Command a Price Premium for Profitable Growth

Everyone knows how to generate more sales—all you have to do is drop your price and sales are likely to increase. While price promotions can increase short-term sales volumes, the long-term consequences of training consumers to expect cheaper prices are dire—margins suffer and investing in advertising and innovation becomes harder and harder. Brands that rely on price promotions often enter a death spiral—failure to innovate and advertise leads to the use of more price promotion, more people are trained to expect discounts and margins continue to suffer, so the vicious cycle continues. Businesses and marketers alike must remember that smart brands can command a price premium and sustain margins.

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THE PERILS OF PRICE PROMOTION

Pursuing market share and volume sales to the detriment of maintaining margins and growing profits is a big mistake. In most cases, a one percent increase in price (provided volume remains constant) will have three times the profit impact of a one percent increase in volume sales. Why? Because all the benefit of the price increase drops to the bottom line, while the increase in volume sales demands an increase in production costs to satisfy that demand.

In a paper published by McKinsey titled *The Power of Pricing*, Marn, Roegner, and Zawada found that for the average S&P 1500 company, volume sales would need to rise by 18 percent in order to offset the profit impact of a five percent price decrease. They conclude that few product categories are that price-elastic, and we do not need to look far to find examples where every brand in a category has suffered by over-utilizing price promotion. Most price promotion has no positive, long-term effect on sales; marketers and businesses alike ignore this reality at their peril.

PRICE PREMIUM VERSUS VOLUME SALES

Premium is classically defined as the additional price that a brand could charge compared to an equivalent, generic product. A more pragmatic definition might be the price that a brand can command over its closest competitor, assuming that the two have similar product specifications.

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Our data demonstrates very clearly that there is a trade-off between commanding a price premium and volume sales. The higher a brand's price relative to the category average, the lower its market share is likely to be (a concave demand curve). However, if brand owners design their strategies solely around what drives volume while ignoring the perceptions that can defend a price premium, then they will inevitably struggle to justify higher price points, and even if the brand penetration grows, margins are likely to erode and profits suffer.

To justify a price premium, brands must go beyond core needs to show that they offer a meaningful difference—that they are unique or a step ahead of the competition. A brand must either aim to be the undisputed best in category, e.g. Gillette razors, or to appeal to a specific target audience better than other brands (which will likely mean it fails to appeal to everyone). This does not mean that the brand must be tangibly differentiated, but it must feel different enough that potential consumers will value it more than the alternatives. As in all things, perceptions matter when it comes to supporting a price premium; the brand needs to be perceived as different, even if its functional offering is similar to the competition.

COMMANDING A PRICE PREMIUM

Smart brands should maximize income stream at a price point that matches value perception without lowering margins, and marketers need to provide consumers with a ready justification for why they would pay more for the brand. The Three Cs—**challenge, credibility, and communication**—are instrumental in influencing people's perceptions of value and building and maintaining a price premium.

Challenge is important particularly if a brand is not able to command a price premium now but wishes to do so. In such cases, brands must break with the status quo using innovation, design, and positioning in order to challenge people's existing perceptions of what the brand stands for.

Once this is done and people believe the brand is worth paying more for, then it is important to keep building **credibility** around that positioning using continued innovation, retail stores, point of purchase, event marketing, and associations with celebrities and other brands.

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Integral to both challenge and credibility is the need to **communicate** what your brand effectively stands for. All marketing activity needs to be aligned to help the brand stand out from the competition and sustain premium perceptions.

Audi in the U.S. and Australian cheese brand Bega are recent examples of brands that utilized The Three Cs to establish and maintain a price premium.

AUDI: OUT WITH THE OLD

In 2007, Audi was often the bridesmaid but rarely the bride. Luxury car buyers would frequently consider Audi when they started shopping, but then drop the brand as they came closer to making a final purchase decision. As a result Mercedes, BMW, and Lexus were the staple choices and the dominant luxury brands in the USA.

