SPECIAL REPORT

How To Price in a Post-COVID-19, Post-Inflationary World

Contents

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Introduction

Consumer businesses have faced dramatic increases in input costs over the past 24 months, primarily due to the lingering impact of COVID-19. To avoid profit erosion, most responded by passing these cost increases on to consumers in the form of higher prices. But consumers, concerned with a potential recession, are adjusting their spending behaviors. With the worst of spiraling inflation hopefully behind us, now is the perfect time for business leaders to reflect on their 2022 pricing actions and consider a holistic reevaluation of their pricing strategies in light of current market conditions.

Reconsidering pricing in a post-inflationary environment

According to L.E.K. Consulting's 2022 Inflation Inflated: Part 2 — The Business Outlook survey, profit margins faced significant pressure if business leaders failed to respond with appropriate pricing actions. Consequently, more than 70% of businesses raised prices in 2022 in response to COVID-19-induced inflation. But getting pricing right remains a top concern because their customers are not blindly accepting price increases (see Figure 1).

Figure 1
How business owners view pricing

>70 of business owners have responded to inflation by **increasing prices**, and ...

40% of business owners ranked **evolving their pricing strategy** as a top three business priority for 2023.

Source: L.E.K. Consulting's "Inflation Inflated: Part 2 — The Business Outlook"

While many consumers enjoyed healthier savings accounts coming out of the pandemic due to government stimulus payments and lighter spend on discretionary entertainment (e.g., movies, concerts, dining out), they are now wary of a potential recession. This makes them even more careful about their spending. L.E.K.'s Consumer Cost-of-Living Survey 2022 found that, on average, respondents intend to reduce overall spend by more than 5% due to inflation, with a higher expected reduction in discretionary spend categories. Spend reduction can manifest in a variety of ways — shifting to less expensive stores, trading down to cheaper options, purchasing in bulk, decreasing purchase frequency or ceasing to purchase altogether.

Pricing is critical to any business (see below). As consumers are being forced to stretch their dollars, companies have an opportunity to drive value by reassessing their pricing strategies to make them more reflective of the current macroeconomic environment. Business leaders should begin by reviewing pricing principles and asking themselves how they can make pricing a strategic lever that drives revenue and margin growth. Today's macroenvironment demands that all businesses revisit their pricing strategies. Executives would be wise to apply the learnings of businesses across the consumer landscape, including fast-moving consumer goods (FMCG), soft goods, durable goods and fixed inventory services. This special report lays out several pricing strategy concepts and case studies to demonstrate how consumer businesses have put best practices into action — namely, by extracting maximum consumer willingness to pay through value-based pricing (VBP) principles.

Why pricing is important for your business

1. Changing prices immediately impacts the bottom line and is the single largest variable in your business's margin
2. Pricing adjustments don't require a broad organizational or operational change and can typically be pulled immediately or in the near term at any point in the value chain
3. Pricing is a key indicator of your brand's relative positioning

Why pricing is important for your business

Topics discussed in the remainder of this report

1 Returning to value-based pricing

Key questions addressed:
- What are the benefits of value-based pricing (VBP)?
- How are VBP principles applied to price strategically within my competitive set?
- How can I incorporate dynamic pricing into my business?

Case studies:
→ FMCG
→ Soft goods
→ Durable goods
→ Fixed inventory services

2 Evaluating feature/benefit trade-offs

Key questions addressed:
- What are feature/benefit trade-offs, and how do they inform strategic decision-making?

Case studies:
→ FMCG
→ Fixed inventory services
→ Durable goods

3 Adapting promotional tactics

Key questions addressed:
- What are the best practices to optimize promotional effectiveness?
- Does promotional activity have a positive, negative or neutral impact on consumer perception of my brand?

Case studies:
→ L.E.K.'s 2023 Consumer Pricing and Promotion Study

Note: FMCG=fast-moving consumer goods
Source: L.E.K. research and analysis

Returning to value-based pricing

Historically, VBP has been touted as the gold standard because it considers consumers' **perceived value** of an offering in determining a product's or service's list price. VBP enables businesses to justify higher price tags by accounting for the additional value that a product or service provides in excess of its cost base. Commuter rail ticket prices are a perfect example of VBP in action. The cost of transporting rail passengers a set distance remains constant regardless of time of day, but commuter rail lines capitalize on heightened demand (therefore, higher perceived value) in the busiest commuting hours to capture a higher margin.

