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Leading the way

Pricing: A fast track to creating sustainable value in consumer products

Introduction

Consumer Products and Retail businesses face a number of trends that will transform the markets they operate in over the next few years. Each of these trends is in itself significant; the fact that they are increasingly interrelated and the magnitude of the potential combined impact makes the challenges for executives even more complex. They include:

- Dramatic growth in emerging markets; slowing growth in developed ones.
- Focus on cost cutting, liquidity, international growth, and diversification.
- Consumers who are more mobile, empowered by technology and connected in real-time.
- Proliferation of data and the need to turn it into actionable insights at the customer, consumer, and shopper level.
- Sharper focus on commodity cost volatility, the responsible sourcing of materials, and sustainability.
- Continuing consolidation across sectors and geographies.
- The increasing impact of regulatory and tax pressures on business strategy.

Deloitte has established a global program to help executives in the consumer industries address these and other critical challenges. The program focuses the deep knowledge and experience of practitioners in Deloitte member firms around the world on specific priority issues and solutions to help executives guide their companies. The intention in each case is to provide executives with our industry-specific perspective and provide practical guidance that has commercial impact.

This paper focuses on the growing importance of pricing and profitability management for consumer products companies. What are the key pricing challenges they face? What pricing and profitability management capabilities are particularly important if they are to maximize shareholder value and margin realization?

I hope you find this study useful and that you will also benefit from our upcoming reports on sustainability, M&A, regulation, and other topics as they become available.

I welcome your ideas and input on this and other topics that you feel are important for your business, and encourage you to contact me or the leaders listed on the back of this report.

Leon Pieters
Consumer Business Propositions Leader
Deloitte Consulting, Netherlands

The growing importance of pricing and profitability management

The bottom line in a changing world

With an average margin improvement of 11.7% from pricing initiatives[1], it is no surprise that most Consumer Products (CP) executives are increasingly asking the question "how do I get my pricing right?" Pricing has always been at the core of the consumer products industry; now, however, it is more important than ever (see chart.) At a macro-level, the world is going through a rapid transformation: 70 million new consumers are entering the middle class in emerging markets every year; inflationary pressures are being felt throughout the major global markets; and commodity prices are rising rapidly. To add further complexity, the global CP industry is undergoing major structural shifts, as global retailers gain power through consolidation and introduction of strong private label brands that compete directly with branded products.

To manage the increased complexity and margin pressures, leading CP companies are using the latest technological advancements such as analytics and pricing software – a huge undertaking in itself, given the plethora of data in developed markets and the lack of data in emerging markets. CP executives are recognizing the need for greater visibility (over brand and channels) and responsiveness to market trends (for example, by increasing frequency and speed of the 'sense and respond' cycle).

Pricing may not be the only answer to all of the challenges faced by the CP executives; however, it is one of the very few areas where improvements directly benefit the bottom-line. That's why so many CP executives consistently place pricing initiatives at the top of the corporate agenda.

Five key pricing challenges facing global CP companies

As advisors to CP executives and as a leader of global pricing initiatives, Deloitte member firms ("Deloitte") are all too aware of the expectations and challenges facing CP leaders. In addition to the foundational capabilities related to pricing, Deloitte has identified five key business issues addressed through pricing and profitability management:

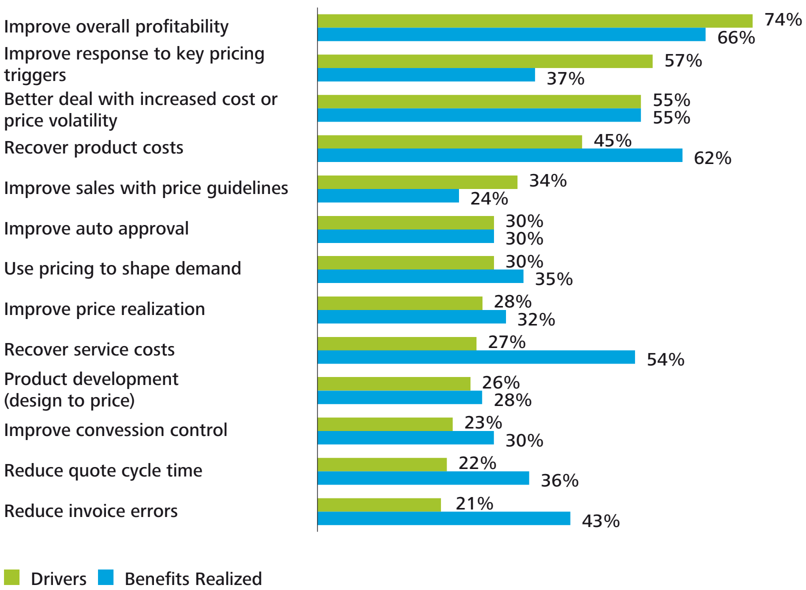
1. What to consider when managing price/promotions given fluctuations in raw materials prices

