••• pricing research

# Take charge of the fourth P

## Why marketing should own pricing

| By Oskar Toerneld and Robin de Rooij


snapshot

The authors outline five pricing-related mistakes and how to avoid them.

Setting the right price is one of the best ways to positively impact a company's bottom line. Yet price-setting is not always top-of-mind, nor is it owned by a single department within a company. This holds true across industries, whether it is consumer goods, health care, telecom, finance or technology. Sometimes marketing takes responsibility for pricing, while other times finance takes on the task. Often, we find there exists no clear pricing strategy at all in companies and thus, no clear ownership of pricing responsibility.

We're all familiar with the four Ps of marketing: product, place, promotion and price. For many of us, it seems natural for marketing to own or at least be involved in the first three but pricing is usually left to other functions. Maybe it's because the first three are a more natural fit for someone with a creative marketing background, while price is seen as more quantitative in nature – more fitting for someone who loves analyzing spreadsheets. Maybe this is the reason it often falls under finance to make decisions on pricing. However, for a pricing strategy to make sense, it has to work for consumers or they will stop buying the product. When this happens, it doesn't matter if a theoretical profit model is being satisfied – focusing on consumers should always drive our decisions, regardless of which P we're talking about. There are three big reasons why marketing and marketing research should get involved and take ownership of that last P of marketing.

1. Market research has the pulse of the market, particularly in terms of how to talk to consumers. Pricing is part of brand communication and it has to be in sync with the rest of the message. We can't communicate luxury in our advertising and price at a discount or, perhaps even more risky, communicate value and charge a premium. While the temptation might be to let profitability restrictions dictate how the product is priced, it's important to also take into account how consumers would react to a price or change in price. Ad hoc research is often necessary to gauge how consumers might respond when launching new products or when predicting what

quirks.com/articles/2017/20170410.aspx

might happen to consumer interest when you increase price. While mark-ups and profit margins might help calculate theoretical profitability, it doesn't say anything about whether consumers will continue to buy your product or choose to switch to a better-priced competitor.

2. Building on the first point, more retail sales are moving to online and the online environment is changing a lot faster than traditional brick and mortar. All decisions have to be made quicker, including how products are being priced. Digital and real-time conditions are driving real-time pricing moves. Pricing decisions should be made by the people who observe and understand the digital consumer and no one understands this consumer better than marketing. Access to big data, better and more intuitive analytics tools and marketing's ownership of other monitoring tools such as Web traffic and social media means that marketing is able to constantly tap into the experiences of consumers.

3. Finally, marketing becomes a team of heroes, as taking control of pricing will turn marketing into a profit center. All the other Ps require risks and often fail to yield high returns. Optimized pricing can make a tremendous positive impact, especially when you're in a highly competitive market. Big data analysis has become the backbone of contemporary pricing over the last five years. That said, modeling prices based on historic data alone is not sufficient. Customer opinions still matter and these can be obtained through any number of means, such as customer panels, surveys and even mobile phone apps. Combining traditional and contemporary pricing methods will yield insights that represent the best of both worlds.

It is of course important to tap into the expertise of all the functions in a company and it is important to do the back-end calculations to ensure that products are profitable at the price at which they're being sold. There is a solid case to be made for having marketing take the lead in order to drive a pricing strategy that puts consumers first in order to drive an overall cohesive strategy.

## Markets have changed

A product portfolio can contain many items addressing a diverse collection of consumer needs. Some products perform well, others less so. Many times, markets have changed since a portfolio was put together and the strategy was outlined. And pricing changes have likely occurred in the category – perhaps driven by changes in the cost of goods.

Because markets are constantly changing, brands are reevaluating constantly, adapting portfolio strategies to maintain financial goals and positioning. Portfolio adjustments can have short-term and long-term consequences, so addressing all options, along with the pros and cons to each, is necessary to finding the best option. Marketers have a unique point of view within the organization and their insight is absolutely necessary for making smart pricing decisions. Here are some common strategic pitfalls that marketers can help brands avoid making:

**Mistake #1: Becoming over-reliant on trade promotion.** Trade promotion is one of the largest drivers of volume in most fast-moving consumer goods (FMCG) categories. In moderation, trade can be incredibly useful. It can be quickly activated (especially temporary price reductions) and it often drives significant volume peaks. It is very visible and because it is so close to the point of sale, it creates the feeling of a strong link between execution and sales. However, there are risks.

Consumers may adjust to a sustained promotion price and expect it to continue, causing some to revolt when prices return to "normal." Trade volume can be much less incremental than it appears at first. The promo product may see a strong lift in sales while being promoted but it often comes by stealing volume from other products from within the same portfolio. This can downtrade consumers from higher-priced tiers and discourage them from returning. Another deceiving source of lift may come from consumers stocking up on sale items, driving a short-term bump that takes away from future volume.

