

Pricing ist Chefsache

42. Congress der Controller

München, 16. Mai 2017

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Simon-Kucher & Partners at a glance

Best consultancy in marketing and sales

<i>manager magazin</i>	<i>brand eins Thema</i>	
Marketing and sales	Marketing and pricing	Sales and CRM
1 Simon-Kucher & Partners	Simon-Kucher & Partners	Simon-Kucher & Partners
2 Boston Consulting Group	McKinsey & Company	McKinsey & Company
3 McKinsey & Company	Boston Consulting Group	Boston Consulting Group

Source: *manager magazin* survey of top managers in Germany, August 2007 and 2011/IMB

Source: *brand eins Thema/Statista* survey of approx. 1,500 partners and project leaders from consulting firms and approx. 1,500 C-level managers from German companies, May 2014, 2015 and 2016

World leader in pricing

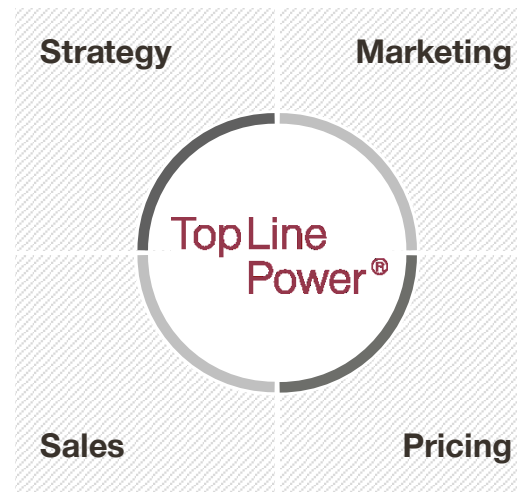
<p><i>World leader in giving advice to companies on how to price their products</i></p> <p><i>BusinessWeek</i></p>	<p><i>The world's leading pricing consultancy</i></p> <p><i>The Economist</i></p>
<p><i>Pricing strategy specialists</i></p> <p><i>The Wall Street Journal</i></p>	<p><i>In pricing you offer something nobody else does</i></p> <p>Professor Peter Drucker</p>

Global presence

33 offices worldwide, 1,000 employees, €240m revenue in 2016



> 3,000 projects in the last 3 years



- Growth and competitive strategies
- Product portfolio (re-)design
- Pricing excellence
- Customer relationship and customer value management
- Sales strategies and sales channel optimization

There's not much in the world we haven't priced



Porsche

Price strategy and pricing for models like Cayenne/
Cayman/Panamera



DHL

Worldwide price-/product optimization (across divisions)



Nokia

Pricing for Virtual Reality



Brown-Foreman

Pricing strategy for Jack Daniels and other brands



Bayer

Launch of Levitra (competitive product to Pfizer's Viagra)



secret.de

Pricing and product strategy for "casual dating"



LinkedIn

Monetization of premium services

Why Pricing matters

Importance of the CEO

The Best and the Rest

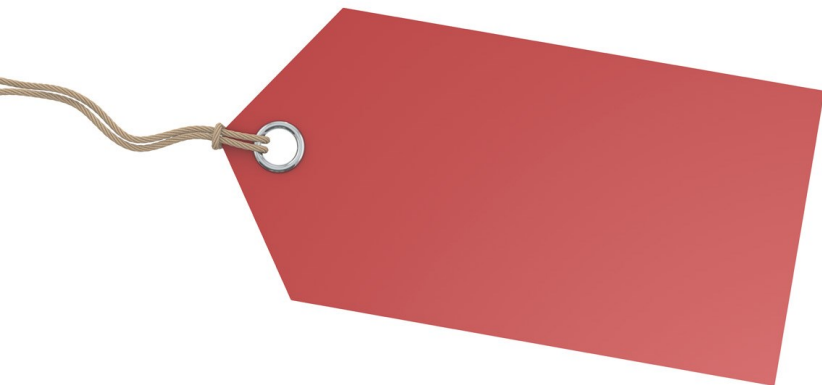
The root evils in Pricing

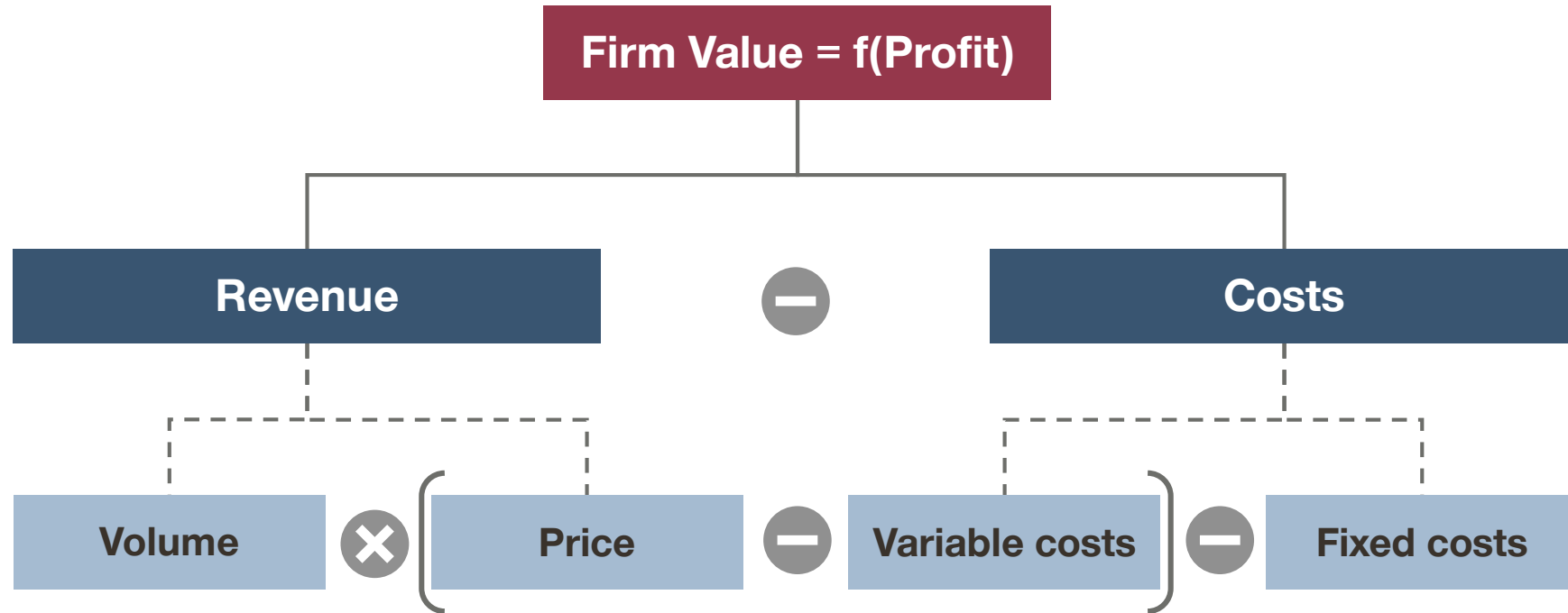
What the CEO should do

Price is the most effective driver

– and destructor –

of a firm's value





Only price, volume and costs have an influence on profit!