Leading companies typically manage input price increases and volatility by balancing the use of four levers: operational/financial hedges; promotional spend adjustments; list price increases; and packaging size decreases.

In developed markets, leading companies carefully coordinate these four levers to provide comprehensive protection against fluctuations. Operational and financial hedges are typically used to manage day-to-day marketplace volatility, while pricing, promotional, and packaging size adjustments occur on a more periodic basis to align with expectations of retail channels.

For developing markets, a similar approach is used, although the increased flexibility to adjust the levers must be carefully orchestrated to balance pricing, profitability, and market share objectives. In some markets, sophisticated companies with more real-time profitability data have capitalized on shifting investment patterns to gain market share with increased promotional investments.

What's driving your company's price management initiatives? (n=112)
Major drivers and benefits



Source: "Price management solutions demonstrate consistent ROI, but adoption remains weak" Gartner, 6 December 2010

Consumer Products executives are recognizing the need for greater visibility and responsiveness to market trends

1 Deloitte U.S. research

2. How to get a handle on the current (decentralized) state of pricing throughout the company

While the overall pricing and promotional capability in traditional CP companies will likely remain fairly decentralized, the recent trend is for increased, cross-functional, and cross-border coordination. The advent of pricing and profitability management software technologies has aided CP companies in providing greater visibility to performance trade-offs (e.g., volume, share, profit); therefore, greater influence and precision can be applied to investments such as discounts and promotions and the execution of strategies and plans. Further, some global CP companies are creating Centers of Excellence (CoEs) to provide their business units and geographies powerful research and analytic capabilities that otherwise could not be funded on a business unit-by-business unit basis.

In Deloitte's experience, a key success factor in the decentralized model is the availability and communication of timely, granular information. Strategies that attempt to force pricing centralization have very often been disruptive, ignoring valuable information gathered at the local or relationship level, and are circumvented in the long run by using discount factors or territory relativities as 'de-facto' pricing models. While new technologies create the temptation to manage centrally, head offices should be communicating their strategies through (a) intuitive exhibits; (b) tools that help the local offices understand the head office perspective; and (c) better incentive structures that align rewards with corporate strategies.

"Who owns pricing?" is a seemingly simple question, but it is often difficult to answer. The reality is that pricing touches everything – and everything touches pricing.

3. How to work with multinational retailers (collaborative friend or competitive foe?)

Historically, the CP manufacturer-retailer relationship has been strongly driven by power of the retailer, with many pricing and promotions policies dictated by the large retailers and compensation demanded for any in-store activity requested by the CP company. As an unintended consequence, retailers limited their own visibility into sales and promotional behaviors, with expensive syndicated data making only marginal improvements in visibility to customer profitability. In some cases in Europe, even access to syndicated data has been traditionally limited by large retailers, and CP companies were instead forced to make big assumptions to get a reading on market share or pricing.

Increasingly, and particularly in Europe, multinational retailers are facing changes in consumer and shopper behavior too. Hypermarket productivity (sales per sq. meter) is down as proximity formats – smaller stores closer to the consumer – increase their market share. To match this trend, larger retailers are opening medium to large stores and are shifting away from their biggest formats. This challenge, in addition to a tougher economic environment and the emergence of e-commerce as a viable alternative, is increasing pressure on retailers to sustain profitable growth.

As a result, retailers are increasingly open to working with CP companies to better understand consumer behavior. Some CP companies are exchanging category insights for sales information in an attempt to create 'win-win' opportunities for both parties. However, it's usually the largest and more sophisticated CP companies that have built the analytical capabilities that allow them to generate and share insights that will help drive higher profitability and share at the point of sale.

