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White Paper

Navigating Pricing Turbulence

Market dynamics are driving CPG manufacturers to take a more strategic approach to pricing

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Introduction

Demand for more strategic pricing practices is intensifying within the consumer packaged goods industry. Several concurrent factors are forcing successful CPG manufacturers to significantly enhance their approach to pricing:

- Dramatic commodity price volatility is significantly impacting costs.
- A challenging economic environment makes consumers ever-more price conscious.
- Retailers have become increasingly sophisticated in their own pricing decisions.
- Competitiveness continues to intensify among producers and distributors of branded goods.
- Consumers' perceptions of product value and price are being reshaped by the internet.

All these factors indicate that historic approaches to pricing are no longer sufficient to compete and win.

In the face of such market turbulence, success requires advanced pricing approaches that are holistic, granular and available in real-time. They must encompass both processes and solutions. CPG leaders are already reaping the benefits of such new approaches. The time is now right for the wide-scale adoption of new, more advanced approaches to pricing. To address these issues, this paper sets out to achieve two major objectives:

1. To describe the landscape of pricing approaches, so companies can assess their own capabilities relative to industry best practices
2. To illustrate by example how companies may apply a more strategic pricing approach to deal with market turbulence and deliver significant value

The Need for a New Approach to Pricing

Industry practitioners have always used price as a lever to create or diminish value. Pricing decisions can apply to all products in the brand or portfolio, in all locations, and they usually have an immediate impact on sales and profits.

Historically, manufacturers made price decisions using their experience, intuition and "sense for the market." They had an understanding of what consumers wanted to pay and how big a gap there should be between their brands and those of their competitors. They could set prices at the start of the year and monitor and tweak pricing throughout the year. And, if they ever made a price decision that didn't produce the expected outcome, they could always change the price back again.

This approach is no longer adequate. A number of major commodities experienced a doubling of cost from 2007 to 2008. They then dropped by about half between 2008 and 2009 before doubling again from 2009 to 2010. All of a sudden, manufacturers were in uncharted waters. They were forced to choose: take significant price increases or allow increased cost of goods to erase profits.

At the same time, the weak economy made retailers both reluctant to absorb cost increases and resistant to passing price increases along to shoppers.

Adding to the pressure, retailers are becoming more sophisticated about pricing. They insist that pricing decisions

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be more tailored to the specific shoppers in their stores. This has led manufacturers to make faster and more frequent pricing decisions. It is no wonder that CPG manufacturers are looking for new techniques.

Finally, the internet has a role in driving price transparency and brand price perception and positioning. Consumers have a lot more information at their finger-tips. The proliferation of internet-based price comparison options and social media has further increased sensitivity of pricing to "un-managed" consumer perception on cost vs. benefits of products. This has increased the need for real-time analytic solutions that can allow pricing managers to tweak pricing strategy with a very short cycle-time.

Pricing Approaches Observed in the Marketplace

Experience across numerous client engagements reveals that multiple approaches to pricing coexist in the marketplace. These different approaches can be summarized under four broad headings: reactive, scientific, strategic and dynamic.

Reactive Pricing

Many companies are highly reactive with respect to their pricing decisions. They tend to make price changes in response to commodity cost changes, competitor actions or other outside pressures. They rarely view price-setting as part of a proactive strategic process.

Scientific Pricing

Manufacturers in the scientific pricing group tend to use more sophisticated analytics to aid their pricing decisions, but even for these companies pricing decisions tend to be inconsistent, made in isolation with little or no interaction between field and headquarters teams. Actions lag due to the time it takes to produce the analytics that are used to inform pricing decisions. Price changes are treated as discrete events, as opposed to an ongoing activity with a congruent foundation, and are frequently driven from the top-down.

Strategic Pricing

Companies in the strategic pricing group combine the better elements of the reactive and scientific pricing approaches with a more holistic, granular and always-on approach to pricing that is tailored to specific consumer groups and retailers. This is enabled by a comprehensive foundation with advanced analytics wrapped in a software solution. A solid foundation enables prices to be aligned from a strategic perspective while also allowing for ongoing tactical pricing decisions to be made in a strategic context.

Dynamic Pricing

Still quite rare in the present market, the dynamic pricing group, which focuses on optimization and manages its pricing structure to influence customer behavior and dynamically shape growth. This represents an aspirational goal for most firms today.

Most companies today have an opportunity to move ahead to strategic pricing practices. This is confirmed by observation of client interactions and by results of a 2011 SymphonyIRI Group poll of more than 120 sales and marketing practitioners, in which a great majority (68%) confirm that they have yet to advance from reactive and scientific pricing to more strategic practices (SymphonyIRI Webinar Poll, Q3 2011).

Significantly, 85% of poll respondents confirmed that "pricing actions in my company are often taken in response to an increase in raw materials or other costs." Two-thirds (66%) confirmed their companies sustain a "strong organizational belief" that the market sets the price. These results suggest that many firms hold on to reactive pricing methods—leaving significant opportunity untapped.

