PROFESSIONAL PPS PRICING SOCIETY™

JULY 2020

PRICING ADVISOR™

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# Pricing Strategy: Foresight is 20/20

**by Sudipto Banerjee and Serena Crivellaro**

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*Many companies are now revising pricing strategies to build resiliency for the aftermath of COVID-19. Companies that refine their pricing strategy with foresight in 2020 will set the stage for a stronger recovery and long-term growth as the crisis abates. In this article, the authors present a roadmap for redeveloping pricing strategy based on insights into three key areas.* *Sudipto Banerjee (sudiptobanerjee@KPMG.com) is Principal at KPMG where he leads the Commercial Excellence and Pricing practice. Serena Crivellaro (scrivellaro@kpmg.com) is Managing Director at KPMG specializing in pricing, sales, and marketing strategy optimization.*

COVID-19 changed the mindsets and behaviors of hundreds of millions of people in a matter of weeks. As the world continues to fight the virus, nearly every business will need to adapt to sharp shifts in demand patterns, low consumer confidence, and the effects of social distancing. While some industries are now facing severe slumps in demand, others are experiencing a dramatic increase. Few are unaffected, and we expect volatility to continue for at least the rest of 2020.

Many companies have cut prices to address immediate challenges, such as volume and share erosion, while others are raising prices to account for temporary shortages of raw materials, parts or labor. Many vexing questions about pricing that confront business leaders vary not only across industries and companies but across product lines, across channels in the same product line, and occasionally for a single customer buying different products.

These temporary price adjustments, however, will not be enough to help many companies withstand a prolonged health crisis and a global recession. We believe that to build resiliency and succeed in the longer term, most companies will need to fundamentally reconsider pricing strategy.

They will need a current and de-

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tailed understanding of the structural changes brought on by COVID-19 and how those changes will affect their industry, customers and competitors. In short, they will need more foresight to navigate a landscape in turmoil.

In our experience, effective pricing strategy creates advantages through variations in demand and competitive position. A thoughtful pricing strategy can also help companies demonstrate empathy and build trust with customers and other stakeholders. We recommend building a long-term pricing strategy based on insights into three main areas:

- Shifts in customer demand by product line, end market and channel
- Relative competitive position within product lines, end-markets or channels
- Demonstrations of genuine empathy that build trust and enhance brand perceptions

Once companies develop insights on these three dimensions, they can choose the appropriate pricing approaches to maximize long-term value. As the exhibit below shows, we recommend specific responses for companies depending on their competitive position and the level of demand in the industry. A strong competitor in a fast-growing market, for example, should take ethical pricing actions and avoid profiteering. See Figure 1 on next page.

## How companies have used the four approaches to pricing during COVID-19

To understand how to apply the four pricing tactics in our model now, we looked at examples of what companies have done since COVID-19 began. This includes examples of what not to do; some firms have focused mainly on short-term goals, such as slowing declines in revenues or market share, making pricing mistakes that could have lasting consequences. Companies that are taking a long-term and truly strategic perspective – including many of the companies in industries where demand has risen – maintain focus on customer relationships and brand perceptions, which take a long time to build but can be squandered quickly.

Here are examples of the four approaches in practice now:

✦ **Pricing under the umbrella**

As billions of people around the world stayed home to prevent the spread of the virus, demand for streaming video services spiked.[1] Leaders such as HBO and Sony Pictures, along with some smaller players, responded by offering some free content or extended trials.[2] They may intend to drive awareness, encourage purchase and capture share, but "pulling forward" demand in this way could create a trough in future sales as viewers exhaust the most appealing content and get off the couch as quarantines are lifted.

