Unlocking the potential of pricing

Are you thriving in the water or lost at sea?

Global Strategy Group

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Authors go here

Sections

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

01

Introduction

The best pricing organizations control, communicate and manage their pricing strategies effectively, and by doing so maximize their potential for greater profitability.

However, for many companies, pricing is still used as a tactical lever and value is left on the table.

Our research findings are clear: many organizations are taking a much more strategic approach to pricing. But it remains very much a work in progress for others and there remains a significant profit opportunity to go for.

Our colleagues at KPMG in the UK conducted 300 executive interviews in September/October 2015 across a range of sectors including Industrial Markets, Retail, Telecommunications, Consumer Goods and Media.

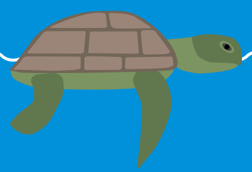
Our findings reinforced some recognized themes, but also highlighted some unexpected results:

- 60 percent of executives interviewed believe they could improve profitability by 5 percent or more through more effective pricing; better still, 25 percent believe they could improve profitability by 10 percent or more.
- 40 percent of companies in our research have not moved beyond (eons-old) 'cost plus' as their core pricing method. Only 25 percent employ value-based pricing.
- 60 percent of companies surveyed have created a dedicated pricing team or function, which is a positive development; however, 40 percent said their company has not, or they don't know.

02

Pricing: How deep is your understanding?

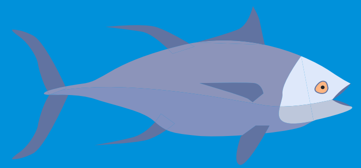
We've defined four categories of organization based on the sophistication of their pricing.



Turtles (10%)

Turtles don't have a defined pricing strategy or pricing team and have no clear approach to tracking pricing performance.

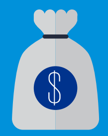
Most are unaware of the size of the prize associated with more effective pricing.

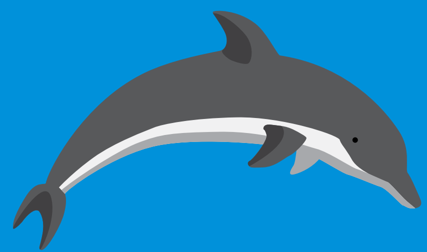


Tuna (30%)

Tuna have been making pricing decisions the same way for a long time and are slow to change. There is typically no pricing team or pricing leader and they don't see the value in taking a more structured approach to pricing. Pricing decisions are primarily based on spreadsheet analysis. They are the most likely to change their prices because of a change in competitors' prices.

Tuna see the pricing opportunity as between 3%–10% profit improvement.

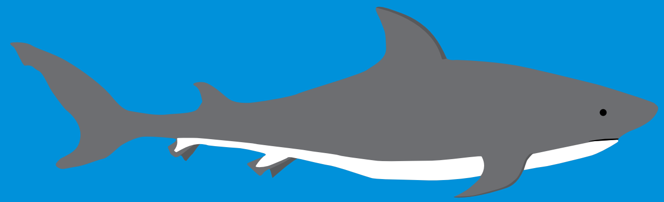




Dolphins (25%)

Dolphins are agile organizations, often newer, smaller and with relatively young workforces. They have a clear pricing strategy, a dedicated pricing team and leader. They use pricing software and track prices against competitors and value delivered for customers. However, they have a tendency to lower their prices quickly if sales targets are not being met.

They see the pricing opportunity as between 6%–10% profit improvement.



Sharks (35%)

Sharks are dominant players, equipped with pricing sensors and ready to take advantage of opportunities quickly. They have invested in pricing as a capability, have a clear pricing strategy, a large pricing team and a pricing leader. The CEO understands the importance of pricing. They track prices against competitors across time, use dedicated pricing software and appreciate the importance of innovative pricing analytics.

Sharks see the pricing opportunity as anywhere in the range of 6%–30% profit improvement.

03

Pricing strategies – clear and understood?

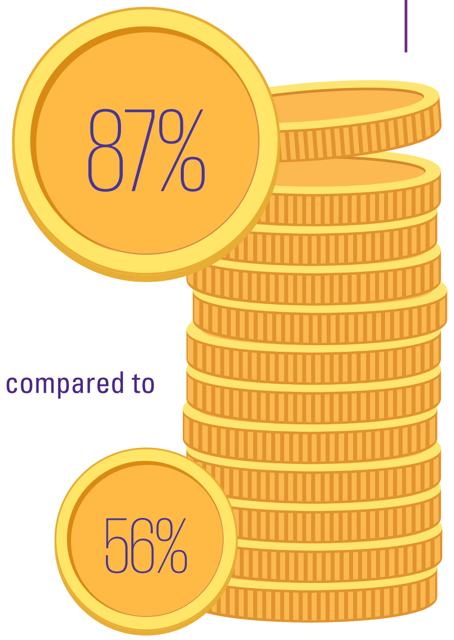
So, is your pricing strategy communicated clearly through the organization? Is it understood and adhered to in practice?

At first sight, our survey results provide good news, with nearly nine in ten businesses (87 percent) claiming to have a clear pricing strategy that is understood and adhered to. For Sharks, the response rate was 99 percent. By way of contrast, when we conducted this survey in 2013, only six in ten (56 percent) responded similarly.

That said, nearly half (44 percent) of companies in this year's survey agree their company is struggling to determine the optimum pricing strategy for the current economic climate, so it's not all plain sailing.

