



cutting through complexity

THE STRATEGY GROUP

UNLOCKING THE POTENTIAL OF PRICING

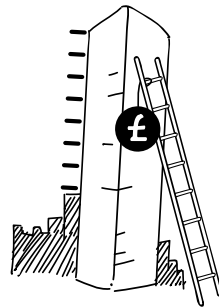
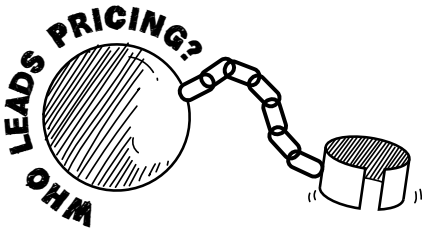


ROBERT BROWNE,
PARTNER, STRATEGY, KPMG IN THE UK

Since the recession many companies have been faced with margin challenges and yet so few have truly grasped the potential of pricing.

CHAPTERS

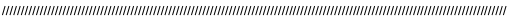
This report is ordered into four chapters below which discuss the critical drivers to more effective pricing.



01 / WHO LEADS PRICING?

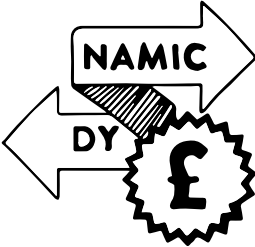
02 / PRICING CLIMBS THE ORGANISATIONAL LADDER

While our previous report, *The 10% Profit Opportunity*, described the potential prize, *Unlocking the Potential of Pricing* seeks to identify the organisational, behavioural and psychological barriers that are preventing companies from improving the effectiveness of their pricing and suggests how they can be overcome.



Rarely do companies lack effective pricing for want of trying. I don't think I have worked with one that was not eager to improve and very few would say pricing isn't a top priority. Most are honest about their shortcomings too. A FTSE-100 CEO company candidly admitted to me that his company would score 3 out of 10 for pricing.

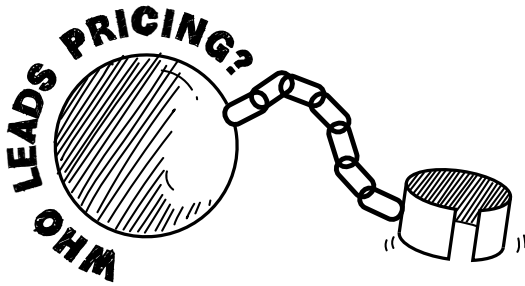
That said, many still consider pricing to be a tactical lever, believing that pricing starts and ends with setting prices. Others get stuck when it comes to investing in the necessary skills and tools. The result is that they leave value on the table and risk get dragged into price wars – not because they have lost control of pricing but because they never had control of it in the first place.





CHAPTER ONE

WHO LEADS PRICING?



The first challenge to effective pricing is accountability, or rather the lack of it.

I frequently talk to executives who cannot articulate their pricing strategy clearly and most admit they don't know who really has the final say on pricing decisions. Pricing usually comes to the attention of boards when it is already too late.

Historically, the responsibility for pricing has been shared by the Marketing, Finance and Sales functions, and this is often where the problem starts. Too often no-one actually leads on pricing and the dialogue across the organisation is shaped by the various departments' competing pressures, viewpoints and incentives. None of them are universally the "right home" for pricing in my view – it very much depends on the particular sector and company. That said, some broad conclusions can be drawn and, to that end, I have asked some colleagues to consider the case for each function to take the lead on pricing.

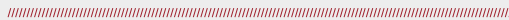


Edoardo Poli presents the case for Marketing. With their insights into the product, market and customer, pricing naturally sits in this function, particularly for consumer-facing and branded firms. Marketing helps design the product and build the brand; it conducts market research on what customers want and what competitors offer; and then sets prices which sales teams take to market.



“MARKETING SHOULD TAKE THE LEAD”

EDOARDO POLI



As the function that best encompasses the skills necessary for an effective pricing strategy, marketing is the natural home for pricing. Indeed handing responsibility for pricing to marketing would help that department place itself at the heart of the business.

Too often marketing is peripheral to the real power within a company: it generates ideas to entice customers but is not accountable for winning them. In many companies, the Chief Marketing Officer does not even sit on the board. That is a mistake in my view, even for B2B companies. Bringing together product management, packaging, advertising and channel management under marketing’s umbrella makes obvious sense, and including pricing as the other side of the proposition to customers is a logical extension of that responsibility. Let us not forget that pricing is one of the four Ps in the marketing mix – product, price, promotion and place – that Jerome McCarthy so famously set out in 1960.

RESPONSIBILITY FOR PRICING WOULD PLACE MARKETING AT THE HEART OF THE BUSINESS.

