

# Week 1: Understanding Customer Value

## Three Pricing Lenses

## Three Lenses of Pricing

Economics



## Three Lenses of Pricing

Customers



## Three Lenses of Pricing



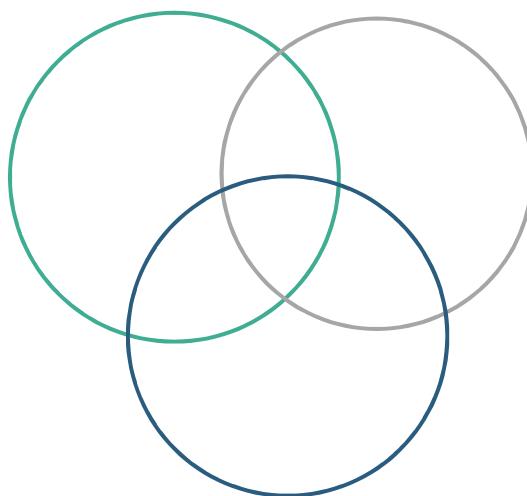
Competitors

## Three Lenses of Pricing

Economics

Customers

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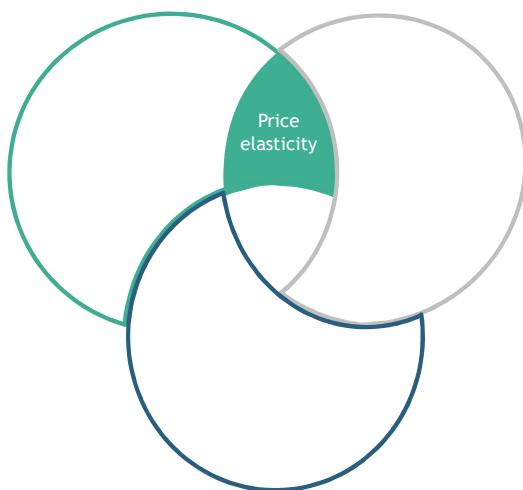


## Three Lenses of Pricing

Economics

Customers

Competitors

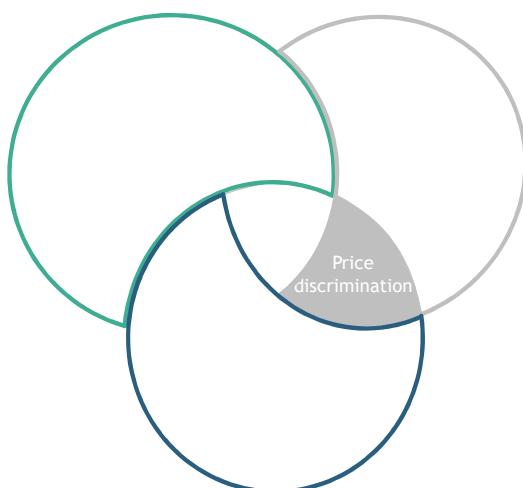


## Three Lenses of Pricing

Economics

Customers

Competitors

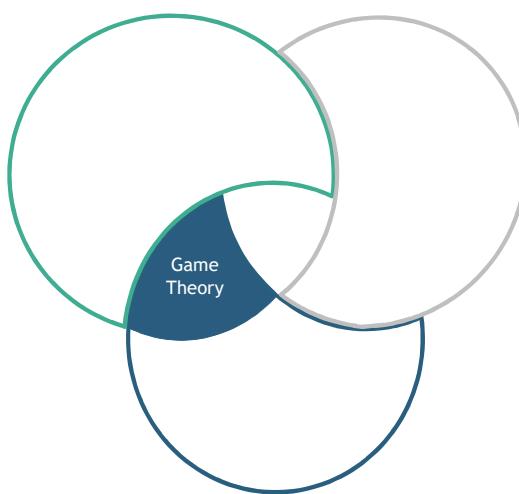


## Three Lenses of Pricing

Economics

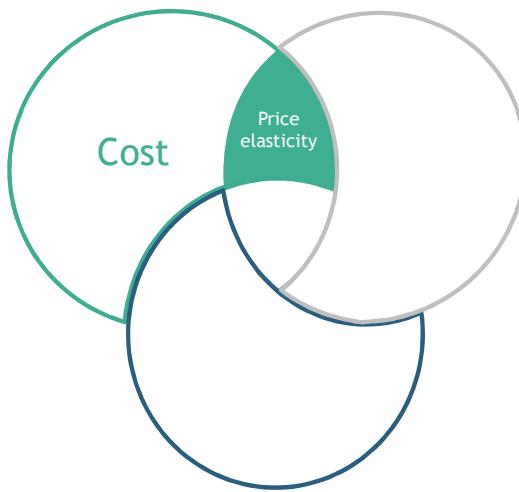
Customers

Competitors

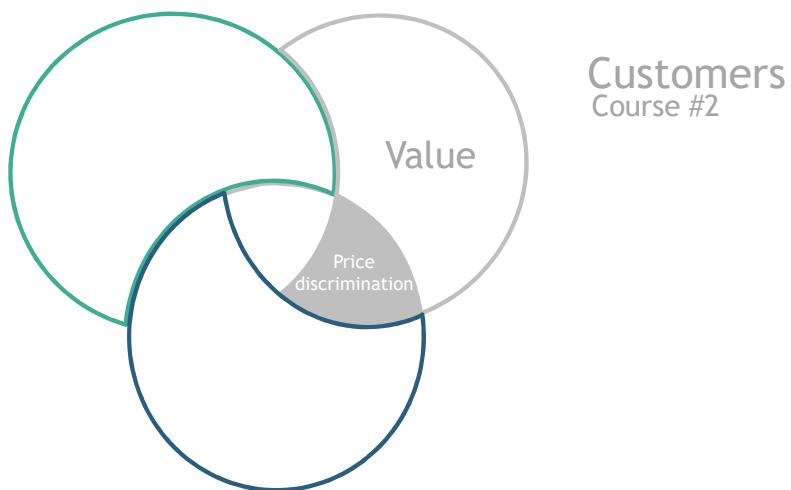


## Three Lenses of Pricing

Economics  
Course #1



## Three Lenses of Pricing

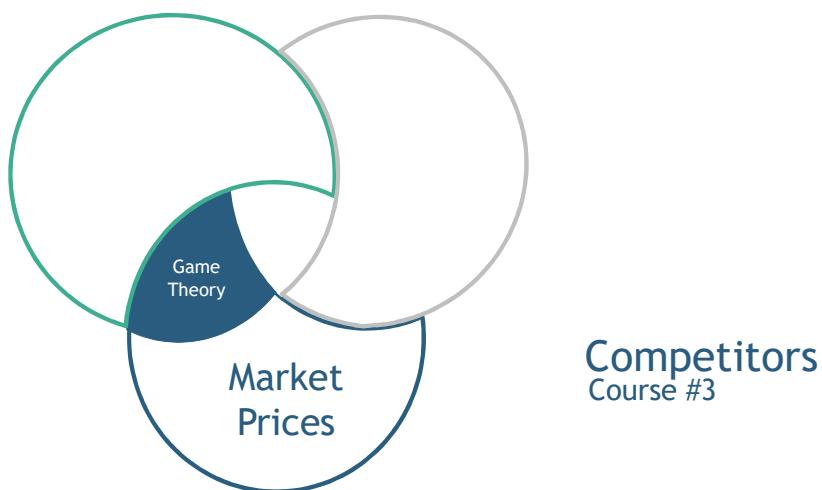


Customers  
Course #2

Value

Price  
discrimination

## Three Lenses of Pricing



Competitors  
Course #3

Market  
Prices

Game  
Theory

## Three lenses of pricing

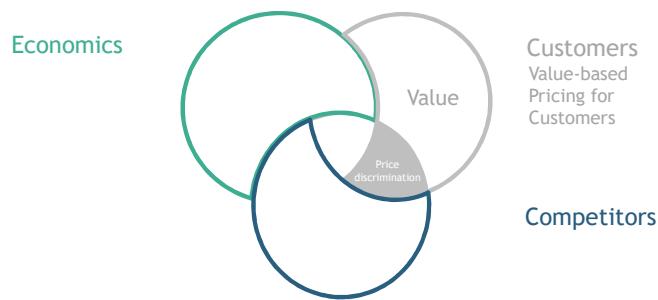


### Pricing strategy optimization

Course # 4 explains how these lenses intersect and work together to determine an optimal pricing strategy

## Week 1 Course & Module Introduction

## Three Lenses of Pricing



### Value-based Pricing for Customers

CONSUMER DECISION PROCESSES,  
PURCHASE PATHWAYS, AND  
WILLINGNESS TO PAY

VALUE-BASED PRICING AND VALUE  
DRIVERS

MEASURING CUSTOMER PREFERENCES  
(RATIONAL UTILITY MODEL)

THE HUMAN NATURE OF CUSTOMERS  
(CONSUMER PRICE PERCEPTIONS)

## By the end of this course you'll be able to...

APPLY KNOWLEDGE OF CUSTOMER VALUE  
TO PRICE PRODUCTS

LEVERAGE CORE VALUE-BASED PRICING  
TECHNIQUES TO INFORM PRICING  
DECISIONS

MEASURE CUSTOMER WILLINGNESS TO PAY  
USING MODELS (SURVEYS, CONJOINT  
ANALYSIS)

EVALUATE AND ACCOUNT FOR THE IMPACT  
OF CONSUMER PSYCHOLOGY ON  
PERCEPTIONS OF PRICE

## In this module...

CONSUMER DECISION PROCESSES AND  
PURCHASE PATHWAYS

THE IMPACT OF PRICE ON CONSUMER  
DECISIONS AT EACH STAGE OF THE PROCESS

CUSTOMER VALUE AND VALUE DRIVERS

DIFFERENTIATING CUSTOMER VALUE BY  
CUSTOMER SEGMENT

CUSTOMER VALUE IN GLOBAL MARKETS

WILLINGNESS TO PAY AND DEMAND CURVES

By the end of this module  
you'll be able to...

