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# Putting Pricing on Fast Forward

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Getting the Price Right in  
Consumer Electronics

*by*  
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Innovation is one thing, where as profiting from the innovation is something entirely different



*Every year more than 5000 new consumer electronics products are launched but only a few become a success. Why do up to 9 out of 10 new products fail financially? Could Polaroid have avoided bankruptcy if its digital cameras had been priced right? Why did DAT never take off? We believe that these historical anecdotes confirm the fact that innovation is one thing, where as profiting from the innovation is something entirely different. Innovations are crucial to work against the constant price decline in the consumer electronics industry. Failing to position them successfully and price them optimally can lead to millions of Euro/Dollars of lost shareholder value.*

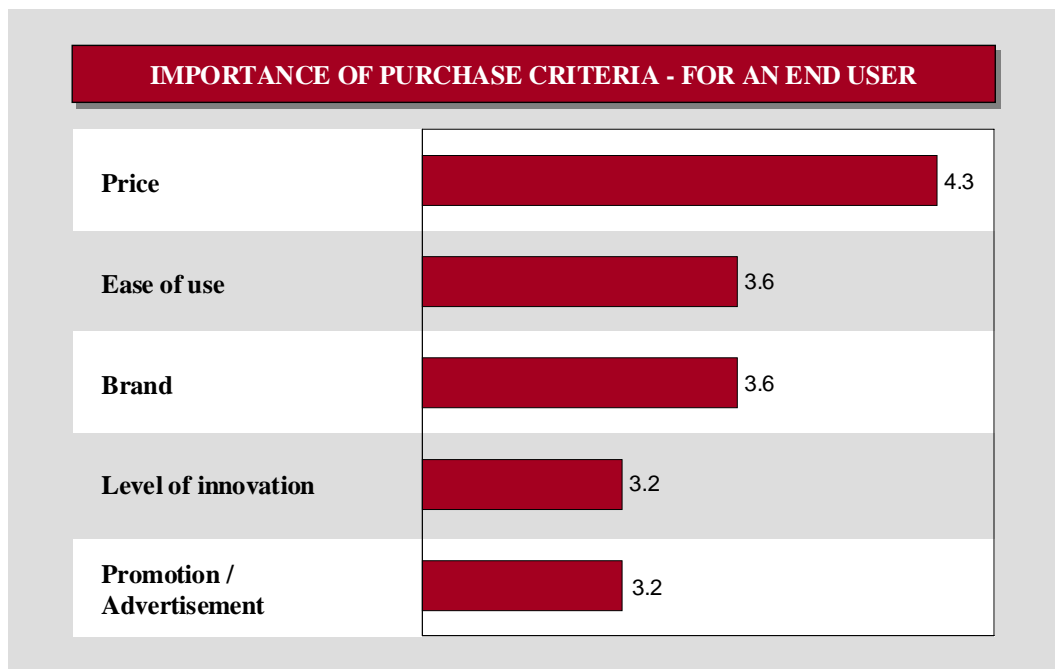
Consumer electronics is an industry on the move. Product categories are merging – PDAs take pictures and lead the way with GPS navigation, printers scan and fax, and mobile phones act as camera, walkman and voice recorder. Gadgets become expressions of lifestyle rather than being mere products. A variety of new standards (e.g. SmartMedia cards vs. Memory Sticks vs. xD-Picture cards) aim for dominance in their respective markets. New players like Dell and Gateway are entering the arena. The resulting intense competition is leading to cannibalisation, commoditisation and constantly falling prices. Under these circumstances, pricing the products right becomes absolutely essential to sustain profitability. In this White Paper we will draw upon our project experience and constant discussions with manufacturers and retailers to highlight some of the elements needed to achieve this, namely,

- the importance of price and understanding customer value,
- a holistic pricing process,
- European price harmonisation and
- key account management.

Paying more attention to better pricing is not only justified; it is a strategic must

## Importance of Price and of Understanding Customer Value

There are only two profit drivers: cost and price. Most companies invest heavily on the cost side of the profit equation by restructuring the supply chain, outsourcing etc., but fail to pay as much attention to price. This is not optimal and is all the more important as price improvements have an immediate positive impact on profit and cash flow, compared to the delayed effect and the expense of cost cutting exercises. The results of a recent SIMON-KUCHER & PARTNERS survey among managers in the consumer electronics industry confirm that price is the most important purchase criteria for an end-user (see chart 1). Paying more attention to better pricing is not only justified; it is a strategic must.



