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Avoid Guesstimates: Measuring Consumers' Willingness to Pay Effectively

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Problem of practice

"Am I leaving money on the table when it comes to pricing my products and services?" This is a perennial question facing product managers and marketing professionals. Unpacking this puzzle, most managers are confronted with the inadequacy of prevailing practice: companies often price products based on the costs they incurred plus an added margin (aka cost-plus pricing). However, this method ignores the customer's true willingness to pay (WTP) for the product. If the cost-plus price is less than the customer's actual WTP, the company has not realised as much profit as it could have. An upgrade to cost-plus price stems from value pricing, which uses techniques such as conjoint analysis. These techniques are better, but they do not account for real-world situations, such as a customer comparing competing products or services. So, how to get even closer to customers' true WTP? Recent research by Sharlene He, Eric T. Anderson, and Derek D. Rucker introduces a new method – the Comparative Method of Valuation (CMV), which accounts for both the relevant comparables and the context of purchase.[1] This essay offers guidance on when to use the new comparative technique and how to deploy it

[1] The article "Measuring Willingness to Pay: A Comparative Method of Valuation" by Sharlene He, Eric T. Anderson, and Derek D. Rucker, featured in Volume 88, Issue 3 of the *Journal of Marketing*, found that willingness to pay depends on customers, comparisons, and situations, and introduced a new method to measure these effects more accurately

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Pricing: The untapped potential

A 1% price increase can generate an 8.7% increase in operating profits, all else being equal, according to a study by McKinsey & Company Inc., a global consultancy.[2] This gain is far greater than the savings from a 1% reduction in variable or workforce costs. But is this price increase feasible? The answer comes from a global industry survey indicating that only 14% of companies base consumer value on WTP.[3] Uncovering consumer WTP for products and services is an elusive problem for marketing and pricing managers, as it seems to require reading consumers' minds and varies across space, time, and consumption contexts. For example, the price the consumer is willing to pay for a bucket of popcorn varies between the multiplex cinema and home.

Managers thus constantly face the risk of overpricing, which leads to lost sales. Or they underprice, leaving money on the table. If managers could understand consumers' minds and the basis for their WTP, it could help them make pricing decisions with confidence. If one were to ask, how should the Olympics' tickets be priced? Tickets for the Paris Olympics 2024 ranged from €90 to €2,700 for the opening ceremony and from €45 to €1,600 for the closing ceremony. Even when the more expensive tickets subsidised the cheaper ones, consumers criticised the prices for being as high as they were during the 2012 London Olympics.[4] Similarly, consumers have rejected fast-food giant PepsiCo's price increases on Frito-Lay potato chips.[5] In fact, Carrefour, a multinational retailer, has stopped selling the chips in France.[6] In all of these cases, the brand could have avoided customer backlash if it had known the WTP in advance. However, just asking customers does not help; as Nobel laureate Daniel Kahnemans critique suggests, "[it is] better described as expressions of attitudes than as indications of economic value".[7]