Others are conducting joint business planning sessions, where leadership from CP companies and retailers (including brand managers and category managers/buyers, respectively) meet at a neutral site to review and, in some cases, align on business objectives. In many cases, such joint business planning sessions provide a safe environment to explain and provide insights and avoid the charged environment that can lead to haggling. However, the key to these collaborative efforts is having the capabilities to generate the fact-based insights that the other parties will value.

2 The 2010 American Pantry Study," Deloitte Development LLC and Harrison Group, 2010

4. What is the state of private label proliferation and what will happen with prices/promotions?

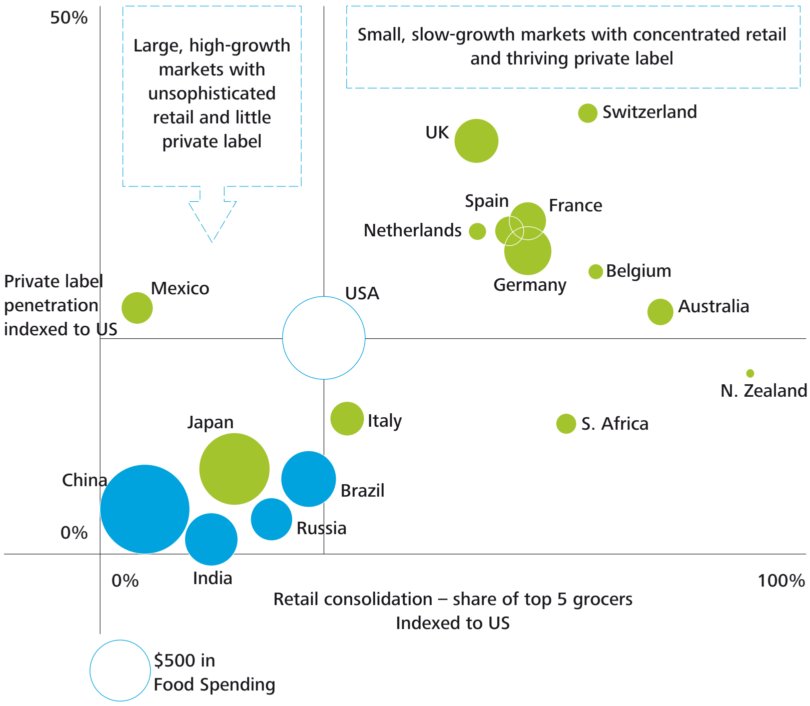
Private label is, and will continue to be, a significant competitor to branded CP companies. In many major markets around the world, private label penetration has increased as the global economic recession continues to encumber the world's largest markets. Deloitte's 2010 American pantry study found that since mid-2008, private label's U.S. market share of total CP unit-volume has grown by more than 16% (from about 18% in mid-2008 to over 21% in Jan. 2011) and that roughly 85% of shoppers in the U.S. currently rate store brands as equal in quality to national brands.[2] Moreover, as they make the switch from branded to private label products, the study found that about 93% of shoppers expect to continue "spending cautiously" on private label products, even after the economy improves. Unlike previous economic recessions that caused temporary changes in shopping habits, this prolonged recession may be turning frugal shopping habits into a more permanent consumer behavior.

5. How to manage price when expanding in emerging markets and influencing distributors/traditional channels with price

In general within CP, price management comes in two forms: (a) setting list prices to meet the new market's strategy, and (b) controlling promotional and discounting practices to support the strategy while maintaining profitability. In Deloitte's experience, many CP companies do well with setting initial list prices based on market-place dynamics, but are sometimes less than diligent about controlling promotional investments and customer discounts to balance the strategic objectives (e.g. volume growth and market-share gains) with net profitability. This can be further exacerbated when CP companies utilize third party wholesalers and distributors, who may introduce their own price discounts to protect their volume or hit volume target incentive levels. Although it may appear advantageous to the consumer, this race to the bottom is not healthy for CP companies or their distribution network.

Often, granular visibility into price behavior is lost at the distributor/wholesale level, potentially damaging the price architecture within and among brands, sending conflicting marketing messages, and confusing consumer buying behavior. Although market penetration is a paramount objective, leading companies also invest in greater visibility throughout the value chain, creating a feedback loop to understand consumer behavior and how the channel affects their pricing execution.

