A Chilled Coke in Tehran

Coke is one of those products for which the value perception depends only marginally on the intrinsic value of the product per se. Where and how the product is presented and sold determines the price level to a large extent.

I am quite used to paying different prices for a coke: €0.99 in a local supermarket in Cologne, €2 in a vending machine at the airport, €3 in a restaurant on the banks of the Rhine, and €8 in a fancy upscale bar in Shanghai, and the list goes on. You get the idea. Coke always stays the same (ok, admittedly the taste, no matter whether Coca Cola or Pepsi, differs slightly in different countries), but there is always something that gets added to the otherwise identical drink that justifies the price difference, for example, the glass, a piece of lemon, the atmosphere, and occasions, just to name a few.

None of the above examples fits an incident that took place in Tehran, the capital as well as the most populous city of Iran. The city impressed me in many ways.

In late spring 2016, I flew from Frankfurt to Tehran for the first time in order to deliver our first-ever project for a large state-owned enterprise. At that time, the United Nations had just lifted sanctions against the Persian Gulf nation after decades of boycott and isolation. Many infrastructure
companies, such as telecommunications and oil companies, as well as many consulting firms from every part of the world, were (re-)entering Iran at that point in time. Among them, there were also many Chinese companies, such as Sinopec, CNPC (oil and gas companies, collectively known as two barrels of oil in China), Huawei, and ZTE (both telecommunication equipment manufacturers). Simon-Kucher & Partners was among the many Western consulting firms that entered the Iranian market then. Our team was tasked with developing pricing strategies and new price models for the latest innovations that the state-owned enterprise planned to bring to the market shortly.

My German colleagues and I plunged into this exotic country, having little idea what we would expect. Not surprisingly, we experienced a kind of culture shock from time to time. For example, we were re-directed multiple times to find the right entrance to an office building on day 1; the company’s staff would just disappear at any time during(!) working hours for whatever reasons; the weekend is Thursday and Friday instead of Saturday and Sunday; fried foods dominated the culinary landscape (although McDonald’s and KFC were nowhere to be found). It was very much of a kind of Newfoundland to us.

There was a neat and quiet Japanese park nearby our client’s office. The park had been donated by the Japanese government and did have a serenity resembling that of Japan in a sparkling way. I detoured to the Japanese park after a quick lunch on a daily basis during the nearly 6-month assignment. Watching koi (brocaded carp in Japanese) in the Japanese park calmed my mind just wonderfully. More often than not, a coke would accompany me on my walks in the park.

After decades of being shut out from the outside world, the retail landscape in Tehran was left severely underdeveloped from a European or Chinese perspective. Convenience stores and supermarkets were non-existent back then. Mom-and-pop kiosks were the go-to place, if one needed drinks, snacks, or elementary groceries. There was this small kiosk just next to the client’s premises, where I usually grabbed a refrigerated Pepsi before going to the Japanese park abovementioned. I would have preferred Coca-Cola, but this drink was hardly ever seen, which made Tehran basically Pepsi’s territory. I don’t recall exactly how much a can of Coke cost in Iranian rial (IRR). The country had been sanctioned for such a long time that the currency exchange rate fluctuated greatly even within the period in which I was stationed there, which was shortly after the ban was revoked. For the sake of simplicity, let’s say that it cost about €1, which means it was not that cheap by local standards. Tehran City has a classic continental climate. April and May are already stiflingly hot, or even sometime scorching for European standards. As far as I was
concerned, €1 was well spent for a chilled coke. The day after the start of Ramadan (early in July 2016, if I am not mistaken), the weather became extraordinarily hot, and the office was inadequately air-conditioned so that a cooled coke at noon was a very welcome drink and something to look forward to.

One day, as soon as the lunch break began, I decided to skip lunch and ran straight to the mom-and-pop kiosk I had been always frequenting. Only after going out with the Coke in my hand did I realize that something was different. It was the price! Counting the changes, I saw that the owner had charged me double the usual price! Trying to find out why, I turned back to have a word with the owner. It was a difficult conversation, as he was bad at English and I’m even worse at Persian. In the end, I came to understand that the price had been raised on account for the unusual heat, which consequently increased the pleasure derived from drinking the cold Coke.

That was an eye-opening moment for me, although I definitely hated it as a consumer. It was an interesting, textbook-like practice of dynamic pricing by temperature, which I had only read about so far.

As early as in the last century, Coca-Cola tested “pricing by temperature” in several markets around the world. The Coke vending machines were equipped with temperature sensors and embedded with pricing software to adjust price in accordance with the change in temperature. The ingenious price experiments did not find many friends, as consumers because of this protested against Coca-Cola, which the media pictured as the greedy merchant. The dynamic pricing scheme that I encountered in Tehran was essentially the same as that tried out by Coca-Cola, although on a more hand-operated level.

