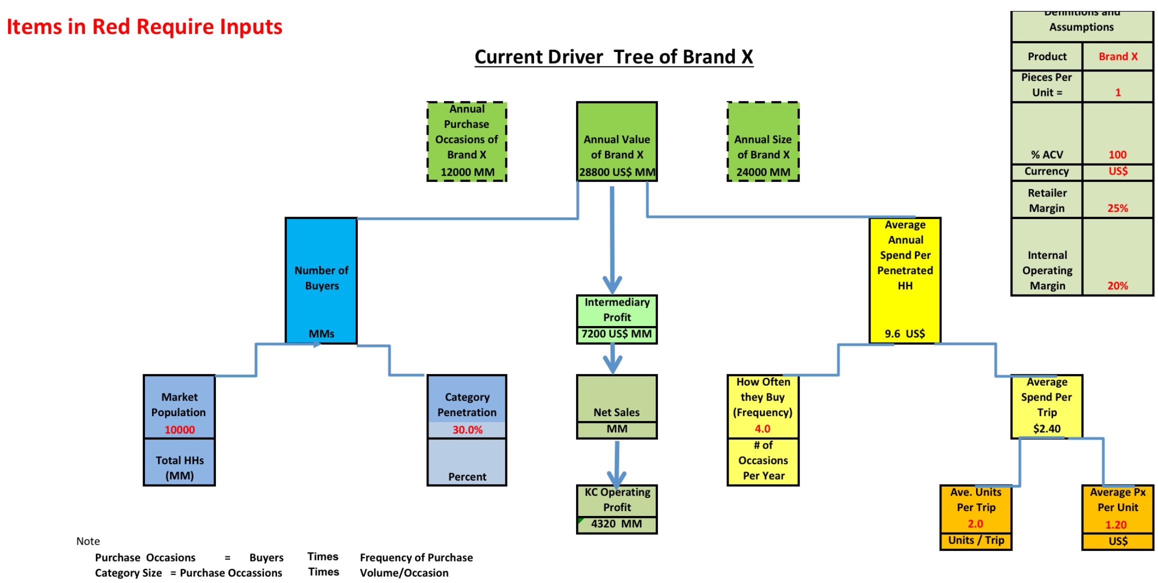
Pricing Tool Guide

Setting Marketing Objectives For Pricing

Setting marketing objectives for pricing is difficult for many of the reasons – unawareness of the trade-offs required, unwillingness to make trade-offs, portfolio effect for risk and reward, and dispersed responsibility for pricing decisions. Another common reason why price objective setting is difficult is due to confusion between ends vs. means objectives. Ends objectives are KPIs, like profit or share, which are covered in the Business Objective Tool Guide. This guide explains how to use a different tool to help determine means objectives for pricing. It is particularly relevant for those in the retail or CPG space, but identifies principles that could apply in other industries. Means objectives are also known as predictive objectives, because they indicate whether the outcome KPIs will be achieved. They include measures such as competitive price indexes, promotional support, out-of-stocks, penetration, and frequency – these are the measures of concern to all of those involved in the marketing, sales, and product supply.

A useful tool to guide discussions around marketing priorities for pricing is a driver tree. These were developed by The Partnering Group for use in category management discussions within retailers, but they are highly adaptable to decomposing sales into manageable sub-measures. A brand's driver tree looks like the following:

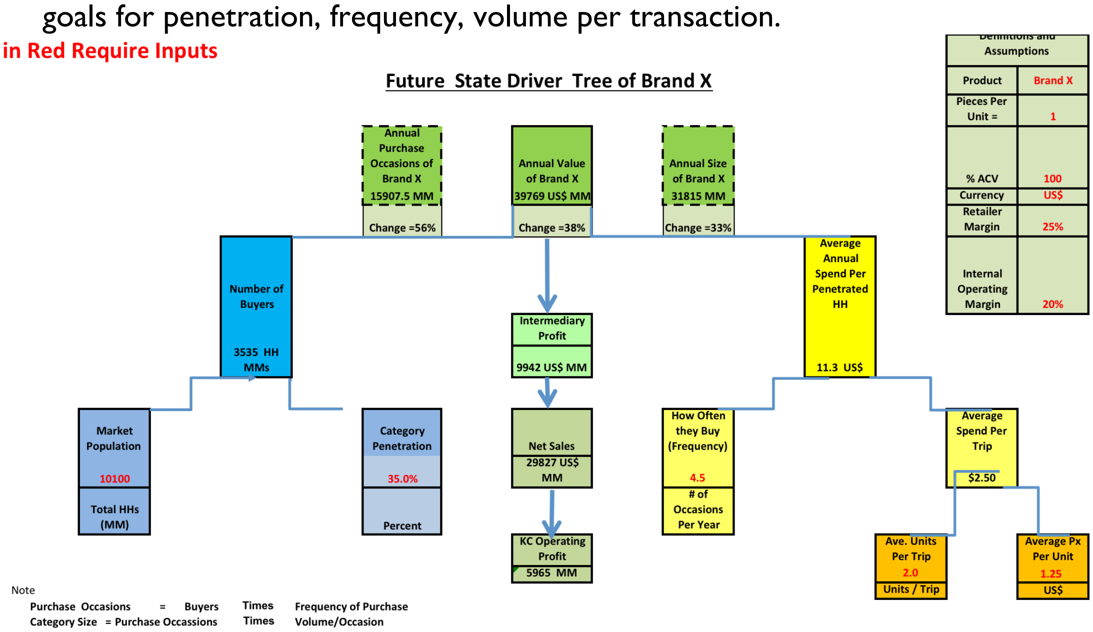


Before drawing the driver tree, there are a couple of decisions to make.

1. First one must define the market both in terms of geography (current vs. potential expansion geographies), shopper units (e.g., households, individuals), category scope, and time frame (year, months, and weeks), and purchase units (packages, nights, pieces). All of these decisions can take the ensuing discussion in different directions and so it is important to make these clear. For instance, defining the period in terms of month vs. year will produce very different measures of penetration vs. frequency.

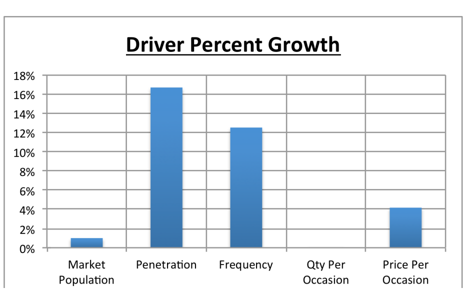
2. Once the definitions are clear, the next step is to input the measures in red – Market Population, Penetration, Frequency, Ave. Units Per Trip, Average Price Per Unit. These measures are preferably found in panel data, if it exists for the market; however, even panel data may need to be massaged in order to get the elements to aggregate to close to the net sales for the company or brand. These can be inputted in the "Marketing Input" tab to show up in the driver tree tab.
3. As an option, the tree provides space for adding simple measures for one's own margins and those of intermediaries (e.g. distributors) to translate market changes into high-level profit and loss translations.
4. Next, one inputs different numbers in the future state driver tree to see how changes in the elements can drive overall results over the upcoming planning cycle. For instance, a straight price increase may have off-setting effects on penetration, frequency, or volume per occasion. Or, an increase in promotional spending will reduce average $ per unit but, one would hope, increase frequency or volume per occasion. Playing with these variables can the help determine the role that changes in pricing per unity can play in driving marketing goals for penetration, frequency, volume per transaction.

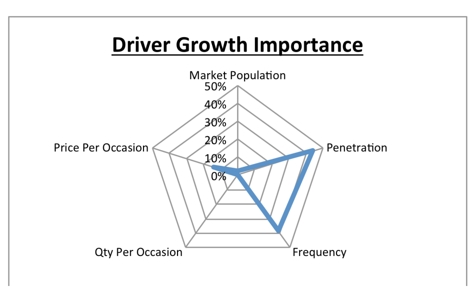
Items in Red Require Inputs



5. Another way to visualize the relative ranking of the different growth drivers to achieve revenue or profit goals is shown below. Two graphs that represent the same information differently are a bar chart and a spider chart, depending upon one's preferences for visualization.

<u>Driver Importance Graphs</u>





6. The role that price changes play in achieving these marketing objectives needs to be squared with the role that they are expected to play in the P&L. If they are not, then either the marketing plan or the forecast should be revised. For instance, pushing to improve operating margins may not be compatible with an increasing penetration, since growth in the latter growth usually requires some upfront margin-diluting investment in price discounting or value enhancement.

Once the business and marketing objectives are reconciled, it should be very clear how to complete the following statements.

- The marketing priorities are….
- Price will contribute to achieving those marketing objectives primarily through…
- Prices will be changed primarily through changes in ……