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The Secrets of Making Surge Pricing Work—Without Turning Off Customers

Companies can offer perks and cap how high prices can rise

People often consider surge pricing unfair, but companies can take steps to avoid alienating customers. ILLUSTRATION: CHRISTOPH HITZ FOR THE WALL STREET JOURNAL

By Christopher S. Tang

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Anyone who has taken Uber during a rainy rush hour has encountered surge pricing, where companies charge a premium when demand is highest. The practice has many advantages—boosting revenue and reducing congestion among them—but it can also alienate customers, who might object to a spike in prices just when they need the service the most.

So, is surge pricing a good idea for companies? Based on my research with Steve Yoo of University College London, the answer is yes—provided organizations follow a few simple guidelines.

Plenty of companies practice surge pricing, of course. We're already familiar with paying more when we book a flight for the Tuesday before Thanksgiving or reserve a hotel room during Super Bowl weekend. Many electric utilities charge higher rates during periods of peak demand for power. And it isn't just businesses. Singapore and London raise road tolls when congestion is greatest.

For companies, surge pricing is appealing because it doesn't leave money on the table—they can maximize revenue from their least price-sensitive customers. Also, it enables a firm to balance demand with supply; surge pricing, for instance, enables Uber to attract more drivers in peak times while "shaving off" demand from riders not willing to pay a premium.

But there are risks. Customers often consider surge pricing unfair—imagine that the price of your favorite ice cream doubled on a hot summer afternoon. Especially when there's competition in a market, unhappy customers not only might avoid a product when demand is high, they may head to competitors for good. Even companies that dominate their markets,

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which obviously have a greater ability to raise prices during peak hours, have to worry about alienating customers and inviting new competition.

Even so, surge pricing is here to stay, and is likely to intrude in more areas of our lives, thanks to online and mobile technologies that make it easier to adopt rapid price changes. Grocers and other retailers are experimenting with electronic price tags, which they could use to change prices during the day or in the face of higher or lower demand. Regal Cinemas, one of the largest movie-theater chains in the U.S., says it plans to experiment in 2018 with charging more for tickets for popular movies during peak times.

Is there a way for companies to get the benefits of surge pricing while avoiding a business-killing consumer backlash? What follows are some suggestions, based on our research, for how they can.

• **Cultivate customer loyalty.** Companies whose customers have well-established shopping habits, we found, are better able to adopt surge pricing. Many consumers are "time loyal," shopping when it's most convenient (after work, say) or when they have free time (seeing movies on weekend evenings). They might be less likely to change habitual behavior in the face of surge prices. But companies shouldn't take them for granted. To hang on to these loyal customers, companies should consider loyalty programs that reward peak-time customers with more points or other benefits during the surge period. For example, some airlines offer more reward points for flight segments with a surge price. These kinds of loyalty programs have been shown to keep customers returning even if prices are higher.

• **Combine surge prices with low-cost perks.** Rewards don't need to be limited to habitual customers. Companies can offer gifts or other rewards to all shoppers during surge periods. For example, a cinema might offer free beverages or popcorn, or a supermarket could give coupons for future visits. Other businesses could hand out redeemable vouchers. This form of investment is small because compared with the extra revenue from surge pricing, the real cost of soft drinks and popcorn is very low, as is the redemption rate of coupons.

• **Take the sting out of higher prices with value-added services.** In some cases, the purpose of surge pricing isn't to manage demand but simply to maximize revenue when traffic is high. For instance, a supermarket deli counter might raise prices at lunchtime, but also leverage the crowds to bring in specialty bakers or outside chefs to create unique food items, providing customers with higher-quality or novel products.

• **Bundle surge and nonsurge items.** Companies that offer a unique bundle of products or services are in the best position to introduce surge pricing without alienating customers, for the obvious reason that customers aren't as likely to notice. Although prices may be raised for certain high-demand items, customers will instead focus on the price of the whole bundle, making the premium prices less obvious. This is especially easy for grocers, where shoppers typically buy a basket of items. For cinemas, the whole bundle can include movie tickets, soft drinks, popcorn and parking fees.

• **Don't take advantage of vulnerable customers.** The surest way to provoke consumer anger is by appearing to use surge pricing to take advantage of sudden, disaster-related spikes in demand. It's one thing to raise prices on soda before the Fourth of July weekend, but quite another at the approach of a hurricane. Customers might not like paying a premium for ride hailing after a popular concert, but they're going to be furious about being charged more after a

terrorist attack. Companies will end up alienating their best customers and inviting retaliatory action such as boycotts.

• **Don't get carried away.** Companies that successfully introduce surge-pricing programs might be tempted to push premium prices to an extreme, especially if they have few competitors and lots of congestion-averse, habitual customers. Still, they risk consumer backlash if prices rise too high, too quickly and too noticeably. Companies can avoid this by putting a cap on surge prices, and by limiting the surge price period over a certain time window.

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