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BEYOND LIST PRICE

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The list price is under threat. Once an indispensable benchmark that expressed a company's confidence in a product's value, the list price now risks becoming overemphasized or, at the other extreme, obsolete. Widespread, easy access to price and product information subjects the list price to intense scrutiny by customers, suppliers, and channel partners alike. How can a single number withstand this onslaught and remain persuasive?

To declare the list price extinct amidst this disruption is reactionary. But to cling to the list price as a primary source of price communication is shortsighted. The management imperative is to evolve the role of the list price. At the same time, management must optimize its price communication. This requires supplementing the list price with other powerful communication approaches—many of which did not exist in the preinternet days when the list price reigned supreme.

Evolving the Role of the List Price

How can companies change the role of the list price to help address divergent customer and partner segments, adapt to market dynamics, and extract full value in a fair and profitable manner? The answer is by deemphasizing the list price, which companies can do in one or more ways: create multiple list prices, soften the impact of the list price through discounts and other incentives, phase out the list price and replace it with another means to convey a price-value relationship, or recalibrate the list price to express value in a way that gains acceptance and drives sales.

As a product matures, the need for more segmented or customized pricing can increase. To address this need, companies can create multiple list prices. Apple and Microsoft use this approach, and each list price targets an important customer segment, such as students or government organizations. This method acknowledges the idea that there is no such thing as a single value for a product; the value is in the eye of the beholder. If a company segments its customers and has a relatively homogeneous product offering, it can use multiple list prices in a way that is perceived as a fair and reliable expression of value.

More commonly, companies evolve the list price by softening its impact after the launch of a product. This recognizes a fact of life in a world where price data and the ability to make comparisons are rarely more than a few clicks away: after years of frequent discounting—whether in the form of store sales or concessions in B2B price negotiations—customers suspect that there is a better price than the list price. In some industries, taking more than 90% off the list price is not unusual, because sales and channel managers use discounting to compete.

In the B2C world, however, discounts of that magnitude can land a company in legal trouble in most developed countries around the world. For example, the US Federal Trade Commission makes this point very explicitly in its "Guides Against Deceptive Pricing": "To the extent that list or suggested retail prices do not in fact correspond to prices at which a substantial number of sales of the article in question are made, the advertisement of a reduction may mislead the consumer."[1]

"May mislead the consumer" is an important phrase. It does not preclude companies from providing sample products for free or making limited-time offers with discounts of as much as 90% off the list price. Media and entertainment companies often do the latter. Instead, the regulations are meant to prevent companies from abusing these tactics by willfully deceiving customers into believing their purchases are "deals" when they really are not.

The most radical approach, from financial, public relations, and legal standpoints, is to forsake the list price entirely. Amazon has been following this path. In one 2016 study, the percentage of products observed to be without list prices on the company's website increased from about 29% to about 70% within two months.[2] In luxury goods markets, where an explicit price can serve as a powerful quality indicator, some suppliers have dispensed with the list price altogether.

If a company decides to maintain a list price in its traditional role, then management should gain a better understanding of a product's intrinsic value and recalculate the list price from the ground up, rather than tweak or adjust the existing price. Market dynamics in terms of product quality, competition, customer segments, price communication, and channel access have likely changed substantially since the company last set the list price. Incremental increases or adjustments to the old number are liable to miss or misrepresent new market realities.

Optimizing Price Communication

As the list price declines in both effectiveness and prominence, companies can use an arsenal of communication approaches to express the relationship between price and value. These methods can accomplish more in terms of reassuring customers—building their confidence that there's an equitable sharing of value—than a list price can on its own. Many of these approaches take advantage of consumers' digitally driven tendencies to hunt for bargains (time permitting) or make snap decisions when what they need at the moment is a mere click away.

How customers will respond to these approaches is only one factor in selecting the optimal set. Companies must also consider the costs of adoption, which may require investing in technology, data, or analytics capabilities. The prevailing market situation may also limit a company's options. In a market where the balance of power favors retailers or distributors, suppliers must consider how their customers will respond. In a mature market with a stable oligopoly, suppliers will be reluctant to be the first to switch away from list prices and disrupt the equilibrium.

Keeping these implementation factors in mind, companies should consider the following approaches:

- **Encourage peer comparisons.** Popularized by Amazon, the famous "People who bought this book also bought…." communication substitutes the objective judgment of a relevant peer group for the seller's claim of value. This approach can be very effective. Liberty Mutual Insurance, a large US auto insurer, found that when it told prospects that fellow college alumni had bought more liability coverage than they did, more than 70% of the prospects upgraded to a larger policy.