Clarity of strategy also varied significantly according to where the individual sits in the organization. 92 percent of CEOs/COOs/CFOs believe their strategy to be clear, but this drops to 82 percent amongst sales directors.

Companies headquartered outside the UK also score lower — suggesting that the strategy is either difficult to communicate clearly across borders or perhaps that the strategy is mainly designed for the organization's home country or market.



have a clear pricing strategy

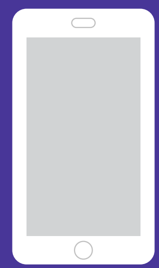
compared to

in our 2013 survey

92% of CEOs/COOs/CFOs believe their pricing strategy to be clear

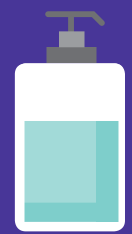
82% However this drops to 82% amongst sales directors

There are marked variations by sector:



100% of respondents in the Telco sector say their pricing strategy is clear

Dropping to



90% in Consumer Goods

80% in Industrial Markets

71% in Business Services

04

Pricing strategy – fit for purpose?

It's one thing to have a clear pricing strategy. But it's another thing having the right one. Forty percent of respondents have not moved beyond 'cost plus' as their core pricing method which is disappointing.

Is your pricing strategy fit for purpose? Is it based on cost, competitors or value created for your customers?

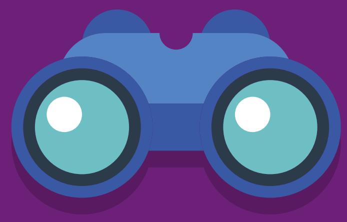
In our view, this is the reverse of how it should be. A value-oriented approach may be more challenging to develop and implement (working out the true value of your products and services — not just the cost — to the customer and how this value can differ by segment or purchase occasion) but it is one that will deliver much better profitability over time.

There were some notable variations by sector in our research. Price-sensitive sectors like Telco and Retail are most likely to pursue a competitor-orientated approach. Media, Industrial Markets and Consumer Goods are more likely to follow a cost-orientated strategy.

Size also matters here. Nearly half of smaller companies employ a cost plus strategy, and it is especially prevalent for those companies with turnovers of below $70M USD. Amongst those companies with turnover of $700M USD there is a marked increase in the proportion of value-orientated strategies — nearly 50 percent. So the largest organizations are taking the most sophisticated of approaches — but that said, still just half of them.

40%

Cost-plus strategy



34%

Competitor- orientated strategy

25%

Value-orientated strategy

1% of respondents did not know/were unclear

05

What leads to a pricing strategy change?

The most common reason given for a pricing strategy change was a new business model or technology disruption in the market (30 percent). This was most noticeable in the Telco sector (38 percent) followed by Media (34 percent).

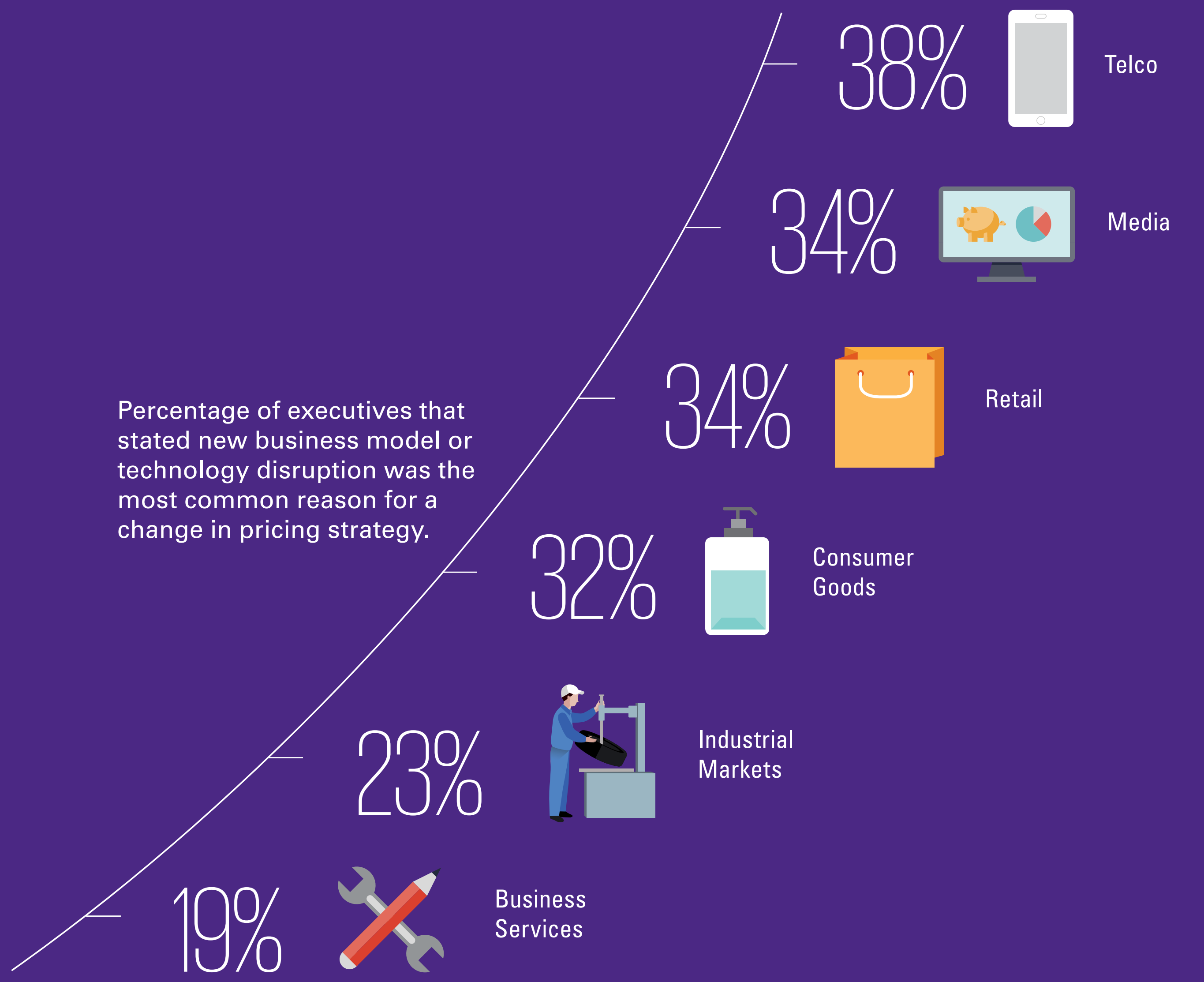
Competitor pricing activity was also a significant factor. Unsurprisingly, it was the top trigger in the Retail sector and Consumer Goods.

