Pricing for sustainability: Linking sustainable principles with pricing strategies

Recently, there has been a notable shift in consumer preferences, with a growing inclination towards choosing sustainable products and services. The increasing impact of climate change-related hazards has brought awareness to the forefront, emphasizing the importance of resource conservation and reducing our carbon footprint. This awareness is especially pronounced among the younger generations, who tend to prioritize their values and actively voice their concerns on social issues.

Retailers are recognizing this shift and incorporating sustainability into their business strategies. This can be achieved through adopting circular economy practices in their production processes or by creating products with sustainability as a key feature and value proposition, such as sustainable clothing lines.

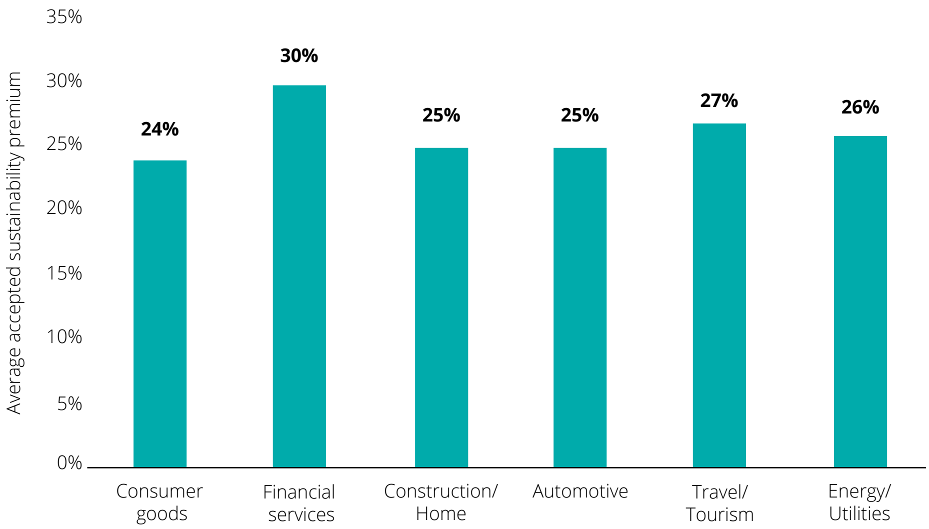

Figure 1: Average sustainability premium consumers would consider acceptable and be willing to pay worldwide in 2022, by category

Source: Statista

As a result, sustainability has become a major differentiating factor in how brands are now interacting and presenting their story to their target audience. There are various dimensions of sustainability that retailers can explore, each of which can impact their value chain at different levels. However, the challenge that remains is the ability to extract and incorporate the real value of these sustainability efforts into the pricing framework. This will further expedite the process of adapting to sustainability and embedding it into the organization's core values.

In conventional pricing terms, a consumer's willingness to pay is directly linked to the perceived value of the product or service and its features. Clearly communicating the value of sustainability initiatives to consumers allows organizations to incorporate it into their pricing strategies. Therefore, to maximize the benefits of such initiatives, the most effective approach is to adopt value-based pricing, which ensures that there is no profit leakage and that all dimensions contributing to consumer value are accurately captured.

Before establishing a framework to incorporate sustainability into retail pricing, retailers should consider several factors:

Alignment with business strategy: Pricing strategies should align with and complement the overall business strategy, ensuring that sustainability efforts are seamlessly integrated.
Strength of sustainability proposition: Pricing strategies are guided by the uniqueness and strength of the sustainability proposition. Customers need to clearly perceive the alignment between sustainability and pricing.
Visibility and communicability: Retailers must ensure that their sustainability proposition is visible and easily communicable to consumers. Transparent communication fosters trust.
Segmentation reevaluation: It may be necessary to reevaluate the existing customer segmentation to understand why customers choose a particular retailer. Retailers can explore various customer categories, including purchasing behavior, preferences, channels, and spending patterns.

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To price sustainability effectively, as a first step, identification of the comparative metrics that serve as inputs for various value-based pricing models is necessary by:

- Identifying the segment into which the product fits;
- Identifying the next best alternative in the market, whether it includes sustainability in the offering or not; and
- Identifying all costs related to making the product/experience sustainable.

There are several techniques that can be used as tools to understand consumers' willingness to pay for a sustainability proposition. These techniques can assist businesses in adapting to an evolving environment capitalizing on the increasing demand for sustainable products and services by actualizing their true value.

Value-based pricing

The most suitable approach for pricing a sustainability proposition is to employ a value-based pricing method. This method essentially aims to capture the value associated with a service or product delivered to the consumer, or conversely, the consumer's perception of the value being provided. It considers the price that customers are willing to pay based on the benefits and value they derive, as opposed to merely relying on production costs or competitor pricing. This approach acknowledges that customers are often willing to pay a premium for products or services that offer distinct or exceptional advantages.