Pricing not only complements Marketing's other roles, but also helps the function provide the right skills needed to add maximum value to a company. Effective marketers need to understand not only the customer psychology and show creativity around product design, packaging and promotion, but also display strong skills in modelling and statistics in order to drive commercial results from its participation. One of the main UK supermarkets, for example, had to delay a pricing campaign for over a year because the marketing team was not sufficiently confident of the financial impact that a price-matching pledge would have on sales and margins.

If pricing has everything to do with the customer's perceptions of the value of one product versus another, then responsibility for pricing should lie with the team that has the greatest understanding of the customer: marketing.

Unfortunately there is often a disconnect. Marketing might set a price that is based on sound logic and research, but which in practice cannot be achieved by sales teams on the ground. For example, large customers might hold such overwhelming buying power that they dictate prices that the supplier has to accept or competitors may be pricing low to win a major customer and sales have to respond. Is it right also that Marketing should have such a fundamental impact on sales performance through pricing, yet are typically not accountable for results?

UNLOCKING THE
POTENTIAL OF PRICING

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So perhaps the solution is for Sales to lead on pricing. That is what Ben Gaster has been considering. Since they are closest to day-to-day trading and are ultimately responsible for delivering top-line growth, sales should lead on pricing and not just the day-to-day setting of prices but the broad direction of travel as well.



“SALES UNDERSTAND THE MARKET”

BEN GASTER



Key pricing decisions should be led by those closest to the market: the people who talk to customers and go head-to-head with competitors daily are best placed to understand and predict the impact of pricing decisions. An effective salesforce has its finger on the pulse of the market so it makes far more sense for them to take the lead on pricing than try to contort themselves into rules imposed by others. This is why pricing should be led by the Sales function.

A failure to give front-line sales authority over pricing saps their effectiveness in two ways. First, they become constrained by fixed price lists which may limit unwarranted discounting but may also limit their efforts to price higher. Second, negotiations with customers become protracted and potentially damaged if Sales have to run decisions past internal pricing ‘gatekeepers’. The net result could be that companies effectively open the door to more nimble competitors.



INSIGHT

Naturally, a pricing function reporting in to Sales would need to receive proper input from, and provide suitable information to, the key stakeholders to ensure the business has both a successful pricing strategy and effective pricing governance. Many companies form a cross-functional pricing committee, chaired by someone on the board, or at the very least reporting directly to someone on it. After all, Sales are accountable for capturing value and that means they should be responsible for the pricing decisions that deliver results.

Many companies operate with sales in the driving seat on pricing but there is one significant problem: unless incentives are designed cleverly, sales teams inevitably chase volume at the expense of price, with the consequent fallout for profit margins. An eloquent client once said to me, "it's like leaving a rabbit to guard a field of lettuces." Can we trust the rabbit with such easy pickings at arms' reach?



SALES ARE ACCOUNTABLE FOR
CAPTURING VALUE AND THAT MEANS THEY
NEED TO BE RESPONSIBLY FOR PRICING
DECISIONS.



Dan Ng makes a case for Finance, which has a strong claim to lead on pricing. It is inside this function that the pricing dialogue frequently starts, often with a request from the CFO to analyse the effect of pricing decisions on margin performance. The finance function typically possesses the requisite data and skills needed to crunch those numbers.



“FINANCE: THE PRICING LAB”

DAN NG



If pricing is a science, based on hard data and empirical evidence, then Finance can claim to be its natural laboratory. Data is the stock in trade of this function: it has a better understanding than any other about the transactions going through a company's books, production costs, margin levels and the impact pricing decisions have on sales and profits.

And Finance not only has the numbers, but also the people to make sense of them. No other team has a comparable mix of modellers, analysts, accountants and other left-brained individuals. In the era of big data, these skillsets are more important than ever in underpinning pricing decisions with robust analysis.

Finance don't normally face off to customers who seek to beat down prices, but that can be an advantage at times: the distance gives them some room to take a broader and less-pressurised view of each transaction. That said, the recession did force CFOs to get more



involved in commercial decisions as well as provide support with the number crunching. Specifically we have seen the emergence of the Commercial Finance role in many companies in the last five years, having previously only been found in very sales-orientated sectors such as retail. Finance is far better placed to assume responsibility for pricing than five or six years ago.

For a great number of companies, including some of the world's biggest, Finance is its central nervous system. The CFO has a leading role in managing company performance and in some organisations plays a role that is close to that of a COO. Being a pricing leader on the board is a natural element of their role. Effective pricing relies on a strong, independent voice at board level and Finance offers just that.

FINANCE HAS
THE BEST
UNDERSTANDING OF
THE IMPACT THAT
PRICING DECISIONS
HAVE ON SALES
AND PROFITS.