DIFFERENTIATE BETWEEN LOW- AND  
HIGH-INVOLVEMENT DECISION  
PROCESSES

EVALUATE THE IMPACT OF PRICE ON  
CONSUMER DECISIONS AT EACH STAGE  
OF THE DECISION PROCESS AND SET  
PRICES ACCORDINGLY

DIFFERENTIATE CUSTOMER VALUE BY  
CUSTOMER SEGMENT

EVALUATE PRICING STRATEGIES IN  
GLOBAL MARKETS

Involvement

## Involvement

### LOW INVOLVEMENT

- Little time or mental energy expended

## Involvement

### LOW INVOLVEMENT

- Little time or mental energy expended



## Involvement

### LOW INVOLVEMENT

- Little time or mental energy expended



### HIGH INVOLVEMENT

- Complex mental process

## Involvement

### LOW INVOLVEMENT

- Little time or mental energy expended



### HIGH INVOLVEMENT

- Complex mental process



## Consumption Visibility

## Consumption Visibility

### INCONSPICUOUS

- People don't see you consume or don't pay attention

## Consumption Visibility

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## Consumption Visibility

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### CONSPICUOUS

- Consumption is public

## Consumption Visibility

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- People don't see you consume or don't pay attention



### CONSPICUOUS

- Consumption is public



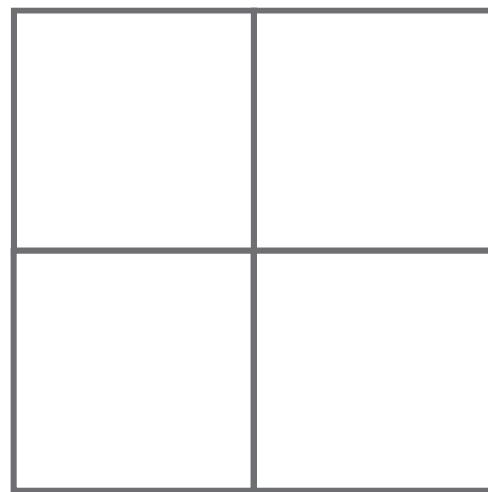
### INVOLVEMENT

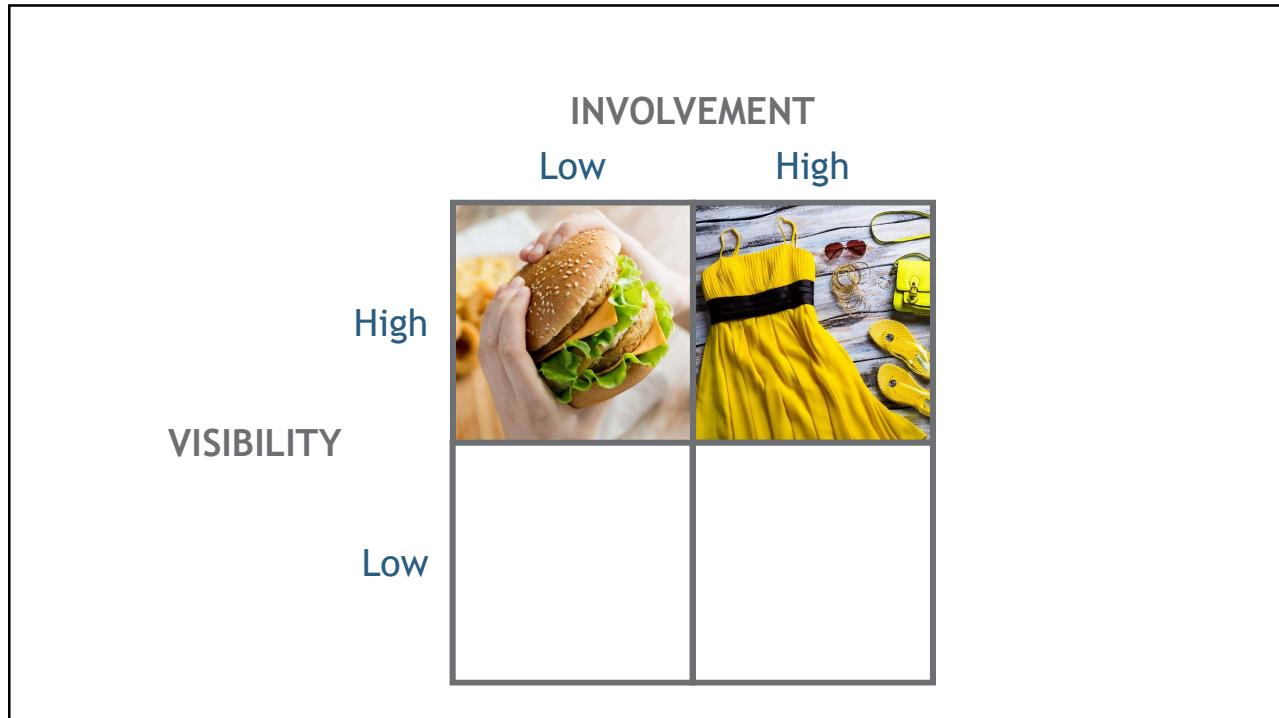
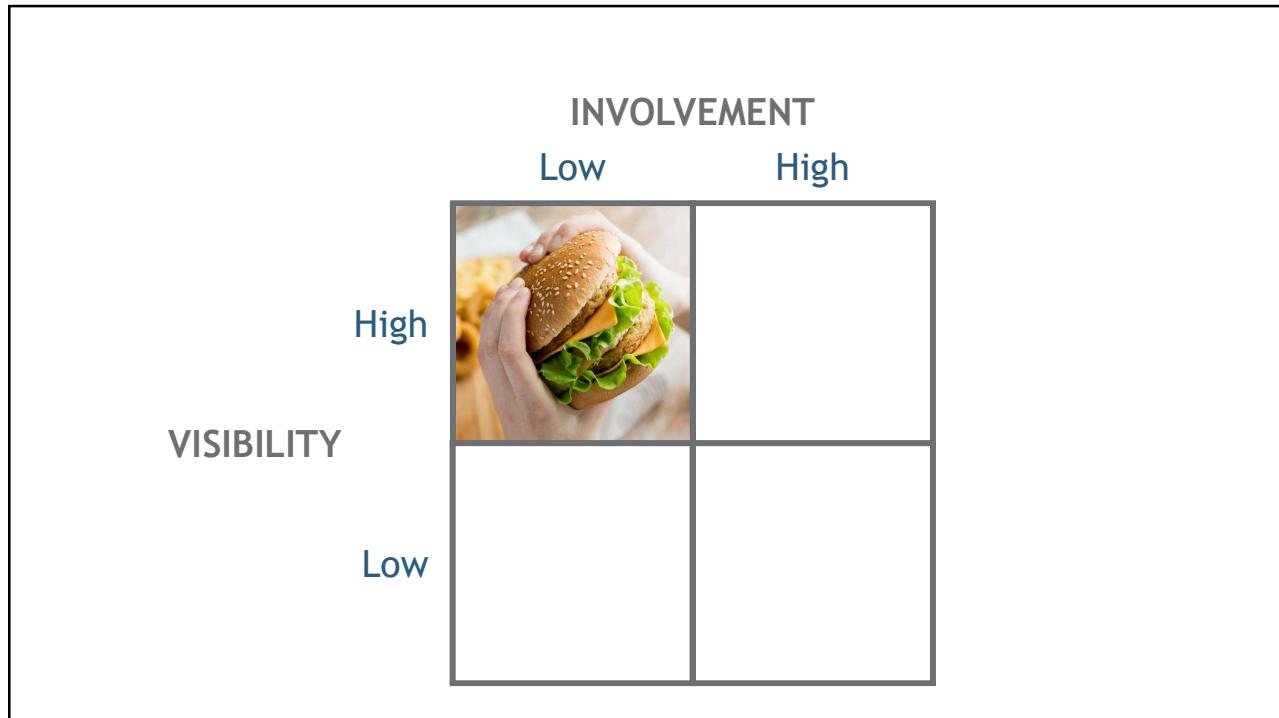
Low                    High