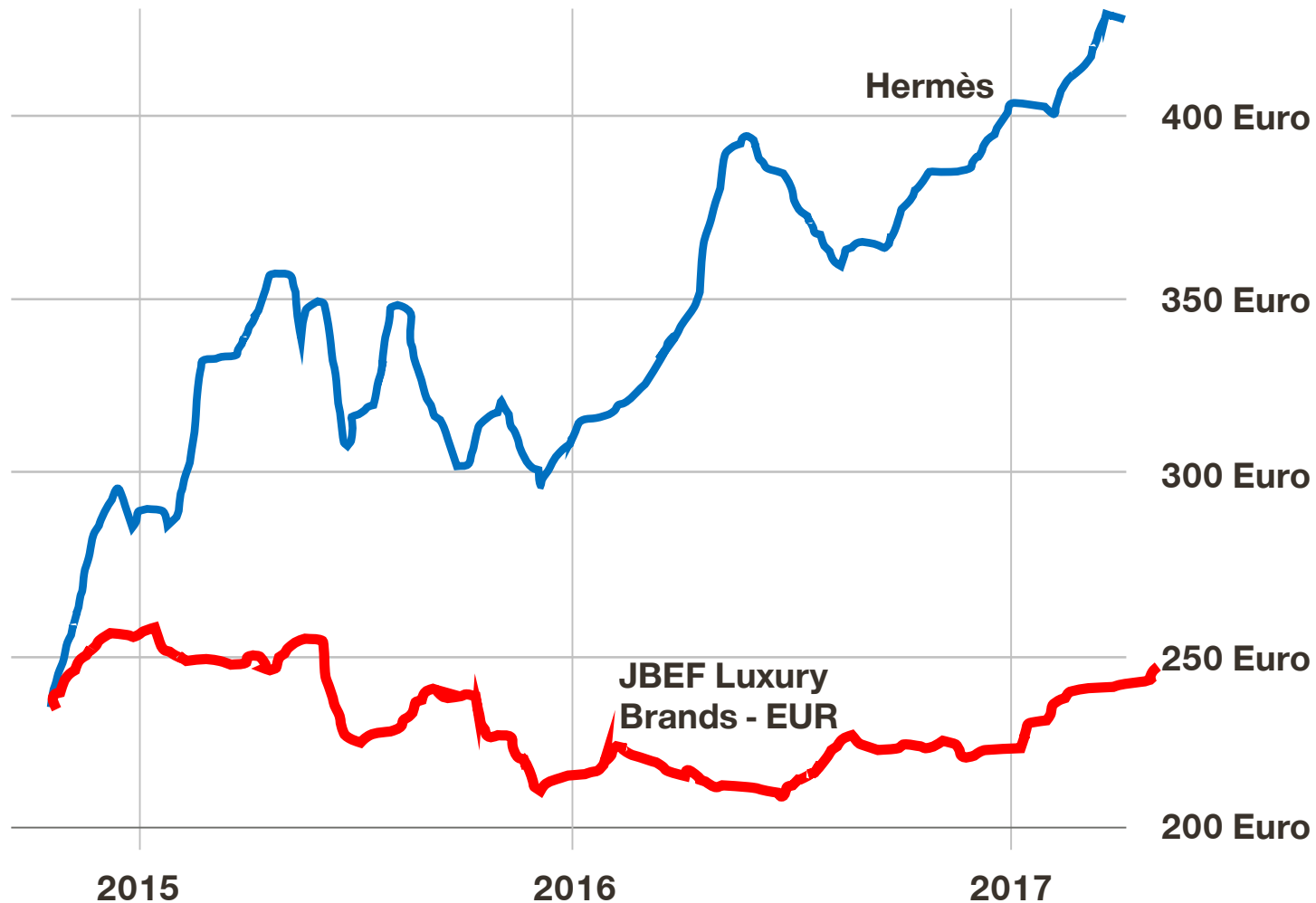
Value destruction through bad pricing

Praktiker (DIY): "20% discount on everything"



Value creation through high pricing Hermès International outperforms JB EF Luxury Brands

“ Hermès bets on higher prices while others even cut their prices.* ”



*The Wall Street Journal, March 25, 2015; Frankfurter Allgemeine Zeitung, March 26, 2015

Source: www.onvista.de

Value destruction through high pricing

J.C. Penney: How the CEO (ex-Apple) ruined the company



Why Pricing matters

Importance of the CEO

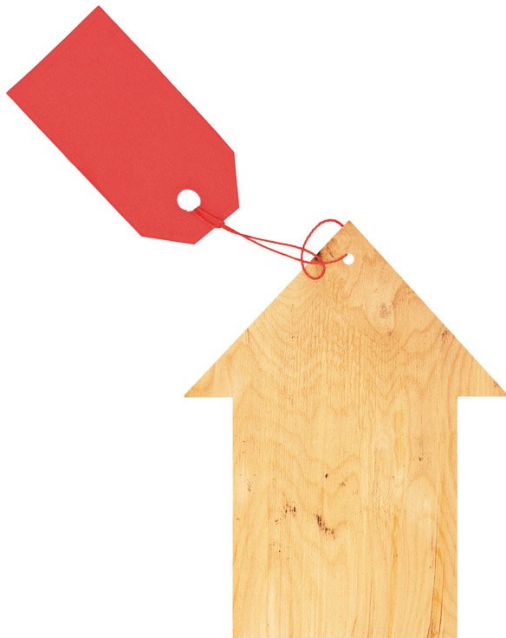
The Best and the Rest

The root evils in Pricing

What the CEO should do

What is the ultimate CEO responsibility?

Increasing the Value of the Firm





Warren Buffett

Quelle: Interview mit Warren Buffett vor der Financial Crisis Inquiry Commission (FCIC) am 26. Mai 2010.

"The single most important business decision in evaluating a business is pricing power."

Share of companies with high Pricing Power



Successful price increases

Share of successful price increases



EBITDA-Improvements after successful price increase



Why Pricing matters

Importance of the CEO

The Best and the Rest

The root evils in Pricing

What the CEO should do

GPS 2016: Increasing price pressure on a global scale

82%

report increasing price pressure!

Why?*

Stronger competition from low-price suppliers

60%

Increasing negotiation power among customers

37%

Greater price transparency

34%

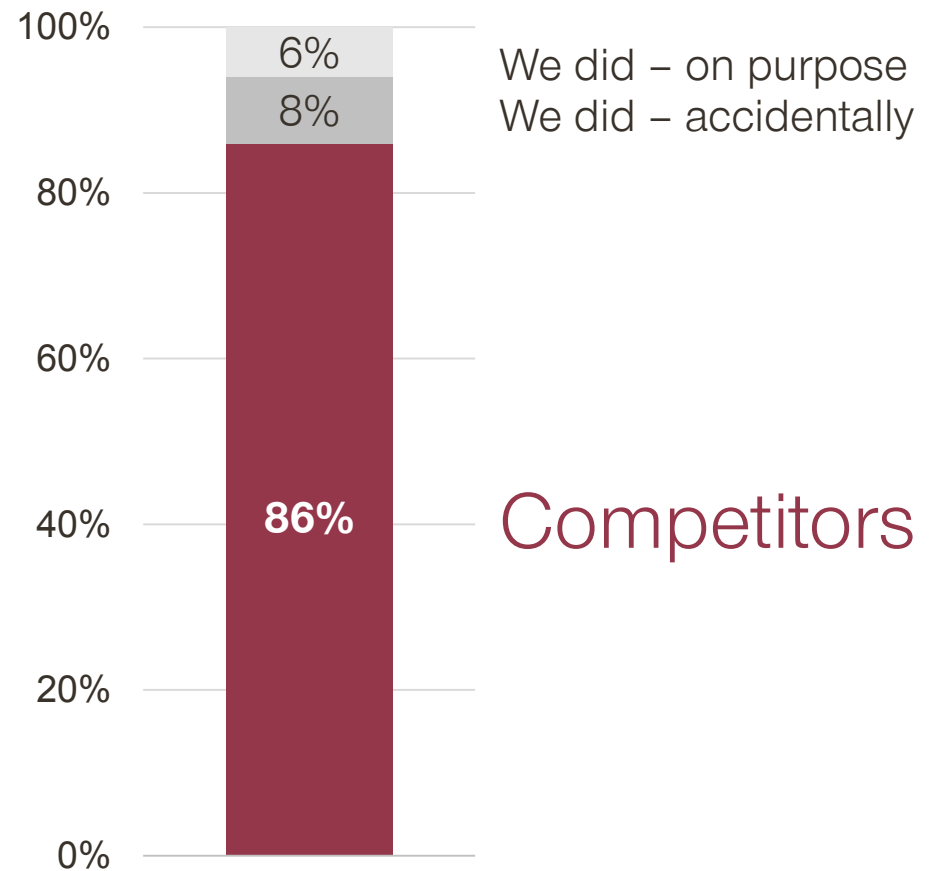
*Multiple responses possible
Source: Global Pricing Study 2016 (n = 2,186)

Every second company is engaged in a price war

49%

**are currently engaged
in a price war!**

Who started the price war?



Innovation does not help either!

72%

of all new products
miss their profit targets



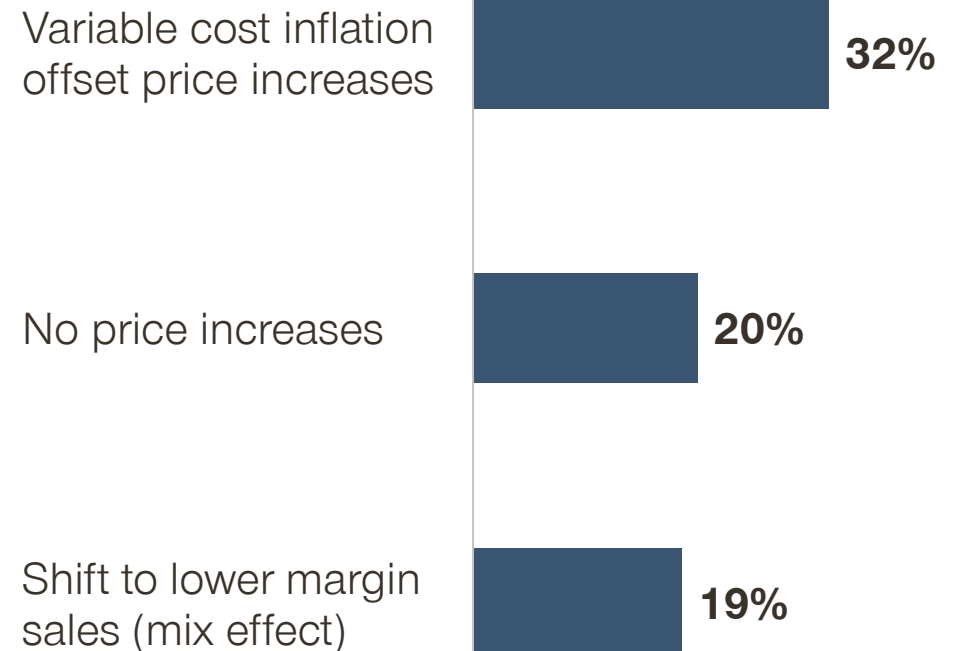
The outcome?

Four out of ten companies fail to improve their margins

39%

did not improve margin percentages last year!