If Audi was to improve its position, it needed to change people's perceptions.

The brand took a three-pronged approach:

1. Introducing new models of existing cars.
2. Launching the R8 as a flagship brand that would reflect well on the entire Audi line-up.
3. Framing the incumbent brands as "old luxury" and, in the process, demonstrating that Audi was a luxury brand on a par with the incumbents.

The launch ad for the R8 was a spoof on the horse head in the bed scene from *The Godfather,* underlining Audi's status as a new luxury brand out to challenge the old. New model introductions and the subsequent "shock the sheep" campaign helped Audi build and maintain credibility by undermining consumers' long-held perceptions of other luxury car brands. Not only was Audi challenging its competitors, it was beating them at their own games—in the categories of growth, *Car and Driver* comparison tests, value retention, and sales. Audi then employed dealer-funded TV and radio media to sustain communication and ensure continued momentum.

Independent evaluations of perceptions that the brand was worth paying more for increased from 2007 to 2011 among people who would consider Audi for purchase, and relative price perceptions remained relatively steady. As a result, market share improved by 69 percent, and Audi has enjoyed its best-ever sales in the USA.

BEGA: AN AUSSIE CHEESE ON A MISSION

When Kraft cheese entered the already-crowded Australian cheese market in 2009, prospects for the local cheese company Bega seemed grim. Bega was a mature brand in a commoditized category; in addition to competing with a new global

entrant, Bega faced rising commodity prices, retailer rationalization, and aggressive discounting across the category.

For Bega to stand a fighting chance, it could not compete on price, but the company could rely on those things that made it meaningfully different from Kraft. In their application for the 2011 Australian Effie awards, Bega marketers noted:

> *To win this war, we knew we had to shift the battle lines. We had to move it beyond discounting and make it about Bega – the brand, the place, the people. We had to let Aussie mums balancing the tight household budget into Bega, let them behind the scenes. We couldn't win the price game; we had to make the battle about "values."*

Bega launched the "Real Town. Real Cheese." ad campaign, which featured bucolic scenes from the beautiful town of Bega in New South Wales where their product—which was 100 percent cheese—was produced. They hoped the campaign would show that they were the local guys who made real food that was good for Australian consumers and their families. The response was immediate and enthusiastic; Bega became the first Australian cheese brand to have more than $200 million in annual sales.

Bega continued to build credibility with consumers by introducing "Real Farmers," unscripted video interviews with Bega farmers and their families, and they supported the community-oriented campaign further by making grants available for other communities in Australia. The emotional response that the campaign generated increased not only volume sales but also value share. Though Bega's competitors were still engaged in price wars, Bega increased sales by 3.7 percent in a year with no category growth and aggressive competition.

SMART BRANDS COMMAND A PRICE PREMIUM

People are still willing to pay a premium for brands that add value to their lives, but brands only retain their value as long as companies and marketers treat them as valuable. The fundamental challenge of business is to grow sales and avoid using price itself to drive volume, and boosting perceptions of meaningful difference will sustain a brand's ability to command a price premium without losing volume. While it is far easier to maintain a brand's premium than to regain it once it is lost, re-establishing premium perceptions is possible.

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Initially this will come through innovation in product, design, or positioning, but thereafter marketing and communication are key to maintaining the feeling of difference.

None of this should be news to anyone; these are the basic principles of building a smart brand. Perhaps the real issue lies not with marketing but with senior management, who incentivize us to achieve market share and volume sales targets without requiring that this be done at a reasonable margin. If companies do not regard their brands as valuable and treat them as such, why would their consumers?

To read more about premium brands, please visit www.mb-blog.com.

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"Brand Premium: How Smart Brands Make More Money" by Nigel Hollis, published by Palgrave Macmillan

"Even Cheaper Brands Need to Differentiate"

"Samsung Can't Buy Love, But Maybe it Can Charge a Premium"