE, the Finnish elevator company. In the 1990s the elevator industry was plagued by price competition. Architects and developers, traditionally appreciative of innovation and extra features, had been largely replaced as decision makers on equipment purchases by purchasing agents and contractors tasked with minimizing costs. Elevators were often sold at a loss, as manufacturers became willing to settle for the later payoff of after-sale service contracts.

In that highly commoditized context KONE introduced the MonoSpace, which required no separate machine room, thus lowering installation costs by more than 20%, and which reduced energy consumption by up to 60%. At the time, the market was unprepared to factor these and other unique benefits into its considerations, much less pay for them.

To provoke customers to value its innovation, KONE started responding to RFPs by submitting two proposals—one quoting its older models at a competitive price, and the other offering MonoSpace at a price that must have struck buyers as wildly off base. The strategy won few contracts at first, but it did spur constructive conversations among developers and their architects and contractors, who often called KONE for an explanation, generating a virtuous sales process.

STRATEGY 3

Partition Prices to Highlight Overlooked Benefits

A third thought-provoking strategy—known as price partitioning—is to break a price into its component charges. This highlights dimensions of differentiation that might otherwise go unnoticed.

For example, cable television customers generally buy a bundle of services from their providers:

Faced with heavy competition, marketers resort to all sorts of price promotions—coupons, quantity discounts, referral discounts, bundling, and targeted promotional offers. Our research shows how counterproductive these can be.

Participants in one study were instructed to assume that they had just moved to a new apartment and wanted a single vendor for their cable TV, internet, and phone services. They were shown the details of a vendor's "base pack" and "max pack," which offered different numbers of channels; for either pack they had a choice of three internet connection speeds and whether or not they wanted to include standard phone service. The final price depended on what options the participants chose. Half of them were also exposed to a promotional offer: a onetime discount for accounts opened over the internet. The discount applied to any package. That simple reminder of cash to be saved proved to have a dramatic effect—and not the one our hypothetical company would have wished for.

Customers alerted to a price promotion seemed to become immune to the higher-quality proposition of faster internet access and more channels. (See the results, right.) The finding is consistent in experiments and field studies we conducted across seven different purchase contexts and six different types of concessions. Far from suppressing customers' price consciousness, promotions actually heighten it. If you want customers to deliberate about your offering's selling points, don't offer them a special price.

How many customers chose some version of the "max pack"?

28%

OF THOSE WHO SAW A PRICE PROMOTION

53%

OF THOSE WHO DID NOT SEE A PRICE PROMOTION

How many customers chose the cheapest version of the "base pack"?

31%

OF THOSE WHO SAW A PRICE PROMOTION

6.7%

OF THOSE WHO DID NOT SEE A PRICE PROMOTION

access to a package of channels, the use of a set-top box and remote control, and, often, movie channels, broadband internet connections, and other offerings. Providers have two pricing options: They can charge one all-inclusive price or they can itemize the bill. The amount payable is the same—so does it matter which approach they use?

Our research shows that it does. Presenting a cost as a set of smaller mandatory charges invites closer analysis and therefore increases the likelihood that a customer will revise a routine consumption behavior. We saw this effect in an experiment in which we presented participants with various options for airline travel from Boston to San Juan. In every case they were asked to choose between a \$165 nondirect, no-frills flight and a \$215 direct flight with ameni-

A Single Price Point Cures “Price Shopping”

When would-be customers were asked to project music downloads they would buy under two pricing scenarios, this was the result:

	VARYING PRICES \$0.89–\$1.29	UNIFORM PRICE \$1.29
LIKELIHOOD OF PURCHASE (ON A SCALE OF 1–7)	2.77	3.63
SONGS PER MONTH	5.05	6.13
IMPLIED ANNUAL REVENUE	\$25.⁹⁵	\$49.¹⁰

ties (in-flight entertainment and meal service). We tested four variations on how the more expensive flight was presented, to see what might induce people to choose it over the cheaper option. We created two levels of amenities, on the theory that six movie channels and a full-service lunch rather than an old sitcom episode and coffee or tea might cause more people to choose the higher fare over the lower one; and we tried price partitioning—some participants saw the higher cost as a lump sum and others saw it broken down (\$205 for the flight plus \$10 for the nonoptional amenities).

It turned out that the quality of the amenities made no difference to those who saw the price as a lump sum. The proportion who chose the higher price did not vary when the quality level was raised. But to those who saw the price partitioned, quality mattered: The better package induced more people to choose the more expensive flight.

