

2016 Industry Pricing Study

re[↻]set to Realize Value

A Strategic Pricing Approach for
Manufacturers and Retailers

CADENT
— Consulting Group —

44 Old Ridgefield Road, Ste. 235
Wilton, CT 06897

203-529-3701
www.cadentcg.com

1 Northfield Plaza, Ste. 300
Northfield, IL 60093

Who We Are

Cadent Consulting Group, established by the founders and senior leadership team from Cannondale Associates and Kantar Retail, is a marketing and sales management consulting firm serving the Consumer Packaged Goods (CPG), Retail and Healthcare industries. We offer a broad array of information, insights, capabilities and expertise across the manufacturer, retailer and shopper spectrums.

Our Mission

Our Mission at Cadent is to help our clients drive growth and profitability while optimizing go-to-market investment and organizational productivity. We aim to translate insights into competitive advantage for our clients.



Our History in Industry Research

Cadent's Management Team, while at Cannondale Associates, published the first Category Management/Leadership Industry Study in 1994, followed by the Trade Promotion Industry Study in 1995 and the annual PowerRanking® Study in 1997. Twenty years of experience in category management, trade promotion and industry best practices has deepened our knowledge and expertise across manufacturers, retailers and consumers/shoppers.

We constantly seek to better understand our client needs at large. Cadent published a study of Manufacturer Spending in 2014, followed by a study on the Path to Purchase in 2015. In 2016, given industry interest in Revenue Management, we focused this year's study on Strategic Pricing.

Executive Summary

Pricing is an Industry Imperative

Growing sales and profit through Revenue Management is a recent, common imperative across consumer packaged goods manufacturers. Cadent has increasingly focused with clients in this area, and we set out to understand varying approaches in an industry survey to Manufacturers and Retailers. This research underscores the importance of Strategic Pricing, especially for Retailers.

96% of Retailers identified pricing as the number one priority for Manufacturers. The percentage of Manufacturers prioritizing pricing fell far below this number by over 25 percentage points.

Current Pricing Approaches Fall Short With Retailers

Survey findings also indicate:

Only 30% of pricing recommendations from a Manufacturer are executed by the Retailer; fewer than half of Retailers understand Manufacturer pricing strategies.

Pricing capability for many organizations tends to be an executional, rather than strategic, exercise focused on closing price gaps versus competition or elasticity-based calculations. This approach falls short with Retailers, who seek pricing based on consumer insights and innovation. As a result, Manufacturers often focus their revenue growth efforts on strategies that Retailers do not implement.

Retailers indicated Consumer Trends to be the most important consideration for pricing strategy; Manufacturers did not include it within their top 10 inputs for strategy development.

The Solution: Establish Revenue Management on a Value-Based Foundation

In this environment, there is an opportunity to “Reset to Realize Value.” This process requires understanding Consumer Value Drivers – the benefits that drive the most value to the product bundle. These are often category specific articulations of consumer macro trends, such as Convenience and Health & Wellness. Once identified, Value Drivers can inform product and pricing strategies for future long-term value realization and Retailer alignment. In this study, Cadent proposes that Revenue Management needs to be driven by Value-Based Management, where marketers plan to capture and create value across the strategic marketing mix.

It's Time to Reset the Value Equation

Over the past 5 years, we've seen companies centrally focused on Productivity, as a means to deliver profitability in a marketplace challenged for growth. The term Zero Based Budgeting, the practice of re-establishing spending baselines, became common vernacular

“*These brands aren't tired, but what consumers value about them has changed.*”
- Leading CPG Retailer

as organizations either (1) internally adopted the approach or (2) were forced to adopt the approach as part of acquisition. The latter case reflects companies that could not evolve quickly enough to efficiency; 2015 was a history making year for mergers and acquisitions in corporate America.

For companies that were able to effectively re-evaluate processes and resource allocation to survive the M&A fall-out, the question becomes **“What's Next for Growth and Profitability?”**

The challenge for Revenue Management groups is much more strategic in nature, beyond the tactical opportunities of recent focus. It requires organizations to revisit the fundamental principles of Strategic Pricing: the consumer value proposition and willingness to pay.