I can think of a few companies that have an effective pricing team led by finance, but I cannot think of many. Finance's problem is its distance from the competitive marketplace. Finance remains the backbone of many companies, but they do so too far from the heat of battle to be trusted with pricing decisions. Similarly as in the case of marketing, finance are not on the hook for sales performance and so there is a mismatch of responsibility and accountability.

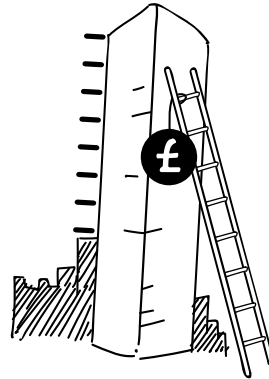


The established contenders to lead pricing struggle to do the job in my view. It is time for a rethink and that might mean it's time to create a completely separate pricing function.



CHAPTER TWO

PRICING CLIMBS THE ORGANISATIONAL LADDER



As a new function it is critical to set it up to succeed. What are the requirements?

First, the function would need complete independence from the departments that have traditionally wielded pricing power.

That would ensure it could gather relevant inputs to lead on pricing but also ensure its decisions are not being skewed by vested interests or incentives.

I believe that independence will only be meaningful if the head of the pricing function sits on or just below board level: the second pre-condition. He or she needs the visibility and status among his or her peers on the

board and in particular engagement from the CEO and CFO. While CEOs cannot be expected to micro-manage pricing decisions, I believe they need to get involved in pricing strategy and key decisions given their effect on company performance. For too many organisations, pricing is pushed too far down the hierarchy and companies are all the poorer for it.



Lastly, the company needs to invest in their pricing capability – both the insights necessary to make smart pricing decisions and also in hiring and developing the right team with the right skills. In failing to understand the full complexity of pricing, too many firms think they can take a finance or sales executive and convert them into a pricing strategist. In fact, the pricing team requires some quite specialist skills. They should have a strong grasp of customer and competitor behaviours

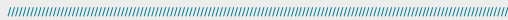
and trends; have the ability to interpret data and apply statistical techniques, and also be able to manage across organisational boundaries. Time and again, I see companies failing to coordinate pricing decisions across the key functions. The Pricing function would need to work across those silos.

In his article, Mukarram Bhaiji describes the role of the Chief Pricing Officer (CPrO). His article sketches out what this person would be responsible for and how they might operate.



“CHIEF PRICING OFFICER JOINS THE BOARD”

MUKARRAM BHAIJI



Pricing is at last starting to get the recognition it deserves, but greater debate in company boardrooms does not go far enough. In my view the moment has arrived for a Chief Pricing Officer (CPrO) to join the board.

It amazes me that the CPrO is not an established executive role already, from multinationals down to mid-sized family firms.

Board members from companies in a number of industries told a recent KPMG survey¹ that poor pricing decisions leave at least 10% profit on the table. Almost all firms have a Chief Procurement Officer to optimise costs,

Source: ¹KPMG
2013 Pricing Survey

yet they fail to give the same prominence to a pricing role that could do the same for revenues and margins.

Finding the role difficult to define may be one reason why companies have not already appointed a CPrO. However, in the face of multi-channel competition and promiscuous buyers, companies need to get on top of pricing and as the idea of a CPrO becomes more accepted, I expect more and more boards to appoint them in the next five years.

For me, the new cohort will perform three distinct roles. First, the CPrO must have their finger on the pulse of the whole company. He or she needs to have a detailed understanding of the company's target customer segments now and in the future, as well as how the company's products and services create value and how this creates differentiation, if at all, from the competition. The broad pricing strategy and policy framework within which the firm operates will be set from the CPrO's desk, working in close collaboration with sales, marketing and finance.

He or she cannot set the strategy and policy framework based on operations and cost. Historically, companies have tended to set prices by asking themselves what it cost to produce a product and then estimating a margin that it can add given the prevailing market. A Chief Pricing Officer should take a new approach to pricing: one based, not on internal factors but, on how the customer values the product or service to generate value.

If, for example, a telecoms operator is rolling out fibre-optic broadband to business customers, they should set a price based on the value that this new technology brings to customers in terms of the extra revenue or



reduced cost they can realise with greater bandwidth and speed, not on what it cost to install or what the market has historically charged for internet connectivity.

To make this value-based approach a success, the pricing team must have an insatiable appetite for data and insight. The CPrO must not only understand the firm's own performance and what this reveals about customers' attitude to its products, but also its position relative to competitors. They then need to be able to translate this data into insights that inform choices across the business.

Second, the CPrO has a responsibility to champion this data-driven, value-based approach within the company. That starts by using data to challenge any boardroom perceptions that the company is a price taker and can't influence pricing performance. To be clear, this is not always about an ability to put prices up and may equally mean that prices for certain products and services may need to be lowered.