Why?*



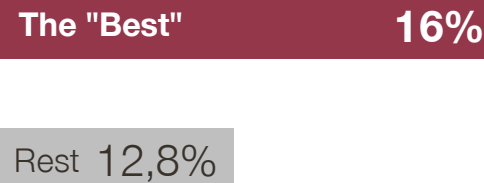
*Multiple responses possible
Source: Global Pricing Study 2016 (n = 2,186)

The Best in pricing substantially outperform the Rest



EBITDA

EBITDA margin
of last 3 years

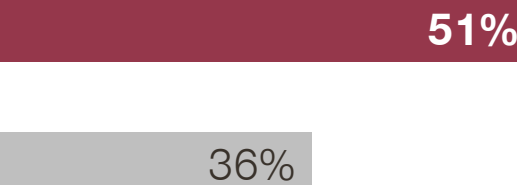


... **25% higher EBITDA margin**



Pricing power

Average price
implementation
rate

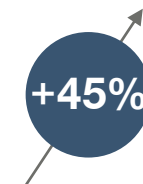
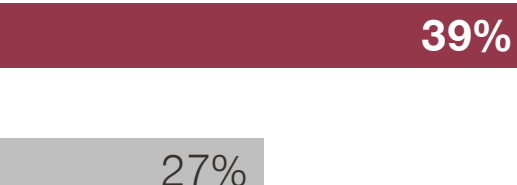


... **41% higher pricing power**



New products

Share of new
products fulfilling
their margin goals



... **45% higher share of successful new product launches**

1) The "Best" classification comprises 10% of all companies participating in the study
Source: Global Pricing Study 2014

Why Pricing matters

Importance of the CEO

The Best and the Rest

The root evils in Pricing

What the CEO should do

- 1. Commoditization and Innovation failure**
- 2. Cost-Plus Pricing**
- 3. Controlling & Accountability deficiencies**



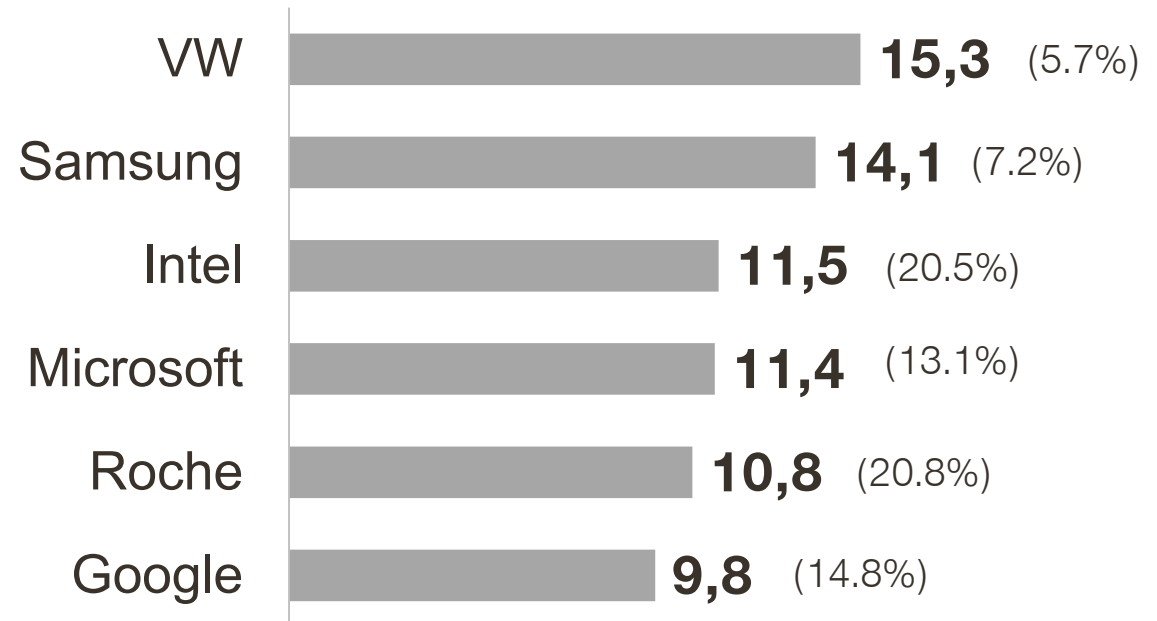
- 1. Commoditization and Innovation failure**
2. Cost-Plus Pricing
3. Controlling & Accountability deficiencies



R&D investments higher than ever



Companies with highest innovation expenditure



R&D investments 2015 in bn¹ (share of turnover)

¹ Source: Battelle, *R&D Magazine* 2016

Despite high investments poor innovation performance

72% of all new products do not achieve profit target

In **25%** of companies all products fail to meet profit target



New products: "flop rate"



Failure category #1: "Feature Shock"



Feature Shock

FirePhone: Hundreds of \$m "burned"



From the iPhone hunter
to a cheap phone

From \$199¹⁾ to \$0.99 in
4 months

\$170 million in inventory
write-downs

1) incl. contract

Failure category #2: "Minivation"



Minivation

Automotive supplier/VW: ParcAssist



Cost plus pricing
towards VW and

other OEMs:

approx. **€100**

OEMs understand
full customer value

VW's customer price:

€670

Failure category #3: "Hidden Gem"



Hidden Gem

Kodak – did not recognize they had it

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Strategy & Marketing Consultants



Kodak

1974

Kodak's Steven Sasson invented the digital camera technology

1995

Kodak introduced its first digital camera; only in 2001 they got serious about that business

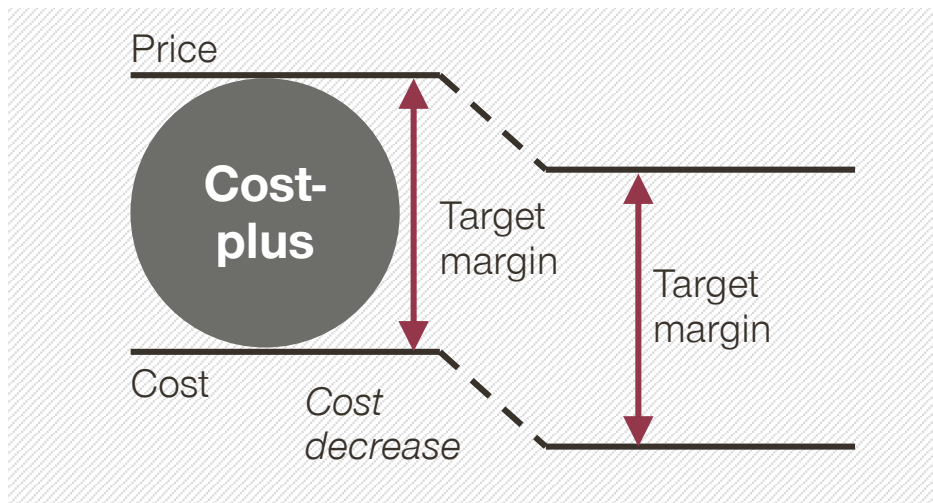
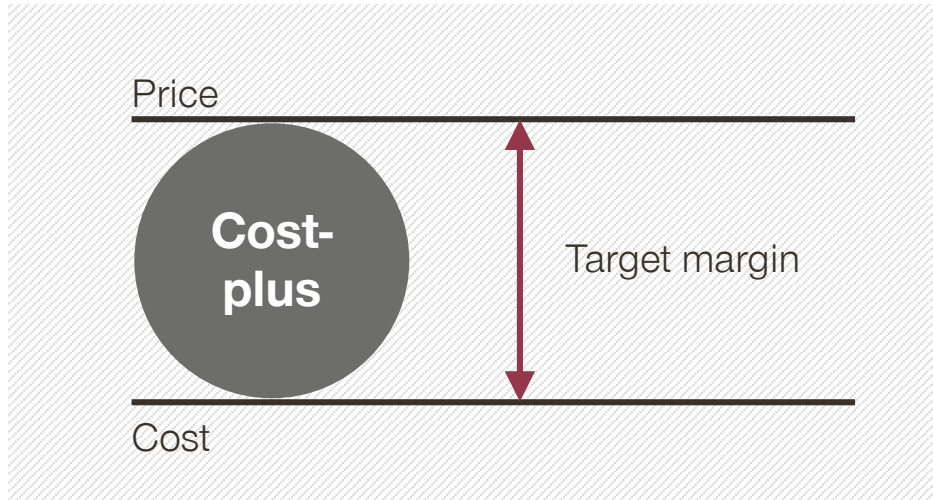
2012

