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RETAIL

These common pricing mistakes destroy luxury brands

December 6, 2019

Proper pricing offers great potential for luxury brands to become even more profitable and build greater brand equity over time. Image credit: Shutterstock. Illustration: Haitong Zheng/Jing Daily

By Daniel Langer

Pricing is one of the most difficult tasks for luxury brands to manage.

Even leading brands and seasoned managers fall into the same trap over and over: pricing based on cost and competitors. Because of this, we see a lot of untapped optimization potential in luxury pricing.

Many luxury brands are not profitable enough because they make pricing mistakes. But what is even worse is when their incorrect pricing erodes hard-won luxury positioning with customers.

When luxury brands fail and disappear from the market, incorrect pricing is often to blame.

It surprises many to learn that many luxury brands are priced too low thanks to bad internal strategies.

Easy growth trap

One common mistake a brand makes is trying to stimulate growth with entry-level pricing.

The pattern typically goes like this: A brand is launched with sharp luxury positioning and items that are identified by customers as luxury products. It goes on to achieve high brand loyalty and a strong connection with customers who have come to worship the brand's iconic items. Unit profitability is high, and the units are kept low.

But to grow, the brand decides to launch additional lines at lower price points. For a car brand, that can look like a more accessible SUV a typical move of many luxury car brands in the mold of Porsche's Cayenne and for a luxury fashion brand, it might be a sportier, more affordable line of clothing.

If this type of extension is consistent with the brand's core positioning, this strategy could work. But most entry-level extensions fail over time and destroy brand equity and customer value in the process.

When line extensions are not congruent with the brand's storytelling and compromise on luxury, they become interchangeable. Once this happens, the brand's loyal consumers will turn away from the brand's high-priced top items, and later, their new, lower-income customers will turn away from the cheaper items.

There are many examples of failed entry-level strategies that go on to weaken a brand's core.

A luxury car brand that sells the majority of its cars at price points above $500,000 recently introduced a cheaper, two-door sports car. The initial reception was overwhelming, and the brand extended its sales by more than ten times the original rollout. The move was celebrated as a success.

However, the company's CEO confessed to me that after the release of this car, sales of the brand's most profitable, top-end vehicles collapsed. Those who had bought the car brand for its air of exclusivity quickly deserted it.

According to the CEO, a driver of the top-end model told him that he would never "drive the same car my dentist drives."

Today, the brand is losing money and selling fewer units, and it recently had to lay off a significant amount of staff.

Meanwhile, a luxury fashion brand decided to launch a more accessible, denim-inspired collection and an even more accessible streetwear collection.

While the initial growth was explosive, profits eventually collapsed. Now, hardly any customers are buying the top-end line. The brand quickly transformed itself from a luxury leader to a struggling, undefined brand that has an uncertain future.

Building an incongruent portfolio is a major pitfall when chasing an easy growth trap. Everything looks great for three to five years until a sudden awakening comes. And when this happens, it is already too late to fix because the brand has lost its cachet and exclusivity with consumers. Only the most drastic corrections have the possibility of helping.

Cost-based pricing trap
Another typical mistake I see is pricing according to cost.

Many luxury brands simply add the cost of items to the desired profit margin and crosscheck with the competition's pricing to set their prices. Alas, nothing could be more wrong.

In luxury, the core task for a brand is to provide "added luxury value" (ALV), which is a value that is based on several social-status effects. Some of those effects are intuitive (signaling social dominance, luxury as an ultimate treat) while others are more hidden (public protection, signaling expertise, or promising enhanced attractiveness).

Perceived ALV is what people pay a very high price for, and not for a product's features. This is a critical distinction.

ALV is driven by the brand's story rather than the product. When brands set their values based on cost and margin expectations, they almost always mistakenly price too low, signaling a lack of ALV. This confuses consumers and they will not buy the brand.

A great example of this is an omelet that is sold in a New York hotel. It is known as the most expensive omelet in the world, with a price that has been set at $1,000 for more than a decade. And yet, after studying the omelet's price with a luxury pricing algorithm, we concluded that the price was by far too low even though that seems counterintuitive.

I suggested to the restaurant that could sell the omelet for at least double the price and then published a case study about it.

Nothing changed for years that is, until the price of caviar increased, and the hotel restaurant raised the price of the omelet to $2,000.

Now, according to press releases, demand for the omelet has increased significantly. Although the caviar price hike forced the restaurant to correct the omelet price, it could have sold the omelet a decade earlier at a price that reflects its real ALV.

Brand storytelling and pricing
ALV is driven by the brand and its story.

To tell a great story, brands need to define an extreme performance point in other words, one element that they do better than anyone else. This is rarely product-related and is more often brand-related, typically touching some deeply ingrained consumer needs.

When brand storytelling is weak, no ALV is created, so the ability to price is negatively impacted.

Unlike mass-market products, luxury pricing should reflect the brand's ALV instead of the product's features. Basing

price on features is one of the deadliest mistakes a luxury brand can make.

WHEN DONE correctly and deployed with smart strategies such as limited editions, proper pricing offers great potential for luxury brands to become even more profitable and build greater brand equity over time.

It is much easier to grow in the short-term by lowering prices. But that easy growth trap will only lead to ruin in the end.

Daniel Langer is CEO of luxury, lifestyle and consumer brand strategy firm quit. He consults some of the leading luxury brands in the world, is the author of several luxury management books, a regular keynote speaker, and holds management seminars in Europe, United States and Asia. Follow @drlanger.

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