For Industrial Markets companies, no single factor dominated, but the most common was a new business model or technology disruption (23 percent). This was also true for Business Services organizations (19 percent).

Among Sharks, the most common trigger for a change in pricing strategy was a new business model or technology disruption (35 percent) and for Dolphins this was 37 percent. This contrasts to Turtles where poor trading performance was the most commonly reported trigger for a change.

But what happens when a competitor lowers its prices? Thirty-eight percent of all our respondents said they lower their prices in response and try to recover margin through negotiation with suppliers, while 15 percent lower their prices and try to make up the gap through internal cost savings. In contrast, a third (35 percent) say they maintain their prices because they believe in the differentiation of their product or service.

Percentage of executives that stated new business model or technology disruption was the most common reason for a change in pricing strategy.



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06

The profitability prize

Quite simply, billions of dollars could be generated through more effective pricing according to our respondents.

Is your organization realizing the profit prize through better pricing? How many initiatives are you running that can generate a 5 percent or 10 percent improvement in profitability?

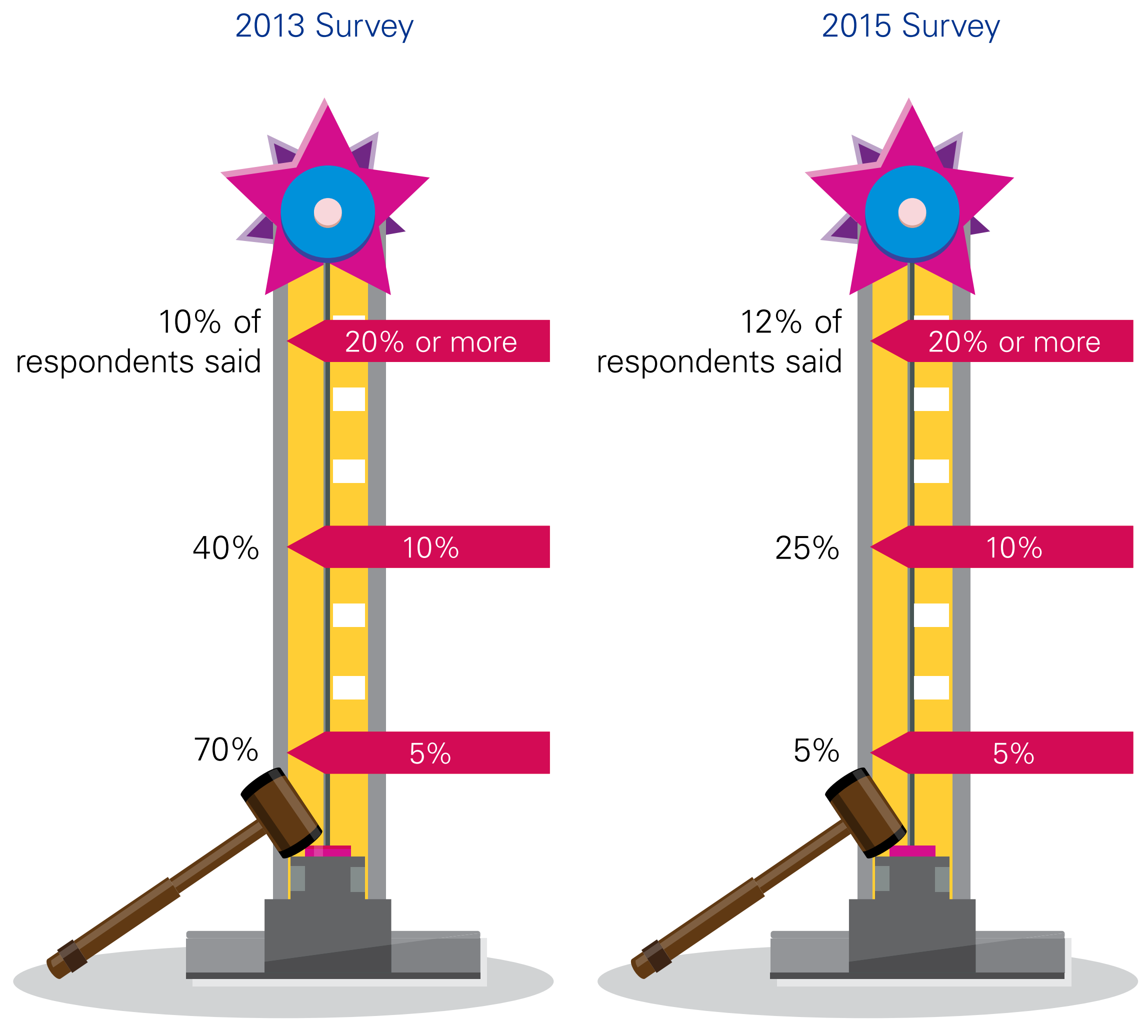
Sixty percent of executives believe they could improve profitability by 5 percent or more through more effective pricing, and 25 percent believe they could improve by 10 percent or more. This is lower than in our 2013 survey when 40 percent of respondents said they could improve profitability by 10 percent or more but still very significant.

