



Profiting from Tough Times

Ways Transactional Price Management can be used to create a competitive advantage during a recession

Deloitte Consulting LLP

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Revenue: The forgotten component of the profit equation during a recession

- At the onset of an economic downturn, a company's traditional reaction is to focus on controlling costs, retaining their largest customers, and hoping to ride out the storm.
- But Companies that focus on revenue, pricing and overall profitability can survive and even thrive during a recession, but only if they go about it in an effective way.



- *A foundational understanding* of the way the business operates, including visibility into transaction-level margin performance is required to make the right decisions.
- **Transactional Price Management** can help a business address the immediate issues presented during a recession, and position the company for long term, profit growth.

What is transactional price management?

What is it?

- Transactional Price Management is a set of processes, tools and actions that help businesses increase margins by providing visibility and improvement into the way they set, execute, and enforce prices and price policies to align with business objectives **at the transaction level**.

What are the typical business issues?

- Inability to capture the significant investment made in development of high value offerings
- Decreasing margins, with revenues increasing faster than profits
- Lack of pricing and margin information, particularly at or before the time of decision or negotiation
- Difficulty determining an appropriate response to a competitor's price movement
- Market share, volume or profit objectives fall short of management expectations
- Sales force requesting price exceptions on a regular basis
- Inability to accurately measure the effectiveness of sales promotions or contract agreements

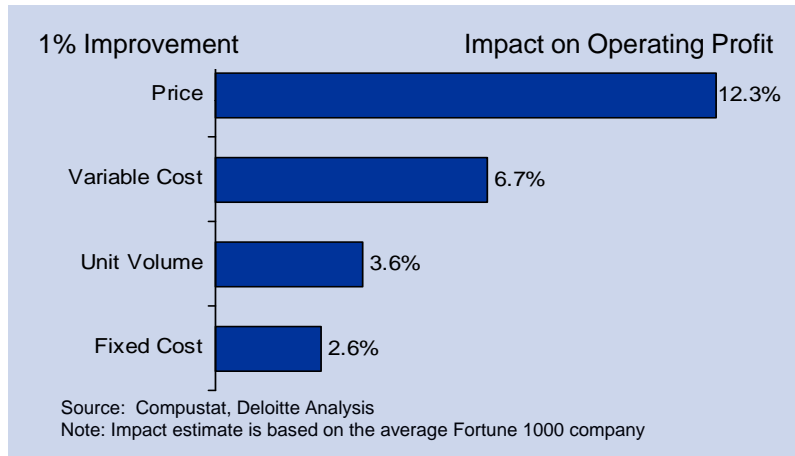
What does Transactional Price Management do?

- Determine profit-maximizing prices for products and/or services
- Identify causes of margin leakage by analyzing historical sales data at the transaction level
- Design more efficient and effective policies and processes that govern profitable decision making
- Design and deploy pricing analytics, optimization and sales execution tools
- Design organization models to include the roles, responsibilities, reporting relationships, and compensation schemes that align behaviors with profit goals

What are the benefits of transactional price management?

Industry Analysts assert the value of Pricing Improvement efforts

Pricing has 3-4 times the effect on Profitability than other improvements



The initial benefits to price management are huge: **200% to 350% ROI** in the first 12 months and **2% to 7% margin increase**.

The average 5% improvement in returns on sales from improved pricing creates **\$1.5 billion of additional value** over 5 years for an average S&P 500 company

Our experience demonstrates that the benefits of Pricing and Profitability Management can be even greater

1-3% of addressable revenue to the bottom line in the first **6-12 months** following the start of a transformation

More than **\$300 million** in identified benefits from a large specialty chemical manufacturer

14 months after implementation, **prices up 5%** (highest quarterly increase in 20 years)

Defined pricing organization and processes which **streamline** the production of price books and price approvals at a large engine and parts manufacturer

Source: Preslan, Laura, "Price Management: Conventional Wisdom is Wrong", AMR Research Outlook, February 2, 2005; Kiewell and Roegner, "The CFO Guide to Better Pricing," McKinsey on Finance, Autumn 2004.

Typical management strategies in a recession

There are five common approaches businesses use to weather recessionary periods; while each is effective to a degree, without the precision of Transactional Price Management, these strategies are often ineffective and, in some cases, can destroy short term profits and long term growth potential.

Traditional Recession Strategy	Strategy Enhanced through Transactional Price Management
1. Don't Stray from Core Competency	1. Understand your Business Competence at a Transactional Level
2. Cut Costs	2. Cut the Right Costs
3. Downsize	3. Redeploy assets on the Drivers of Profitability
4. Cater to you "Best" Customers	4. Identify Who Your "Best" Customers Really Are (Not simply a Volume Perspective); Treat your "Best" Customers Well, Fire your "Worst" Ones
5. Do Whatever it Takes to Protect Earnings	5. Decision Framework to Improve Near Term Earnings, while Establishing the Platform for Sustained Margin and Revenue Growth

1. Obtaining a foundational understanding of the business

Traditional Recession Strategy

- Many businesses choose to manage recession-related risk by focusing on core competencies.