Companies generally fear price increases as they always fear customers might leave. This is not universally a bad thing however, if some customers enjoying low prices actually cost more to serve. The CPrO therefore needs to challenge and demonstrate, for instance, that customers who might leave following a price rise might actually be a group worth sacrificing. More broadly though, the CPrO needs to get the organisation on the front foot in understanding the true relationship between price and demand for its products and services, which is a major gap in many companies today.

Third, the Pricing function's evangelising mission must permeate the whole company. It would be the CPrO's job to arm front-line sales teams with the necessary



data and insight to change from cost- to value-based conversations with customers. That might mean proactively segmenting customers by volume, sector or quality and passing that intelligence to the sales force. If a steel company has a dozen products and sells each of those products to four or five customer groups it should be the pricing team that sets the broad pricing strategy – and policy – for each segment.

The CPrO would need to work closely with Sales. It is easy to imagine hard-pressed sales teams resenting interference from a function that leads on pricing but does not have to deal with customers directly. Done well though and a CPrO would empower Sales to negotiate with confidence based on their research of the market and analysis of past transactions.

For Marketing, a powerful pricing function led by a CPrO would help avoid costly errors. Too often, companies focus on product development or advertising decisions without fully recognising the pricing strategy. Set too high and sales will flop. Set too low and the company will have set a pricing benchmark that it will be almost impossible to escape later on. These are costly mistakes that a CPrO would help avoid.

Apart from the CEO, no other function has such a remit across all functions and that gives the Chief Pricing Officer invaluable insight. But there is another reason they should sit alongside the heads of Sales, Finance and Marketing: the CPrO and their function define the most basic question any company must ask itself – what will the customer pay for our product or service?

Their establishment and promotion is long overdue.



I have a lot of time for Mukarram Bhaiji's idea and it is a model that a small, but increasing, number of companies are adopting.

However, if creating a wholly separate pricing function is a step too far for some, having them report to Strategy or Marketing is the next best alternative in my view. That way, they remain independent from Sales and Finance and can take a longer term view of pricing rather than focus only on short-term trading. If companies want to be 'strategic' about pricing, then placing it in a strong Strategy or Marketing function is a good start.

We believe the time has come for companies to establish a pricing function. The role of Chief Pricing Officer (CPrO) leading that function would put pricing firmly in the Boardroom.





CHAPTER THREE

IS THERE MORE TO BE DONE?

The issue of organisational ownership is not the only thing preventing companies from achieving great pricing results.

Fear, overconfidence and incentives are often at the root of poor pricing decisions.



The most common lament I hear from senior management on pricing is that they are price takers not price makers: “We don’t have control of our pricing – the market does” they say. I don’t agree with that for the most part but it is this fear of the unknown and the consequent lack of proactive action that Dan Ng explores.



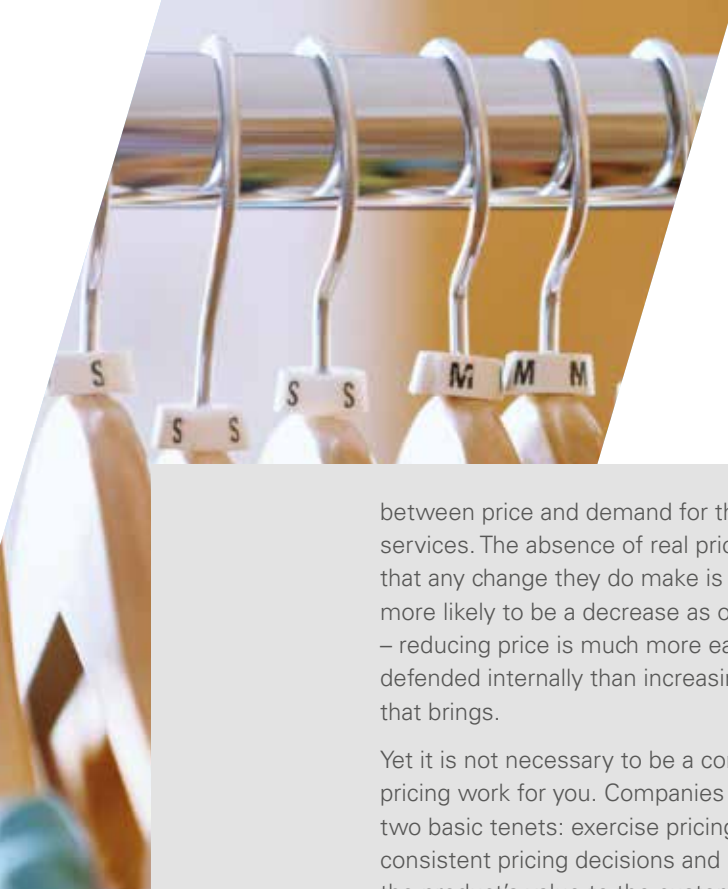
“FEAR OF THE UNKNOWN”

DAN NG

Talk to senior management about pricing and one clear message comes through: a concern over the unknown consequences of taking action. Put the price up and customers may leave in droves. Set it lower and competitors may follow.