HBO's "fenced-in" trial featuring spe-

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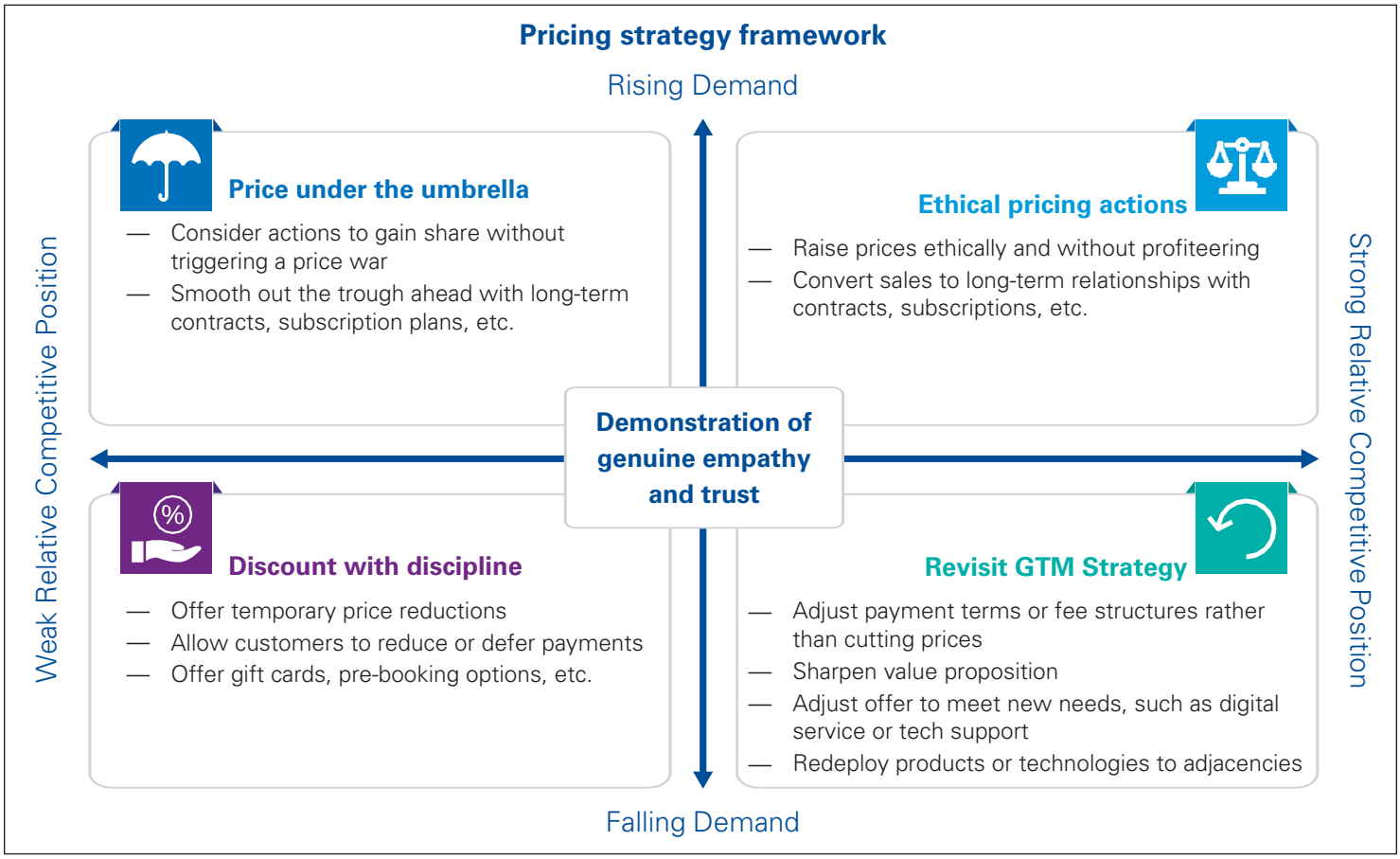
# PPS Happenings

*Click on event graphic below or go to the PPS website at PricingSociety.com for more information on programs and events.*

*Figure 1*




cific series for a limited period – is a masterclass in using discounts to convert a short-term demand bump into longer-term customer relationships and share gains. Non-dominant players attempting to use such an approach should be careful not to start price wars that bigger competitors have the resources to win.