Because the pandemic caused so much disruption, many businesses temporarily shifted away from VBP principles, adopting a "cost plus" model to pass on skyrocketing input costs. While this may seem like a logical approach, in practice it is shortsighted, as it does not account for changing competitive dynamics within the category or how consumers may respond to these higher price points.

As the dust of peak inflation pricing settles, it's time for business leaders to reexamine how to extract maximum willingness to pay from their consumer base. We will now discuss two successful strategies to achieve this: strategic price positioning and dynamic pricing.

Strategic price positioning

In order to position a product or service appropriately, it is important to understand your consumers, what they value about your product and how much they are willing to pay for it (which may differ significantly from your cost base). You also need to know how competitors' products are priced and your strategic objectives with respect to those competitors. The case studies that follow highlight examples of brands that use VBP principles to achieve various business objectives.

FMCG case study

Using a low-price positioning strategy to capture market share

Private-label brands routinely enter categories positioned as a low-priced player to capture market share. A key reason private-label brands adopt a low-price positioning strategy is that they often don't have the equity and consumer trust to price above branded players, especially when entering new categories. Retailers don't spend as much as national brands on advertising the benefits or credentials of their products, rendering them unable to capture additional willingness to pay. Therefore, once an attractive category has been identified, the retailer will select a competitor to undercut on pricing (and typically mimic their packaging) in an attempt to steal market share. Some retailers even create multiple tiers of private-label products, which allows them to capture share in various market niches. For example, in the ice cream category, Kroger owns Simple Truth (a health-focused line, including nondairy offerings), Private Selection (focused on gourmet products) and the Kroger brand (focused on basic everyday flavors).

Soft goods case study

Using a premium price positioning strategy to capture margin

In the standardized luggage category, brands such as Away, Briggs & Riley and RIMOWA have managed to command significant (70% – 300%+) price premiums over mainstream brands like Samsonite, primarily by successfully marketing their brand positioning points (see Figure 2).

Figure 2

Price premiums among luggage brands

	Samsonite	Away	Briggs & Riley	RIMOWA
Product name	Voltage DLX Medium Spinner	The Medium Flex	Sympatico, Medium Expandable Spinner	Essential Check-In M
List price	**$230**	**$395**	**$699**	**$1,025**
Price premium to Samsonite	n/a	~70%	>200%	>300%
Material	Polypropylene	Polycarbonate	Polycarbonate	Polycarbonate
Number of wheels	4	4	4	4
Expandable?	Yes	Yes	Yes	No
Exterior dimensions (inches)	27.36 × 18.62 × 11.65	26 × 18.5 × 11	27 × 18.5 × 11.5	26.4 × 17.8 × 9.5
Weight (pounds)	8.15	10.8	12	9
Key driver of brand's premium positioning	n/a	Aspirational aesthetic	Technological innovation (e.g., compression technology); quality (lifetime guarantee)	Easily recognizable design; quality (lifetime guarantee)

Source: Company websites

Durable goods case study

Using strategic portfolio positioning to target multiple consumer segments

For companies with a variety of brands, it is important to avoid cannibalizing your own sales by using each brand to target a different consumer. The Volkswagen Group (owner of Audi, Bentley, Lamborghini, Porsche, Volkswagen, and others) is a good example. The Volkswagen brand sits in the value tier near competitors like Toyota, Honda, Nissan and Kia. Audi is in the premium tier, competing with brands like BMW, Lexus and Infiniti. Meanwhile, Porsche, Bentley and Lamborghini compete in the luxury price tier against brands like Maserati and Rolls-Royce. When marketing and pricing each brand, the Volkswagen Group must be conscious of how to differentiate each brand against its unique competitive set.

It's important to keep in mind that competitor pricing may have shifted in the past few years; therefore, the gap between premium and mainstream brands may have grown or narrowed. Brand alignment with target consumers may have changed, and you may now consider other brands as your competitors; therefore, now is a critical time to reevaluate your brand's price positioning.

