



# DOES PRICE REALLY MATTER?

Managing what  
customers think about  
price is more important  
than reality



Retailers invest huge amounts of effort and money in price. Chinese consumers have a surprisingly poor knowledge of actual prices, but do know where to get the best deal. Managing the perception of price is critically important for all retailers, but in the grocery around

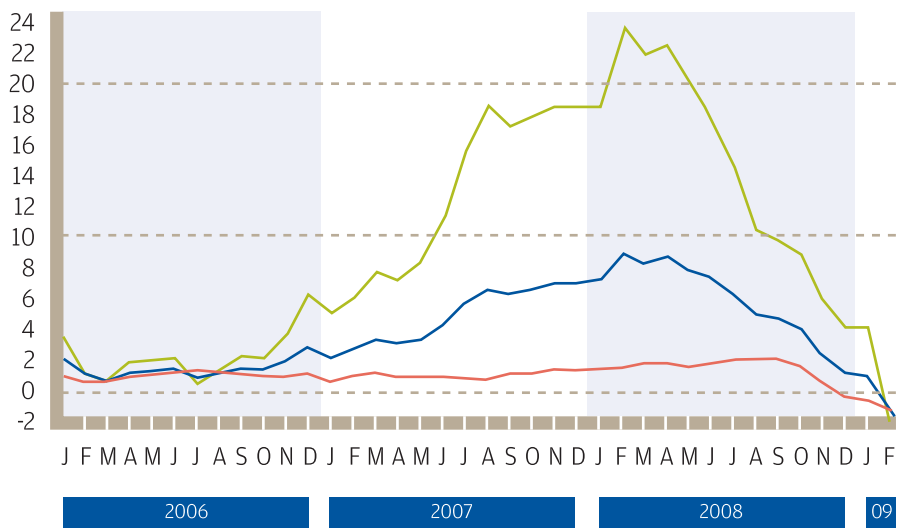
China's Western brands are coming off badly and may be wasting margin. Targeted investment in perception-driving products and categories is one of the proven mechanisms to harness price as an effective competitive weapon.

# PRICES ARE GOOD AT GRABBING HEADLINES

# China's volatile food prices

China CPI, 2006 - 2009

YO Y%Change



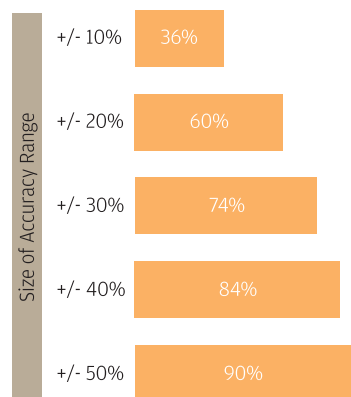
In 2007 and 2008 the media was buzzing with reports on China's dramatic food price inflation and its implications. The food CPI eventually peaked at no less than 23% growth in February 2008 and since then has never looked back - indeed, in 2009 it is deflation that is making the headlines. Sustained deflation is tough for retailers, but not so bad for consumers. However without the reports, how much would consumers really notice price changes in the shops?

Perhaps very little. OC&C's recent research on grocery price perception in Shanghai and Wuxi suggests that Chinese people have little idea about real prices. In the survey, a thousand customers were asked to name the prices of a basket of 20 everyday items, such as orange juice, pork and soap - but not a single person knew all the products to within a 10% range. On average, if prices changed by 10% the respondents would notice this change on only a third of items.

## Price awareness is surprisingly low among hypermarket shoppers

Average Number of Items Correct, at Different Accuracy Ranges

n = 1000



**Accuracy Summary**

**In Terms of Items...(Left)**

- On average, the 1000 respondents knew just over a third of basket items to within 10% of the real price
- Respondents were over 50% off the real price of some items

**In Terms of People...(not shown)**

- 85% of the respondents did not know half the basket to within 10% of the real price
- No one knew all 20 items to within 10% of the real price

It appears that surprisingly few would have noticed the fluctuations in food prices measured by the CPI if it wasn't for the headlines. Of course, changing prices will act on wallets regardless of consumer awareness, and there is no doubt that people do care about cost. However

respondents' lack of knowledge implies that actual prices might not be as big a concern to consumers as the media hype suggests - and that moving prices alone and expecting shoppers to notice will not drive sales.

