SIMON ◆ KUCHER & PARTNERS

consumer insights

Perspectives on the consumer industry by Simon-Kucher & Partners

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Leveraging **Behavioral Psychology**

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Contributors

Editor-in-Chief
ELLEN KAN

Editors
KYLE POYAR
MARIA ORLOWSKI

Contributors
SUSAN LEE
MADHAVAN RAMANUJAM
LIREN TRUONG
KERRY WU

Graphics
ANKE SCHUMANN

Please send inquiries and comments to: **ConsumerInsights@simon-kucher.com**
Visit our website at **http://www.simon-kucher.com**

what's HOT

Strategic Questions
that are top of mind this quarter

- **New product** pricing
- **Value-based** consumer pricing
- Leveraging **big data**
- Commercial policy and **trade terms**

By the Numbers

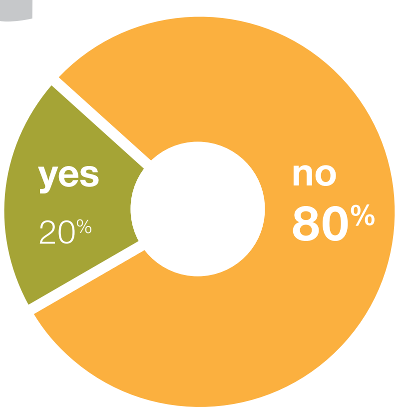
50% **Manufacturers** who do not regularly conduct market research studies to understand online consumer's willingness-to-pay

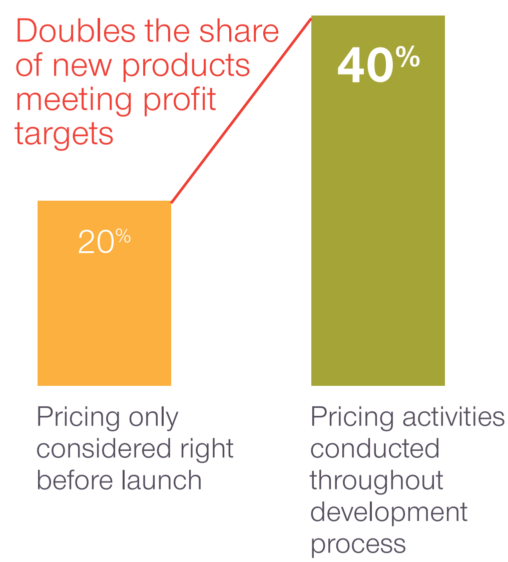
29% **Telco-media-tech companies** (TMT) who said they have significantly adapted their revenue models to digitization and changes in consumer usage patterns

40% **TMT** companies who do not consistently use consumer segmentation to inform pricing decisions

72% of new products launched by surveyed companies fail to meet their profit targets

Q. Do you make a continual, consistent effort to perform essential pricing activities?





Source: Simon-Kucher Global Pricing Study, Simon-Kucher Multichannel study partner column

Leveraging consumer psychology: Fully capturing the value you create

Susan Lee *is a Partner in the Boston office of Simon-Kucher & Partners, the world's leading pricing consulting firm. She runs the firm's consumer and retail practice in North America. Her comments have appeared in publications such as TIME, Forbes and Internet Retailer.*

Welcome to the third issue of Consumer Insights! In this issue, we will be covering a topic that has been top-of-mind for many of our clients recently, as they wonder how to best capitalize on the wealth of consumer data at their fingertips: How to effectively leverage consumer psychology to fully capture the value you create. The articles in this issue provide specific examples of how companies can successfully integrate consumer psychology into their pricing, covering both strategic and tactical dimensions.

We are also excited to launch two new regular features in this issue that we hope will enrich your reading experience. "Ask the Expert" will feature a Q&A with a Simon-Kucher subject matter expert, providing actionable and practical tips on some common tactical questions that arise from our clients. "Executive Perspectives" will bring you interviews with industry practitioners sharing their expertise and lessons learned from years of leading top brands and companies.

These additions are part of a continual effort to keep the newsletter fresh and relevant to you and the challenges you face. We hope you will find them valuable and drop us a line on topics you would like to see covered or other suggestions for improvement.

