The 10% profit opportunity

Why pricing should be at the top of the board agenda

Realizing value series

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

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The pricing prize

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

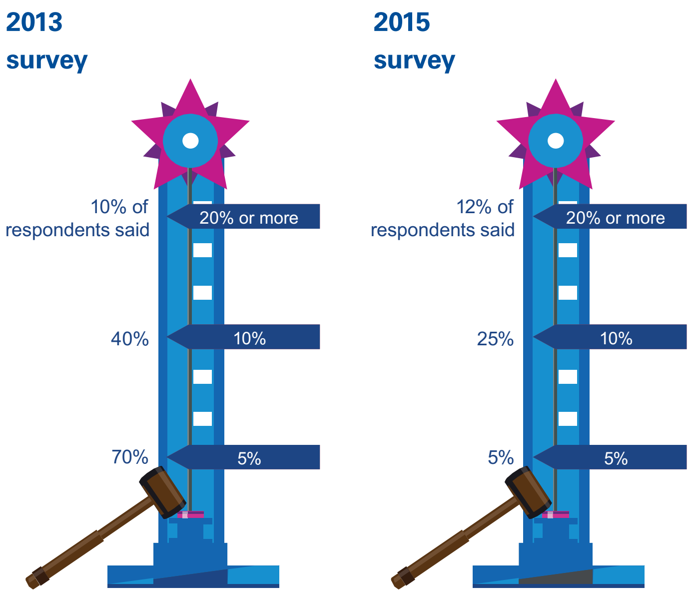
Despite this potential, as a discipline and function, it was largely ignored until the recent recession when life got much more difficult for sellers.

Over the past five years, the importance of pricing has risen as companies struggled to grow in a flat economy. CEOs are talking more these days about 'better pricing' and 'getting paid for value' but, in reality, pricing is not top of the board agenda for most companies.

KPMG's Global Strategy Group believes the opportunity is second to none. Research was conducted in the UK in 2013 and repeated in 2015 across a range of sectors. It found that 60-70% of respondents said they could generate at least a 5% profit improvement through more effective pricing and 25-40% said they could generate at least 10%.

These numbers are eye-watering and represent very significant shareholder value but will require companies to think about pricing as a strategic capability.

How much can profitability be improved through more effective pricing?[1]



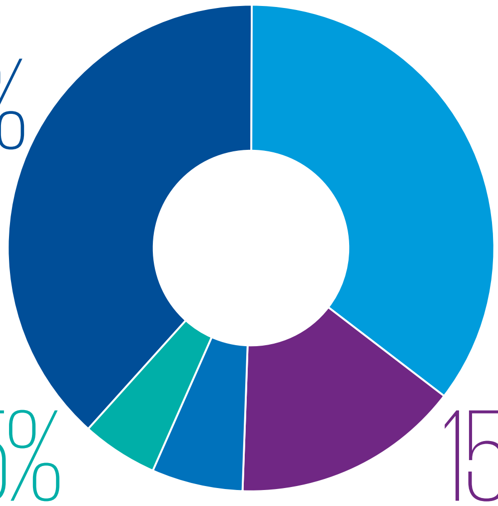
About this report

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

Rethinking price and volume

Demand is not as responsive to price changes as one would expect.

When a competitor lowers their prices, what best describes your response?[2]



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

Slow economic growth in recent years has forced many organizations to focus on volume and fight for every point of market share. After several years of this, companies have been conditioned to think of pricing as a lever to drive volume and that by lowering prices, volumes can increase or be maintained.

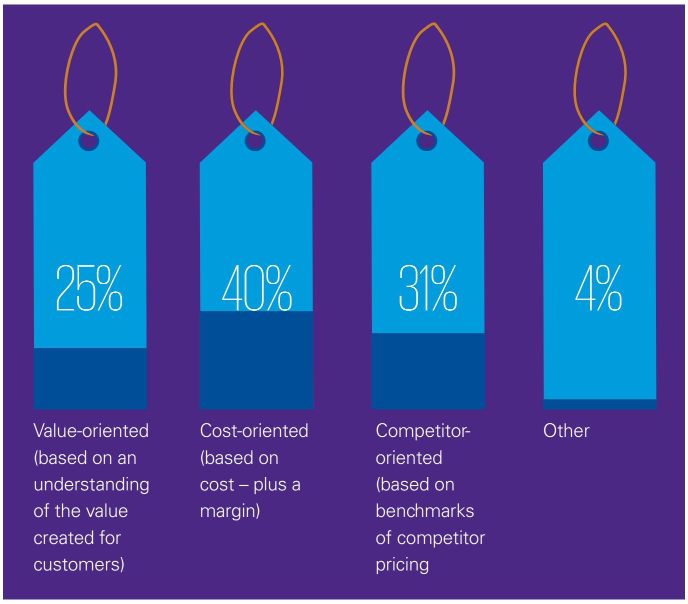
The reality is that demand is not as responsive to price changes as one would expect. Many companies have cut prices (or increased discounts) substantially only to see volumes move minimally. And discount levels have ratcheted up in the past five years. A 10 percent mark-down or £1 off is no longer considered appealing when 50% discounts or 2-for-1 offers are common and these are what customers have come to expect.