There are many factors that could be behind this, such as a more stable economic climate, improved pricing capabilities, and the fact that pricing is now on the board agenda for more companies.

Interestingly, the higher up the organization you go, the higher the profitability increase expected. At the C-level, 40 percent of executives in our research believe their organization could generate more than 10 percent improvement in profitability compared to 25 percent for all respondents. C-suite respondents were 20 percent more likely to think that a 20 percent plus improvement in profitability is possible than all other respondents.

So, at the highest level in organizations, the pricing opportunity is seen clearly but these expectations are not always being realized. The prize, as such, is still out there.

How much can profitability be improved through more effective pricing?



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07

Who – if anyone – is in control of pricing?

Who controls pricing in your organization?

From our survey, 35 percent of companies see final pricing decisions resting with the CEO or Board, while a similar proportion (33 percent) give the pricing reins to Sales or Marketing, and 28 percent let Operations or Finance take control.

There is something of a functional bias however, with respondents most likely to believe their own area controls pricing. This is most prevalent in Sales and in Marketing, where respondents are 44 percent and 36 percent more likely than all other respondents to believe pricing responsibility lies with Sales and Marketing. The only group that is not subject to bias are Turtles. Almost every respondent in this group is certain that responsibility does not lie in his/her team, which is a worrying finding in itself.

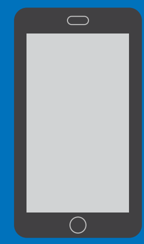
It is also interesting to point out that Dolphins are the only group where the final decision on pricing is more evenly distributed across the organization, indicating how smaller, newer organizations take a more delegated approach to pricing authority. Conversely, Sharks are more traditional where the CEO/board has the final say on pricing in 50 percent of cases.

In our view, the responsibility for pricing is typically shared between Marketing, Finance and Sales, and this is where the problem starts. The input of each is shaped by the various departments' pressures, insights and incentives. We believe it's time to consider a standalone, independent pricing function.

Final say is most likely to sit with the CEO or Board

37% Industrial Markets

40% Telco



22% Retail

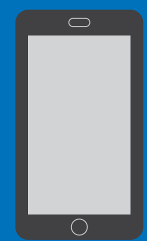
37% Media

Sectors most likely to have a dedicated pricing team are:

78% Consumer Goods

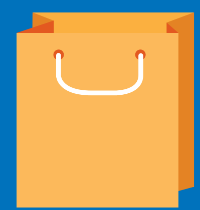
52% Media

75% Telco



59% Industrial Markets

61% Retail



53% Business Services

08

The rise of the CPrO — but only in half of companies

Does your organization have a CPrO or Head of Pricing? If not, why not?

