KPMG
cutting through complexity

# The 10 percent profit opportunity

## Pricing effectiveness and margin performance in the Australian market

Australian Pricing Survey 2015

**kpmg.com.au**


© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.

# Foreword

KPMG is proud to present our inaugural *Australian Pricing Survey 2015*, a first-of-its-kind study into pricing effectiveness and margin performance in the Australian market.

The purpose of the research is to understand the challenges and trends Australian businesses are facing in pricing and selling their products and services, and to unlock the opportunities that effective pricing can deliver.

While our findings show that businesses understand the potential benefits of effective pricing, there appears to be considerable variance between intentions and practice. Only a small portion of our respondent companies regularly review their pricing strategies and these are often not well understood within the organisation in any case. Moreover, while we discovered that many businesses had plans to up their prices over the next 12 months, passing on this price increase was clearly problematic.

Ultimately, our findings confirm the notion that while businesses are comfortable creating value, and are moving towards a value-oriented approach to pricing, they simply are not doing enough to capture that value.

The survey is based on the responses of more than 160 of Australia's largest businesses across a range of sectors. Fifty percent of the respondents were C-level or business unit heads.

Please feel free to discuss the results of the survey with us.
All feedback is warmly welcomed.

**Ronan Gilhawley**

**Partner in Charge**
**Strategy & Planning**

© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.

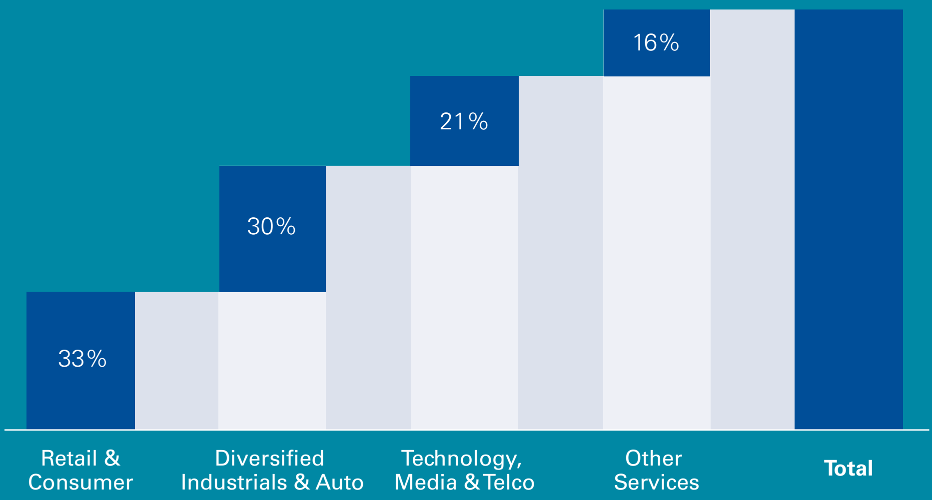
# Profile of participants

**161** businesses

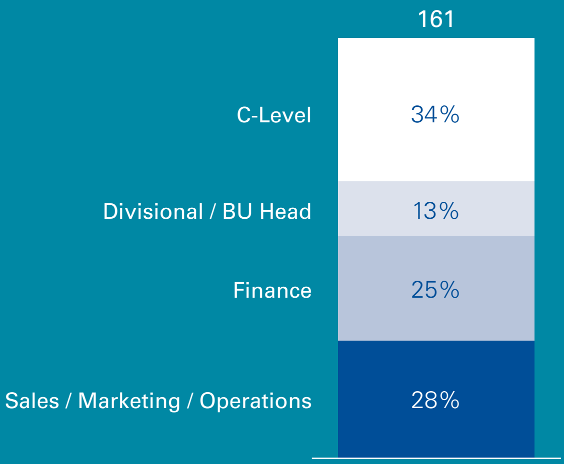
**55%** organisations of 200 people or less

**16%** organisations with 1,000 employees or more

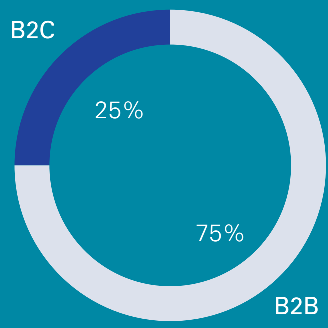
**Respondents sector span**




**Level of respondents**




**B2B / B2C focus**




## Turnover

- 44 percent reported turnover of $49 million or less
- 11 percent reported turnover of $1 billion or more

## Margin

- 6.4 percent reported negative EBITDA
- Approximately 20 percent reported margins of 4 percent or less
- Over 25 percent reported margins of 5-9 percent

© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved. The KPMG name, logo and “cutting through complexity” are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.

# Executive summary

On average, Australian companies consider more effective pricing would generate an extra 10 percent in profit improvement. That's according to the results of our *2015 Pricing Study*, a first of its kind in Australia.

It is a compelling notion. As most sectors across the country struggle with acute margin pressures, the need for a re-think on pricing is critical.

Our survey reveals that most companies recognise the importance of pricing and most believe they have a good plan to do it well. However the reality of pricing practices in the market, does not match rhetoric, 74 percent of companies note increased price pressure in the past 2 years with 57 percent of companies stating there is a price war in their industry. Further, price realisation remains a major problem with companies only able to realise on average 55 percent of their planned price increases.

The good news is that Australian businesses are recognising this and have plans to change. This is reflected in the fact that organisations are moving towards a value-oriented approach to pricing, where they can optimise margins through aligning price to value. Indeed, our survey indicates we are likely to see a 14 percent rise in the number of businesses that will price based on value in the next 2 years compared with today.

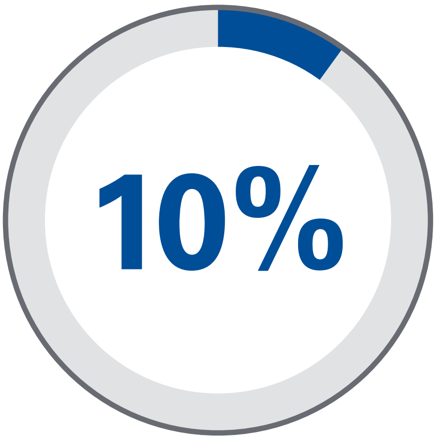
It remains to be seen whether businesses achieve this however. Clearly it takes leadership – and yet we found nearly a third of senior managers do not regard their pricing strategy as a key area of focus while almost half (45 percent) of our respondents agreed they were not completely clear about who was responsible for setting and managing prices. Also worrying is the fact that only 13 percent of those surveyed had formally reviewed their pricing strategy over the past 2 years. The 10 percent profit opportunity may prove elusive to many companies despite the best of intentions.

© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.

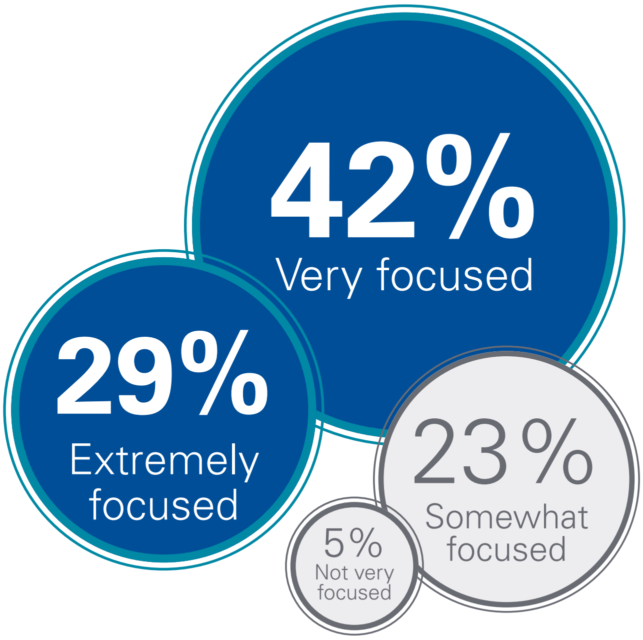
Most companies recognise the importance of pricing and most believe they have a good plan to do it well

© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.

# There is strong recognition from management that an effective pricing strategy is key to profit maximisation




The amount respondents believe more effective pricing would generate in profit improvement




70%

believes pricing strategy is a primary area of focus for senior management

### The 10 percent profit opportunity

On average, Australian business think more effective pricing would generate an additional 10 percent profit improvement. This varied to some extent in our survey – from 12 percent in business services to 7 percent in automotive and diversified industrials.