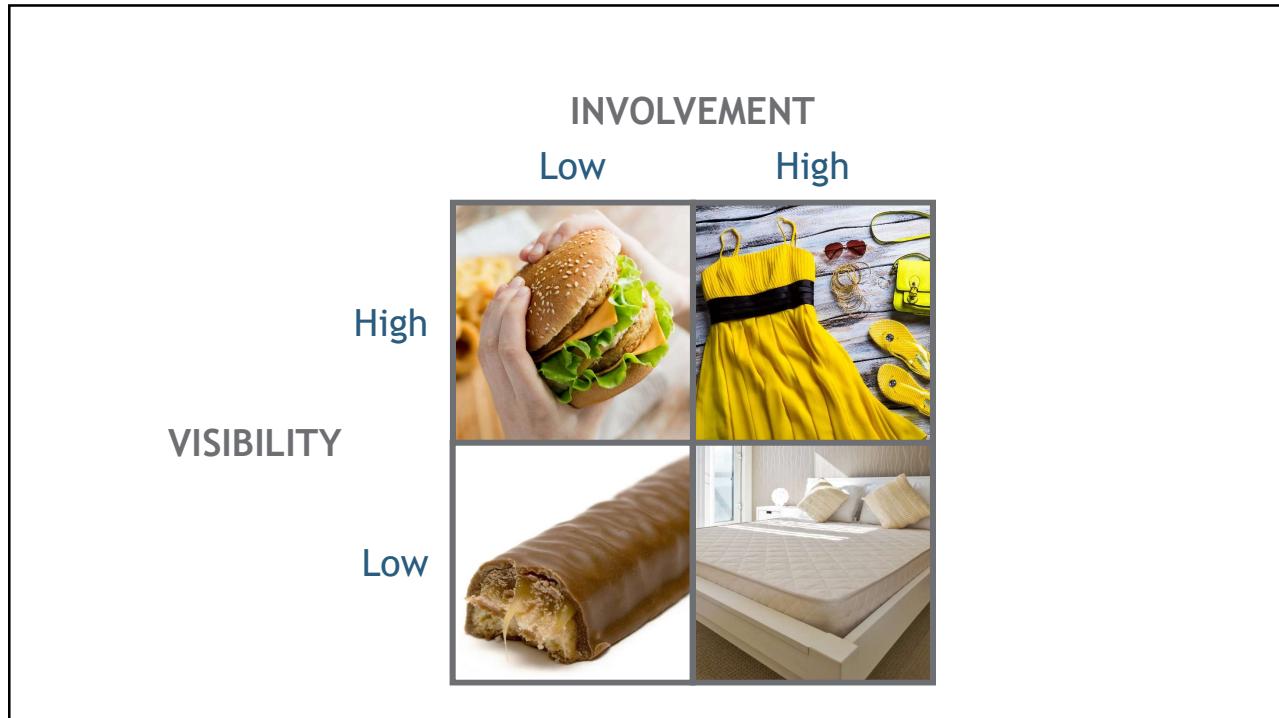
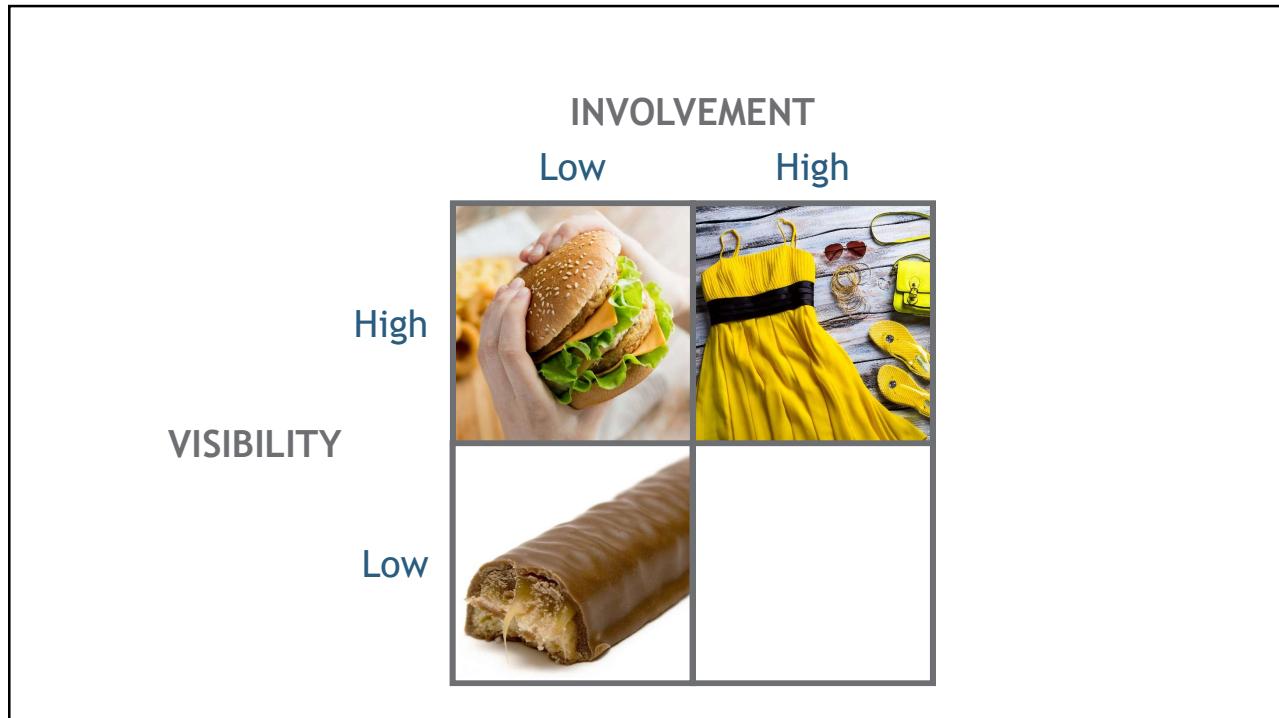
High

