Price Smarter on the Net

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Executive Summary

Companies generally have set prices on the Internet in two ways. Many start-ups have offered untenably low prices in a rush to capture first-mover advantage. Many incumbents have simply charged the same prices on-line as they do off-line. Either way, companies are missing a big opportunity.

The fundamental value of the Internet lies not in lowering prices or making them consistent but in optimizing them. After all, if it's easy for customers to compare prices on the Internet, it's also easy for companies to track customers' behavior and adjust prices accordingly.

The Net lets companies optimize prices in three ways. First, it lets them set and announce prices with greater precision. Different prices can be tested easily, and customers' responses can be collected instantly. Companies can set the most profitable prices, and they can tap into previously hidden customer demand.

Second, because it's so easy to change prices on the Internet, companies can adjust prices in response to even small fluctuations in market conditions, customer demand, or competitors' behavior.

Third, companies can use the clickstream data and purchase histories that it collects through the Internet to segment customers quickly. Then it can offer segment-specific prices or promotions immediately.

By taking full advantage of the unique possibilities afforded by the Internet to set prices with precision, adapt to changing circumstances quickly, and segment customers accurately, companies can get their pricing right. It's one of the ultimate drivers of e-business success.

Two very different approaches to pricing—neither optimal—have dominated the sale of goods and services through the Internet. Many start-ups have offered untenably low prices in the rush to capture first-mover advantage. Many incumbents, by contrast, have simply transferred their off-line prices onto the Internet. In some cases, they believe their brand strength inoculates them from the need to price competitively; in other cases, they feel pressure to establish an on-line presence but aren't prepared for the complexities—or potential cannibalization—of multichannel pricing.

Both approaches cause companies to miss a big opportunity. The Internet allows companies to price with far more precision than they can off-line and to create enormous value in the process. Transparency and efficiency, after all, go both ways. Just as it's easy for customers to compare prices on the Internet, so is it easy for companies to track customers' behavior and adjust prices accordingly. But organizations must act quickly and rethink their on-line policies before habit and customer expectations make changes difficult, if not disastrous.