Consumption calculus: global markets … by no means created equal
2010 grocery retail markets: attractiveness for CPG



Source: Planet Retail; Deloitte Analysis

Pricing and Profitability case studies

Case study 1: Price optimization for a leading South American beverage manufacturer

The South American company produces inputs to over 200 final soft drink products and sells its ingredients to a third-party bottling and distribution company. The company serves its product across four primary customer segments: supercenters, supermarkets, mom and pop stores, and restaurants and bars. The company is a leading carbonated soft drink maker in South America that also produces non-carbonated juices and waters.

Client challenges:

The client needed a demand model tool to evaluate the trade-off between competing objectives as well as an analytical model to suggest optimal product portfolios by customer segment:

- Price setting was done by rule-of-thumb, and certain constituents had volume targets while others were focused on profits.

- No suggested portfolios existed based on historical performance, and due to volume-driven metrics, the sales force typically sold the lowest price (and often the lowest-margin) products.

Engagement details:

Deloitte approached the project with two teams working in a co-ordinated fashion to solve these challenges:

- The price optimization team used advanced analytics to calculate price sensitivities and quantify volume-profit trade-offs.

- The price execution thread used transactional analytics to suggest an optimal product mix by customer micro-segment.

The two threads worked to understand true product profitability, marketplace dynamics, and price sensitivities.

Key results:

- **Scenario analysis:** Alternative scenarios were built along an efficient frontier to allow for margin and volume trade-offs, and category-by-category selections of these margin targets were made for each category along the frontier.

- **Demand models:** Demand models were built for the top 80 products (accounting for 95% of revenue), and the chosen price optimization scenario had an estimated benefit of US$10 million.

- **Suggested portfolios:** Company clients were segmented on performance, as well as other behavioral dimensions, and models were built considering the most profitable customers in each segment.

- **Implementation strategy:** Bottlers will be provided optimized B2C prices to communicate to retailers, leading to gradual adoption. The estimated benefit for this initiative is up to US$10 million in annual margin improvement.

Top Pricing Consulting Practices, 2009

Rank	Firm
1	Deloitte
2	McKinsey & Co.
3	The Boston Consulting Group
4	Bain & Co.
5	Simon-Kucher

Source: Kennedy, Customer Strategy and Interaction Consulting Marketplace 2009-2012; © BNA Subsidiaries, LLC. Reproduced under license.

Case study 2: Building customer profitability capabilities for a leading food and beverage manufacturer

Deloitte was engaged to help build customer profitability capabilities at a multi-billion dollar food manufacturer. The client was navigating an increasingly complex retail environment with a more diverse customer and consumer base, a growing variety of product assortments, a shift in promotional and marketing strategies, and an evolving set of customer supply chain requirements.

Client challenges:

The organization needed an advanced capability to build insight into the true financial performance of the products, services, and investments that comprised their go-to-market portfolio. Customer-facing teams needed to be empowered – with new tools, support and incentives – to navigate this increasingly complex marketplace and win with customers and consumers. The organization desired a transformation to:

- Drive profitable growth through win-win opportunities with retailers.
- Generate real-time visibility, insights and fresh perspectives on commercial, operational and financial performance with customers.
- Deliver actionable strategies and programs to transform the organization.

Engagement details:

Deloitte worked with the client to launch a multi-year, transformational program intended to deliver superior revenue and profit growth with retailers. A cross-functional team representing the company's top leaders from Field Sales, Trade Marketing, Brand Marketing, Finance, Customer Service, Supply Chain and Information Technology set out to build their customer profitability capability. The capability is enabled by a robust reporting and analytical toolset that harnesses data from multiple, disparate sources and provides visibility and insight into customer and product profitability. Account teams now have detailed analytics on commercial, operational, and financial performance so they can make informed business decisions to maximize both revenue and profits.

The customized toolset consolidates numerous reporting, analytical and planning tools to provide detailed and standardized visibility across a broad array of performance metrics, including:

- Promotions ROI and trade spend effectiveness opportunities.
- Integrated marketing (trade, couponing, etc.) improvements within and across brands.
- Assortment Profitability and opportunities to "fix the mix" at individual customers.
- SKU Profitability.
- ROI of additional customer investments.
- Customer order patterns and profitability of supply chain service requirements.
- Supply chain opportunities for joint process improvement collaboration and cost take-out.