The opportunity to **“RESET”** value equations is not simple or easy. CPG manufacturer product portfolios are often overwhelmed with SKU offerings and product groups. A change in pricing can impact all elements of the retail marketing mix: product, assortment, shelving and promotion.

Cadent set out to understand approaches to the value equation. We sent out a survey to Manufacturers and Retailers to gain a better understanding on key needs, challenges and perspectives, including:

- > How important is pricing?
- > Does consumer understanding factor into strategy development?
- > How satisfied are Manufacturers and Retailers with the articulation and execution of pricing strategies?
- > How well do Manufacturers and Retailers collaborate on value opportunities?
- > What are the biggest challenges?

Here's what we learned >

96% of Retailers: Pricing is THE Number One Priority

There is no question that Pricing is the right area of focus. In fact, “Getting price right is THE #1 priority” for 96% of Retailers to realize value, +26 pts higher than Manufacturers. For Manufacturers, pricing falls second in priority to innovation and of equal importance to other efforts, including cost management and investment optimization.

RETAILER	MANUFACTURER
“How important are the following manufacturer initiatives to realizing value?”	“How does your organization prioritize the following to realize value?”
Top 2 Box	Top 2 Box



Manufacturers Are Missing the Most Important Element of an Effective Pricing Strategy: Consumer Trends

Even more revealing, Manufacturers and Retailers **prioritize different elements** of effective pricing strategy. A comparison of perspectives on key elements indicates that compared to Retailers, Manufacturers under-value consumer trends in developing pricing strategies.

RETAILER	MANUFACTURER
<p>“What should manufacturers present as part of a persuasive pricing recommendation?” Top 5</p>	<p>“How often do you consider the following when developing pricing strategy at your organization?” Top 5</p>
<ul style="list-style-type: none"> 1 Macro Consumer Trends 2 Existing Key Price Points 3 Competitive Pricing 4 Promotion Plans 5 Strategic Objectives 	<ul style="list-style-type: none"> 1 Competitive Pricing 2 Existing Key Price Points 3 Profit Requirements 4 Sales Requirements 5 Strategic Objectives ⋮ 13 Macro Consumer Trends



The Retailer focus on macro consumer trends is eye-opening. A recent conversation with the CEO of a major food manufacturer underscores that pricing strategies have lost touch with the consumer:

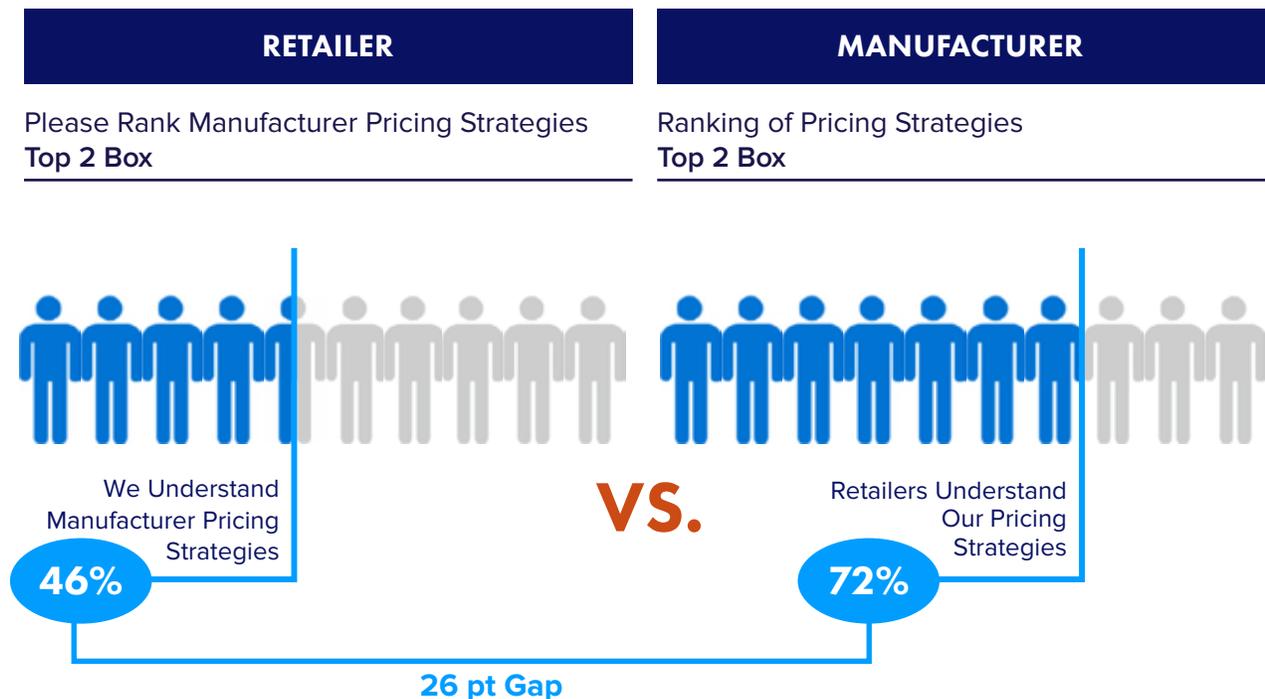
“*We have plenty of people analyzing price gaps, but I feel like we are chasing our tail, optimizing against ourselves... we don't have the discipline to determine how to do this differently. We need a new strategic approach to pricing.*
– Major Food Manufacturer, CEO”

Retailers: “We Don’t Understand Manufacturer Pricing Strategies”

In our research, we asked Retailers, “What makes a manufacturer best in class at pricing strategy?” Two representative retailer responses are below:



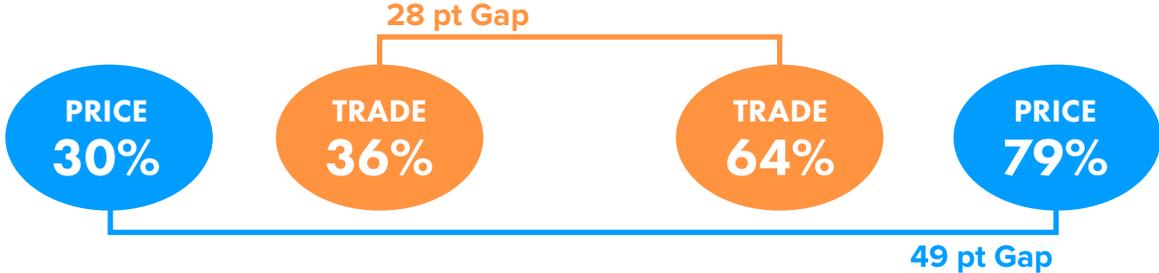
In reality, Retailers have a hard time understanding Manufacturer pricing communication:



Manufacturer Strategies Aren't Being Executed

The wide disparity between Manufacturers and Retailers on how to manage the value equation becomes even more evident in the translation from strategy to execution. It should be sobering for Manufacturers to realize the feedback from Retailers on their approach to pricing is quite different from a self-assessment.

RETAILER	MANUFACTURER
Please rank how often your organization follows manufacturer recommendations on price/trade Top 2 Box	Please rank the frequency with which retailers implement your recommendations Top 2 Box



The Retailer Tends to Lower Price

The retail landscape has intensified as stores look to heighten the shopping experience for consumers, while providing lower prices.