Turning to the theme for this issue: We chose to focus on consumer psychology to address a scenario we commonly encounter in our work with clients.

"The articles in this issue provide specific examples of how companies can successfully integrate consumer psychology into their pricing, covering both strategic and tactical dimensions."

Companies are making big investments and advancements in the area of big data that are supposed to enable them to achieve a new level of sophistication when it comes to marketing to their consumers. However, few have fully realized this potential due to lack of know-how or prioritization, especially when it comes to leveraging consumer psychology to boost their pricing power. Does this sound familiar to you?

In our experience, the best companies actively and regularly leverage consumer insights to first get value-based pricing right, and then to introduce elements of behavioral psychology into their pricing.

It starts first with understanding both the rational and irrational aspects of your consumer's decision-making process, and then ensuring that all aspects of your business, from price setting to promotion design, either align with that process or leverage it to influence desired consumer behavior.

In "Executive Perspectives", Steinway CMO Darren Marshall explains how Steinway puts this principle into action by ensuring that all components of consumer interaction, even down to store design, reflect the brand's identity and integrate a deep understanding of individual consumer segments' needs and purchasing behavior. The iconic brand has a strong focus on brand building and establishing relationships with consumers – both essential components of value communication and making the purchase decision about more than just price.

"Ask the Expert" features Madhavan Ramanujam discussing tips and tricks for leveraging the irrational aspects of consumer decision making. Our experience has shown that the key is to ensure all elements of your pricing are consistent with your desired brand personality because these are compelling signals to the consumer. This principle should guide decisions ranging from whether stacked promotions are the right vehicle for you to whether you should introduce add-on fees to your package subscription fee.

Finally, Liren Truong shows how all companies can use smart portfolio design to drive desired consumer behavior, regardless of whether you are a telco-media company trying to determine the right packaging line-up, a CPG company seeking to optimize your pack-price architecture, or a retailer making decisions on prioritizing limited shelf space. Simon-Kucher's past experience has proven over again that structuring your portfolio such that it incorporates an attractive opening price point, a sensible landing point and a premium showcase offering can help companies both acquire new customers and upsell existing ones.

These are just a few examples to demonstrate the power of leveraging consumer psychology and incorporating it into your company's pricing decisions. Companies today have a wealth of consumer data at their finger-tips. The most successful ones will invest in translating this data into actionable insights about consumers' needs and behaviors, and then leverage these insights to both drive value for consumers and more effectively capture this value through smart pricing and packaging. ◆

Susan Lee can be reached at
susan.lee@simon-kucher.com

Ask the Expert

Madhavan Ramanujam *is a Partner at Simon-Kucher & Partners in San Francisco and specializes in pricing and marketing for technology companies. He has more than a decade of technology and consulting experience.*

Simon-Kucher: *Do consumers behave rationally when they make purchase decisions?*

MR: The way people actually make decisions is a combination of rational and emotional. Based on the context, you can trigger one or the other. For example, imagine you are on a beach on a hot day and want a beer but there is only one place nearby where you could buy it. How much would you pay? Studies[1] have shown that it depends as much on the context you create as on the beer itself.

Simon-Kucher: *What's an example that you've seen recently?*

MR: We've seen numerous examples. One that comes up time and again is with packaging and the importance of having a Good – Better – Best line up. If you give consumers a choice between just two products, they typically skew towards the cheaper one. But when you slot in a new premium offering, you actually steer consumers to the middle because most consumers prefer to avoid extremes.

Simon-Kucher: *Why should companies consider behavioral psychology in formulating their pricing strategies?*

MR: We know that the emotions of consumers affect purchase decisions. That's been proven in our work and in studies. If you believe in that, you can't just base packaging and pricing strategies on what's rational. The challenge is that most methods used to understand consumer behavior assume a rational consumer.

Simon-Kucher: *How advanced are B2C companies at leveraging on consumer behavior?*

MR: As a rule there is significant opportunity to improve. Internet businesses are probably most advanced since they have the capability of running controlled experiments to perfect how they communicate price and value to the consumer.

