Weird science

Do your products and services have the right price level and structure? Have you presented your offer in the right way? This Insight discusses how controlled pricing experiments can help answer these questions and help increase sales and profits.

Choices, choices

The level, structure and presentation of the prices for consumer products and services tend to be decided in one of three ways.

- ***The punt method.*** About 1 in 10 companies use this method. It is most frequently used when there is not a similar product or service available in the market; and so there is little to go on. Intuition and rules-of-thumb based, perhaps, on typical mark-ups over cost, are the order of the day. The pricing strategy is, inevitably, a bit trial-and-error or iterative in its nature.

- ***The educated guess method.*** About 7 in 10 companies use this method, which is by far the most common. There is something to go on. A similar product or service sold in the past, or in a related market, provides a guide to what the right pricing strategy is likely to be. Often seen in relation to consumer products such as music and book publishing, consumer electronics and FMCG.

- ***The scientific (or 'weird science') method.*** About 2 in 10 companies use this method. It involves making like-for-like comparisons between products and services to understand how different pricing strategies affect sales and profits. It is the commercial equivalent of a clinical trial, where a treatment group (taking a pill) is compared to a control group (taking a placebo).

The weird science method comes in the three flavours illustrated in the following figure.

Figure 1: Flavours of weird science

Each of the three approaches to pricing strategy have their own pros and cons. The punt method is undoubtedly the least cost way and, in some cases, may be the only method available. But, of course, it carries the highest risk of being commercially unsatisfactory and being open to shareholder and stakeholder challenge. The educated guess method is likely to be about right 80 out of 100 times, and pricing strategies that do not chime with the educated guess method (also known as failing the sniff test) are unlikely to get much traction, even if they are based on the weird science method (which we rather like, see below).

The remainder of this note explores the weird science method further, and sets out how it can be used alongside the punt and educated guess approaches to make better pricing strategy decisions.

Experimentation

The main advantage of the weird science method is that it provides a robust basis for making pricing strategy decisions. It won't be right all of the time; but on average it will beat the educated guess method for two reasons.

- First, this approach typically draws on a bigger and better information set than the other methods – this is not contentious (there is more debate regarding how one should use the various techniques associated with the approach efficiently and effectively, discussed below).

- Second, the process of designing and implementing the method encourages fresh thinking about the products and services they sell.[1] Our experience is that this benefit exists, but is rarely discussed or explicitly valued when considering pursuing weird science methods in a commercial environment (although, interestingly, it is one of the main reasons quoted for applying such techniques in a research context). Put simply, the method helps stimulate the natural curiosity in commercial teams, which can lead to 'why' and 'what if' questions that in turn need to be answered. The old rules-of-thumb, which may be inaccurate or outdated, or just plain wrong, get challenged. For example, accepted wisdom such as: *"we can't increase our prices because customers will switch to X..."* start to be questioned: *"but what if they have already switched? Aren't we then left with less price sensitive customers than before?"*

[1] *Perhaps this explains why 'geek' and 'nerd' is now a positive term? See http://www.bbc.co.uk/news/magazine-20325517.*

We like the weird science method for these reasons. But when is it used? Usually when only fact and information will help make a decision. For example, when:

- ***The other methods aren't working so well anymore.*** Your sales and profits are falling or your performance is not up to scratch compared to your rivals.
- ***It is tough to call between different options.*** You are not sure whether to go 'high' or go 'low'. You don't know whether to price at £19.50 or £19.99. Will offering a subscription service for e-books increase sales, or just cannibalise existing ones?
- ***Things are changing.*** The market you operate in is experiencing a major structural change. New technology might put you at a major competitive advantage or disadvantage.

The trick is in knowing how to use the method efficiently and effectively; and relatedly, determining what types of analysis (econometrics, surveys and trials) are best in different circumstances.

Picking a winner

In our experience, businesses get the best out of the weird science method when they follow the following tips.

"There are significant commercial benefits associated with using weird science for developing pricing strategies. Efficient and effective analysis, supported by a generous helping of commercial acumen, can help businesses gain competitive advantage."

- ***Tip 1: Start in the right place.*** Anchor the analyses to one or more commercial objectives, and precisely identify the commercial questions that need to be answered. This means that the method is targeted and cost-effective, not a general trawl that results in a large, but ultimately uninteresting, 'fact pack'.
- ***Tip 2: Use actual sales and profits data wherever possible.*** We think that econometrics supported by trials work best – that is, an approach which is informed by actual, rather than stated, consumer behaviour and then tested in the market of interest. It is simply less reliant on getting a consumer survey right. That said, there are situations where surveys supported by trials are valuable. For example, the product or service in question may be sufficiently different from those sold in the past or in other markets, to mean that there is simply no useful 'actual' consumer behaviour to look at.
- ***Tip 3: Forget the weird science for a moment.*** At the end of the process, you should put the lessons from the other methods, the punt and the educated guess, to good use. If the weird science method, which can appear more 'black box' than other approaches, generates an unexpected answer – challenge it. You should expect to receive a coherent set of reasons about why the answer makes sense. This exchange ensures that the full benefit of the work is realised.

Conclusion

There are significant commercial benefits associated with using weird science for developing pricing strategies. Efficient and effective analysis, supported by a generous helping of commercial acumen, can help businesses gain competitive advantage.

Economic Insight provides pricing strategy advice and analysis to leading organisations across a range of industries.

Further information

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