

In a Downturn, Protect Pricing without Alienating Customers

Consumers feel pinched and are cutting their discretionary spending. But are they more likely to buy *cheaper* or *fewer* products and services? Oliver Wyman's research suggests that customers tend to reduce the number of products they buy, and are selective in what they choose. For example, a recent Oliver Wyman online survey of more than 500 U.S. adults found that consumers are six times more likely to delay purchase of a new electronic device, such as a notebook computer, color printer, music player, or digital cameras, rather than purchase a cheaper device now.

With holiday season sales forecast to remain flat or even shrink compared to last year, marketers in virtually every industry are cutting prices, with the hope that it will induce demand and get consumers to spend. Our survey found that in most electronic device categories, a price discount of 20% would indeed increase unit sales, but not enough, in terms of overall revenues, to offset the revenue loss of customers who would have purchased at the higher price. It is imperative, therefore, for companies to ensure that they're not giving away too much through a discount.

Some firms are avoiding discounts. Most analysts were expecting Apple to launch a Mac priced under \$1,000 to better compete with the low-cost PCs. Instead, Apple chose to pack more features into new aluminum MacBooks it unveiled in October, at price points far higher than average notebook prices. The strategy allows Apple to maintain its brand's premium reputation while protecting its industry-high profit margins. By contrast, for the past quarter, Chinese PC maker Lenovo reported a 78% drop in quarterly profit from a year earlier, blaming diminished demand and "aggressive pricing."

Understanding What Customers Value

In both good and bad economic times, marketers need to clearly understand how customers make purchase decisions. Our research suggests that customers are more likely to stay with strong and established brands and products that deliver value rather than choose cheaper products. Instead of across-the-board price cuts, marketers should highlight those product aspects that have high perceived value and cut those aspects that are valued less by customers. They should clearly understand elasticity of demand to price and other value components of their offer at a very granular level—by segment, product, geography, and so on—and they should focus price and promotion messaging on the most impactful areas and most responsive customers.

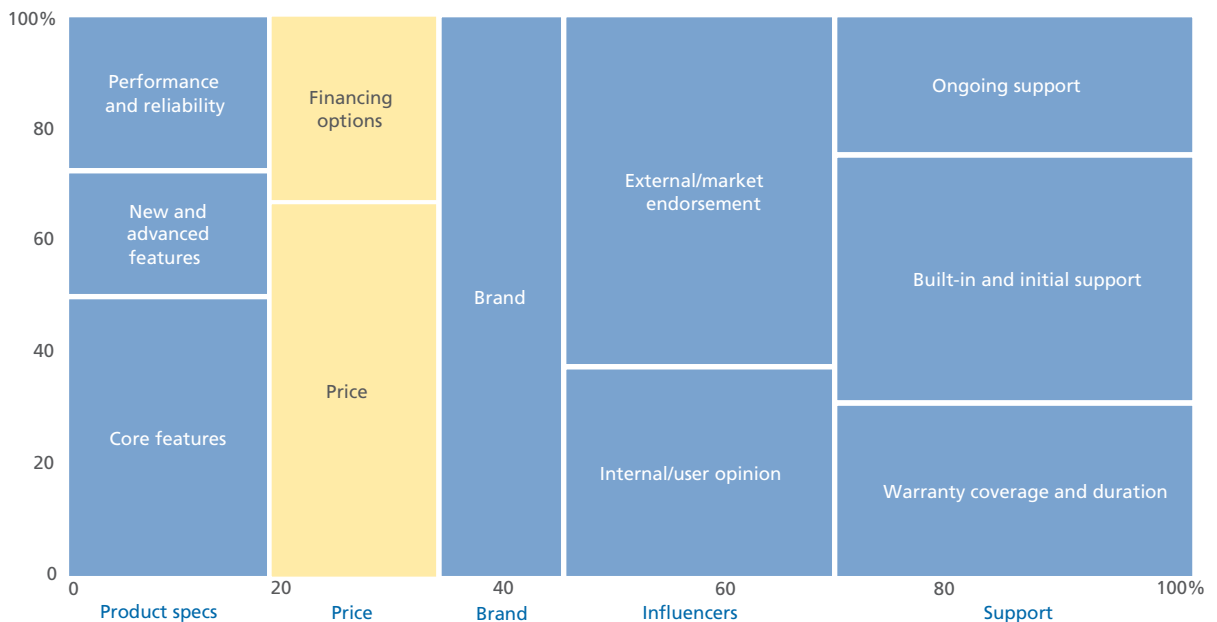
Companies should also get more creative with their pricing and how they position their products. First, they should educate customers about what features are part of a sale. Then, simplify the decision for the customer by unbundling the offer and pricing services using an *a la carte* menu. By letting the customer choose what he or she desires and can afford,