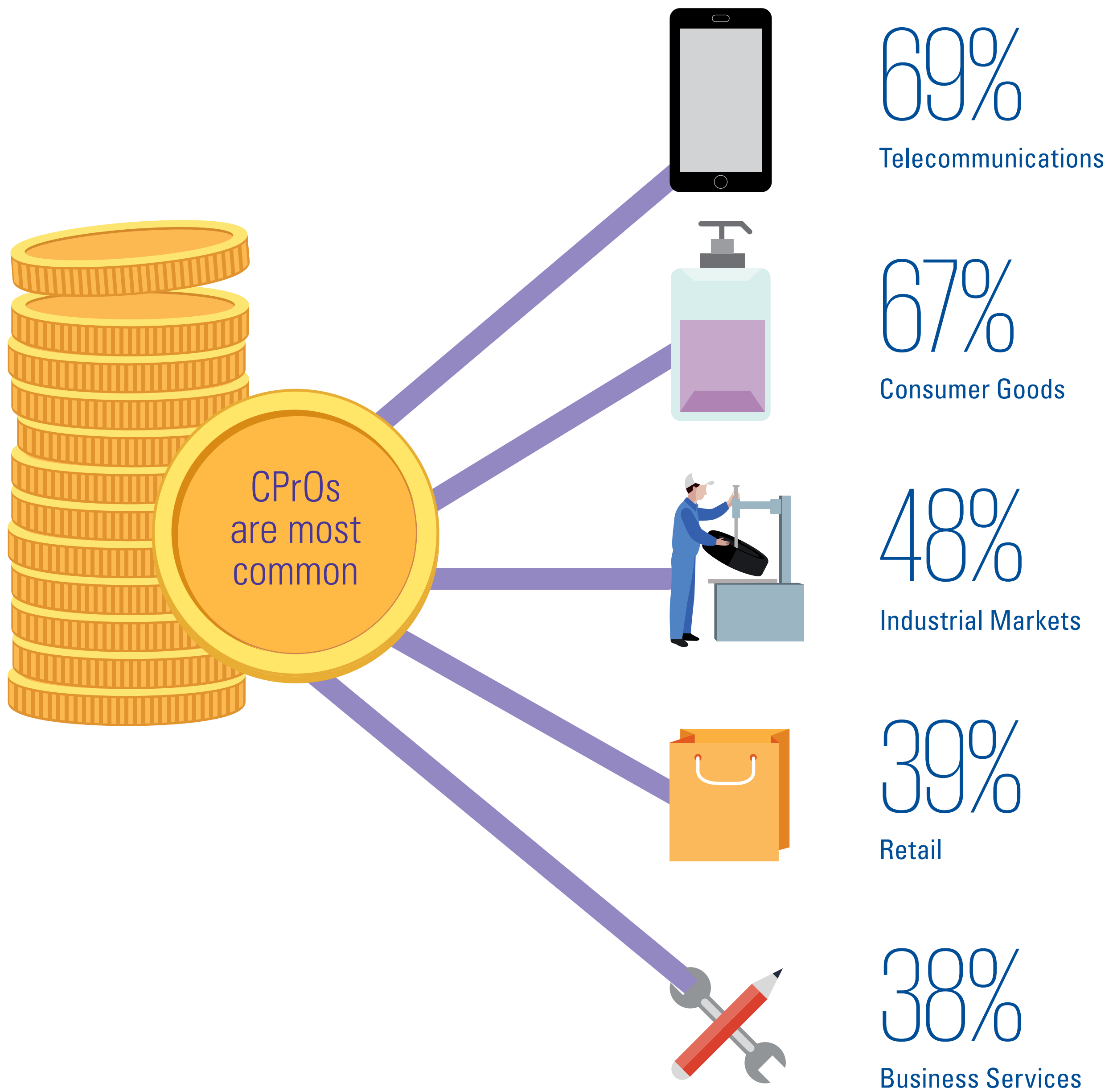
Another striking factor in our research is the rise of the Chief Pricing Officer (CPrO)*.

The presence of a CPrO depends on the type of organization. 81 percent of Dolphins and 85 percent of Sharks have a CPrO but for Turtles and Tuna, the percentage drops to less than 10 percent.

CPrOs are most common in Telcos and Consumer Goods (69 percent and 67 percent respectively) while Business Services organizations are least likely (38 percent) to have one, followed by Retail (39 percent) — perhaps surprisingly for such a price-sensitive industry.

There are clear signs that having a CPrO helps to introduce greater pricing rigour. Companies with a CPrO are 19 percent more likely to use dedicated pricing software and 15 percent more likely to track prices relative to value delivered to customers.

*CPrO or Head of Pricing



09

What makes a good CPrO?

Does your organization have a CPrO or Head of Pricing? If not, why not?

Interestingly, advanced analytical and data-driven skills ranked as only the third highest skill required according to respondents (15 percent). Ahead of that were an understanding of the commercial environment (41 percent) and influence at Board level (24 percent).

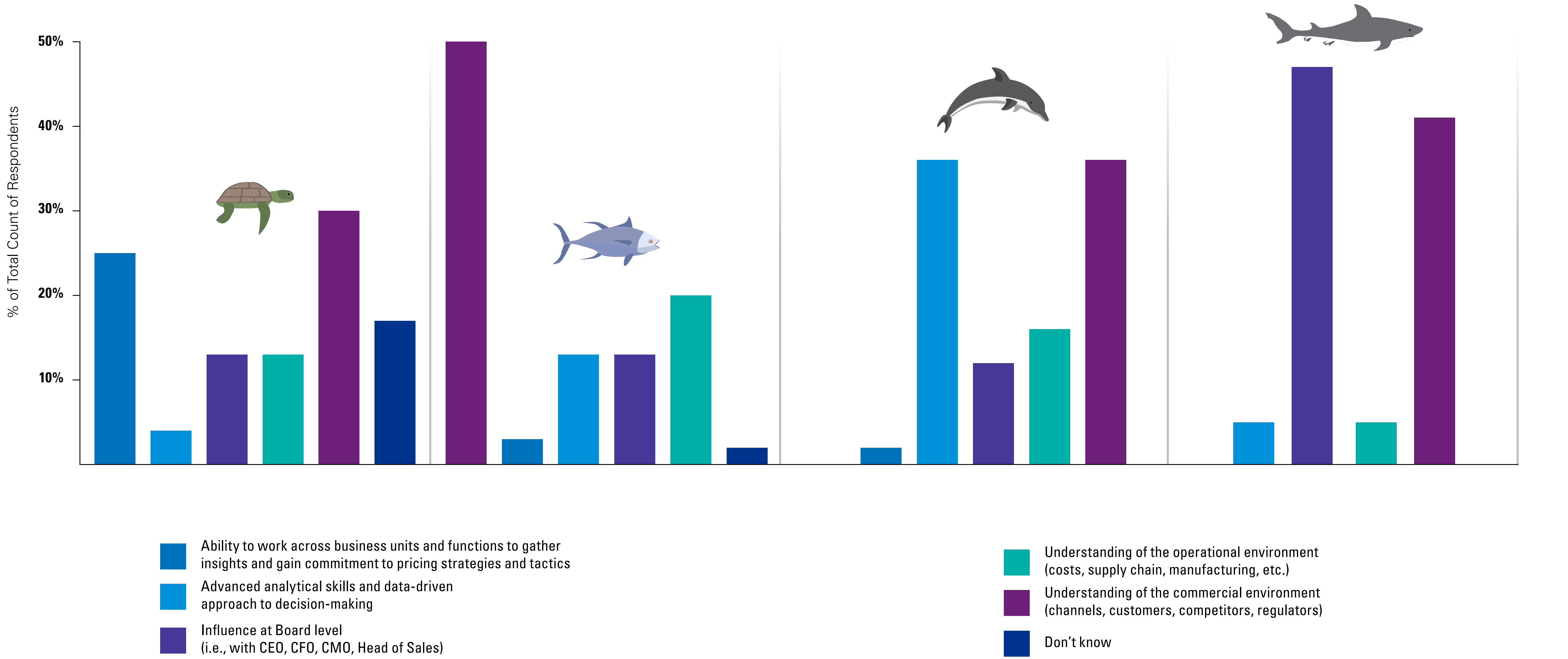
Generally, companies with a CPrO recognize the need for him/her to have a multi-disciplinary skillset. Companies considering appointing one for the first time should take note of this — it is not necessarily just a case of appointing a respected sales manager or financial professional, for example.