Dynamic pricing

Dynamic pricing is a strategy that allows companies to price the same product or service on a variable, rather than a fixed, basis. The benefit is that the same offering can be sold at different prices to different consumers in response to real-time supply and demand shifts. Fixed inventory services businesses are masters of dynamic pricing.

Fixed inventory services case studies

- **Airline ticket prices** fluctuate minute by minute up until the day of the flight, so passengers sitting next to each other may have paid different prices for essentially the same level of seating
- **Sports arenas and concert venues** will vary pricing based on location within the venue (i.e., better seats for a higher price); secondary market sellers of tickets to these events will often adjust pricing based on minute-by-minute changes in demand, similar to airlines
- **Movie theaters**, such as AMC Theatres, have recently taken a page out of the sports and music playbook and announced that they will begin to differentially price seats based on their location within the theater (i.e., front row cheaper, middle of theater more expensive)[1]
- **Rideshare apps** like Uber and Lyft utilize "surge pricing," which increases the price of taking rides in poor weather conditions, at the end of a popular event and during rush hour traffic

In some categories (e.g., airlines), consumers are conditioned to expect dynamic pricing. In contrast, they may still be adjusting to dynamic pricing in other categories (e.g., modifying concert ticket prices based on demand). L.E.K.'s 2023 Consumer Pricing and Promotion Study highlights this phenomenon, noting that more than 60% of consumers monitor price changes for flight purchases, but less than 40% do the same for concert tickets. However, in both categories, around one-third of consumers still opt to purchase based on convenience as opposed to waiting for a deal.

Dynamic pricing allows businesses to capture incremental revenue they could not have captured with a static price point. Still, dynamic pricing principles are more applicable to some industries than others. For example, FMCG manufacturers that sell through retail channels may not be able to price dynamically because they cannot directly determine pricing for their end consumer, and price changes take time to roll out in-store. On the other hand, companies in more concentrated markets selling directly to consumers should determine whether dynamic pricing can be incorporated into their business. For businesses that may have difficulty implementing dynamic pricing, another way to maximize consumer willingness to pay is by assessing which features and benefits your customers value the most and raising prices where the willingness to pay more is highest.

Evaluating feature/benefit trade-offs

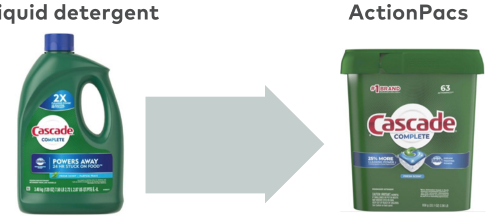
Feature/benefit analysis can be conducted across all types of consumer businesses to drive economic value. The analysis helps businesses estimate the value that consumers attribute to particular features, which in turn informs pricing choices. When demand analysis (e.g., conjoint) is combined with an assessment of the market's supply of these attributes, business leaders can identify the sweet spots where demand outpaces supply. Several businesses have successfully used feature/benefit analysis to design products that align with consumers' willingness to pay, as the following examples demonstrate.

Using feature/benefit analysis to command a price premium

FMCG case study

FMCG businesses frequently use feature/benefit analysis to improve the "price-pack architecture" of their product offerings. For example, bulky liquid dish detergent jugs were at one time the industry standard for use in dishwashers. However, Cascade (and others) realized that consumers would pay a premium for the convenience of premeasured detergent packs that take the guesswork and the mess out of filling the dish detergent dispenser. With this insight in mind, Cascade launched "ActionPacs," which command an approximately 520% price per ounce premium compared with the brand's liquid detergent jugs (see Figure 3).

Figure 3
Price-pack architecture showing cost per ounce



	Liquid detergent	ActionPacs
List price	**$9.89**	**$16.99**
Ounces	120	33.1
Price/ounce	$0.08	$0.51

~520% increase

Source: Target.com

It is worth noting that innovations like ActionPacs typically sit alongside legacy products such as traditional liquid detergent to create a good/better or good/better/best product assortment for the brand. This gives consumers the option of purchasing a more expensive product with an incremental benefit or a less expensive product without all the bells and whistles. L.E.K.'s 2023 Consumer Pricing and Promotion Study confirms that consumers favor having a choice of multiple sizes, packaging types and product benefits/claims on the shelf. Nearly 70% of consumers indicated that they prefer having more than one option per brand when purchasing everyday food, beverages and personal care items.

