Designing a Differential Pricing Program

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In 2000 a major electronic retailer began selling the same DVD movies at different prices to different customers. The differential prices were based on the customer's previous purchases. Customers who had purchased more DVDs in the past were actually charged a higher price. In essence, the retailer was trying to target price incentives to new or infrequent customers. Loyal customers soon uncovered the differential pricing strategy and flooded the chat boards with complaints. The retailer was eventually forced to discontinue the differential pricing and refund the customers who had paid higher prices.

That experience highlights the fact that differential pricing in any firm can be controversial and perceived as unfair. In a cooperative, where most customers are also owners, it is particularly important that differential prices be perceived as fair and transparent. The category or the qualification for obtaining a more favorable price should be clearly communicated. The pricing program should appear equitable. If the rationale for differential; prices is not obvious (example-handling cost differences) than the indirect benefit to the cooperative and members should be communicated. Our on-line retailer could have learned from all of those principles.

Basing differential pricing on bundled transactions can be more effective. For example, offering a small discount on fertilizer for members who deliver over a threshold amount of grain rewards loyalty. Bundled discounts are also less likely to result in a bidding war with the competition. A bundled discount or "preferred customer program" also encourage a strategic change in patronage rather than simply winning a single transaction. You might recall that in 2005, the on-line retailer I mentioned created a new membership category that linked shipping cost benefits to the purchase decisions.

If you're considering differential pricing, that is a "Prime" example.