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Sizing the prize
The power of pricing

How much value can pricing really deliver? After five years, and after analyzing more than 100 projects with more than $1.7 billion in annual profit improvement, here's what we found.

It's been said many times before that of the levers a company can pull to improve performance, pricing routinely delivers the most significant results. Still, many business leaders have their doubts. In fact, pricing often ends up on the bottom of the list of changes companies make in their quests to improve performance. Why is that?

For some, the question is how much pricing can really deliver. Performance improvements are always welcome, but exactly how much should the business expect from pricing? Others question if the improvements that can be gained from pricing are worth it in the grand scheme of things. How much extra effort will it require elsewhere in the business? What are the unexpected ripple effects? Is it worth the risk of losing customers?

These are all legitimate concerns — and we've encountered them in our work helping a variety of companies improve performance through pricing. We recently commissioned an analysis of more than 100 pricing engagements that we've performed over the last five years to more effectively characterize the benefits achieved and address such concerns. Starting with revenue and margin improvements, we put a host of other factors under the microscope, from timeframe of benefit realization to value by improvement lever and beyond. We wanted to understand in detail how, when, where, and why pricing improvements had the desired impact on the business.

In this article, you will find selected results of this study — along with our thoughts on what they mean for companies looking to get the most from their efforts in the area of pricing.

Margin and revenue increases: What to expect

Our clients' annual margin benefits equal an average of 3.2 percent of revenue

Pricing consultancies typically tend to provide benefits that range between 1 percent and 3 percent of the revenue that the initiative addresses. These claims don't often speak to how the benefits will be generated, or exactly how that figure may change based on the industry or solution that was delivered. In our experience, results vary widely by industry. On average, our clients have been able to increase margin by the equivalent of 3.2 percent of revenue. And in some industries, the benefits have been much larger.

In some of our more recent conversations with clients, we have found that they are looking for pricing to fill a hole in their current forecast against the annual

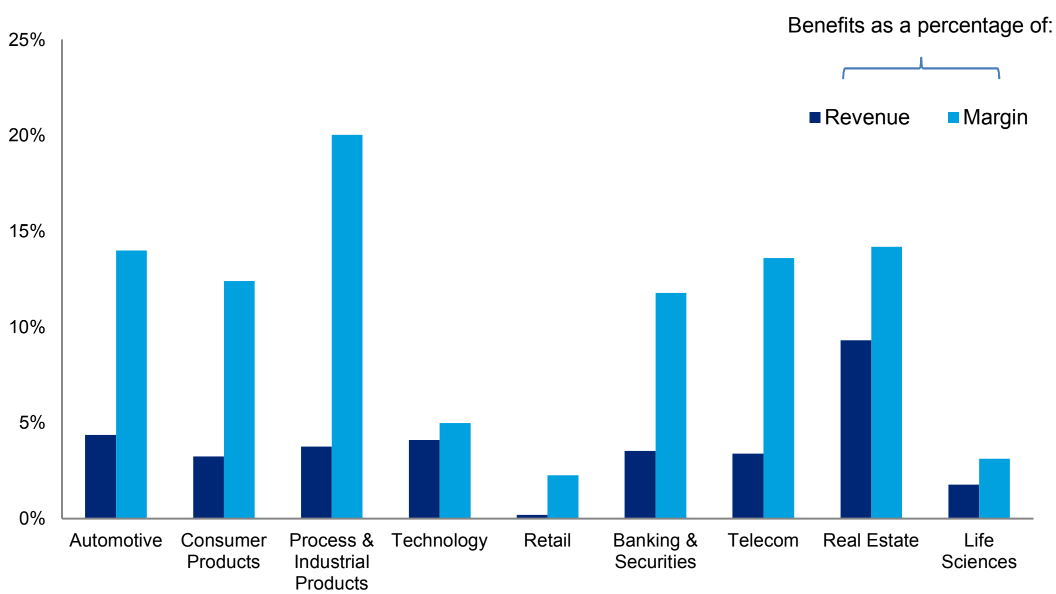
We analyzed 100 of our projects to find out **how long** projects took, what **they delivered**, and **where** results came from.

operating plan that may have been eroded by increasing commodity prices, increased competitive intensity, or an expected amount of promotional activity or other measures intended to maintain share. In those instances, measuring the benefits as a percentage of margin is more relevant. We've seen projects increase margins by an average of nearly 17 percent, varying in a range of 4 to 21 percent (25th to 75th percentiles). Again these results vary largely based on the company's industry. The following chart shows the levels of improvement companies in different industries have achieved in our previous pricing improvement projects:

How long should it take?