Simon-Kucher: *How do you help clients figure out whether a tactic works for their unique situation?*

MR: You should always test ideas before bringing them to market. In some cases we've seen companies implement behavioral pricing because it seems cool, only to have the idea backfire. There are three main ways to test: focus groups, controlled experiments and price tests. Ideally you'd try all three, but time and resources limit most companies to picking one or two.

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1 Richard Thaler (1985), "Mental accounting and consumer choice." Marketing Science, 4, 199-214

Simon-Kucher: *What resources would you recommend for readers who want to learn more?*

MR: I would highly recommend two books: Predictably Irrational and Thinking, Fast and Slow. We help companies use the types of learnings that are found in those books and apply them to their unique situation.

Simon-Kucher: *Will the same behavioral concepts be suitable for all companies?*

MR: There are far too many behavioral concepts and so most concepts will not be suitable. Knowing which tactics to apply when is usually the most difficult task our clients face. My key recommendation is to make sure to apply behavioral tactics that are aligned with your brand personality.

Simon-Kucher: *How do you help companies decide which behavioral tactics best apply?*

MR: Start by identifying what is your desired brand personality[2] – is it sincere, competent and so on. Then look at what pricing and behavioral tactics best apply to the personality. If you're a sincere brand, for example Southwest Airlines, you'll want to reinforce sincerity and transparency through your pricing. Hidden fees won't work for Southwest like they have for other airlines because they don't fit the brand.

Figure 1: "Simon-Kucher Pricing Personality Map" shows how pricing reinforces branding

Sincerity

(transparency, consistency, simplicity, pay-as-you-go) i.e. Southwest

- Simple fee per trx/no tears
- Transparency/no hidden fees
- EDLP/cost-plus

Competence

(reliability, predictability, leadership, choice, differentiation) i.e. The Economist

- Subscription all-you-can-eat
- Multi-dimensional/surcharges
- Bundles/line-up/tiers

Excitement

(eye-catching, emotional involvement, acquisition/retention, deferred payment) i.e. CVS

- Promotions/trial
- Freemium model
- Loyalty/rewards

Sophistication

(prestige, profit, flexibility, skimming, limited availability/channels) i.e. Apple

- Exclusivity/membership
- Premium/minimaldiscounting
- Build-your-own/á-la-carte

Simon-Kucher: *Experts have said that price can be a signal of quality for consumers when they buy luxury goods such as high-end wine. Have you come across this in your work?*

MR: This concept actually applies to every industry. Wine is the classic example, but this has even been observed with pharmaceuticals. Dan Ariely conducted a study[3] where he gave subjects a pain killer and told one group the price was $2.50 per dose and told another it was just $0.10 per dose. The group that took the "expensive" pill was far more likely to say they experienced pain relief than the group that took the "cheap" one. In reality Dan gave both groups the same thing – a sugar pill. And this study isn't an outlier; we see it again and again.

Simon-Kucher: *Finally, what are the biggest mistakes you see in the market and how do you recommend minimizing these risks?*

MR: Many companies are on one extreme when it comes to behavioral pricing; they either ignore it or put all their eggs in the irrational basket. Behavioral pricing should really be seen as pricing 2.0. The first step should be value-based packaging and pricing. When that is set, behavioral pricing gives an added push. And always strive to 'test and learn', not 'test and burn'! ◆

Madhavan Ramanujam can be reached at
madhavan.ramanujam@simon-kucher.com

2 Jennifer Aaker (1997), "Dimensions of brand personality." Journal of Marketing Research, 347-356.

3 Rebecca Waber, Baba Shiv, Ziv Carmon and Dan Ariely (2008), "Commercial Features of Placebo and Therapeutic Efficacy." JAMA-The Journal of the American Medical Association. Vol. 299, No 9.

Executive Perspective *with* Darren Marshall

EVP and CMO of Steinway & Sons

Darren Marshall is the Executive Vice President and Chief Marketing Officer of Steinway & Sons, where he is responsible for accelerating the global growth of one of the world's most prestigious cultural icons. He is a global business leader with 20 years of experience delivering profitable consumer sector growth in international leadership roles with corporations such as Coca-Cola, Procter & Gamble and PepsiCo.

In this interview, he shares Steinway's long-term vision for its brand and how the company thinks about communicating its brand value in a way that establishes a relationship with consumers and aligns with their needs and buying processes.

