

IN SEARCH FOR OPTIMAL PRICE

THE IMPORTANCE OF DEMAND-BASED APPROACH

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Traditionally, sale prices are set by companies according to two approaches: cost-based or competition-based. This excludes an approach that is essential to pricing: demand-based. This is a less mechanical approach and is all about determining the psychological price in order to maximize consumer demand. This approach has two specific characteristics: firstly, it determines the volume/value optimum ratio and secondly, it considers the marketing mix both dynamically and as a whole.

THE FIVE BENEFITS OF DEMAND-BASED PRICING

For the most part, prices are set by companies according to two approaches, often combined:

- / **Cost-based approach:** the price is the result of the cost price plus the desired margin..
- / **Competition-based approach:** the price is set in line with those of the competitors, according to the desired positioning for the product (value for money, premium quality etc.).

In some sectors, regulatory constraints are also taken into account (regulated prices, threshold at which sales make a loss etc.).

When a price is set for a product or service, the demand-based approach, also referred to as 'the approach to determine the optimal price', is often little known or neglected. It involves determining the so-called 'psychological price' (or 'acceptable price'), which maximizes demand. Whilst this approach is not often used, it is based on a less 'mechanical' methodology than previous approaches and it takes a more holistic line in terms of considering the marketing mix as a whole. It has 5 major benefits compared to the other methods, whether they are used separately or together:

- / **Determining the volume/value optimum ratio:** the main product of the methodology for the definition of the optimum price is the determination of the right price to maximize demand. In other words, this approach makes it possible to determine the price point (value) for which the catch rate is the highest (volume). Compared to other methods, the main benefit of the optimum price approach therefore

lies in its capacity to integrate the price, the volume at the topline of the product economic model, and even the company's business plan.

- / **Determining the range of acceptable prices:** the optimal price point method determines the minimum and maximum prices to be considered for a given product or service.
- / **Segment analysis:** this method makes it possible to segment demand. The optimal price is calculated for each target (prospects, clients) and per segment. All types of segmentation may then be considered, whether it involves a RFM segmentation (Recency - Frequency - Monetary Value), a behavioral segmentation or a value-based segmentation.
- / **Adjustment of all marketing mix levers:** the demand-based approach is not limited to the 'price' lever of the mix. It integrates all levers in a dynamic way, regardless of the target of product. The ideal customer experience is often tested through this approach, as well as the distribution channels or commercial and promotional mechanisms.
- / **Taking the brands and the competitive ecosystem into account:** lastly, the demand-based approach makes it possible to determine the optimal price for a product in general terms (e.g. a cinema ticket), but also for one brand and competing brands. As a result, it also employs the competition-based approach.

VERY BROAD APPLICABILITY

The demand-based price-setting approach is suitable for all products and services, whether it is used in addition to the traditional approaches or on its own. This approach can be applied to all the territories concerned at the same time.

Some businesses - generally within certain specific sectors - have standardized and industrialized the pricing process with the help of dedicated teams (pricers) and price setting tools with combined cost- and competition-based approaches. This is the case for large retailers and telecoms operators, for example. Nonetheless, the demand-based approach remains one of the most relevant for these players when it comes to product launches, repositioning of product ranges and brand relaunches.

In principle, this methodology is recommended for companies which are not industrializing this process, i.e. the overwhelming majority, either because the product range does not justify it or for brand positioning reasons (particularly for premium positioning) and in the event of dynamic marketing mix management.

This approach can be applied to any kind of sector, whether it is media, clothing, cinema operation and distribution, football clubs or even cultural institutions. The definition of an optimal price can be applied to all or some of the range of products and services, whether existing or those to be launched in the future.

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A ROBUST METHODOLOGY

The method of defining an optimal price is often confused with the price elasticity analysis. In fact, their mechanisms and aims are highly distinct: price elasticity is an indicator of how demand responds to price fluctuations; methodologically speaking the input is the price fluctuation and the demand is the outcome. Conversely, with a demand-based methodology, the input is the demand and the outcome is the optimal price.

The demand-based approach is founded on 3 methodological steps:

/ **A qualitative study:** one or several focus groups are used to test consumers' habits and experience regarding one product or several products and services. The first objective is to take on the consumer's language to subsequently 'correctly' designate the attributes of the tested offers. In concrete terms, for a project that aims, for example, to determine an optimal price for digital services such as on-demand video, it is a matter of finding out whether consumers talk about a "replay" or instead about a "catch-up service", whether they talk about "subscription" or "SVOD" etc. For example, this can indicate that all

segments tested in a qualitative study - including 'non-digital native' consumers - use a highly specific and relatively technical vocabulary. The second objective of the focus groups is to test the consumers' ideal experience, especially with regards to the services tested.

/ **A quantitative study:** the quantitative study is carried out using a representative sample for the intended target group (typically prospects and customers, the target is therefore generally quite wide with samples of at least 1,000 respondents). This study is often carried out online, for all geographical areas concerned. It integrates the wording that was identified during the first stage and surveys consumers on their appetite for products and/or services (existing or to be launched in future) and invites them to identify a certain number of prices.