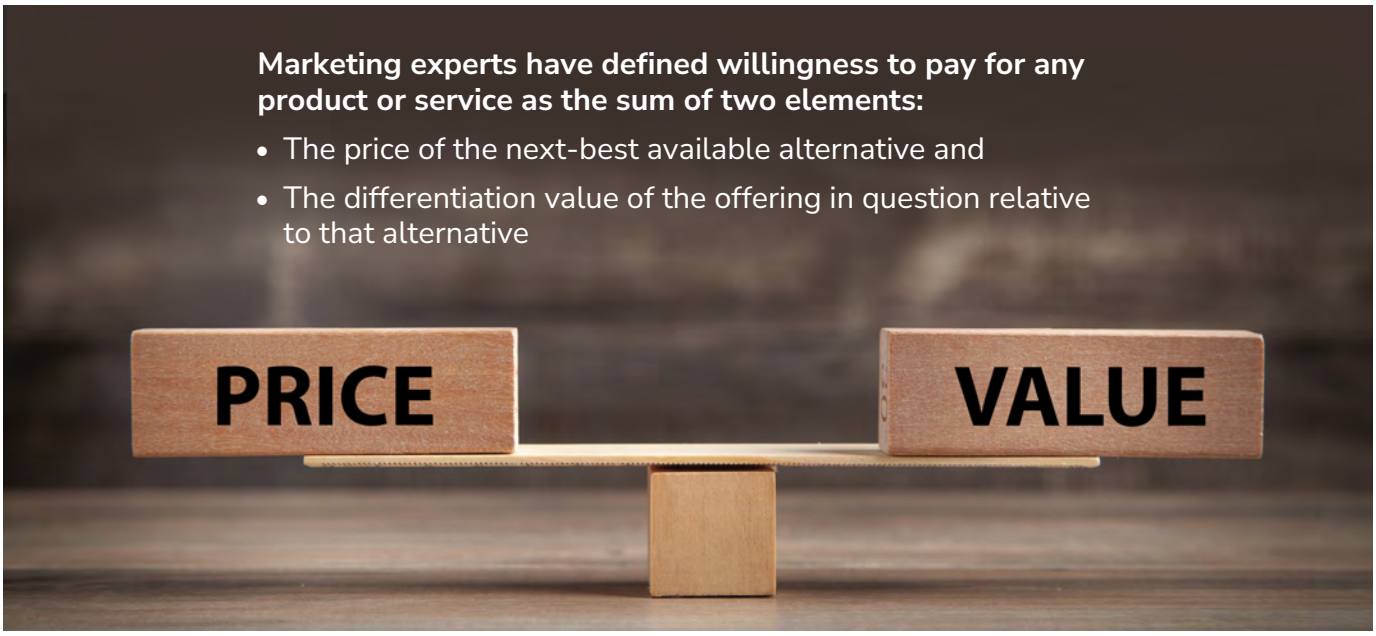
So pricing is important, but not easy. An industry expert lists six mistakes that even large corporations commit:[8]

- Pricing as an afterthought to product strategy (Google Meet as a bundle vs Zoom's digital meeting as the primary product)
- Pricing too low (see Asus example below)
- Ignoring the differences among segments and treating them as a single market (Hulu's offers of ESPN+ as an add-on, for which avid sports lovers are ready to pay more)[9]
- Pricing per user or seat (PayPal brings in revenue to the company; on the other hand, Atlassian helps in improving operations)
- Ignoring the dynamics of retention and upsell, and finally,
- Treating pricing as static (Amazon Web Services reduced prices at least 61 times to scale up; on the other hand, ASUS underpriced when the product was flying off the shelves, where a price increase was the appropriate decision)[10]

So what are the options for measuring the elusive maximum price a customer is willing to pay, short of



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reading minds? To help us think through this puzzle, we need to understand what pricing represents. Modern thinkers view a customer's purchase decision as creating value, which is appropriated and distributed fairly among stakeholders – customers, distributors, producers, suppliers, etc. In this view, pricing is the value-capturing mechanism. Managers and marketers want to understand the maximum price they can charge for their products and services, as well as how to maximise profits without upsetting consumers.

Overpricing could push customers to switch to comparable or alternative brands. In contrast, underpricing squanders the opportunity to make legitimate profits. To quantify this WTP for any product or service, marketing experts have defined it as the sum of two elements:

- The price of the next-best available alternative and
- The differentiation value of the offering in question relative to that alternative

The research by He and team argues that estimating WTP requires comparing a product with alternatives that consumers may consider in different purchase and consumption scenarios. Prevalent methods (e.g., Conjoint Analysis[a], the Van Westendorp Price Sensitivity Meter[b], and in-depth interviews) are inadequate for two reasons. First, they often measure WTP without accounting for these comparisons. Second, they assume that the products and services consumers compare are fixed – but in the real world, these can vary based on the shopping context.

Comparative is best

To address the shortcomings of existing methods, have invented the comparative method of valuation (CMV). This method taps into two distinct consumer comparative mechanisms: direct and indirect. See **Figure 1** for an illustration of these pathways.

