EXECUTIVE INSIGHTS

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Maintaining a Strong Pricing Strategy During a Weak Economy

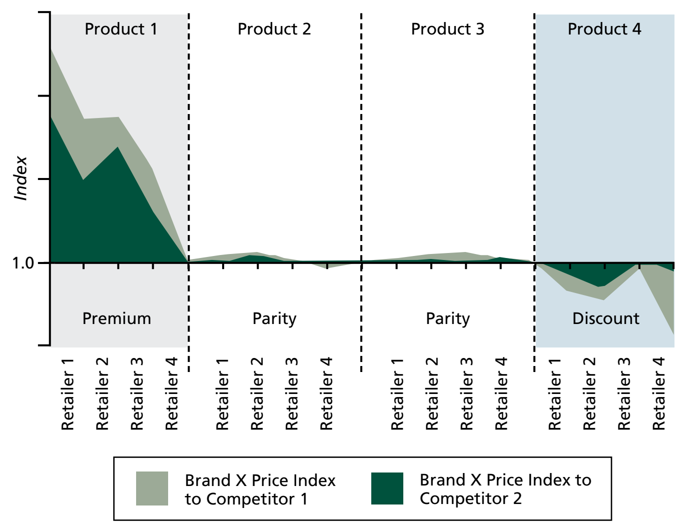
The tepid economy is making consumers more price-conscious than ever. Many brands are responding to market pressures by trimming prices and implementing aggressive promotional campaigns to attract and retain customers. While sales during the short term are certainly important, consumer products executives must also carefully consider how they can make price concessions today to remain competitive without tarnishing their brand over the long term. For example, how will a premium brand be perceived if it cuts its prices in a particular channel or on a specific product to compete with private labels and other aggressive competitors?

There are steps that companies should take today to ensure that their current pricing strategy is consistent across all channels, and that they have the agility to address competitive changes rapidly. L.E.K. Consulting has identified four key questions that senior executives should consider as they work to maximize profits and reinforce brand positioning.

1. Can You Clearly Explain how Your Pricing Strategy Reinforces Your Business Goals? A pricing strategy provides a framework for existing products and future offerings. These strategies should provide firm rules for base price and guidelines for trade promotion. Unfortunately, many companies' once-disciplined pricing guidelines have devolved over time to encompass a hodge-podge of "rules of thumb" notional competitive benchmarks and default cost-plus orientations. In Figure 1, for example, Brand X appears to have an inconsistent pricing strategy across its product lines (as tracked across four key retail channels). Product 1 is priced at a premium relative to its two key competitors. Products 2 and 3 are priced roughly at parity, while product 4 is priced at a substantial discount. If the company was trying to position itself as a premium brand, its message would be diluted and confusing to consumers.

Figure 1

Price Index to Competitors by Retailer



Source: L.E.K. Consulting

Best Practice Idea: Have a clearly documented pricing strategy "playbook" informed by market-facing inputs such as relative pricing power (a function of such factors as relative market share, price elasticity and competitive intensity). In a clear strategy, a company identifies pricing levers at its disposal such as relative competitive price and price per unit. Then specific rules for each are defined as a function of relative pricing power. Documenting such a strategy is important to provide

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unambiguous guidance for applying and communicating the strategy internally and to external partners. It is essential for your channel and distribution partners to understand your pricing strategy relative to your broader sales and marketing initiatives, and how it supports the overall brand position.