The real problem is that lower prices do not drive volumes if everyone lowers their prices (or increased discounts) at the same time. In that case, only customers benefit. In KPMG's 2015 research, 53% of respondents said they would lower their prices in response to a competitor price reduction. This compares to 35% who would maintain their prices because they believe in the differentiation of their product or service plus 6% who would maintain them because they believe direct comparison to competitors is not possible. For companies unable to break free of the pricing downdraft, this will likely create significant long-term profit problems.

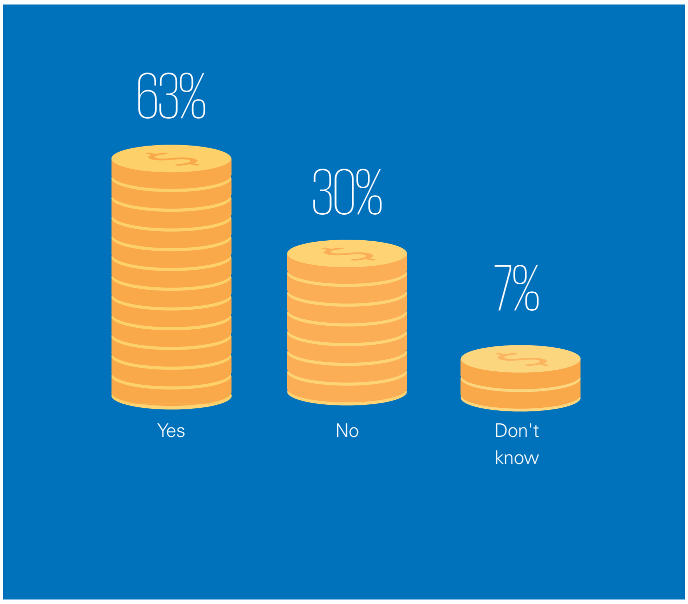
The value equation

Every company could benefit from having a pricing capability.

How would you describe your company's approach to setting prices today?[3]



Does your organization have a dedicated pricing function or team?[4]



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

According to our survey, in B2B sectors for example, this has been exacerbated by procurement teams ready to take advantage of unstructured pricing and discounting practices and force price competition on suppliers. Big retailers, for example, are well known for this, but it applies just as much to industrials and financial services.

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

There is still a lot of work to be done. In KPMG's research, a quarter of respondents said their current approach to setting prices was value-oriented, meaning it is based on an understanding of the value that their product or service creates for the customer. This is where pricing should be and shows that these companies are starting to get a good understanding of the value equation. However, 40% said that they were still using the centuries-old cost-plus approach to pricing which is likely to leave value behind.

Finally, 63% of respondents said they now have a dedicated pricing function or team and 37% said they did not or don't know. In our view, every company could benefit from having a pricing capability, even if it starts out as a team of one.

What's next for pricing?

Analytics will be a critical capability for companies to mine their customer and transaction data to optimize pricing and promotions.

Looking ahead, the next big change for pricing will likely come when organizations start to apply sophisticated analytics to pricing. Indeed, within the next three years, or even sooner, pricing analytics could fundamentally transform pricing in the UK and other developed markets. Retailers and airlines have been masters of this for some time and online companies start with it in their DNA. Over time, other companies are expected to follow suit. It seems inevitable that pricing analytics will be a critical capability for companies to mine their customer and transaction data as a means to optimize pricing and promotions. Many are there already.

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

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

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

Taking the right steps

Pricing leaders should focus on three key areas to drive sales and profit growth:

1

Knowing where and how much value is created

Companies need to understand and quantify how their products or services create value for customers compared to competitors. This will require organizations to 'unpack' where the value lies, by customer segment, to inform better propositions and pricing decisions.

2

Leveraging data to inform decision-making

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

3

Developing pricing capabilities

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

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

Reader comments

Actions:

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Sourcing & notes

1. KPMG pricing survey 2013 and 2015 – not publicly available
2. KPMG pricing survey 2015 – not publicly available
3. Ibid.
4. Ibid.

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