Figure 1: Direct and indirect mechanisms for consumer comparisons

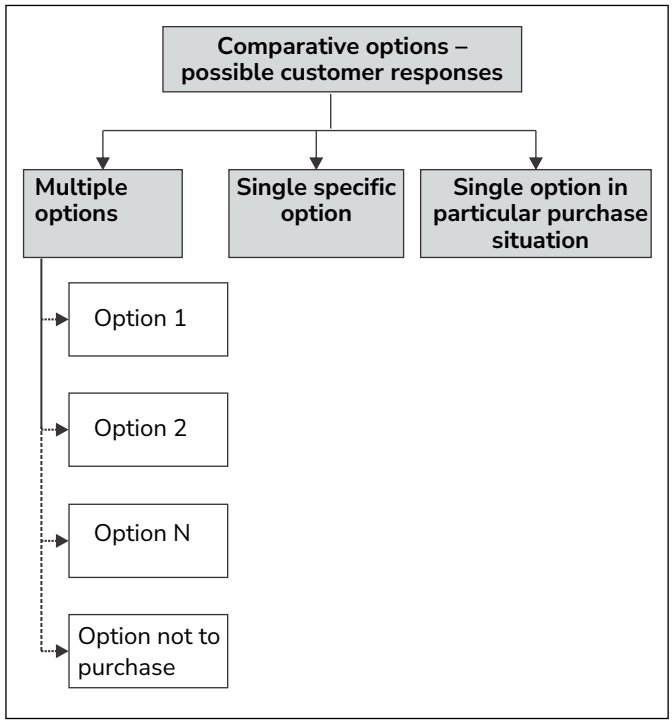
Mechanism	What changes?	Example: Hoegaarden beer	Impact on WTP
Direct	The purchase or consumption situation changes, but the alternative product stays the same	Budweiser remains the alternative, but the setting changes from a beachside location to a five-star hotel bar	Since Budweiser costs more at the hotel bar, consumers may be willing to pay more for Hoegaarden
Indirect	Both the purchase situation and the alternative product change	At the five-star hotel bar, consumers may compare Hoegaarden to a higher-priced cocktail rather than to Budweiser	The higher-priced alternative may lead consumers to accept an even higher price for Hoegaarden

Source: Created by the authors based on Sharlene He et al., "Measuring Willingness to Pay: A Comparative Method of Valuation," Journal of Marketing 88, no. 3 (2024): 50–68, https://doi.org/10.1177/00222429231195564

There are three steps to measuring CMV-based WTP. We illustrate these steps with a fast-moving consumer goods example below.

Step 1A: Identify a suitable comparative option. Choose a comparable brand, it could be a direct competitor or the most relevant comparative option based on a particular purchase situation. For example, let's say the brand manager of Cherry-Coke would like to measure its WTP against a comparable, for which Coca-Cola could be chosen. If the comparative options are less obvious, the marketer should ask consumers which option is most relevant to a particular purchase situation (see **Figure 2**).

Figure 2. Comparative options for WTP measurement



Source: Created by the authors based on Sharlene He et al., "Measuring Willingness to Pay: A Comparative Method of Valuation," Journal of Marketing 88, no. 3 (2024): 50–68, https://doi.org/10.1177/00222429231195564

Step 1B: State the product price point of indifference. Consumers are then asked to state a price for the target brand (Cherry Coke) that would leave them indifferent between buying it at that price and buying the alternative (Coca-Cola) at its specified price. So, then the marketer asks the consumers: "What price for Cherry Coke would make you equally happy to buy it v/s Coca-Cola at US$1.10?" Let's say the consumers answered US$1.30.

Step 2: Equalise the preferences. Here, consumers are given a visual scale where they must equalise their preferences between the target brand and the comparative option at a given price. For our Cherry Coke example, the marketer would ask consumers the following:

"On a scale of 1 to 7, rate your preference to buy Cherry Coke at the stated price (e.g., US$1.30), or buy the comparative option (Coca-Cola) at US$1.10, or prefer both equally?"