/ **Analysis of the optimal price and adjustments to the mix:** the purpose of this last phase is to analyze all the data and model them to determine the "take rate", price levels (minimum, maximum and optimal) for the product(s) and services concerned as well as the adjustments required for all the marketing mix levers; whether for existing products or for those which will be launched in the future.

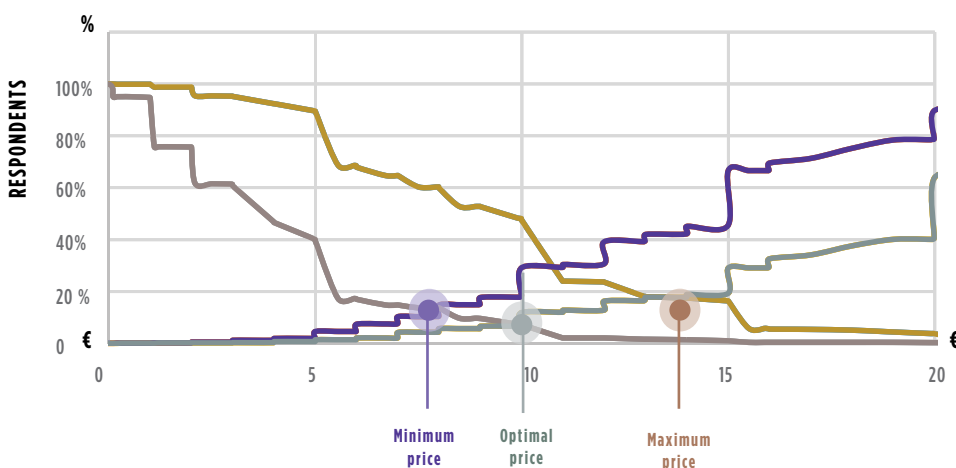
Measurement of the catch rate and acceptable price zone

The demand-based approach is based on the Van Westendorp method, which asks the consumer for their opinion on four price levels:

- 1 At what price would you consider the product/service to be a bargain?
- 2 At what price would you consider the product/service starts to get expensive, but is still acceptable?
- 3 At what price would you consider the product/service to be priced so low that you would feel the quality couldn't be very good?
- 4 At what price would you consider the product/service to be so expensive that you would not consider buying it?

Only those consumers who claim to be 'very interested' by a product or service are surveyed to ensure that the results are reliable.

Van Westendorp Method



The optimal price point is the intersection of the price curves:

- Too cheap
- Too expensive

■ Too cheap
■ Cheap price
■ High yet acceptable price
■ Too expensive



Through analysis, the optimum price is defined, i.e. the price point for which the mix volume (catch rate) and value (price) are maximized. The range of acceptable prices is also defined, namely the range between the minimum and the maximum prices.

Not only can generic products be tested (e.g. 'a cinema ticket') but also can brands (e.g. 'a ticket for a specific cinema').

Adjustments to the marketing mix

The quantitative phase of the method also allows for the following:

- / **Testing of all the marketing mix levers.** The study 'examines' the consumer on the mix's other levers, and especially those that are affected by a product launch or repositioning. Hence, the promotional channels and mechanisms will be tested and analyzed within the framework of a digital repositioning,
- / **Testing of all segments.** The study makes it possible to carry out analyses of the optimal price and the 'acceptable price range' for all segments: questions referred to as 'qualifying' questions in a

quantitative study make it possible to carry out drill downs for all types of segmentation: classic (age, use etc.), RFM, value, behavioral etc.

The 'ideal' product or service experience

The demand-based approach also tests the consumer's ideal experience. Typically, when an offer is launched, a large number of attributes are tested: in this way, consumers' level of appetite is determined by segment for these attributes as well as their importance (the attributes for which the appetite is the strongest are prioritized by consumers). Alternatively, for existing products or services, the 'ideal' offer is tested: consumers are called upon to give their opinion on the products - or more generally the services - that they would like to have for a given use. The optimal price analysis is then applied to this target experience.

In short, if we take the example of the cinema ticket, the demand-based approach will make it possible to:

- / **Determine the consumer's optimal price, maximum price and minimum**

price generically and/or by brand.

- / **Determine the acceptable price range by segment** (e.g. defining targeted offers for young people or senior citizens...).
- / **Study the other associated products and services** such as subscriptions and snacks that are provided.
- / **Adjust the elements of the marketing mix** by testing for example the cinema ticket sold using different distribution channels.
- / **Determine the 'ideal' cinema experience** by identifying most prized products and services (e.g. reserved seats, refreshments brought to your seat etc.) and **determine the price at which these new services could be offered to the public.**

Whilst this approach is less mechanical than the cost- and competition-based approaches, it can nevertheless be implemented quickly (generally in 6 to 8 weeks) and allows overall consideration of the comprehensive positioning of the offer, whether existing or in the pre-launch phase.

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