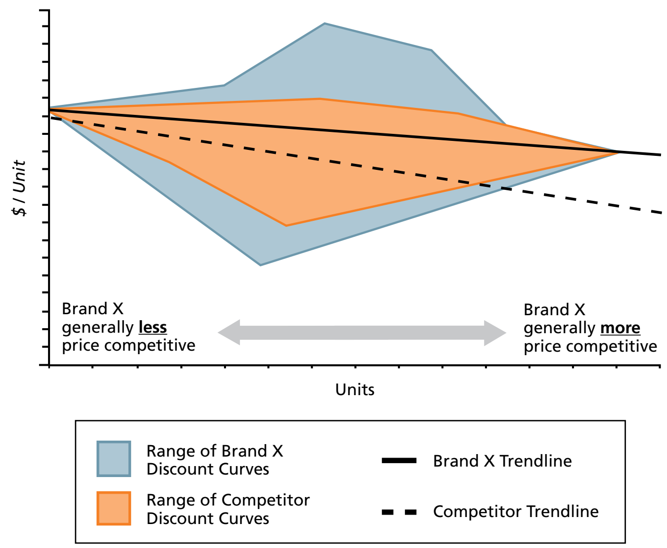
2. Is Your Pricing Strategy Consistent Across Channels? Channels vary dramatically (e.g., every day low price [EDLP] vs. hi-lo). While a pricing strategy should not vary by channel, the application of it will because certain channels look to others for reference in setting their retail prices. For example, in many packaged food categories, other channels will look to the grocery channel (and even to specific grocery chains) to establish their price point. However, many consumer products companies may set wholesale and suggested retail prices in channels without explicitly considering how retailers typically set prices against each other across channels. Adding to the complexity, retailers monitor both list and promoted price across channels. To ensure pricing consistency, cross-channel pricing strategies should include trade promotion to accurately incorporate true product pricing dynamics across channels.

It is important to analyze individual and volume product pricing to truly understand the impact of a brand's pricing strategy. Figure 2 shows the dispersion for the range of volume discount curves for a brand's product line across several major accounts. The wider dispersion for Brand X than its competitors suggests that Brand X has a less consistent approach to pricing across SKUs and channels than its key competitors. This is symptomatic of an inconsistent pricing strategy that may be a competitive liability.

Best Practice Idea: Look for opportunities to segment channels. When retailers set their retail prices by referencing prices across channels, it can significantly limit the ability of a brand to follow a consistent pricing strategy, particularly across hi-lo and EDLP channels. When faced with these constraints, a brand can try to segment its product offer across channels with unique SKUs designed to reduce comparability across channels (especially mass vs. food/drug/specialty). In success, this will give it more room to set prices in accordance with its own pricing strategy. This has been a long-established practice in the consumer electronics sector where unique SKUs are used by

Figure 2

Spread and Trendline of $ / Unit Across Categories and Accounts



Source: L.E.K. Consulting

manufacturers to provide channel and retailer-specific products such as TVs.

3. Can You Monitor Competitive Pricing and Respond Quickly? Pricing in the marketplace is dynamic, as a brand may face competitive price changes by other brands or private labels. These pricing changes may take the form of list price, promotional frequency, promotional depth or a combination of these. The real challenge is that it can be difficult to know when these pricing changes occur and their potential impact. Conventional point-of-sale (POS) tracking services provide pricing trend data, but this information can have significant shortcomings. It can mask the timing and magnitude of price changes in specific retailers because the information is aggregated, and requires extensive parsing by retailer and/or SKU to identify deeper competitive trends.

Best Practice Idea: Formally enlist the field sales force as the front line of competitive price monitoring. In addition to having a contextual understanding of their specific accounts, the field sales team can spot and report on competitive price changes in specific retailers and geographies faster and more reliably than the syndicated POS data services. The sales team's input can then be coupled with POS data analysis to gain a deeper understanding of the impact of observed pricing changes.

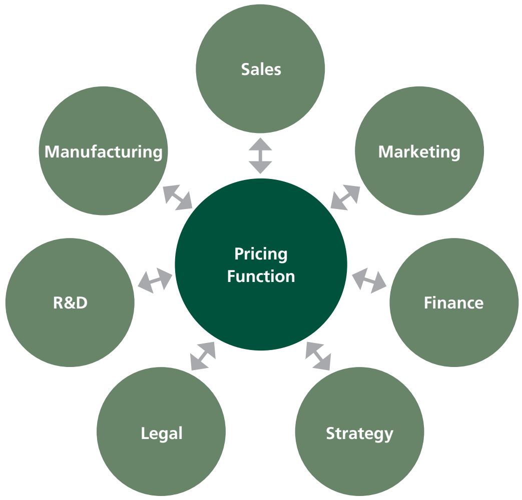
Don't take POS data at face value. For example, at L.E.K. we have developed a proprietary algorithm for analyzing POS data. We use sales intelligence to normalize syndicated SKU-level sales data for volatility due to consumer purchase patterns, changes in distribution and promotion. Additionally, social media sites are often filled with consumer chatter about the latest deals and bargains, and are another great resource for identifying competitive moves. Brands can monitor these sites for competitive pricing changes, and could also incent loyal consumers to serve as a virtual "pricing panel" in exchange for coupons and other rewards.

