The PRICING ADVISOR
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Theory of Relativity: Using Relative Price Points to Guide Consumer Behavior

The context in which consumers shop for products has a significant impact on buying behavior. Pricing and economic research has shown that consumers constantly make trade-offs between the options put in front of them, whether consciously or not. In this article, the author presents four best practices pricing practitioners can apply to leverage relative price points and successfully restructure your portfolio. Liren Truong is a Consultant at Simon-Kucher's Boston office. She has a background in consumer psychology and experience structuring product portfolios. She can be reached at liren.truong@simon-kucher.com.

Consumers constantly make trade-offs between the options put in front of them, whether consciously or not. When evaluating a product, they fixate on the relative price and value compared to the available alternatives. **Successful companies have learned to proactively adjust the options they make available to consumers and, in doing so, influence what consumers buy and how much they spend.**

The impact of strategically restructuring your portfolio isn't trivial. For example, an online marketplace increased average revenue per user by 88% and monthly recurring revenue by 62% just through optimizing their portfolio and pricing architecture.

As we've seen on numerous occasions, restructuring your portfolio helps substantially increase revenue, both by bringing in more customers and by increasing your average spend per customer. This article will share four best practices to leverage relative price points and successfully restructure your portfolio.

Beacon offering: Drive interest and adoption with a low opening price point

One of the best ways to entice consumers is to present them with a beacon offering. The price of this offering should be relatively low compared to the rest of your portfolio to spark interest ("make the phone ring") and decrease the perceived risk of trial.

A pricing consulting company deployed a beacon offering to help the Toronto Blue Jays baseball team set optimal prices for tickets. Using regression analysis, they found that price was a major driver of game attendance, especially for bleacher seats, and that the Blue Jays had room to attract far more attendees with a lower opening price. A beacon offering gave the Blue Jays a rallying point for their marketing and generated increased interest from casual and price-sensitive fans. By generating more incoming traffic, the salesforce not only sold more tickets, but also gained opportunities to upsell and cross-sell fans. The Blue Jays managed to increase attendance by 30% and realize higher average ticket prices upon introducing the recommended price changes – and this was despite poor on-field performance.

In some cases, freemium products or free trials are recommended to act as beacon offerings. These allow consumers to experience the core value proposition of a company's offering without any financial commitment. The "free" price point is extremely attractive to consumers and draws on the "penny gap" phenomenon observed in consumer behavior: the drop in demand with an increase from free to one cent is much more dramatic than the drop in demand with an increase from one cent to two cents.

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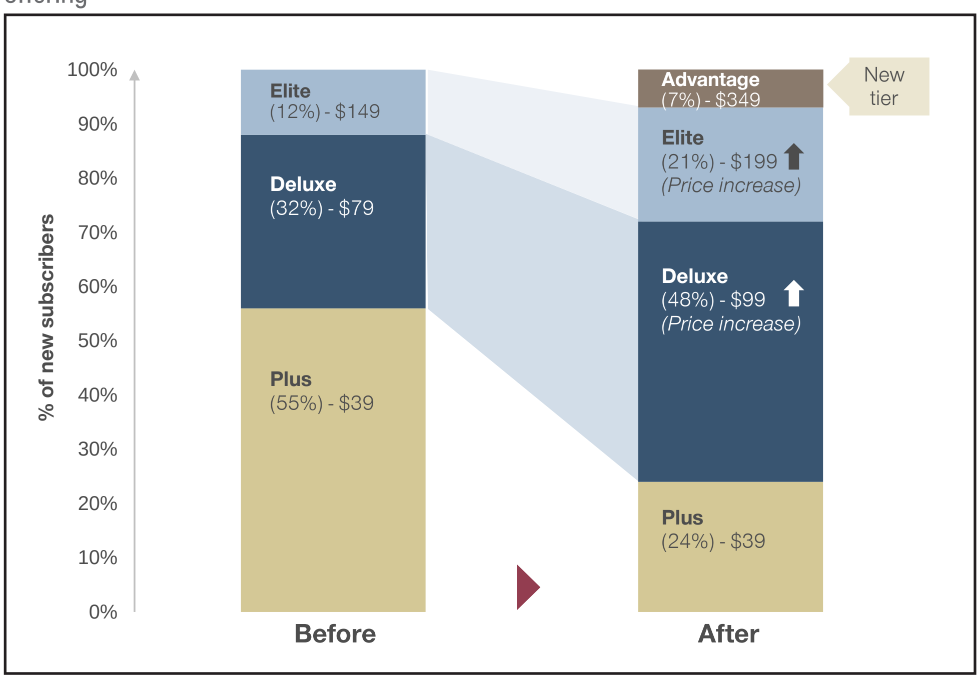
Figure 1: Online marketplace package uptake rates before and after introducing show case offering



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Landing point: Serve the needs of the crowd with an offering that's just right

A low price point grabs the attention of potential consumers; however, once consumers are engaged and start examining their choices, many tend to avoid the options at the extremes of the portfolio. Most consumers prefer a product that's "just right" – neither too cheap nor too expensive (this is also known as the "compromise effect" in behavioral economics).

