



Contextual Pricing: Moving Up the Learning Curve – Part 2 of 2

Establishing Price within a Menu of Goods or Services

Marketers know that many elements impact strategic pricing decisions. While the over-riding goal is clearly to price to be profitable, determining potential consumer response to alternative pricing strategies has proven to be one of the more challenging inputs to pricing decisions.

In this, the second part of our two-part mailing series on pricing approaches, we will delve into Component and Contextual Pricing. Both fall on the more sophisticated end of the pricing research spectrum and can help address the most complex questions facing your business. In our previous mailing we covered the simpler end of the spectrum with Monadic and Competitive Pricing (please contact us using the information provided if you'd like to receive that previous mailer).

Component Pricing

Suppose we are selling a car, computer, cellular service plan or complex medical device. We can offer 'plain Jane' versions to 'top of the line', fully-configured versions. Some customers want one, others want another. It does no good to understand how the 'plain Jane' buyers feel about pricing for the 'top of the line' offer. Here we need to adapt the interview to the customer's buying space.

We want to retain the robustness of competition and the power of individual-based choice modeling. But we also want them to build the product or service that fits their own consideration space and allow them to make pricing decisions within a context relevant to their own situation.

Adaptive Choice modeling accomplishes this goal. Without going into great detail here, the customer first 'builds his/her own' product or service from component parts. Then the program generates alternative products and services similar to the one that was designed, offering these at higher and lower prices under different brand names and varying components.

Here again, we can establish an individually-based pricing model in a simulator to depict alternative competitive scenarios.

Contextual Pricing

All of the scenarios posed thus far have assumed the purchase of a single product or service. Our marketplace is not always so straightforward. What if I am running a restaurant or I am a medical service provider?

The purchase decision is more complex. I need to choose the provider and decide what I will buy. If the menu is too costly, I will choose another restaurant. When I choose the restaurant I must decide what to order. If the drinks are too expensive I may only order an entrée. If the entrees are costly I may forego an appetizer. In other words, my willingness to pay for one item depends to some degree on the cost of the other items.

On the services side, a good example is an eye care facility. If the eye exam is relatively inexpensive I might pay more for the frames and lenses. If both are too costly I may look to another provider.

But ultimately, the decision likely lies in the cost of the total bill.

Now we have two measurements to take. First, let's work with the choice of provider. We have a 'menu of services', and the cost of the services can vary. We also have alternative providers – be they restaurants or eye care facilities. Using a robustly constructed Choice Modeling design, we present differently priced 'menus' under alternative providers. Here we have a great number of moving parts but a straightforward decision – who would you choose? This provides a measure of the 'traffic' or 'stopping power' of the offer.

Now we must attack the actual purchase. For this we will turn to the Adaptive approach under the principle that customers need to define their own purchasing space. First we let them select the items of interest to them. Then, under the 'build your own' portion they construct an 'order', and the program tallies the price. We then construct alternative orders for them from their 'acceptable' list of items while varying the total price of the order. Through their preferences for orders, we gain knowledge of their price sensitivities. Do they reject orders too costly for their budget? Are they willing to accept alternatives to their first choice as prices drop?

From this data, we build individual-level models to describe the price sensitivities. By manipulating these models, we can make strategic recommendations on both the individual components of the 'menu' as well as the overall price tier.

As we have shown in these two mailers, the options available to you are vast, are built with varying levels of complexity, and provide a great deal of flexibility for you as you wrestle with pricing. To learn more about these approaches and how they can best be applied to address your pricing research needs please visit us at www.datadw.com or call your contacts listed below.

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