This is recognized by Dolphins who place the same level of importance on understanding the commercial environment as on analytical skills.

Tuna are mainly focused on understanding the commercial and operational environment and Sharks (where the CEO and Board have a high influence on pricing decision) focus the relevance of the CPrO's ability to influence them.

In our view, all companies need to have a CPrO or Head of Pricing to lead pricing on behalf of the board.

What are the most important characteristics of a Chief Pricing Officer?



10

Keeping 'tabs' on pricing

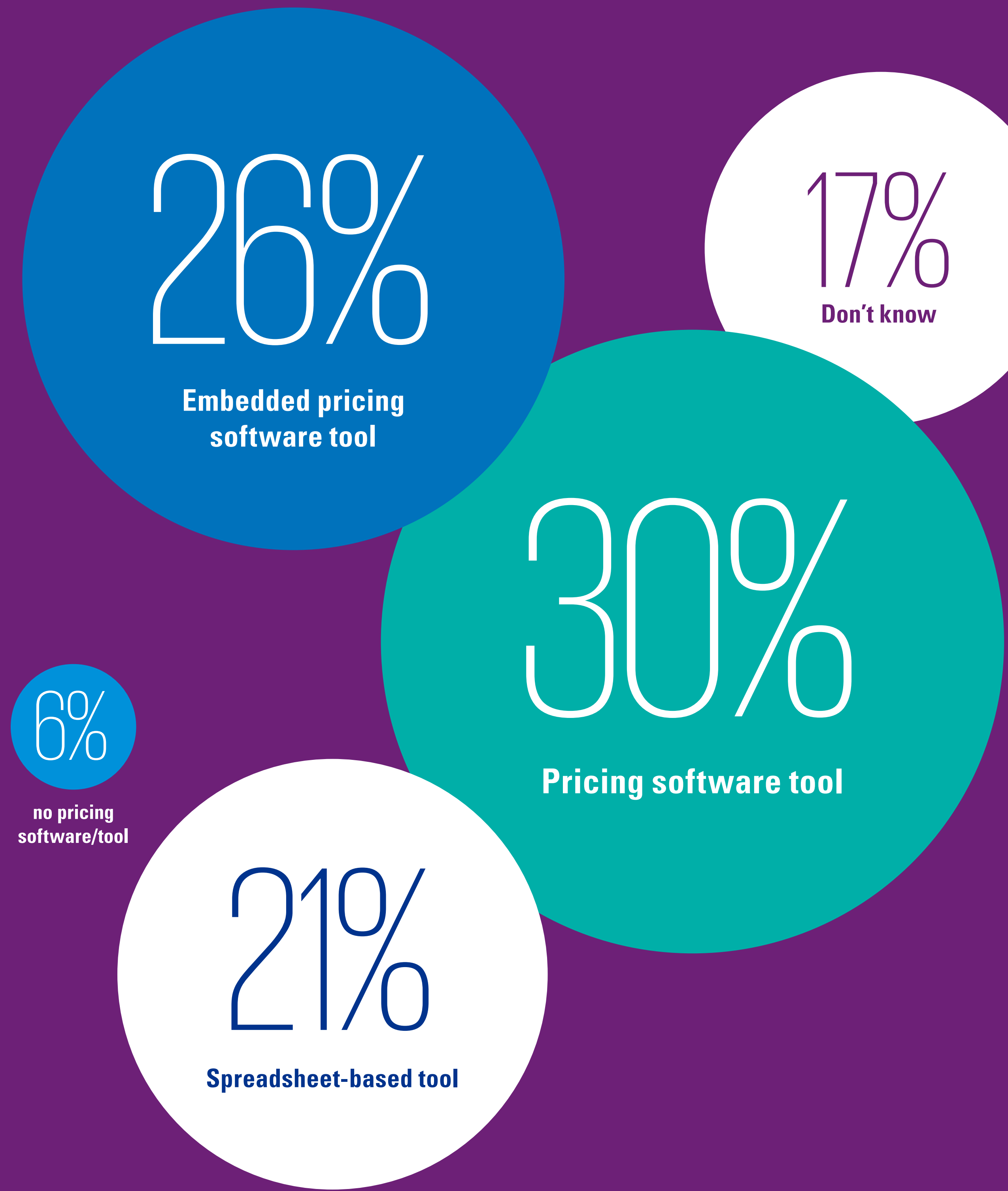
A key finding from our research is that the majority of companies now track pricing performance through a variety of pricing tools. Just 6 percent do not, although a further 17 percent of respondents said they didn't know.