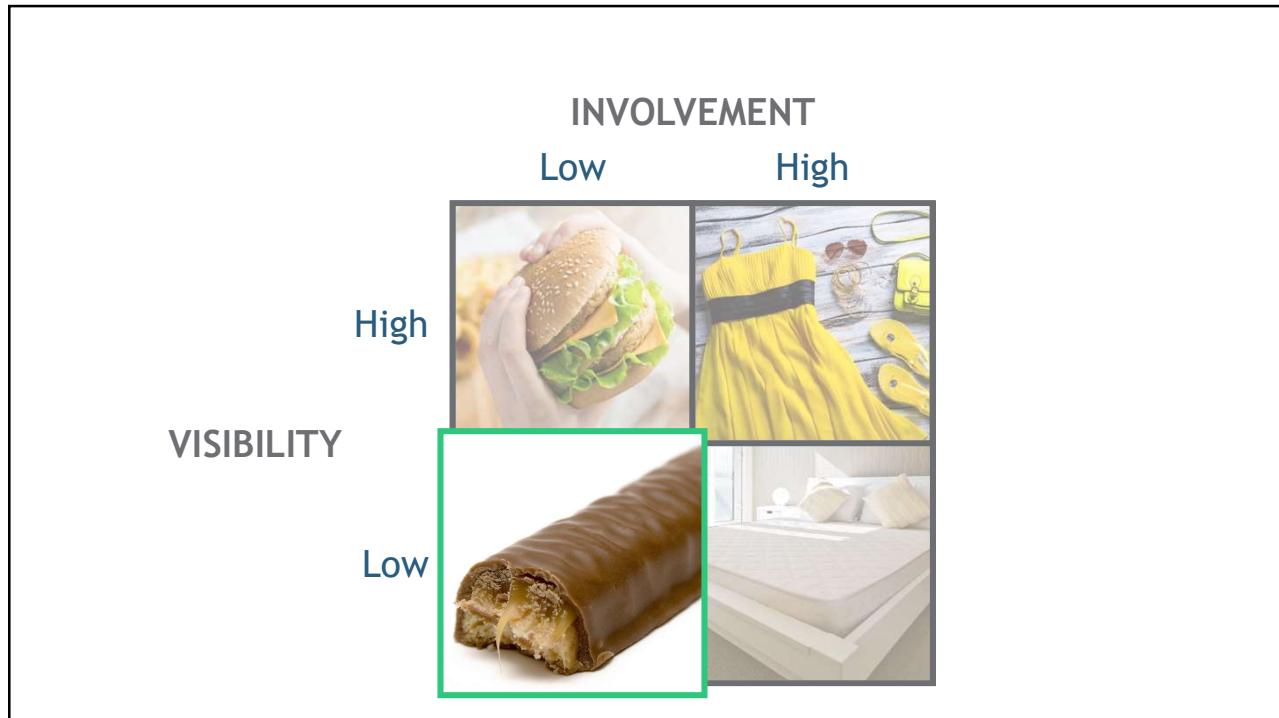
VISIBILITY

Low





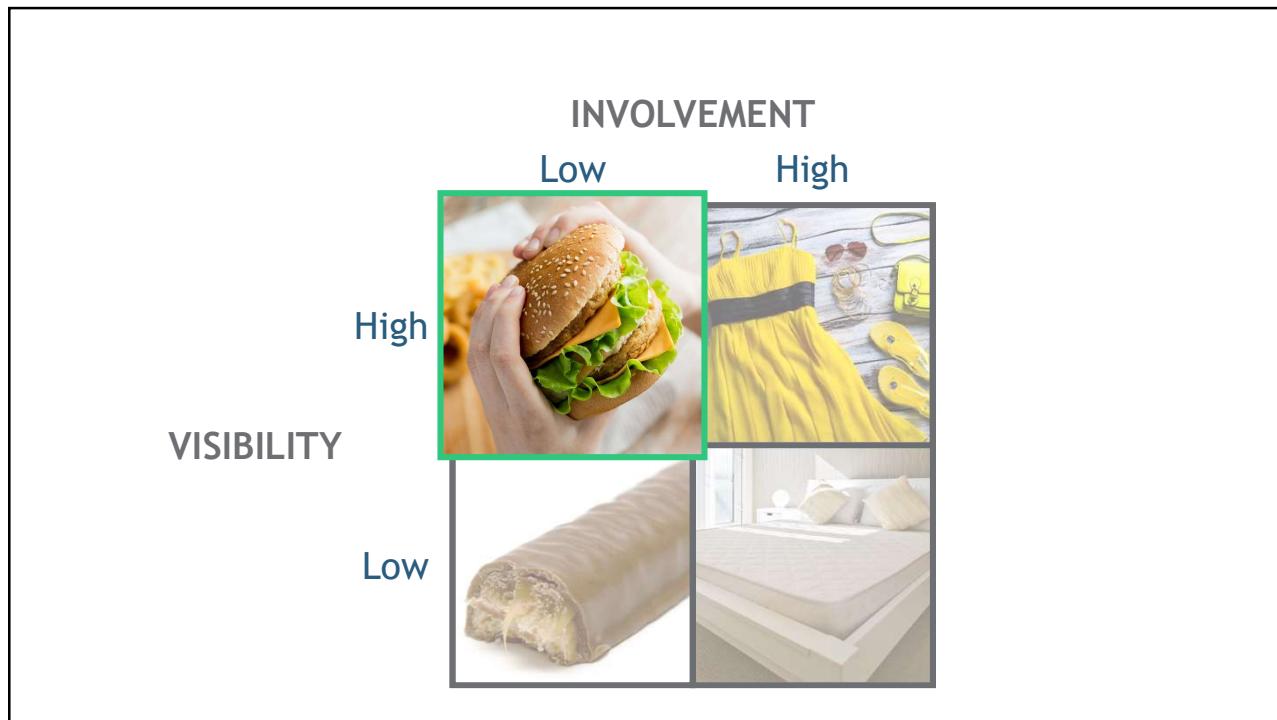




## Low Involvement, Low Visibility

- Price thresholds
- Price insensitive below threshold
- Price takes a back seat to convenience

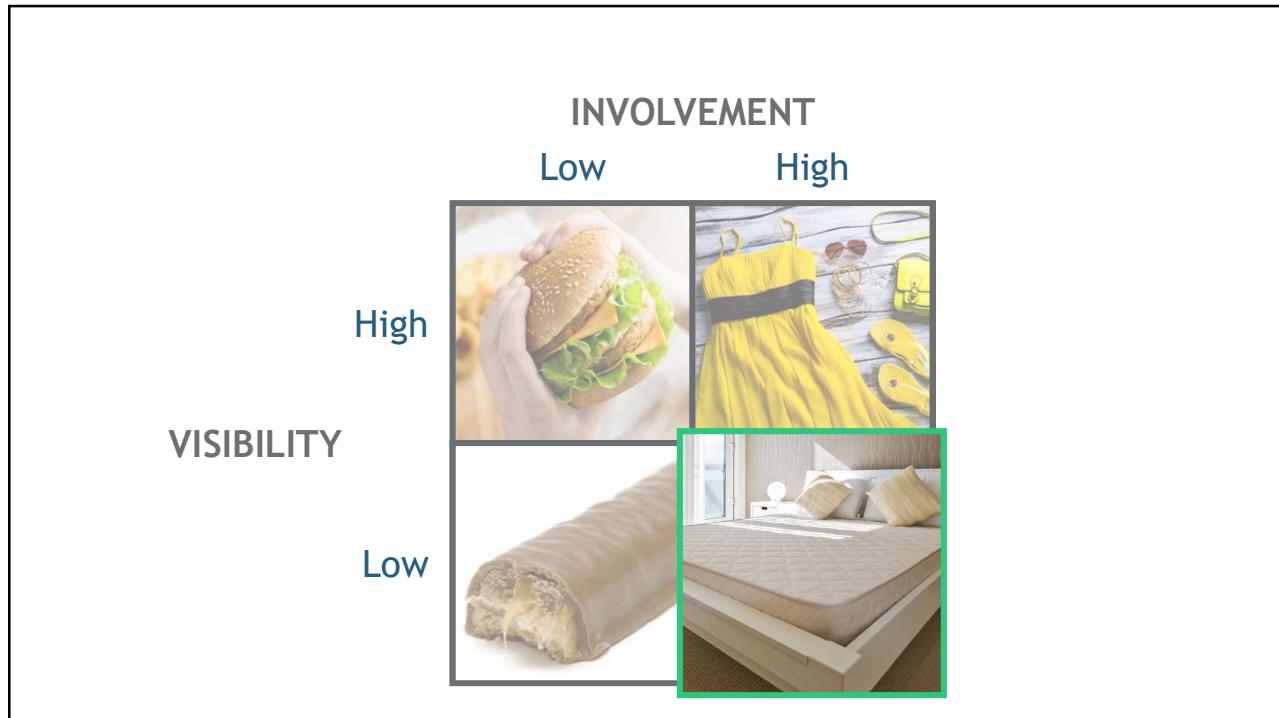




## Low Involvement, High Visibility

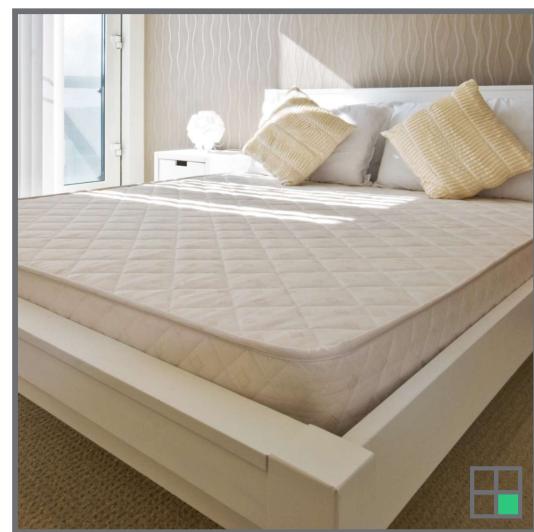
- Price thresholds
- Price important for repeat purchases
- Deal seeking

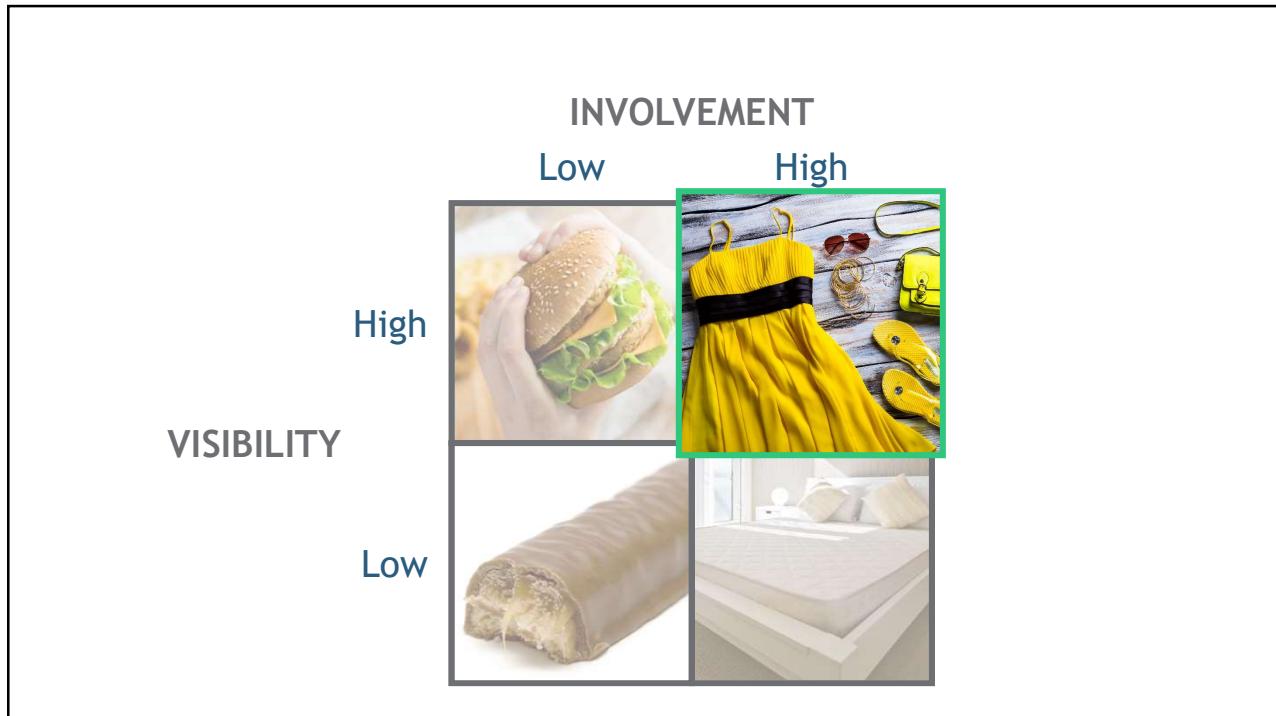




## High Involvement, Low Visibility

- Price impacts consideration set
- Price weighed against other attributes
- Extensive price search possible





## High Involvement, High Visibility

- Price impacts consideration set
- Extensive price search
- Price may become part of the consumption value