Social distancing has made access to golf courses a rare commodity, but course operators are generally limiting price increases even though they typically rely on dynamic pricing models. We believe this is a sound strategy; while a golf course may have a captive audience among dedicated golfers or within small geographies, golf is only one of several recreation and sporting options. In this scenario, cautious price increases can help preserve long-term customer relationships, including membership or season pass renewals where applicable.

**✦ Ethical pricing as a competitive advantage**

As millions of people began working and studying remotely, demand jumped for consumer and professional video conferencing. Rather than raise fees to make the most of the situation, one company did the opposite, expanding its free services. This "ethical pricing" earned it ample goodwill that may spur loyalty and prompt more users to purchase licenses.

A major software company is playing the long game with ethical pricing by providing students with free access to some products through the end of the school year. It is also offering free temporary access to one of its lesser-known business tools to current and new customers.

LVMH stopped manufacturing many of its luxury products during the pandemic, thereby maintaining scarcity, avoiding a buildup of unsold stock and supporting high price points. Indeed, according to news reports, the company raised prices on some of its Louis Vuitton handbags and clothing by 5 to 17 percent as sales began to pick up in April.[3] It also mobilized its perfumes and cosmetics production facilities during the pandemic to make hand-sanitizing gels to distribute – free of charge – to hospitals and front-line organizations in France. This humanitarian gesture should help build goodwill for the house of brands.

**✦ Discounting with discipline**

In sectors where demand has fallen sharply, companies are experimenting with a wide range of approaches to protect brands, revenues and market share. Based on our experience and research, we expect that those who maintain discounting discipline will have the strongest long-term results.

In the highly competitive auto insurance industry, where no carrier's market share exceeds 18 percent, leading companies including Allstate, Geico, and Progressive offered similar discounts (15 to 25 percent) for March and April premiums, reflecting a sharp drop in driving and accidents. Offers like these can reduce churn, build goodwill and even take share from less flexible competitors. The most disciplined insurers won't destroy value with these offers: their discounts will not exceed what they expect to save on claim payments.

Smaller companies are taking creative approaches to pricing in the crisis, too, including gyms, hair salons and restaurants. Some are offering discounts on gift cards to be redeemed for future services, offer-

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ing "power-ups" for refunds converted to store credit, or conversely hosting good-hearted "bidding wars" for the first appointments once businesses re-open, with the funds going to staff who have been unemployed for weeks or months.

✦ **Revisit pricing and go-to-market strategy**

Where demand has fallen, businesses with strong market shares or competitive positions may feel their hands are tied. We urge them to look beyond price points to revisit the broader pricing strategy. What valuable elements can be disassociated from the old offer and sold separately, for example? How has the value of each element changed during the crisis? Leading companies across industries are making headway with fresh go-to-market strategies:

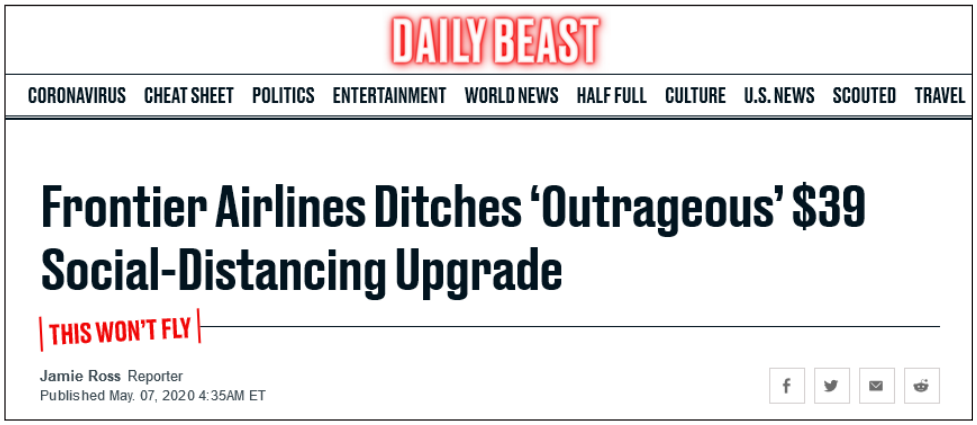
- Leading auto manufacturers and online sellers such as Carvana are reducing or waiving monthly car or lease payments for customers facing financial strain. Most of these offers are for a limited period or cap the waiver amount, or available only to customers who have lost their jobs. Others are not lowering prices but are offering interest-free financing or free add-ons.
- Sephora and other large cosmetics manufacturers and retailers are seeing steep sales as house-bound customers use less make-up. In response, some companies are accelerating a pivot towards skincare and considering other adjustments. For example, the purchasing experience may also need to change: in-store testers may be replaced by virtual try-ons.