Pricing is seen by many as an art: those who have a good ‘feel’ for the market are given a freedom to set prices based on how they think customers and competitors will respond. Many believe – wrongly – that it’s simply not necessary or worthwhile to invest in a pricing capability. In fact, pricing is a science and robust analytics should always underpin pricing decisions given their impact on financial performance. However, many C-level executives still don’t buy that.

Most companies tend to be price followers – looking at competitors before setting their prices slightly cheaper or slightly more expensive. We have talked to over 100 companies in the UK over the past 18 months, and the majority do not fully understand the true relationship



between price and demand for their products and services. The absence of real pricing insights means that any change they do make is invariably smaller and more likely to be a decrease as opposed to an increase – reducing price is much more easily explained and defended internally than increasing price, with the risks that brings.

Yet it is not necessary to be a corporate giant to make pricing work for you. Companies should keep in mind two basic tenets: exercise pricing discipline to drive consistent pricing decisions and make sure price reflects the product's value to the customer. With those in mind, all companies will be able to improve their pricing performance and deliver better results.

Changing prices will always bring risks of unintended consequences, but it's better to tackle it head on with analysis and insights than to ignore it. The best companies in the world see pricing as a real source of competitive advantage.

The solution is simple: companies should invest in their pricing capability and arm themselves with data and insight to make pricing decisions with confidence even if, for example, all the bargaining power is in the hands of their customers.



That lack of insight and information can also have the opposite effect, breeding overconfidence as Edoardo Poli describes.



“OVER-CONFIDENCE OBSCURES THE FACTS”

EDOARDO POLI

Pricing decisions require both a mix of analysis and intuition, yet too often management make pricing decisions based on perceptions alone. Without the statistical rigour to back up those perceptions and without constantly testing their pricing models, companies can be lulled into a false sense of security.

Part of the problem is that many of those responsible for pricing either see themselves as a typical customer or believe they can relate to what that person thinks. So if sales are poor, executives often put the problem down to pricing at a level they themselves wouldn't be willing to pay. They may then go further and commission customer research or focus groups to test their pricing hypotheses.

While these studies are certainly useful, they rarely reveal the full picture on pricing and might even mislead since what customers say and what they do often differs. I believe that organisations need to do a much better job of analysing their own transaction data and getting to grips with the price-demand relationships for their own products and those of key competitors. Relying on intuition and failing to bring statistical skills to bear are two common reasons for poor pricing outcomes.

False confidence also leads to companies thinking that what has worked to date will continue to hold. I recall

one client who needed to increase prices because input costs had gone up, but went about applying the same change across all customers as opposed to adjusting it based on price sensitivity by segment.

At its root, too few executives have a sufficient understanding of how (and how much) their products and services create value for customers or how this value varies by customer segment. This is a real blind spot for most companies today but the very best companies obsess about it.

Looking to the future, companies constantly need to challenge their pricing to keep ahead of emerging trends and changing behaviours. We live far more connected lives and consumer trends are shifting faster than ever. Pay-as-you-go models are disrupting subscription models. Online sellers are using pricing analytics to customise offers and promotions. Name-your-price and other bidding models are becoming common. Despite these changes, firms that are over-confident in their pricing tend to run with the same segmentation and pricing models for years.

As the digital economy moves on, what once was effective pricing may no longer apply and companies need to constantly analyse whether shifts in sales are the result of its own actions, competitive actions, or customers moving to an entirely better solution.

Companies must guard against the mistaken belief that sticking a price tag on a product is a simple task. Setting prices based on a mix of intuition and anecdote is a dangerous but common practice as he points out. In almost every impediment to effective pricing is a failure to harness data and make properly informed decisions.



Looking at incentives Ben Gaster argues that companies must look again at the sales team's goals and incentives in order to ensure they are making the best pricing decisions for the wider organisation and not leaving margins behind.



"INCENTIVES: A MOTIVATIONAL MINEFIELD"

BEN GASTER

Sales teams need to change the 'volume at all costs' mind-set to shift the dial on pricing. Far too often their incentives are the root cause of the problem, encouraging them to move volume rather than to sell at a price that reflects the true value of that product to the customer.