Fixed inventory services case studies

Service businesses also use feature/benefit analysis to determine the most effective way to create pricing tiers and bundles. Car wash businesses, for example, are well versed in creating tiered offerings. Many offer a basic wash and dry, an intensive car detailing service and several offerings in between. The benefit of creating multiple tiers is twofold: Consumers only pay for the services they need, and businesses capture revenue from customers at several points on the demand curve. Creating multiple offerings also helps these businesses defend their share of wallet, since customers who come in for an occasional car detailing can supplement that with more frequent basic wash services from the same service provider.

Car wash businesses are somewhat unique in that they are less capacity-constrained than other service businesses such as beauty salons and movie theaters. For a car wash business, the goal of tiered pricing is to maximize revenue through the optimal use of equipment. For businesses whose inventory is more constrained than car wash businesses, it becomes increasingly important to use pricing to maximize the average revenue utilization of assets.

Using feature/benefit analysis to compete at an entry-level price point

While the above examples demonstrate how consumers are willing to pay more for additional benefits and features, the inverse can also be true. For example, IKEA is the world's largest furniture company, and its business model revolves around the idea of **stripping away features** and benefits that are typically offered by furniture retailers.

Durable goods case study

While traditional furniture manufacturers sell fully assembled furniture in a variety of fabrics, colors, finishes and sizes, IKEA offers minimally customizable modular furniture that the consumer assembles at home. In a culture obsessed with the customization of products from skincare to sneakers, IKEA has maintained a stronghold in the furniture market by selling large volumes of standardized furniture at affordable prices. This stripped-down pricing strategy is also applicable in other consumer categories.

Adapting promotional tactics

For businesses looking to adjust pricing on a nonpermanent basis, promotions are a quick way to manipulate competitive positioning in real time. There are two elements to keep in mind when designing a promotional strategy: optimizing effectiveness and understanding the impact on consumer perception.

Optimizing effectiveness of promotional strategy

In the current economic climate, promotions can be especially important for easing consumers into higher price points and preventing trade-down behavior. Promotions also offer more flexibility than list price changes because they can be customized and optimized for a variety of variables: discount depth, offer type, day of the week, time of the year, which products/services to include, which retailers/channels to include, etc. Different consumer segments have different elasticities for promotions, so it's critical to determine the desired response from each segment in order to implement the proper promotional tactic. There are a few best practices to keep in mind when defining your business's promotional strategy, as shown in Figure 4.

Figure 4
Selected best practices for defining a promotional strategy

Vary timing of offers throughout the year
Schedule activity for days, months or seasons when consumers are shopping most frequently to drive market share

Vary offer types
Keep in mind that a dollar- or percentage-off offer is not always the optimal type of promotion

Vary promotional activities by competitive positioning
Spend more promotional dollars where relative positioning is weakest so as not to waste funds

Vary offers by product/service type
Use an elasticity-based framework to define promotional roles by offering instead of treating all offerings the same

Vary offers by customer type
Use deeper promotions to acquire customers or reactivate existing customers; use lighter offers for existing customers

Vary offers by channel
Understand the most effective ways to promote in each channel and adjust promotional strategy accordingly