## The value of trust and empathy

In times of crisis, trust and empathy are more important than ever. In the current economic downturn, shoppers appear to be using more coupons and comparing prices more often, but many are also sympathetic to people in trouble and more willing to tip.

> **In times of crisis, trust and empathy are more important than ever. In the current economic downturn, shoppers appear to be using more coupons and comparing prices more often, but many are also sympathetic to people in trouble and more willing to tip.**

At the same time, consumers are less willing to overlook what they consider predatory behavior. Early attempts at price-gouging and profiteering became front-page news, and the backlash was swift and harsh. Facing outrage from lawmakers and the public, Frontier Airlines quickly scuttled a plan to charge passengers $39 or more for social-distance seating. The airline quickly apologized and rescinded its "More Room" offer. People who are suffering economically may not soon forget companies that tried to take advantage of sudden scarcity or an urgent need.


DAILY BEAST

CORONAVIRUS CHEAT SHEET POLITICS ENTERTAINMENT WORLD NEWS HALF FULL CULTURE U.S. NEWS SCOUTED TRAVEL

Frontier Airlines Ditches 'Outrageous' $39 Social-Distancing Upgrade

THIS WON'T FLY

Jamie Ross Reporter
Published May. 07, 2020 4:35AM ET

*Frontier Airlines received negative publicity over its $39 "More Room" promotion, as demonstrated by this headline in the DailyBeast.com.*

As we have shown, many companies are showing empathy, building trust and strengthening their brands and long-term customer relationships during this difficult period. In addition to helping customers in need, some consumer-facing companies, such as mobile carriers, have offered assistance and billing leniency to first responders.[4]

B2B companies are focusing on helping their channel partners, which are often vulnerable small- and medium-sized businesses. Some insurers, for example, are supporting a trust fund established by an industry trade group to help independent insurance agencies and brokerages.

In short, the biggest opportunities in this crisis may be to strengthen trusting relationships which will endure long after the recovery.

## Next steps

We urge clients to take four steps to adapt their go-to-market approaches to today's volatile and uncertain economy:

▪ **Take stock of the new environment:** Demand will shift across products, sectors and channels, and each unique competitive position may require different pricing responses. A thorough review of the landscape, including how it has been impacted by the crisis, will provide a foundation for demand planning, scenario forecasting and thinking through risks and opportunities as the situation evolves.

▪ **Refine pricing strategy:** Consider how pricing needs to evolve to meet strategic goals in the new environment. Pricing moves for each product, customer segment and channel should be building blocks in a coherent strategy that addresses individual nuances without breaking the portfolio.

▪ **Move quickly, but with caution:** Making price changes quickly can help recover lost ground and seize opportunities. But this is a moment to be especially sensitive to perceptions; we recommend that companies track customers' reactions carefully and adjust policies accordingly. Senior leaders and sales teams may need to work closely with Legal to manage the risks of changes in terms and conditions. Clear pricing governance and reporting can put guardrails around price changes to help manage risk, especially for a remote sales force.