Issue: How well do companies truly know their business(es)?

Transactional Price Management Strategy

- Use Transactional Price Management to gain an understanding of the business at the most basic level.
- Examine and manage the business through transaction level data.

Benefits of Transactional Price Management

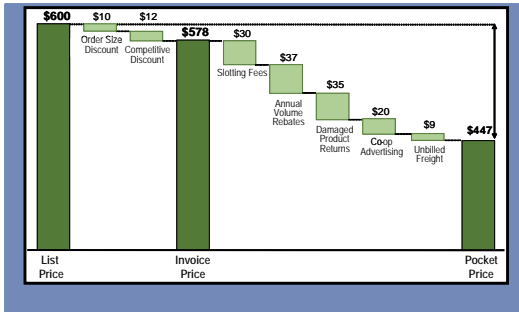
- Organizations armed with an improved understanding of their business model can be more agile and responsive to the market by developing effective strategies and early-warning systems.
- These organizations know which customers and products are profitable, and why.
- These organizations know *in detail* who the unprofitable customers, regions, channels and products are, and specifically what needs to change in order to reverse the situation (or the financial benefits of removing these transactions from the business).

Improved visibility into the fundamentals of the business can help executive leadership develop actionable, downturn-specific pricing strategies for its products and services. With aggressive execution, these strategies can improve margin performance while in a recession.

Examining and managing your business through transaction-level data

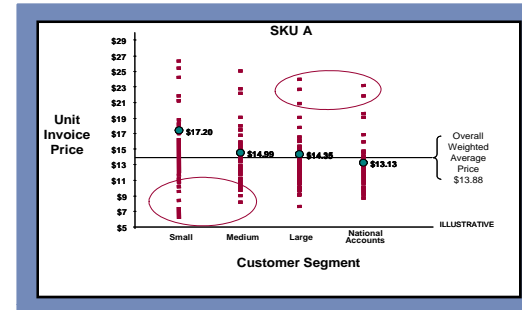
Many organizations have automated tools that make transaction analysis efficient and effective.

Price/Profitability Waterfall Tool



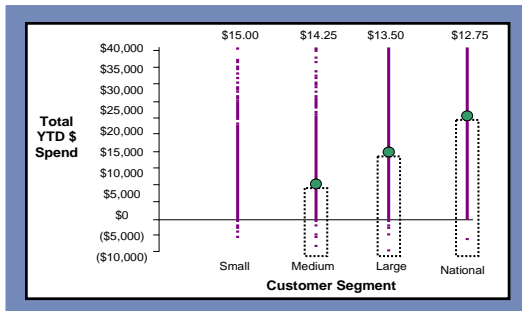
- Understand the flow of price and profit at the transaction level
- Identify major drivers of margin leakage; quantify and begin to manage profits by managing each of the leakage points

Price Band Analysis Tool



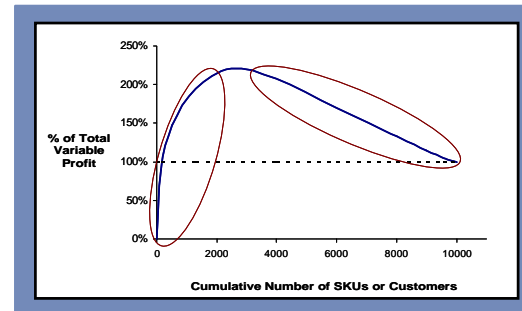
- Identify patterns of low-priced transactions
- Identify patterns of high-priced transactions
- Identify “fix-or-flush” transactions, customers, personnel
- Begin to focus sales force on high-value customers and transactions

Segment Performance Analysis Tool



- Identify unwarranted price concessions
- Identify price/volume discrepancies
- Challenge volume-based segmentation assumptions
- Realign customers with data-driven value segmentation

Customer/Product Contribution Analysis Tool



- Identify SKUs and contracts with favorable profit margin
- Identify SKUs and contracts that have negative profit margin
- Begin to match customer and product contribution to transaction level

2. Avoiding “Across the Board” cost cuts

Traditional Recession Strategy

- The initial reaction of a company facing a recession is to focus on cutting costs because they perceive costs as more “controllable” than other aspects of a business.

Issues: Cutting costs has a finite end, indiscriminant cost cuts can erode “value”.

Most companies don't truly understand their costs enough to know the impact of their cuts.

Transactional Price Management Strategy

- Obtain a more thorough understanding of the true Costs to Serve different customers and align prices and discount levels to ensure profits.
- Perform a transaction-level analysis of each cost element, and assign the SG&A burden to the appropriate transaction(s).

Benefits of Transactional Price Management

- Organizations obtain a fully-loaded “pocket margin,” which represents economic profit, not merely accounting profit.
- This “new picture” into the company’s cost structure can help a company discern which areas of business are most profitable and which areas don’t add value, or worse, are a financial drain.

Cost cutting insight can be even more crucial during a recession; a company that makes across the board cuts, instead of focusing on the unprofitable products/customers, may be cutting the “differentiators” that keep them alive in the near term.