Addiction to pricing promotions can train consumers not to purchase until the product is on deal. The promotion becomes the de facto price. While it's difficult to predict the long-term effect of promotions using models, experienced marketers know that it can bite brands down the road.

**Mistake #2: Cutting off the incremental assortment tail.** Removing poorly-performing products from a portfolio makes room for new and innovative products on the shelf. However, the temptation is often to define performance by sales rate and overlook how incremental the product is to the rest of the portfolio.

It's usually a better strategy to delist the SKUs whose volume is most likely to flow back to the rest of the portfolio. For example, if you have two very similar products in your portfolio, delisting one of them is likely to shift sales to the other one, the assumption being that both products fulfill the needs of the same consumers.

Most marketers are cognizant of the fact that adding a close-in line extension doesn't gain a new audience; it largely cannibalizes the base business. What some overlook, however, is that incrementality is equally at play when delisting. Delisting a close-in line extension would have most customers flowing back to the base business. On the other hand, discontinuing a small but incremental platform would be costly and may result in losing consumers to competitors or from the category entirely.

**Mistake #3: Ignoring price thresholds.** A brand risks losing sales when a price is raised and when that price crosses a certain threshold. This psychological barrier is why many brands price at $1.99 rather than $2.00. This is relatively straightforward and intuitive to marketers. However, it is easy to overlook the context of competitive pricing. There is absolute price and then there is your price compared to your competitors'; the difference is the "gap."

No brand exists in a vacuum. In order for it to make sense for the retailer to execute a strategy, one has to consider the entire category not just a single brand alone. If a brand is considering implementing a new strategy, it must consider the impact that it leaves on the overall category. For example, increasing the price of a top seller might drive margin while sacrificing some unit sales. Increasing price too much might actually lead to fewer consumers even walking down the aisle, hurting sales for the entire category. Before implementing a strategy, take a step back and consider the potential side effects.

**Mistake #4: Forgetting who stands between you and your customer.** CPG manufacturers often invest a great deal of time, money and resources building smart portfolio optimization and then fail to consider their retailers' priorities. When a manufacturer does pricing research, it too often thinks of the end customer as the customer – forgetting that the retailer is a key stakeholder standing in between. When that happens, you've just spent a lot of time strategizing around a model that is ultimately irrelevant.

A brand must consider how the changes to its portfolio impact the overall category for the retailer. If one is able to create a scenario that benefits both one's own franchise as well as the overall category, it is more likely the retailer will implement your suggestion.

This is especially challenging in developing markets, where distribution can be highly fragmented, with a lot privately-owned mini-market or provision stores. In this case, the brand needs to anticipate how retailers are likely to set their prices based on the price they pay. Keeping in mind that typical pricing strategies of small retailers may be to offer products at easy, rounded price points. A seemingly small price increase to the retailer at the wrong time can result in unintended drastic price increases to the consumer.

**Mistake #5: Changing size without really considering value.** In the eyes of the consumer, less is usually less. But sometimes it feels like more. Conventional wisdom tells us that any downsize without lowering price can leave people feel short-changed. But sometimes a profit-enhancing "downsize" can be framed as beneficial to the consumer, such as with convenience sizes.

Downsizing without considering the price/value proposition can lead to unexpected consumer backlash, especially if the change is visibly noticeable. It's tempting to downsize in the hope that it's less obvious to consumers than a price change. It also allows the product to stay within its promoted price group, simplifying implementation. At best, you risk consumers noticing the loss in value that comes from getting less product for the same price. At worst, customers may feel like they've been cheated.

However, if the brand is able to downsize while adding some other value to the consumer experience, customers may be happy to pay extra for the added benefits. Within the snacking category, convenience packs often carry a higher price-per-pound than their corresponding base items. However, they provide benefits such as being easier to pack in a lunch bag or maintaining freshness for longer, so consumers happily pay the premium.

This phenomenon is not limited to only the snack foods industry; coffee pods and devices are a popular trend despite costing many times more per serving than ordinary coffee grounds. The significant convenience factor of having a hot cup of coffee at the push of a button helps to justify the price differential.

For a pricing strategy to make sense, it has to work for consumers. The best way to ensure success is to make sure marketing has a seat at the table when portfolio decisions are made.

Oskar Toerneld is VP pricing and portfolio solutions at research company SKIM, Hoboken, N.J. He can be reached at o.toerneld@skimgroup.com. Based in Singapore, Robin de Rooij is director Asia Pacific at SKIM. He can be reached at r.derooij@skimgroup.com.