



June 21, 2001

Capital

How Technology Tailors Price Tags

CHARGING EVERY CONSUMER the same posted price was a 19th-century innovation that took time to spread. Not so long ago, a tailor on New York's Lower East Side would say in a thick East European accent, "For you, a special price."

You, of course, had no way of telling whether that "special price" was high or low. So you'd haggle and, if the salesman was any good, you'd walk away with a suit and a sense that you had gotten a bargain, even if you hadn't.

Then came stores that charged everyone the same no-haggling-allowed price. Now, technology is attacking that -- and not just on the Internet or for air fares.

Faster computers, more sophisticated analysis and huge amounts of data that retailers are collecting allow grocers, drugstores, mortgage lenders, computer makers and other merchants to charge you a "special price" without exactly saying so.

Just because technology makes this possible doesn't mean it will happen soon. Pricing managers across the economy were spooked by the uproar that followed **Amazon.com's** experiment last fall with charging different prices for the same DVD on the same day. Consumer worries about privacy limit retailers' willingness and, sometimes, ability to use data they've collected. And there will be losers: Consumers who are charged less won't complain; those charged more may.

But smart merchants are relearning the tailor's savvy about the customer's perceptions. "Amazon.com's biggest mistake was getting caught," says Jared Blank, an analyst at Jupiter Media Matrix Inc. in New York. Don't charge anyone more, consultants advise. Just charge some less. It sounds impossible, yet that's how coupons work, and that's what is happening as computers turn pricing from art to science.

PRICING CHANGED when airline deregulation in 1978 forced airlines to compete on price. At the time, air travel seemed a special case. The product is perishable; an empty seat can't be sold later. Prices were posted electronically and thus were easy to change. In 1985, American Airlines figured out how to adjust prices automatically to maximize revenue. Other airlines, hotel chains and rental-car companies followed. Airlines weren't unique.


Any merchant would love to sell a product at the highest price each customer will pay. A store might price a dress at \$300 and sell three even though one customer might be willing to pay \$500, and another \$400. The trick: Make identical dresses seem different and price each one differently. Airlines perfected this. A tourist who books a month in advance pays less than an executive who booked the day before yet both arrive at the same instant.

E-commerce appeared an ideal way to do the same elsewhere, and to some extent it has. **Dell Computer Corp.** charges one price on its Web site for small firms, another on a site for local government. **EBay** auctions set prices one buyer at a time. PNC Bank in Pittsburgh auctions certificates of deposit as small as \$5,000; if your bid is among the 25 best, you get it.

Online retailing didn't change the world as fast as it was supposed to. But the big action in pricing is off the Internet, and that's where most people shop.

Until recently, big mortgage lenders offered every accepted applicant the same interest rate. Today, their computers draw increasingly fine distinctions and are programmed to offer higher-rate mortgages to slightly riskier applicants who otherwise would have been turned away.

The small initiative generates good public relations because borrowers otherwise would have paid even more elsewhere. But the technology opens the door to charging every applicant a rate based on his or her individual risk. Computers make

 ⁰See more information about some of the items mentioned in this column.

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separating sterling risks from ordinary risks easy. The obstacle: Charging the best risks (read rich) a bit less and others a bit more is ugly. But it's probably inevitable.

GROCERY STORES APPEAR to be the model of one price for all. But even today, they post one price, charge another to shoppers willing to clip coupons and a third to those with frequent-shopper cards that allow stores to collect detailed data on buying habits. With help from firms armed with Ph.D.s and sophisticated software, big chains use that data to boost revenue by raising some prices and cutting others.

The next steps are already in sight. "Pricing is moving from the product to the store to the individual consumer," says grocery-industry veteran Patrick Kiernan. Some chains automatically dispatch diaper coupons when a frequent shopper buys baby food but not diapers. Next: Once the computer notes that a regular customer stocks up on Progresso tomato sauce every time it goes on sale, the computer will simply offer the sales price automatically at the cash register whether it's on sale or not.

Before long, the only person paying the posted price -- the "insult price," Mr. Kiernan calls it -- will be a stranger or a customer who prizes privacy so much she'll pay extra for it.

-- David Wessel

Write to David Wessel at capital@wsj.com³

Resources

Click on these links for an economics textbook view of [pricing](#)⁴ and [price discrimination](#)⁵. These excerpts, reproduced with permission, are from MIT professor N. Gregory Mankiw's Principles of Economics, Second Edition, published by Harcourt College Publishers, copyright 2001. For more on this textbook, see: www.harcourtcollege.com/econ/mankiw⁶.

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For more on PNC Bank's CD auctions, see: <http://www.pncbank.com/auction/>⁷

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For more on the evolution of pricing strategies, see:
www.crmproject.com/wp/Phillips.html⁸

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For more from firms that advise companies on pricing, see:
www.khimetrics.com⁹
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[Dell Fine-Tunes Its PC Pricing to Gain an Edge in Slow Market](#)¹²

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