▪ **Communicate, communicate, communicate:** Keep in mind that customers are struggling, too. Clearly explain any

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changes to pricing, discounting and credit policies, including specific qualification guidelines, when and how credit will be applied, when the new terms will end (or be reassessed), etc., to help clients plan their purchasing decisions.

Companies that refine their pricing strategy with foresight in 2020 will set the stage for a stronger recovery and long-term growth as the crisis abates. ❖

**Endnotes:**

1. Alasdair Sandford, Coronavirus: Half of humanity now on lockdown as 90 countries call for confinement, Euronews.com, March 4, 2020

2. Source: Eric Deggans, These TV Services (And More) Are Offering Free Access, NPR.com, April 24, 2020

3. Source: Silvia Aloisi and Sophie Yu, Luxury handbags jump in price as brands make up for coronavirus hit, Reuters, May 14, 2020

4. Source: Todd Spangler, *AT&T Giving Doctors and Nurses Three Months Free Unlimited Wireless Service*, Variety, April 13, 2020.


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Pricing Transformation: Decision Making Required, Software Optional

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# The Management Pricing Cycle for Mature Businesses

*In this article, the author presents a scenario of an all too common lifecycle that plays out consistently in pricing management groups in mature companies: new pricing managers are hired for growth, they immediately lower prices while ignoring other key indicators, and when this doesn't work they scramble for other solutions or leave before creating a black mark on their resume. This article describes how to break this cycle and provides strategies for new pricing managers to help improve their chances of success. Seth McMenemy is an Analytics and Pricing Analyst at Hallmark Cards. He can be reached at Aaron.Mcmenemy@hallmark.com.*

**by Seth McMenemy**

In my 16 years of working in pricing groups at mature companies, I've seen a specific management price cycle play out with some regularity. This article describes the cycle, offers advice to break free of it and gives new managers pointers on what to focus on to improve their chances of success.

The cycle starts when new managers take over. This tends to happen every 3-5 years in mature companies when the Board of Directors or senior leadership hires new managers to do what the previous managers could not: get the mature business onto a growth trajectory, preferably a unit growth trajectory.

**The next 3-5 years tend to look like the chart in Figure 1.**

1. **New managers** are hired for growth.
2. **Price is the reason.** The new managers come to believe the primary cause of the company's stalled or declining unit trajectory is high price, recent price increases, or both, and decide that prices must be rolled back to grow the business.
3. **Lower prices.** They lower price, either in tests or on a wide-scale.
4. **Doesn't work.** Units respond positively, but not enough to grow revenue or to substantially change the company's unit trajectory.
5. **Try more price-related actions (more price stuff).** They then come to believe one or more of the following:
   - It will take more time for customers to respond to the price reductions.
   - Their initial price drop wasn't drastic enough to get customers' attention, so they need to make a bigger, more noticeable price drop.
   - The lower prices need to be advertised more so customers will know about them
6. **Move on.** As these additional efforts don't move the needle enough, the managers lose interest in price actions. Sometimes they raise prices to help meet top-line goals (and set up the cycle for the next set of managers). Some become more interested in other factors holding the business back. But, they've used so much of their runway trying to solve it with price, they have little left to produce results with their new efforts before being held accountable for not making substantive progress. Either the Board of Directors replaces them, or they move on to avoid a bad mark on their resume.

*Figure 1: The Next 3-5 Years*


## Why does this happen?

This happens due to a combination of mistaken gut instinct that assumes high price elasticity and a focus on easily-tracked metrics, price and units, while ignoring less obvious information.

It is common for mature businesses to have unit volume decline at close to the same rate as prices have risen. For example, "Units are down 14% over the past 3 years and prices have increased 15%."

This confirms the new manager's gut instinct that units and price move one-for-one opposite of each other when prices go up.

But, what really happened is that the previous manager, after completing step 5 of their cycle, raised prices just enough each year to offset the units lost to the less obvious and harder-to-track factors.

