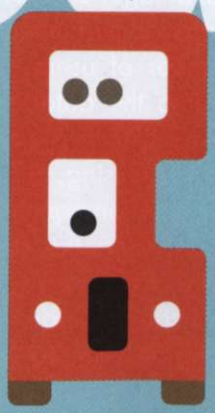
Pricing To Create Shared Value



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Rethinking the way prices are set can expand the pie for everyone.

by Marco Bertini and John T. Gourville

The way most companies make money is not just broken; it's destructive. From insurance and financial services to telecommunications and air travel, companies use pricing to extract what they can from every transaction. Look, for example, at how airlines siphon off value. Once a customer buys a ticket, the slow bleed begins. Want extra legroom? Pay us. Want to check a bag? Pay us. Want a pillow or something to eat? Pay us. This antagonistic approach may have worked in the past. But today's consumers are not passive price takers. They root out and disseminate information about a firm's prices, exploiting social media platforms to publicize policies that they believe are unfair. And they don't hesitate to abandon companies that cross the line.

Consider the swift responses to companies whose aggressive pricing consumers deemed unjust:

WHEN BANK OF AMERICA announced in September 2011 that it would start charging a $5 monthly debit card fee, the public outcry was so intense that the bank soon rescinded the plan. But the damage was done: Account closings in the final months of 2011 increased 20% compared with the same period in 2010.

WHEN NETFLIX implemented a 60% price increase in July 2011 for customers who both rented DVDs and streamed video, 800,000 users cancelled their service and the company's market cap plummeted by more than 70%.

AND WHEN MARKS & SPENCER was targeted by irate consumers in 2008 for charging £2.00 more for bras with large cups, the British retailer initially defended the practice, pointing to the higher cost of goods. But as the complaint gained traction on social media, the company relented, implementing a "one price fits all" policy and offering a monthlong 25% discount on all bras.

The challenge—and the opportunity—for companies is profound. Consumers aren't simply rejecting questionable prices; they're rejecting many firms' fundamental approach to making money.

Here's the problem: Companies have traditionally treated value in the marketplace as a fixed pie and have reasoned that they must compete with their customers to appropriate as much of it as those customers will relinquish. Whatever value they can extract is value customers miss out on, and vice versa. What's more, firms have presumed that they are the rightful owners of value and are therefore entitled to charge whatever the market will bear. To that end, they have treated pricing as an optimization problem, pricing mechanically in the pursuit of profit and

routinely exploiting any consumer disadvantage, such as a lack of information or understanding, limited attention, or limited choice.

But value neither originates with nor belongs solely to the firm. Without a willing customer, there is no value. Therefore, value must be shared by a firm and its customers. In addition, value is not the fixed pie that most companies imagine; rather, it can be enlarged through collaboration with customers, such as when a firm provides a well-crafted discount that not only boosts sales and encourages referrals but also promotes the brand and builds loyalty. As Michael Porter and Mark Kramer noted in their January-February 2011 HBR article, "Creating Shared Value," "Shared value [is not] about 'sharing' the value already created by firms—a redistribution approach. Instead, it is about expanding the total pool of economic and social value."

Firms must take the lead in creating shared value, perfecting the language they use most often to communicate with customers: pricing. Few signals are more powerful than price when it comes to motivating consumers—in ways that may be good or bad for the firm, customers, or both. Whereas branding campaigns are often dismissed as clever attempts at persuasion, pricing is a call to action that puts customers in control. Prices send unequivocal messages about what the firm believes in, what it thinks of its customers, and how it wants to interact with them. These messages can drive customers away, destroying value, or, as we'll show, they can engage customers in ways that create new value. For firms, that expanded pool of value can lead to new revenue, increased customer satisfaction and loyalty, positive word of mouth, cost savings, and other advantages.

The short-term benefits of aggressive pricing are well documented. But as Bank of America, Marks & Spencer, Netflix, and countless other firms are learning, it may not be a sustainable long-term strategy. Shared-value pricing could become a competitive necessity.