*Chart 1: Importance of purchase criteria for end-users (SKP survey with consumer electronics managers)*

Even the world's leading companies that are so good in creating and delivering value to the customer struggle to "extract" the right value from their customers

This lack of attention to pricing decisions is often coupled with a lack of understanding of the true value-to-customer of a product and its features. Too many product designs are driven by engineers without any input from the market. We recently completed a market assessment study for a highly innovative company whose engineers had developed a product with six innovative technical features. The assessment showed that only two of these were relevant for the customer and consequently the customers' willingness-to-pay for the product was much lower than the planned production cost. The product was streamlined, some of the engineers' 'toys' removed and now the product is selling very successfully. However, several hundred thousand R&D Dollars could have been saved, if the customer's voice had been heard during and not after the development process.

The under-investment in understanding value-to-customer and in price optimisation capabilities is often the main reason that leads to price wars. These are triggered when over-pricing is quickly corrected by strongly reducing prices, sending terrible signals to the market. By launching its Xbox gaming console at 479 euros and having to reduce the price by nearly 50% within the following year, Microsoft triggered a price war in this industry. Sony and Nintendo reacted with strong price cuts, and contribution levels in what many believe is already a subsidised product category plummeted.

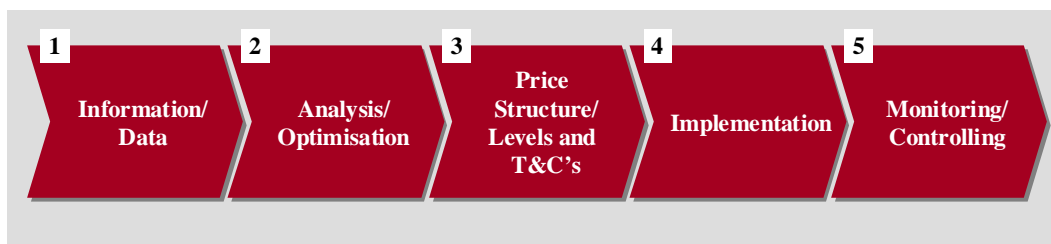
The other extreme is committing one of the cardinal sins of product launch: "under-pricing". This is just as bad. When Sony launched its highly successful electronic dog AIBO in 1999, stores (off and online) sold out in minutes and products were available on Ebay at four times the launch price or more. Sony left millions on the table by pricing too conservatively.

Even the world's leading companies that are so good in creating and delivering value to the customer struggle to "extract" the right value from their customers. Sophisticated pricing and value analysis needs to be done to quantify the value-to-customer and optimise the pricing of innovations using modern methodologies, such as target costing, conjoint analysis and decision support models.

But, can the fast-moving consumer electronics industry that is characterised by a plethora of products and product life cycles that are often measured in months (e.g. digital cameras) afford to carry out such an exercise for all its products? Clearly not. The answer to this challenge lies in establishing the appropriate pricing process.

## Pricing Process

A pricing process is a set of rules and procedures to determine, implement and manage prices. Establishing a formal pricing process is especially vital when a business sells many different products or when several generations of the same product exist, as it is the case in the consumer electronics industry. An effective pricing process consists of the following five core phases:



*Chart 2: Phases of a pricing process*

Optimising a pricing process in particular means:

- improving the quality of key decision-support data and of its analysis,

## An improvement of pricing processes leads to massive profit increases

- optimising price structures and levels,
- fine-tuning terms and conditions,
- introducing rules and guidelines for easier pricing decisions,
- improving actual price achievement in the market, and
- developing more efficient measures for price controlling and monitoring.

This might seem trivial and you might think ‘we are doing this already’. But to optimise a pricing process is a comprehensive and focussed exercise. If such an exercise has never been consciously done significant improvement potential will exist. In our experience, an improvement of pricing processes leads to massive profit increases. Return on sales typically increases by 1 to 2 percentage points, a lot of which comes as quick wins. Chart 3 summarises the results from a recent project for a global technology company.

