THE PRICING CONUNDRUM

PRICE INCREASE? EVERYDAY LOW PRICE? KEY DECISIONS THAT CAN IMPACT YOUR BRAND.

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nielsen

AN UNCOMMON SENSE OF THE CONSUMER™

PRICING IS CERTAINLY AN ART AS WELL AS A SCIENCE.

Consumer packaged goods (CPG) companies are looking for growth. But high growth in developing markets is no longer making up for slow growth in developed markets. In such an environment, it's tempting to consider changes in pricing strategy.

These are some of the most complicated issues facing brand strategists. On one hand, managing price is a critically important lever to increase profitability and generate funds for investment. On the other hand, significant price changes in either direction can have unexpected effects on the market. When one important brand lowered its price to compete against generic competitors back in the early 90s, it lost a staggering 26% of its market capitalization because the market read the signal very broadly as indicating a future in which brands would have less pricing power (something that turned out not to be true).

Leveraging a low-price strategy, however, can be executed successfully. Walmart's founding mission was to offer low prices to customers, every day. The promise has been a main driver for the business and a reason that many attribute for their success in owning the EDLP retail space. In fact, in 2015 the retailer significantly dialed back on ads and asked their manufacturer to do the same, instead encouraging them to put resources into furthering the retailer's EDLP strategy over advertising.

Low price assurances have often been part of a retailer's vision, but it wasn't until the mid-1990s that it emerged as a manufacturer pricing strategy. Here, the idea was to redirect all or most trade promotion dollars—historically used to fuel temporary price reductions (TPRs), retail features/ads and in-store displays—into the regular price. Price sensitive categories tend to have the most successful trade events, but our analysis over the course of three years has shown that companies are still missing the maximum potential for trade promotion events.

When it comes to pricing, the strategy is also highly dependent on the specific products' price elasticity, or, consumers' willingness to pay a different price for a product without affecting demand. Nielsen's 2016 Global Benchmark Analysis showed that the most elastic categories globally were found mostly in food categories, but ran the gamut from hand dish soap to sweet spread and toilet paper. However, the least elastic global categories all fell within personal care.

With so many factors affecting your bottom line, it can be difficult to determine the best way to price your product so it drives profit and customer loyalty. Below are two common pricing strategies – EDLP and a price increase – as well as a guide to key factors you should consider before choosing one plan over another.

> “WITH SO MANY FACTORS AFFECTING YOUR BOTTOM LINE, IT CAN BE DIFFICULT TO DETERMINE THE BEST WAY TO PRICE YOUR PRODUCT SO IT DRIVES PROFIT AND CUSTOMER LOYALTY.”

WHEN TO CONSIDER A PRICE INCREASE

Pricing is certainly an art as well as a science. This is good, because adhering strictly to the science of pricing could lead to decisions that take too narrow a view of price increases. Often, price increases are reactive – perhaps the competition has raised prices; perhaps their cost of goods sold has gone up. In the first case, they focus too narrowly on a simple calculation of profit expectations. In the second, they do the same thing, except that the focus is now on making up the margin lost to increased costs.

This leaves marketers vulnerable to the law of unintended consequences, which are bound to result if you haven't considered all the factors that drive whether a price increase will have the desired effect. Here are just a few factors to consider when looking at a price increase.

BRAND DYNAMICS

- **Brand role in portfolio.** A product's role in the corporate portfolio and where it is in its life-stage are two key internal determinants of a price strategy. For example, if a product is maturing, but not brand new in its lifecycle, the corporate objective will typically shift from volume growth to profit growth, so a price increase might make sense. On the other hand, if a brand is a cash cow, a company will generally be content to accept volume loss, as long as the brand generates a predictable and steady stream of profit and as long as managing the brand does not divert marketing and sales resources from the other brands that are growing. Strategy should frame all risks – including how changing product price could potentially impact other areas of the overall strategy, including trade promotion. Ultimately, all pricing and promotion actions should ladder up to an overarching strategy for the business.

- **Brand Equity.** How strong is your brand equity? The answer to this question can make or break a price advance. Strong brands (well-differentiated products with high share and brand equity) lower the risk of a price increase. Another important question is whether one's strength is linked more to "own price" or more to "price gap." If "own price" is the key, then, if you go up a dime, you lose no matter what competition does; but if price gap is key, you are insulated if (but only if) competition matches your dime increase.

- **Brand trends.** Another indicator of the safety or riskiness of a price increase is whether the brand is getting stronger or weaker at the time of the price increase. If the brand is getting stronger, the risk is lower, and vice versa.

- **Product margin.** A product with lower margins can afford more volume loss before the price change leads to a significant overall fall in profit, all else being equal. Cost structure also matters — products whose costs are primarily variable are in a better position to raise price than if fixed costs are more important, because you can easily lower your costs by producing less, if necessary. Another cost-structure example is that products whose supply chain is more vertically integrated will typically have more cushion in handling pricing contingencies.

- **Velocity.** A brand with SKUs in its portfolio that "turn" slowly may lose some distribution points with a price increase. This results in even a greater loss in volume than what modeling would have suggested.