Simon-Kucher: *When you are building a relationship with customers, what is the first thing you should consider?*

DM: Consumers will often buy a car simply based on its badge. The consumer buys the brand because of what it says about them and what their values are – that's your North Star. So the first step must be defining that image of what you truly want your brand to mean. It must be a sustaining, timeless type of element. If you don't have that magnetic pull, you won't have the compass that will point you to where you want to go.

Simon-Kucher: *What is Steinway's brand culture and relationship with its customers like?*

DM: For Steinway, our value-add for the past 150 years has always been in product and manufacturing. And for all of those hundred-plus years, our three broad buckets of consumers – artists, families and listeners – haven't changed. We have a huge reverence for the product and crafting the best piano possible, and professionals definitely recognize that; just look at how many artists have chosen to perform on Steinways over the years. What's been less clear until recently is our relationship with the average consumer and our understanding of their different desires. But the needs-based segmentation work we've done together with Simon-Kucher to identify the size and distinct needs of each segment has helped to fill these knowledge gaps – and that will form the foundation for the long-term vision of the brand.

Simon-Kucher: *What are some of the challenges facing a luxury brand such as Steinway?*

DM: Tastes change over time. We have been a musical icon for a century and half, but the market for pianos has been shrinking for years. On the high-end, we're not just competing against other pianos; we're competing with swimming pools, works of art, a new Mercedes. And the demand for culture, the music, it's not what it used to be. When there are less fish in the sea, you can build a tighter fishnet to catch more fish. But eventually you have to think about how to move your boat into another ocean. The real challenge is creating demand, not closing demand that already exists. Looking at it this way, my biggest job is not selling pianos. It is really about selling music and culture, and then the pianos will come.

Simon-Kucher: *Philosophically, how does that affect the way you are bringing your brand into the future?*

DM: It means that our thought process needs to start well before a customer walks through the door. The Steinway name already has so much history and tradition. But what are the true levers that drive our product and brand? What's in it for the consumer? These are the things we have been looking into, because those are the drivers that you can then replicate in others. For example, if we can truly understand our artists, perhaps we can apply those learnings to meet the needs of the families we need to woo. Our product may not change that much, but how we position and communicate to consumers is where we will build Steinway's future.

Simon-Kucher: *What has surprised you most as you've explored your consumers' psychology?*

DM: The most striking observation was the emotional and experiential nature of the purchase process. For the artist, performing isn't just about getting applause. It's first and foremost about moving your audience and touching them through music; that's the timeless element. To do that, the instrument becomes a hugely emotional piece for them, and finding the right one is really a mating process. They use the language of love, like they are searching for the right "partner". As with people, you can't just think about the technical details – like she's 5'8" with green eyes – the emotional component is critical. We have been thinking too rationally, when we really need to de-commoditize the product and romanticize the emotional connections with pianos and music.

Simon-Kucher: *How do you apply these lessons from an implementation standpoint?*

DM: Your focus should not be on how to sell your product but on how consumers buy it. Think about your core segments and how you can redesign the buying experience for each of them. For Steinway, the essence of our brand is there, but we must bring the touch points to the common consumer. The artists will likely bypass everything and go straight to the factory; the retail space needs to be about families. But walking into a Steinway store can be intimidating for the less experienced. They see rows of identical-looking, black pianos with salespeople hovering over them. They shy away, as though they aren't good enough to touch and play these masterpieces with everyone watching. We need to curate our stores to enable the "mating process" and form the emotional bond between player and piano. ◆

Steinway & Sons *is the world's leading manufacturer of premium pianos. Founded in 1853, the handcrafted Steinway & Sons pianos have been renowned by generations of artists and audiences alike.*

Theory of relativity: Using relative price points to guide consumer behavior

Liren Truong, Consultant at Simon-Kucher Boston

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, Simon-Kucher helped an online marketplace increase average revenue per user by 88% and monthly recurring revenue by 62% just through optimizing their portfolio and pricing architecture.

As we've seen across numerous clients, 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.

> "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."

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.

Simon-Kucher deployed a beacon offering to help the Toronto Blue Jays baseball team set optimal prices for tickets. Using regression analysis, we 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 up-sell 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, we recommend freemium products or free trials 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.