To be successful, sales staff will need to take a fundamentally different approach to sales conversations and negotiations. If a customer is unwilling or unable to meet a particular price, then a salesperson should consider amending what they sell rather than simply cutting the price for the same goods or service. What would an apple seller do if he wanted to sell three apples for £3, but the customer only had £2? If he understands the value of his product – everything from premium apples for expensive fruit bowls to misshapen fruit for a pie – then instead of dropping the price, he might offer two premium apples for £2, or offer three slightly misshapen fruit for the same price.

Shifting to 'value-based selling' is difficult based on current incentive structures. In my experience sales teams are likely to give way on price if they are chasing

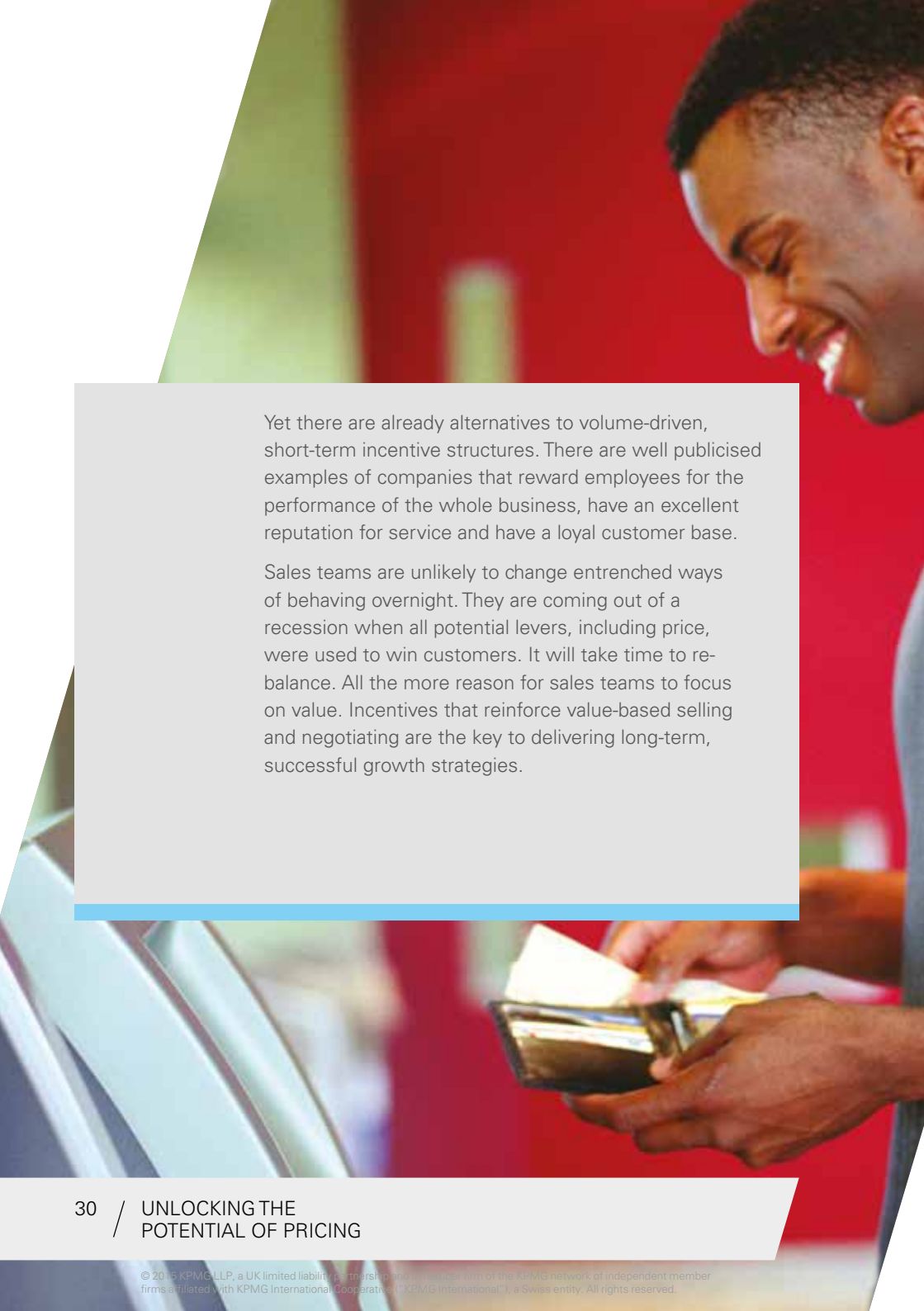
a bonus pot based on a sales or volume target, but they then behave differently when these targets have been met or removed.

