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Why discounts are a dangerous overreaction to a crisis

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Pricing is one of the more challenging aspects of managing a luxury brand in normal times, but it becomes even more critical in a crisis. Image credits: Prada, Shutterstock. Composite: Haitong Zheng/Jing Daily

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Pricing is one of the most challenging aspects of managing luxury brands in normal times, but in a crisis, it becomes even more critical.

Over the past weeks, I have been approached by several luxury brands on what is the best pricing strategy during this pandemic.

In a recent COVID-19 mitigation master class, pricing was one of the areas in which the participants were most interested. This shows that the current crisis is challenging managers of companies in an unprecedented way.

Given that our surveys show that more than 80 percent of managers believe that the COVID-19 impact will last well into 2021, companies need to look into their pricing in a much more strategic fashion.

Why is luxury pricing so difficult?
When we audit brands, we find a recurring theme.

Pricing is often set by adding the desired profit margin on a product and by comparing the brand to its main competitors.

But there are many reasons why this is the wrong approach.

One of the most important is that cost-based pricing does not reflect the value that a luxury brand creates.

Luxury is never about cost it is about value. One of the most relevant quotes says to "charge confidently and give generously." It implies that we create enough value so that we can charge for it while creating lasting memories for our customers. This is a core principle of luxury.

Pricing similarly to the competition implies that your brand creates the same value as the brand on which you have based our assumptions.

If a brand embarks on a luxury journey, then its most important task is to define and execute its value creation model. How do we create extreme value for our customers? How do we excite them again and again? How do we make them dream in a very specific way about our brand?

If a brand only benchmarks against its competition, then it is signaling to its customers that they have nothing different than what those competitors offer.

This logic of cost-based and competitor-based benchmarking may hold for normal brands that are not overly differentiated, but these techniques break down in the luxury category. In luxury, extreme value creation becomes one of the most critical issues.

Pricing can create two dilemmas.

One, when the price is too high, higher than the value, then the item will not sell. And two, when the price is too low, the brand is signaling to its consumers that they create less value than it seems, which destroys value and lowers brand perception for no reason.

Surprisingly, underpriced luxury brands often sell less than correctly priced ones, adding insult to injury. Not only are brands giving up relative profitability, but they compound this effect by selling less at lower margins. Nothing is deadlier in the luxury industry.

Why short-term thinking is wrong when it comes to pricing

Unfortunately, managers often feel left on their own to decide on prices.

Tools such as conjoint measurement a standard in pricing simulations in relatively undifferentiated mass-market settings do not work in luxury.

Therefore, many managers would rather use their gut when it comes to pricing than use a methodical system.

But pricing is too important to just be an afterthought.

Managers of luxury brands must instead think differently, developing data-driven and systematic estimates for the values they create.

The Luxury Index, which I developed as part of my doctoral research, is one powerful method that can be used for identifying pricing mistakes, gaps or opportunities.

Ultimately, pricing is quite strategic for a luxury brand, and it should never be the result of short-term, tactical considerations.

The danger of a crisis

Most luxury brands took a huge hit during the first quarter of this year, regardless of their category.

The best brands closed their quarter with -5 to -15 percent less revenue compared to the previous year. Good brands came in closer to -25 percent.

But many brands saw revenue hits at around -40 percent or more.

If you are in the latter group, there is a good chance that your branding issues go far beyond the virus and that gaps need to be addressed immediately.

Confronted with negative numbers, some brands decided to offer COVID-19 discounts.

Discounts of 15, 25, or even 50 percent are now widespread in the luxury industry, especially from smaller or weaker brands.

The rationales I most often hear are centered around the idea that underperforming brands have too much inventory and need to sell it out before the season ends.

While this rationale may calm down decision-makers, it has a fatal effect on brand perception.

If a consumer bought a luxury handbag for $5,000 before the crisis, but it is now available for 25-percent less, brand damage will be significant.

Brands risk alienating their most loyal consumers who were happy to buy at full price, in the hopes of attracting ad-hoc, one-time customers with a hot offer.

In our experience, this will not work, and the long-term brand equity loss will be brutal.

Tactical, short-term considerations dramatically impact the brand once a crisis is over.

Consequently, the best-managed luxury brands are not discounting right now and are preserving their brand equity.

Since the most price-sensitive customers will delay purchase decisions in this current reality anyway, discounting over-reactions could lead to direct profit destruction in the short-term that will be difficult to correct and will alienate the best and most loyal customers. It is the fastest way to weaken a luxury brand in crisis.

The way out

Instead, managers of luxury brands should focus on the essence of what luxury is: extreme value creation.

Inspire your customers, innovate and give them rational and emotional reasons to consider your brand.

Be human, connect, excite and be available to your customers.

Develop the most personalized customer journeys to make them feel valued in a time where they may have other priorities than splurging on your brand.

However, once customers are ready to spend again, they will remember the brands that inspired them the most.

THE COVID-19 CRISIS will divide brands into two categories: those who innovated, excited, and strengthened their brand equities and those who became passive and focused on quick sales and heavy discounts.

The first group of brands will emerge from this crisis much stronger, while the second group may not be around afterward.

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