Firms that adopt a strategic pricing approach put very active price management practices in place. These market leaders attain a deeper understanding of the implications of their pricing decisions on consumers and retail trading partners. They fairly assess their competitive environment, and they align their organizations and practices to take full advantage of these insights in their day-to-day business decisions.

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A Roadmap to Becoming a Strategic Pricing Leader

We have identified some commonalities that are essential to any CPG manufacturer who wishes to embrace a more strategic approach to pricing. There are four key components:

Data

Access to very granular, comprehensive data that includes all relevant products in the category at the lowest levels of the geographic hierarchy is essential.

Analytics

Advanced analytics need to be applied to these data sets in a scalable and reliable manner to obtain a deep understanding of how shoppers at different retail trading partners respond to price and promotion changes.

Technology

Easy-to-use applications for accessing and using this data must have the scale and power to get quickly to the essential insights. Ideally, they should be embedded within daily decision systems, with usability designed so that sales, marketing and consumer/shopper insights professionals can easily apply them to make business decisions on a daily basis to realize significant value.

Support

Solutions on their own are not sufficient. We frequently witness situations where CPG manufacturers have licensed expensive systems to assist with pricing and then have not been able to deploy them in such a way as to ensure they are used in decision-making. In our experience, firms also need reliable support from experienced industry professionals to ensure insights are translated into business decisions that can be successfully sold into retail trading partners to capture real value.

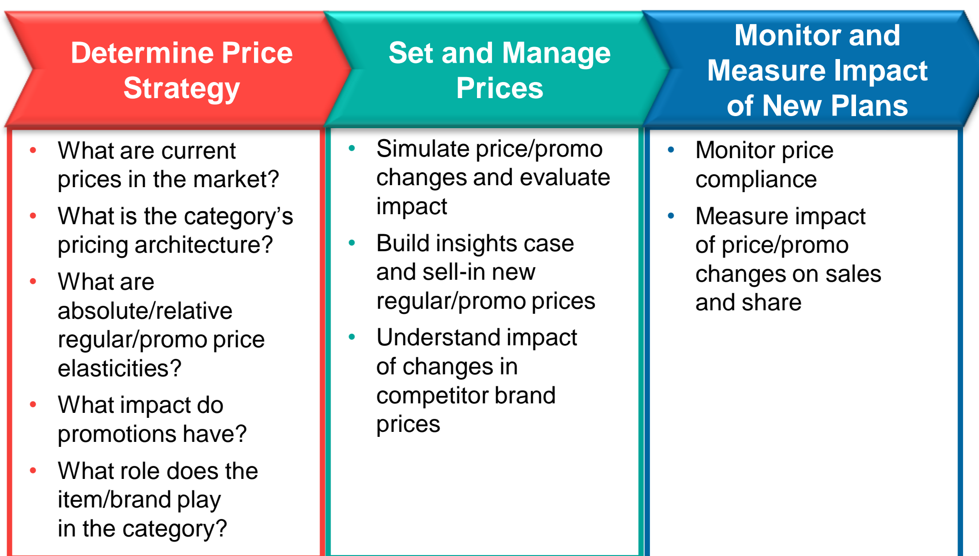

Figure 1. To put pricing strategy into action, it must be executed through aligned and integrated price plans and its impact must be measured.

Companies that practice strategic pricing will delineate between determining the strategic price plan and ongoing strategic price management. The two activities encompass the following actions:

1. Determine the Strategic Price Plan

- Understand the role of pricing within the greater marketing mix.
- Maintain a consistent pricing approach based on an overall vision and understanding of the *pricing architecture* surrounding the brand and its category.
- Systematically translate the overall pricing strategy into the specific prices for each item in each brand and for each retail trading partner.
- Develop a compelling and holistic sell in story for retail trading partners that encompasses the item, the brand, the retailer's private label products, the retailer's overall category and the shopper.
- Monitor the impact of pricing changes on performance.

2. Strategic Price Management

- Routinely challenge, simulate and validate the pricing architecture.
- Develop a fully-dimensioned case for any ongoing changes in pricing.
- Understand and respond appropriately to competitor pricing actions.

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The Strategic Price Plan and Pricing Architecture

When determining the strategic price plan, pricing architecture deserves some special attention (Fig.1, previous page). This is a framework that balances all the relevant components of the price decision. Pricing architecture goes beyond a one-brand view to consider how each item is positioned within the category – premium versus value, level of price sensitivity, price gaps, geographic variance, relative price elasticity, and regular and promoted price elasticities.

A challenging part of the process is the translation of pricing strategies into price plans that are acceptable to retailers. Simulation solutions perform much of the heavy lifting in this part of the process. They let decision makers evaluate price plan alternatives prior to presenting and executing prices on the shelf. An insight-supported rationale allows for a more constructive and reasoned discussion with retail trading partners.

Once a manufacturer has successfully determined the pricing strategy, translated the strategy into specific, tailored price plans and successfully sold in those new price plans to retail trading partners, it is critical to monitor price compliance to ensure that retailers have accurately executed the agreed upon price plans. Inconsistencies in implementation often blunt the positive impact of a price plan that looked successful on paper.