Our clients have found that on average, the majority of benefits generated by pricing improvements are achieved in 18 to 24 months. In fact, it's worth noting that extending any specific initiative beyond this time period does not tend to improve the results. Once the analysis is performed and viewed within the context of improving the company's overall profitability, implementation can begin promptly and produce instant results. To that end, many of the projects we examined shared a particular trait: after an initial analysis period of 8 to 10 weeks, the projects produced "quick

Average benefits tend to vary widely by industry
Benefits by industry

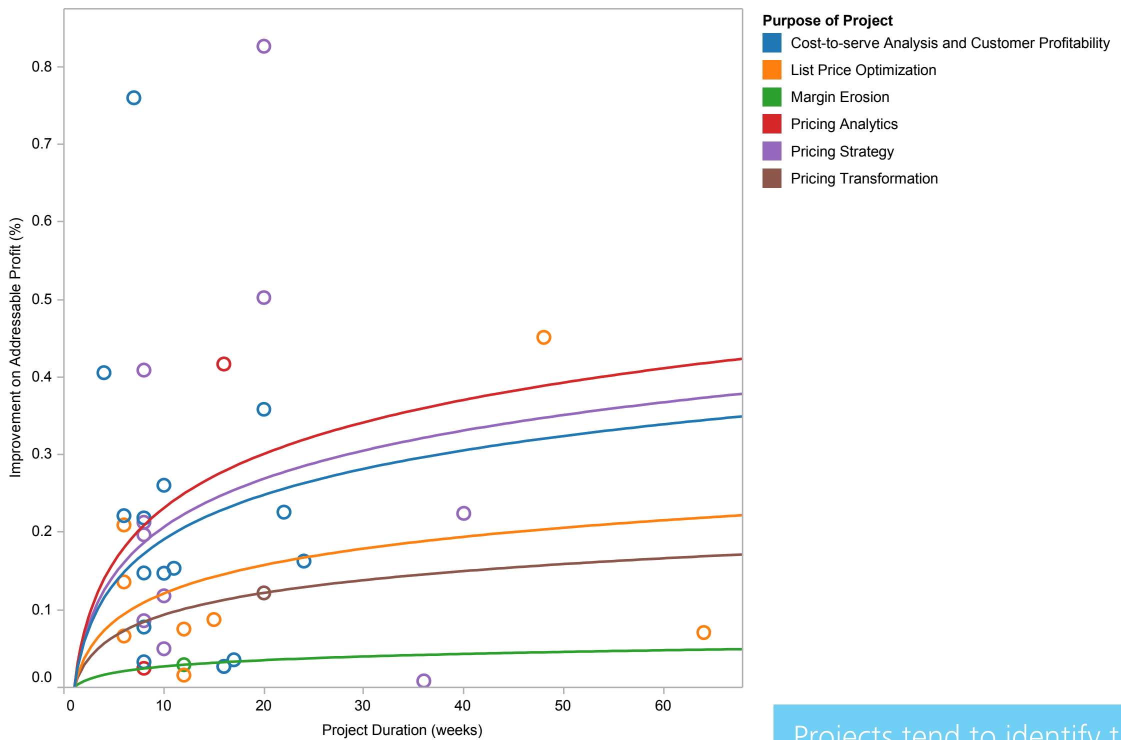


Source: Deloitte Research

wins" that were rapidly surfaced to client executives as opportunities to change pricing or some other aspect of profitability in the near term. The size of these quick wins depended on the purpose of the project, but in many cases the opportunity set was identified during an initial phase, with subsequent work focused on capturing or harvesting that value (see figure below).

Moreover, many of these quick wins were able to offset, or sometimes fully fund, other efforts in the pricing and profitability transformation (as measured by the ratio of benefits to project fees, which we don't depict here). In many of these instances, client executives agreed to pursue these opportunities and value was generated as the project was still in progress.

Sum of Project Duration (weeks) vs. sum of Improvement on Addressable Profit (%). Color shows details about Purpose of Project. Details are shown for Client.



Source: Deloitte Research

Projects tend to identify the value within 8 to 10 weeks, often producing quick wins that fund the overall initiative.

Bottom line: Not only do the benefits take root in the near-term, but you can specifically scope the opportunities within a couple of months.

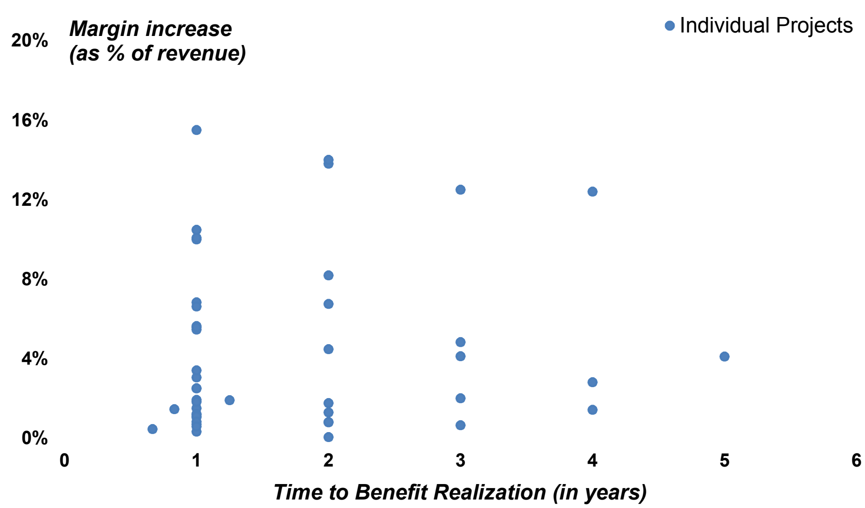
Here's a detailed look at the level of improvements our clients achieved on a month-by-month basis — notice that the average improvement stabilizes after a year from the project start.