- **Retail relationships.** If retailers question your commitment to a product – specifically to keeping the product relevant – your position in the market will be substantially weakened. Maximizing the importance of your product to retailers means maximizing it to consumers. Refreshing flavors and packaging, making your offerings more contemporary, increasing your innovation rate – and communicating all this enthusiastically to the market – make all the difference in the world.

SHOULD YOU CONSIDER RAISING THE PRICE OF YOUR PRODUCT?

Is the brand you're considering raising the price on an up-in-coming product (and not the brand's "cash cow")?

YES NO

Does the brand have strong equity in the market?

YES NO

Do fixed costs affect the product cost of your product the most?

YES NO

Does the brand turn over quickly on the shelf?

YES NO

Would your retailer partners be on-board if you increased price?

YES NO

If you answered "yes" to all of the above questions, it might be time to consider a price increase on your product.

EDLP EMERGED IN RESPONSE TO MANY CPG HOUSEHOLD GOODS BEING LOW ON 'EXPANDABLE USAGE.'

WHEN TO CONSIDER EVERYDAY LOW PRICE (EDLP)

The EDLP strategy emerged in response to the fact that many CPG household goods, as well as categories such as personal care, baby/family products and healthcare products are low on "expandable usage." For example, having more bottles of shampoo in the house would not typically lead you to wash your hair more often (not like snacks, which are high on expandable usage: having more snack products likely leads to more snack usage). That meant that an emphasis on deals would be counterproductive–because people would buy in bulk only or mostly on deal, without buying more of the product than they would otherwise need.

What products is an EDLP strategy ideally suited to?

BRAND DYNAMICS.

- **Corporate Role.** A product's role in the company's portfolio has downstream implications for virtually every important decision. A marquee product will get a great deal of attention and investment, while a "competitive fighter-product," whose primary role may be as a spoiler, might receive scant focus. Brands toward the competitive-fighter end of the continuum are natural candidates for an EDLP strategy. After all, once the strategy is established, the product is effectively on auto-pilot, and can simply be managed for efficiency.

  Just like determining if you should increase the price of a product, making the choice to adopt an EDLP strategy needs to be driven by broader strategies. A change to EDLP would impact trade promotions (and may completely negate them). Before considering any shift, strategy needs to have a seat at the table.

- **Brand Strength.** Strong brands, almost by definition, have a larger strategic arsenal at their disposal. With the exception of specialty/niche brands, which usually possess high brand equity and provide a benefit unmatched by competition, small brands are typically under a permanent state of siege. They will generally employ a high-low strategy, because trade promotion drives volume and excitement, as well as generating attention and funds from retailers.

- **Profitability and Price Elasticity Insights.** Sometimes, the decision to adopt an EDLP strategy is purely a quantitative matter, and strategic issues don't come into it. EDLP products tend to have relatively high everyday price elasticity, and enjoy relatively low lift from trade promotion activities. Products priced using a high-low strategy tend to show the opposite pattern—relatively lower everyday price sensitivity and high promotion lifts.

- **Consumer Metrics.** Marketing and sales plans often include consumer metrics objectives, such as "grow penetration by one point." Consumer metrics also include buy rate and loyalty, and might include performance in key demographics ("grow penetration among Hispanics"). A constant, "fair" price generates consistent consumer purchase patterns. Similarly, however, this loyalty may be among fewer consumers. But trading the low-value households generally associated with discounting might still be a prudent move. High loyalty is also associated with higher brand equity. It's hard to measure, but of such high value that it's very often an appropriate goal.

SHOULD YOU CONSIDER MOVING TO AN EDLP STRATEGY FOR YOUR PRODUCT?

Is the brand you're considering fighting in a competitive landscape?

YES NO

Does the product have a high price elasticity?

YES NO

Has the product historically not seen strong lift from trade promotions?

YES NO

Does the product have a goal to drive loyalty among a specific consumer demographic?

YES NO

If you answered "yes" to all of the above questions, you may want to consider an EDLP strategy for your brand.

MAKE CONFIDENT, DATA-DRIVEN PRICING DECISIONS

Companies devote significant time and resources to finding the right price to fit their business objectives. In fact, many have entire departments devoted to just this task. Are you confident in your pricing decisions and trade promotions? Leverage Nielsen's **data visualization tool** to find out. Contact your Nielsen Representative to learn more and optimize your pricing and promotion activities.

ABOUT NIELSEN

The Nielsen Company is a global performance management company that provides a comprehensive understanding of what consumers watch and buy. Nielsen's Watch segment provides media and advertising clients with Total Audience measurement services for all devices on which content - video, audio and text - is consumed. The Buy segment offers consumer packaged goods manufacturers and retailers the industry's only global view of retail performance measurement. By integrating information from its Watch and Buy segments and other data sources, Nielsen also provides its clients with analytics that help improve performance. Nielsen, an S&P 500 company, has operations in over 100 countries, covering more than 90% of the world's population.

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