Regardless, it represents a significant increase and certainly indicates that businesses are aware of the value of more effective pricing and its impact on their margins.

This is further supported by the fact that one fifth of respondents agreed that "changing your pricing strategy represents a huge opportunity to improve your company's performance".

### Focus from management

While it is heartening that 70 percent of senior managers consider their pricing strategy as a primary area of focus, we cannot ignore the fact that nearly a third don't. There is no doubt that pricing is of sufficient importance that it should be elevated to the C-level. This is supported by the fact that companies who have pricing on the C-level agenda have on average higher margins.

Whilst important, setting the 'optimal' price may not be at the forefront of the C-suite's strategic agenda given it is largely a mechanical exercise. The Chief Executive Officer's (CEO) agenda should concern a business's ability to sustain the competitive advantage to command premium prices. While the former remains a priority, it is the latter that requires the CEO's attention.

"A third of senior managers do not regard their pricing strategy as a key area of focus, while almost half (45 percent) of our respondents agreed they were not completely clear about who was responsible for setting and managing prices."

© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.

# Pricing objectives – what are management seeking to achieve in their pricing strategies?

**Top 5 pricing imperatives**


**Over 50 percent of respondents consider that 'ensuring price levels maintain profitability' is their greatest pricing imperative.**

The remaining pricing imperatives relate to the ability to understand the key value drivers of the customer and effectively build these into pricing, thereby getting paid appropriately for the value delivered to customers.

These pricing imperatives are not just relevant to Australia. In our UK pricing survey, three out of Australia's top five pricing imperatives are the same.

Seventy percent of UK respondents considered ensuring pricing levels maintain profitability is the number one pricing imperative, closely followed by 65 percent of organisations who have difficulty in effectively defining and pricing customer solutions and 57 percent who focused on maintaining control over pricing.

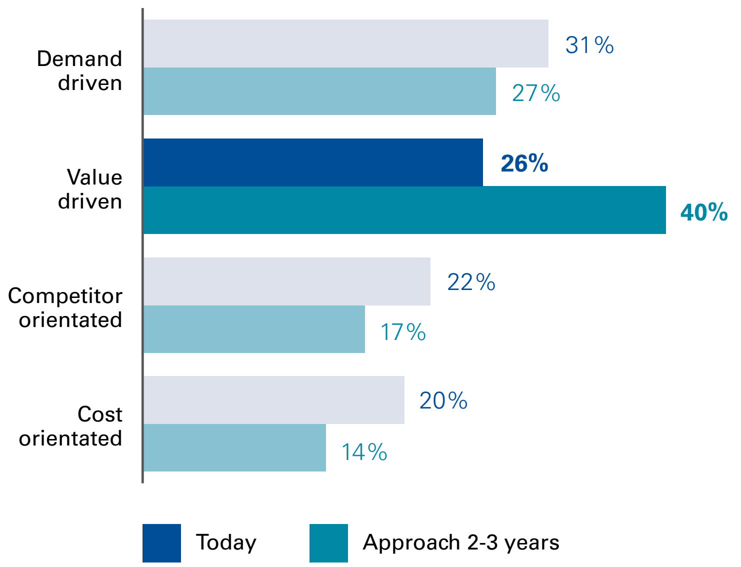
"Most of the top pricing imperatives relate to the access to the right data to make informed decisions. It is almost impossible to maintain control over pricing when pricing data is of a poor quality at a customer level."

© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.

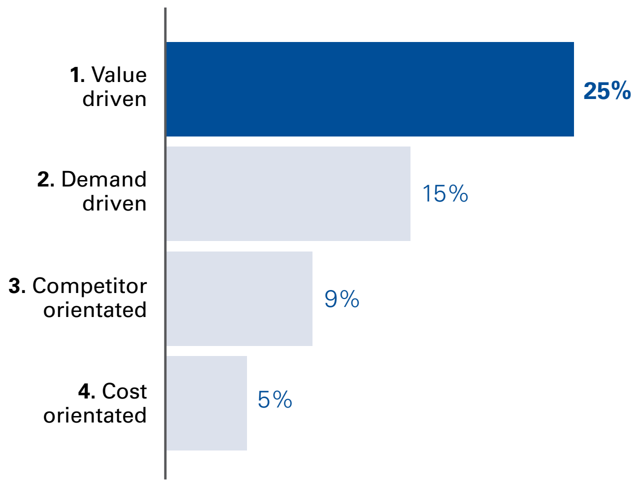
# We see a slow but sure evolution in the relative level of sophistication of pricing strategies in Australia driving margin improvement

| Approach to pricing | Description |
|---|---|
| **Demand driven** | Based on an understanding of customers willingness to pay |
| **Value driven** | Based on an understanding of the value created for customers |
| **Competitor orientated** | Based on benchmarks of competitor pricing |
| **Cost orientated** | Based on cost plus a margin |

**Approach to setting prices: today and 2-3 years**




**Average EBITDA by price setting approach**




**Despite low business confidence, many Australian businesses understand that there needs to be a shift in their approach to pricing.**

Our survey indicates that over the next 2 years, there will be a 14 percent rise in the number of companies that will price based on value compared with today.

This recognises the opportunity to optimise margins through aligning price to value. It replaces traditional cost and competitor orientated approaches, among others. While the centuries old cost-plus approach – where a standard margin is added to the cost – can be a useful starting point to ensure companies are not undercharging, it is rarely backed by science and unrelated to the value delivered to customers. Similarly, the competitor oriented approach, which is based on benchmark of competitor prices, has little regard for the value equation.

The shift toward value-orientated pricing is a very positive sign. Companies who price based on value today enjoy significantly higher margins than those pricing based on the competition, demand, or the cost to deliver goods and services.

Our figures show that those companies pricing based on value delivered have an average EBITDA (earnings before interest taxes, depreciation and amortisation) of 25 percent. This compares with only 5 percent for companies employing a cost-plus approach. It represents an enormous 500 percent increase in profitability.

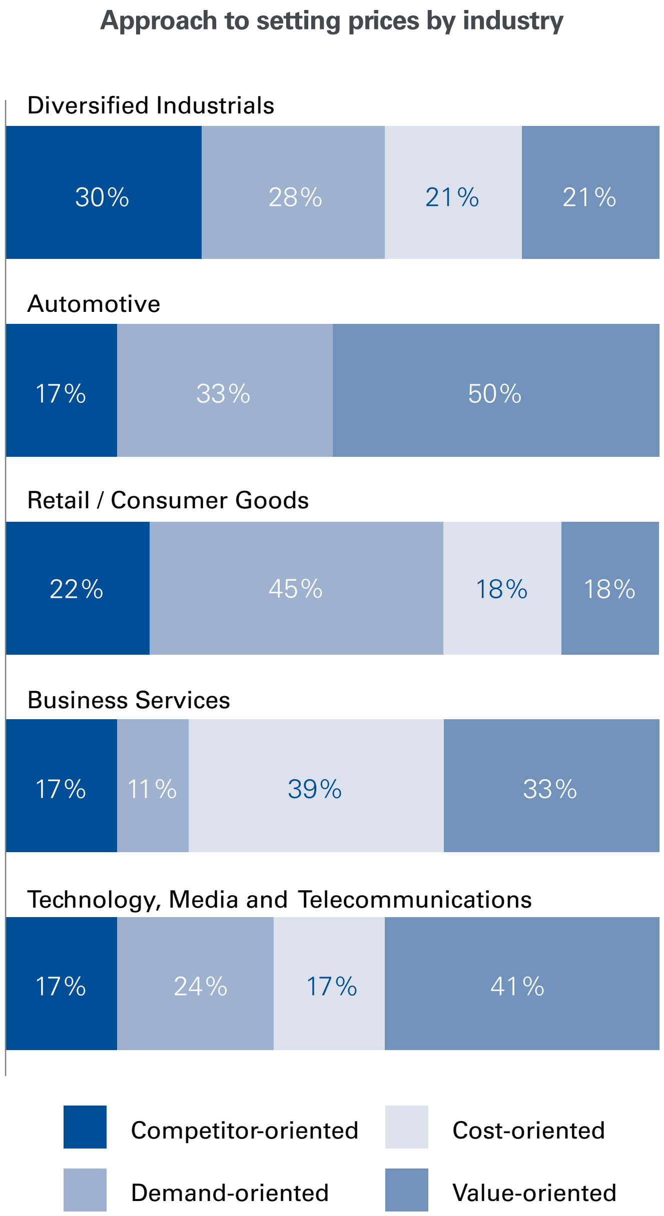
Those businesses waking up to the importance of the value equation are looking to enhance their products, either through product innovation or bundled solutions, as a way to reposition their products and command a better price.