Contributing to the "lower prices" conclusion are poorly synthesized market research that appears to point to high price

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*Figure 2: Easy to Conclude That Units Decline*

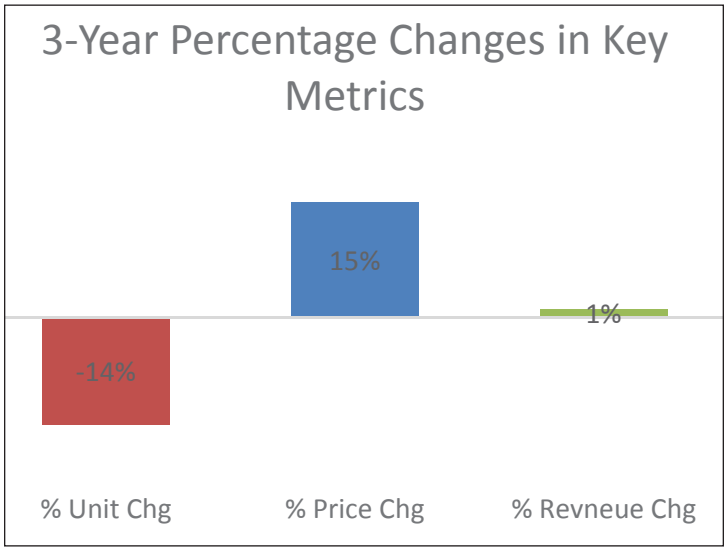
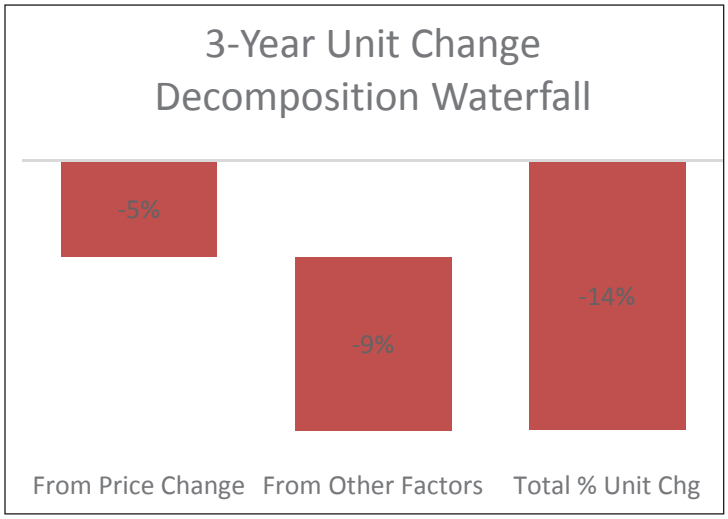



*Figure 3: After Estimating Impact of Price on Units, Other Factors Have Caused 9% of Decline*




as a big problem and pricing naysayers embedded in the organization (but those are topics for future articles).

## Break the cycle

New managers can improve their chance of success by skipping steps 1 thru 5 of the management price cycle and instead start their tenure with confidence in the fact that lowering the company's prices will not accomplish their goals. Rather, they should, at the very least, entertain the idea that the real problems might be found by a close inspection of market saturation, emerging competition, evolving substitutes and consumer preferences.

If the company's pricing or marketing group knows the price elasticity of its products, they should use it to estimate how much of the unit trend was caused by price increases.

If price elasticity is unknown, a good estimate to start with for a mature business is -0.3.

Use price elasticity to back out the price impact from the unit trend and what remains is an **extremely valuable insight**: the impact of the other forces on the business.

In the previous example, where units declined 14% over three years as prices climbed 15% (see Figure 2), -0.3 price elasticity implies price increases caused -5%-points of the unit trend.

This means other factors shrunk the business by 9%-points to get to the total decline of -14%, as reflected in Figure 3.

Another way to say this: If the business held prices flat over the past 3 years, sales and units would both have declined 9%. With the price increases, sales are up 1% and units are down 14%.