3. Righting the “Right Size”

Traditional Recession Strategy

- Downsizing is often the biggest fear for management and employees as the economy slows, and justifiably so – it is a common solution to company’s cost problem.

Issue: Reducing headcount may limit the organization’s ability to increase revenue.

Transactional Price Management Strategy

- Realign the entire organization so that it is focused on profitability business transactions.
- View a recession as an opportune time to change the behaviors, habits, and culture.
 - Employees are usually more willing and motivated to change behavior in order to save either their jobs or the company.

Benefits of Transactional Price Management

- The use of pricing analyses can give very specific insight into field personnel performance and compensation that will help a company realign the organization to focus on profitability.
- Transaction analysis identifies the most effective employees in terms of profitability.

Pricing analyses can reap significant financial benefits in the short term by deploying critical resources with the most profitable areas of the business - traditional “rightsizing” approaches is far less precise and can damage brand and limit growth.

4. Understanding Customer Profitability

Traditional Recession Strategy

- Many companies try to hold onto all of their current customers - often increasing incentives for the promise of maintaining revenue.
- Companies often cater to their “best” customers in an attempt to increase customer loyalty.

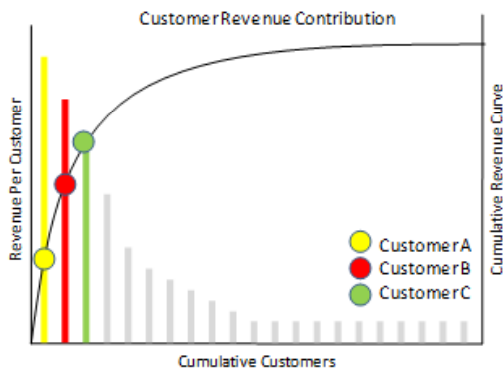
Issue: Inaccurate, oversimplified metrics often lead to disastrous decisions, and in many cases allow good customers to subsidize the bad ones.

Transactional Price Management Strategy

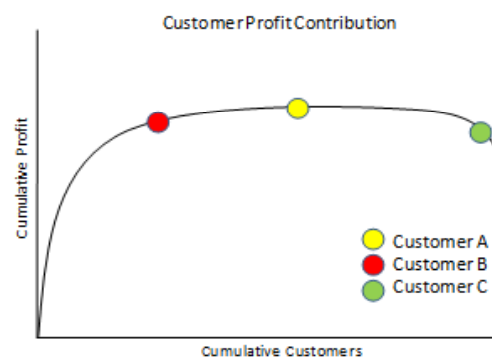
- Focus on turning unprofitable customers into profitable ones.
- Use transaction-level insight to identify the true value of each customer, and focus on increasing sales with that limited set of profitable customers.
- Work to identify existing customers who represent more potential value than previously realized— due to their relatively high revenue, margins, mix – and drive programs to capture this business.

Who Are My Profitable Customers?

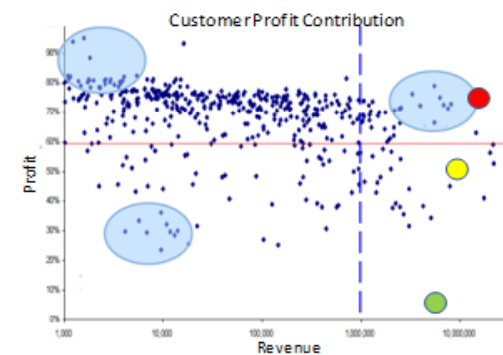
You think these are your best customers?



Are you still sure?



Focusing here will have more impact



5. Establishing a foundation for long term growth

Traditional Recession Strategy

- Organizations use short-term strategies to deal with a recessionary period, which often leads to price cuts, with the rationale that prices can be raised once the economy has recovered.

Issue: While a recession may only last a year or two, the impact of impulsive price cutting is extremely difficult to overcome for many years.

Transactional Price Management Strategy

- Transactional Price Management provides the insight necessary to help the business protect near-term profits and earnings, while establishing a foundation for long term *profitable growth*.

Benefits of Transactional Price Management

- With fact-based insight into the business, a company can begin to emphasize growth in geographies and channel relationships with counter-cyclical demand (or currency fluctuations for multi-national companies), which could improve profitability in both the short term and long term.
- Transactional Price Management can help companies avoid severe damage to profits through unwarranted price cuts, when demand elasticity is less than perceived for their products and services.

Organizations will have the needed visibility and fact base to limit the likelihood that short-term pricing actions (i.e., price cuts) will affect long term viability.

Transactional Price Management Strategies

1. Understand your Business at a Transactional Level
2. Cut the Right Costs
3. Redeploy assets to focus on the Drivers of Profitability
4. Identify Who Your “Best” Customers Really Are, and not from a Volume Perspective; Treat your “Best” Customers Well, Fire your “Worst” Ones
5. Improve Near Term Earnings while Establishing the Platform for Margin and Revenue Growth

Companies who focus on price and profitability management at the transaction level consistently deliver higher than average shareholder returns. A recession offers an excellent platform for change that is hard to create when times are good.

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