Kodak declared bankruptcy

The root evils in Pricing

1. Commoditization and Innovation failure
- 2. Cost-Plus Pricing**
3. Controlling & Accountability deficiencies

Why Cost-plus pricing doesn't work

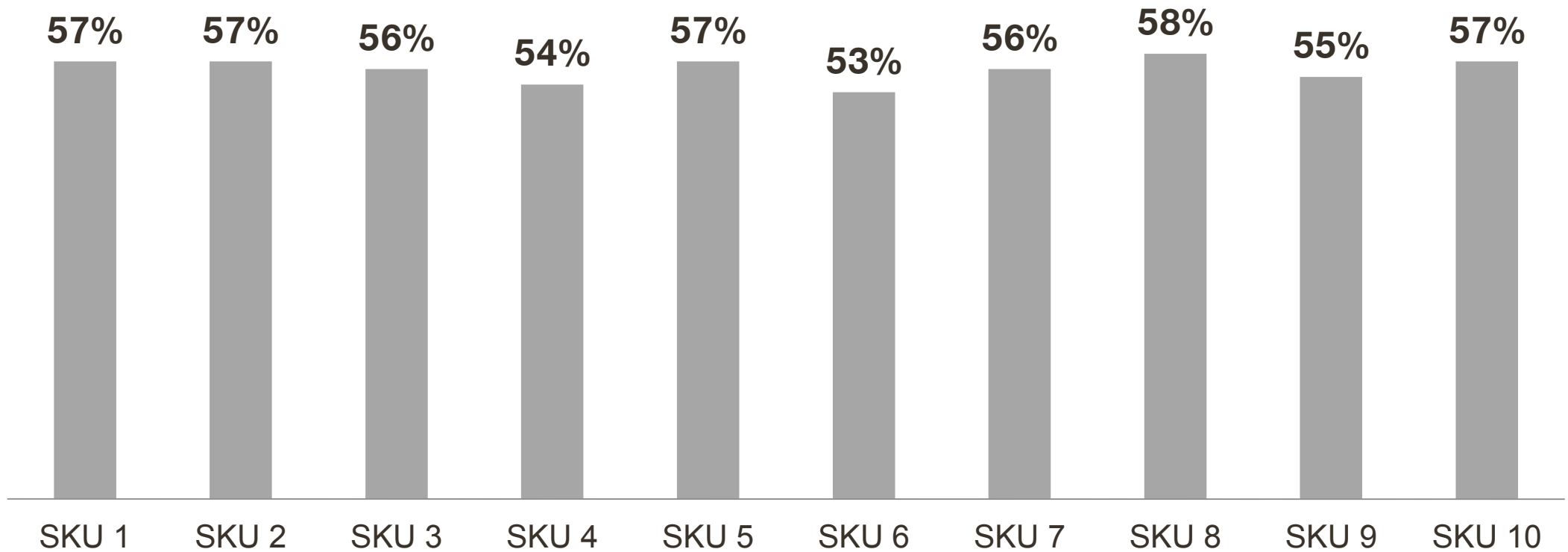


- + Simple and cheap solution
- + Required data is usually readily available
- Cost improvements are passed on to the market immediately
- High willingness to pay not fully extracted

What we often see at cost-plus clients

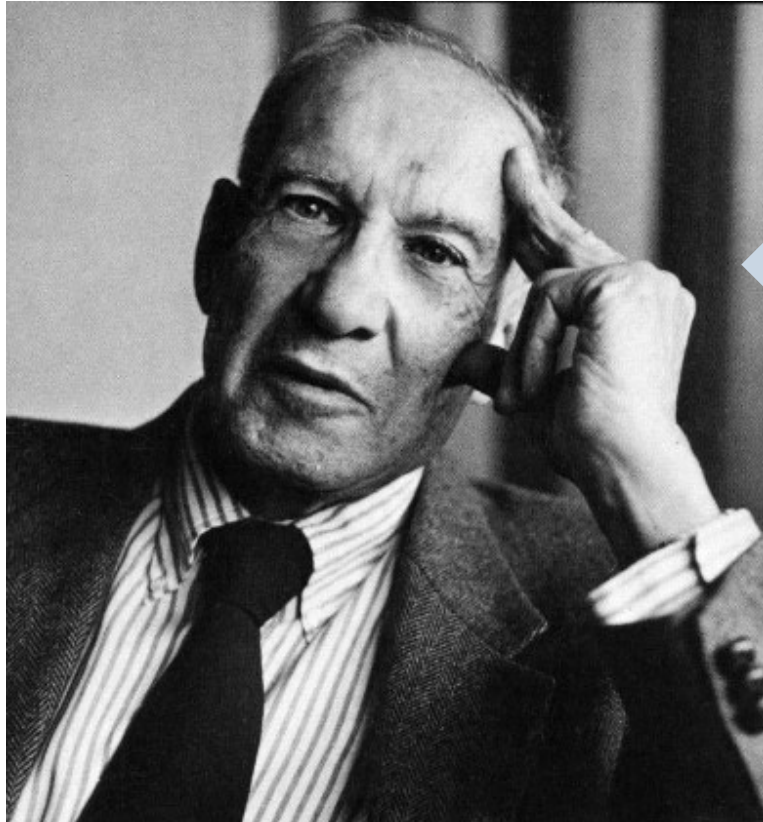
Project Example

Gross margin



Value is key

Customers pay a price because they want to get a certain value. They never pay a price to cover the cost they incur.



*"Customers don't buy products.
They buy advantages that those
products offer to them."*

Peter F. Drucker

One of the greatest management
thinkers of all times

It is the key job of management to create as much value for the customer as possible – and charge according to that value, not according to the cost to maximise profits.