**The value equation**

The 'value equation' is the relationship between a product's benefit to its price, relative to alternatives. In other words, it is about the customers' perception of value.

© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.

# However, implementing value orientated pricing is a difficult exercise




**Good intentions are not the same as setting and achieving a goal however. Implementing a value orientated pricing system can be a difficult exercise.**

Not only does it require the ability to measure the value delivered over and above the competition, it often calls for a mindset shift both internally and by the market.

It is also worth keeping in mind that value-based pricing isn't the be all and end all of pricing. For many companies it is unsuitable or unnecessary. Some businesses have fallen into the trap of changing their approach to pricing in pursuit of higher margins and ended up worse off.

Conversely, some companies have had a marked improvement in profitability just through changing their employees' mindset to the value equation and working on the development of value communication.

A majority of organisations (56 percent) describe themselves as either demand orientated or value orientated in their pricing strategy.

Business services follows the most cost orientated approach (39 percent), while industrials are the most competitor orientated (30 percent).

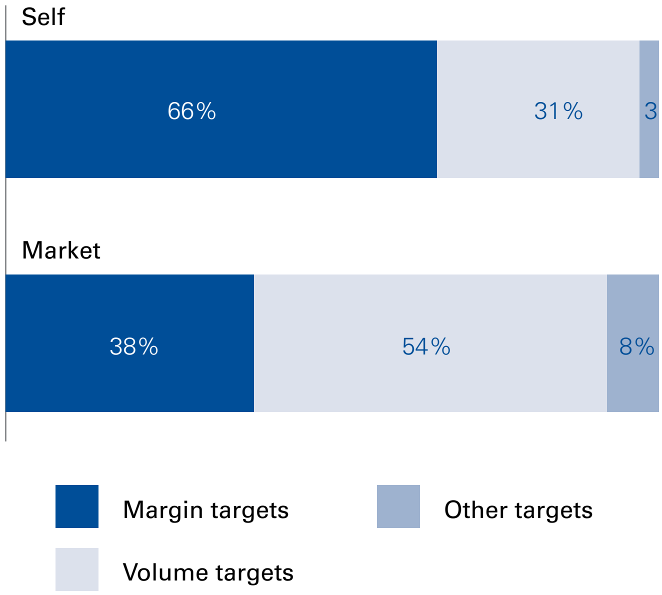
Retail is the most demand driven sector (45 percent) while telecommunications is the most value driven (41 percent) – this correlates closely with both sectors lower overall focus on margin as a governing objective in pricing.

"Over recent years, companies have focused on the price lever to increase the value equation in their favour and prevent customers buying from the competition. 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. However it applies just as much to industrials and consumer brands."

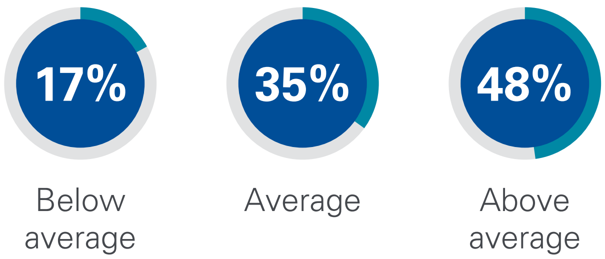
© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.

# In general, we note that self perception of pricing effectiveness does not align well to market reality

**Self assessment / Market assessment**




**Self perception of profitability versus the market**




**The majority of respondents see themselves as margin orientated.**

Two thirds of organisations (66 percent) claim to be focused on margin / profit compared with a third who claim a stronger volume / share focus.

Telecommunications and retail were the sectors least driven by margin strategies, at 55 percent and 62 percent of the total respectively, whereas automotive (100 percent) and business services (81 percent) are considered the most margin focused.

**Likewise many see the market as volume orientated.**

Conversely, in reflecting on the prevalent pricing trend in their respective industry, over a half (54 percent) noted the market was focused on volume / market share, compared with 38 percent who see it as profit orientated.

There is a clear misperception between internal focus and external messaging, which calls into question the messages companies are signalling to the market. There is a distinct difference between paying corporate lip service to 'margin focus' and acting upon it and these perceptions are driving defensive and volume / market share focused behaviour in the market.

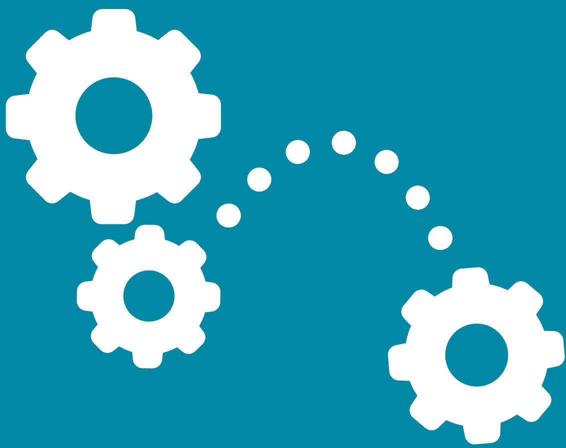
The largest differential is in the automotive sector where all respondents consider they are 100 percent margin focused however the same respondents consider 86 percent of the market is volume orientated.

**A majority see themselves as more profitable than the average.**

One third of respondents (35 percent) see themselves as having industry average profit margins with almost half (48 percent) seeing themselves as having above average profit margins for their industry. This leaves only 17 percent who consider their profits below industry average.

This suggests many use a subjective assessment of relative performance rather than an objective, fact-based assessment. A key challenge companies have is getting a robust, factual understanding of both their own and the market's pricing performance.

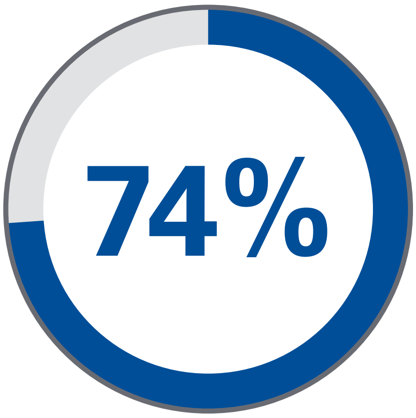
© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.



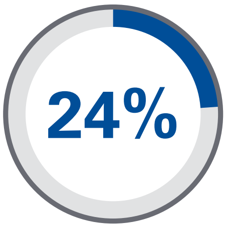
# …however, the reality of pricing practices in the market does not match rhetoric

© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.

# A majority of companies note significant pricing pressures in the local market over the past 2 years



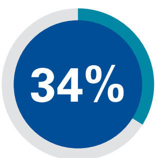

of respondents indicated they have experienced higher price pressure over the last 2 years



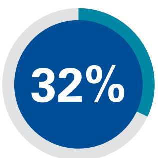

About the same price pressure


Price pressure has decreased

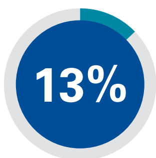
**Reasons for a change in price pressure**



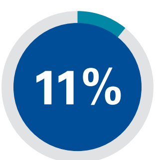

1. Customers expect more and more discounts



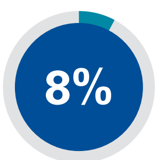

2. Low price competition



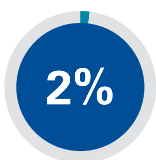

3. Lowering prices is a natural trend in our industry




4. We offer a commodity product




5. We compete on low prices




6. Cost decreases that we need to pass onto our customers

**For all business sectors, margin pressures are an ongoing issue.**

Unfortunately, the response since the global financial crisis (GFC) has been to cut costs. Now, after more than 5 years of cost cutting, organisations have nowhere left to go.

This creates an imperative to pursue an alternative pricing strategy. But that takes a significant degree of business confidence, something that isn't readily apparent in the Australian market just now.[1]

This can be traced back to excessive price pressures. Three quarters of our respondents (74 percent) confirmed they had experienced higher price pressures over the past 2 years. Reasons for pricing pressures vary, but the predominant views were that it was either demand driven (customers seeking deeper discounts, 34 percent), or supply driven (new entrants / low priced competition, 32 percent).

Retail and telecommunications, media and technology (TMT) respondents cite having the highest level of response on customer expectations driving discounts (46 percent and 40 percent respectively).

