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Pricing Perspective

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Increasing Consumer Prices? Proceed with Care

Business leaders don't have to look very far to see consumer outrage at companies like Netflix and Bank of America for inadvisably boosting prices and adding new fees. Before increasing prices, companies would be well served by taking the time and care needed to understand which customers value which products and services, their price sensitivity especially given the current economic conditions, and the competitive landscape.

The Netflix strategy to raise prices – to the tune of 20 to 60 percent across the board – was under the guise of continuing its DVD delivery service while it invested in building its media library and delivery services. In the company's explanation of its new business model – separating streaming content (Netflix) and DVD delivery (Qwikster) – it proposed that customers would prefer to buy services a la carte. So rather than continuing to charge an extra $2 per-month add-on for DVD delivery, Netflix opted to charge for the delivery methods separately. Outside observers believe that insufficient research was done to determine perceived customer value and valid price points for service offerings.

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The outcry over the price increase and the division of the services resulted in a mea culpa from Netflix's co-founder and CEO Reed Hastings – he sent an email to the customer base apologizing for the company's perceived lack of humility and respect in announcing the new business model. But many customers weren't appeased, and despite the reunification of the streaming and DVD services under the Netflix name, more than 800,000 subscribers left the service, and stock prices have plummeted by two thirds in the wake of the news.

Some pricing experts argue that losing an estimated three percent of a customer base in exchange for the remaining 97 percent paying 20 to 60 percent more is a profitable decision. But, as the company's decline in stock price and dreary forecast for Q4 2011 performance proves, Netflix pricing strategy appears to have backfired, regardless of the justification behind it.

With the benefit of 20/20 hindsight, what could Netflix have done to more effectively increase its prices? What can your company do as it contemplates a similar move?

1. **Conduct an in-depth pricing analysis.** Take a multi-dimensional deep dive into past transactions and use market response models to determine which services drive revenue, which customer segments value which services the most/least, and how much they would be willing to pay.
2. **Incorporate market intelligence.** Today's consumers are constantly changing what they value, how they buy, and their relationships with their vendors. Invest in external market research to better understand consumer behavior, competitive pricing trends and market surveys.
3. **Fine tune market segmentation strategy.** Leverage the intelligence gained from internal pricing analysis (e.g. price elasticity models) and external market intelligence to iteratively develop more granular market segments. Determine goals for each segment that factor in revenue, profitability and market share.
4. **Strengthen the pricing strategy.** Combine internal and external intelligence with refreshed market segment strategies to develop value based pricing. Create special offers or bundles and promotions that are better aligned with customer thinking.
5. **Test pricing changes with multiple 'what-if' scenarios.** Incorporate potential pricing change options into several 'what if' scenario plans. Test each scenario by varying sales and cost results; analyze and compare the results of each to segment goals.
6. **Limit price increases to test market segment.** Select one or more likely scenarios and test market price increases and communications strategies in small target segments. Be prepared to incorporate customer feedback prior to implementing across the board.
7. **Continue to monitor** customer transactions and market intelligence. Conduct analysis on a regular basis and/or ad hoc as conditions change. Remain connected to the customer and anticipate competitive moves.

Despite the current economic environment, companies may well need to increase their prices across the board. The learning here is to develop a market-oriented plan, take advantage of industry best pricing practices - and potentially information technology solutions - to fully assess the situation, communicate well and proceed with care.