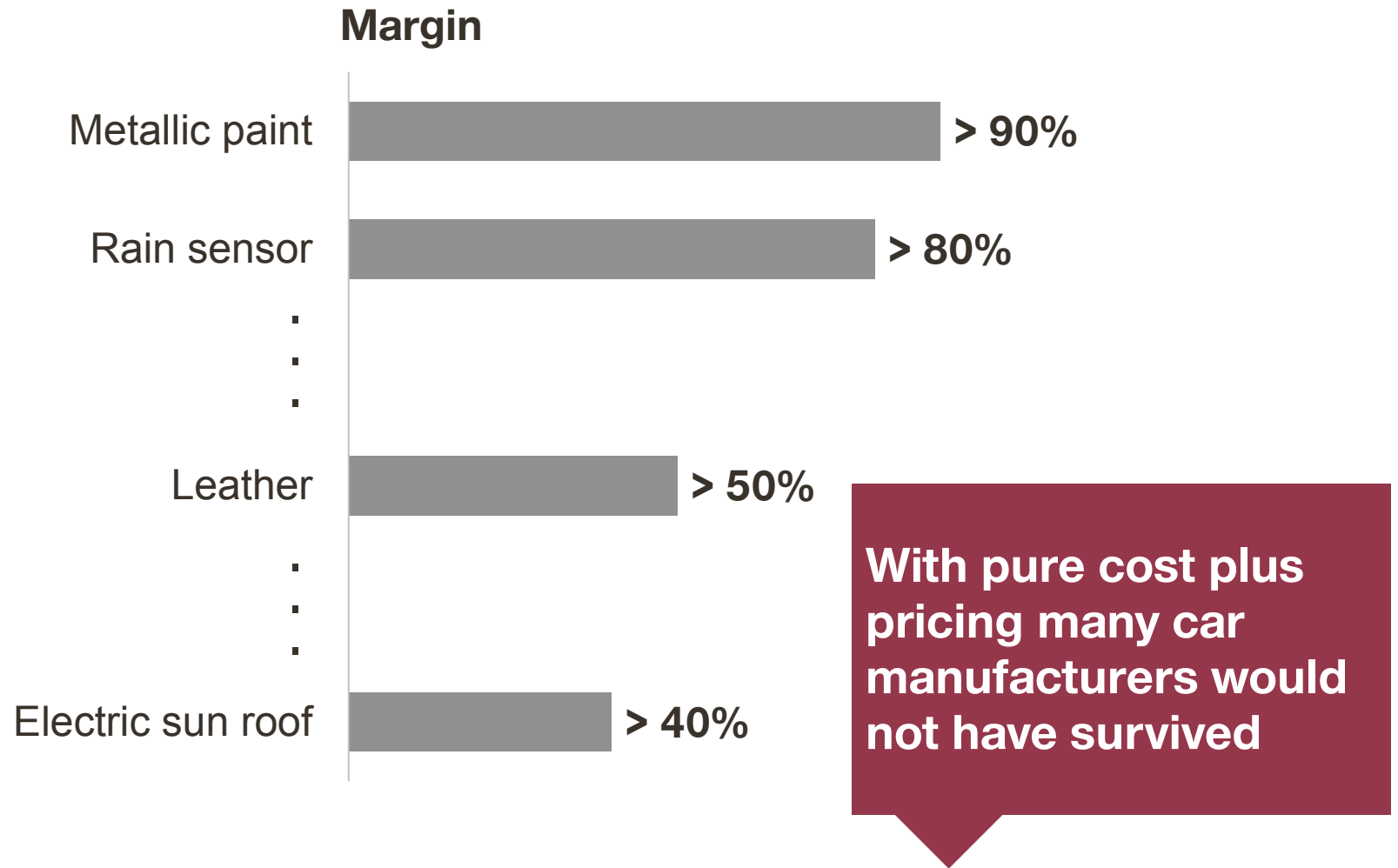
A look at the Roman Empire



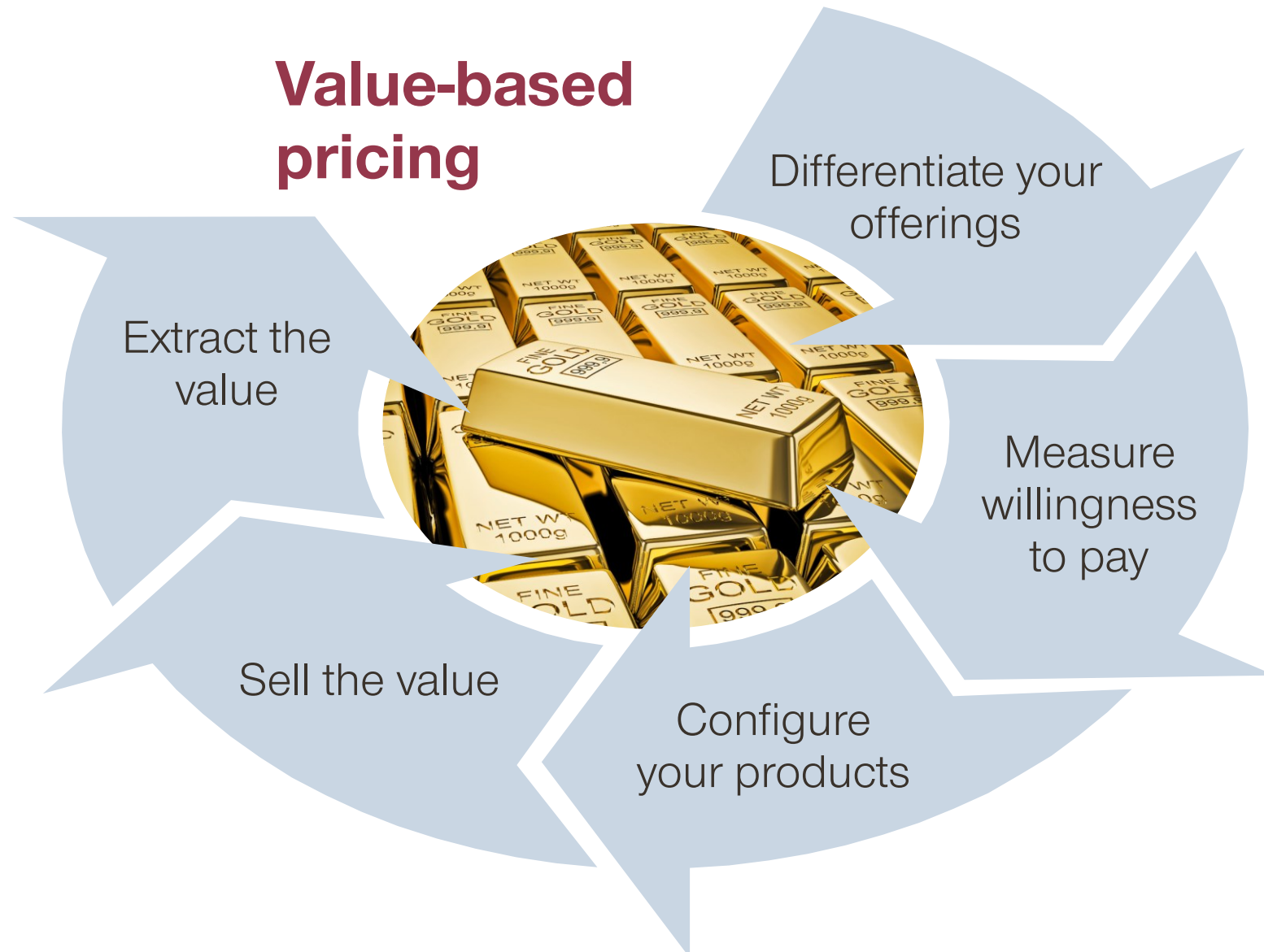
Pretium = Price = Value



Value pricing for car options










The five tasks in value-based pricing



Differentiate your offerings: When segmentation goes wrong

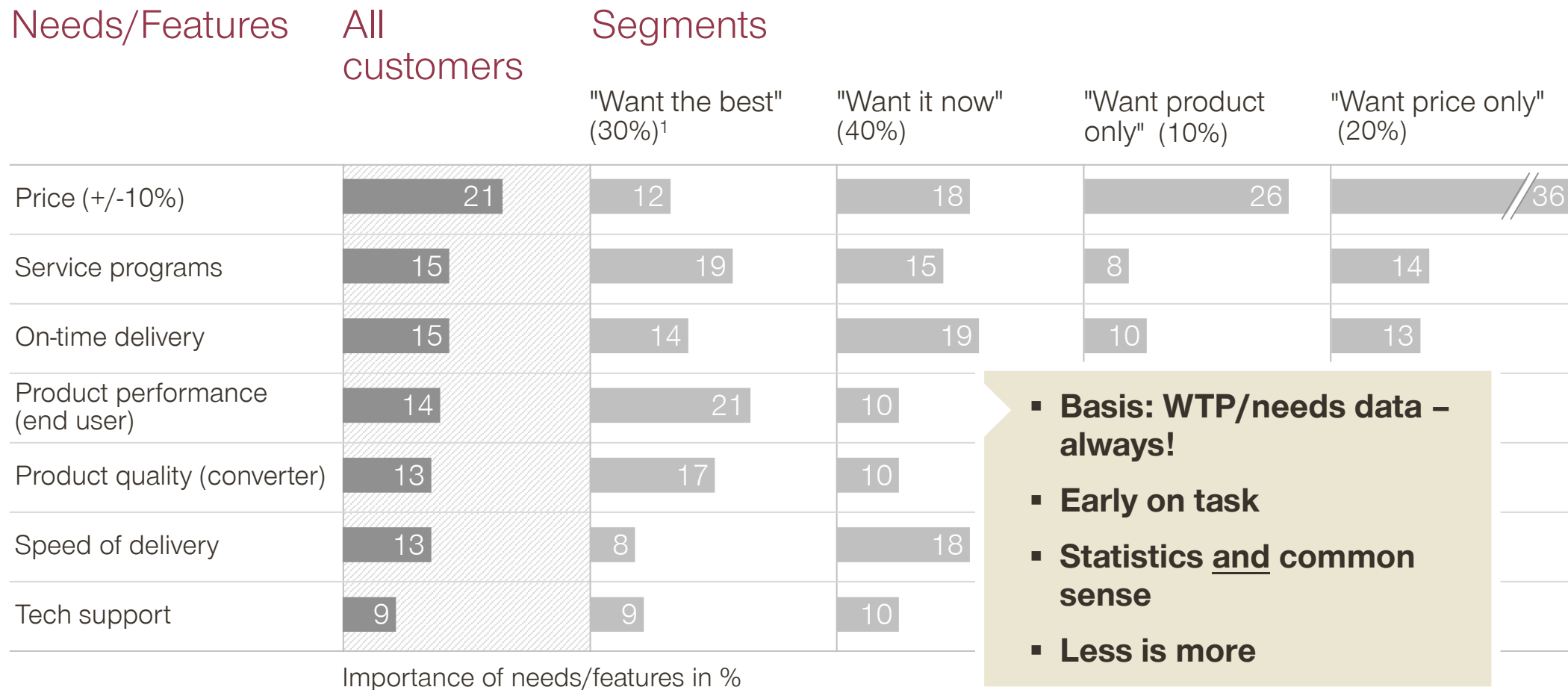
Two customers: Seemingly alike...

...but very different

 AGE	68	68
 BORN	UK	UK
 MARRIED		
 HOME	Castle	Castle
 INCOME LEVEL	Wealthy	Wealthy



Differentiate your offerings: Segment based on value desired by the customer



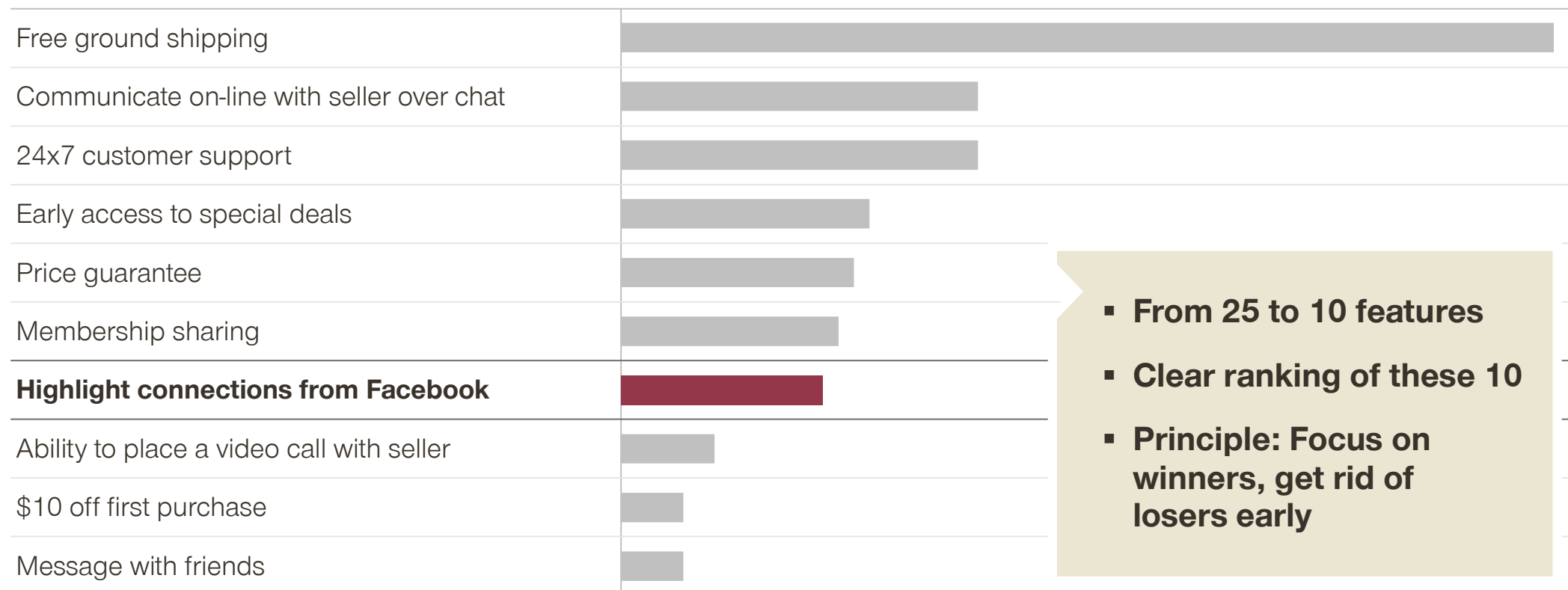
* Segment size (value)