- **Make direct competitive comparisons.** T-Mobile, a large telecommunications company, makes the claim that its prices are "15% below AT&T's price." This approach reinforces T-Mobile's value proposition and competitive positioning and renders the list price irrelevant. Progressive Casualty Insurance, whose offerings by nature are much more heterogeneous than a mobile phone plan, does the price-comparison research on behalf of its potential customers. A customer proposal shows explicitly the cost of a recommended Progressive plan, compared with the cost of the same plan from a handful of direct competitors.

  Price transparency favors this kind of approach. The more easily customers can compare one company's price with that of its competitors, the stronger the message will come across. The approach is also promising when the difference between a company's price and that of the market leader is large enough to attract attention and draw away customers, but not so large that the market leader may respond with price cuts of its own. Companies with an advantageous cost position (for example, Amazon, Walmart, and Aldi) have more latitude to price below a competitive benchmark price and still maintain satisfactory margins.

- **Emphasize discounts.** The US retail chain J.C. Penney built a reputation around constant and occasionally aggressive discounting. When Ron Johnson, the mastermind behind Apple's successful retail stores, took over as J.C. Penney's CEO, he switched the pricing model to one that was similar to Apple's: no discounting. One message became clear as J.C. Penney's revenue declined and its share price plummeted: many of its customers were attracted to—even addicted to—discounts, which conveyed that the immediate purchase opportunity was special.

  Discounts still work, as big retailers have found out repeatedly. Research has demonstrated that many shoppers pay more attention to the discount percentage or discount amount than to the selling price. Granted, any discount or savings calculation has a list price embedded in it (list price minus the selling price equals the discount amount). But emphasizing the right-hand side of the equation conveys a much different and occasionally more alluring message to consumers. The US menswear retailer Jos. A. Bank Clothiers has made discounts a fundamental part of its business model and its price communication. Varying combinations of buy-one, get-one promotions, as well as offers of a deep discount after purchasing one item at full price, are designed to make it hard for any customer to leave the store with only one suit, one shirt, or one accessory.

- **Revisit dynamic pricing.** When a customer uses an app to book a ride with a ride-hailing service (for example, Uber), he or she isn't presented with a list price. The price the passenger sees is based on an algorithm that has processed a large number of variables. The customer's only context to evaluate that price is his or her current situation and riding history with that service. Although some resistance remains, consumers have grown more accustomed to prices that change frequently.

- **Change the pricing model and reset expectations.** Over time, a list price can lose its link to the underlying value of the product or service. When this occurs, companies can adopt a pricing model on the basis of a metric that better reflects how the customer derives the product's value. An example is the consumption-based pricing model, under which customers pay only for what they use on an ongoing basis instead of paying a large price upfront. This essentially transforms a product-based business into a service business. Many manufacturers of consumer durables or industrial machinery have adopted such models in recent years.

- **Differentiate prices on the basis of deep customer databases.** To improve their position in a negotiation, the sales units of industrial goods companies have built databases that include buyer data, such as purchaser title, past purchases, business unit information, and even data on the customer's customers. In other industries, the customer relationship has largely shifted from producers to companies in the sales channel, putting them in the best position to collect data and assess customers' price sensitivities as well as their preferences for price structures. Some retailers have built loyalty and rebate programs to better understand and retain their customers. The more sophisticated retailers have begun to track purchase occasion as well as customers' other habits. This effort puts those retailers in a better position to tailor their offers to repeat customers.

These price communication approaches allow companies to reduce their reliance on the list price by removing it from the customer's primary field of vision, even if the list price still serves as the starting point or anchor for calculating a discount.

INSTANT ACCESS TO price information has fundamentally changed how customers, suppliers, and channel partners perceive value and judge prices. It was inevitable that this disruption would diminish the role of the list price. The shift is a signal to companies that they should evolve their list price approach and find opportunities to use price communication in ways that benefit themselves as well as their customers and partners. Although its dominance will likely never return, list price can still play an important role in an optimized price communications mix.

NOTES

1. *Electronic Code of Federal Regulation*, US Government Publishing Office, accessed August 14, 2018.
2. "Amazon Is Quietly Eliminating List Prices," *New York Times*, July 3, 2016.

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