Where to focus

We have established that pricing can generate significant benefits if pursued properly. But "pricing improvement" can be a nebulous term. Does it mean setting the most effective price, considering underlying demand? Adapting the list price to market conditions? Negotiating contractual price points such as trade, merchandising, and other support? Measuring adherence to stated process goals? In short, we have seen benefits generated at each step of the pricing lifecycle. Focusing on different areas will likely yield distinct results, so you should prioritize where you focus your efforts. The survey uncovered some clear trends that can be instructive for companies in any industry.

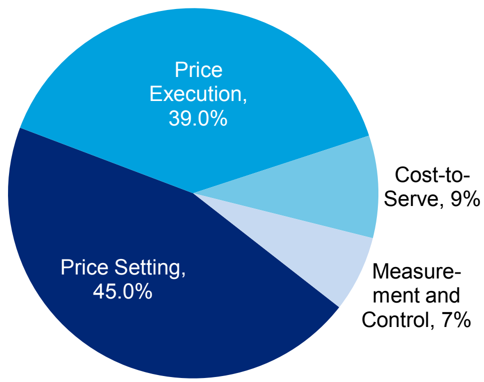
Our analysis reveals that value resides beyond just price setting. Price execution, which represents a focused approach to improve internal efficiency through well-defined rules and policies, coupled with continuous measurement and control efforts, can have significant impact on margin. The figure at right illustrates that remarkable margin improvements have been realized without altering list prices in the marketplace.

Margin increase vs. years to realize



Source: Deloitte Research

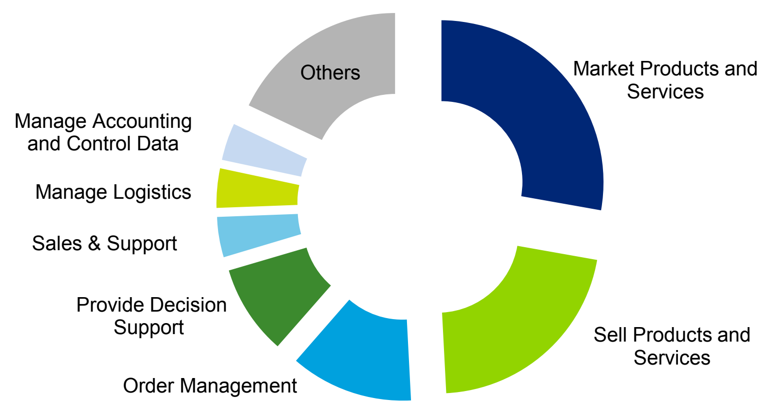
Many are surprised that price *execution* generates a significant portion of benefits
Sources of pricing benefits



Source: Deloitte Research

We also examined value delivered by individual processes. Predictably, marketing and sales processes generated significant improvements. But so did a lot of other processes — namely order management, decision support, and logistics — that may be less obvious. This may be due to the fact that in many organizations there is no coordinated function responsible for overall profitability nor does pricing typically reside in a singular function. In one company sales may be an order-taking function. In another, sales may have the discretion to discount without boundaries. At one recent client organization, the finance team set the suggested price on a monthly basis for each product based on input costs and a target margin — essentially a cost-plus pricing strategy. An initial hypothesis was to refine the cost-plus algorithm to include customer segmentation and concepts of value-based pricing. But a transactional analysis revealed sales was changing price well in excess of norms to specific clients, and policies were based on aggregate measures. These client discounts ranged from 70 percent off to a 30 percent price surcharge to any given client. Needless to say, the price being set wasn't the biggest problem — instead, it was making sure the intended price was being consistently applied to customers. Pricing can uncover improvements in many unexpected places, as these findings demonstrate.

Large benefits are driven by marketing processes — but 70 percent of benefits come from other processes
Sources of pricing benefits by processes



Source: Deloitte Research

Bottom line

The margin and revenue increases that come from pricing are well demonstrated. Think about it: What could your organization do with extra profit equivalent to 3.2 percent of revenue? Plus, clients report that the majority of benefits from pricing arrive between one and two years — with many demonstrable benefits appearing within as little as eight weeks. That's not a long time to wait for benefits like these. If you've ever dismissed pricing improvements on the grounds of ROI or time to benefit, you're running out of excuses.

Even if pricing is relatively far down the list of levers you plan on pulling to improve performance, there may be no other lever that is more effective at margin enhancement. Moreover, in many organizations, those other levers have been pulled already. In that context, pricing is looking better each day.

This article originally appeared in the Journal of Professional Pricing *and is the first in a three-part series. Next, we examine how one can "connect the dots" by taking a broader view of pricing. Finally, we take a look at the price one must pay for pricing effectiveness. To read the other articles in the series, or for more information on Deloitte's Pricing and Profitability Management practice, please visit www.deloitte.com/us/ppm.*

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