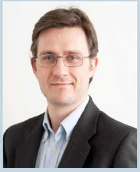
Ask the expert

Mark Billige is Managing Partner of the Simon-Kucher London office. **Christian Atherton,** Director at Simon-Kucher interviews him regarding why Private Equity isn't giving pricing the attention that it deserves as a value creation lever.

CA: *Hi Mark, to start the ball rolling, what advantages do you think pricing offers as compared to the other value creation levers available to Private Equity?*

MB: Well, the simple answer is that it's by far and away your most important profit lever. Let's say you have a business with 10% Operating Income and variable and fixed costs pretty much of equal value. If you focus on improving either of those costs through expensive and risky cost programmes and achieve a 3% reduction you will end up with around a 14% improvement in Operating Income.

But if you achieve a 3% increase in price you'll get a 33% improvement in Operating Income. That's double the improvement with arguably much lower investment and execution risk in most cases.

CA: *OK, so granted it's a powerful profit lever, but what makes you think Private Equity is not focusing on this enough?*

MB: In my experience, pricing has typically been covered in a due diligence as a potential risk, but hardly ever as a significant opportunity for value creation. In the value creation plans I've seen it is typically found as a 'quick win' with relatively little thought and time dedicated to it and a correspondingly low value attached to it.

CA: *So why is it that not enough attention is brought to bear on this topic in PE value creation plans?*

MB: I think it's for two main reasons. Firstly, I don't think the consultants generally used for due diligence work have the right level of focus. If you think about it, apart from the financial and legal teams you will bring on a strategic and possibly an operational due diligence team. As such, the kinds of improvements they will recommend will be closer to their mix of experience.

To extract the kind of value you can find in pricing you really do need experts. Track record and 'muscle memory' in dealing with the kinds of questions pricing throws up is absolutely critical so in this respect it's no surprise it's less well attended.

Secondly, you're facing the same set of reasons why companies don't focus enough on pricing. Lack of ownership of the pricing question, lack of understanding about pricing, inadequate data and inappropriate incentives from an internal perspective. And from an external or market perspective, the usual suspects of price aggressive competition, growing commoditisation and big customers with lots of negotiating power.

CA: *You mention a lack of ownership and understanding about pricing. Could you elaborate on this?*

MB: Sure. In terms of clarity of ownership on pricing, what I mean is that there is often no real ownership of pricing decisions in organisations. Pricing is complex and a bunch of functions have something to say about it. Marketing and product management will have strong views about it, sales people will have pretty strong views on the matter as well. Even finance and operations have a lot to say; think of how much influence they have on pricing in a cost plus environment. The result of so many people, perspectives and interactions in the context of time pressure is to be expected. It's often pretty chaotic and sub-optimal pricing is the result.

With respect to a lack of understanding about pricing. Ask your sales people what's better, accepting a 5% decline in volume and holding prices constant or dropping prices by 5% and holding volumes constant. The good ones will look confused and the best may pull out their calculators, but many will say it doesn't matter.

The answer is that the 5% decrease in volume is preferable and the narrower your margins are to start with, the more preferable it is. Surprisingly though, people will often lose their jobs over a 5% loss in market share, but won't bat an eyelid over a 20% decline in margin.

CA: *What about the incentives?*

MB: If you don't reward appropriate pricing behaviour, then it's no surprise that sales delivers sub-optimal prices. This often manifests itself through discounting behaviour. If a 5% discount gives you 5% extra volume it's just not worth it, but if that's the way your rewards are set up then you are likely to be leaving a lot of money on the table.

CA: *What would you say about the external pricing challenges faced by PE portfolio businesses? In particular, what can businesses do about increasingly price aggressive environments?*

MB: The first question to ask here is what is driving this price aggressive behaviour. In our global pricing study we asked companies whether they were currently in a price war. Nearly 60% said that they were. When we asked then who started the price war, 90% of them said it was somebody else! In short, you need to see to what extent your own business is contributing to irrational behaviour in the market and address that if you can.

Another important approach is to do your best to compete on factors besides price. It seems obvious, but our clients often overestimate the importance of prices to their clients or customers.

CA: *So are higher prices always the answer?*

MB: By no means, but I think that this is the case more often than many of us think. The key is to make sure you address the question with a fact based approach that helps you to get to the right prices. In general, companies are a lot better at value creation than value extraction.

Also it's about having consistent objectives. Are you chasing volume or value, market share or profit? Is your market share target going to trigger a price war?

CA: *You mentioned increasing commoditisation earlier. What can companies do when it is very difficult to differentiate?*

MB: The first thing to do is to test that assumption. I can think of any number of examples of companies that operate in "commoditised" markets that charge significant premiums. You can take seemingly pure commodity products like water or office pencils and in both cases you find players with huge price premiums AND significant market shares.

In commoditised business services like construction, a good place to start is to understand the nature of the value you're providing. For example, delivering things at the right time in an industry in which delays cost lots of money is critical. As a result, differentiated charging for this can drive real value.

CA: *What elements would you start with when looking at value creation opportunities in pricing? What does a typical pricing project look like?*

MB: It's quite hard to say exactly what a 'typical' pricing project looks like as every situation really is quite unique, even within a single industry. That said, the most typical question we are answering for private equity backed businesses is usually the question "what is the value that we are leaving on the table and what are the root causes of poor pricing?" The way we answer that kind of question is to start with a wide screening stage where we identify and size the possible opportunities. We then deep dive on the high potential options, validate, and finally plan the implementation.

CA: *OK, thanks for your time, Mark.*

Simon-Kucher & Partners

Simon-Kucher & Partners is a global marketing and strategy consulting firm with ~1,000 employees in 30 offices worldwide over five continents. Founded in 1985, the company has over 30 years of experience providing strategy and marketing consulting, and is regarded as the world's leading pricing advisor.

London Office
1 Plough Place, London EC4A 1DE
Tel. +44 207 832 6700