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THE STRATEGY GROUP

The 10% profit opportunity

Why pricing should be at the top of the board agenda

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CONTENTS

TO HEAR MORE ON ROBERT'S VIEWS ON PRICING WATCH THE VIDEO ON SLANT

About this report

Independent, anonymous opinion research was conducted among 200 UK based senior managers in the largest corporate firms across a range of sectors including industrial goods and services, automotive, consumer goods and business services sectors.

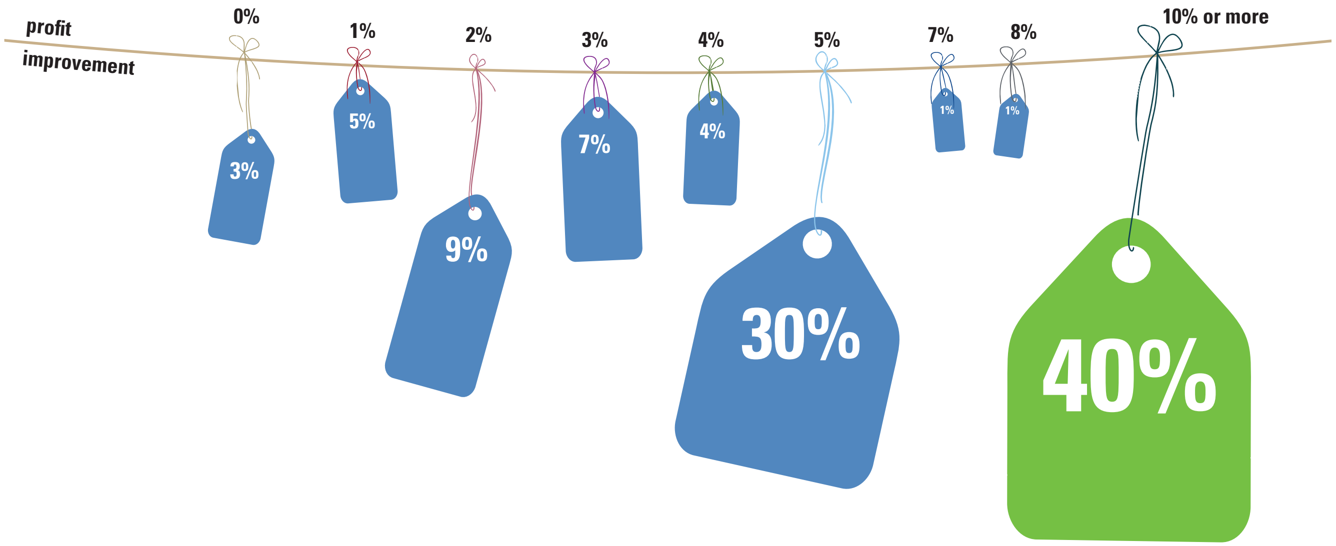
About the author

Robert Browne is a pricing specialist and partner in KPMG's Strategy Group. Robert has spent his career working with international firms, across sectors, to improve their pricing strategies and help them to think about pricing as a strategic capability.

THE PRICING PRIZE

Companies that are thinking about pricing as a strategic capability will outperform their peers on sales and profit growth. But this requires a step-change in mindset for many companies, where pricing is traditionally viewed as a tactical lever to drive volume.

In the current market conditions, what profit improvement would you estimate your company could generate with more effective pricing?



Getting pricing right has the potential to transform a company's performance but, as a discipline and function, it was largely ignored until the recent recession when life got much more difficult for sellers.

Over the past five years, the importance of pricing has risen as companies struggled to grow profits in a lacklustre economy. CEOs are now talking about 'better pricing' and 'getting paid for value' but, in reality, pricing is still the elephant in the room for most companies.

The opportunity is second to none. In research we conducted this year with 200 of the largest companies in the UK across a range of sectors, 40 percent said they could generate at least a 10 percent profit improvement through more effective pricing and 10 percent said they could generate at least 20 percent.

These numbers are eye-watering and represent very significant shareholder value yet pricing is still overlooked and underdeveloped as a capability for most companies.

"Getting pricing right has the potential to transform a company's performance."