Pricing in Practice

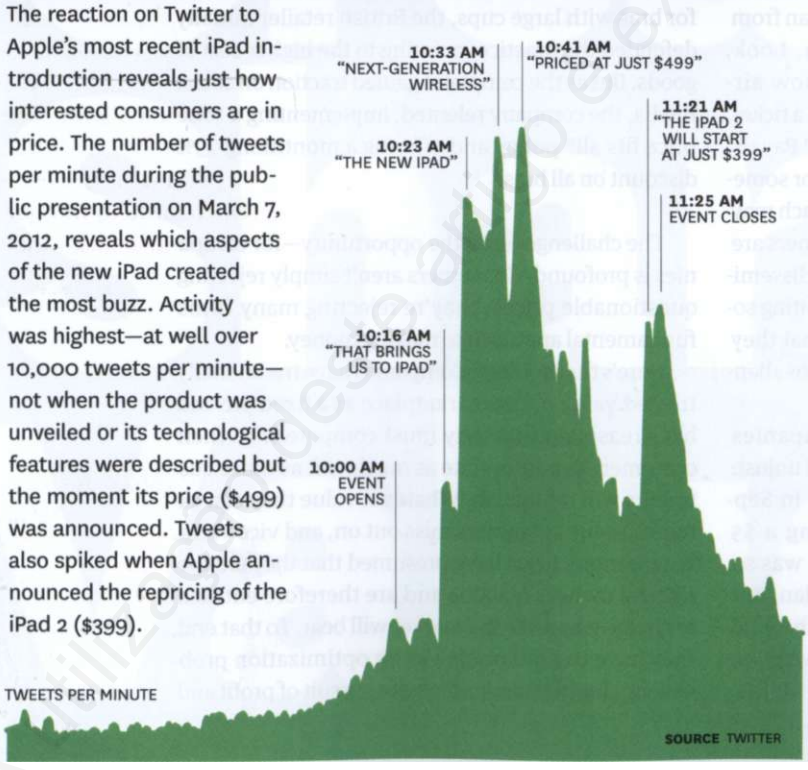
Traditional pricing strategy is by definition antagonistic, but it needs to become a more socially conscious, collaborative exercise. Businesses should look beyond the dry mechanics of "running the numbers"—still relevant but no longer sufficient—and recognize that humanizing the way they generate revenue can open up opportunities to create additional value. That means viewing customers as partners in value creation—a collaboration that increases customers' engagement and taps their insights about the value they seek and how firms could deliver it. The result is a bigger pie, which benefits firms and customers alike.

What does a shared-value approach to pricing look like? Consider the upcoming London 2012 Olympic Games, in which more than 12,000 athletes will compete in 26 sports over the course of 16 days. The London Organising Committee of the Olympic and Paralympic Games is offering 8 million tickets to this sporting spectacle at prices ranging from £20 to £2,012. Beyond revenue, however, the committee's stated goal is to make the 2012 Olympics "Everybody's Games"—an explicit social mission that has required a creative, shared-value approach to an exceedingly complex pricing challenge.

Yet that challenge is not unique; it's the same one most firms face but writ large and executed in a highly compressed time frame under intense public scrutiny. While few firms have been as explicit as the Organising Committee in stating a shared-

The Importance of Price

The reaction on Twitter to Apple's most recent iPad introduction reveals just how interested consumers are in price. The number of tweets per minute during the public presentation on March 7, 2012, reveals which aspects of the new iPad created the most buzz. Activity was highest—at well over 10,000 tweets per minute—not when the product was unveiled or its technological features were described but the moment its price ($499) was announced. Tweets also spiked when Apple announced the repricing of the iPad 2 ($399).



Idea in Brief

Companies have long used pricing to extract as much value as they can from transactions. This approach is destructive in two ways: It antagonizes customers, who are quick to punish companies they feel abuse them, and it fails to create new value that can benefit both the company and its customers. Companies must take the lead in creating shared value with customers. Five pricing strategies can help.

FOCUS ON RELATIONSHIPS, NOT ON TRANSACTIONS. Use pricing to communicate that you value your customers as people, not as wallets.

BE PROACTIVE. Set prices in ways that encourage customer behavior that benefits both the firm and your customers.

PUT A PREMIUM ON FLEXIBILITY. Design pricing so that it can change in response to shifting consumer needs and ensure the equitable sharing of value.

PROMOTE TRANSPARENCY. Provide the rationale for your pricing to consumers.

MANAGE THE MARKET'S STANDARDS FOR FAIRNESS. Make sure that your pricing meets customers' expectations about what is fair and that the pricing process is clear.

value mission, most can nonetheless learn from the multiyear process used to devise the Games' pricing. (See the sidebar "Pricing Lessons from the London Olympics.") Our in-depth study of the 2012 Games, detailed in a Harvard Business School teaching case (HBS Case 510-039), suggests five pricing principles that every business could profitably adopt.