companies can help maintain revenues for the core product. For example, companies can unbundle pricing for such services as expedited delivery, warranty, installation services, and support responsiveness, and pass on incremental costs directly to customers.

Based on hundreds of proprietary studies that examine elasticity of demand across a broad range of categories, Oliver Wyman has found that, for consumers, price accounts for less than one-fifth of the “weight” in a decision, while other factors including product or service features and related “wrapper” elements such as service or terms and conditions account for the vast majority of the weight, as illustrated in the exhibit for a technology product. This weighting, of course, changes by specific products, customer segments, purchase occasions, and geographies.

Decision factors for a technology product

Relative impact on decision making



Source: Oliver Wyman disguised case analysis.

Case Study: A leisure and entertainment company gets smarter on price sensitivity

A major leisure and entertainment company asked Oliver Wyman to analyze customer elasticity to demand at a very detailed level—by customer objectives, by segment, and by day of week and time of day. We found three broad customer segments based on their price sensitivity:

- For the **price-sensitive** segment, price reductions have the most impact on driving sales. Still, convenience factors (e.g., location, time of travel, under one roof) are major drivers of demand that can be used instead of cutting prices. This is the least profitable segment, so cutting prices further will only increase the risk of losing money.

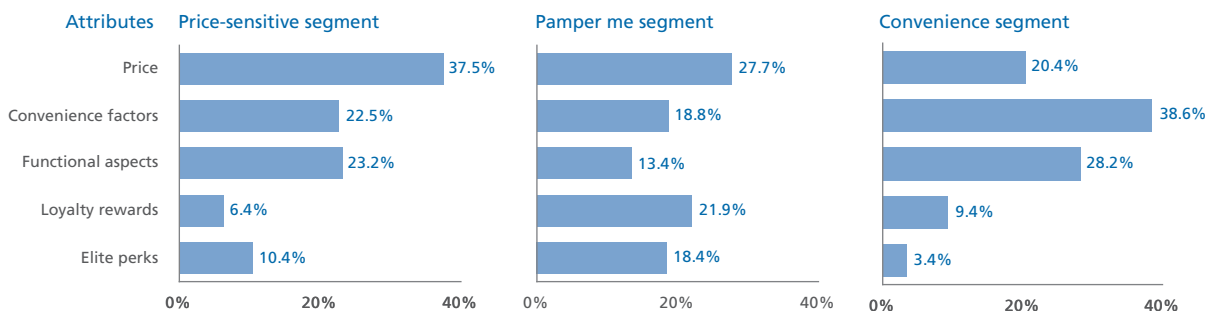
- For the **pamper me** segment, even though price is the most important driver, customers can be attracted through relationship benefits such as elite perks and better options for loyalty rewards. This was the second most profitable segment.
- For the **convenience** segment, all that matters is flexibility and functional aspects (e.g., facilities and service). Not only are price reductions not helpful, they leave profit on the table. This is the most profitable segment, with the highest willingness to pay.

