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Just-in-Time Pricing

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It's said that timing is everything, and that rule certainly applies to pricing. An often overlooked factor in driving purchase decisions, timing can be applied to nearly every pricing approach, from discounting to cross-selling, to achieve "just-in-time pricing." A company in the travel industry, for instance, was able to sell more than 90 percent of its unsold inventory, increasing net income margin by half a percentage point, simply by splitting up the purchase decision over time. The company found that consumers were more likely to purchase an upgrade or an add-on amenity when contacted close to their travel date than when presented with the same offer at the time of the initial purchase. With little investment—just a small change in strategy—the company more than doubled the success of its upselling efforts.

Strategies such as this are especially relevant now, when companies are seeking growth avenues compatible with their customers' tight wallets. Raising prices across the board often is not a viable option in tough times. Just-in-time pricing can help drive overall profit through improved discounting, cross-selling, upselling, bundling, and unbundling of offerings.

When Time Is on Your Side

There are many ways to implement just-in-time pricing. In addition to stretching out the elements of a purchase decision, those elements can be brought closer together, as when a sales clerk offers shoe polish as an add-on to a shoe sale. Or time pressure can be applied to a special price, as in Amazon.com's 24-hour Deal of the Day. Moreover, just-in-time pricing can be used in many sectors of the economy—in pricing not just to consumers, but to business customers as well.

We have identified six ways that companies can drive purchase decisions to their advantage by using time in their pricing strategies. (See the exhibit.)

Lock in Now, Upsell Later

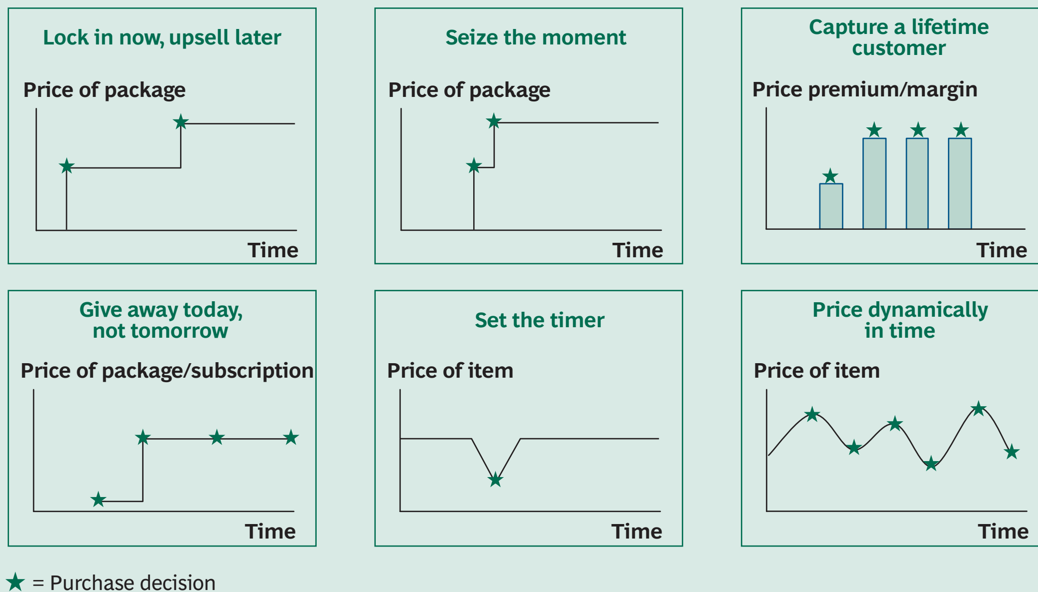
By dividing a big purchase into two or more smaller ones (as the travel company described above did), companies can capture an initial sale and then follow up with an offer for an add-on purchase. So, for example, a car dealer, after placing a new-car order, could call the customer with an offer for an upgraded options package at a special price. Or it could call shortly after delivery with an offer for maintenance services. Such an approach—which requires that companies have contact information on customers—may be best suited to big-ticket items with longer lead times, such as furniture and consumer electronics (in addition to travel and automobiles).