Source: L.E.K. research and analysis

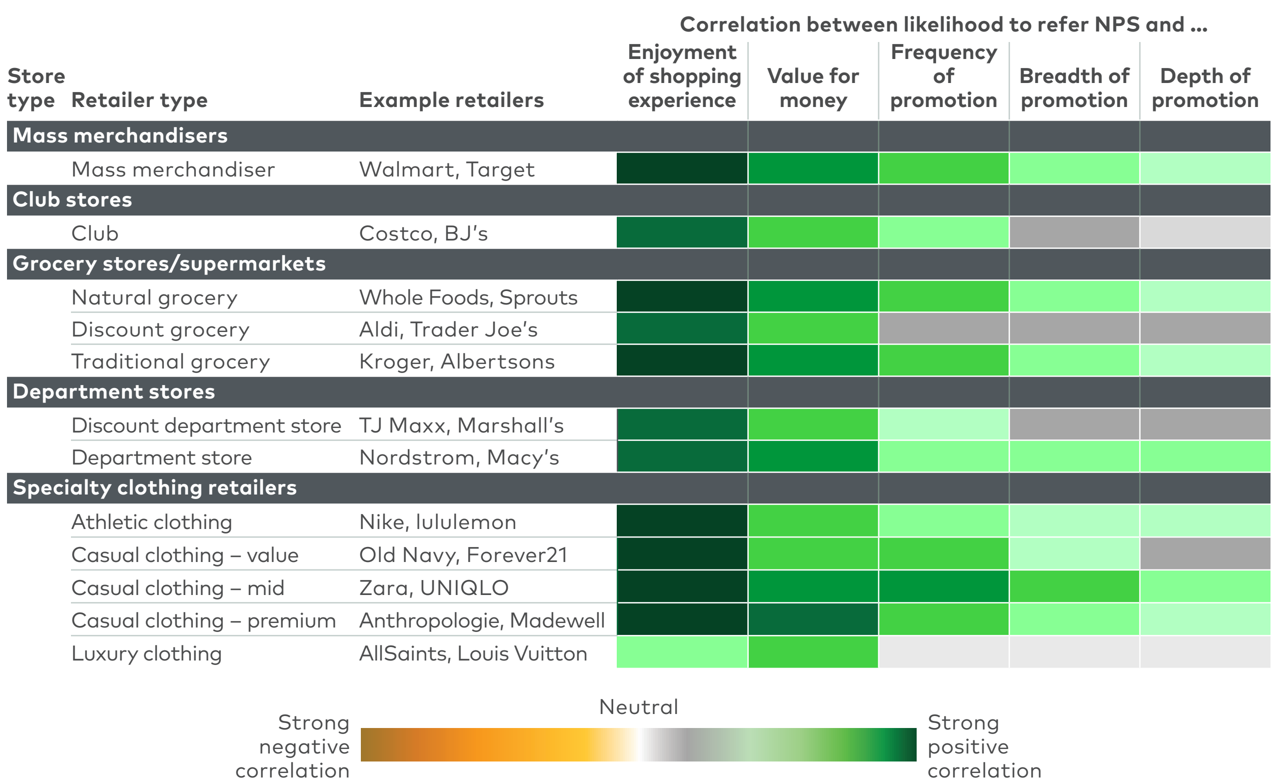
For brands that sell within retail channels, the trade spend budget is key to funding promotions (in addition to funding displays, circulars, slotting fees, etc.) and to building relationships with channel partners, especially retailers. Traditionally, trade and marketing spend budgets have been treated relatively interchangeably, and funds are allocated based on which tactics companies wish to use to sell additional products. However, in a post-inflationary environment, businesses may opt to shift trading funds in order to focus on explicit price reduction on the shelves.

Understanding the impact of promotional activity on consumer perception

Business owners often worry that offering too many promotions might damage their brand. While there is evidence that frequent use of monetary promotions can dilute some aspects of brand equity,[2] there are also benefits to promotions that should not be ignored. For example, L.E.K.'s 2023 Consumer Pricing and Promotion Study demonstrates that promotions generally contribute positively to the net promoter score (NPS) (see Figure 5).

Figure 5

Correlation between net promoter score and attributes of retail channels



Source: L.E.K.'s 2023 Consumer Pricing and Promotion Study

Across all retailer types, promotions are positively to neutrally correlated with NPS, implying that consumers generally view strong promotional activity as a reason to recommend a company to others. Luxury clothing retailers, however, see a much lower correlation between promotional activity and NPS. The data also implies that retailers should favor more frequent promotions as opposed to providing broader or deeper discounts to win over shoppers.

Still, promotions are only one piece of a broader strategy for driving positive consumer sentiment. In fact, retailers with vastly different promotional strategies (e.g., Aldi and Publix) received roughly the same NPS in L.E.K.'s survey. This demonstrates that retailers with lower everyday prices and lighter promotional activity (Aldi) and retailers with higher everyday prices and more robust promotional activity (Publix) are recommended equally by consumers (see Figure 6).

