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Solving The Puzzle of Irrational Consumer Behavior

by Paul Hunt – President

Why on earth did they buy that there? Sometimes, it seems customers act irrationally when it comes to their buying behaviors. But that is never the case. Customers always behave in ways they perceive are in their own interest. And yet, the rationale behind these decisions is often puzzling.

I have found over the past 20 years that **understanding consumer behavior is the key to solving this mystery**. The following are some examples of behaviors that, on the surface, make no sense, but, upon closer inspection, uncover significant pricing opportunities.

Example 1: Wal-Mart customers are the least price-sensitive.

A number of years ago, we conducted research for a company that was selling its product in three distribution channels: mass (Wal-Mart), drug and food. The study focused on understanding the price sensitivity of consumers with respect to the company's brand. The findings were surprising. They revealed Wal-Mart customers were the most brand-loyal and had the lowest sensitivity to price increases. How could this be? Don't customers go to Wal-Mart for its low prices?

As we dug deeper into the data, the answer became clear. There are two levels of price sensitivity: store elasticity (e. g. which store customers choose); and brand elasticity, the brand they select. The study indicated that **Wal-Mart customers are very price-sensitive in terms of the store they choose**. They shop at Wal-Mart precisely because they are price sensitive–up to a point.

Once they are in Wal-Mart, however, they are very brand loyal, or at least more so than shoppers in drug and food stores. In other words, **they are more prepared to sacrifice the store in which they shop than the brand that they buy**. Drug and food shoppers, on the other hand, are the exact opposite. They are more committed to their store preference, and more willing to give up on their brand preference in order to enjoy what they perceive as the benefits of shopping at a drugstore or grocery store–convenience, pleasant environment, etc. That means they are willing to trade off their favorite brands in order to get a better deal.

Wal-Mart customers are **the least sensitive to price increases** for their favorite brand.

Implication

A customer can be price-sensitive at many different levels, such as store, brand, etc. If you understand how that works for your customers, you can price more intelligently.

Example 2: Brand loyalty and price sensitivity aren't mutually exclusive.

Another study we did indicated a leader in the allergy-relief category had the highest levels of both brand loyalty and price sensitivity. How is it possible to have the most loyal customers and the highest level of price sensitivity? Upon further analysis, we found that c**onsumers were very loyal to the brand, but not to the stock-keeping unit (SKU) they chose within the brand**. In other words, they would shop aggressively within the brand to find the best deal. For example, if different package sizes (60 tablets instead of 36) or different formats (liquid versus tablet) were on sale, they would switch.

Implication

Sometimes it is not the price versus the competition that matters as much as the price gaps within your own product line.

Example 3: Volume doesn't always go down if you raise prices.

A few years ago, the brewer of Stella Artois beer began advertising extensively, focusing its message on quality. At the same time, the company implemented price increases and volume grew substantially. Why? The brand was being heavily consumed in bars, and when the young men, who comprise most of the market, drink beer in bars, they are very sensitive to the image they are projecting; they perceive the beer they buy as a symbol of their success. Therefore, the more the company raised the price, the more it fed into its customers' desired image, and the more sales increased.

Implication

In some cases, customers use **price as an indicator of quality**. In these situations, higher prices can lead to higher volumes.

Example 4: People who pay cash for their prescription drugs are the least price-sensitive.

You would think that if you were paying for your drugs, you would be highly price-sensitive. Conversely, if you had a subsidized plan, you would not be price-sensitive, since the plan would pay for most of it. In fact, our findings indicate just the opposite.

People who pay cash are relatively price-insensitive. The reason: They are already paying for their prescription products and are therefore willing to pay a bit more to get a product they feel will work better. People who are on drug plans, however, are used to getting their drugs for free or at a substantially reduced price. Buying a more expensive drug often means paying something versus paying nothing. Therefore, **people who are used to getting their drugs for "free" are very price-sensitive** when they go from paying nothing to paying out of pocket.

Implication

The customer segments that you expect to be the most price-sensitive may not be.

Example 5: There may be other reasons why people will pay more for your product.

A chemical company was selling a product it thought was a commodity. After doing some research, however, we found that it was the only company that could guarantee supply. Purchasing agents and technical buyers valued this, and were willing to pay a significant premium to ensure supply. The company discovered it could support **a 15% price gap** versus the competition, based on this important differentiator.

Implication

Sometimes the service you wrap around your product has **hidden opportunities** for premium pricing.

Selling The Value

The key to effective pricing is **to gain deep insight into your customers' needs and buying** behaviors, not costs. This enables you to price according to the value of your product or service, and to optimize the pricing to the consumer.