

# Six Keys for Successful Price Planning in a Shaken Economy

Proven approaches and best practice information for Brand Managers, Market Researchers and key pricing stakeholders

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## Overview

The economic downturn continues to put stress on consumers, resulting in accelerating changes in basic purchasing patterns. An important part of the overall equation for consumers is the relationship between price and value. As consumers develop new value systems, how should manufacturers and retailers view and manage the other side of the equation—price? If your business models and pricing strategies pre-date recent changes in the economy and consumer behavior, you could be headed for trouble. Perhaps now more than ever, pricing can serve as marketing's most powerful lever to drive performance. We all realize we're dealing with unprecedented circumstances, and need to act, but what are the guiding principles for successful price planning? These Six Keys for Successful Price Planning provide a roadmap for marketers to navigate through our new pricing environment.

## The New Pricing Environment

The environment in which your pricing strategy operates has changed significantly due to the economic downturn. Fluctuating prices and costs, changes in consumer behavior, and increased or decreased price sensitivity may impact the effectiveness of your pricing strategy. Let's take a closer look at three forces defining the new pricing environment:

- Fluctuating Prices & Costs
- Changes in Consumer Behavior
- Price Elasticity

## Fluctuating Prices and Costs

Inflation followed by recession. A commodity bubble drove shelf prices up, and when the bubble burst, shelf prices were left in limbo. Manufacturers are trying to hold on to price increases, retailers are pressuring for price rollbacks and private label is now frequently a price leader. For manufacturers who have locked in long-term futures contracts, this presents a difficult challenge since prices can't be lowered to match private label price cuts. And given the volatility in commodity markets, costs might go back up, reversing the whole process again.

Pricing is often one of the most powerful and under-managed levers companies have to drive performance.

## Changes in Consumer Behavior

In response to the recession, consumers are changing their definition of "value." Changes in shopper buying behavior are a direct result of consumers' new value paradigm, driving the macro changes taking place across the economy. For the consumer goods industry, this has meant dramatic swings in category trends that have swamped the inflationary price increase taken a year ago.

Tighter budgets are driving a fundamental resetting of household priorities—feeding the family is first and foremost while luxuries are expendable. And everything in between is being re-evaluated. Purchases across all categories are being reexamined with an eye toward necessity and basic value. For some, it means eating out less often and cooking at home, eating more chicken, burgers and pasta and less steak. Some are shifting to lower price tiers within categories, including private label brands. Consumers' new definition of value is fundamentally resetting the relationship between value and price.

Reviewing pricing annually or sporadically is no longer viable in today's rapidly evolving environment.

## Is Price Elasticity Changing?

Consumers are changing their definition of value at a macro-level. They're trading down across categories, moving from premium brands to less expensive alternatives and switching outlets for lower price formats. However, this does not necessarily mean price elasticity has changed. In fact, Nielsen research across 50 major categories shows that price elasticity (on average) is only slightly higher since the recession began. Items in some categories have become more price-sensitive and some less.

You can ensure your pricing strategy considers the changes we're experiencing with fluctuating prices and costs, changes in consumer behavior, and price elasticity by following the six keys to successful price planning.

## Six Keys for Successful Price Planning

### 1. Plan Pricing from Two Starting Points

Just as careful planning was necessary for the two links of the transcontinental railroad to link up exactly at Promontory, Utah, successful price planning begins at two distant starting points and meets in the middle at the shelf—and satisfies all constituents along the way.

Point one is supply, and point two is demand. Considerations along the supply side begin with cost of raw materials and packaging and proceed to labor costs, transportation costs, profit requirements and plant capacity needs. Starting from the demand side, marketers must understand consumer price elasticity, both

for the product in question and its price relative to competitors. The point where supply and demand must meet seamlessly is on shelf, where retailer needs must be satisfied to achieve success.