Key results:

- Consistent and standardized view of how customers and products contribute to top-line and bottom-line performance to better engage with customers and unleash additional value for all parties.
- Simplified investment planning processes and incentives aligned with the go-to-market approach.
- Increased identification of mutually beneficial growth opportunities with customers and stronger customer relationships with increased transparency, trust, and commitment.
- Expanded Account Manager's responsibility to encompass full business management with the customer as each Account Manager gains accountability for both top-line and bottom-line growth.
- Detailed training for Sales, Marketing, Finance and Supply Chain managers at company headquarters and in the field.

How do you get started?

The root cause of most pricing and profitability challenges is the lack of visibility required to take action – in its simplest form: "I can't manage what I can't see". This notion runs the entire length of the company corridor, from informing strategic decisions with granular evidence, to translating strategy to investments at the geographic, brand, account, or package level, aligning the investments with field incentive plans and specific account-by-account negotiation scripts with granular feedback at all levels. There is significant volume, share, or margin at stake and all must be considered to make the change real.

An open conversation with select CP executives, followed by a quick data and capability diagnostic taking two to three weeks typically reveals value that can return results – worthy of reporting to the street – within two to four quarters.

Open items on one or both of the checklists below indicate the need for a closer look at pricing and profitability practices, and the opportunity to lead when going to market.

Pricing and profitability strategy	Supporting capabilities
• Corporate objectives clearly defined *(e.g. revenue, share and profit)* • Growth driven by "right" products and customers • Trade promotions support growth/profit objectives • Organizational investments support growth objectives • Promotional strategies aligned across Sales and Marketing • Net prices holding/increasing • Gross margins holding/increasing	• Anticipation of changes in customer behavior • Visibility real-time to true pocket price and profitability • Clarity on priority accounts • Incorporation of trade insights into marketing • Minimized spend leakage by customers • Supply chain that adds value and price premium • High levels of customer service and satisfaction
Healthy?	**Healthy?**

Core capabilities of effective pricing and profitability management

There are six foundational capabilities required for effective pricing and profitability management in order to maximize shareholder value and margin realization. Given that no one function 'owns' all six of these capabilities, cross-functional collaboration is an absolute imperative.

Price strategy:
Defining a framework that supports business objectives by understanding and capturing the value of an offering relative to competitive alternatives and demand

Price setting & advanced analytics:
Providing the right set of tools and information to identify strategic trade-offs and improve decision-making in time to impact business performance

Price execution:
Executive defined policies and processes that govern profitable decision making on a daily operational level

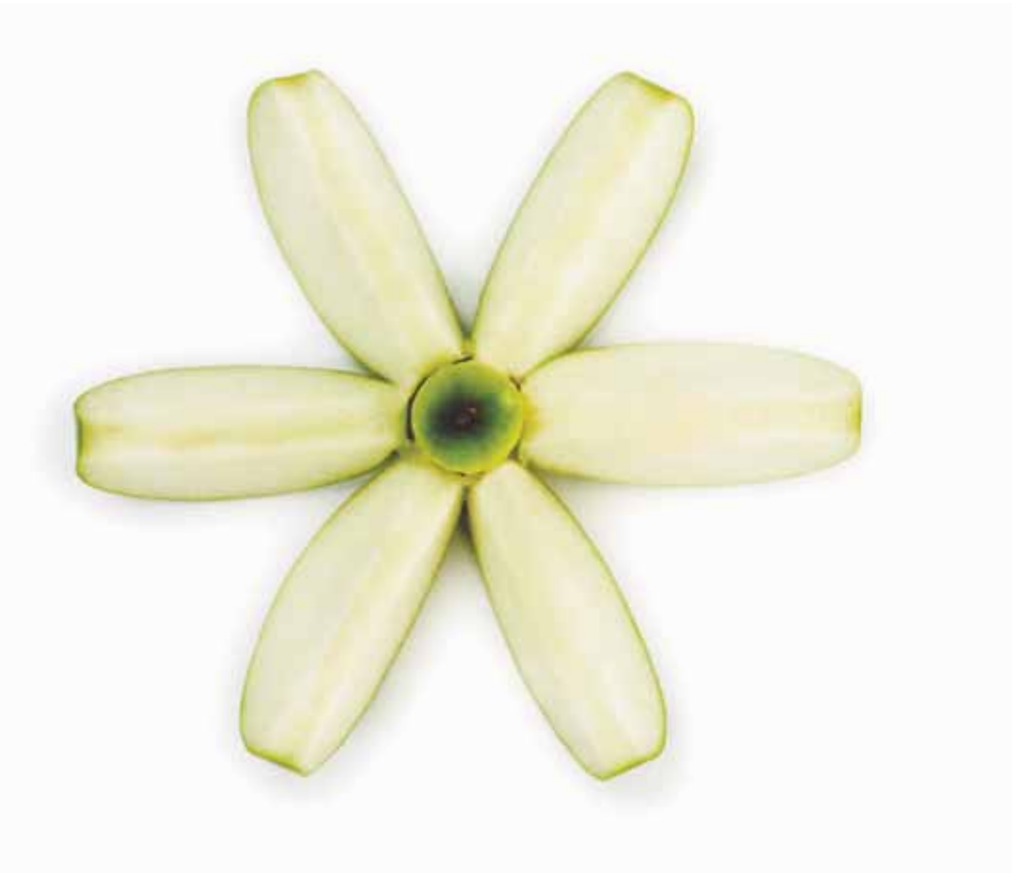
Price strategy	Price setting & analytics	Price execution
Technology & data management	Organization alignment	Regulatory alignment