Conversely industrials and automotive cite low priced competition is a strong driver of price pressure at 42 percent and 33 percent respectively.

Worryingly, 13 percent of respondents cited 'Lowering prices is a natural trend in our industry' and 11 percent of respondents considered 'We offer a commodity product'. Whilst these figures aren't considerable they do show a worrying undercurrent.

**Price Pressure**

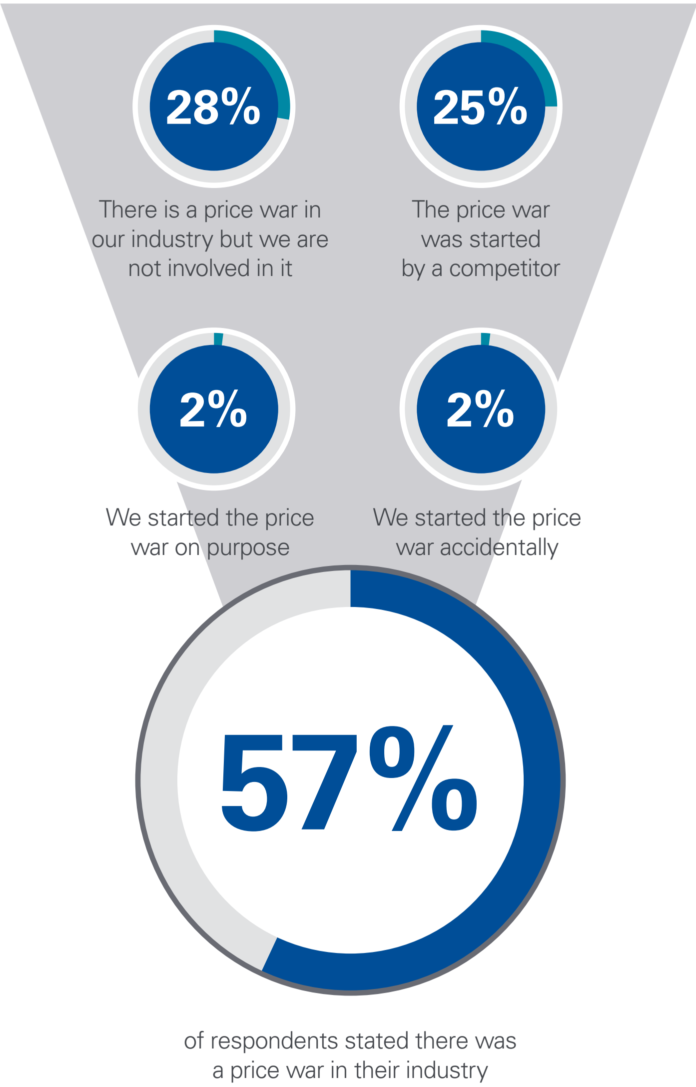
'Price pressure' refers to the need to lower prices or give more discounts, rebates or promotional offers to customers

1 NAB's February Business Confidence Index notes: "The confidence index dropped by 3 points to 0 index points, which is its lowest level since before the Federal election in 2013." For more information see http://business.nab.com.au/wp-content/uploads/2015/03/Monthly-Business-Survey-%E2%80%93-February-2015-PDF-187KB.pdf

© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International.
Liability limited by a scheme approved under Professional Standards Legislation.

# The prevalence of price wars would suggest that many use price discounting as a competitive lever

**Prevalence of price wars**




**A disconnect exists between market perception and reality.**

In assessing price competition, a majority (57 percent) of respondents believe there is a price war in their industry, with over a quarter (29 percent) being directly involved in one, whilst 43 percent of respondents note they did not start and are not involved in one.

Meanwhile 44 percent said it was started by a competitor and only 7 percent claimed to have started it themselves. This is not feasible. In fact companies often don't realise they have started a price war. Such 'battles to the bottom' tend to be triggered by aggressive price behaviour, unclear communication to the market, or misinterpretation by competitors. The big risk is that they set prices and margins in an industry permanently lower.

From a sector perspective the automotive and industrials sectors see the strongest prevalence of price wars with 67 percent and 62 percent respectively. Meanwhile business services and retail / consumer sectors noted the lowest frequency of price wars with 52 percent and 55 percent respectively.

Comparatively, KPMG's pricing study in the UK concluded that 25 percent of respondents were engaged in a price war (2013). This is significantly lower than the 57 percent highlighted by Australian businesses, which reinforces the view that price is being used as a competitive lever.

**Case Study – Milk price war, Coles and Woolworths**

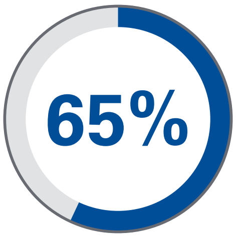
The $1 milk price war between Coles and Woolworths is an apt illustration of the inherent risks. As Nielsen executive director Kosta Conomos noted in the Sydney Morning Herald in 2013: ''The price drop inevitably had a downward effect on value sales. It has taken 2 years for the milk category to almost get back to similar value sales seen in 2010.''[2]

2 http://www.smh.com.au/national/coles-trouncing-woolies-in-milk-price-war-figures-show-20130328-2gx9m.html

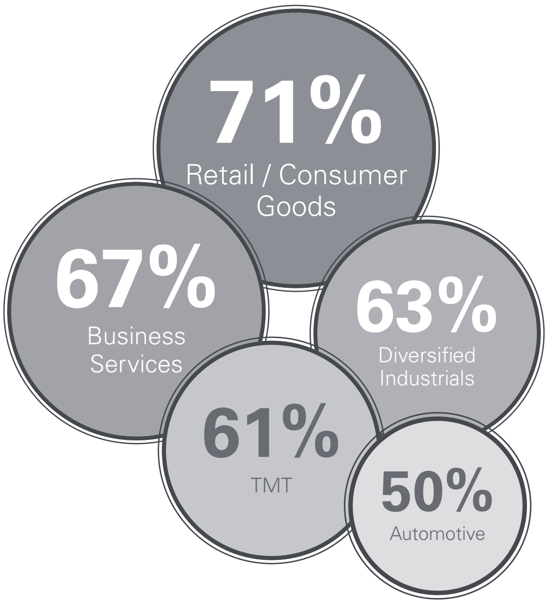
© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.

# Many are planning price rises above inflation

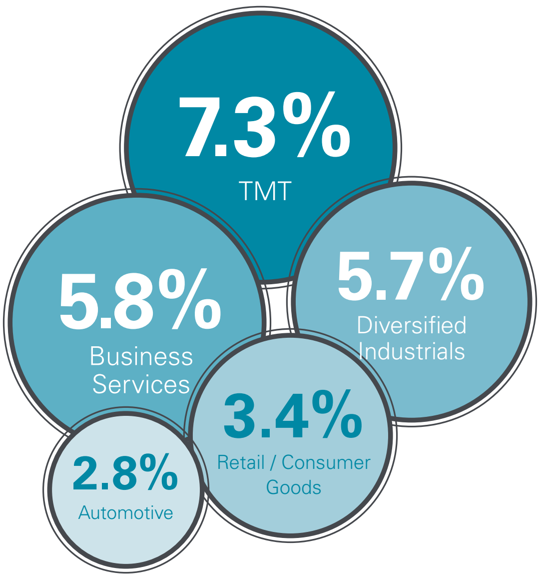
**Companies planning a price increase in the next 12 months**




**Percentage of companies planning a price increase in the next 12 months by sector**




**Average planned price increase by sector**




**Despite the doom and gloom, however, there are signs that many Australian companies are prepared to up the ante.**

Through our study we discovered that up to two thirds (65 percent) of businesses were planning to increase their prices over the next 12 months.

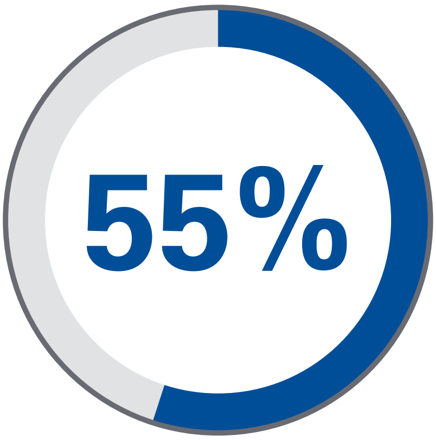
The retail / consumer goods sector leads the charge with 71 percent anticipating price increases, while industrials, TMT and automotive is less so at 63 percent, 61 percent and 50 percent respectively.