## Price and Process

- The more involved the buying process, the longer the buyer will consider price
  - Pay attention to price search
    - *Search Engine Optimization (SEO)*
    - *Advertise price*
  - Consider “Mental Accounting” type deals
  - May need a product line
    - *Customers are trading off attributes and price*
    - *Different customers make different trade-offs*

## Price and Process

- The more visible the consumption, the more likely it is that price is part of the intrinsic value of the object
  - High prices - or low prices - may be consistent with buyers' self-image
  - Sam Walton and his pick-up truck

## Price and Process

- The more visible the consumption, the more likely it is that price is part of the intrinsic value of the object
  - High prices - or low prices - may be consistent with buyers' self-image
  - Sam Walton and his pick-up truck
  - Veblen goods: money-burning

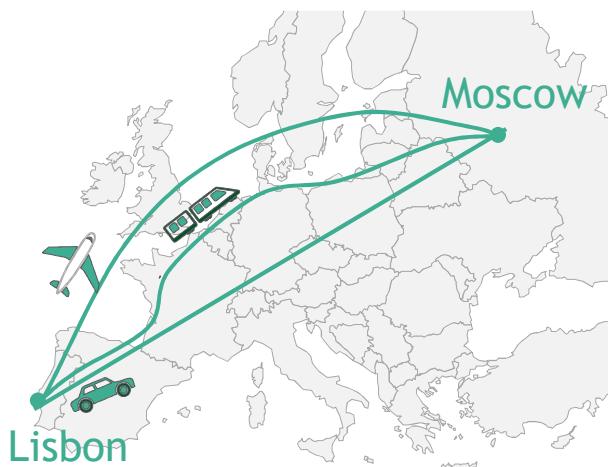


#3

## Differentiating Customer Value by Customer Segment

(Thomas)

## What is customer value?



## What is customer value?

### Customer value equation

$$\text{Customer value} = \sum_{\text{all } i}^{\text{Sum of}} \text{Value-drivers}_i$$

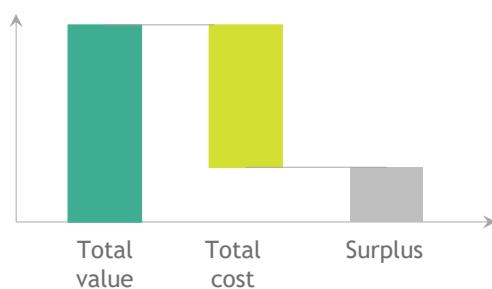
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Customer value = Value of next best alternative + Net value of differences to next best alternative

## Customer surplus

### Related concept

Customer surplus  $\equiv$  Customer value - Cost for customer



## Value-drivers

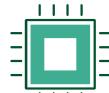
### Customer value equation

$$\text{Customer value} \equiv \sum_{\text{all } i} \text{Value-drivers}_i$$

- Technical ... stuff, performance
- Functional ... experiences
- Emotional ... satisfaction



## Technical value drivers



### Technical

Product features that provide technical benefits.  
Connect to functional and emotional benefits

Product value drivers	<ul style="list-style-type: none"><li>• Speed</li><li>• Space</li></ul>
Non-product value drivers	<ul style="list-style-type: none"><li>• WiFi access</li><li>• Meals</li><li>• Cancellation policy</li></ul>



## Functional value drivers



### Functional

How the customer **experiences product** during purchase, set-up, usage

Product value drivers	<ul style="list-style-type: none"><li>• Ease of booking</li><li>• Convenience during trip</li></ul>
Non-product value drivers	<ul style="list-style-type: none"><li>• Customer service</li><li>• Value-added services</li></ul>



## Emotional value drivers



### Emotional

How the customer **feels** about product based on his brand perception, its reputation, and their personal experience

Product value drivers	<ul style="list-style-type: none"><li>• Brand</li><li>• Prestige</li></ul>
Non-product value drivers	<ul style="list-style-type: none"><li>• Courtesy of staff</li><li>• Trust</li></ul>



## Customer value varies

### Customer value equation

$$\text{Customer value} = \sum_{\text{all } i} \text{Value-drivers}_i$$

### Varies by customer depending on

- Needs, wants, fears
- Willingness / ability to pay
- Context of purchase



## Why do customers value the "same" service so differently?



Cover model  
photo shoot



World famous  
hair stylist

\$\$\$



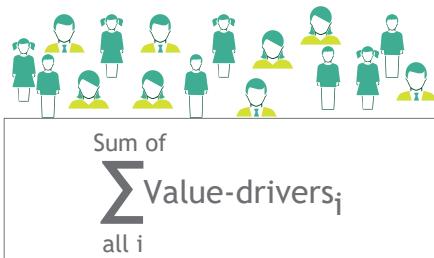
Monthly, routine  
men's haircut



Neighborhood  
barber

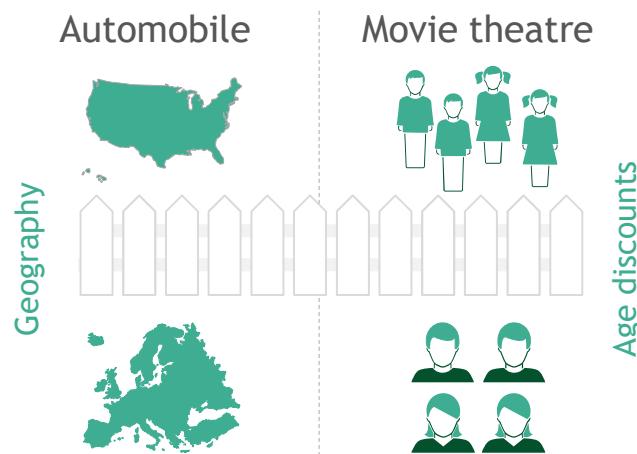
\$

## Group customers into segments with similar value drivers



- Address similar needs and wants
- Price in line with willingness to pay
- Market and sell effectively

## Use price fences to differentiate price by customer segment



## What makes effective price fences?

Fence	Industry	Mechanism
Product feature	Airlines	Class restrictions (Advance purchase, Saturday night stay)
Geography	Automobiles	List prices by country
Customer characteristic	Movie theaters	Age discounts (children / senior citizens)

## Two tactics to manage what customers pay



### Avoid

"trading down" by removing features critical to a segment



### Encourage

"trading up" by emphasizing incremental benefits and additional incentives

## Key steps for differentiating customer value segments

1

Understand the customer value your business provides

2

Articulate how the value drivers differ by customer segment

3

Differentiate your offering to maximize value for your target segment and price accordingly

#4

## Willingness-to-pay and Demand curves

(Thomas)

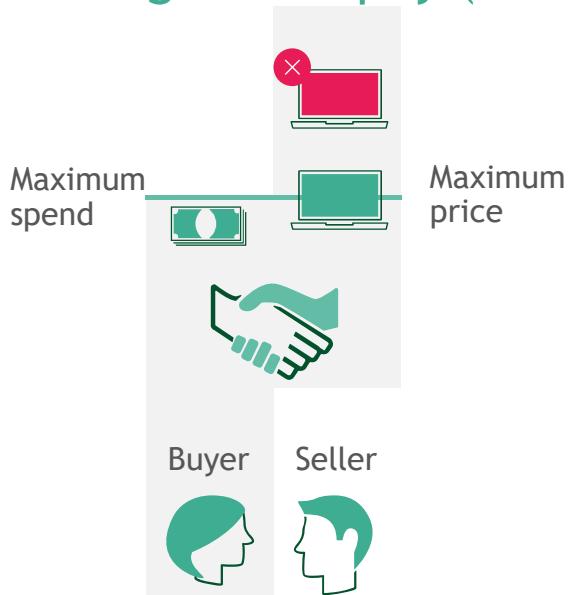
### Willingness to pay (WTP) Definition

The **maximum amount** of money a customer is **willing to pay** for a product or service

OR

The **price at or below** a customer **will buy** a product or service

## Willingness to pay (WTP)



## Willingness to pay (WTP)

- Customers **MUST BE** ready, willing and able to spend
- Customers with "hypothetical WTP"  
**DO NOT** count
- WTP is highly context sensitive, ties back to customer value equation



Measuring willingness to pay important,  
but difficult!