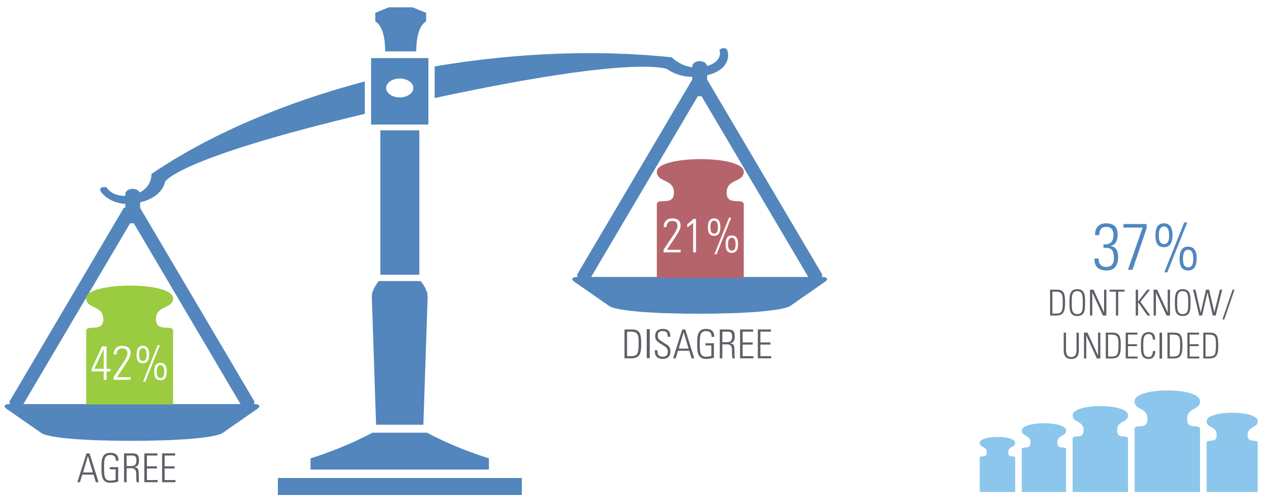
RETHINKING PRICE AND VOLUME

The recession forced many organisations to focus squarely on volume and fight for every point of market share. After several years of this, companies have been conditioned to think of pricing as a lever to drive volume and that by lowering prices volumes can increase or be maintained.

The reality is that demand is not as responsive to price changes as one would expect. I have seen companies cut prices by as much as 20 percent only to see volumes move minimally. And discount levels have ratcheted up in the past five years. A 10 percent mark-down or £1 off is no longer considered appealing when 3-for-2 or 2-for-1 offers are common and these are what shoppers have come to expect.

The problem is that lower prices do not drive volumes if everyone lowers their prices (or increase promotional discounts) at the same time. In that case, only customers benefit. In our research, respondents were twice as likely to agree as disagree that growth in discounting over the past five years has led to promotional wars which have reset prices permanently lower for their products. For companies unable to break free of the pricing downdraft, this will create significant long-term profit problems.

Given the growth in discounting over the past five years, promotional wars have now reset prices permanently lower for some products.



"The problem is that lower prices do not drive volumes if everyone lowers their prices at the same time."

THE VALUE EQUATION

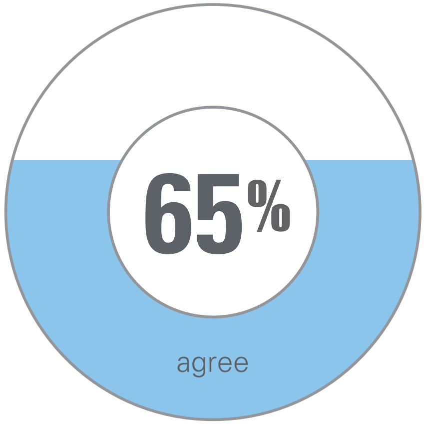
We know that the customer's perception of value (which sits at the core of their purchase decision) is the relationship between a product's benefit to its price, relative to alternatives. We call this the value equation. Over the past five years, companies have focused in spades on adjusting price to improve the value equation in their favour.

This has been exacerbated by procurement functions ready to take advantage of unstructured pricing and discounting practices and force price competition on suppliers. Big retailers are well known for this, but it applies just as much to industrials and consumer brands.

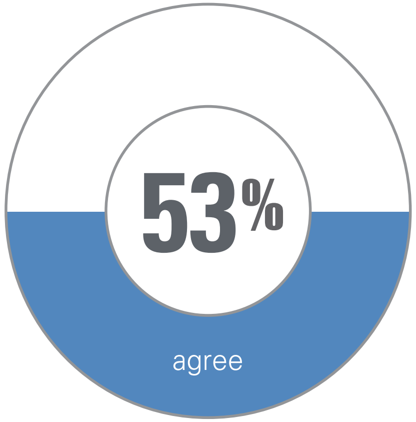
It doesn't help that pricing capabilities are at least a decade behind procurement in terms of sophistication. In my day-to-day work, I find it a challenge to locate a single person in UK companies with pricing in their job title and a pricing function is a truly rare find.

However, some businesses are waking up to the importance of the value equation and are looking to enhance their products, either through product innovation or bundled solutions, as a way to reposition their products and command a better price.