Value-based pricing also serves as a powerful tool for promoting sustainability in the pricing landscape. By aligning prices with the true value of sustainable products and services, businesses can effectively encourage consumers to choose these eco-conscious options over less sustainable alternatives. This strategic approach not only stimulates increased demand for sustainable offerings but also sets a compelling example for other businesses to integrate sustainability into their pricing strategies.

Examples of approaches to value-based pricing include the Conjoint Pricing Model, the Van Westendorp Price Sensitivity Meter, the Gabor-Granger Pricing Method, and the Economic Value to the Customer (EVC) framework. Each of these methods offer a unique perspective on capturing and leveraging customer value.

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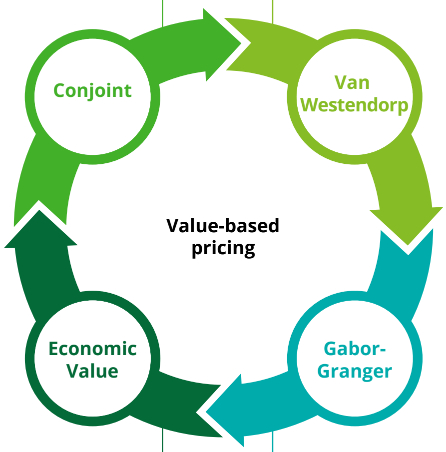
Conjoint Pricing Model
A strategic method for businesses to identify the ideal pricing strategy by studying customer preferences and willingness to pay. Customers are presented with a range of pricing scenarios that incorporate different price levels, features, or product combinations. This approach aims to determine the impact of these factors on customers' choices when making purchases. The output allows businesses to optimize pricing for maximum revenue and customer satisfaction.

The Van Westendorp Price Sensitivity Meter
Market research that surveys potential customers on various price points and tags their feedback on each pricing as a cheap, bargain, expensive, or very expensive price point. Multiple responses are mapped on a chart to help businesses identify the price bracket where consumers perceive the offering as providing good value, aiding in pricing decisions.



Economic Value to the Customer (EVC)
This method assesses the comprehensive economic benefits a customer gains from utilizing the offering, including cost reductions, enhanced efficiency, and overall advantages. The base for added value is determined by comparing it to the closest competitor with similar benefits.

Gabor-Granger Pricing Method
Used to assess price elasticity or demand for a product or service. It involves conducting surveys to gauge consumer interest in purchasing the product at different price levels. By analyzing these responses using a cumulative frequency chart, businesses can estimate the price at which demand becomes substantial, aiding in pricing decisions to maximize revenue and market share.

Figure 2: Different value-based pricing methods

However, a distinct dilemma exists between optimizing profitability through value-based pricing and employing pricing strategies to shape consumer demand towards sustainable products with more appealing pricing. The appropriateness of each approach depends on the overarching brand strategy, its alignment with the proposed pricing structure, and the short-term and long-term business objectives.

When pricing a product with substantial price elasticity, especially if it caters to price-sensitive consumers, one could argue that a penetration pricing strategy might be more suitable. This entails setting a lower price initially to stimulate demand and gradually transitioning to value-based pricing once the demand stabilizes, leveraging the support of marketing interventions. In contrast, for products or services with a more inelastic price structure, adopting value-based pricing while reinforcing it with a sustainability-focused marketing narrative may offer a more favorable approach.

Pricing analytics

Pricing analytics can be employed to monitor competitor pricing strategies, uncovering opportunities for businesses to distinguish themselves in the market. Through a comprehensive analysis of competitor pricing approaches and identifying areas where rivals may be pricing too low or too high, businesses can refine their own pricing strategies, gaining a competitive edge. It can act as a powerful tool for monitoring shifts in demand for sustainable products and services in response to price fluctuations. Such data can be leveraged for dynamic pricing adjustments, ensuring that businesses consistently offer optimal value to their customers.

Reimagine your pricing strategy

To effectively convert sustainable products and services into profitable ventures, pricing strategists need to challenge conventional norms and propose fresh approaches to pricing. This entails exploring inventive pricing models, such as usage-based or subscription-based pricing, as they have the potential to encourage sustainable practices and minimize waste. It also involves a willingness to reconsider current pricing strategies and business frameworks to ensure they harmonize with sustainable principles.

Pricing strategists must demonstrate innovative thinking and a willingness to take calculated risks in order to drive positive transformation. By challenging existing business models and embracing new pricing methods, they can assist companies in developing sustainable offerings that align with the evolving preferences and expectations of customers and deliver against their stated environmental, social, and governance (ESG) objectives.

Ultimately, it's crucial to engage in a process of continuous testing and learning, regardless of the pricing model or playbook chosen to be implemented. As both customer requirements and competitive dynamics constantly evolve, pricing cannot operate in isolation and must adapt accordingly each time a shift occurs.

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