A more accurate conclusion is that raising price helped the company maintain the top-line in the presence of other erosive forces, as Figure 4 shows. To grow the business, those forces must be addressed.

## Grow the business

New managers who successfully skip steps 1 through 5 of the management price cycle will have a head start addressing these other factors. These factors tend to be a mix of the following.

**Market saturation** is a key impediment of mature businesses. It means that the company's products are easily available to nearly all the folks who value them.

When Chipotle had six stores, it could double its business by opening six more locations in new areas. Now that Chipotle has locations near much of the population, it saturated the market and growth is not easy to maintain. People can only eat so much.

**Emerging Competition.** Success breeds competition, and new competition consistently emerges offering slightly different versions of the same product. Sometimes these new versions start to win over customers. Blackberry's dominant position in the smartphone market was erased by the slightly different versions of smartphones from Apple.

**Substitutes** are less obvious because these are often not seen as viable competitors. For example, Kodak management discounted the idea that digital photos could be good substitutes to film and photo paper, because in their early days digital quality was low. It was easy to believe digital would stay niche, something for real estate agents, for example, but not good enough to capture family vacation memories. They

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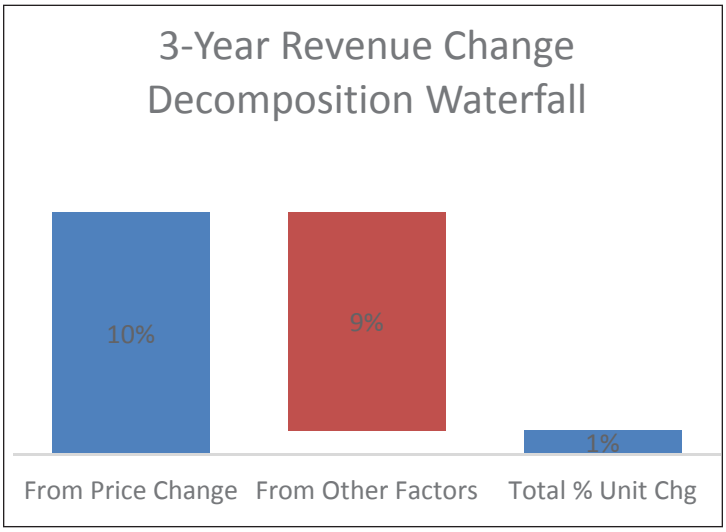
*Figure 4: Price Increases Were Just Enough to Offset the Losses from Other Factors*



didn't consider how technology advancements could change that. Few people can.

**Consumer preferences continuously evolve**. Twenty years ago, convenience meant making a stop at a nearby store to pick something up. Today, it means clicking a few images on your phone to have it delivered soon.

Gaining perspective on how these things are impacting the business is challenging because the information is messy, open to interpretation and nuanced. It's not as easy as looking at 3-year price and unit history table and concluding price is the problem.

Addressing these problems requires innovation, which has a 1-in-10 chance of paying off. Managers of mature businesses often make the mistake of trying too few innovations, maybe 1-2 per year. With a 1-in-10 chance of paying off, it can take years to find something that works with that approach. But, that also is a subject for another article.

If tasked with hiring managers for a mature business, I would look for candidates primed to skip the management price cycle and begin attacking the real problems on day one. ❖

# Agile Pricing for COVID-19: 10 Smart B2B Pricing Measures for the Crisis

**by Dr. Daniel Bornemann and Andreas Hudelmaier**

**Dr. Daniel Bornemann**

**Andreas Hudelmaier**

*The coronavirus crisis is affecting companies and the economy with full force. The consequences are multifaceted, from the increasing vulnerability of supply chains and the rising number of infections on production lines to added stress on sales teams, which must react to rapidly changing market events. Adding agility to their pricing processes and price models can help companies reduce the impact of the crisis, as the authors explain. Dr. Daniel Bornemann and Andreas Hudelmaier are Partners at Simon-Kucher & Partners. They can be reached via www.simon-kucher.com. The content and recommendations in this article are based on the situation at the time the article was originally published (July 7, 2020).*

The economy and numerous companies are currently contending with a variety of challenges created by the COVID-19 crisis. On the sales side, for example, firms are primarily having to deal with the extremely limited mobility of their sales teams. As a result, many companies are focusing on remote selling and digital channels, accelerating a trend started in the B2C sector affecting B2B sales even before the pandemic.