Looking at the average planned price increase the TMT sector is planning the biggest price increases at 7.3 percent, while retail / consumer and automotive are anticipating the smallest quantum at 3.4 percent and 2.8 percent respectively.

Add to this the fact that Australian inflation currently sits at 2.3 percent and you soon find that the 35 percent of business who are not planning a price hike are effectively passing a decrease in price onto their customers.

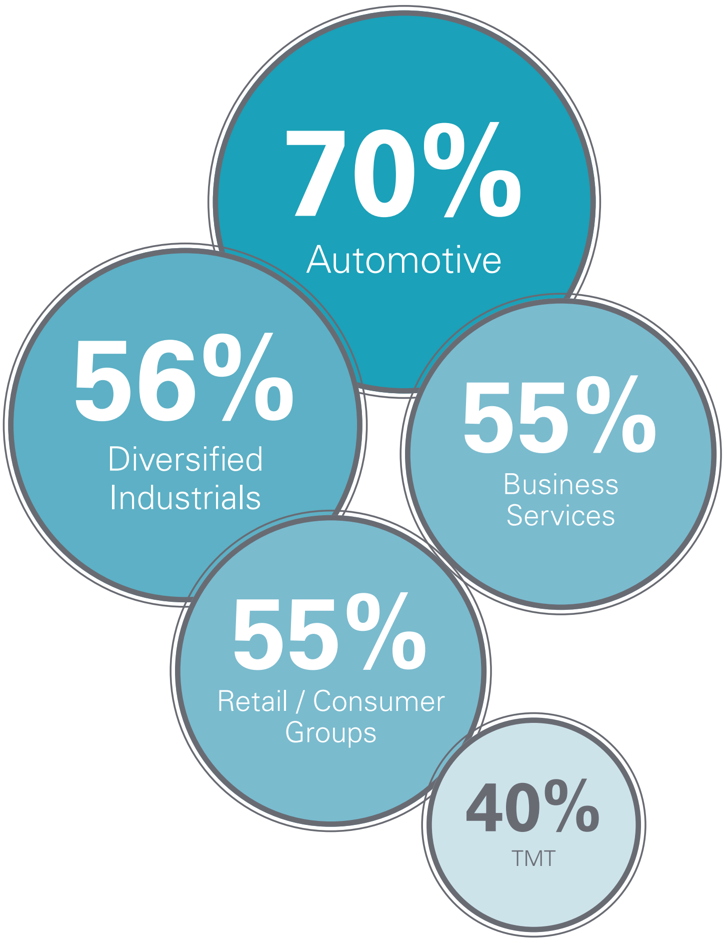
© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.

# However, price realisation suggests most companies are struggling to achieve their stated goals




The average price realisation across sectors

**Average price realisation by sector**




**Passing on a price increase to customers remains a significant issue for Australian businesses.**

Price realisation varies between 40 and 70 percent, which means in effect only 30 to 60 percent of the intended price increase actually sticks.

Forty percent of respondents note that they are only able to realise up to 40 percent of their planned price increase.

Only 1 in 3 companies are able to realise 80-100 percent of their planned price increase, with only 16 percent able to realise 100 percent of their planned increase.

In our study, we found that the Automotive industry passed on the highest proportion of any price increase (about 70 percent), followed by industrials at 56 percent compared with TMT the lowest at only 40 percent.

Certainly passing a price increase on to customers is a difficult task and one which companies fail at time and again – often aided by a reluctant sales force who is given the job of implementing the increases. Yet the task is not impossible.

"We believe it is essential higher prices are passed on to customers in a targeted and informed way using data and analytics, rather than through blanket increases, which are unlikely to stick and may frustrate important customers. Additionally, the sales force needs to have the right tools, support and incentives to give it the best chance of realising the planned increases."

**Price Realisation**

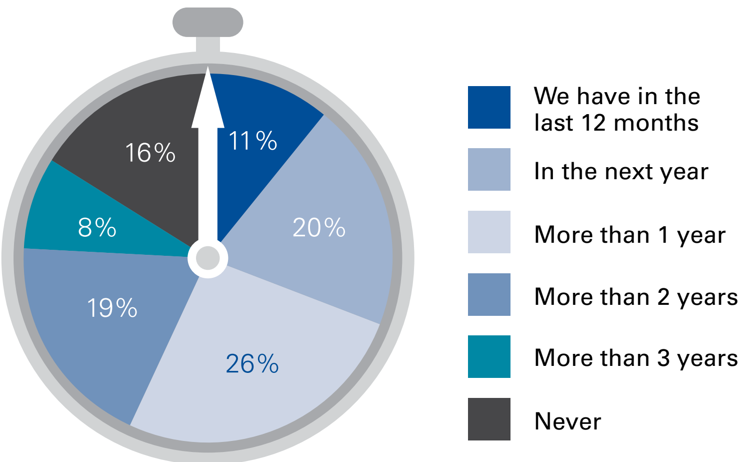
Price realisation refers to how much of the total price increase is actually passed on to customers. So, a 0 percent price realisation, means the net price paid by customers doesn't change following an attempted price increase. A 100 percent price realisation, on the other hand, means the entire price increase is passed on to customers.

© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.

# The outlook is bleak for the next 2 years, with a significant majority believing it will be a considerable period before the market shows an appetite for improved pricing


of organisations believe it will be a year or more before they can pass on material price increases

**Estimated time before companies can introduce any significant price increases**




**It is encouraging that one in five businesses are planning a material price increase in the next 12 months.**

However, over half (53 percent) of respondents believe it will be a year or more until they can pass along material price increases of 5 percent or more.

A surprising proportion (16 percent) believe they will never be in a position to pass on price increases. This was the highest in automotive and TMT sectors, with 33 percent and 21 percent respectively.

Only 11 percent of respondents had passed through a material price increase in the past 12 months.

Over 30 percent of companies note that either they or their competition are struggling to achieve an optimal pricing strategy in the current market climate. This is likely to lead to an inability to decide how and when price increases should be implemented and therefore companies are likely to continue to push back on planned price increases.

Likewise a further third are consciously delaying price increases or deferring removal of discounts for fear of losing customers.

"Whilst delaying price increases is a natural response to increasing price pressures, it is imperative that companies continue to invest in Research and Development (R&D) and innovate their products, thereby increasing the value perception customers have of their products and preventing a downward spiral of margins."

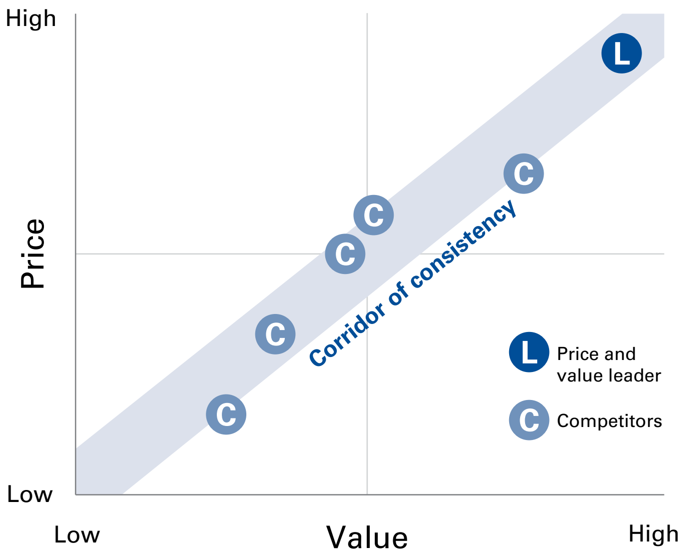
© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.

# There are a number of reasons why organisations are not achieving their desired outcomes

**Issues organisations are facing today**

| | |
|---|---|
| 19% | Companies in your industry are struggling to determine an optimum pricing strategy in the current economic environment. |
| 18% | Your company is delaying price increases as a result of weakness in your markets |
| 18% | Changing your pricing strategy represents a huge opportunity to improve your company's performance |
| 15% | You are concerned that if you are first to remove discounts, you risk losing customers / sales volume |
| 14% | Customers who have received discounts will be unwilling to spend more for the same when the economy improves |
| 12% | Your company is struggling to determine an optimum pricing strategy in the current economic environment |
| 5% | Your pricing strategy is inadequately aligned with your business strategy |

**Industry value map**




**Putting possible internal factors to one side, there are a combination of industry issues and customer pressures which are preventing organisations from achieving their desired pricing goals.**

### Industry issues

- Eighteen percent of respondents are delaying price increases as a result of weaknesses in their markets.
- Nineteen percent consider companies in their industry are struggling to determine an optimum pricing strategy in the current economic environment.