Focus on relationships, not on transactions. Consumers often come to identify with the brands they buy, and firms hope to encourage this, preferring loyal customers to ones who engage on a merely transactional basis. But pricing decisions often undermine the relationship between brands and their followers. While a firm's brand communications may say, "We value you as a person," its pricing practices often say, "We value you as a wallet." Customers instantly pick up on the inconsistency and respond accordingly.

Consider the World Triathlon Corporation (WTC), a U.S.-based, for-profit company founded in 1990, which organizes, promotes, and licenses triathlons under the Ironman brand. To triathletes and sports enthusiasts, the Ironman name was synonymous with extreme physical challenge and camaraderie through disciplined training. Beginning in 2008, however, when a private equity firm acquired the WTC, loyal followers sensed a shift from those core values to commercialization. First, the company decided that people who finished half-Ironman races also should have the right to call themselves "Ironmen." Second, it greatly expanded its licensing agreements, leading to the introduction of dubious Ironman-branded products such as a mattress, a cologne, and a jogging stroller. Third, and most visibly, in October 2010 it launched Ironman Access, a membership program that allowed preferential access to hard-to-enter Ironman events—for a $1,000 annual fee.

The response was quick and decisive. Serious triathletes overwhelmingly criticized the move as a money grab, inconsistent with the true character of the brand. They rejected any attempt by the WTC to rationalize the value of the program for customers and mobilized an online protest that forced the company to rescind the program and post an apology the day following its introduction. The message many triathletes got from the commercialization efforts was that the WTC cared more about monetizing the Ironman brand than about the customer relationships that had sustained the brand.

Compare WTC's actions with those of Hilti, the European maker of high-end power tools. In an industry accustomed to selling tools to construction companies, Hilti decided to provide a service instead. Customers subscribing to Hilti's Fleet Management program pay a monthly fee—customized to fit their business models—that

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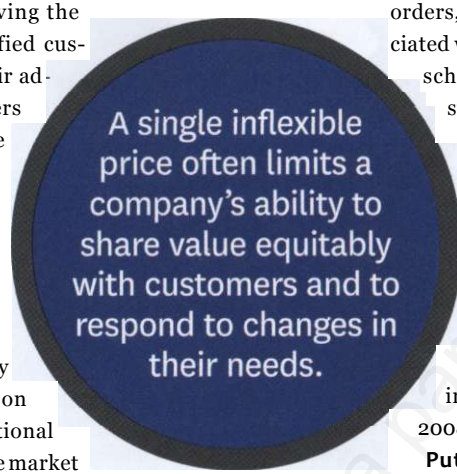
covers the use, service, and repair of all tools. Driving the creation of Fleet Management was the realization that construction companies cared not about owning tools but about the productivity they could achieve from using them. Hilti's approach is best captured in the slogan, "We manage your tools, so you can manage your business." By removing the burden of ownership, the company simplified customers' financial planning and reduced their administrative work and downtime. Customers report finding new types of intangible value in the relationship, such as the enhanced professionalism of using a set of high-quality tools.

Hilti's program is a textbook example of a shared-value approach. The company realized that by serving its customers' needs rather than selling physical products—by focusing on the relationship rather than on the transaction—it could both create additional value for customers and capture more of the market for itself.

Be proactive. Managers often price reactively, setting or adjusting prices in response to competitors' actions or customers' complaints. To create shared value, they must price proactively, guided by the knowledge of which consumers they want to serve and how those people will likely react to various pricing schemes. For instance, customers often seek to avoid paying if there's a simple and legitimate work-around. They're also sensitive to sunk costs, and they react differently to small recurring fees than to large onetime fees. Knowing those things, a firm can price proactively either to discourage detrimental behavior or to encourage behavior that is beneficial to both the firm and its customers.

Let's return to the airline industry. Few practices antagonize passengers more than baggage fees, which airlines introduced to compensate for their vanishing margins on airfares. But the adverse impact of this practice goes beyond the financial burden it places on customers. It actually encourages behavior that makes the flying experience worse for everyone. To avoid the fee, many travelers carry on luggage and other items that they previously would have checked. As a result, security lines move more slowly, overhead bins fill quickly and beyond capacity, and loading and unloading planes take much longer. Yes, the airlines benefit in the short run, but at customers' significant inconvenience, which leads to their long-term disenchantment.