In fact, some sectors are removing sales and volume incentives altogether to promote customer experience improvements and hopefully resulting in less focus on price. I am not advocating removing sales-focused schemes altogether, but instead companies should consider moving towards incentives that focus on value. Staff could still be paid based on achieving sales targets, but with an additional measure attached, based on value. The greater the value of their sale, achieved through more effective pricing, the greater their payoff.

That should help solve a common problem with pricing. Because companies must sell volume to cover fixed costs and drive profits they quickly seize upon any signal that their price is too high (and cut it). How many sales people have you heard say their prices are too low for example? And how often would a clothing retailer raise prices when the latest range is selling well? The fact is that management are more likely to interpret strong sales as the result of a well-designed product, not a poorly-priced product relative to the value customers see in it.

It is difficult to design perfect incentives however. They are often developed to attract and retain the best sales people based on what they can get elsewhere and often put little or no weight on the long-term business or brand objectives. Transitioning from one incentive structure to another is also challenging. Any perceived challenge and companies will fear losing their best sales staff.





Yet there are already alternatives to volume-driven, short-term incentive structures. There are well publicised examples of companies that reward employees for the performance of the whole business, have an excellent reputation for service and have a loyal customer base.

Sales teams are unlikely to change entrenched ways of behaving overnight. They are coming out of a recession when all potential levers, including price, were used to win customers. It will take time to re-balance. All the more reason for sales teams to focus on value. Incentives that reinforce value-based selling and negotiating are the key to delivering long-term, successful growth strategies.

I would also suggest that most companies need to really test the relationship between price and volume. All too often I see companies chasing volume by cutting prices by 10% and even 20% and not getting the expected volume uplift.

Companies should only take these actions once they have a full understanding, for instance, of the precise relationship between price and demand in the mind of their customers but also how competitors are likely to react to their pricing actions.

Companies can only gain this kind of insight if they build a pricing capability and, to their credit, almost all big firms have made some effort. Where they fall short in my experience is in not thinking about how to make that capability sustainable – to build a permanent capability that can be successful both internally and externally.

If pricing is tackled as a project – perhaps focused on a specific product, category or country – it invariably fades away as easy wins are exhausted, key personnel move on or departments get stuck on key decisions. Even if the project is successful, it is a one-off and momentum is lost.





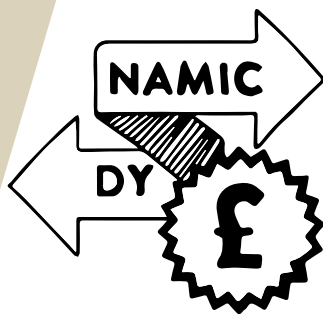
Pricing cannot and should not be run in a piecemeal fashion. Companies should be bolder and invest in pricing as they do other key functions, with its own team, processes and metrics. It is too important not to, as many companies have found out.





CHAPTER FOUR

DOES PRICING HAVE A LIMIT?



“ WE BELIEVE THE CUSTOMER SHOULD BE IN CONTROL OF THEIR OWN INFORMATION. YOU MIGHT LIKE THESE SO-CALLED FREE SERVICES, BUT WE DON'T THINK THEY'RE WORTH HAVING YOUR EMAIL, YOUR SEARCH HISTORY AND NOW EVEN YOUR FAMILY PHOTOS DATA MINED AND SOLD OFF FOR GOD KNOWS WHAT ADVERTISING PURPOSE.* ”

TIM COOK, APPLE

Several years ago Coca Cola tested a vending machine that increased the price as the weather got hotter¹. It was a clever idea but consumers hated it. The problem was that at a very basic level the machines undermined a principle that is implicit in any transaction: customers need to feel they are being treated fairly.

Today sellers would do well to remember this example as they deploy ever more sophisticated algorithms to dynamically price transactions. If they fail to heed the lesson, they risk a far greater backlash than that inflicted on Coke.

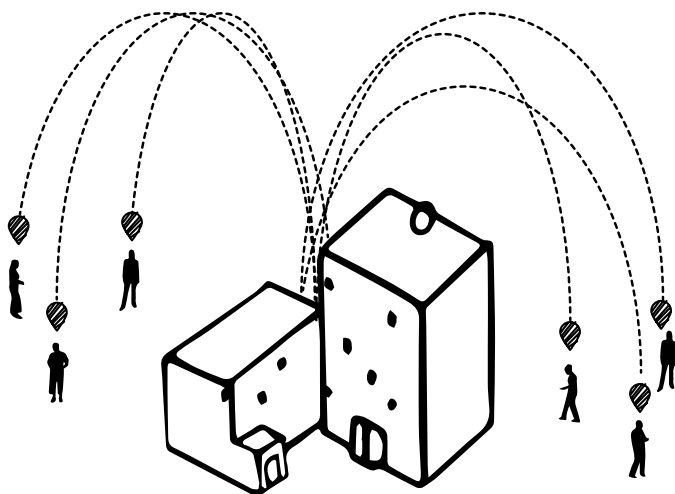
For years, airlines have used dynamic pricing to sell the same seat at different prices based on what they know about supply and demand. Now other businesses have taken this model into almost every corner of retail, but with one important distinction: they have a much better

understanding of how much we want the product. They are doing that by analysing and predicting our behaviours in ways that the majority of people don't understand and because of this I believe they risk crossing an important line with customers.