### Customer pressures

- Fourteen percent of respondents noted that customers who have received discounts will be unwilling to spend more for the same when the economy improves.
- Fifteen percent of respondents are concerned that if you are first to remove discounts, you risk losing customers / sales volume. Whilst this maybe true for some customers, by aggressive use of discounting, companies are increasingly likely to enter into price wars, which can reduce prices and margins permanently.

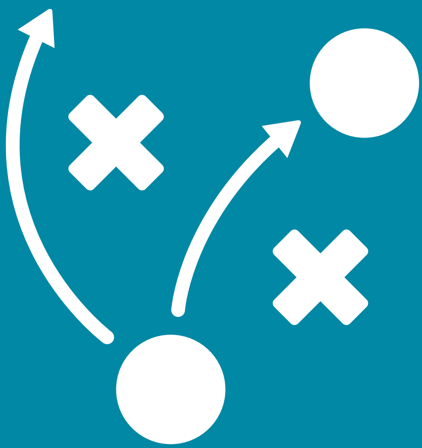
### The industry value map

In an ideal situation as the 'value map' (see left) indicates, the value leader in an industry should be the first to increase prices, thereby allowing others who do not achieve the same levels of value to follow suit. This allows the order of price and value to remain consistent throughout an industry.

In reality this is often not the case, which means in order to retain a 'fair' price, companies need to find ways to differentiate themselves from the competition, thereby improving customer's value perception (and increasing their score on the x axis).

Unfortunately the easiest value driver to differentiate with is price, which leads to heavy discounting and price wars when competitors follow suit.

© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.



So what are the tactics that work and what can you do to achieve better price realisation?

© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International.
Liability limited by a scheme approved under Professional Standards Legislation.

## We see examples of bad and good pricing practices everyday

There are numerous under optimised pricing practices undertaken by Australian businesses, many of which are relatively quick to fix and can cause a major uplift in profitability

- Premium retailers focusing on discount based promotions
- Market leader cutting prices to fend off generics eating market share
- Sales force have absolute discretion over discounts given
- No circumstantial price differentiation
- Pricing based on intuition rather than data
- No pricing KPI's to track success of pricing decisions
- Different segments of customers treated in the same way
- Unintentionally starting price wars by mis-communicating with the market
- Prices based solely on the cost to produce rather than the value delivered

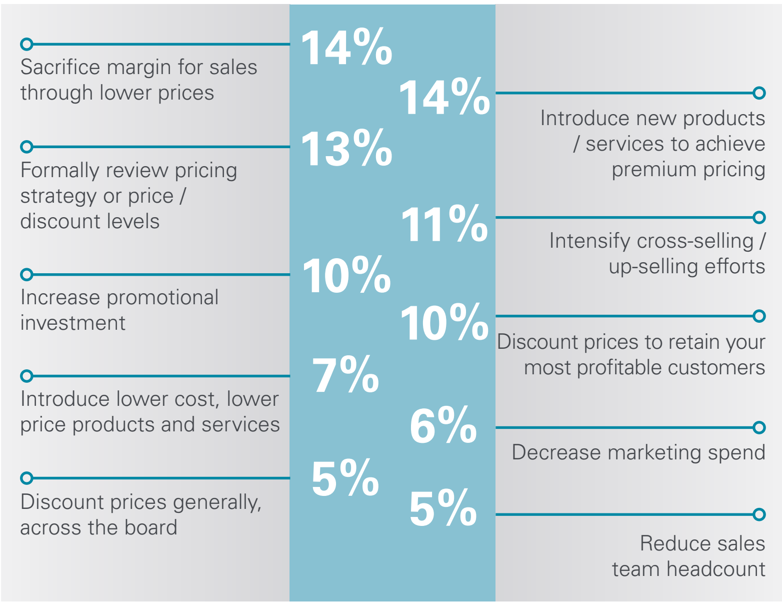
Some of the world's leading businesses have developed intelligent pricing practices which align cost with value and ensure maximum profitability

- Value based pricing: **Cost per click web based advertising**
- Demand based pricing: **Taxi surge pricing**
- Dynamic pricing: **Airline model**
- Innovative bundles: **Fast food value meals**
- Channel-based price differentiation: **Hotel chains**
- Multi-person pricing (MMP): **Health insurance for families**
- Personal price differentiation: **Student travel tariffs**
- Surcharge pricing: **Low cost carriers**
- Premium pricing: **Spring water**

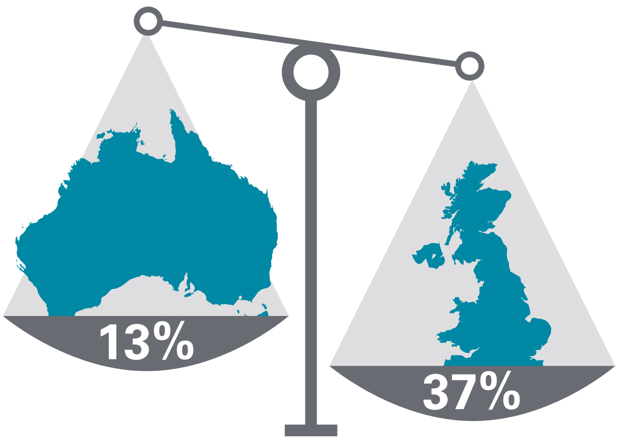
© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.

# Looking backwards, what has worked for organisations in achieving their desired outcomes?

**Actions undertaken in the past 2 years**




**Formally reviewed pricing strategy in the past 2 years**




**Of the pricing activities undertaken by organisations over the past 2 years, around half of the activities related to removing cost e.g. 5 percent of organisations reduced sales team headcount, 6 percent who decreased marketing spend.**

Over 33 percent of organisations have undertaken focused, broad based discounting, price matching to stimulate sales, or consciously sacrificed margin for volume sales. This has been most prominent in the industrials sector (36 percent).

Five percent of respondents have discounted prices generally across the board, which when added to inflationary change, means operational performance would have to significantly improve in order to maintain existing margins.

Reducing cost during a period of economic difficulty is an essential part of remaining profitable, yet many organisations forget or chose to ignore initiatives to grow revenue.

In our survey just 21 percent of respondents have undertaken greater effort in cross selling or promotional spend to stimulate top line sales, most popular in business services (25 percent).

We see pricing in the Australian market as less mature than some other developed markets, for example, the United Kingdom. This is demonstrated in a number of ways. For instance, our survey shows that only 13 percent of Australian businesses have formally reviewed their pricing strategy over the past 2 years, compared with 37 percent in the United Kingdom (2014).

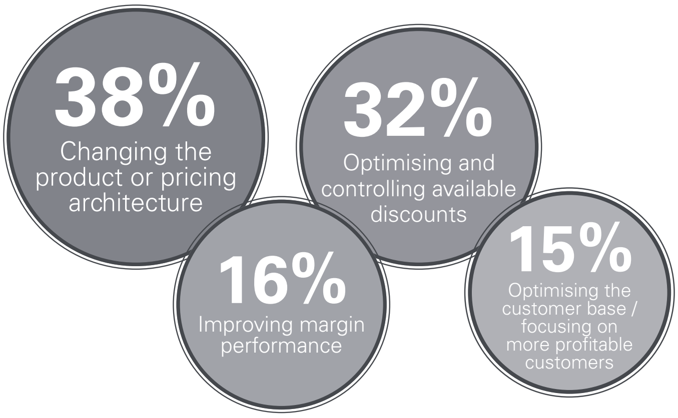
We would argue that it should fall into the whole business planning review process just as organisations do with regards to business strategy development, budgeting or setting sales targets.

There are other signs that pricing in Australia is less mature. According to our study, one in five Australian businesses is struggling to determine an optimum pricing strategy. This is likely to be further undermined by the fact that a significant number of companies (27 percent) have a pricing strategy that is not well understood within their organisation.