## Demand curve - recap

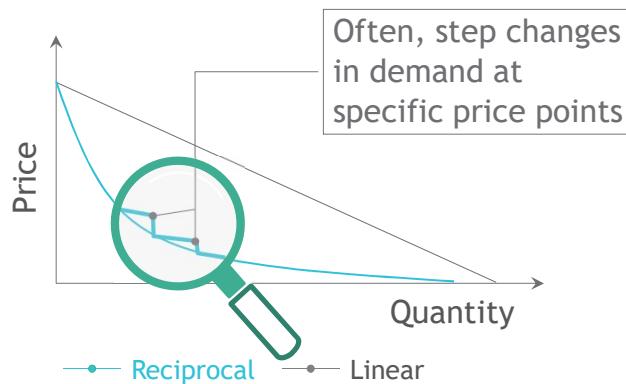
Plot of quantity along WTP for an individual, segment, and market



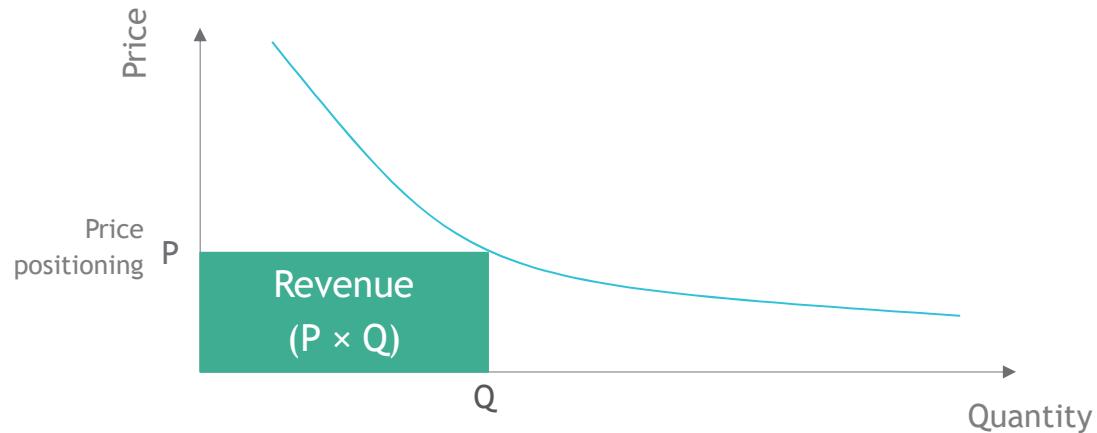
Law of demand:

Demand goes up when prices go down

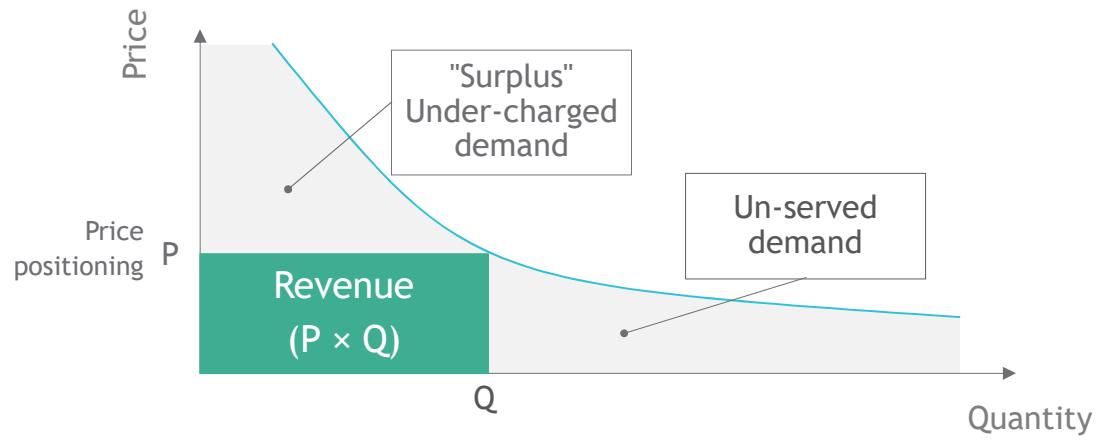
## Demand curve - shapes



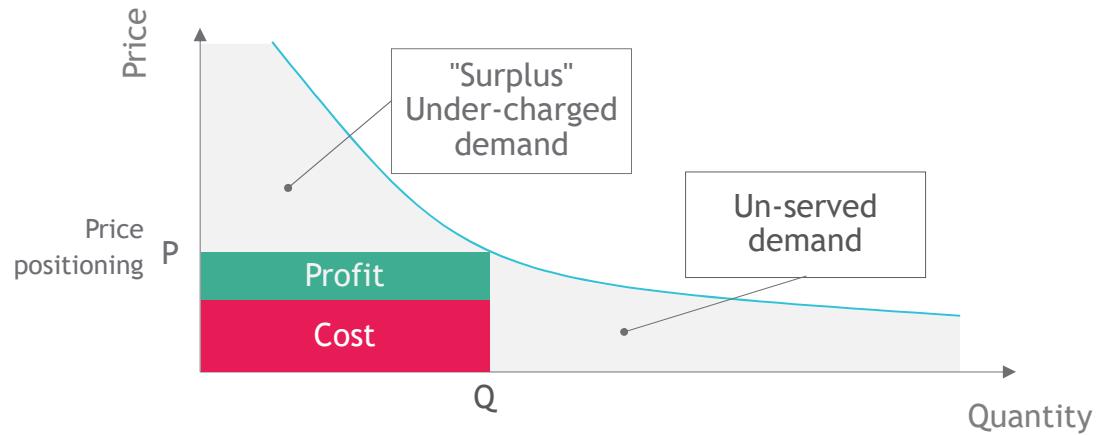
## Show me the money!



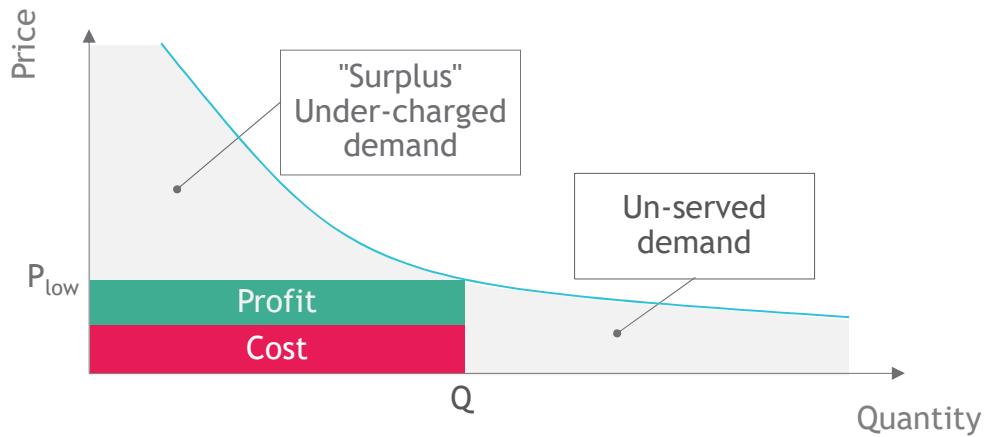
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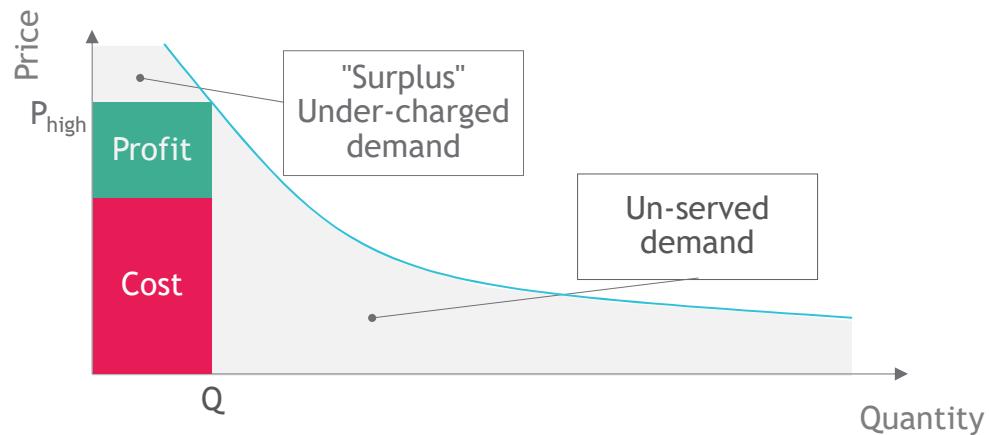
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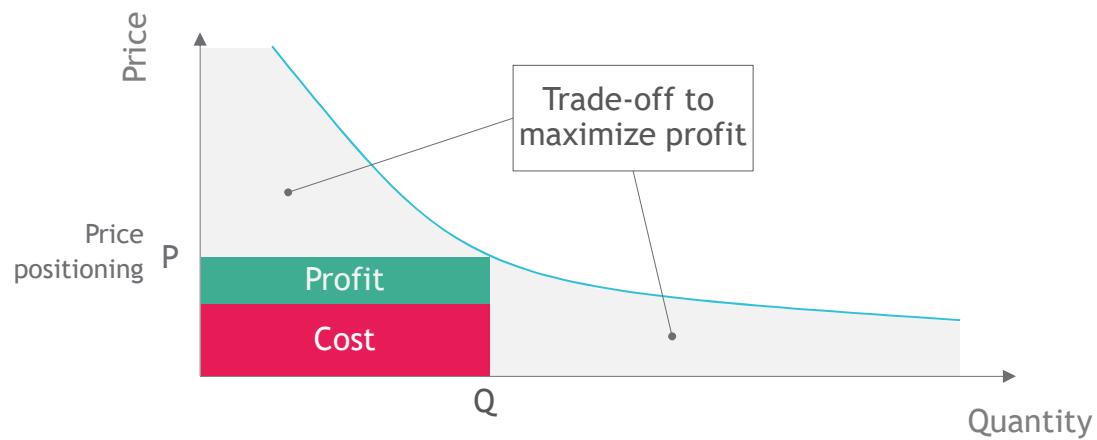
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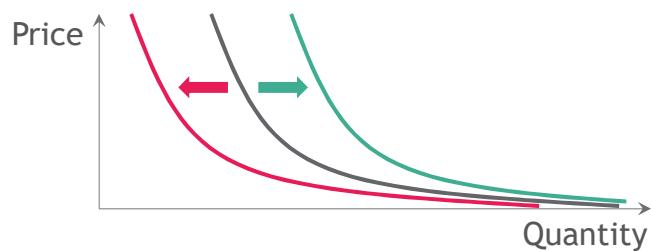
## Show me the money!