## Short-term price increases are a no-go, but cost increases can be passed on

Companies are having to address another problem created by the current situation: rapidly changing demand profiles. While certain sectors, such as areas of the pharmaceutical industry and mail order business, are experiencing a significant increase in demand from individual customer segments, other industries, such as tourism and automotive, are virtually collapsing. Sales teams need to actively make smart price and offer adjustments. Companies must refrain from implementing massive, short-term price increases at all costs to avoid giving off the impression they're exploiting their customers in emergency situations. However, it's necessary to pass on short-term cost increases to consumers, for example, to compensate increased logistics costs and consider changes in demand behavior in pricing over the medium term.

## Achieve success during the crisis with 10 pricing measures

Customers are becoming increasingly risk averse and more reluctant to invest. Companies can overcome this challenge too with smart pricing, adapting their offer structure and introducing alternative price models. Most importantly, this involves switching the model from CAPEX to OPEX. Price models that don't require high initial investments are preferable if liquidity allows it. In addition, companies should place a strong focus on the less volatile service business if this is possible in their current environment.

Clever pricing is the answer to numerous problems caused by the coronavirus crisis. Here are 10 pricing measures to enable your company to emerge from the crisis more successful than before. These measures can be divided into three main groups:

**Increase prices:**

1. Correct outliers and past mistakes
2. Implement scarcity pricing, where appropriate
3. Focus on highly differentiated products

**Change offer:**

4. Bundle offers and implement versioning
5. Introduce less expensive alternatives
6. Change the price model from CAPEX to OPEX
7. Revise surcharges and prices for services

**Cut prices:**

8. Only lower prices where it will have a positive effect
9. Grant clever discounts and link them with conditions
10. Reduce the risk for customers through contract modalities

To identify the measures that are right for your company, you should start by critically reviewing and evaluating your customer and product portfolios, which will ultimately enable you to develop a differentiated approach.

## First define targets, then identify measures

Before introducing any operational pricing measures, it's necessary to define a clear strategy. Particularly in the context of the current crisis, you can only determine the right means to achieve your strategic targets once you have clarified what these targets are. Targets relevant to pricing range from stronger sales, more market share, and better capacity utilization to higher profits and cash flow, with each objective having different implications for pricing.

It's important to keep in mind that the overall market tends to shrink in many areas during a crisis. In addition, a constant market share in a dwindling overall market often results in a reduction in sales. Companies aiming to keep their sales constant typically implement an aggressive pricing strategy. However, you should think carefully before taking such an approach, particularly in a crisis environment, as it's likely to trigger potential competitive reactions, increasing the risk of price wars and a fur-

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ther downward spiral.

### Use customer and product segmentation as the basis for pricing decisions

The crisis can affect areas of the product and customer portfolios in significantly different ways. Companies are strongly advised to conduct a targeted review and evaluation as the basis for a differentiated pricing approach. Customers can be pragmatically classified according to, for example, size, crisis winner or loser, and probability of default. Companies can also divide the product portfolio relatively easily according to sales relevance (fast-moving items), lifecycle, type of business (machine vs. service business), or degree of differentiation. This creates a good starting point for making pricing decisions in a pragmatic way.

Even if you know which pricing measures are right for your company, you shouldn't neglect to consider communication and implementation. It's important to provide sales teams with guidance on communication and prepare and support implementation in a targeted manner. By developing communication measures and arguments for changing prices centrally, you can significantly improve the stringency of your pricing measures and, as a result, the probability that they will succeed. ❖