4. Does Your Organization Have a Clear Pricing Decision-making Strategy? Base pricing and trade promotion are interrelated elements of the price equation, yet are often set in brand management/marketing and sales silos, respectively. In some organizations, one function may dominate. In other organizations, finance may wield significant influence and use pricing as a tool to manage margins.

Best Practice Idea: Establish a clearly defined pricing function to oversee base pricing and trade promotion policies within the broader brand guidelines (see Figure 3). Ideally, the pricing function is staffed with full-time pricing experts who can bring expertise and discipline to pricing decisions. The size of the pricing function will depend on the complexity and dynamism of pricing in the categories served. Regardless of where the pricing function sits, it should retain tight communication loops with both the marketing (base pricing) and sales (trade promotion) functions. The pricing function ensures that pricing decisions are not made in a one-off manner, but instead serve the greater needs of the brand. The pricing function's mandate is to ensure adherence to pricing strategy and maximize value for the brand and organization. An effective pricing function should also have clear feedback loops with manufacturing and R&D – as well as an agreement with finance regarding operating parameters such as margin guidelines. Depending on the organization, communication with strategy, legal and other departments may be important as well.

Figure 3

An Effective Pricing Function Must Have Ongoing Communication with Sales and Marketing, and also Work Closely with Other Business Operations



Source: L.E.K. Consulting

Pricing Strategy Reset

Your brand may be unwittingly leaving "money on the table" due to outdated pricing strategies and not realizing a sales channel's full profit potential. Many brands that we have worked with have realized meaningful top- and bottom-line results by resetting their pricing strategies. A finely tuned pricing strategy across channels can help to increase overall revenues and maximize a brand's value.

Brands – especially premium products – that fail to establish the right price points can undercut a company's profitability in the short-term and erode the brand's overall positioning in the longer term. Pricing misalignment can fuel market confusion if specific premium products are priced below private-label competitors that are marketed based on value.

To address these issues, companies can undertake a pricing strategy diagnostic program to evaluate pricing rules and practices within the organization. This pricing diagnostic can be conducted as a standalone exercise or as a prelude to a full pricing strategy review.

Take our Pricing Strategy Test

Take the following test to help gauge the relative performance of your organization's pricing strategy. Answer "yes" or "no" to the following questions for your organization:

Question	"Yes" or "No"
1. Can you clearly explain how your pricing strategy reinforces your business goals?	
2. Can your key channel and distribution partners articulate your pricing strategy?	
3. Is your pricing strategy consistent across channels?	
4. Is your pricing strategy aligned with your trade promotion strategy?	
5. Can you independently verify when a competitor has taken a pricing action that is not publicly announced?	
6. Do you have a documented pricing "playbook" (or the equivalent) to help you respond to competitive pricing actions and other market developments?	
7. Does your organization have a clear pricing decision-making process?	
8. Does this process harmonize with the needs of brand management/marketing and sales?	

If you answered "no" to one or more of these, it may make sense to consider a pricing strategy diagnostic to help your organization address the following:

- Review how your prices are currently set
- Examine how your pricing compares competitively within and across channels
- Identify how your current pricing practices conform to your brand strategy
- Clarify opportunities for immediate wins
- Determine longer term strategic opportunities

L.E.K. Consulting is a global management consulting firm that uses deep industry expertise and analytical rigor to help clients solve their most critical business problems. Founded nearly 30 years ago, L.E.K. employs more than 900 professionals in 20 offices across Europe, the Americas and Asia-Pacific. L.E.K. advises and supports global companies that are leaders in their industries – including the largest private and public sector organizations, private equity firms and emerging entrepreneurial businesses. L.E.K. helps business leaders consistently make better decisions, deliver improved business performance and create greater shareholder returns.

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