A similar technique may be useful in instances of business-to-business selling where a basic contract is signed initially and upgrades are negotiated further down the road. In sectors such as heavy equipment and IT integration, for example, purchasing departments often put extreme pressure on the initial bid. Vendors therefore try to ensure that the initial price wins them the chance to start working, and they hold off discussions of alternative solutions—which could bring more value to both sides—until later on. Since these alternative solutions may be the only source of margin, companies must be very systematic about capturing them. To complicate matters, some companies are hampered by the fact that those responsible for selling and pricing may not be the same individuals who handle the customer during execution and service. Processes and organizational structures that support coordination can help ensure follow-through from lock-in through upselling.

Seize the Moment

Waiting to introduce an add-on offer may make sense in some situations, but in other cases, the best

Six Levers to Achieve Just-in-Time Pricing



Source: BCG analysis.

timing is immediate. Consumers tend to be more open to the idea of protecting their investment in a new product at the moment they decide to make that investment. That is when they may agree to add shoe polish to a shoe purchase, insurance to a car rental, or an extended warranty to a new TV.

This approach is often used when purchases are closely related, such as when an add-on is designed to enhance the enjoyment of the initial purchase or protect the initial investment. It works because connecting the two items in time is likely to make the add-on seem inexpensive compared with the primary purchase. Car dealers take advantage of this tendency to compare and aggregate when they offer options such as leather seats and GPS devices that are only a fraction of the price of the car itself.

Capture a Lifetime Customer

The classic examples of all-in-one systems, in which a single consumer item requires related purchases to function over its life cycle, are well known: razors and blades, printers and ink, coffee machines and cups. Technology and telecommunications companies sometimes follow a similar model by offering inexpensive software licenses with monthly data subscriptions, or subsidized handsets with long service contracts. For these items, customer value—and the appropriate pricing schemes—must be measured over time. The first sale demands competitive pricing in order to reduce entry barriers to the system. Subsequent sales can then be priced appropriately to ensure that profits come with repeat purchases made in the future.

Some companies have taken this concept to a new level, introducing it to entirely different product categories. For example, a global tire manufacturer observed a significant variation in the repurchase rate across car models. Owners of higher-end cars were much more likely to replace their tires with the type that was originally on the car, while owners of lower-end cars were more likely to shop around and switch. Armed with detailed calculations of repurchase rates specific to each car model, the company was able to optimize the price of tires sold to the carmaker based on the likelihood that a particular tire would be purchased as a replacement in the future.

Give Away Today, Not Tomorrow

For businesses that sell long-term service contracts, one powerful just-in-time pricing mechanism is to offer something free at the start, followed by pricing that more than makes up for the initial giveaway. These offers are routine in the financial services industry, where zero-percentage-rate offers on the first

year of a credit card may be followed by slightly higher-than-average rates in subsequent years, and in telecommunications, where companies may offer new subscribers a free initial month of service with a one-year contract at the usual price.

The secret to the success of this approach is the tendency of the consumer to disproportionately discount the impact of future expenditures compared with current ones. Few consumers create spreadsheets to calculate the net present value of their purchase decisions. In the rose-colored glasses of the average shopper, the financial picture is always brighter in the future, and a dollar saved today seems well worth a few extra dollars spent tomorrow. Government regulators are rightly cracking down on abuses of this approach, which should never be used in a misleading way. But when applied with integrity and transparency, the use of a near-term free lunch to capture future customer spending is a valid timing tactic.

Set the Timer

Pricing discounts and bundled offers that expire use time to create a sense of urgency. Traditional retailers have been using the one-day sale for decades, and now a number of online stores have been set up around the same concept. For example, Gilt Groupe, a U.S. fashion site, features designer clothing at 70 percent off retail prices in exclusive, "invitation only" sales lasting just 36 hours. The proliferation of private-sale shopping clubs is one of the few new online business models that have quickly attained global reach. Web sites such as vente-privee.com in France, brands4friends.de in Germany, and kupivip.ru in Russia have succeeded by "setting the timer" on steep discounts and using an invitation-only model that shields them from price comparison engines.