In spite of the miserable outcome of Coca-Cola’s pricing by temperature experiments, its underlying logic merits a deeper look. By linking the Coke price to temperature, Coca-Cola was basically asserting that the price should reflect the value provided to the consumer. In this particular case, the assumption was that when the temperature gets higher, consumers find greater value in having a chilled Coke. In turn, the seller should be able to demand a higher price for the incremental value. Cost did not play a role here. Value for consumers should determine and drive the price. If you look around, there are plenty of examples where consumers are ready to pay different prices for the same product or service, without much hesitation:

- If one picks up a coffee at a convenience store or a bakery, it cost €1. For the same coffee, Starbucks would charge €3 and more. In the lounge of a premium hotel, it might cost €5 or €6.
• The entry tickets for Shanghai Disneyland cost 55% more on peak days than on normal days. The price differential goes up 80% during super high season such as Spring Festival and National Day. Nevertheless, the amusement park is still packed.
• Cab fares of Uber or Didi drivers could shoot up by 50% more than usual during peak times. Although people complain about the peak price, they will still be more than willing to be pay for it (especially when they are under time pressure to catch a plane or a train).
• Food menus can be (very much) more expensive in railway stations and at airports. As a rule of thumb, the closer you are to the point of departure, the more desperate you are, and the higher price you are willing to pay for a bottle of water or some mundane snacks.
• Airlines and travel agencies change prices dynamically over the year. You seldom hear passengers complaining about it.
• Hotel rooms in Tokyo cost over 20 times the normal rates during Olympic Games 2020 (unfortunately postponed to 2021 due to the COVID-19 pandemic).

The abovementioned examples demonstrate under what circumstances price differentiation is defendable, in other words legitimate. Specifically, my takeaways are as follows:

• Inelastic demand: if people set their minds on doing something (e.g., going to Disneyland with their family or going on a well-deserved vacation with old pals), price plays a lesser role in decision-making.
• Sparsity of alternatives: the concert has just finished; it is late at night. Public transportation is no longer in operation. In order to get home, you will have to take a taxi or walk. At the same time, others from the audience to the concert are also eager to make it home. Uber/Didi price spikes and you accept it.
• Proof of greater efforts: it is about fairness. Consumers are likely to pay more when they believe the service provider is going the extra mile (taxi trips late at night).
• Enhanced value perception: this is probably the most underrated factor. Value needs to be brought across to the recipient. In order to charge a higher price, the seller needs to make sure that the buyer understands the higher value of what is offered (a cup of coffee at Starbucks brings perks such as delightful atmosphere, free Wi-Fi, etc. that a bakery can hardly match). Otherwise it will simply not work.
In light of the analysis above, Coca-Cola failed for good reasons. Although consumers are likely to associate higher value with a chilled Coke on a hot day, they can choose to not pay it and just go shopping elsewhere. More importantly, it appears to consumers that Coca-Cola is taking advantage of them without putting in any additional efforts. This is the decisive reason that causes consumers to disapprove of pricing by temperature.

Even if the Coca-Cola Company were able to get away with the pricing by temperature scheme, it might not be in its best interest to do so. The optimal price depends on the shape of the demand curve. See Fig. 1.

For the sake of simplicity, let’s assume that the demand curves for Coke are linear. The optimal price that maximizes profit lies at the midpoint between the variable cost per unit and the maximum price. Maximum price is defined as the price at which the quantity drops to zero. In scenario I, we observe a parallel shift of the demand curve to the right when the weather becomes hot, resulting in the increase of the maximal price. So it would make sense to increase the price. In scenario II, however, only the slope of the curve of the demand curve becomes steeper. It means that for the same price, there will be more consumers willing to buy a coke. However, the maximum price does not change. In this scenario, Coca-Cola will be better off keeping the selling price unchanged. So it is not so straightforward. One could also argue that there would be scenarios with nonlinear demand curves, in which companies should actually lower prices to maximize profit in hot weather.

Regardless of the shape of the demand curve, a sudden price increase will definitely not resonate with customers. I despise the kiosk which charged me

![Fig. 1 Demand curves for coke. (Source: Author’s own figure)](image)
double the normal price on the grounds of hot weather. That said, I am not regretful about paying the extra price for the Coke in Tehran. After all, it provided me with a good story to talk about.

**Remember This!**

- Price differentiation is an important means when it comes to exploring consumers’ willingness to pay.
- A solid understanding of what drives customers’ perception of value and fairness underpins successful price differentiation.
- Even if customers accept pricing by temperature, a variation of price differentiation, it might not be in the best interest of the company to implement this, because the optimal price depends on the underlying demand curve.