“Winning approaches have an everyday focus on price and segmented strategies on price at the shelf.”
– Retailer response

“We have opportunities in price. And whilst we have pockets of leadership, in more competitive markets, our gain is too small.”
Greg Foran, Walmart's Head of U.S. Operations - April 2015

In fact, Retailers are 5X more aggressive in taking pricing decreases than Manufacturers perceive:

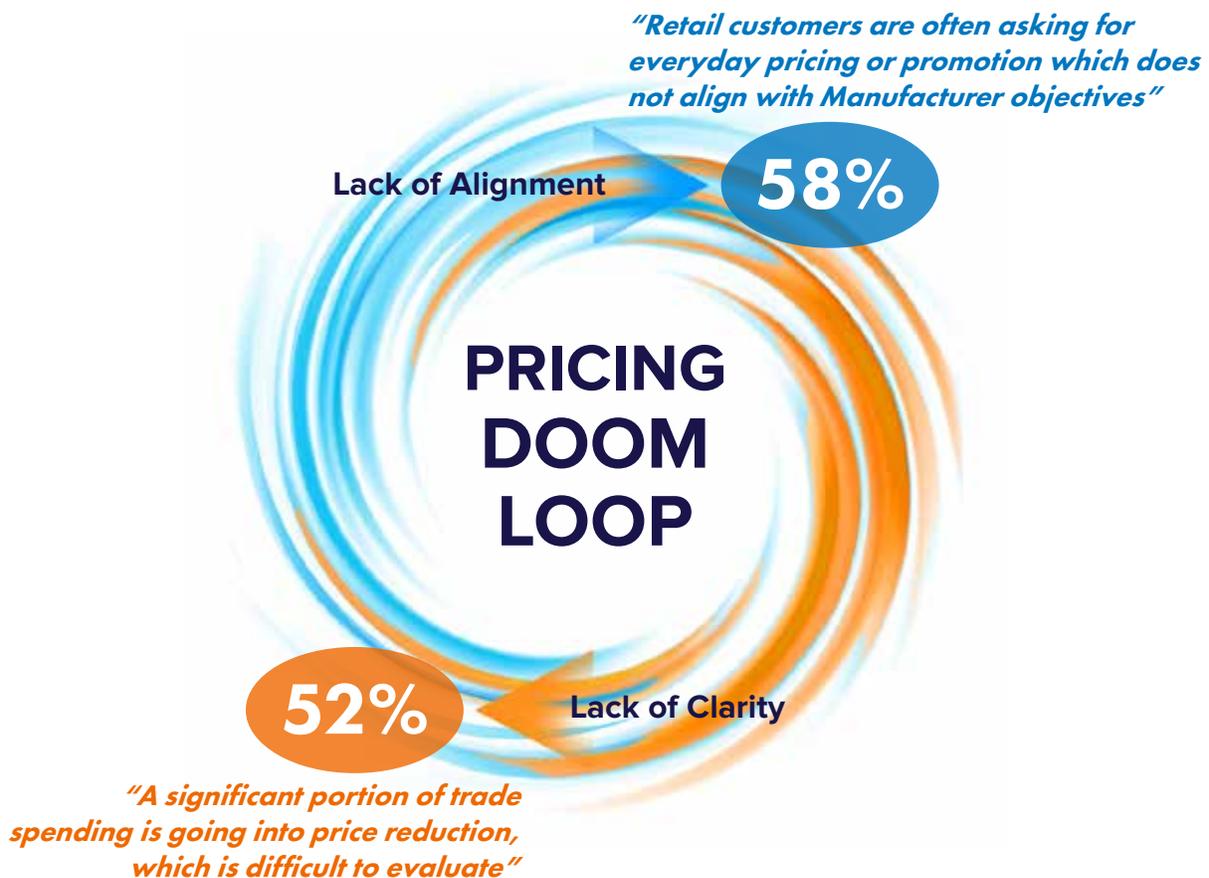


Manufacturers Are Trapped in the “Pricing Doom Loop”

There are two prevailing tendencies:

- (1) lack of alignment on pricing strategy and execution
- (2) the retailer bias to lower price

