The PRICING ADVISOR
A Professional Pricing Society Publication
3535 Roswell Road, Suite 59
Marietta, GA 30062
770-509-9933
www.pricingsociety.com

Price Matching in B2C: Pricing Like a Sheep or Like a Wolf?

Price matching tactics are prevalent in B2C environments. Retailers are quick to offer to match a competitor's price so as to preserve market share. However, these tactics are causing many companies to price themselves out of business. In this article, the author analyzes these situations and offers alternative approaches for B2C pricers. Nickolas Cherrier is a consultant at Simon-Kucher & Partners. He can be reached by e-mail at nickolas.cherrier@simon-kucher.com.

In B2B we talk of "Most Favored Customer" business practice when a promise is made whereby a customer will benefit from the lowest price on offer. This implies that one key account has the power to enforce a clause whereby no other customer will receive better treatment, hence ensuring a cost advantage. Far more common is the B2C case where retailers promise to match competitor prices. Benefiting customers therefore find themselves in a position of assurance that they are not being ripped-off. This price matching tactic is in fact a powerful trump card.

If you, as a customer, are able to provide proof that the CD you are about to buy for $20 is available for only $18 down the road, you may save yourself a valuable $2. The customer, it seems, benefits greatly from such a policy. No wonder then that so many stores advertise "We'll beat any offer", "Seen it cheaper? We'll match it!" and messages to such effect. Retailers are fighting to the death in a volume before value mentality.

Many retailers will be quick to point to this business practice in identifying sources of margin deterioration. Indeed, typically competitors respond to such practices by lowering prices and advertising their own price guarantees in return.

The endgame is not difficult to forecast: Price War. In the short term, this is very bad for the industry, but attractive for customers. Anyone versed in basic microeconomic theory will draw a parallel to the magic of perfect competition.

We are witnessing competitive forces at work which may ultimately result in the reduction of price to the level of zero profitability. Like sheep to the slaughter, companies are pricing themselves out of business.

Price increase management

The increased market information brought by the digital age is rapidly turning customers into price scavengers. Assuming all else to be equal, price competition benefits lower prices. Price matching therefore allows companies to price their goods at a level which makes them at least as attractive as their competitors. And here lies the trump card. Not all companies using this practice are pricing like sheep. Some may be wolves in sheep's clothing.

Let us assume two companies A and B. They both sell CDs at $18. A is interested in raising prices in order to increase profits but is afraid of losing volume. Customers would eventually become aware of B's price advantage and A's sales would drop significantly. Perhaps B would follow the price rise and both would be better off, but as it is, A has no insurance that would happen. Judging from past behavior, B is quite likely to keep prices constant and increase its market share.

What if A decides to introduce a price matching promise while increasing its price to $20? It offers to match all competitors' prices. Assuming B does not budge the status quo remains. A continues to sell at $18 by price matching B. If B increases prices, up to $20, A's price level will automatically adjust itself.

By introducing the promise, A manages to rid itself of the non-cooperative issue and signals to B that they should raise prices to $20. The impact was entirely positive and A did not take any risk in raising its price. When used as a tool for price increase management, price matching promises may provide a real strategic edge through price anchoring.

Price transparency

Price transparency is a secondary advantage of price matching. In the above case, the market was described as rather transparent. Of course, that is not always the case. Very often companies need to invest in market research and competitive monitoring to understand changes in consumer behavior and competition tactics. With such opacity, it may be costly to follow all competitors' price movements. Price matching however

> When used as a tool for price increase management, price matching promises may provide a real strategic edge through price anchoring.

3535 Roswell Road, Suite 59
Marietta, GA 30062
770-509-9933
www.pricingsociety.com

manages to provide the information at zero cost.

If we continue with the above scenario, A now knows that B has reached the $20 price point as A no longer receives requests to price match its competitor. If B decides to lower prices however, A will be made aware through its customers' requests. Indeed, A will be informed of the exact price point and location of the store where B is pricing below $20.

This information gathering mechanism is in fact quite useful for companies to track price movements in different geography for tactical responses, or worse, to enforce price points in oligopolistic markets.

While evidence suggests price matching often leads to price wars, game theory leaves the door open for another outcome.

Wealth of Most Favored Nations

"People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices." These famous words written by Adam Smith in the Wealth of Nations describe the nature of business in rather alarming terms. Nonetheless it raises the unequivocal truth that market coordination is extremely dangerous to the public. Smith however argued little could be done, legally or otherwise, to prevent businesses from seeking to exploit the system.

Regulators never take kindly to market coordination and hefty fines are dealt to those found guilty of price fixing. Signaling desired price points to competitors in an effort to drive industry prices up is considered highly illegal in a great number of countries. Nonetheless, despite the potential signaling advantages of price matching, the promise to offer a better price to the customer is in itself favorable to consumers. Additionally, empirical data strongly supports price matching leading to a downward price spiral rather than the more "wolfish" price increase management case.

Best Buy, Sears, Target and Walmart all offer to price match, and the effect it has had on the US retail industry was to push prices down. Consequences however need to be weighted with the objectives.

Industries set in a battle for market share use such pricing tactics for volume gains. This does not mean that in the future we may not see an opposite trend in an industry set on margin recovery.

While evidence suggests price matching often leads to price wars, game theory leaves the door open for another outcome. As a price increase management instrument, this practice may allow companies to rig the game in their favor by anchoring a desired price point for all competitors to see, while avoiding the risks associated with unilateral price rises.