Some businesses have added a sense of drama to the countdown. Marketers of vacation ownership properties have mastered the art of applying time limits, gathering a group of potential owners for a presentation and announcing a special offer that expires in an hour. They may ring a bell each time the offer is accepted, increasing the pressure on the remaining holdouts. In France, open-air markets sell china and tableware with theatrical flair. After piling up a host of wares, the salesperson calls out a low price, adding glasses and plates every few minutes to sweeten the deal. But when the countdown ends and no one in the crowd has made a purchase, the seller makes the final offer irrevocably final—by taking out a hammer and smashing the entire set. Next time around, buyers know they'd better act quickly!

A combination of scarcity and time pressure can effectively drive impulse purchases. Television shopping networks understand this, featuring products only available at a "special price" while the product is "on the air." Tchibo, a successful German nonfood retailer, has changing assortments of private-label products that are only available for two weeks at a time and are clustered around themes such as spring cleaning, back to school, or first snowfall. These sales help attract shoppers and capitalize on foot traffic at the adjacent premium-coffee business. Similarly, last-minute deals are frequently used in the travel industry to lure spontaneous travelers who might not otherwise take a trip at all.

Extremely time-limited pricing is designed to drive deal-driven consumers to make a purchase—hopefully without causing the perception of value to deteriorate, as a more generous discount window might. To maximize profit, these price reductions should be infrequent, unpredictable (in terms of either when they occur or what is discounted), and conducted on short notice. This will allow the company to capture primarily the patient, bargain-hunting segment of buyers (who would not purchase at a higher price), rather than those who must fill a short-term need (and therefore would pay full price).

Price Dynamically in Time

Charging a different price according to the time of day, day of the week, or time of the year is widespread in capacity-based industries, where the practice has served to spread demand as much as to drive purchase decisions or maximize profits. Airlines, railroads, and cruise and hotel operators have all pushed these practices to their limit, assisted by online travel sites that offer pricing transparency to the consumer. The old-fashioned happy hour and early-bird special at bars and restaurants likewise illustrate how dynamic pricing improves the use of selling capacity. Retailers of ski equipment, outdoor furniture, snow tires, or any other seasonal product can use discounts to extend the selling season. Other capacity-based players, such as telecommunications operators and utilities, may offer discounts at off-peak times such as nights and weekends.

A variation on this technique can be applied to capture differences in the willingness to pay sooner rather than later. For example, hardcover books come out earlier and are priced higher than paperbacks, not because the binding costs more or supplies are limited, but primarily because the demand elasticity of early and late buyers differs. Impatient readers are willing to pay more to read a book now, while others are willing to wait for a lower price.

Mysteries of the Consumer Mind

Effective just-in-time pricing models are designed to influence the purchase decision—to reinforce up-selling efforts or encourage a higher-margin product choice. Therefore they rely on a deep understanding of consumer psychology.

The lock in now, upsell later strategy, for example, is grounded in a specific set of emotions and behaviors:

- *Price Amnesia:* As time passes, memory fades and the pain of a purchase recedes. The more time consumers can put between themselves and the original purchase decision, the more likely it is that they will become desensitized to spending on something new. In fact, consumers can experience a sort of "price amnesia" that causes the actual price they paid for a product or service to depreciate in their minds over time.

- *Commitment to the Purchase:* Consumers look forward to the benefits of the initial purchase and become emotionally invested in the purchase decision. Over time, they grow increasingly inclined toward similar purchases.

- *Assessing Affordability:* When a purchase is split in two, each individual spending decision becomes smaller and more manageable. This can allow mass-market consumers to stretch their paycheck.

- *Staying Within Budget:* For consumers who rely on credit and have to deal with credit card limits, moving part of the purchase to a future payment cycle can make a meaningful difference in the ability to pay.

- *Dividing the Purchase Decision:* The purchase decision can sometimes be made by two parties—the wife booking the vacation, for example, and the husband adding the golf package.

Each of our just-in-time pricing models is relevant to a slightly different set of behavior patterns. A targeted investment in consumer or customer insight can help determine which models are most appropriate for your company.