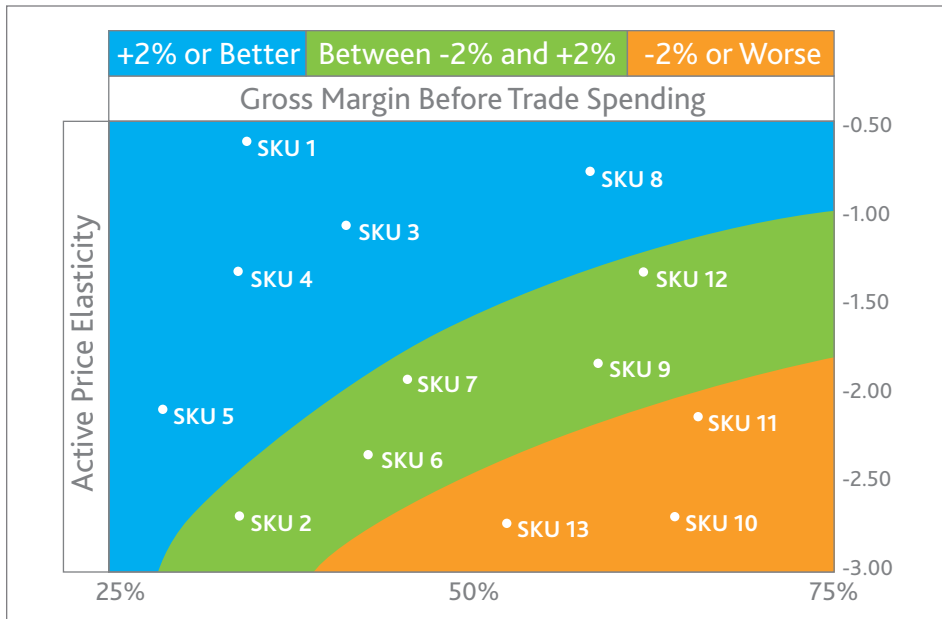
### 2. Put in Place an Ongoing and Flexible Process

Many manufacturers used to review pricing annually—some allowing years to go by without increasing prices. This approach is no longer viable in today's rapidly evolving environment. Driven by a constantly updated cost-of-goods forecast and monitoring of the competitive pricing landscape, price planning must now include constant reviews and revisions. Commodity cost volatility means speed and flexibility are more important than ever. Volatility is expected to continue through 2009 and into 2010, and changing consumer shopping behavior adds to the complexity. With supply considerations and demand considerations in an ongoing state of flux, the optimal pricing plan is often a moving target—and more reason to have in place a flexible and ongoing planning process.

### 3. Take a Portfolio Approach

Every company has broad strategic goals, and these goals cascade down to the pricing strategy for each brand. Strategic goals and the pricing strategy for each brand must align to achieve overall corporate goals. Each brand has its own pricing considerations—different strategic roles, margin requirements, price elasticities, competitive situations and promotion environments. Trade-offs will be necessary across brands, depending on the considerations specific to the brand. Each brand's unique factors and its role in the corporate portfolio play an important role in determining the optimal pricing strategy.

## Gross Profit Grid—5% Price Increase



- What is the brand's role in the corporate portfolio?
- What pricing power does each brand have? Is the brand a leader or follower?
- What are minimum turn rate requirements?
- How do regular price and promoted price intersect?
- What are key price thresholds and gaps versus competitors?

*Nielsen Portfolio Pricing Profit Grid. By mapping all of your products on this grid (by elasticity and gross margin), you can identify pricing opportunities across your portfolio. Price elasticity and gross margin, factored together, predict the impact on gross profit of price changes across all items. Products in the blue (top) band should consider a price increase. Products in the green (lower) band should not raise price (and could consider a price rollback). Products in the grey band will see only minor changes to gross profit with a price change.*

### 4. Hard Metrics Must Drive the Planning Process

A successful pricing strategy cannot be based on intuition or anecdotal information. Hard metrics are necessary for a portfolio planning process, and must drive the process from beginning to end. And metrics must be consistent across all brands/sizes. Key metrics to observe include:

- Current shelf prices (regular and promoted) of all key internal and external items (must be understood in each planning geography; including any recent price changes)
- Current and expected cost of goods for each brand/size
- Current list price
- Current gross margin before trade spending
- Most recent contribution to overall corporate sales and profits
- Most recent annual trade spending by channel and region or key customer
- Competitive prices in each channel and region or key customer

### 5. Establish Key Performance Indicators and Milestones

Any ongoing and flexible plan must incorporate KPIs and milestones for all key brands/sizes to evaluate performance on a regular basis and make adjustments accordingly. Scorecards should be created uniformly and communicated to all internal stakeholders. As actual execution and performance varies from initial KPI goals, plans and goals must be modified. Managers must maintain an up-to-date understanding of execution versus plan, and act accordingly to improve execution or modify the pricing plan.