Measure willingness to pay: Customer desire is not enough

**Project example
2-sided marketplace**

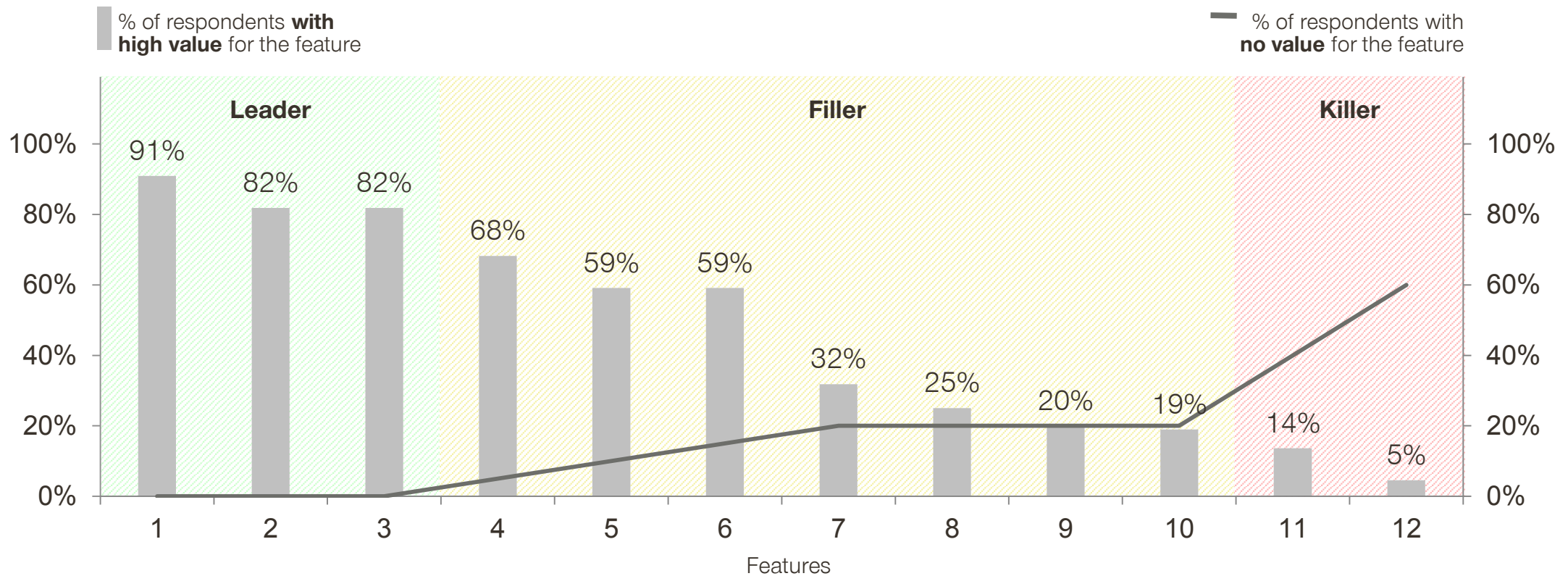
Features

WTP in \$



- **From 25 to 10 features**
- **Clear ranking of these 10**
- **Principle: Focus on winners, get rid of losers early**

Configure your products: Product configuration is more science than art!



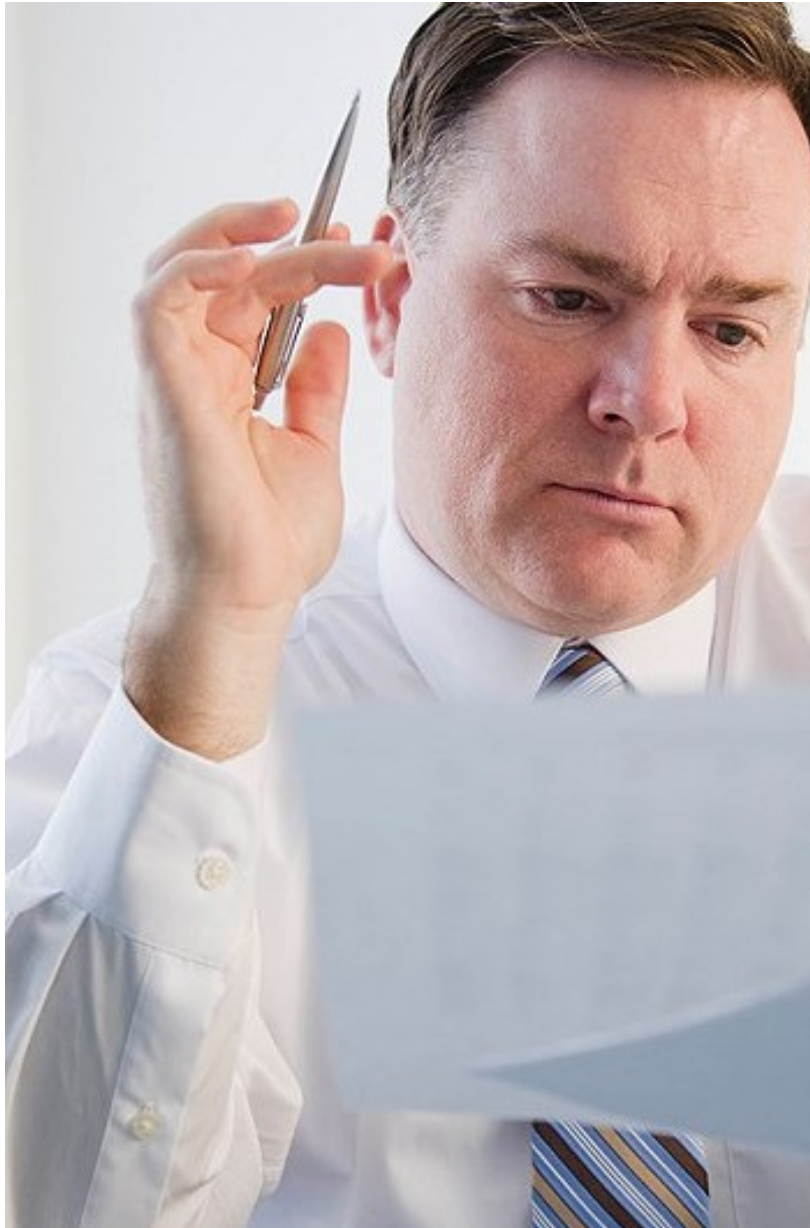
Sell the value: IoT massively reduces maintenance cost at Caterpillar

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Strategy & Marketing Consultants



- **Predictive maintenance almost eliminates down time**
- **Repair cost are down as well**
- **Specific case in mining:
Cost decrease by 90%**
- **Typical cost savings
across industries: 30%**

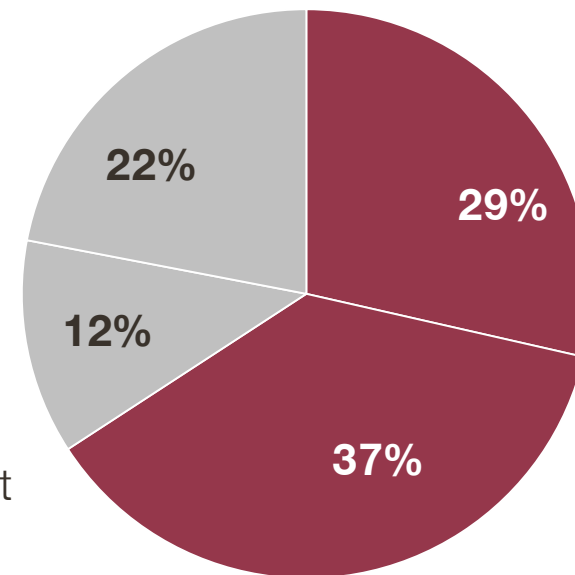
Extract the value: Two thirds of the companies work on new price models



**Do you think about
changing your revenue model
because of higher price pressure?**

No –
never
thought
about it

No –
thought
about it but
declined



Yes –
vague
initiative

Yes –
actively
planned

Extract the value: Debundle

RYANAIR
LOW FARES. MADE SIMPLE.

ESCAPE
The Irish Summer
Fly from
€19.99

FIND YOUR FLIGHT
FIND FLIGHTS

- Analysis: PE of base price much, much higher than that of surcharges
- Model:
Debundling; low base price + lots of surcharges
- Reinvented the whole industry
- Revenue/market capitalization (2014/15) (€bn)
Ryanair: 5.6/18.7
Lufthansa: 30.0/ 5.5

Extract the value: ...and optimize the pricing components

2006:
price for 20kg = €3.50



2014:
price for 20kg = €35.00

Wohnsitz
Passagier 1 Bitte wählen Sie das Land Ihres Wohnsitzes ▾

Sie sind bereits versichert? Wählen Sie im Dropdown-Menü "Unversichert Reisen" aus.

Aufzugebende Gepäckstücke


Kostenloses Handgepäck bis 10 kg (für [Abmessungen hier klicken](#)). Bezahlen Sie bis zu 2 aufzugebende Gepäckstücke pro Person, Gesamtgewicht max. 35 kg.

Passagiername
Passagier 1 ▾
Aufzugebendes Gepäck für Hinflug bezahlen
20 kg (35,00 EUR) ▾
Aufzugebendes Gepäck für Rückflug bezahlen
20 kg (35,00 EUR) ▾


Passagiername
Passagier 1 ▾
Aufzugebendes Gepäck für Hinflug bezahlen
20 kg (35,00 EUR) ▾
Aufzugebendes Gepäck für Rückflug bezahlen
20 kg (35,00 EUR) ▾

BUCHUNGSÜBERSICHT

► Passagier(e)

 Dortmund → Málaga
Di., 12 Aug 2014 10:10 - 13:20

▼ 1 Erwachsener, 43,99 EUR
1 x Erwachsener Tarif 43,99 EUR

 Málaga → Dortmund
Sa., 16 Aug 2014 06:40 - 09:45

▼ 1 Erwachsener, 188,99 EUR
1 x Erwachsener Tarif 188,99 EUR

Rabattzahlung mit Debitkarte:
232,98 EUR
 Zahlung mit Kreditkarte: 237,64 EUR

SUMME 232,98 EUR

Extract the value: Influence the customer's decision

The Economist

Option 1

Option	Price in USD	% of people choosing option
Online	59	68
Print + online	125	32

Average revenue per subscriber **\$80.12**

The Economist

Option 2

Option	Price in USD	% of people choosing option
Online	59	16
Print	125	0
Print + online	125	84

Average revenue per subscriber **\$114.44**

Integrate intelligent price anchors

Revenue per subscriber: +43%

Extract the value: Let price speak for quality

In an experiment, participants were asked to estimate the effect of a painkiller after being treated with electrical impulses

Pain-killing effect confirmed by



Group 1	\$2.50	~100 ¹⁾
Group 2	\$0.10	~50 ¹⁾

You can't separate price from quality!