# THE CHINESE KNOW WHERE TO GET A GOOD DEAL

For everyday purchases, it is much more important to know relative prices than exactly how much items cost. In many ways, consumers can do little about average price points for an item, but they can vote with their wallets when they choose where to buy. It is much more useful for a consumer to know where an item is cheapest than if it is a little more than last week. Rival retailers are quick to point out where customers can get a better bargain – especially during slowing sales.

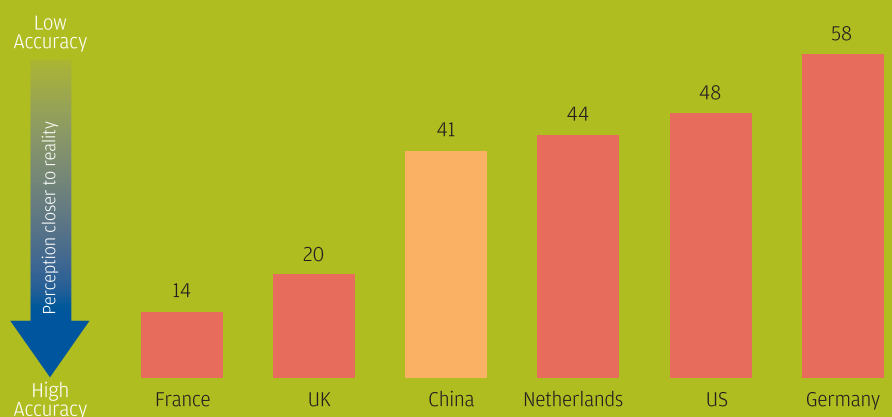
OC&C has conducted extensive research across 6 countries, examining how consumers perceive prices. The main conclusions from the research in China are:

1. Customers are of course not stupid. They may not always know individual prices, but in general they have a good understanding of the overall price positions of different retailers
2. Managing price image is critical – and those retailers with a good price image are the ones who make most effort to communicate it to customers
3. If you don't tell the customer you are good value they assume you are expensive, especially for foreign brands
4. Some items disproportionately influence overall perception of prices – these are key levers to actively managing overall price positioning and price perception
5. Price consistency within categories is important, but difference in positioning between can be acceptable (and even recommended) – consumers often don't spot it

Consumer awareness of relative price positioning of retailers (ie who is ranked as cheapest, who most expensive), shows significant difference across countries. In this aspect of price awareness, the Chinese are well informed. They may not know exact prices, but they do know where to get a good deal – at least as well as the Dutch and Americans.