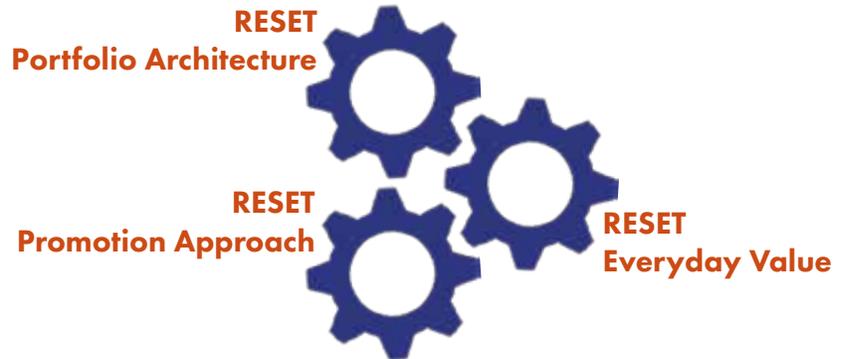
These tendencies converge into what we call the “Pricing Doom Loop” for Manufacturers – lowering everyday pricing via trade spending, which is difficult to evaluate:



We call this the “Doom Loop” as Manufacturers tend to spiral downward, resulting in a highly reactive approach to pricing with the Retailer. This can become very detrimental, particularly if Manufacturers do not have a sense of where consumers are willing to pay for their products, or – said differently, protect the value drivers within their business.

The Solution: Reset to Realize Value

There is a way for manufacturers to break the Pricing Doom Loop. That solution, **Reset to Realize Value**, consists of three iterative steps:



RESET Portfolio Architecture

This step is typically overlooked by many Manufacturers, because marketers are focused on optimizing at a tactical level. This includes minimizing unproductive events, targeting price points, closing competitive gaps at the account level, and resizing a product in order to hit a critical threshold.

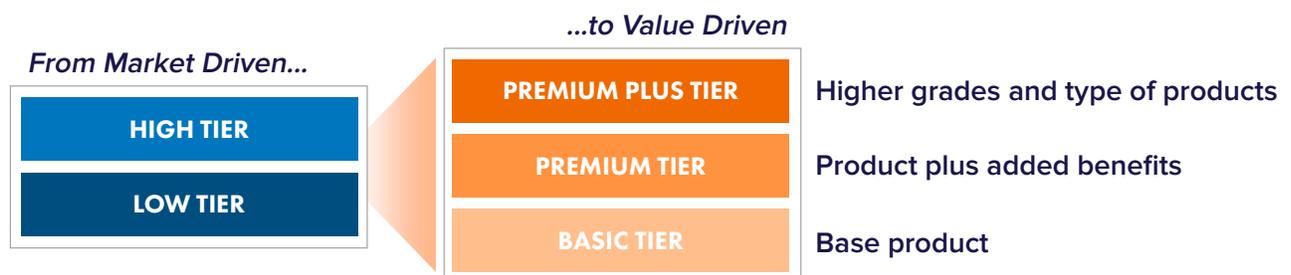
Pricing strategies are often missing the Consumer.

A recent case study reflects an old-school philosophy implemented by many suppliers today: hit the key price points in the marketplace. Items were assigned on a cost-plus basis to one of two price points which enabled scale promotions across a highly complex portfolio containing over 500 SKUs.

Identifying consumer value drivers unlocked profitability for the business.

Value Drivers, key benefits with high pricing power, were identified as opportunities and led to a new approach on the number of tiers, based on the type of product input. More importantly, the benefit platform enabled the business to develop innovation opportunities to drive overall category value and pricing upward.