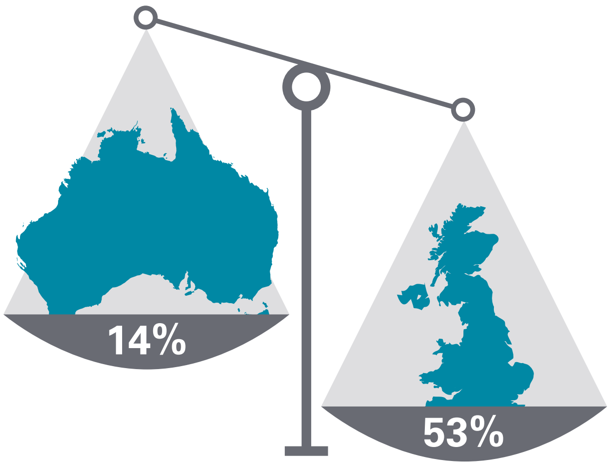
© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.

# Looking forwards, what are organisations contemplating?

**Four schools of thought to pricing strategies over the next 12 months**




**Introduced new products / services targeting premium pricing**




**The major pricing focus of respondents over the next 12 months will be in changing the product or pricing architecture (38 percent) and discount optimisation (32 percent).**

However the absolute proportion of respondents undertaking these initiatives remains extremely low.

Australian businesses pay little regard to premium prices, according to our survey – only 14 percent of respondents had introduced new products or services targeting premium pricing. That's quite remarkable when you consider this figure rises to 53 percent in the United Kingdom (2014). There may be good reason for this however. One simple explanation could be that Australia tends to be a few years behind the United Kingdom in this regard and will, with time, catch up.

Another explanation could be that for decades, geographic distance and a lack of competition have allowed overseas and domestic brands to charge significantly higher prices to Australians, which may allow for less nuanced pricing.

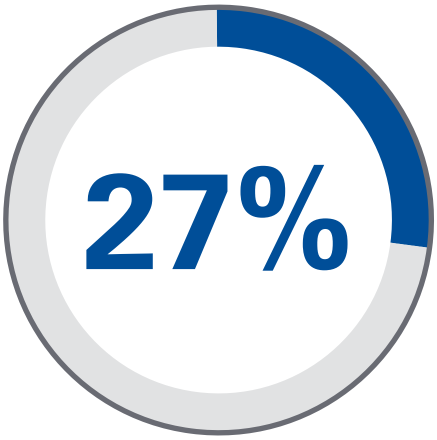
There are signs of change here however. Due to its strong mining sector Australia's economy suffered little through the GFC and as a result attracted investment from a number of international retailers through physical store openings (for example, Costco, Aldi and Lidl in 2015) or through improved internet retailing access (such as Marks & Spencer's opening its website to Australian orders). This has benefited the Australian consumer who can now see and access products being sold significantly cheaper overseas.

David Jones is one store which has responded in kind, implementing a huge price harmonisation program aimed at achieving a better alignment of prices within Australia to those found online and overseas. The retailer has negotiated with 250 international brands which it identified as being 'in need of harmonisation' in order to reduce supply costs and reduce prices for the consumer.

© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International.
Liability limited by a scheme approved under Professional Standards Legislation.

# Governance and management – Earnings performance correlates with clarity on pricing strategy

**Pricing strategy that is not understood and broadly adhered to across the organisation**




**Over one quarter (27 percent) of respondents felt their pricing strategies were not well understood or broadly adhered to.**

This implies one quarter of organisations have a workforce who are working towards misaligned goals, which will greatly impede a company's ability to achieve its objectives.

This does not just relate to the workforce, we often see management teams who have different interpretations of their pricing strategy, which clearly does not then filter down through the business.

This is supported by the fact that 45 percent of companies note that they are less than completely clear on who is responsible for setting and managing prices in their organisations.

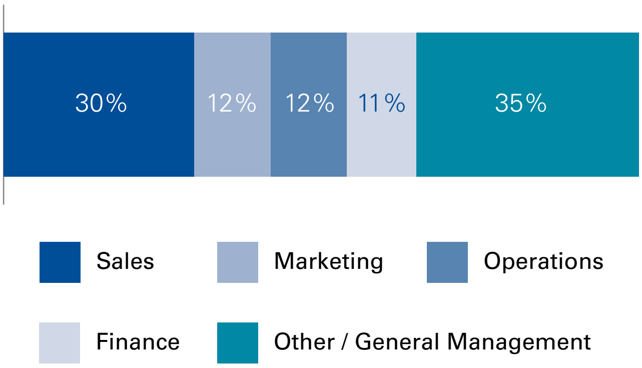
A quarter of companies cite they have poor accountability and governance over their pricing strategy (26 percent).

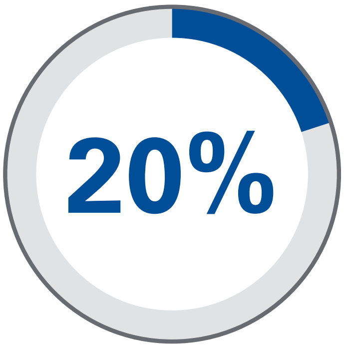
We further note that there appears to be correlation between EBITDA performance and clarity on pricing strategy, with 58 percent of companies with high EBITDA (greater than 20 percent) that are clear on their pricing strategy compared with 47 percent of companies with low EBITDA (less than 20 percent).

© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.

# Strategy and policy – Price setting is typically the domain of general management, sales or finance, but varies by industry

**Price setting of gross / list price by function**




of respondents' organisations price according to intuition

**GREATER THAN 50%**

of respondents use a mix of intuition and data to set prices

**Price setting is one of the most important and difficult activities an organisation must undertake and there is no 'one size fits all' approach.**

Fortunately however, prices are not permanent. Organisations can test prices in the market (often in 'pilot' markets / products) and then change them if they do not deliver on expected results.

One big mistake organisations make, when launching new products or services, is pricing too low. It is very difficult to raise the price of a new product shortly after a full scale launch. Price too high, then selected price promotions and discounts can easily be implemented to bring prices down. Good practice is always to test a planned price with a pilot segment.

Clear from our survey responses, is that list price setting varies by industry. In TMT, pricing is substantially led by sales; 43 percent of gross / list prices are set by sales. Conversely in automotive this falls to 20 percent.

Marketing has no involvement in price setting in the business services and automotive industry, however in 23 percent of cases in retail / consumer goods sectors, marketing set the gross / list prices.

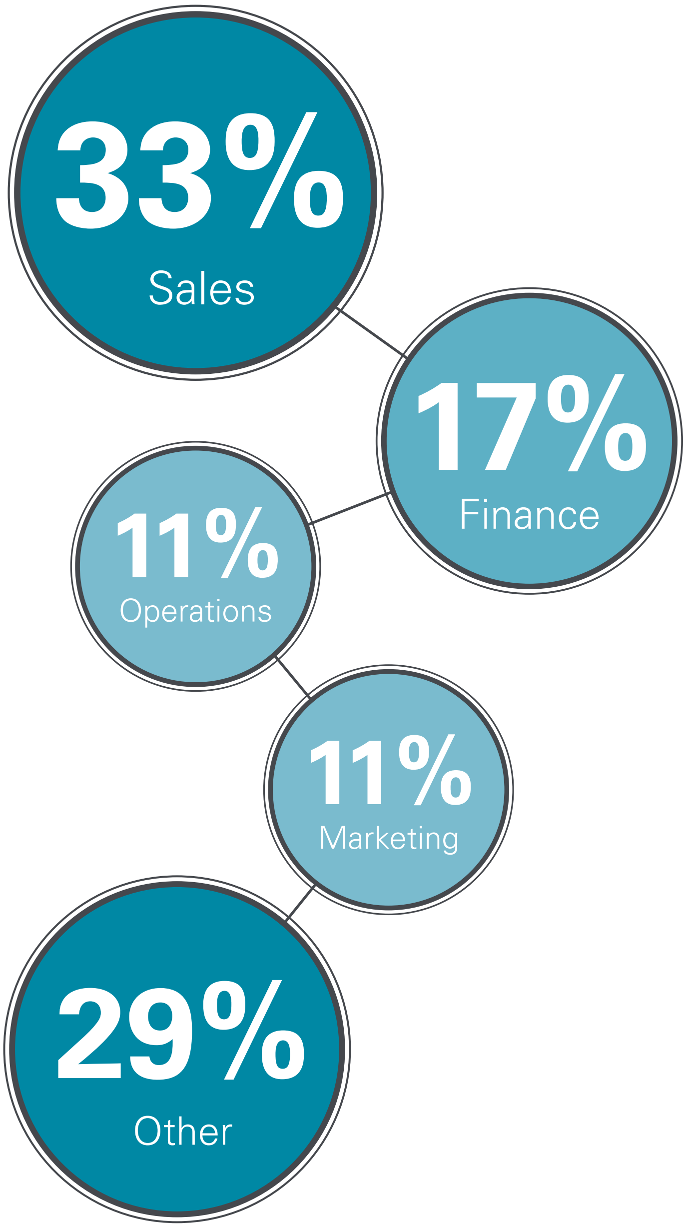
Finance sets the list / gross price around 20 percent of the time in TMT and automotive and slightly less in retail / consumer (16 percent).