### 6. Endorse and Enforce

In order to be effective, the portfolio pricing process must be endorsed by the highest levels of management and enforced across the organization. This may be the single most important of the six keys—without it, each part of the company will likely fall back on their old disparate planning processes. By definition, a portfolio approach will mean that some brands must align their plans to portfolio needs. Old habits die hard, so strong leadership and communication is mandatory.

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## Putting the Six Keys into Action

Effectively executing the six keys for successful pricing strategy requires three fundamental competencies: the right data, the right analytics and the right expertise.

**The right data:** Analysis of trended sales and pricing data should be conducted to monitor both regular and promoted pricing at the national, market and retailer levels. Price positioning must be understood by category and segment. Purchase behaviors should be understood for all key segments of your consumer audience. KPIs must be set—typically including volume, share, distribution, regular price, promoted price, baseline trends, etc.

**The right analytics:** Combining the right modeling techniques with accurate and robust data inputs enables the marketer to simulate scenarios and better predict consumer responses. For existing brands/sizes, modeling at the store-week level is ideal and should include competitive cross-effects. Models also should include regular price, promoted price and promotion types and should be run for each retail channel and planning geography. From a portfolio planning perspective, model approaches and timing should align across as much of the organization as is practical. For new products or scenarios outside historical parameters, consumer interview-based conjoint analysis is typically run to understand the impact of price. Other custom approaches can be designed as needed.

**The right expertise:** Identifying and integrating optimal strategies for regular and promotional pricing also requires

in-depth knowledge of data, analytics, and the consumer goods industry. Partner with a firm that can offer extensive experience and expertise in pricing analyses across different industries and geographic locations. This experience will enable you to solve pricing issues across a broad spectrum, and help determine the best pricing strategies to make tactical, precise decisions and achieve profitable growth.

## Conclusion

In a time when consumers are fundamentally resetting their priorities, values and behaviors and when commodity prices have fluctuated wildly, it is more important than ever to constantly review pricing plans and the results of pricing actions. Each manufacturer and brand faces a unique set of situational factors that are in an ongoing state of flux due to economic uncertainties. Because of all of this, strategic price planning across the portfolio is a complex undertaking. Pricing is perhaps the single most powerful tool available to marketers, so the payoff is well worth the effort. To optimize your price planning process and create a competitive advantage, be sure your pricing strategy follows the six keys to success:

- 1 Plan Pricing from Two Starting Points
- 2 Put in Place an Ongoing and Flexible Process
- 3 Take a Portfolio Approach
- 4 Hard Metrics Must Drive the Planning Process
- 5 Establish KPIs
- 6 Endorse and Enforce

## About The Nielsen Pricing and Sales Modeling Expertise Area

The Nielsen Company's pricing and sales modeling solutions can help you improve overall ROI through price optimization and promotion strategies. We bring deep experience in pricing strategy, with decades of experience and broad and diverse set of tools and proven modeling techniques. Nielsen tracks purchasing behaviors in 250,000 households in 27 countries, and measures 40 billion retail product transactions each year. We've conducted more than 20,000 pricing analyses globally across 30 different industries.

Above all else, our ongoing commitment is to align our business with our clients' needs to ensure they have a competitive edge in an expanding global economy.

## About The Nielsen Company

The Nielsen Company is a global information and media company with leading market positions in marketing and consumer information, television and other media measurement, online intelligence, mobile measurement, trade shows and business publications (*Billboard*, *The Hollywood Reporter*, and *Adweek*). The privately held company is active in more than 100 countries, with headquarters in New York, USA. For more information, please visit [www.nielsen.com](http://www.nielsen.com).

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