## Chinese consumers are well informed, but have a long way to go to match the price knowledge of the French & English

**Accuracy in Perception of Grocer Price Positioning, by Country**  
Index of Actual vs Perceived Price Positioning



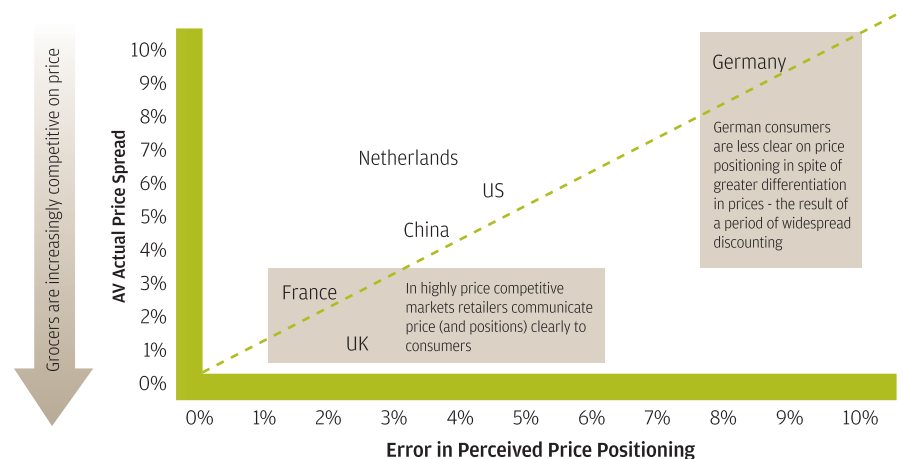
Price awareness tends to increase as markets become more competitive on price. British and French consumers are the most in tune with real price positions in grocery because leading grocers in these markets compete heavily on price and put much effort into communicating it to their shoppers. In the UK, in spite of prices almost identical to Tesco, Asda and Morrisons are able to benefit from a lower price perception - actually creating a market where consumers think there is a bigger price gap than reality.

In China the grocery market is still in an early stage of evolution, with less structure and many more players. Fully inclusive brands with consistent and understood values are relatively new to consumers - and the opportunity to become reknown as a price leader is still open.

The Germans are least well informed about relative price positions. This confusion is a legacy of increasingly heavy discounting during the German recession in 2001-02 and following revisions in rebate laws in 2003. In the current slowdown, Chinese retailers should heed this lesson in the long-term danger of market-wide discounting. Pricing is now a less effective tool for German retailers because their consumers are confused about positioning.

## Retailers communicate price positions more clearly as markets become more price competitive

Accuracy of Price Positioning Awareness vs Actual Price Distribution  
% Delta from All Retailer Average



# PERCEPTION MATTERS MOST



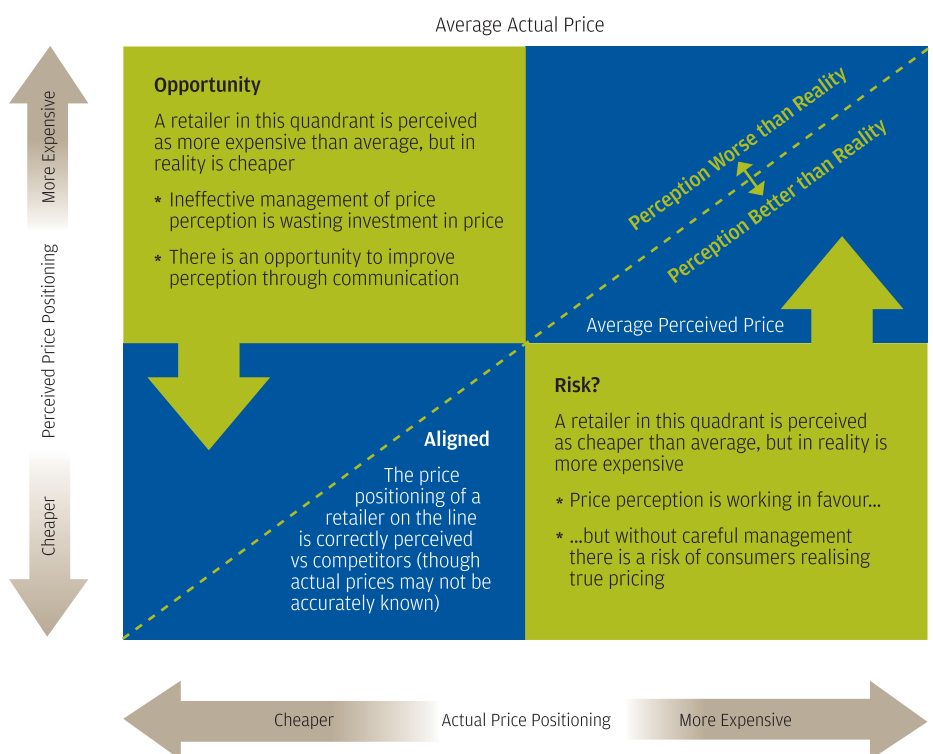


Retailers invest a lot of money in price, but it is the perception of price, relative to the competition, that drives customer choices and leads them to buy. Without effectively communicating and managing this, any other improvements to pricing are worthless.

