How Companies Raise Prices Without Raising Prices

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The demand curve imposes its tyranny on every business. Raise prices and sales will begin to falter. Cut prices and customers will flock to you. It's usually either higher sales or higher profit.

The holy grail of pricing strategy is in finding ways to circumvent this seemingly ironclad economic law, to raise prices without losing sales. That becomes even more crucial at times like now, when input costs are increasing quickly, and raising prices is necessary just to keep the business running.

But we live in a time when customers have sharp eyes and loud voices. When a company raises prices directly, some vigilant customer is bound to notice and complain on social media, no matter how small the increase or valid the reason. A few complaints could then spiral into a firestorm of outrage, upturning even the most carefully orchestrated price increase.

The solution for many companies is to raise prices, but covertly. Companies hope that by making price increases hard to evaluate, they can then escape notice and avoid a customer backlash.

Here are common ways companies raise prices covertly.

1. Unbundling services, lowering product quality and devaluing reward programs

My favorite pricing aphorism is, "Raise prices but keep them the same." It sounds like a Zen koan, and it holds the key to a successful price increase. Consider this telling statistic from a recent Wall Street Journal article on airline prices: The average domestic airline ticket price is about the same today as 25 years ago, $260, versus $284 in 1996. And that's *before* adjusting for inflation. How is it possible that the airline industry hasn't increased ticket prices in over two decades?

It isn't, really. Most of us are paying a lot more to fly today, thanks to a combination of three covert price increases. First, airlines have unbundled services so that fliers pay extra for checking luggage, boarding early, selecting a seat, having a meal and so on. The charges for these services don't show up on the ticket price, but they are substantial. Second, the airplane seat's quality, as measured by its pitch, width, seat material and heft, has declined considerably, meaning customers are getting far less value for the ticket price. And third, many airlines have steadily eroded the value of frequent-flier miles, increasing costs for today's heavy fliers relative to those in 1996.

These practices are also common in other industries, whether it's resort fees in hotels, cheaper raw materials in garments and appliances, or more-stringent restaurant and credit-card rewards programs.

The average domestic airline ticket price is about the same as 25 years ago, but airlines have found several other ways to raise the cost of flying.
PHOTO: BILL SIKES/ASSOCIATED PRESS

2. Shrinkflation and the quantity surcharge

Most people are familiar with shrinkflation—the common practice in the grocery industry of reducing weight, quantity or volume of a package while maintaining price. It works effectively as a covert price increase, because consumers are far more likely to notice price increases than equivalent weight or quantity decreases.

Less well known is a little psychological trick companies use with larger packages. Many shoppers assume that such packages with labels like "Party Size" or "Jumbo" will be cheaper on a per-unit basis. This is often not the case. Brands routinely exploit this common consumer belief by marking up larger packages *more*, and earning a greater margin on them. Researchers call this a "quantity surcharge."

At the same time, in many categories like cola and cookies, smaller packages still often cost a lot more per unit than standard-size packages, just as consumers expect.
The critical insight is that every product in a brand's lineup has different markups and margins that aren't always intuitive to customers. To raise prices covertly, the brand or the grocery store sells more of the higher-margin items by increasing their availability and visibility in the store, or withdrawing popular lower-margin items from circulation for a period. The prices don't change, but customers pay more.

3. Disappearing deals and coupons

Incentives such as coupons, "buy one, get one" offers and free shipping are common in many industries. Every promotion lowers the actual price paid by customers. So it makes sense that companies can routinely *raise* prices covertly by reducing the incentives they offer.
Even increasing the threshold for free shipping, from $49 to $99, is tantamount to a price increase. Customers might grumble when they realize their favorite deal is no longer available, but relatively few of them change their behavior in response.

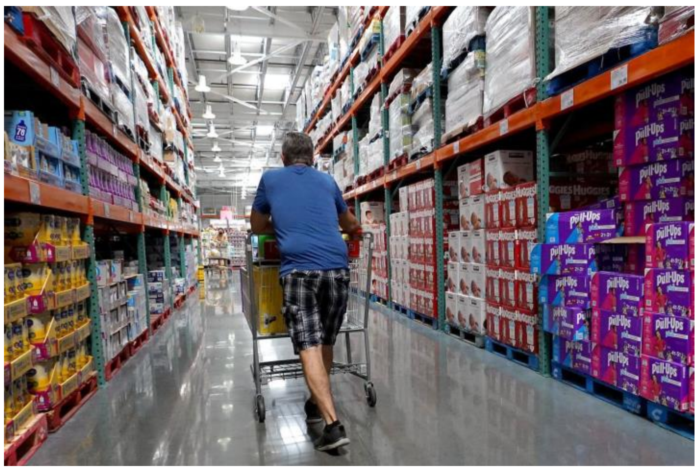
4. The sunk costs of memberships

Consider the following comparison: Which one is cheaper, a 64-ounce container of mayonnaise at a warehouse club that costs $7.99, or a 48-ounce bottle of the same brand at a supermarket for $5.94?

Most people will guess the warehouse club because of its low-price image. If you do the math, the price per ounce is roughly the same. But if you consider that the warehouse club requires a separate mandatory membership fee, the customer is actually paying more per ounce at the warehouse club.

Still, even though they pay it, most warehouse customers almost always ignore the initial fee, even if it's recurring. They treat it as a sunk cost and fail to account for it in calculating the actual price they are paying for an item.

Known as two-part pricing, the membership fee camouflages the actual price paid by customers—and is behind the success of Costco, Amazon and likely your neighborhood gym. (A gym's initiation fee, a landlord's application or administrative fee, and an online ticket seller's per-transaction processing fee all serve the same purpose.)



5. From good to better and from better to best

Another way to raise prices covertly is to introduce new, higher-quality versions at higher prices. This is called "good-better-best" pricing. Consumers like this approach because it gives them more choices. But its side effect is a stealthy price increase.

Many companies have used this method to benefit from higher consumer demand and earn higher prices during the pandemic. For example, Peloton lowered the price of its most popular basic spin bike by $350, or 16%, from $2,245 to $1,895. At the same time, it introduced a more expensive and profitable new bike for $2,495.

I believe that both moves effectively increased the average prices paid by Peloton customers, although the company won't confirm that's the case.

The smartest companies don’t raise their prices with great fanfare, because direct price increases are often met with customer resistance. What they do instead is to employ nuanced pricing strategies to increase prices covertly, often keeping their regular or visible prices unchanged. Most customers don’t notice, and some customers may even benefit by paying less. But in the end, the company enjoys higher sales and profit margins than before.

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