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).

> "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."

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 we have studied extensively and encountered many times in our work with our clients.

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. Simon-Kucher found that there was demand for a more comprehensive showcase offering. We 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. (Figure 1)

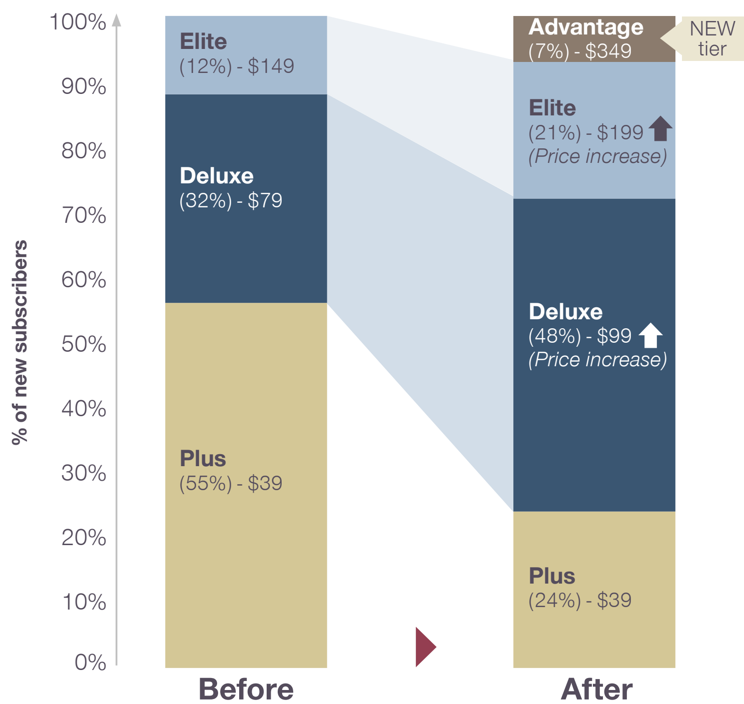


Figure 1: Online marketplace package uptake rates before and after introducing show case offering

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.

A notable study conducted by Professor Iyengar at Columbia University demonstrates this principle with a simple jam display experiment. Iyenger 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.

In our project experience, Simon-Kucher has similarly found that fewer choices can yield better results. In an engagement with a telco provider, Simon-Kucher 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. Our testing found that the selective approach increased both market share and revenue due to reduced customer confusion and purchase paralysis. (Figure 2)

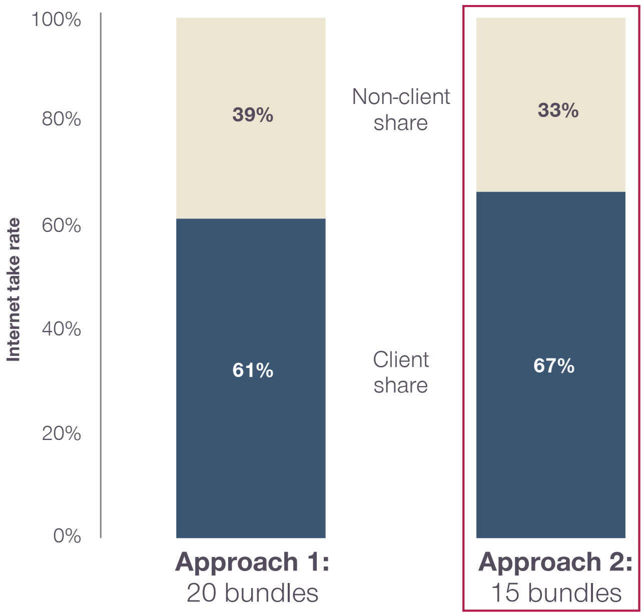


Figure 2: Telco provider revenue index with 20 vs. 15 internet plan bundles

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. ◆

Liren Truong can be reached at
liren.truong@simon-kucher.com

project spotlight

the Client

Leading provider of cable TV, broadband internet and landline phone in North America.