However, finding the right balance between perceived price and reality is challenging. Perceived prices that are much lower than reality run the risk that consumer awareness will catch up and sales will fall; perceived prices that are too much higher lead to wasted profit margin. To be sustainable, expectations set by price perceptions need to be aligned with brand positioning, product quality and store environment.

## Framework for perceived price positioning

### Actual vs Perceived Price Relative to Competitors



**WESTERN  
RETAILERS IN  
CHINA DON'T  
GET THE CREDIT  
THEY DESERVE**





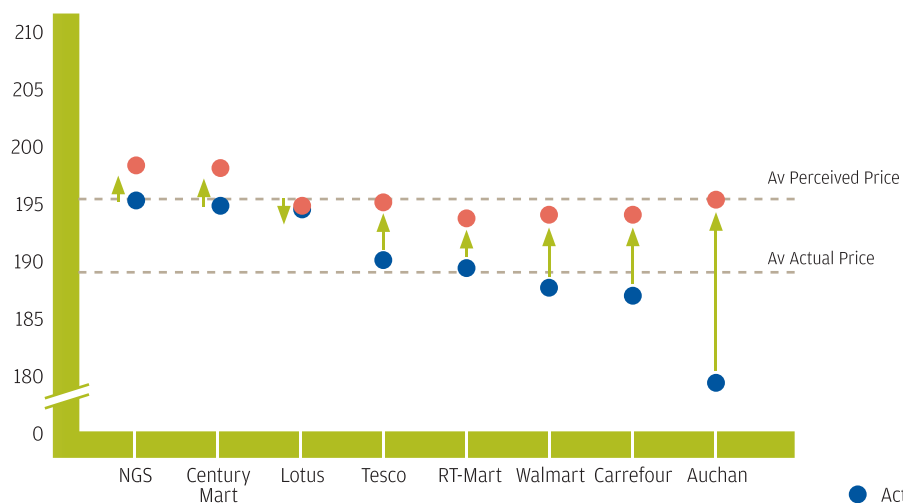
Price perception on large grocers in China does not act equally. Local Chinese companies were the most expensive across the basket OC&C tested - while the big Western retailers were on average 5% cheaper for the whole basket.

However in price perception, respondents tended to overestimate the prices offered by all retailers - and particularly among the Western brands. This has three consequences.

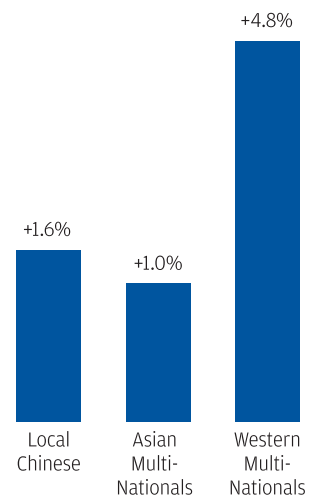
# Western grocers in China are wasting investment in price

## Absolute Price Perception Gaps in China Grocery <sup>1</sup>

Average Actual Price vs Perceived Price for Key Grocers  
Total Basket Value, RMB