Four similar experiments reinforced our finding: People are unlikely to factor a benefit into their choice unless an explicit charge is made for it. Though easily applied, this finding is often resisted—sometimes for good reason. Customers may be annoyed by price

partitioning, especially when they sense that sellers aren’t being straightforward about the total cost. This is a common reaction to so-called low-cost airlines that partition fees for mandatory services such as check-in and luggage handling. Worst of all, sometimes these fees are revealed only as the customer advances through the purchase process, making the price less transparent for comparison. This type of partitioning produces resentful customers, buyers who simply lacked the energy to repeat the whole process with a competing seller. It also backfires because it highlights standard features (checking in is unavoidable) rather than competitive advantages. Partitioning succeeds only when it primes customers to see a real benefit they would otherwise have overlooked.

STRATEGY 4

Equalize Price Points to Crystallize Personal Relevance

A final strategy for turning price sensitivity to your advantage applies when customers are asked to choose among several options designed to appeal to different tastes. Our research suggests that in such cases all the variants should be priced the same, because customers will then be compelled to discover which option best suits their needs. They will work to fully appreciate the range of options a seller is offering, not to find ways to shed features for a lower purchase price.

This is an atypical approach to pricing customizable offerings. Usually, different prices are set for the different options on offer. A beverage company, for example, would price fruit smoothies higher if they were made from exotic fruits such as mango and papaya rather than from apples and pears. The same principle applies to milk, whose price typically varies depending on the fat content. This makes sense to companies that believe in cost-plus pricing, because different product options often involve different production costs: If the goal is to maintain a constant profit margin on items sold, the company must charge different prices.

The problem is that in most mature markets, customers are unresponsive to marginal changes in value. They have lost interest in understanding how each product option might serve them, and they default to price minimization. In fact, a list of options at different prices doesn’t make them examine the relative merits of those options; it activates their predisposition to pare the price.

Consider an online music store deciding whether to sell songs at a single price or to vary the price according to popularity or genre. We ran an experiment in which half the participants were told that the store would charge \$1.29 for current hits, \$1.19 for soundtracks, \$1.09 for classical music, 99 cents for country, Latin, and jazz, and 89 cents for everything else. The other half were told that every download would cost \$1.29. (Note that the single-price option matched the highest price in the varied set.)

We were prompted to stage this experiment by the seemingly irrational choice at Apple to charge 99 cents for any track available on iTunes. Many media analysts, along with major record companies such as Universal, Sony, and EMI, had criticized Steve Jobs for passing up an opportunity to skim the market and capture more surplus through price discrimination. They believed he was missing the basic point that high-demand products—or those demanded by less price-sensitive consumers—can carry a higher price, while lower-demand products must be priced lower.

Given how things went for Apple, the results of our experiment didn't surprise us—but the size of the effect did. Participants who were offered music at a uniform price of \$1.29 were 31% more likely to buy and anticipated buying 1.08 more songs, on average, per month. That would amount to spending \$49.10 a year on music rather than \$25.95—an increase in revenue of about 89%. We believe that the uniform price provoked respondents to think about their desire to consume music in general, instead of reinforcing their fixation on saving as much as possible. As Steve Jobs explained, to charge a uniform price not only was fair but also got customers to think about the benefit of iTunes' huge selection.

Groundbreaking as Steve Jobs is, he did not invent this tactic. When Nicholas Hayek brought the Swatch to international markets, in the 1980s, every design had the same price. Hayek's goal was to defeat price-based competition from Asian manufacturers whose cheap quartz technology offered timekeeping precision on a par with Swiss mechanical works. The plastic watches he created couldn't be sold more cheaply than those rival products, but with an array of fresh, colorful designs, they offered a new means of cool self-expression. Why was their pricing thought-provoking? Imagine a price-fixated consumer arriving at a watch display. When she encounters a broad assortment of Swatches, all for \$40, her price fixation is suppressed by the question "Which of these is right for me?"

When Steve Jobs charged a uniform price, it not only was fair but also got customers to think about the benefit of iTunes' huge selection.



MOST MARKETING TEXTBOOKS claim that a price tag does two things. First, it names the terms of the exchange: just how much money a customer has to give up to procure the offering. Second, it often signals quality—particularly when that is hard to ascertain independently. The research described in this article reveals a third aspect: A price tag can actually shape the value of the product or service by motivating customers to better understand what they're being offered.

Some companies prefer to keep customers focused on price because they have a basic cost advantage to leverage. Most companies, however, would benefit from getting people to think harder about value. They need customers to appreciate the innovations they introduce, but as their markets mature, those innovations no longer get the attention they deserve.

The trick is to fight customers' disengagement with the one marketing variable that still penetrates their consciousness: price. None of the moves we've described resemble conventional practice, which is to keep winning business through targeted price discounts. Nor do they involve hiking prices mindlessly in an attempt to signal higher quality. Rather, they call for pricing in a thought-provoking way. Challenging the customer to ask "What am I actually paying for?" and "What aspects of this offer do I really need?" begins to revive the conversation between buyer and seller. Customers are fixated on price—and the best strategy is to turn that to your advantage. ▢

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