By cutting prices across the boards, targeting the whole customer base, the company would

have exposed itself to price competition, further deteriorating the business. Instead, using the segment analysis, the firm promoted its value proposition in service and played up the relationship benefits to the pamper me segment. In addition, by linking these granular insights with its internal customer database, the firm was able to execute targeted marketing and promotional campaigns to maximize profits among the pamper me and convenience segments. Through various price simulations, we could further optimize pricing by segment. In our work over the years, we have found that such segment-specific pricing insights are applicable in many other consumer product categories such as electronics and mobile phones.

Choice of an entertainment package

% impact on decision-making by segment



Source: Oliver Wyman disguised case analysis.

Case Study: Telecom Provider Unbundles Choices

One of the leading telecom providers was looking for ways to better compete in business-to-business markets. Commissioned to more effectively position its products and services, Oliver Wyman found that the provider's bundling and pricing structure were misaligned with marketplace realities. As the exhibit illustrates, existing bundled prices were hurting market share, as the product was perceived to be expensive. If these ser-

vices were offered free of charge, most had a strong positive impact on share, indicating that consumers still valued some of them.

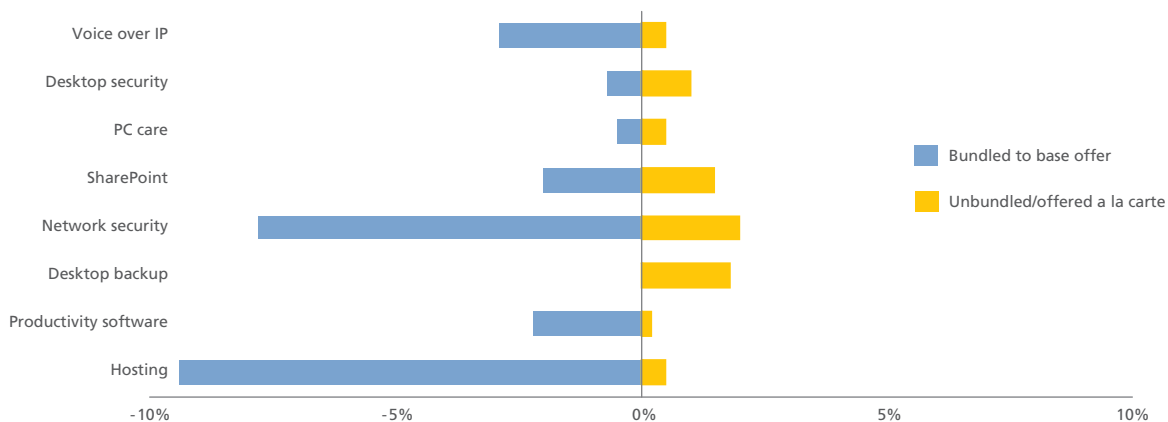
The telecom provider was considering lowering bundled prices, involving a complex decision-making and internal consensus-building process to find optimal pricing without affecting profit margins. Managers also were concerned that they would start a price war

and potentially dilute the brand's value. Based on a detailed assessment of elasticities by various components of the product bundle (using menu-choice models), Oliver Wyman recommended pricing the services a

la carte. Essentially, customers that liked and valued certain services would continue purchasing them at an extra cost, while others bought just the base product.

Telecom value-added-services lift for bundled vs. a *la carte* offers

Market share gain/loss (relative to current "base")



Source: Oliver Wyman disguised case analysis.

By changing the pricing structure, the company gave customers the power to decide what they wanted, while reducing customer churn and improving loyalty. Even though overall revenue remained flat in the short-

term, profit margins continued to climb. Most importantly, this shift allowed the company to reposition its products and services for success in the long term.

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Pricing is not easy. To get it right, you need to account for the impact on overall operating profits and margins in the short-term and long-term, the impact on sales of the overall portfolio of products, the effect on brand image, and ultimately, how the firm is positioned for the next economic upturn. It all begins with developing a detailed understanding of what customers value, the role and impact of price in driving purchase decisions, and which customer segments present pockets of opportunity to leverage the assets that the company possesses.

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