Imagine looking at a store display with two bottles of a similar type of wine – one costs $15 and the other costs $20. In our experience, consumers will typically purchase the $15 bottle because the perceived difference in quality between the two bottles of wine is negligible, and this option saves them some money. Upon introducing a $40 bottle of wine on the shelf, the trade-off in a consumer's mind shifts. Consumers now "compromise" and drive toward the middle price point (the $20 bottle). This is an effect that has been studied extensively and encountered many times in past experience.

Showcase offering: Nudge customers up with a super-premium option

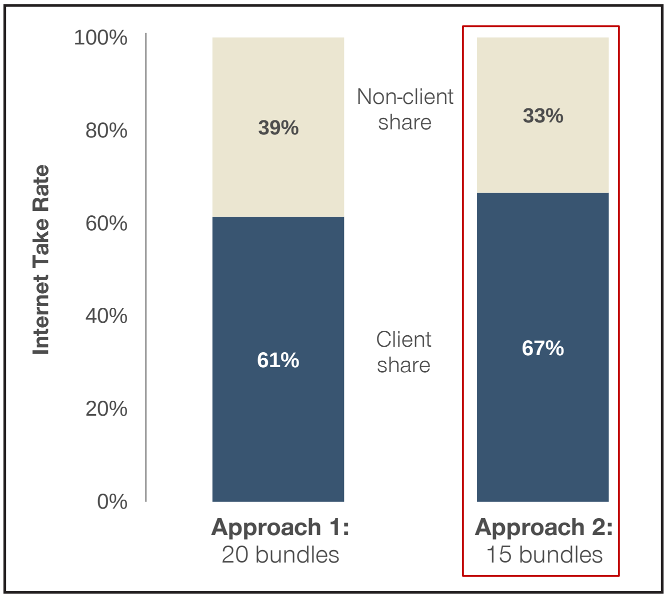
Having a showcase offering is a great way to maximize revenue through market skimming. A showcase offering provides a premium product to customers with the highest willingness-to-pay for a relatively high price. An added benefit is that this type of offering creates a "deal effect" – making everything else in your portfolio look more affordable.

In the previously mentioned online marketplace example, the client initially offered three tiers of featured listings to subscribers who wanted to sell or rent properties to consumers. Their pricing consultants found that there was demand for a more comprehensive showcase offering. They therefore recommended adding a super-premium tier (Advantage) at a high price point. With the new Advantage tier, the client was not only able to capture additional revenue from customers with a high willingness-to-pay, but also able to encourage subscribers to purchase the Elite or Deluxe tiers who would have otherwise thought they were too expensive. (See Figure 1)

K.I.S.S.: Keep your portfolio simple

When designing your portfolio architecture, you must also make sure your options do not get too numerous. **If presented with too many products, consumers get turned off by the need to evaluate all the options and may walk away from the purchase decision completely.**

Figure 2: Telco provider revenue index with 20 vs. 15 internet plan bundles



A notable study conducted by Professor Iyengar at Columbia University demonstrates this principle with a simple jam display experiment. Iyengar and team prepared two types of displays to test in a store – one with 6 varieties of jam and one with 24 varieties. While more consumers approached the display with more varieties, more consumers overall decided to purchase jam from the more simple display with only 6 varieties.

Past project experience has similarly found that fewer choices can yield better results. In an engagement with a telco provider, the company tested different approaches for adding internet plans with usage caps to the product portfolio, which at the time only had plans with unlimited usage. Approach 1 offered a capped option everywhere – resulting in 20 bundles and approach 2 offered a capped option selectively – resulting in 15 bundles. Testing found that the selective approach increased both market share and revenue due to reduced customer confusion and purchase paralysis. (See Figure 2)

The context in which consumers shop for products has a significant impact on buying behavior. A low price beacon offering grabs the interest of price-sensitive customers, a showcase offering maximizes revenue from premium segments, and a middle offering provides a landing point for consumers who want to fall somewhere in between. By balancing adequate coverage of your market and a simple product portfolio using these relative price points, you can guide consumer behavior to align with your product and overall business goals.