Nearly a third (30 percent) of companies use specific pricing software/tools and just over a quarter (26 percent) use a pricing tool embedded in other software.

However, just over one in five (21 percent) still 'keep tabs' on pricing on a spreadsheet. This approach can be liable to error or omission, and unlikely to be sophisticated or dynamic enough to properly track pricing trends, so this is an area of concern.

Encouragingly, most companies track prices from a range of standpoints, including: changes in price relative to competitors, changes in net prices relative to prior periods, changes in prices relative to value delivered to customers, and the impact of price changes on sales volumes and/or market share.

Keeping 'tabs' on pricing



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Into the future...

Companies with the clearest pricing strategies, that are owned at a strategic senior level and are flexible, dynamic and truly value-orientated, will have the best chance of driving and sustaining profit growth.

So what does the future of pricing hold?

Three fifths of respondents agree that pricing and data analytics are a must-have for companies to compete effectively. Half of senior decision makers in Retail and Consumer Goods agree that the future will be characterized by much more dynamic pricing where prices change based on location, available stock, time of the day and week etc, and so on.

These statistics may sound convincing but both leave significant proportions of respondents not in agreement.

This will present some challenging issues to manage in the future.

– Half of executives were concerned that dynamic pricing could cross an acceptable line into price discrimination (where pricing is adapted unfairly to each individual).

– Three fifths of executives in Telcos and two fifths in Media companies were worried that their sectors were engaged in a 'race to the bottom' in which companies are forced ever lower in their pricing to win customers.

There is no doubt that pricing strategies and approaches will need to continue to evolve in the face of ongoing market pressures including technology and service disruptors.

In our view, even sophisticated pricing organizations (Sharks and Dolphins) are in danger of underplaying how much pricing may change in the coming years. We believe that analytical tools will be essential and that pricing will become — if not overnight, then steadily over the next decade — increasingly dynamic, led by the ever-continuing evolution of technology.

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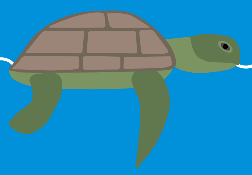
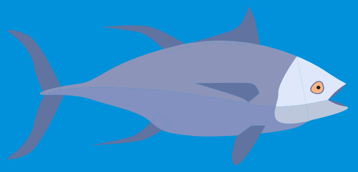
Recommendations

Based on the common trends observed for each of the four categories of organization we recommend the following:



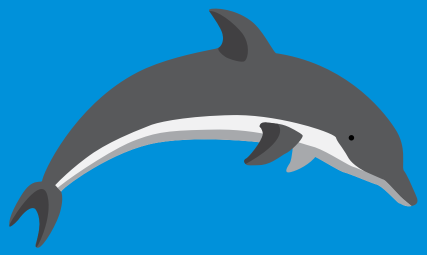
Turtles need to make a start:

- Develop pricing baselines — pricing performance by product and customer
- Map how pricing decisions are made and identify improvements
- Create awareness for pricing as a profit opportunity at board level
- Identify potential pricing leaders/champions
- Generate a set of pricing pilots as proof of concept



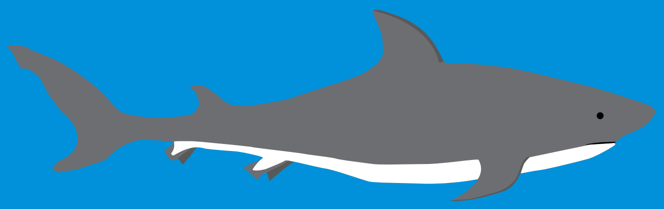
Tuna need to make pricing a priority:

- Invest in understanding and quantifying value created for customers
- Develop and communicate a clear pricing strategy
- Develop pricing training for sales and product teams
- Create a senior management role to champion and lead pricing across the organization



Dolphins need to fully leverage the pricing foundation they have created:

- Create and embed value-based pricing and selling skills across the organization, from product development through to customer service
- Embed pricing metrics in sales reporting and management Information
- Invest in pricing analytics and robust scenario modelling to test pricing actions



Sharks need to maintain the advantage they have created:

- Leverage new data sources to improve pricing analytics and optimization
- Develop and test scenarios for competitive pricing actions and responses
- Continue to invest in cutting-edge pricing tools and algorithms