Source: Ariely, 2010
1) Index

The root evils in Pricing

1. Commoditization and Innovation failure
2. Cost-Plus Pricing
3. Controlling & Accountability deficiencies



Deficiency: Too many product margins too low

Project Example

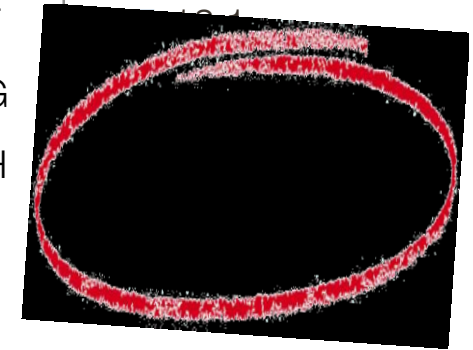
"No-Go" Zone

Margin	Product ABCD Classification			
	A Product	B Product	C Product	D Product
<0%	9%	1%	1%	1%
>10%	31%	13%	10%	6%
>20%	27%	17%	15%	14%
>30%	17%	30%	24%	20%
>40%	12%	31%	40%	41%
>50%	4%	8%	10%	17%

MIN —————

Sales share in the no-go zone

- Area A 5,2
- Area B 8,3
- Area C 9,0
- Area D 10,5
- Area E 11,9
- Area F 12,8
- Area G 13,7
- Area H 14,6
- Area I 15,5



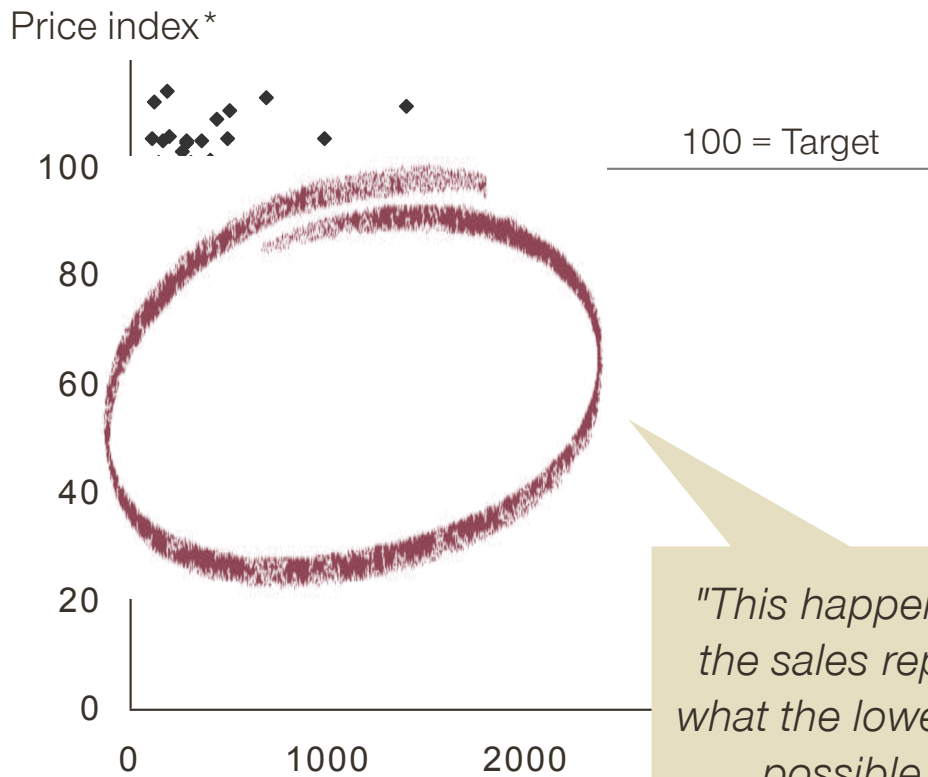
Deficiency: Customer prices inconsistent

The pricing freedom is too large for sales reps. There are no price limits that cannot be overstepped.

Project Example

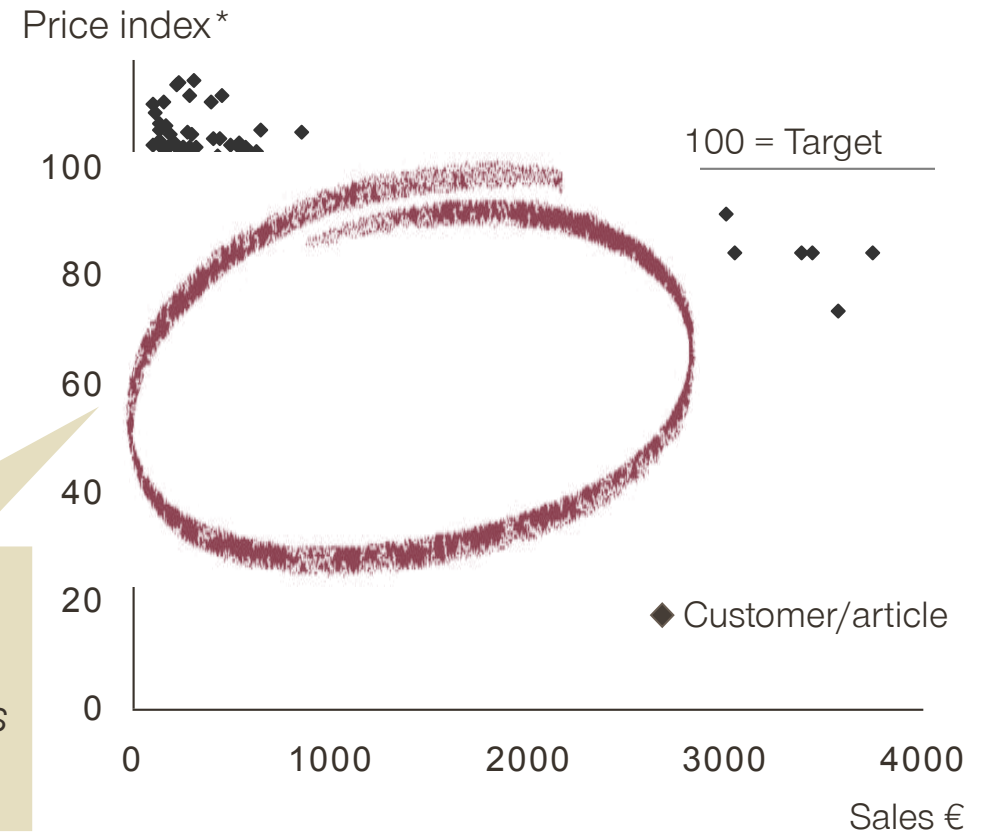
Status quo vs. target in warehouse business

Non-Professional



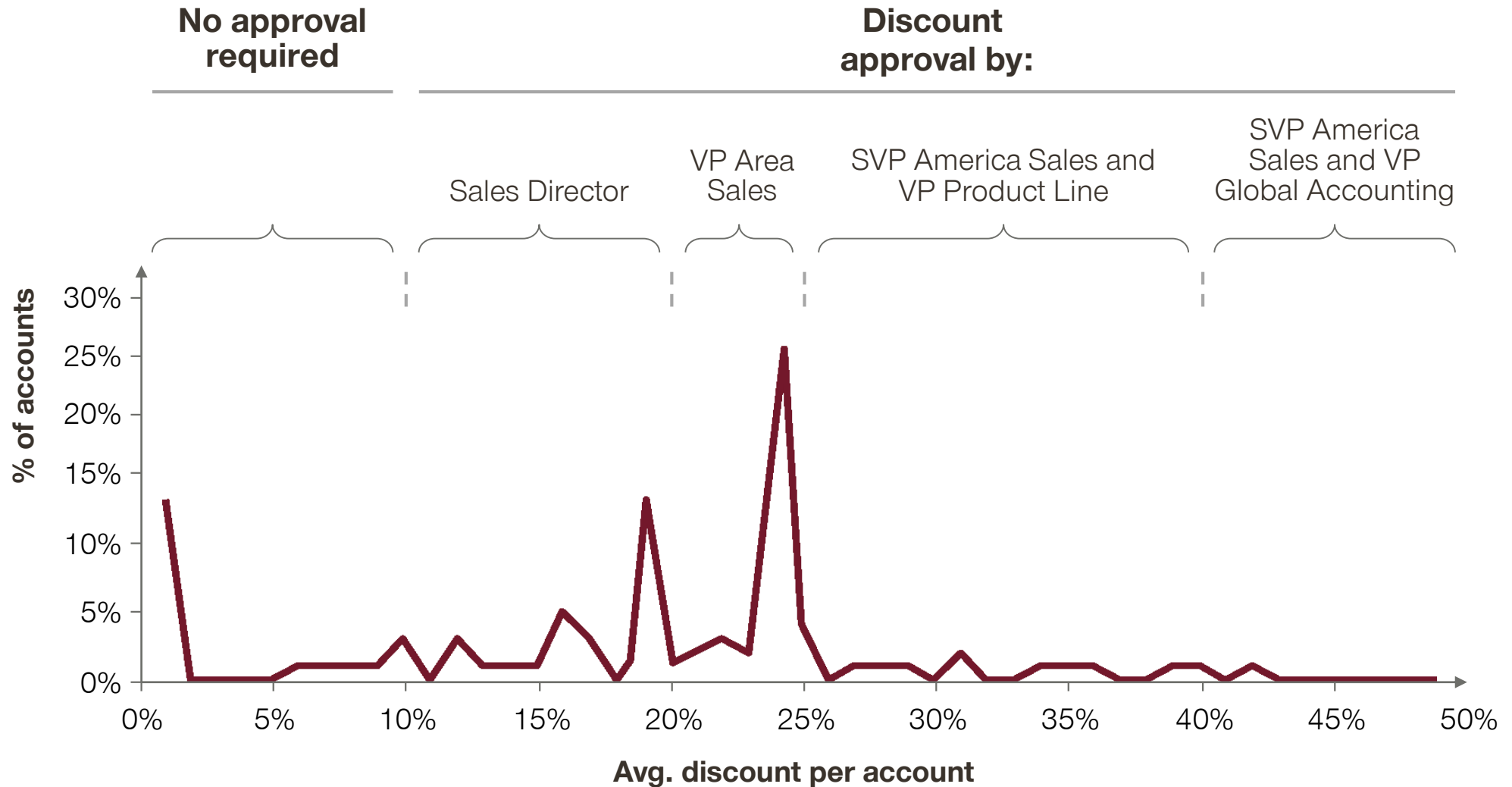
"This happens when the sales rep knows what the lowest prices possible are."