Defining customer solutions and pricing them appropriately is now one of our top pricing challenges.



In the past one to two years, my company has introduced new products/services to achieve premium pricing.



In our research, almost two thirds of respondents (65 percent) said that the need to define customer solutions and price them appropriately is now one of their top pricing challenges and more than half (53 percent) said they had introduced new products to achieve premium pricing within the past two years.

"It doesn't help that pricing capabilities are at least a decade behind procurement in terms of sophistication."

GETTING IT RIGHT (AND WRONG)

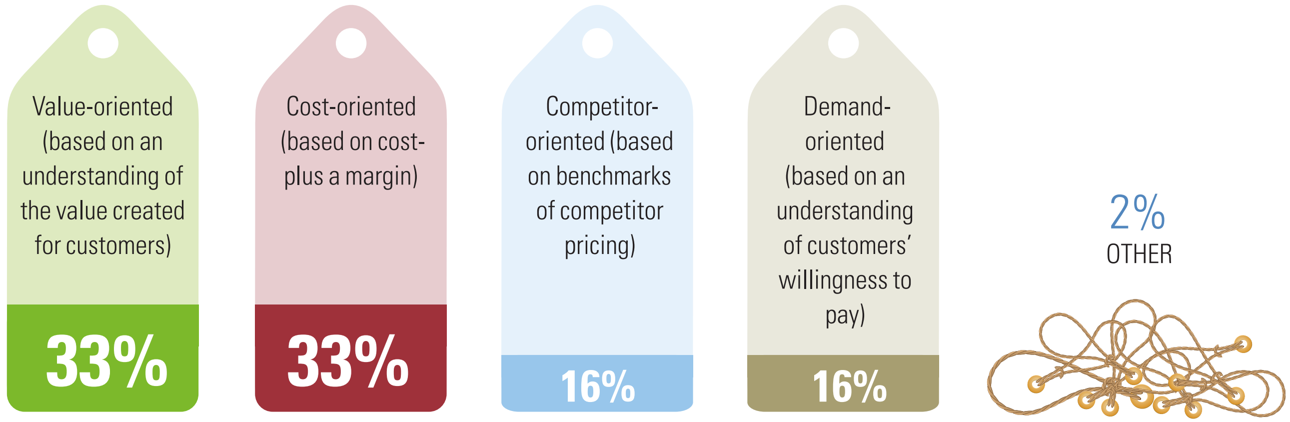
The need to focus on and invest in pricing is acute across many companies but their response to this need is what will clearly separate winners from losers.

One third of respondents said their current approach to setting prices was value-oriented, in other words based on an understanding of the value that their product or service creates for the customer. This is where pricing should be and shows that these companies are starting to get a good understanding of the value equation. However, another third said that they were still using the centuries-old cost-plus approach to pricing which is guaranteed to leave value behind.

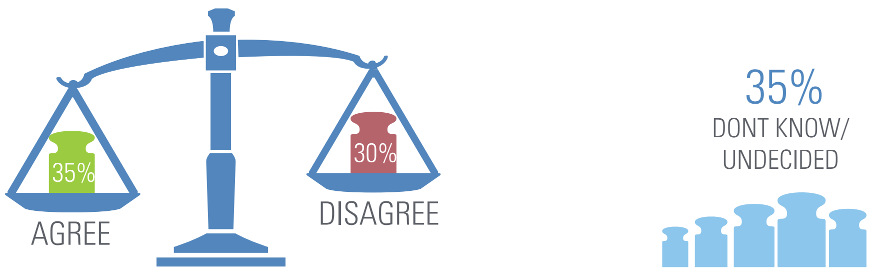
The research also pointed to other signs of a clear divergence between pricing winners and losers. About a third (35 percent) of respondents said they had a schedule of discounts that was clear on what was required for customers to qualify for each concession level, while an almost equal number (30 percent) said they did not.

Further, 50 percent of respondents said they had established pricing processes that worked well and about the same number said that responsibility for setting and managing prices within their company was clear; and a similar figure again said they believed pricing received sufficient focus from senior management. The other half answered these questions negatively or didn't know.

How would you describe your company's approach to setting prices today?



My organisation has a schedule of discounts that are clear on what is required for customers to qualify for each concession level.