Measure	Profit	Plus
■ Pricing for long-term customer loyalty contracts	2.3 M €	0.6%
■ Guidelines for applying discounts	1.5 M €	0.4%
■ Optimising key account management	0.8 M €	0.2%
■ Structuring markups and fees	1.1 M €	0.3%
■ Improved structures for product prices	1.5 M €	0.4%
■ Introduction of a price monitoring tool	0.4 M €	0.1%
<b>Sum:</b>	<b>7.6 M €</b>	<b>2.0%</b>
(Basis: 380.0 M € p.a.)		

*Chart 3: Example – results from pricing process improvement*

A national view of pricing is no longer sufficient in today's environment

Optimise pan-European profits by establishing a price corridor and managing the European floor price

## European Price Harmonisation

A national view of pricing is no longer sufficient in today's environment as parallel imports are on the rise and both offline and online dealers exploit the huge price spreads across Europe (and globally) resulting from independent national operations. Parallel imports are legal, but a European view is necessary to maximise profits and optimise value across the EU and beyond, especially considering the huge expansion of its boundaries over the next years.

Prices are different across countries and that is how it should be. Prices differ within a country, within a city, so why not amongst countries? For example, in London the price of a Sony Digital Camera DSC-P92 ranges from £312.54 at the Comet store to £399.99 at Tesco (SKP research in September 2003).

Therefore, the objective of price harmonisation is not to make the prices exactly the same all across Europe (which will not be profit optimal) but to optimise pan-European profits by establishing a "price corridor" and managing the European floor price. Price differences should prevail to take advantage of the varying country-specific price elasticities that exist due to differences in cost, culture, competition, distribution systems etc.

Such a delicate balance is best achieved by defining a "European price corridor" (see chart 4), which sets a hard lower price limit as well as a soft upper limit. The hard lower price limit, or European floor price, is absolutely binding for all countries and the product may not be sold below this limit. The lower limit is strict, because it would disrupt the entire European price harmony if a single country were to break out of

the corridor thereby potentially serving then as a base for parallel imports or as a benchmark for price negotiations. The upper limit is flexible, because individual countries could raise the price for a certain product, if they are willing to accept possible parallel imports that it might cause.