To see how proactive pricing can engage and reward firms and customers, look at Amazon. The company recognized that many of its customers disliked shipping costs and long waits for delivery, so in 2005 it introduced Amazon Prime, which, for a $79 annual fee, provides two-day shipping on all orders, thereby eliminating the pain of paying associated with each order. At a tactical level, this pricing scheme rewards high-volume customers. More strategically, however, it has helped Amazon change buying behavior by encouraging customers to do more of their shopping with the company. In return for Prime's benefits, members are happy to buy more products, more often, and in greater variety, and they often introduce family and friends to the service. Observers attribute Amazon's 300% increase in share price and 30% increase in sales during the recession years of 2008 to 2010 in large part to Amazon Prime.

Put a premium on flexibility. Pricing tends to be rigid. Firms often strive to find the single 'right" price that will maximize revenue or profits to meet a particular goal that may be transitory. But individual customers may value the same product differently, and what constitutes value for a given customer may change over time. For instance, he or she may greatly appreciate functionality when buying a new computer but want technical support and customization later on. A single inflexible price often limits a company's ability to share value equitably with customers or to shift prices in response to changes in their needs.

Today's largest mobile operators, for example, are lamenting a decision they made years ago, when the technology for data services, or mobile broadband, first became available. Encouraged by financial markets that rewarded subscriber growth, they offered data packages that allowed unlimited usage. While the "all you can eat" plans initially helped companies acquire customers, they now restrict the firms' options and have contributed to overloaded networks, which diminish the customer experience for many users. While operators are now fighting to link pricing to usage, high-usage customers are feverishly opposing any such change.

The SKF Group, the largest bearing manufacturer in the world, has taken a more effective approach, making pricing flexibility central to its interaction with customers. SKF is driven by the belief that if customers make more money, SKF will too. To that

end, the firm is aggressively moving away from pricing products to pricing the incremental value created in each partnership. For example, SKF may take over a customer's maintenance operations and agree to split the monetary savings that accrue from the advanced knowledge SKF brings to the task. Because each customer engagement is unique, each customer has its own price, which is a function of the shared value that is created.

Promote transparency. A firm that is transparent about the way it makes money fosters engagement and builds trust and goodwill among customers. Engaged customers cost less to retain, often migrate to higher-end products or invest in accessories and additional services, provide more-useful feedback and product innovation ideas, and are more forgiving of mistakes. Conversely, a firm that is less transparent signals that it has something to hide, distancing itself from its customers and putting both parties on the defensive. It is no surprise that many of the sectors with the worst customer satisfaction scores also have the most extensive product lines, complicated pricing plans, and obscure contractual terms—in other words, the most opaque relationships with customers.

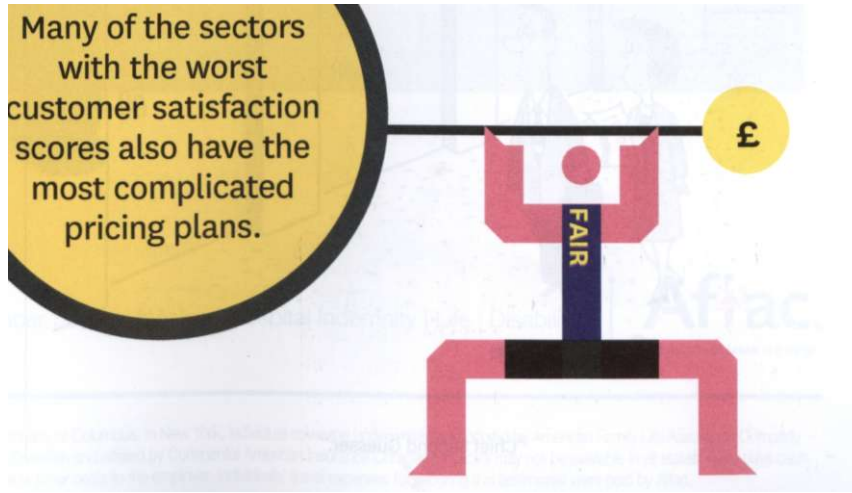
Retail banking offers perhaps the clearest example of this (sadly, one can pick almost any major bank to make the point). For years, banks made significant profits on a charge known as an overdraft fee—a penalty that few customers ever anticipated but many, especially those in lower-income households, fell victim to. In 2009 alone, U.S. consumers paid more than $35 billion in overdraft fees.

When legislation took effect in 2010 to curtail this lucrative revenue stream, many banks brought back an account-keeping fee, which they had abolished years earlier in order to attract customers. Indeed, from 2009 to 2011, the percentage of large U.S. banks offering free checking dropped from 96% to 35%. Years ago shifting the revenue stream from a visible checking account fee to a hidden overdraft fee made sense. Customers tended to welcome free checking and to fail to notice or anticipate the likelihood of incurring the new fee. Now, as banks reinstate account-keeping fees, consumers are responding: From 2010 to 2011, the number of consumers opening accounts at credit unions, where checking is free, has doubled.