## Show me the money!



## Non-price demand drivers

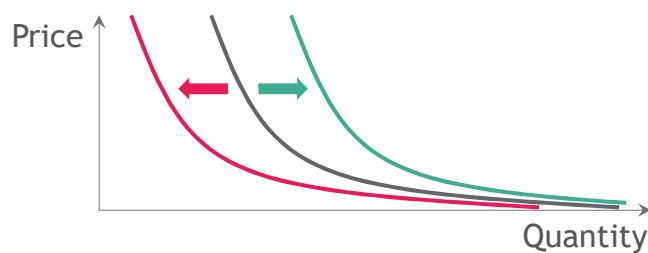


Non-price  
demand drivers

Shift to left

Shift to right

## Non-price demand drivers



Non-price  
demand drivers

Shift to left

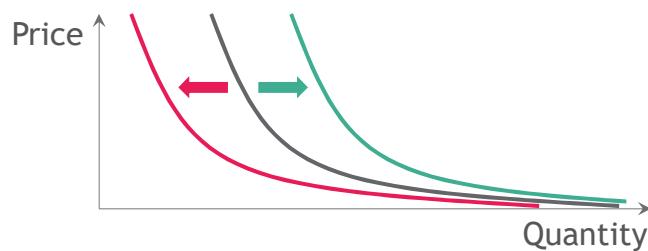
Shift to right

Purchasing power/income

Lower

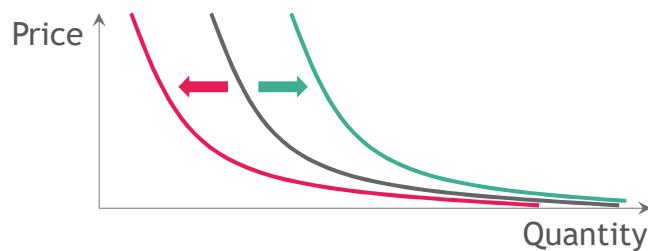
Higher

## Non-price demand drivers



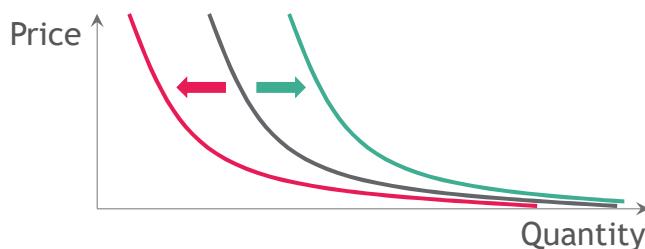
Non-price demand drivers		Shift to left	Shift to right
Purchasing power/income	Lower		
Market population	Shrinking		Growing

## Non-price demand drivers



Non-price demand drivers		Shift to left	Shift to right
Purchasing power/income	Lower		Higher
Market population	Shrinking		Growing
Substitutes priced...	Lower		Higher

## Non-price demand drivers



Non-price demand drivers	Shift to left	Shift to right
Purchasing power/income	Lower	Higher
Market population	Shrinking	Growing
Substitutes priced...	Lower	Higher
Complements priced...	Higher	Lower

## Demand curve - tips



Be aware when working with demand curves!

- Demand curves do not account for non-price determinant demand drivers
- Demand curves can change (over time but also quite quickly)
- Rarely linear



Still, a very important and useful concept!

## Questions I think about for all client cases

- What is the **most and the least a segment is** willing to pay?
- How might **WTP change** if a client's product was positioned differently?
- **What shape** does the demand curve most likely have?
- At **what price points** should clients expect step-changes in demand?
- Is the client making the **optimal trade-off** between under-charged and un-served demand?

## Customer Value Across Global Markets

## By the end of these videos, you'll be able to...

- Describe the “bottom of the pyramid” and the potential risks and advantages of this market
- Evaluate pricing strategies in global markets
- Contrast two approaches to pricing in developing economies

## The Income Inequality Pyramid



Source: 2011 Pew Report; [http://www.pewglobal.org/files/2015/08/Global-Middle-Class-Report\\_8-12-15-final.pdf](http://www.pewglobal.org/files/2015/08/Global-Middle-Class-Report_8-12-15-final.pdf)

## Moving into Global Markets: The Challenge

- Is it possible to charge a higher price in developing markets?
- Is it possible to extract value from the bottom of the world market?

## Risks at the Bottom of the Pyramid



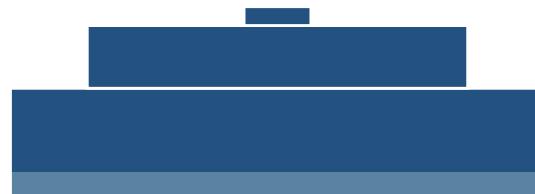
## Risks at the Bottom of the Pyramid

- Exploitation



## Risks at the Bottom of the Pyramid

- Exploitation
- Brand



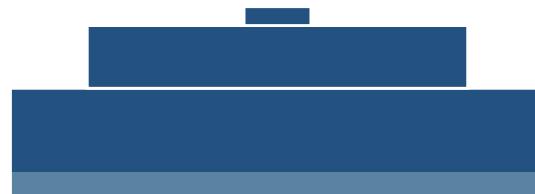
## Risks at the Bottom of the Pyramid

- Exploitation
- Brand
- Cannibalization



## Risks at the Bottom of the Pyramid

- Exploitation
- Brand
- Cannibalization
- Local competitive reactions



## Is the bottom of the pyramid really for you?

- Can you manage high volume of low-value transactions?
  - Are production and distribution systems suitable?

## Is the bottom of the pyramid really for you?

- Can you manage high volume of low-value transactions?
  - Are production and distribution systems suitable?
- Can you work with informal markets?



Photo by Dennis Jarvis (Flickr)

## Is the bottom of the pyramid really for you?

- Can you manage high volume of low-value transactions?
  - Are production and distribution systems suitable?
- Can you work with informal markets?
- Can you keep out legacy and overhead costs?

## Is the bottom of the pyramid really for you?

- Can you manage high volume of low-value transactions?
  - Are production and distribution systems suitable?
- Can you work with informal markets?
- Can you keep out legacy and overhead costs?
- Do your leaders have a long-range mindset?

## Two Firms, Two Approaches

LOW PRICE



Photo by Karoly Lorentey (Flickr)

VALUE PRICE



Photo by Sean Blehle (Flickr)

## The Story of Tata & the Nano

## India

- Emerging economy
- Growing middle class
- Large population “at the bottom of the pyramid”
  - \$6,200 (2015) per capita average annual income



## India's Automobile Market: 2004

- One of the largest, fastest-growing in the world
  - ~25% annual growth
  - ~12% growth in exports annually
    - Exporting 300,000+ cars
- Out of reach for many
  - \$2,910 average cost
  - Higher variable costs (fuel, maintenance, parts)

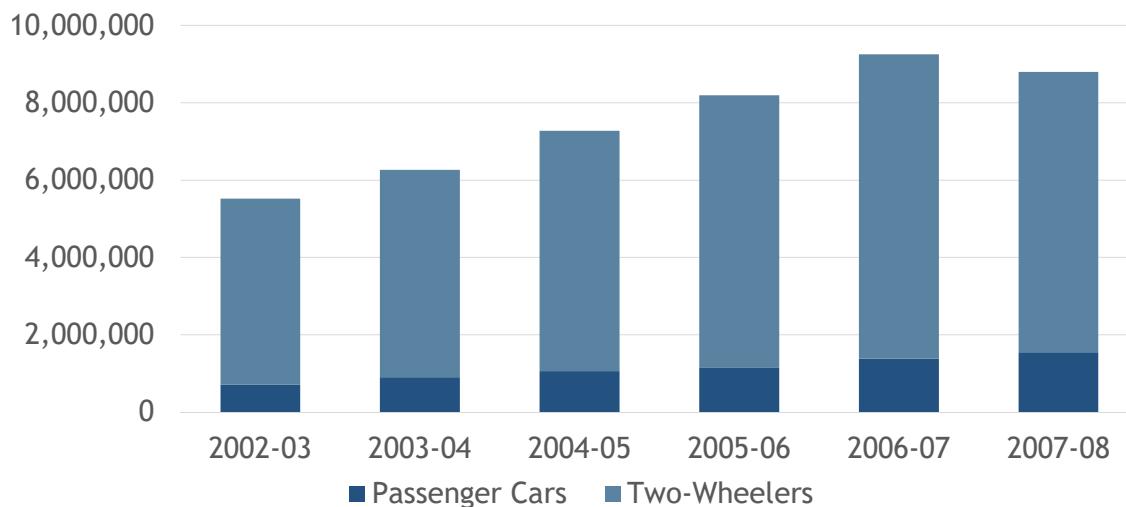
## India's Two & Three-Wheeler Market



## India's Two & Three-Wheeler Market: 2004

- Second largest in the world
  - Exporting 1,000,000/year
  - Selling close to 8,000,000/year!
- Attractive for many reasons
  - Average cost: \$552
  - Lower variable costs (fuel, maintenance, parts)