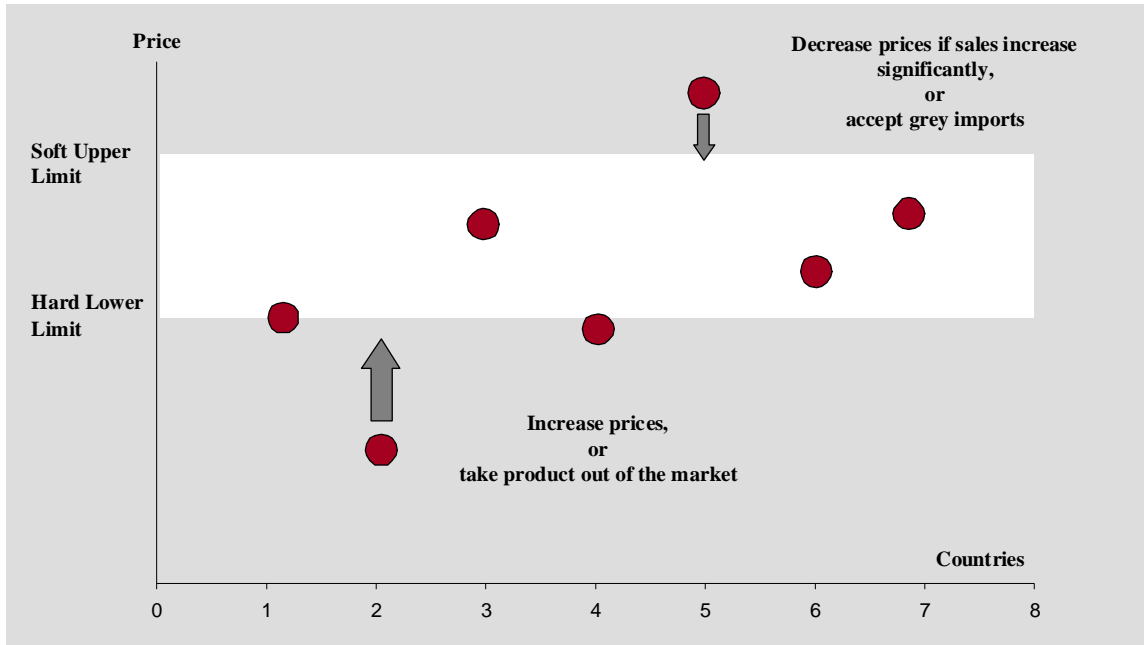


Chart 4: Price corridor

A major consumer electronics manufacturer had strongly varying prices for identical products in different countries. On average the price differences were between 20-30%, but could be as high as 150%. At the same time, the customers (wholesalers, electronic superstores etc.) were becoming increasingly aware of price differences across Europe and were exploiting this situation readily. Several leading retailers had started to manage their entire European purchasing through a central hub. This, of course, would jeopardise the manufacturer's margins and overall profitability in Europe. The manufacturer managed this situation through an effective "European price harmonisation" strategy based on a European price corridor and increased European profits by 6.5% losing only 1% in volume.

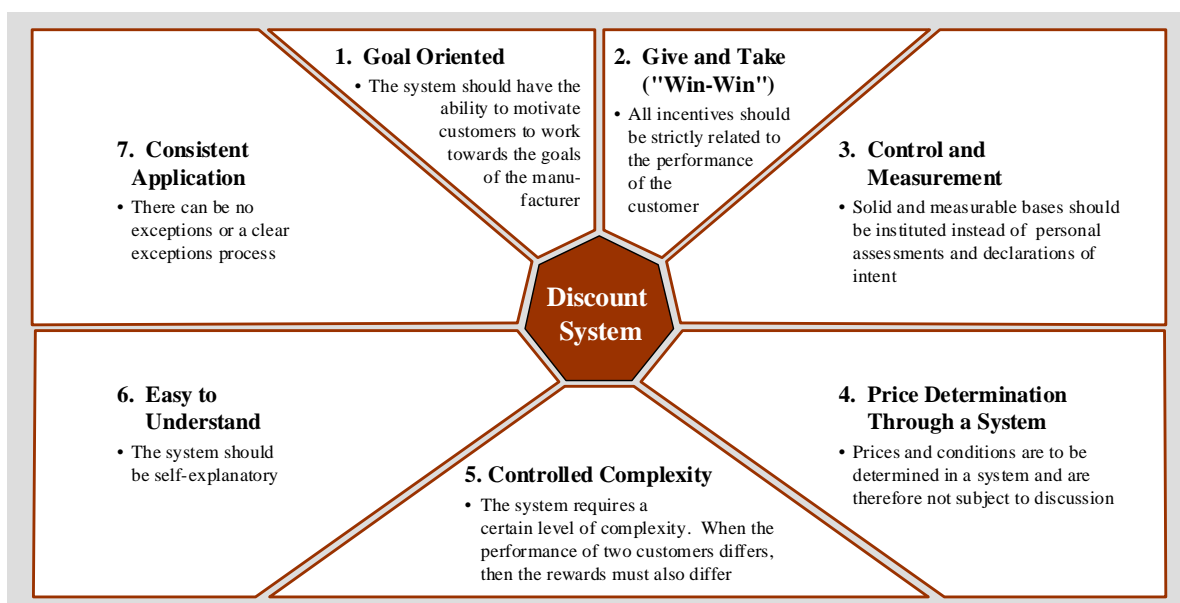
## The key account business hardly fits into the "normal" sales strategy and organisation

A "European price corridor", however, is only one part of a successful pan-European pricing strategy, the other part is the implementation of an effective key account management.

### Key Account Management

The emergence of large European electronic retail groups such as the Dixons Group and Metro is changing the way they need to be dealt with locally and on a European level. The key account business hardly fits into the "normal" sales strategy and organisation, but needs a dedicated key account team, which operates within a set of clear strategic guidelines.

Usually, key accounts will ask for or qualify for above average discounts and terms and conditions. In order to avoid the common threat that they demand prices for all of Europe based on the level of the current lowest priced country, a specific discount strategy must be implemented which considers seven key points that are summarised on chart 5:



*Chart 5: Key elements for key account discount system*

While all seven factors are important, the one that could be highlighted is the need to create a win-win situation for manufacturer and customer. For example, this means that additional discounts could be attached to growth or that both partners together seek cost reduction opportunities in the logistics chain that are then shared.

Companies in the consumer electronics industry face an increasing challenge to sustain their market position. Concentrating on pricing, pricing processes, European price harmonisation and effective key account management would be a smart way to increase the bottom-line.

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