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The common luxury pricing mistakes that destroy brands

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While it seems like luxury pricing should factor in production costs and the competition's prices, but the most important factor is ALV. Image credit: Shutterstock

By Daniel Langer

When asked what luxury is, many people answer "expensive." But this is only a reflection of the value a luxury item or brand creates.

Luxury is all about extreme value creation. No consumer will buy a luxury brand if the price seems too high, and when it seems too high, that means the price is exceeding the brand's perceived value.

Luxury brands' number one task is to create extreme value.

I find that value in luxury is *not* connected to products and features it is connected to brands. The product is important design, quality, materials, craftsmanship, etc. but the main value driver in luxury is Added Luxury Value (ALV), which is the result of tangible and intangible effects that people intuitively connect to a luxury brand.

ALV is driven by a brand's equity rather than its product features even in engineer-driven categories such as the luxury car industry.

Some of those ALV drivers are expected deliverables such as social status. Others are what I call "hidden drivers" of luxury value attributes like social protection.

For example, a famous luxury hotel has a whole floor dedicated to patients who just came out of plastic surgery.

The guests, many of whom are well-known celebrities, enter the hotel through a secret and dedicated security-protected entrance and are transported to the floor via a separate elevator so no other guest will ever see them.

There is also a medical team on duty 24/7 to service them if they need assistance. They stay there until they have healed so that even their staff will not know that they have had a procedure upon their return all while they stay protected from the paparazzi.

While they are at the hotel, they spend an enormous sum but not for the room. They are paying for a hidden driver of ALV: public protection.

Similarly, the creative director for an iconic fashion brand told me that discretion hence public protection is the main value driver for his high-end clientele rather than the fashion items themselves. If he was ever to disclose the names of his best clients, they would go elsewhere.

Because of this, ALV needs to be managed as rigorously as brands manage their product portfolios or their marketing budgets.

Since ALV is mostly intangible and perceived intuitively, managing it incorrectly can destroy all ALV.

If this happens, brands cannot create the extreme value needed to support their high prices.

When a luxury brand fails, it is usually because it was not able to create, sustain and grow ALV over time.

Pricing mistakes are common in luxury and are one of the biggest culprits behind value destruction.

One common mistake surprisingly is pricing a brand too low. This happens because managers are not fully aware of the Added Luxury Value they create.

Instead of pricing for value, they set prices based on production costs or against the competition's prices. They feel that this makes for a "safe bet." But what if this leads to incorrect pricing?

Intuition does not help.

A famous restaurant served an omelet for $1,000. Intuitively, that price sounds expensive even excessive for one dish.

The restaurant's rationale is that it is worth the sum of its ingredients in that case, caviar) among other reasons. This is a typical example of cost-based pricing.

If the ingredients are $600 and the brand wants to get to a certain profit margin, they might price the product at $1,000.

Managers feel safe with this rationale because it comes from tangible things.

What they forget, though, is that luxury is not the sum of tangible features it comes from intangible ALV created by their brand.

When I measured the ALV of the omelet with my luxury pricing tool, the Luxury Index, I found that the omelet's ALV was far exceeding the price the restaurant charged: $2,000 or higher was the appropriate price.

When I confronted the restaurant years ago with my findings, they felt that increasing the price would collapse the demand, and they opted against a price hike.

Years later, the price of caviar skyrocketed, and the restaurant was forced to increase the omelet's prices. Yet at $2,000 the price I had initially recommended based on ALV measurements the omelet sold more units than ever before to the surprise of the management team. That is because the price now better reflects the omelet's true ALV.

But unfortunately, the restaurant lost almost a decade of profit opportunity as they could have sold many more units at drastically higher profitability.

The positive impact of increasing the price of an omelet from $1,000 to $2,000 shows that cost-based pricing destroys value since fewer people bought the omelet at its lower price.

Intuition in luxury pricing is wrong. Instead, luxury brands must measure and understand ALV, so they can price correctly.

Pricing brand products because competitors price their products at a certain level is similarly dangerous. This method assumes that a brand creates the same ALV in a category that their main competitors do, which is rare if not inconceivable.

But what this pricing method also does is to signal to consumers that the brand is *not* more valuable than its competitors.

With this approach, they set a wrong reference price and ruin perceived value if that price is too low. And after that price is set, corrections are difficult.

Pricing mistakes always confuse consumers. They position a brand into a competitive set, as the price is the easiest signal to understand and compare.

A mismatch between ALV and pricing will lead to confusion, uncertainty and fewer sales. It is the single biggest profit destroyer and reason luxury brands go out of business.

The CEO of one of the most luxurious shoe brands in the world recently acknowledged that after learning the ALV in his category that his shoes should be priced ten times higher.

Yet, since he launched his brand at prices that are "too low" but comparable with other luxury shoe brands it will be a challenge to correct his pricing architecture. The damage has been done with immediate revenue and profit implications.

Yield-management is another common value-destroying tool in luxury.

It has become popular in the luxury hospitality and airline industries, including shared private jet services that have fluctuating prices based on demand. Hence, if an airline seat is not sold, the airline may sell it last minute at a lower price.

Similarly, many luxury hotels use dynamic pricing to sell their room inventory when demand is lower.

From a consumer perspective, this destroys value and creates confusion.

If a consumer pays $1,500 for a suite one week but learns the price is only $500 the following week, they will feel ripped off. Or if they paid $500 one week, but the hotel asks for $1,500 the next, a consumer will not stay there again because the perceived value was initially set at $500.

While dynamic pricing can make sense for highly commoditized products, it destroys value in the luxury space.

Always remember: Consumers do not pay for the product hotel room, airline seat, handbag, etc. they pay for perceived ALV.

Dynamic pricing will always confuse consumers and has a major impact on a brand's extreme value perception.

Luxury pricing is one of the weak spots for most brands I assess.

Just because others are making the same mistakes that does not mean a luxury brand should continue to do what has always done.

A mismatch between ALV and price will always impact brand perception and weaken a brand's equity over time, and incongruent pricing within a portfolio further weakens a brand.

PRICING REQUIRES the same meticulous management as all other aspects.

Because of its visibility and strong signal, pricing mistakes can destroy a brand faster than other brand management mistakes.

Still, surprisingly little attention is paid to pricing.

Done correctly, it is an enormous lever for revenue growth and will dramatically strengthen brand equity.

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