1	2	3	4	5	6	7
Strongly prefer Cherry Coke at US$1.30			Equally prefer both options			Strongly prefer Coca-Cola at US$1.10

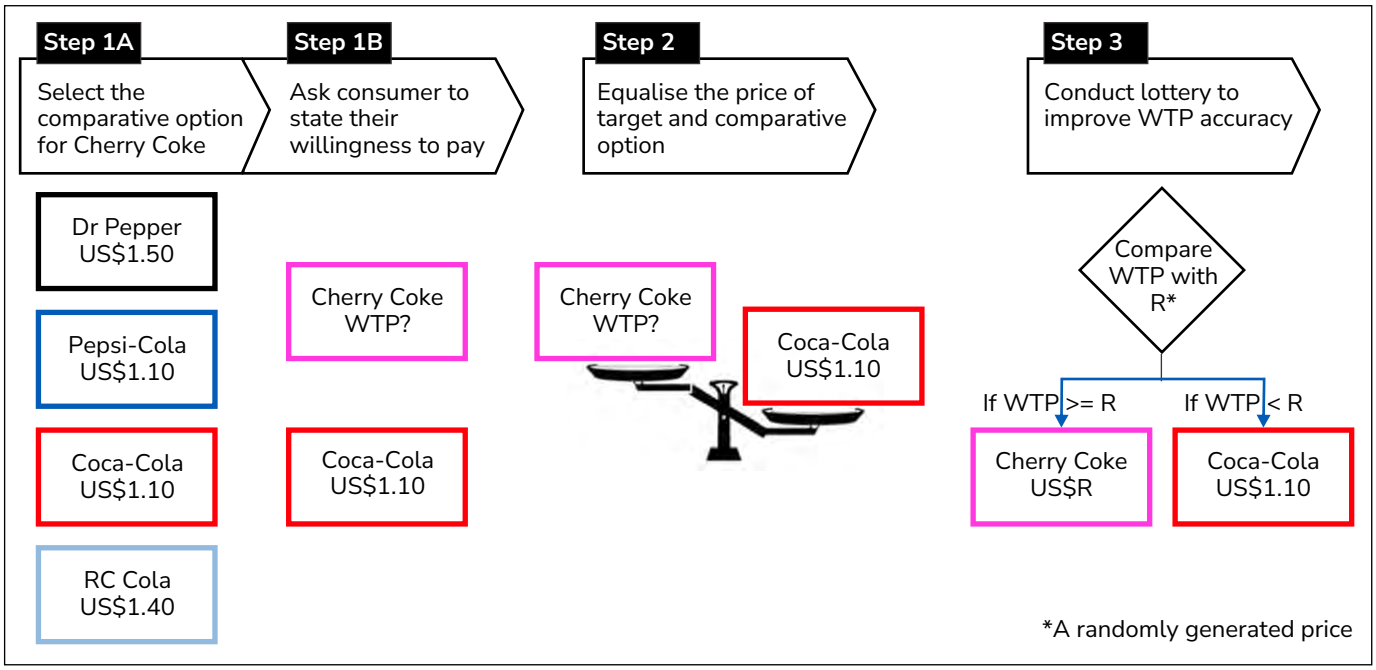


The rating process continues – with changing prices – until the participant reaches the midpoint of the measurement scale (4). In the example, let's say the consumers revise their initial state price for Cherry Coke from US$1.30 to US$1.20; this is the point of equal preference for Cherry Coke relative to Coca-Cola at US$1.10.

Step 3: Lottery. Inform participants that the seller will randomly generate a price (US$R) during this process. Either outcome can occur based on their stated price. If their stated price for the target option (Cherry Coke) is greater than or equal to the randomly generated price US$R, they will receive the Cherry Coke and pay US$R. If their stated price for the target option is less than the randomly generated price of US$R, they will not receive the Cherry Coke at their stated price (US$1.20). Still, they will instead receive the comparable Coca-Cola and pay its specified price of US$1.10. Participants are then given a chance to revise their WTP. At this point, consumers are more likely to truthfully state their WTP for Cherry Coke before the lottery is conducted, as they are more likely to benefit from it.