## Average Price Gap by Type of Retailer %



1. Based on basket of 14 products in Shanghai and Wuxi; n = 1,000

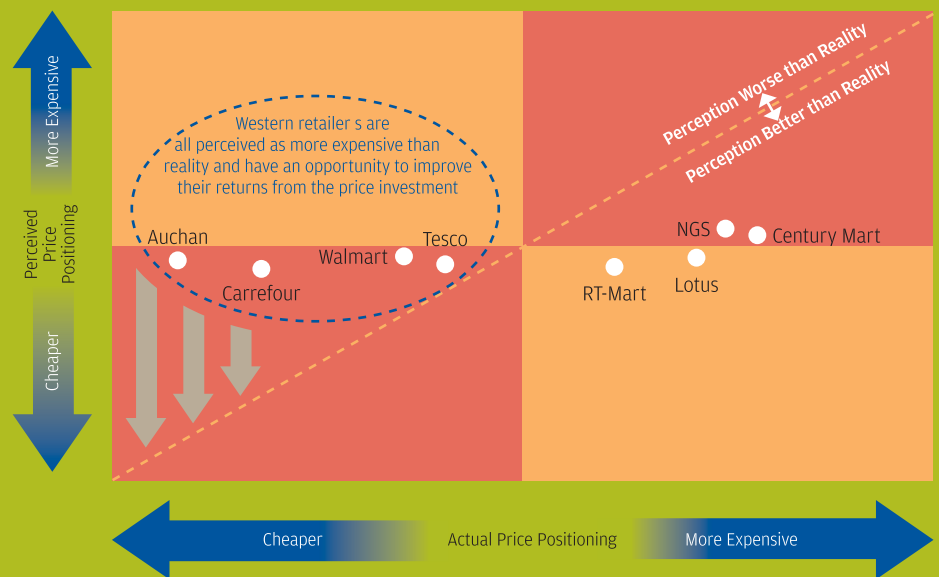
First, the perceived range of total basket prices is considerably narrower than reality, with the average gap between Western and Chinese retailers dropping to only 2%. The big Western brands are investing heavily in lower prices (to the benefit of Chinese consumers), but are not getting credit for it. They may be wasting a large amount of margin by ineffectively communicating their price position.

Second, local Chinese grocers are correctly perceived as being the most expensive. This was the case across every item in the research basket and may explain part of their declining market share. However their bottom line (relative to competitors) also benefits from the advantage of a small perception gap.

Third, the playing field is levelled to such an extent that consumers recognise no clear price leader. This may be due in part to general preconceptions about large branded outlets (particularly Western) in comparison to more familiar and traditional shops. Branded retailers have established themselves at the high end of most other retail categories and grocery has yet to differentiate itself for consumers. This shows that grocery price leadership remains an opportunity for a grocer of any brand origin who can successfully reach out to the Chinese people