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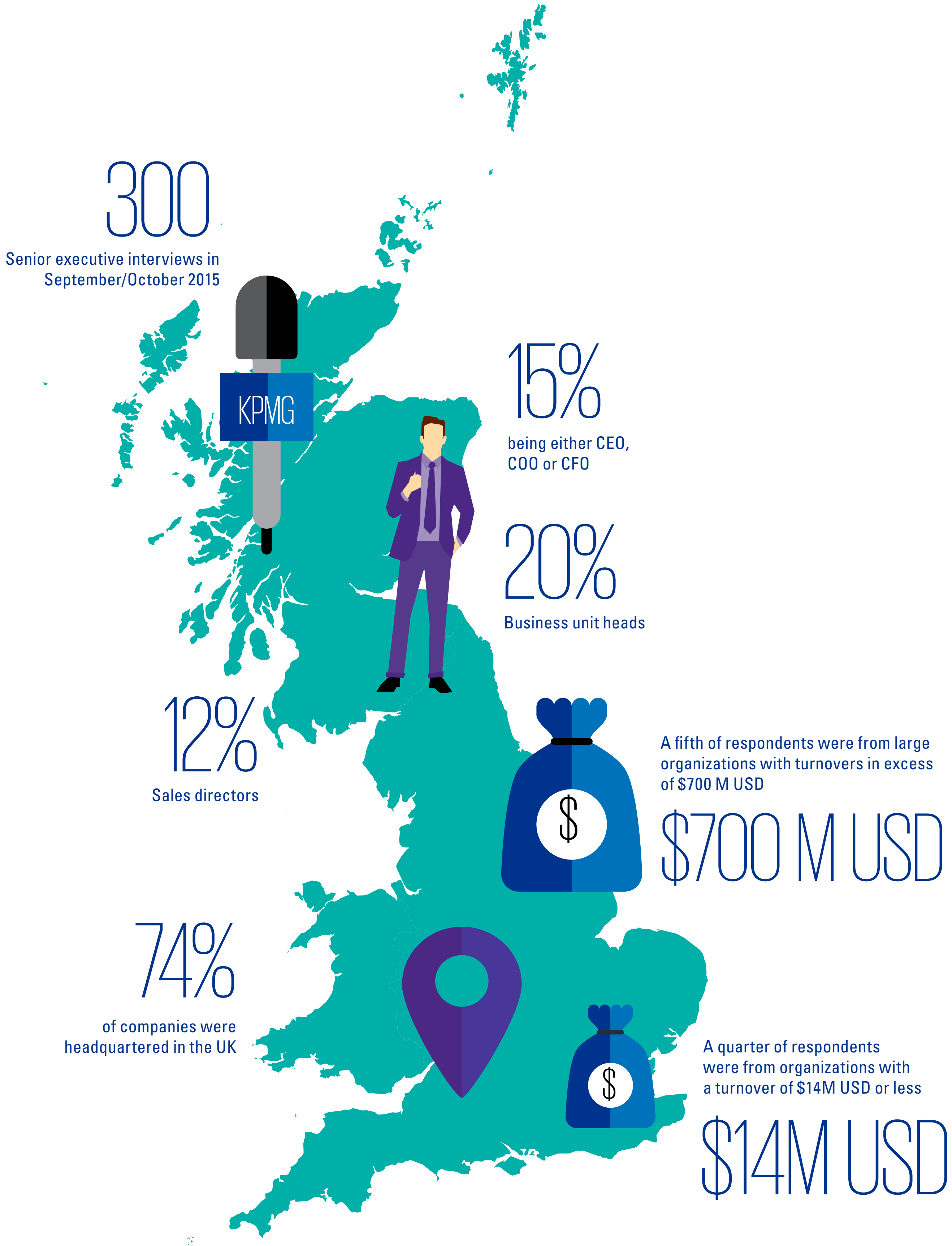
About the survey

We conducted 300 executive interviews in September/October 2015 from companies spread across sectors, including Industrial Markets, Retail, Telecommunications, Consumer Goods and Media. Over a fifth of respondents were from large organizations with over 10,000 employees and turnovers in excess of $700M USD. A quarter of respondents were from organizations with a turnover of $14M USD or less. Respondents were senior executives, with 15 percent being either CEO, COO or CFO. Over a fifth were business unit heads while 12 percent were sales directors.



14

Pricing diagnostic test

1. Who takes responsibility in your organization for pricing?

- I'm not sure who is responsible (1 point)
- The sales or marketing teams mainly (2 points)
- Our dedicated pricing team and CPrO/Head of Pricing (3 points)
- The pricing team and CPrO, but the CEO/Board is also involved in key decisions (4 points)

2. How do you think people in your organization would describe your pricing strategy?

- I'm not sure we have one (1 point)
- Cost-plus (2 points)
- Competitor-orientated (3 points)
- Value-oriented (4 points)

3. How does your organization track pricing in the market?

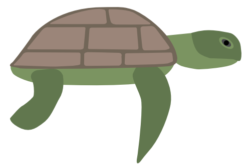
- We don't track pricing performance (1 point)
- We mainly track against sales volumes (2 points)
- We mainly track against competitors (3 points)
- We track across multiple benchmarks including value delivered to customers (4 points)

4. How important would you say pricing analytics such as elasticity analysis or scenario modelling is in developing your organization's pricing strategy?

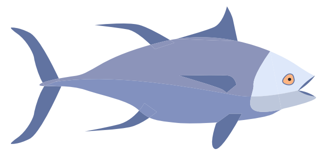
- Not very important (1 point)
- Quite important (2 points)
- Important (3 points)
- Essential (4 points)

5. Do you believe that dynamic pricing and pricing auctions will become significant features in the future?

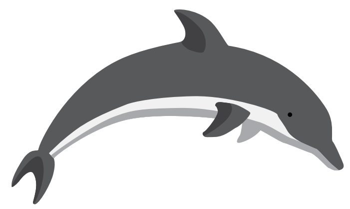
- No (2 points)
- Yes (4 points)



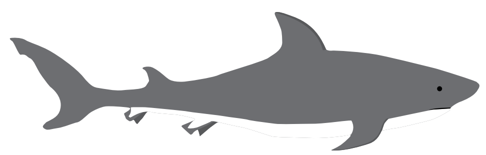
6-8 points:
Turtle



9-12 points:
Tuna



13-16 points:
Dolphin



17-20 points:
Shark

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