The three steps above (summarised in **Figure 3**) provide a systematic approach to determining the maximum price a customer segment will pay in a realistic scenario – the elusive WTP.

Figure 3: Comparative options for WTP measurement – Cherry Coke example



Source: Created by the authors based on Sharlene He et al., "Measuring Willingness to Pay: A Comparative Method of Valuation," Journal of Marketing 88, no. 3 (2024): 50–68, https://doi.org/10.1177/00222429231195564

The right fit for comparative

CMV works best when:

- The purchase or consumption situation is clearly defined
- A credible comparative alternative exists
- Customers are effectively choosing to accept or reject the offer

Note that these comparisons work well not only for rival brands, but also for own-brand, upgraded variants. For example, a specialised haircut versus a regular haircut at the same salon, or a premium economy seat v/s a regular economy seat on the same airline. On a related note, CMV can also help set levels for dynamic pricing, tiered subscription plans, or price increases.

On the flip side, when no credible comparative option exists, as with new-to-the-world products such as smart glasses, then managers should look to traditional approaches such as conjoint analysis.[11] The same is true when WTP must be estimated across multiple attributes and contexts simultaneously: conjoint analysis and similar approaches are better suited than CMV.

Usually, managers must choose between speed, accuracy, and cost. Relative to traditional, model-based approaches like conjoint, CMV is better on all three fronts – when WTP is the goal. CMV requires fewer data points, no specialised modelling software, and no statistical analyst to interpret complex results or set up complex experimental designs.

The major costs of deploying CMV include survey design (digital or paper), respondent recruitment and incentives, lottery payouts (the cost of the products purchased in the real world), and analysis time. Remember, managers do need first to specify the target brand, identify one relevant comparative option and its prevailing market price, and describe the valued purchase or consumption situation. If the right comparables are not obvious, then managers need to

The CMV method – in the right pricing situation – helps avoid many pricing errors, such as over-, under-, and static pricing. So, for better pricing, know thy customers and your brand's comparables



fund a short, preliminary study. Another data source for comparables is customer relationship management data, which often stores key inputs such as comparable options and purchase context. This creates a feedback loop, as the resulting WTP estimates guide pricing and marketing, while actual purchase behaviour helps refine them over time.

A final caution: as the number of comparative options and situations multiplies, running CMV across many situation-by-comparison combinations becomes unwieldy. At that point, conjoint analysis, despite its higher fixed setup cost, may deliver more insight. In summary, for a company with a handful of products and a clearly identifiable comparison, CMV is typically the more economical route to a solid WTP estimate.

WTP bottom line

Pricing – and WTP – is not just a fixed number. Seasoned pricing managers already appreciate how WTP might vary over time, across contexts, and by perception across segments. While previously elusive, expensive, and complex to determine, WTP can now be estimated systematically, relatively quickly, and affordably using the CMV method. The CMV method works best when customers have alternative(s) to compare. This method – in the right pricing situation – helps avoid many pricing errors, such as over-, under-, and static pricing. So, for better pricing, know thy customers and your brand's comparables.

Glossary of technical terms used

[a]**Conjoint analysis:** It is a survey-based statistical method used in market research to determine how customers value different product features (attributes) by analysing the trade-offs they make.

Source: Agarwal, James, Wayne S. DeSarbo, Naresh K. Malhotra, and Vithala R. Rao. "An Interdisciplinary Review of Research in Conjoint Analysis: Recent Developments and Directions for Future Research." Customer Needs and Solutions 2, no. 1 (2015): 19–40. https://doi.org/10.1007/s40547-014-0029-5

[b]**Van Westendorp Price Sensitivity Meter (PSM):** A survey-based pricing technique that uses four questions about when a product is perceived as too cheap, inexpensive, expensive, or too expensive to identify consumers' acceptable price range and key price points.

Source: van Westendorp, Peter H. "NSS: Price Sensitivity Meter (PSM): A New Approach to Study Consumer Perception of Price." Proceedings of the ESOMAR Congress, 1976, 139–167.



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