Lessons in Pricing Strategy

As shown in the preceding examples, some companies are already using time in their pricing strategies. But others may be missing an opportunity. For example, even with big-ticket consumer durables like furniture and appliances, where there can be significant lead time between receiving an order and delivering the product, companies don't often contact their customers in the interim—to suggest, perhaps, that they order a slipcover and pillows to match their new couch.

Companies need to think about how time can be incorporated into their pricing strategies in order to enhance discounting, cross-selling, upselling, bundling, and unbundling. In fact, there are pricing considerations that can have an impact on every part of the value chain. Some critical questions to ask include:

- Do we have a thorough understanding of our customers' purchasing patterns and psychology, and of the drivers of decision making in our category?

- Have we embedded pricing discussions into the innovation and new-product launch process so that any potential opportunities to bundle or unbundle products, create all-in-one systems, or develop add-on products are identified early on?

- Do we have a clear view of how pricing may be used to reflect the economic cost of unused capacity—or to manage around capacity constraints?
- Is our customer relationship management (CRM) system sufficiently robust to allow for tracking, contacting, and upselling to customers over time?
- How strong are our steering mechanisms for managing the sales force so that it can execute more nuanced, multistep pricing strategies?
- Do we have tools in place to measure our customers' lifetime value and repurchase rates?
- Do we know where our price leaks are? Can we pinpoint the biggest factors (such as trade spending, discounts, upgrades, and commissions) driving the difference between list price and net realized price, so that we know where to focus price changes first for the greatest impact on margin?

From Idea to Reality

Any new pricing strategy will succeed or fail on the strength of its implementation. First, the company must perform in-depth research to gain an understanding of customers' mindset and decision-making process, and it must develop new product options and potential pricing schemes followed by an iterative pilot, testing, and rollout program. Second, the rollout itself may require changes to the sales operation, such as retraining, revised selling scripts, dedication of sales representatives to upselling activities, and new incentive systems. Many just-in-time approaches also require upgraded or adapted CRM systems to better contact or track customers over time. Finally, and perhaps most important, change management efforts will be required to drive buy-in on the new pricing strategy.

The following are four key success factors derived from our experience helping clients with just-in-time pricing.

- *Go beyond "test and learn":* In piloting just-in-time pricing options, companies are likely to fail a few times before they get it right. They need to go beyond the standard test-and-learn approach, retesting and relearning—perhaps multiple times—in order to figure out which variables matter to the outcome. Senior leadership must therefore give the organization full permission to experiment, which can represent a big cultural shift.
- *Apply a solid analytical capability:* The second- and third-order effects of pricing changes are hidden in the data generated by pilots and testing. In most companies, getting to the bottom of it all involves a small but skilled team of analysts with engineering and mathematical backgrounds. These people must be comfortable analyzing huge amounts of data, putting metrics in place, and building tracking tools that work.
- *Anchor decisions in customer insight:* Pricing decisions are not just about numbers, however. Sometimes the reason an offering works or doesn't work has more to do with emotions than with facts. So managers looking to apply just-in-time pricing need close connections with their customer-insight or market-research teams. These experts, armed with a history of customer research and understanding, can help interpret the why behind the outcome of pricing tests.
- *Tweak sales force incentives:* Listening in as sales representatives called customers to offer upgrades, managers at the travel company described above noticed something about the most successful reps. By focusing on cases where the difference between the price of the initial purchase and the upgrade was smallest, these reps were getting a strong positive response but not much incremental revenue. They had an incentive to work this way because they were being compensated for each conversion, not for its dollar value or the profit generated. A tweak to the sales force compensation system was needed to optimize the impact of the initiative.

Incorporating just-in time pricing is not necessarily costly. There is no massive technical investment. You

don't need to hire an army of people. Yet it is not always easy. Managers need to change their mindset and how they operate. These changes will ripple through the pricing process, from setting prices to reviewing and tracking results. And while the new approach may not require big cash outlays, it will require energy and commitment from senior leaders over many months.

Timing—a key element of pricing that is too often taken for granted—can be a useful lens with which to explore opportunities. With most consumers still holding on tight to their wallets and businesses keeping a close eye on their bottom line, now is the time to implement just-in-time pricing. Companies that do it successfully, in ways that are grounded in true insights into their customers, will capture significant untapped profits.

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