## Perceived price positioning is not aligned to reality

### Perceived Price Positioning in China Grocery



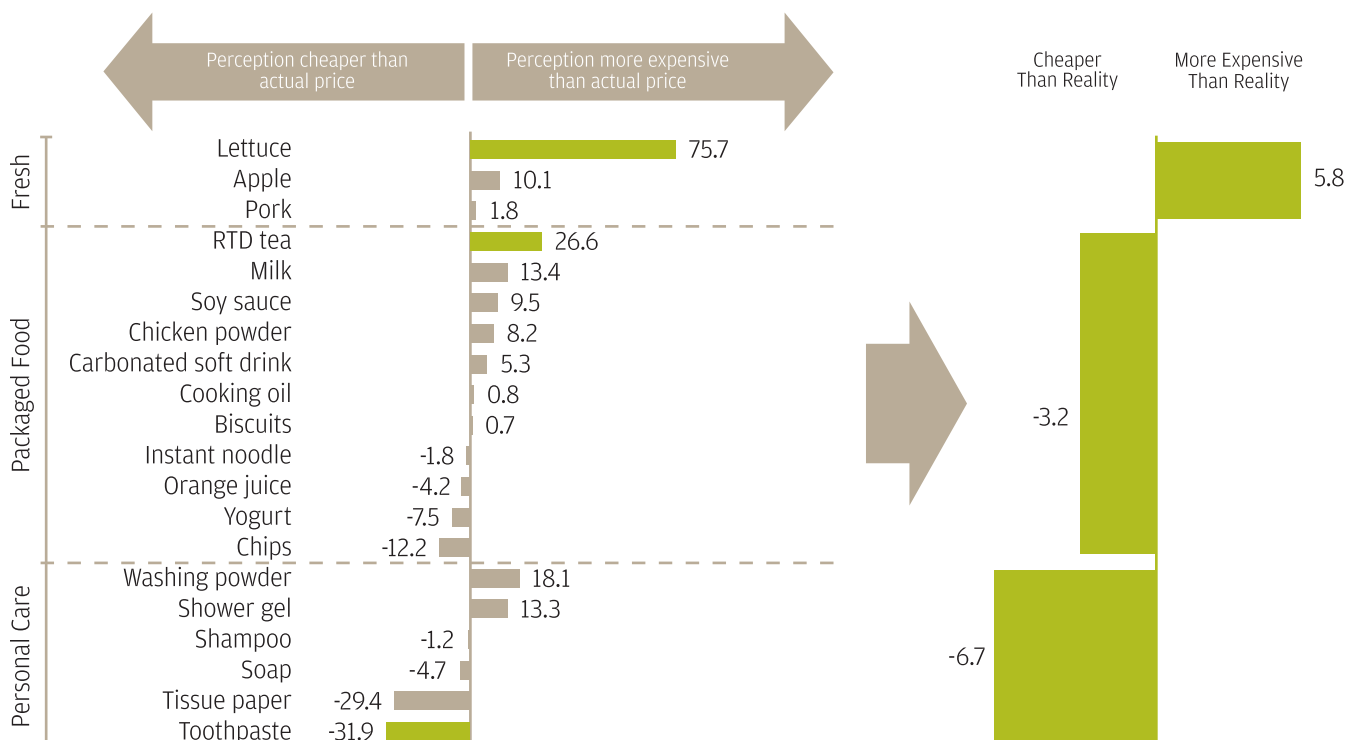
# NOT ALL PRICES MATTER

There is also a difference in the accuracy of perception between products. Among items in the survey, prices of packaged foods, such as cooking oil and biscuits, tend to be the best known among customers - alongside some iconic products in other categories that are particularly high profile, such as pork and shampoo. Retailers need to take care with these prices - consumers are likely to notice if they are wrongly positioned.

Fresh items on the other hand (eg lettuce and apples) are usually overestimated. Although prices here can vary on a single product from day to day and can be difficult for consumers to know accurately, retailers might benefit from improving their communication where and when good deals do become available. Fresh items may actually suffer from oversignage in many of China's large grocers, effectively rendering consumers less sensitive to these prices.

## Packaged Food prices are known better than Fresh and Personal Care

Average Actual vs Perceived Price  
% Delta, n = 1000



Some items have a greater influence on overall price perception than others and represent key levers to control communication of prices - particularly where they are seen as more expensive than reality. In general, items with greater impact are

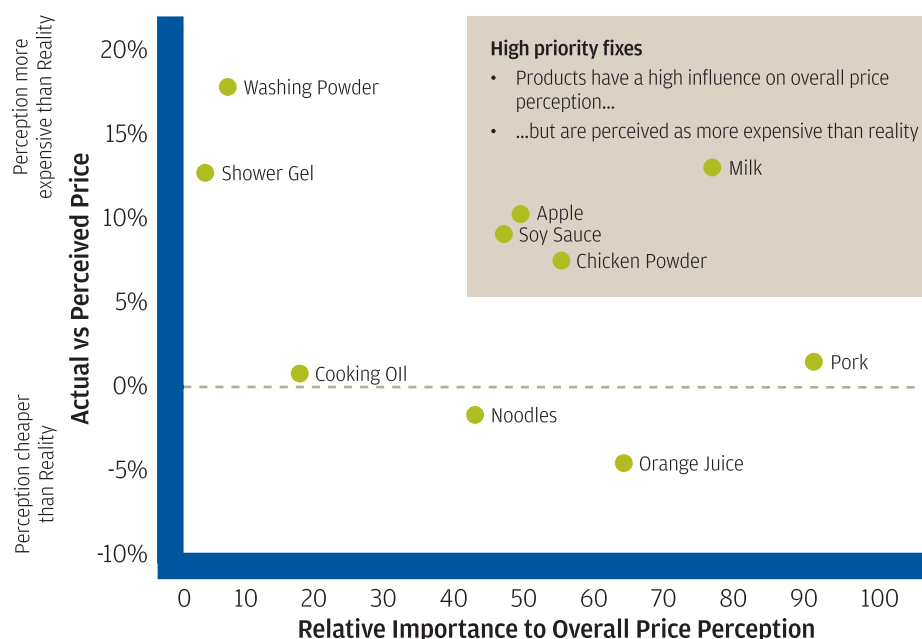
- Frequent-buy products
- Easily compared (where product quality varies less across brands)
- Lower value items (both within and between categories)