Pricing technology & data management:
Designing and deploying pricing analytics and execution tools in order to enable effective pricing decisions and to enhance quality and consistency of pricing process

Organizational alignment and governance:
Price is the fundamental intersection between buyer and seller – it's all about managing human interaction

Tax & regulatory effectivness:
Proactively managing the tax, regulatory compliance and governance issues related to pricing decisions

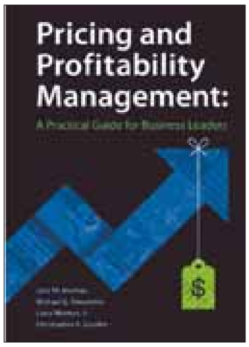
Success in pricing is about managing all of these components simultaneously; in reality, however, most CP companies tend to lean too heavily on one component, and struggle to "make it real" through a balanced and integrated approach that involves all others.



Deloitte's eminence and perspectives on pricing and profitability

Deloitte has a dedicated team of professionals focused on research and eminence providing both practical and visionary solutions. In addition to the research effort, member firm practitioners gather and organize the knowledge and experience of Deloitte engagement teams that have worked with global companies on pricing and profitability programs. In the spirit of knowledge sharing, Deloitte continues to develop provocative and relevant publications that address the issues that matter most to Consumer Products company executives. A very small sampling of Deloitte's eminence includes the following:

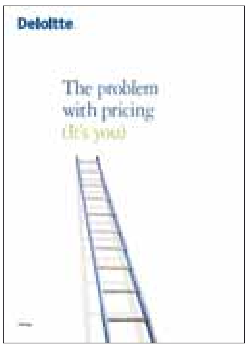
How profitable are your customers…really?
Using cost-to-serve analysis to identify profit improvement opportunities



Pricing and Profitability Management:
A practical guide for business leaders

Is there a career in pricing?
An insider's view of the pricing profession

Did you say "free"?
What it takes to win in a world where "free" is the optimum price point



The problem with pricing (It's you)
Why CEOs should play close attention to pricing

The Deloitte global network

With a strong network of 200+ dedicated member firm pricing practitioners operating in more than 30 countries throughout the Americas, Europe, and Asia Pacific, Deloitte's Consumer Business specialists combine deep industry experience and understanding of regional markets to help companies around the world succeed wherever they operate.

Deloitte member firms serve:

- 24 of the 27 consumer products companies in the Fortune Global 500®.
- All eight of the consumer products companies in the FTSE 100.
- Four of the world's five largest brewing companies.
- Three of the world's largest wine and spirits companies.

Deloitte member firm clients in the Consumer Products space include:

- Anheuser-Busch Inbev
- Avon Products Inc.
- Carlsberg
- China Resources National Corporation
- Clorox Company
- The Coca-Cola Company
- Columbia Sportswear Co
- Crown Imports
- Danone
- FEMSA
- Grupo Bimbo
- Grupo Modelo
- Kraft
- L'Oréal
- Nestlé
- Procter & Gamble Company
- Tate & Lyle
- Wacoal International Corp

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