In contrast to the antagonism such practices create, consider how transparency helped Shenzhen Telecom, a subsidiary of China Telecom, improve both its relations with customers and its bottom line. In 2005, when managers saw customer satisfaction slipping, they took a close look at the complex bills that had long prompted inquiries and complaints. The firm redesigned and simplified the bills to provide detailed and useful information in a way that was intuitive and comprehensible. These seemingly cosmetic changes halved the number of complaints to the call center in a matter of months—which translated to substantial cost savings and fewer delayed payments. It also improved customer satisfaction and loyalty. In many service industries, the invoice is a firm's only communication with customers. A clear, simple bill sends a powerful message that the firm cares about engaging honestly with them.

Manage the market's standards for fairness. Finally, it's crucial to understand and be able to influence consumers' perceptions of pricing fairness. When prices seem fair, consumers often buy more and are more willing to pay a premium. Conversely, when prices seem unfair, consumers may punish companies. Critically, perceptions of fairness relate not only to final prices but also to the process by which they are set.

Consider the widely reviled online ticketing company Ticketmaster (*Wired* magazine captured the sentiment in the 2010 article "Everyone Hates Ticketmaster-But No One Can Take It Down"). The company's problem can be traced to the failure to manage public expectations of what is "fair" in the ticketing world. In particular, consumers resented the seemingly mysterious service charges, convenience charges, and processing charges commonly added on top of ticket prices, and Ticketmaster



exacerbated the hostility by hiding these fees until late in the already tedious purchase process. Recently, however, the company began disclosing them at the start, a simple move that Ticketmaster reports has increased repeat purchases.

IKEA, in contrast, has done a stellar job of managing expectations, as reflected in the almost spiritual loyalty of its customers. Navigating a vast, mazelike store, transporting unassembled furniture, and putting it together at home isn't for everyone, but for those who are willing, IKEA makes a promise. On its website and in its marketing literature, the company explicitly states what a consumer can expect and unfailingly delivers on that promise. IKEA will scour the globe for smart ways to make good-looking furniture, find suppliers who are willing to provide the most suitable materials at low prices, and then buy in bulk to get deals that allow the company to offer prices 30% to 50% below competitors'. In return, customers must be willing to engage with the challenging purchase, transport, and assembly process. In this IKEA is unapologetic: You do your part and we will do ours. The result is a shopping experience in which IKEA and its customers jointly create and share value, and jointly keep prices low.

"Chief Second Guesser."

An Evolving Strategy

Most firms rate poorly on at least several of our principles for shared-value pricing. If your company is among them, you can either treat your customers like partners in value creation and set prices accordingly or watch firms that do steal market share and profits.

J.C. Penney, in a bid to reverse a long decline, is doing the former. As recently as last year, Penney bombarded shoppers with almost 600 promotions, each one more confusing than the last, all focused on driving up sales. The message was more "we value your money" than "we value you." Today under a new CEO, Ron Johnson, Penney is busily remaking the customer experience, and pricing is central to the strategy. Previously, Johnson created the famously engaging Apple Store, and that focus is increasingly apparent at Penney. In a highly publicized move, the retailer has introduced "fair and square" pricing, which is meant to be in sync with customers' lives rather than to coerce shoppers into unplanned and often unnecessary purchases. To signal this new transparency, the chain offers only three types of prices—everyday, monthlong, and clearance. And, in a small but symbolic move, all prices end in .00, not in .99.

The major U.S. airlines, in contrast, are doing the latter, watching as first Southwest, then JetBlue, and now Virgin America provide for free many of the amenities that the majors charge for. It is little wonder why J.D. Power named those three airlines "2012 Customer Service Champions" and why each has an increasingly loyal following and climbing market share.

Time will tell how effective Penney's new pricing strategy is. It could fall short because of poor implementation, underlying business conditions, or other factors. Similarly, the Olympics' pricing scheme will probably experience some glitches. Shared-value pricing is a nascent and evolving strategy, and some experiments will surely fail. But given the fundamental shifts in consumers' power and expectations, customers will have dwindling patience for antagonistic pricing. And considering the benefits to be gained by increasing the pool of value in the marketplace and sharing it with customers, any firm that is not evaluating its pricing through a shared-value lens should ask whether it can afford not to.

Fonte: Harvard Business Review, Boston, v. 90, n. 6, p. 96-99; 102-104, June 2012.