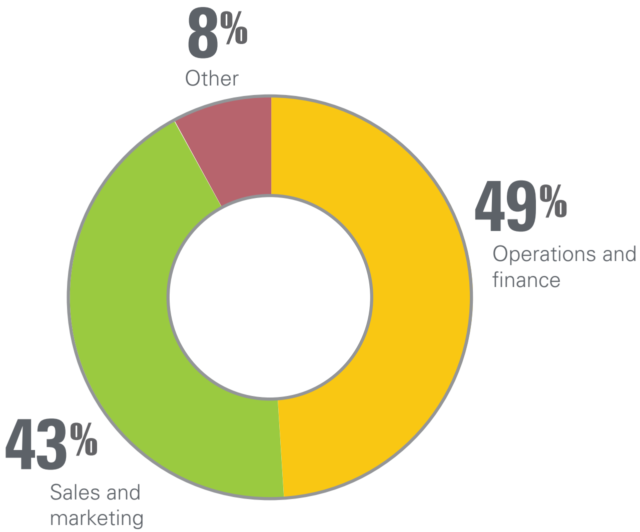
GETTING IT RIGHT (AND WRONG) CONTINUED...

Amazingly though, an almost equal number of respondents said that either finance or operations have the final say on prices as said sales and marketing. I interpret this as organisations trying to get a grip on prices and margins during the recession but this finding should be of grave concern to companies. Finance and operations do not, nor should they, have the market and customer insights that are required to make final pricing decisions. They should have an input into pricing, but they should not have the final say.

These are all pricing basics: discount schedules, pricing processes and accountability for pricing decisions. What the data shows is that one camp continue to follow the same approach to pricing that is largely volume or market share-driven, reactive and cost-based, while the other camp have evolved to be more profit-driven, proactive and value-based. The difference will be immense. The winners will put themselves in a position to realise the 10 percent profit opportunity and the losers will not.

To what extent do you agree with the following statements about your company?

Who has the final say on pricing decisions in your organisations?



WHAT'S NEXT FOR PRICING?

Looking ahead, I firmly believe that the next big change for pricing will come when organisations start to apply sophisticated data analytics to pricing. Indeed, within the next five years, or sooner, pricing analytics will fundamentally transform pricing in the UK and other developed markets. Retailers and airlines have been masters of this for some time and online companies have it in their DNA. Over time, other companies will follow suit. I believe it's inevitable that pricing analytics will be a critical capability for companies to mine their customer and transaction data as a means to optimise pricing and promotions.

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MOVING AWAY FROM STATIC PRICES

As more businesses build up their understanding of customers through data, we will start to see prices being set much more dynamically. We are already used to being charged more for a taxi ride at night than during the day, as we are with the most popular online grocery delivery slots, and for just about everything around Christmas.

In the future, prices for some products will change based on the time of day, month or year, weather, and so on. Rather than selling out of stock, retailers will adjust prices or remove promotions in real-time depending on demand. We are already used to this when booking travel or entertainment but in the future we should expect to see prices for everyday items such as petrol, food, and clothes vary by month, day or hour. The technology and tools for dynamic pricing already exist and all that's needed is for consumers to accept it. And we have demonstrated we can.

Five years ago, the online world shifted the balance of power to consumers by creating price transparency across retailers and providing peer-to-peer insights on the value equation for products and services. But, as companies invest more in pricing analytics, power is shifting back to sellers and I expect will continue to do for the foreseeable future. We need only look at Google and imagine how their data and analytics could inform pricing to get a glimpse of what's ahead.

TAKING THE RIGHT STEPS

In my experience, pricing leaders focus on three key areas to drive sales and profit growth and others can follow.

1) Knowing where and how much value is created
Companies need to understand and quantify how their products or services create value for customers compared to competitors. This will require organisations to "unpack" where the value lies, by customer segment, to inform better propositions and pricing decisions.

2) Leveraging data to inform decision making

Accurately calculating profit by customer is a vital requirement to inform decision making. Analysing past transaction data is another must and price elasticity data can be invaluable. What companies must certainly do, however, is move away from making pricing decisions based on "intuition" as many do today.

3) Developing pricing capabilities.
Companies must focus on continuously improving their pricing capabilities, processes and controls. Clear pricing and discounting guidelines are a requirement as is the need for sales and marketing to be armed with the right data and skills to make informed decisions during negotiations and walk away when the price is not right.

THE ROAD AHEAD

Although progress has been made, there is a long way to go before companies in the UK are truly optimising their pricing and, in turn, their profitability. This is a big opportunity and the timing is important. Over the past five years, there is evidence some companies have been investing in clear and disciplined, value-oriented pricing. I believe they will emerge as winners in their sectors. Those that do not follow will see their profits erode and possibly their very survival will be under threat.

"This is a big opportunity and the timing is important"

FIVE QUESTIONS TO ASK YOURSELF

1

Do you have a clear pricing strategy that is based on an understanding of customer value?

2

Do you understand the impact price changes have on your demand and profitability?

3

Are you using robust data and insights to inform pricing decisions or is it based more on intuition and consensus?

4

Are policies and processes embedded to ensure your pricing strategy is consistently executed?

5

Do you have pricing metrics or management information that inform if your pricing is successful?

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