¹ <http://www.nytimes.com/1999/10/28/business/variable-price-coke-machine-being-tested.html>

* Speaking at EPIC's Champions of Freedom event in Washington. <http://techcrunch.com/2015/06/02/apples-tim-cook-delivers-blistering-speech-on-encryption-privacy/#.l0pev1:0tFF>





**TRACK AND PRICE
INDIVIDUALLY**

Few of us properly realise the information that companies have about us. Just think about any of your loyalty cards. They know your previous purchases, what promotions you go for, and what combination of products you buy together. Now add in your online profile and your history of searches and purchases. Predictive analytics help companies get a handle on your wish list; they may also know the area where you live, what you drive, and so on. Finally, add in your mobile phone and companies can track where you are and what you are browsing right now.

I don't have a problem with companies having this information but I do believe consumers should be more aware of how this information is being used. The issue here though is whether predictive analytics are being used to change offers and discounts based on what they know about us and whether customers believe that is fair.

Take for example the way that a new wave of taxi service providers increase prices as demand rises.

What if part of their pricing equation draws on our past travel history and predicts our insensitivity to price at certain times of the day or for certain journeys? Or what if we searched the same product online several times and pricing analytics detected our desire to purchase? These pricing algorithms are top secret, particularly among online businesses, and are capable of setting prices or changing discounts and promotions in real time. I believe using algorithms to set prices customer by customer raises some questions.

Algorithm-generated pricing is already happening on an industrial scale. Software start-up Boomerang Commerce estimated recently that Amazon set 10 billion different prices for products sold to customers in the holiday season last year². According to their research, Amazon can change thousands of prices in seconds to optimise prices for every product in every basket and they are certainly not alone in having this capability. There is in fact an industry full of software companies working on price optimisation tools and analytics.

² <http://recode.net/2015/01/13/how-amazon-tricks-you-into-thinking-it-always-has-the-lowest-prices/>



Hasn't differential pricing always existed though? What difference is there between these practices and the astute seller who sets his price based on the cut of the customer's suit, or the Chelsea petrol station that charges the highest fuel prices in London? They don't charge more because their costs are higher but because Chelsea's residents can afford it. What distinguishes this pricing behaviour from the kind of pricing used dynamically online is the use of predictive analytics.

I should stress that online sellers are not ramping up prices for any customers beyond 'full price'. Instead they use the fact that so many products are never sold at full price. It therefore becomes a question of figuring out how big a discount one or another customer is offered to get them to buy. There are a couple of issues at play here. The petrol station in Chelsea can charge more because it can get away with it but they charge the same to everyone who comes in. What if they knew you were nearly out of petrol and decided to charge you more? Also, by dint of the fact that most shoppers trust sellers to offer the same price to everyone, they may not perform a wider price search and end up paying a higher price for some items.

So what's going to stop pricing analytics from becoming too powerful and crossing an important line with customers? I can think of two good reasons why companies would be wise to stay on the right side of the line.

First, I believe dynamic pricing will come under increasing scrutiny from government, regulators and consumer protection agencies. We know that information relating to our online behaviours is being sold and our 'free' email accounts are not private. These privacy questions are gaining traction in political circles and if companies don't show restraint, it may be imposed upon them.

Second, sellers should remember that brands can easily be harmed if customers feel they have been treated unfairly. Yes, companies should be smart with pricing, but I would strongly advise them not to veer into the territory where analytics takes advantage of individuals and their context. There is a strong case for self-regulation.

Companies could demonstrate the integrity of their brand by codifying and abiding by a clear set of pricing principles. For example, sellers could follow the example of the Alliance of Automobile Manufacturers who have pledged to keep consumer data private in the new era of connected cars. They could join together in developing a pricing code of conduct that protects consumers.

Dynamic pricing has already fundamentally changed the way companies sell, yet the concept is still in its infancy. The ability of companies to access our data and predict our behaviour in ways we may oppose grows greater every month. That is why sellers urgently need to consider how they are using pricing analytics before their businesses become hooked on morally questionable methods.





Unlocking the potential of pricing:

1. Who leads pricing on your board?
2. How professional is your pricing capability?
3. Does your organisation have a positive pricing culture?



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www.kpmg.com/uk/pricingpotential

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