Professional



Deficiency: Discounts peak at escalation limits

How approval thresholds drive the pricing execution of sales



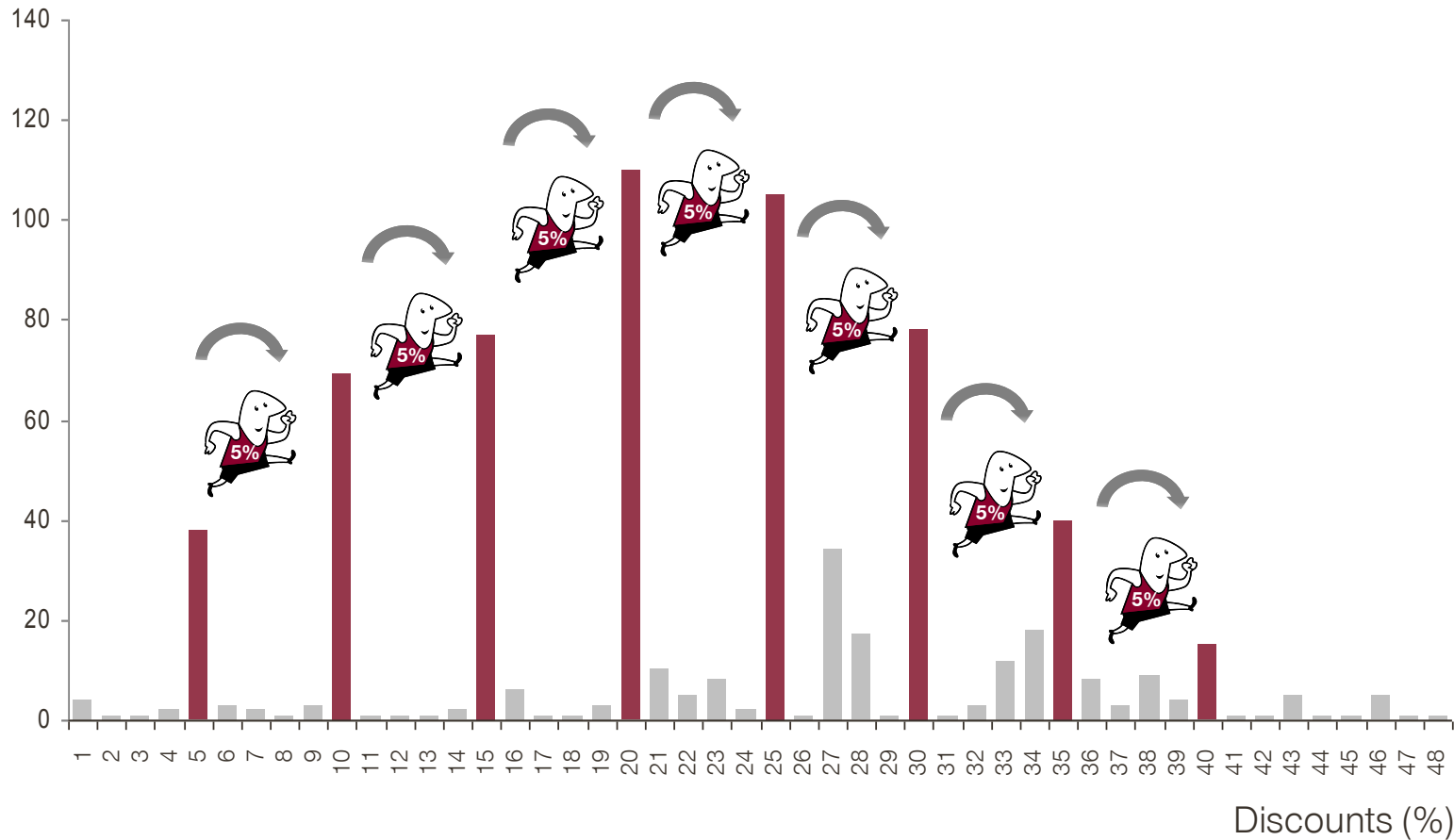
Source: Simon-Kucher project; data altered to protect confidentiality

Schmidt-Gallas_Pricing ist Chefsache_42. Congress der Controller

Deficiency: Rounding off of discounts

Project Example

Number of contracts



Discounts should look like this:

- 7.23%
- 5.14%
- 3.18%

And they should get smaller in each negotiation round!

Deficiency: The opposite of good is good intentions



- The CEO of one of the largest logistics enterprises loved visiting the CEOs of his key customers himself
- The CEOs of his customers often demanded higher price concessions – to which he gave in
- This undermined the many preceding negotiations and frustrated his sales team
- We advised the CEO to stop his visits which in turn led to one percentage point increase in margin (which is a lot in this industry)

Why Pricing matters

Importance of the CEO

The Best and the Rest

The root evils in Pricing

What the CEO should do

Make pricing a key topic in the organization



**Steve Ballmer,
former CEO Microsoft**

**"Price is really really
important but a lot of people
under-think it through"**

Clarify your price position



**Norbert Reithofer,
former CEO BMW**

„Premium products and discounts don't go together well.

That's why we have decided to not defend our market share at any cost.“

Take over price leadership



Johan Molin, CEO Assa Abloy
(World market leader door opening solutions, EBIT-Margin 16.3%)

“We are by far the market leader. It is the task of the market leader to help prices up.”

Organize the pricing process



Albert Baehny, Chairman Geberit
(World market leader in behind the wall sanitary systems, EBIT-Margin 27.5%)

„Margins rise significantly and sustainably if you have a well-defined pricing process and clear rules for price decisions, price implementation and price controlling.

If the CEO delegates pricing responsibility or even worse, leaves it to the market, there is no way you can shine against your competitors. "

Enforce price discipline



**Jeffrey Immelt,
CEO General Electric**

“We have carried out a pricing analysis and revealed that about 5 bn Dollars are at stake. If you take into account all decisions, sales staff can make themselves then it’s about this enormous amount of money.

On the cost side we would never allow anything like this. If it’s about our purchasing prices, we analyze, compare and bargain them down. But with our selling prices, we are sloppy.”

- Price is the **most effective driver – and destructor – of a firm’s value**:
Play it right and your benefit is massive, play it wrong and you’re doomed.
- The **CEO’s job is to increase the value of the firm**. If pricing gets his attention or not has a ~30% impact on important KPIs.
- Companies see themselves under **enormous price pressure**. Every other firm is entangled in **price wars** – which they claim others have started.
- There are **three root evils in Pricing**
 1. Commoditization and Innovation failure
 2. Cost-Plus Pricing
 3. Controlling & Accountability deficiencies
- To fix these evils, the **CEO can help with five actions**
 - 1. Make pricing a key topic in the organization**
 - 2. Clarify your price position**
 - 3. Take over price leadership**
 - 4. Organize the pricing process**
 - 5. Enforce price discipline**

All this requires **the determination, stamina and relentlessness** of the CEO.

**"Costs are a
matter of facts ...
Pricing is a matter
of guts"**

Jack Welch



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Profile

Dr. Dirk Schmidt-Gallas is a Senior Partner at Simon-Kucher & Partners and Member of the Board at Simon-Kucher. Furthermore, he manages the company's Frankfurt office.

Dirk looks back at more than fifteen years of consulting experience, all in the field of pricing, sales and strategy. His projects have covered more than 40 countries across the globe. His clients seek his advice on strategy, pricing, sales and product optimization.

Dirk has authored and co-authored numerous books and articles on the topics of strategy, pricing and sales and is a regular speaker at leading domestic and international conferences.

He studied business administration at the University of Mainz focusing on marketing and finance/risk management. In collaboration with Deutsche Bank, he wrote his dissertation on strategic product design. For this he was able to use the knowledge he had gained from a research assignment at Yale University (USA).