Figure 6
Retailers with similar net promoter scores but different promotional strategies

Retailer	ALDI	Publix
Pricing and promotional strategy	Predominantly everyday low-price strategy with promotional prices for select items weekly	High-low strategy with frequent in-store and online promotions
Types of promotions offered	Weekly ads feature "Aldi Savers" prices, which are promotional prices layered on top of everyday low prices	• In-store promotions (e.g., BOGO offers, reduced prices) • Digital store coupons available in the Publix app or at Publix.com • Manufacturers' coupons • Competitors' coupons

Note: BOGO=buy one get one
Source: Krazy Coupon Lady; Taste of Home; company websites; L.E.K. research and analysis

Of the criteria assessed in our study, an enjoyable shopping experience and high perceived value for money were more strongly related to NPS than was promotional activity. Club and discount retailers were a slight exception to this rule; they were evaluated less harshly on these criteria because consumers already know they are getting a deal and can excuse a less lavish shopping experience, as long as the savings make the trip worthwhile. But overall, if consumers enjoy shopping at your store and feel that products are priced appropriately, they will recommend your store regardless of how often, how widely or how deeply you promote.

Given these insights, retailers and brands should not be afraid to offer some level of promotion if it fits within their broader strategy. The key is to ensure that your promotional strategy will have a positive margin impact and to understand the promotional tipping point at which consumers start to expect and wait for discounts.

Promotions should be used strategically to gain a competitive edge and should be closely scrutinized to ensure they are achieving desired goals. In today's tough economic times, consumers may be even more receptive to promotions as discretionary spend decreases. For companies that typically avoid promotions to maintain their brand image, it may be worth considering one-off promotional activities (e.g., flash sales/holiday sales, joint promotions with a complementary business, and social media contests and giveaways) to provide consumer value on a limited-time basis.

Reevaluating pricing strategy

Today's macroeconomic environment is certainly challenging, but it offers an opportunity for business leaders to rebuild their pricing strategies from the ground up and to incorporate VBP best practices. The 2022 "cost plus" approach is a blunt instrument that was exercised in a time of crisis. It ignores a broader, longer-term approach to pricing strategy and could ultimately have a negative impact on sales. Adopting a longer-term strategic approach, on the other hand, will help businesses maximize revenues in a post-inflationary environment.

Business leaders should ask themselves the following questions to ensure they are viewing pricing through a longer-term strategic lens:

- **To incorporate VBP:**
  - Do I understand my target customers and the relative value they place on my product/service?
  - Do I understand my competitive set and how my product's/service's differentiation is coming through in my pricing?
  - Can I utilize dynamic pricing to capture incremental revenue from consumers at multiple points on the demand curve?

- **To evaluate feature/benefit trade-offs:**
  - Which features or benefits of my product/service are most important to my customers? Least important?
  - What is the willingness to pay for each of these features or benefits?
  - Do any features or benefits need to be offered in combination with one another at all price points?
  - How can I add/take away features or benefits to optimize my competitive positioning?

- **To implement more effective promotions:**
  - When are discounts most likely to stimulate a sufficient sales response?
  - Which products are most likely to garner more response when they're promoted?
  - How does response vary across tactics (i.e., discount depths and promotion structure)?
  - Who is most likely to respond (e.g., new versus existing customer groups)?

- Am I promoting too often/often enough to hit my business targets and satisfy my customers?

In addition to understanding the fundamental questions to ask to determine pricing and promotional strategy, it is important to consider organization-wide readiness to successfully execute these changes.

- **To consider optional frameworks for pricing excellence:**
  - Do my sales teams have the right playbook to communicate value-based products?
  - Do I have internal frameworks to ensure consistent approaches to discounting, etc.?

We invite you to connect with us to learn more about how L.E.K. can help your business craft a holistic pricing strategy.

For more information, please contact strategy@lek.com.

Endnotes

[1]Variety, "AMC Theatres to Change Movie Ticket Prices Based on Seat Location." https://variety.com/2023/film/news/amc-theaters-movie-ticket-price-seat-location-1235514262/

[2]Journal of Business Research (Volume 66, Issue 1, p.115-122), "Examining the role of advertising and sales promotions in brand equity creation." https://www.sciencedirect.com/science/article/abs/pii/S0148296311002669?via%3Dihub

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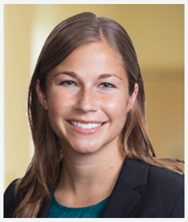

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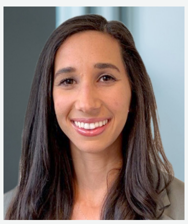

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