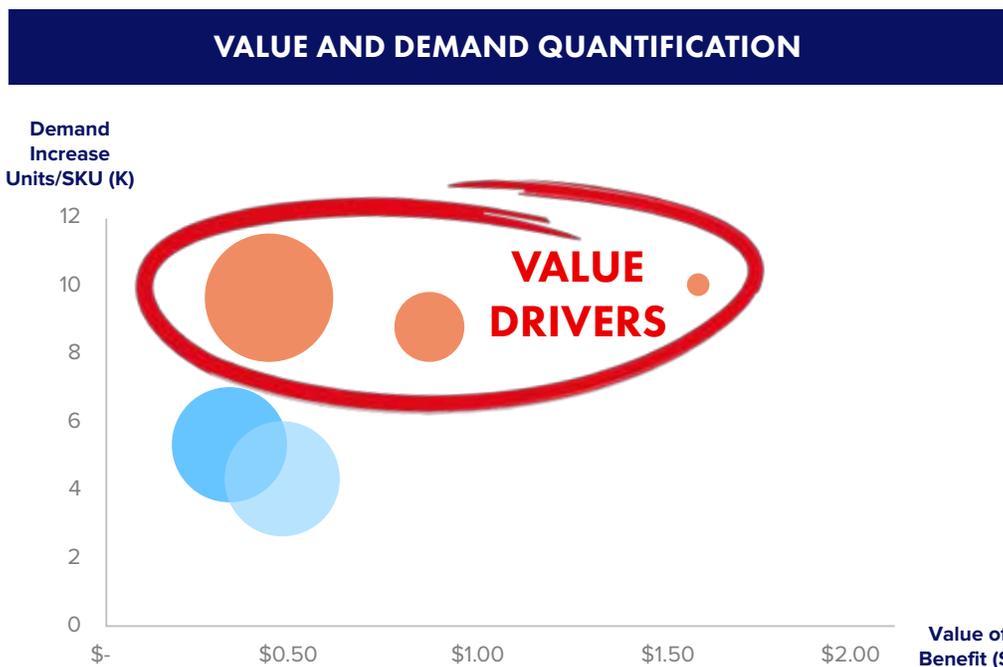
The result was an incremental realization of 16% in profit for the business.



The Solution: Reset to Realize Value

RESET Everyday Value

New definitions of portfolio groupings require an evaluation of everyday value. Has your organization analyzed the value of a product benefit to consumers versus their willingness to pay? How much can product benefits command?



Targeted market research and analytical methods are useful here to identify and determine pricing opportunities, as well as best ways to pursue. At Cadent, the optimal method integrates both analytical modeling as well as subsequent targeted research.

The opportunity is to identify benefits which command a premium, and to use these “Value Drivers” in a strategic framework to create portfolio value. These pricing platforms articulate pricing strategy to the retailer, thereby resetting retailer value and other elements of retail execution, such as promotion and assortment. In short:

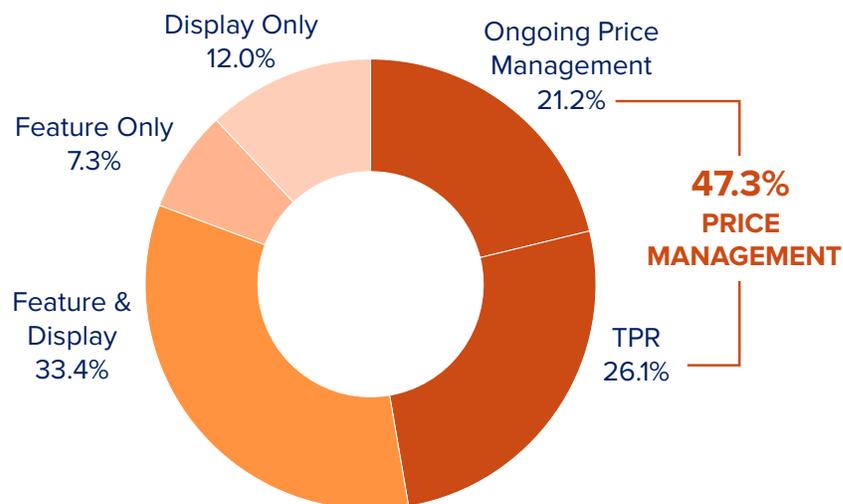
Figure out value drivers for your business to link consumer strategy to retail execution.

The Solution: Reset to Realize Value

RESET Promotion Approach

A recent Cadent survey on trade spending and investment areas revealed that about 50% of funding is used to lower prices to the consumer.