For any category of goods (grocery or otherwise) the most important items will vary according to each individual consumer's preferences, their promiscuity in shopping across different grocers and their own sensitivity to price. It is often possible to identify these items for high impact groups of consumers to make a significant difference to price perception and sales. In the fickle world of Chinese shopping, investing in even a few key items can draw in a customer and leading to an eventual purchase of a much wider basket of goods.

In grocery, Chinese consumers tend to be sensitive to key 'hygiene' items such as eggs, rice and pork. However in general, OC&C's research has shown that it is less obvious items such as milk, chicken powder and soy sauce that are driving higher price perceptions. Fixing these items should be a high priority to both drive recognition of lower positioning and retrieve wasted margin. Other items, such as cooking oil, were surprisingly less important to consumers - in this case, perhaps because consumers expect prices to be similar at all the top grocers.

## Some items are key levers for influencing price perception

**Derived Importance of Products to Overall Price Perception (Selected Products Only)**  
Index, % Delta Actual vs Perceived Price <sup>1</sup>



<sup>1</sup>. % Delta Actual vs Perceived Price is average across all retailers

# WHAT DOES THIS MEAN FOR CHINESE RETAILERS AND MANUFACTURERS?

Low accuracy of price perception is a problem for retailers and manufacturers alike. There is little point investing in price if customers don't notice. Price is only an effective competitive lever if it can be communicated to customers with predictable consequences.

However, actively managing what customers think is a tricky business. "Price" is complicated, and is delivered and communicated to the customer in many ways. The impact of each on perception is different, so it is important to target investment where return will be greatest.

The good news is that it costs less to improve price perception than reduce prices. OC&C's research shows there are three key factors that can influence price perception in China, beyond (the knowledge of) price itself. Managing these is critical to the health of any retail business.

## 1. Understand your own customers in order to maximize price as a lever for profitability

- Identify items that have the most (and least) potential to influence price perception for key customer groups
- Maintain margins where price is less influential
- Avoid adjustments to individual items that disturb the overall structure

## 2. Be clear, effective and consistent in your communication of price position

- Point it out to your customers, especially where perception is higher than reality
- Specifically understand and target pre-conceptions and non-deliberate price communication associated with your own operations
- Align target perceptions with branding, product quality and a customer's overall shopping experience

## 3. Deploy price changes with care

- Consider the long-term consequences, particularly competitive positioning
- Take action on a few strategic areas. This is likely to be just as effective as wider initiatives, and probably much healthier
- Target price-seeking (but profitable) consumer groups



Manufacturers are exposed to price perception through unit sales and promotions. Understanding the drivers is an important skill in serving key accounts well. With access to levers that are unavailable to retailers, they should make sure they are playing their part in the game.

- Actively manage product brands to align with end price positioning on the shelves
- Ensure promotions reinforce, not undermine perceptions; their impact can be big, but they must be deployed selectively and effectively
- Capitalise on product packaging; this is highly influential and escorts consumers from product selection to the home

Chinese consumers in general may not know absolute prices, but they have a keen sense of relative positioning. Pricing is a critical lever for both the top and bottom line, influencing sales volume through the perception rather than reality. However there is no golden formula to successfully exploiting the relationship between the two. The first step to a truly effective pricing strategy is to understand the individual circumstances for your own business.

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