Yes, You Can Raise Prices
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A few smart companies are raising prices in the recession. Shouldyou? A simple but useful matrix can help.

The signs in the window of Jay Kos, an upscale men's wear boutique on Park Avenue in Manhattan, seemed at best cheeky, at worst clueless. Surrounded by glaring economic-crisis headlines cut out of newspapers, they said, "cashmere sweater: $2,500. RECESSION PRICE: $2,500." "LAMB'S FLEECE JACKET: $11,000. RECESSION PRICE: $11,000." It was an in-your-face declaration that the business, whose clients include bankers and celebrities, wasn't going to cave in to any mere economic collapse. "Some people hated it," says the shop's eponymous owner. "But most people loved it. And some people even bought because of it."

That story is worth pondering because one of the most important decisions businesses must make in this recession is what to do about prices. Cutting them seems the obvious move, and thousands of companies, from electronics retailers to Walt Disney World, are doing it. But others, like DuPont, are maintaining prices, and a few, including Colgate-Palmolive and McDonald's, are in some cases even raising them (the price of a double cheeseburger went up 19 cents in December).

The matter is critical because it affects not only immediate results but also longer-term competitive positions and brand power. Price cutters can steal customers but may sacrifice profitability that could take years to get back. For luxury products, price may be part of the brand identity. If a Hermes bag were priced temporarily at $200 instead of $5,000, the whole meaning of the brand would shift radically. Even nonluxury businesses pizza and gasoline, say face the same risk: Competing on price could define you as a commodity.

To help understand how companies price any product or service, I like to think of a two-dimensional matrix. On one axis is how differentiated the customer considers the product or service, ranging from a commodity to utterly unique. On the other axis is how strongly the customer feels a need for the product or service, from considering it a must-have to seeing it as totally discretionary. Where do various products and services including yours land on this matrix?

The best spot is the corner representing a unique necessity; the customer has gotta have it, and no close substitutes exist. Occupying this vaunted space are surprisingly humble products, like Colgate toothpaste. Few people will stop brushing their teeth no matter how bad the recession gets, and personal-care brand preferences are deeply ingrained. That's why Colgate has been able to raise prices—and it's an important part of why the company's profits rose last year and are forecast to increase smartly this year.

Conversely, the worst locale on the matrix is the opposite corner, where we find discretionary commodities. One competitor is much like another, and at any given moment most people don't really need any of them. In this miserable spot sit many major airlines. Travel can often be postponed, and there's little reason to choose one carrier over another on well-traveled routes. U.S. carmakers occupy the same corner; you can probably use your current car for another year, and if you do decide to buy a new one, the brand strength of the U.S. makers is much weaker than the imports'. The other two corners of the matrix are in-between cases. Must-have commodities are things like light bulbs and toilet paper; no one will stop buying them, but the brands don't matter much. Highly differentiated discretionary purchases are things like a Rolls-Royce; it's unique, but no one really needs one.

Smart companies use tools like this to analyze customers. The matrix is based entirely on customer perceptions, which vary widely, so for any product or service it's useful to plot the perceptions of each customer segment. That way you can create different value propositions

in which price will play greater or lesser roles. McKinsey, for example, reports that a beverage company found price sensitivity varied by a factor of three just across zip codes within Jacksonville. Offering all of them the same price wouldn't make much sense; varying prices in the obvious way would be a simple way to increase total profit.

Pricing is always important, but in booms you don't have to get it exactly right. Nowyou do. Decide carefully, because you'll be living with the consequences for a long time.

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