MANUFACTURER – TRADE PROMOTION SPENDING BY VEHICLE 2014



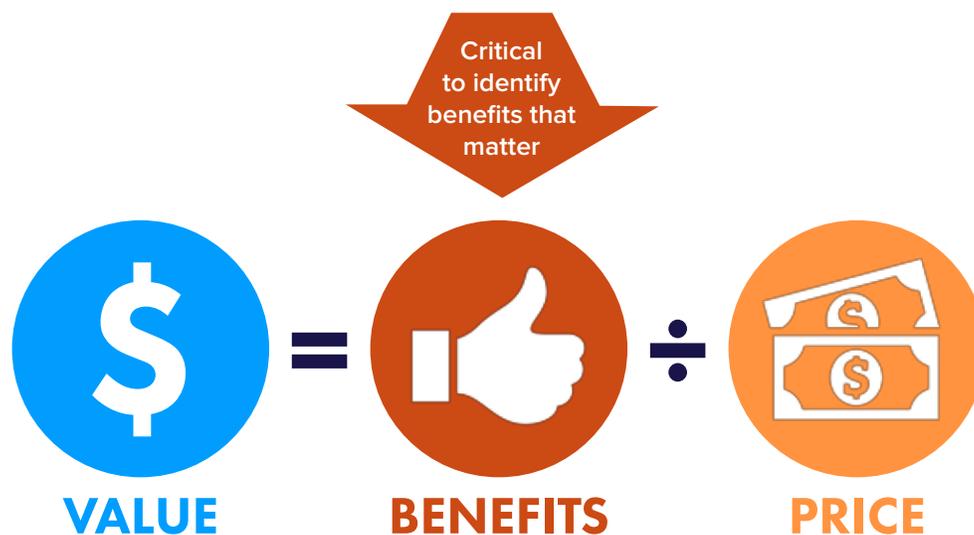
Resetting Portfolio architecture and Everyday Pricing also enables a Reset on Promotion. Once Value Drivers have been established to clarify a strategic approach to portfolio and everyday pricing, they can be leveraged to drive promotion optimization.

Promotion approaches must be evaluated in terms of effectiveness and productivity, but understanding Value Drivers can also bring clarity to promotion strategy. Marketers have often resorted to promotional reliance to build share, resulting in further pricing and value dilution on products where consumers are willing to pay more.

A Reset on Product Groupings, Everyday Pricing and Promotion provides marketers with a comprehensive approach to value and the ability to differentiate true assets within the business. Importantly, it allows the marketer to plan for long-term value capture and creation by posing the following questions: Which products can command more value? How can this value be unlocked? How does product or commercial innovation support the portfolio vision?

The Shift to Value Based Management is Transformational

For Marketing and Sales managers, pricing can be the Achilles heel, or it can be the keystone. Manufacturers that integrate value based pricing into Revenue Management will ultimately succeed. The approach forces Manufacturers to evaluate all elements of the strategic marketing mix relative to the value proposition:



The result of a Reset initiative can be a call to action on innovation, a more disciplined approach to long-term planning, a realization for assortment rationalization, or urgency to re-evaluate promotion investment. In particular, organizations which undertake the Reset journey adopt a more holistic approach to value by integrating innovation with long range pricing opportunities. This influences organizational culture by changing corporate processes, creating alignment across functions, increasing risk tolerance and improving retail capability.

Start With These 6 Key Questions

In conclusion, we challenge the corporate marketplace to begin with the following questions, stemming from the research shared throughout this paper:

- 1 Is your organization focused enough on pricing?
- 2 Does Revenue Management leverage understanding of consumer trends? Is there a strategic process?
- 3 What are the category value drivers for your business?
- 4 Does your pricing strategy make sense to the retailer? Do they agree?
- 5 How much spending is in price reduction? Are price points and portfolio architecture aligned with product value?
- 6 What does pricing execution look like, and is there a reliable system for tracking compliance?

Answers to the above will provide direction on where to begin to Reset, to Realize Value.