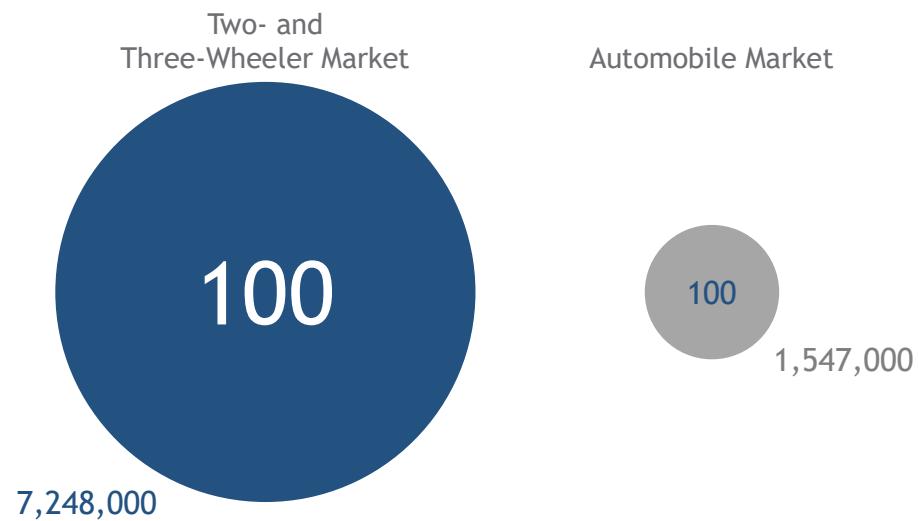
## Sales Trends of Automobiles and Motorbikes



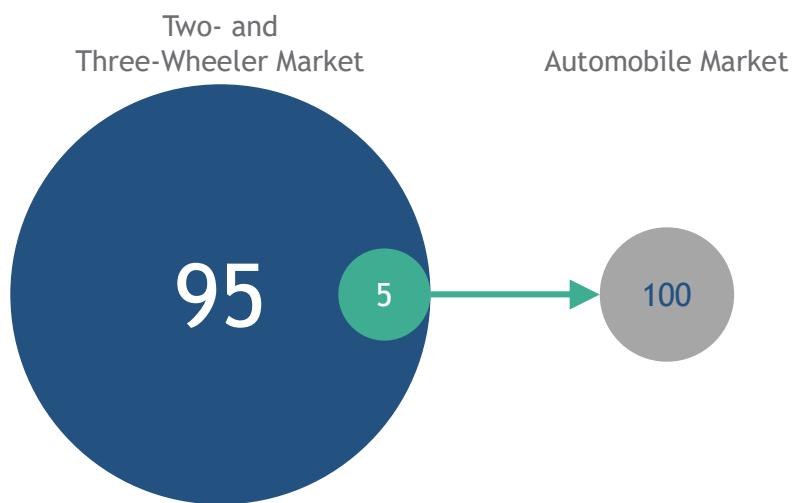
## Tata Motors: Up for the challenge?

- 6<sup>th</sup> largest automobile company in the world
- First Indian manufacturing company to be listed on the New York Stock Exchange
- Acquired premium brands: Land Rover & Jaguar
- Focused on economy cars: Indica, Indigo, Ace
- Major exporter of economy cars to Asia and Africa

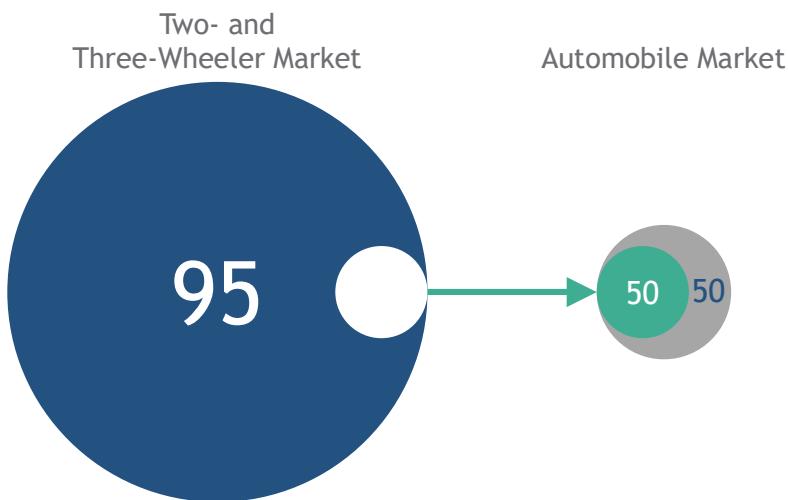
## Tata sees an opportunity!



## Tata sees an opportunity!



## Tata sees an opportunity!



## The Idea for a Super Economy Car

- Set price at \$2,500
- Forego features
  - AC, Power Steering, Power Windows, Tachometer, Dual Windshield Wipers
- Streamline design
  - Modular components produced at different sites for local manufacture
  - Components serve more than one function

## Designer Girish Wagh: The whizkid who shaped Tata Nano

▪ The Economic Times, 2008 Jan 12

## Wah, Wagh! How Team Tata cut the costs

▪ The Telegraph (Calcutta), 2008 Jan 10

## Micro car for the masses

▪ Sydney Morning Herald, 2008 Jan 10

## The result? The Tata Nano!

The “World’s  
Cheapest Car”



Photo by High Contrast (Wikimedia Commons)

## So, what happened?

- Couldn't quite hit the target price point
- Mismatched advertising (online, flashy showrooms) and their audience (markets, shops, bazaars)
- Sales were less than stellar
  - Launched in Myanmar, Sri Lanka, and Nepal with similar results
  - As of Jan 2015, sales limited to ~1,300 units/month

## Big Ah-Ha

- Cars project wealth and upward mobility
- Consumers did not want to be associated with purchasing the “World's Cheapest Car”

## Takeaways from Tata's Experience with the Nano

- Low price point innovation is only the beginning
- Go-to-Market has its own challenges
  - Perception of cheap vs aspiration
  - Support systems - financing, dealers, maintenance
- Need to innovate on all four pillars of the marketing mix (product, price, place, promotion)

## The Story of Unilever and Ala Laundry Detergent

## Brazil: Economy Varies by Region

### Brazil: Economy Varies by Region

- Northeast:
  - Large population “at the bottom of the pyramid”



## Brazil: Economy Varies by Region

- Northeast:
  - Large population “at the bottom of the pyramid”
- South:
  - Growing middle class
  - Established wealthy population



## Same Task, Different Approaches

## Same Task, Different Approaches

WEALTHY AREAS



## Same Task, Different Approaches

WEALTHY AREAS



POOR AREAS



## Different Segments, Different Priorities

### Wealthy

Whitening	✓
Fragrance/Suds	
Stain Removal	✓
Ability to Dissolve	✓
Packaging	
Color-Safeness	✓
Price	✓

## Different Segments, Different Priorities

### Wealthy | Poor

Whitening	✓	✓
Fragrance/Suds		✓
Stain Removal	✓	
Ability to Dissolve	✓	
Packaging		✓
Color-Safeness	✓	
Price	✓	✓

## Unilever's Existing Product Line

- Designed for use in washing machines
  - Large packaging
  - Effective stain removal
- Competes at the higher end of northeastern Brazil market with its Omo brand

## Unilever sees an opportunity!

- Change the formula
- Eliminate ingredients that add nothing for hand-washing or the target consumer
- Improve whitening power and perfume
- Lower the price and gain market share from competition more than from Omo

## Unilever sees an opportunity!

- Create a simple name

# ALA

## Unilever sees an opportunity!

- Create a simple name
- Package for usage style
  - Cheap plastic bags that protect from humidity
  - Orange to draw attention and for fade resistance
  - Small size



## Unilever sees an opportunity!

- Create a simple name
- Package for usage style
  - Cheap plastic bags that protect from humidity
  - Orange to draw attention and for fade resistance
  - Small size



## Unilever sees an opportunity!

- Create a simple name
- Package for usage style
  - Cheap plastic bags that protect from humidity
  - Orange to draw attention and for fade resistance
- Priced to fit budget
  - Small package size



## Unilever sees an opportunity!



## Unilever sees an opportunity!



## Unilever sees an opportunity!



## So, what happened?

- Ala market share grew to almost 20% in 12 years
  - Market expanded to South Eastern Brazil
- Omo's share of the market declined by 11%

## Conclusion

Is it possible to extract value from the bottom of the world market?

## Conclusion

Is it possible to extract value from the bottom of the world market?



YES!

## Takeaways from Unilever's Experience with Ala

- Position products as especially made to meet the needs of the low income consumers.
- Avoid the common mistake of assuming low income consumers mean cheaper products.

## Conclusion

## Two Firms, Two Approaches

LOW PRICE



Photo by Karoly Lorentey (Flickr)

VALUE PRICE



Photo by Sean Blehle (Flickr)

## Pricing Strategies

- Targeting lower income consumers does not necessarily imply a low price strategy
- Provide value
  - Identify unique needs and provide customized products, in sizes and packaging that work for consumers at the bottom of the pyramid
  - Develop a comprehensive marketing strategy that is consistent with the product value proposition

## Understanding Customer Value Takeaways

### Now you can...

- Differentiate between low- and high-involvement decision processes
- Evaluate the impact of price on consumer decisions at each stage of the decision process and set prices accordingly
- Differentiate customer value by customer segment
- Evaluate pricing strategies in global markets