Key market characteristics:

- Client is the market leader in most markets it serves
- Increasing price pressure as new players enter the market and compete on price
- As younger consumers ‘cut the cable cord’, broadband internet becomes the most important product in the portfolio

the Situation

Client has seen broadband internet usage skyrocket, growing at roughly 50% per year due to the boom in streaming video services. If unchecked, rising bandwidth will lead to large cost increases and lower profitability.

the Objective

Monetize rising internet bandwidth by implementing a usage-based pricing scheme.

Incorporate usage plans across the portfolio of Single Plays, Double Plays and Triple Plays

our Approach

- Collect industry best practices from around the world
- Prioritize a short-list of usage-based billing approaches
- Capture voice-of-customer through focus groups and an online survey
- Conduct conjoint research to optimize the new pricing scheme
- Build a market simulation model to quantify financial impact under different scenarios

the Results

We found that the Client should **selectively introduce usage** plans into its portfolio. Widely offering usage plans **overwhelmed consumers and sales by providing too much choice**, leading to fewer sales and less revenue.

Client directly implemented the new pricing and portfolio recommendations.

the Impact

A **2% incremental** uplift in broadband revenue plus reduced costs in the long-term

Simon-Kucher

NEWS

Key insights from Simon-Kucher's 2014 Global Pricing Study revealed


Global Pricing Study 2014*

Innovation in crisis?
72 percent of all new products are flops

They miss their profit targets because companies neglect or ignore key pricing and marketing activities until it's too late. This puts their short-term profits and long-term survival at risk

www.simon-kucher.com

Market conditions are oppressive, forcing companies to seek new profit opportunities:

- 83% of companies face increasing price pressure; 58% in a price war; 89% blame competition
- Companies raise prices by only 1.9% for every 5% they attempt
- 77% of companies see innovative/differentiated products as their best measure against price pressure

Most new products fail to meet profit targets, putting companies' profits and survival at risk:

- 72% of new products launched fail to meet their profit targets

The "Best" launch profitable innovations thrive despite oppressive market conditions:

- 10% of companies in the GPS are considered the "Best"
- They have 25% higher profits, are 41% better at achieving price increase targets, and have a 45% greater share of new products that meet profit targets

In the Press

The results of the 2014 Global Pricing Study were recently discussed in an interview with Harvard Business Review

To read this article, and hear more from our CEO on the study results, visit: *blogs.hbr.org/2014/09/the-silent-killer-of-new-products-lazy-pricing*

Best half year ever for Simon-Kucher

Simon-Kucher generated **revenue of $112 million in the first six months of 2014**. This is **14% more** than the same period last year. Order entries were on a similarly high level indicating positive development in the months to come.

Simon-Kucher opens office in Barcelona

This office joins our Madrid office as the 2nd office in Spain. Worldwide we now have **720 associates** operating in **28 offices** across **22 different countries**.

About

Simon-Kucher & Partners

Simon-Kucher is a global consulting firm specializing in strategy, marketing, pricing and sales. Founded in 1985, the company focuses on Smart Profit Growth℠ by helping clients to boost their top line instead of cutting costs. With 720 professionals in 28 offices worldwide, our practice is built on evidence-based, practical strategies for profit improvement.

What others are saying

BusinessWeek

"...world leader in giving advice to companies on how to price their products..."

The Economist

"...the world's leading pricing consultancy..."

Priceless

"The influence of Simon-Kucher on the prices we pay for just about everything is as little recognized as it is staggering."

-William Poundstone

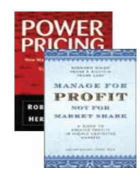
Our proven record

We support market leaders across industries and countries. Our specialized Consumer Goods and Retail team has supported clients such as Barnes & Noble, Kimberly-Clark, Pepsico, Office Depot and many more.

1-5

Percentage points of margin improvement

40



Books written on pricing and business management

2000

Projects completed in the last 3 years alone

720

Pricing professionals located across 28 offices worldwide

SIMON • KUCHER & PARTNERS
www.simon-kucher.com

Consumer & Retail Practice
Boston Office
One Canal Park
Cambridge, MA 02141
+1 617 231 4500
susan.lee@simon-kucher.com

Telco & Media Practice
New York Office
17 State Street, 37th Fl
New York, NY 10004
+1 212 537 0770
andre.weber@simon-kucher.com