The other / general management segment is the largest list / gross price setter across all industries, highest in automotive (60 percent) and business services (44 percent).

© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.

# Execution and measurement – Net price is more typically controlled by sales

**Functions who have the final say on net / discounted price**




**One third of organisations cited final say on net / discounted price sits with the sales force.**

This is nothing new, however companies require a grasp of actually how much sales force discretion is in play with discounting.

Without effective sales steering in place, such as effective incentive schemes, which combine revenue and margin; discount escalation schemes so that sales cannot offer maximum discount without sign-off; and tools and training so sales are clear on the impact of their discount decisions on margin, companies can face significant margin leakage.

Pricing controls appear to be another area of leakage, with 45 percent noting they 'often' use price lists and 16 percent noting they are sometimes, rarely, or never used.

Measurement of price performance is not necessarily consistent with strategy. Almost half (45 percent) of companies track pricing performance relative to prior periods (as opposed to measured value or competitive basis).

One quarter (24 percent) of companies track pricing relative to the competition, most prevalent in TMT and industrials.

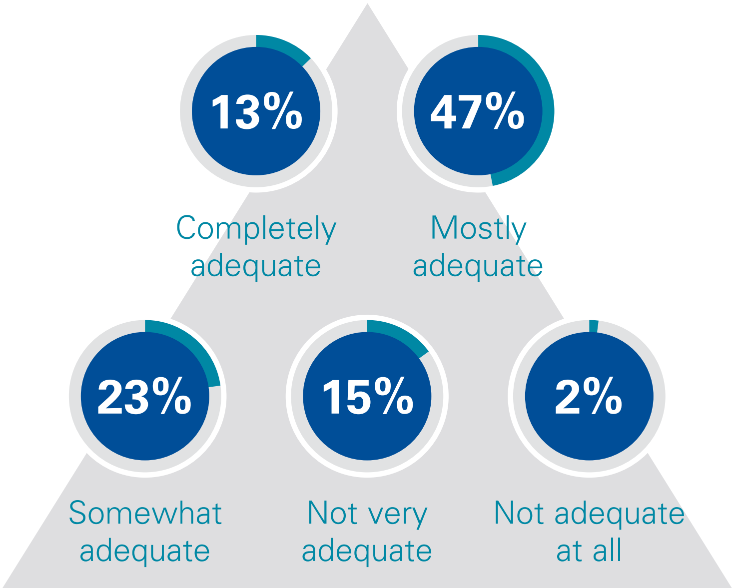
"Not long ago, a guy here did an analysis of our pricing in appliances and found out that about $5 billion of it is discretionary. Given all the decisions that sales reps can make on their own, that's how much is in play. We would never allow something like that on the cost side. When it comes to the prices we pay, we study them, we map them, we work them. But with the prices we charge, we're too sloppy."

**Jeffrey Immelt, CEO General Electric**

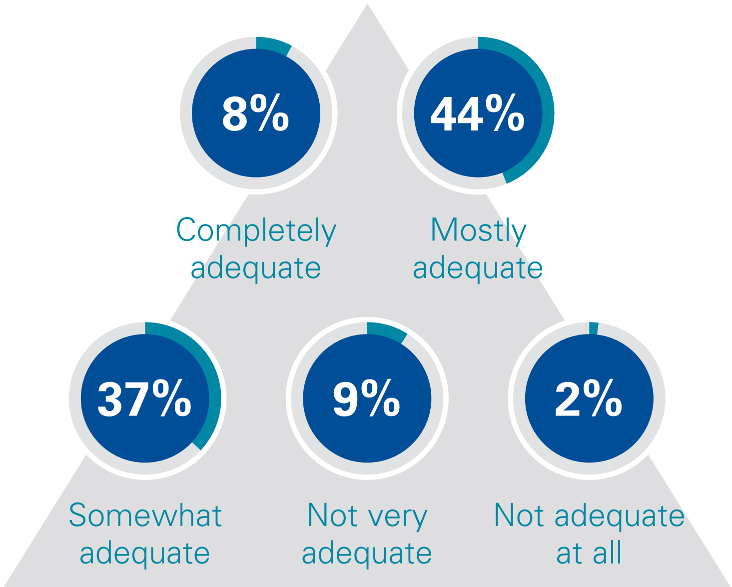
© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.

# Tools and capability – Limitations in people, resources and tools

**Adequate people and resources focused on pricing**




**Adequate tools to support effective pricing decisions**




**Respondents cited a large void in the people and resources focused on pricing, with only 13 percent of respondents noting they were completely adequate.**

Almost half (47 percent) of respondents indicated pricing people and resources were mostly adequate, with 40 percent stating they were somewhat adequate or less.

This appears to be a major black hole, with a large proportion of businesses lacking the right people and resources to manage the end-to-end pricing process, report to management on the impact of pricing decisions and co-ordinate with sales and product teams.

Notably, over the past 2 years, there has been a marked increase in the number of job titles which include pricing in their position description.

One example is the recent evolution of the Chief Revenue Officer (CRO), who typically takes responsibility for sales, pricing and marketing, thereby giving a holistic view of revenue generation. Nevertheless, we would note that most pricing functions are about 5 years behind their procurement counterparts in terms of sophistication.

There also appears to be a dearth of quality tools to support effective pricing decisions. Only 44 percent of respondents said their pricing tools were "mostly adequate" while just 8 percent said they were "completely adequate".

**Sound decisions rely on a clear, insightful picture.**

Among the pricing challenges companies face today, the following were viewed as particularly significant, according to our survey:

1. Identifying the most profitable products / services.
2. Obtaining accurate data to enable visibility of the impact of pricing on profitability.
3. Identifying the most profitable customers.

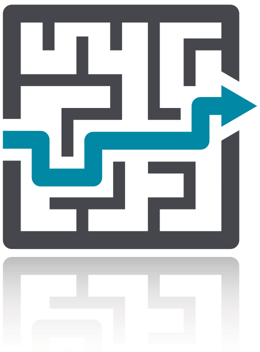
© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International.
Liability limited by a scheme approved under Professional Standards Legislation.

# Key takeaways

## 1. Evaluate where and how much value has been created.

You need to understand and quantify how your company's products and services create value for customers compared to your competitors. This necessitates a clear understanding of where the value lies by customer segment to inform better propositions and pricing decisions.

## 2. Develop a pricing strategy to extract value across the product lifecycle.



Once your company can demonstrate value creation, you need to arrive at an appropriate way of extracting that value. A robust pricing strategy should communicate how to do this, detailing an approach that is achievable, action orientated and widely understood and accepted throughout the organisation.

## 3. Invest in pricing infrastructure.

Building a strong pricing infrastructure is one of the best investments your company can make. This is about having a strong leader and team, as well as the necessary processes, performance management, systems and tools in place. Ongoing engagement and support from your company's board and management is essential.

© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.

## Contact us

**Ronan Gilhawley**
**Partner in Charge**
**Strategy & Planning**
+61 2 9335 7029
rgilhawley@kpmg.com.au

**Jonathan Attia**
**Associate Director**
**Strategy & Planning**
+61 2 9335 8386
jattia1@kpmg.com.au

**kpmg.com.au**

The information contained in this document is of a general nature and is not intended to address the objectives, financial situation or needs of any particular individual or entity. It is provided for information purposes only and does not constitute, nor should it be regarded in any manner whatsoever, as advice and is not intended to influence a person in making a decision, including, if applicable, in relation to any financial product or an interest in a financial product. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

To the extent permissible by law, KPMG and its associated entities shall not be liable for any errors, omissions, defects or misrepresentations in the information or for any loss or damage suffered by persons who use or rely on such information (including for reasons of negligence, negligent misstatement or otherwise).

© 2015 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.

The KPMG name, logo and “cutting through complexity” are registered trademarks or trademarks of KPMG International.

Liability limited by a scheme approved under Professional Standards Legislation.

August 2015. NSW N13038ADV.