A strategic approach to pricing is also the foundation for ongoing strategic price management. The same data, analytical insights, software solutions and support infrastructure should be leveraged to tactically respond to market conditions within a strategic context. For example, in responding to a competitor price change, the decision-maker may proactively model various scenarios where a manufacturer leads competition on pricing, follows a competitor on pricing, or elects not to respond.

Case Study: Commodity Price Change Response Using Simulation

Situation

A leading manufacturer had three product offerings within a single brand: a premium offering, a mid-tier offering and a value offering. Each of these brand offerings contained a different amount of a key commodity ingredient. When the price of the commodity increased dramatically, the costs of each product rose by differing amounts, in proportion to the amount of the commodity that was present in each. The premium offering was most affected and the value offering was least affected.

	Premium Brand	Mid-Tier Brand	Value Brand
Commodity Cost Increase	10%	10%	10%
Cost Increase per Offering	15%	10%	5%
GM%	High	Med	Low
Price Relative to Competition	Higher	Parity	Lower
Elasticity	Medium	High	Low

Source: SymphonyIRI

Table 1. Manufacturer Multi-Tier Pricing Situation Summary

Each of the three product offerings also varied with respect to price elasticity, gross margin percent and pricing relative to the competition. The situation is summarized in Table 1.

Analysis

In assessing the situation, the manufacturer recognized four pricing response options open for its consideration:

1. Don't increase prices of any of the brand offerings
2. Increase the price of each brand offering by 10%
3. Match the competitor's prices for each brand offering
4. Determine the best overall price plan across the three brand offerings, taking into account all available factors

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Each possible response had potential benefits and risks. Foregoing any price increases would minimize the risks of losing volume but would ensure that gross margins would be impacted for the worse. Increasing prices of each item by 10% would potentially minimize the impact on gross margins but also expose the manufacturer to potentially damaging volume declines, especially if competition didn't also raise their prices. Matching its competitor's prices for each brand offering would minimize any relative changes in volume, but could lead overall category volume down, essentially equivalent to outsourcing the pricing decisions to the competition.

Determining the best overall price plan across all three items using all available information looked like the most desirable option, but seemed complicated in practice. Would the extra effort prove worthwhile?

Action

The manufacturer decided to use Price and Trade Advantage, a simulation software from SymphonyIRI, to determine the likely impacts of the possible response options. Prior to approaching the retailer with their suggested plan, they evaluated each of the four scenarios using the simulation software and compared the results. These are summarized in Table 2.

	Scenario 1: No Price Increase	Scenario 2: Increase prices by 10%	Scenario 3: Match Competition	Scenario 4: Optimal Price Management
Change in Weighted Brand Cost %	10%	8%	11%	8%
Change in Weighted Brand Price %	0%	8%	2%	11%
Change in Overall Brand Volume (%)	0%	-14%	-1%	-8%
Change in Overall Brand Revenue (%)	0%	-9%	-7%	-5%
Change in Overall Brand GM$'s (%)	-33%	-6%	-29%	1%

Source: SymphonyIRI

Table 2. Comparison of Pricing Response Scenarios from Simulation

Outcome

The optimal price management approach increased the price of the value brand by more than 10%, increased the price of the mid-tier brand by less than 10% and increased the price of the premium brand by 10%. This approach took all relevant factors into account and allowed the manufacturer to protect its margins across all three items while minimizing the impact on revenues. By comparison, all other options explored would have had a significant detrimental impact on volume, revenues, profits or all three.

Where Do You Go from Here?

The strategic pricing decision maker leverages a wide set of insights to develop a coherent pricing strategy. Consistent translation of pricing strategies into prices for each item in each retailer's stores requires easy-to-use solutions that leverage a comprehensive and granular data set and an advanced analytical approach.

Selling in new price plans to retail trading partners requires a broad perspective that encompasses a manufacturer's brands, the retailer's private label brands, the retailer's overall category and the shopper. All these factors are essential if pricing strategies are to be executed at the shelf and value is to be realized.

POLL
Practitioners Seek Strategic Pricing

Despite the inherent challenges, more than 92% of respondents indicated an intent to start planning a more strategic approach to pricing. In the same poll 85% said that learning to determine how to best respond to the latest commodity cost increase is a high priority.

SymphonyIRI Group webinar poll of sales and marketing practitioners, Q3 2011.

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This strategic pricing foundation positions the manufacturer to respond to tactical changes in the market, such as competitor price changes or commodity cost changes, within a strategic context, ensuring that great strategic price plans are not undone by tactical missteps throughout the course of the year.

Evolving to a more strategic approach to pricing is hardly a simple proposition, but it can be mastered with the right analytical solutions, the right methodologies and the right partners. The benefits are real, significant and achievable, and leaders that seize the opportunities presented by this period of turbulence will emerge stronger and more competitive.

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Symphony Analytics, a division of SymphonyIRI

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