SIMON ◆ KUCHER & PARTNERS
Strategy & Marketing Consultants

# EVP – Enterprise Value of Pricing

A new performance measure to track your pricing achievements and to communicate price performance to analysts

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**Are you a C-level executive of a publicly traded company? Are you missing an equity story around the quality of your pricing and your topline growth? The Enterprise Value of Pricing (EVP™) is a powerful new KPI developed by Simon-Kucher & Partners. For the first time, you can use this innovative measure to see at one glance – with one number – how better pricing directly impacts shareholder value. EVP™ helps to identify and seize pricing opportunities and to build a much stronger equity story around pricing.**

As a C-level executive, you know that exercising pricing power will drive topline growth and boost profits. You have heard that message a thousand times. You also know that your ultimate metric – the one your board and the capital markets measure you against – is shareholder value. Grow and you stay. Decline and you go.

Until now, any connection between better pricing and your shareholder or enterprise value has been either a qualitative assumption or back-of-the-envelope math. Even then, it was a challenge to draw conclusions because the units don't match. We perceive and measure pricing improvement and enterprise value in different ways.

Now imagine the usefulness and influence of a single number which could incorporate market expectations and estimated pricing impact at your company in an easy-to-understand way. Simon-Kucher met the challenge by creating a new KPI called EVP™ (Enterprise Value of Pricing™), which expresses the ratio of two important numbers for any executive:

- the additional enterprise value from a one-percent price increase that sticks
- the average analysts' expectations for the change in enterprise value over the coming 12 months.

$$\text{EVP} = \frac{\text{VP}}{\text{VEG}} = \frac{\dfrac{R \times (1-T) \times 1\%}{wacc - g}}{EV_{+1} - EV_0}$$

**Value of Price**

**Value of Expected Growth**

One brief look into how it works: EVP™ expresses the additional enterprise value that a 1% price increase will generate using a basic discounted cash flow model. This value of price is compared to the expected change of EV, which is the difference between existing enterprise value and the expectation of analysts over the next 12 months.

The single most important decision in evaluating a business is pricing power.

The 1% price increase with no volume loss represents the enterprise's untapped pricing power, Warren Buffett succinctly described the fundamental importance of pricing power a few years ago when he said: "The single most important decision in evaluating a business is pricing power."

The EVP™ relies on a rigorous approach, uses a rich and consistent set of publicly available data, and expresses enterprise value and the benefits of better pricing in the same units. It can change perspectives, guide planning decisions, and simplify communication in a number of ways.

## One powerful number: The meaning of EVP™

Let's say you have an EVP™ of 0.6. That means that exercising pricing power, as defined by making a one-percent price increase stick, can account for 60 percent of the increase in enterprise value that analysts expect for the next 12 months. In other words, if analysts expected your enterprise value to grow by $3 billion, pricing would be able to supply $1.8 billion of that increase. The higher this percentage or ratio (as shown by the EVP™), the stronger the argument that your firm can invest its scarce resources in pricing initiatives as opposed to other growth initiatives.

Without knowing your EVP™, you may still have a vague idea, perhaps even a confident belief, that your pricing needs to improve and that this improvement will ultimately manifest itself in greater enterprise value. Once you know the EVP™, which once again derives from recognized and respected market data and a robust model, you know in more precise and actionable terms how much pricing power your firm has. You also know better than ever what is at stake if you don't exercise it. In today's 'Big Data' world, there is a premium on the ability to synthesize data into one meaningful indicator, especially one which allows people to make insightful apples-to-apples comparisons across companies and industries. The EVP™ does that for pricing power.

## Using the EVP™ for more confident strategy and resource planning

The EVP™ is easy to interpret. It provides a C-level team immediate and useful information on how to prioritize pricing initiatives and how to communicate their importance relative to other growth measures you can undertake.

If your EVP™ is positive it means that analysts expect growth in enterprise value in the coming year. The only question is how much of a role pricing can play in achieving that growth.

**Immediate, large growth opportunity: This applies to an EVP™ greater than 1.**

Your company has either underestimated its pricing power or underutilized it. No matter how bullish analysts may be about your growth prospects, your potential from better pricing alone can exceed their expectations. The opportunity to boost enterprise value is large enough that even small successes or quick wins can have a positive, material effect on the value of your firm.

**Significant growth opportunity: This applies to an EVP™ between 0 and 1**

Better pricing can make a powerful contribution to your growth in the coming year. Your company should take a close look at the upside from investments in pricing as opposed to other growth initiatives. Pricing initiatives tend to have better returns and require less investment than other growth initiatives. Keep this in mind as you select the growth initiatives which will help you meet or beat market expectations. If your EVP is negative it means that the consensus sentiment among market analysts is bearish. The question now becomes how much pricing can help you offset or even erase that negative sentiment.

**Defensive measure: This applies to an EVP™ between 0 and -1**

The market is bearish toward your company, as analysts lack confidence either in your firm's capabilities or in your sector as a whole. Your pricing practices or pricing climate may have contributed to this sentiment, due to price wars, unsuccessful attempts to innovate, or due to former success strategies which became outdated as your market shifted. Better pricing can offer you a viable way to offset those doubts and give the market better-than-expected performance, while also giving your company a foundation for more sustainable growth.

**Turnaround weapon: This applies to an EVP™ less than -1**

Your potential from better pricing is not only strong enough to offset bearish sentiment towards you or your sector; it can erase that sentiment entirely. You have latent pricing power to unlock, and the results will be transformative if you pursue it to its full extent.

While structural issues in the market may contribute to the sentiment and the low EVP™, companies with an EVP™ this low have probably neglected or underestimated pricing in their strategy planning, resource allocation, and market communication. Analysts are probably as unaware of your potential as you are. You have an opportunity to shake up your market, and better pricing can lead the way.

## Using EVP™ to improve market communication

Finally, the EVP™ also eases another burden facing most executives at publicly-traded companies: market communication and guidance. Telling an equity story is a fundamental part of any C-level executive's job, not just a task for the investor relations team. But equity stories have rarely included a substantive discussion of pricing. C-level executives, investor relations teams, and other communications specialists would love to have a way to talk about pricing in a powerful way and make comparisons to others in their industry, without revealing too much specific data or making subjective judgments.

Enter the EVP™.

The EVP™ enables a CEO or CFO to talk intelligently, comfortably, and openly about pricing, without scaring investors or raising alarm bells at the antirust offices. EVP™ helps you incorporate pricing into your equity story, because it is a robust metric derived entirely from your firm's own publicly available data. It gives you a powerful and creative new way to differentiate your equity story and make it more compelling. Pricing doesn't have to be a third-rail topic anymore.

The EVP™ keeps you out of the swamp by establishing a direct link between the exercise of pricing power and its considerable impact on shareholder value. As part of your equity story, EVP™ can help you explain your growth initiatives, defend and justify a pricing or value initiative, and draw comparisons to competitors and to companies in other industries.

If you are a C-level executive at a publicly traded company, let us introduce you to the EVP™ in more detail and show you how to take advantage of it.

## Authors

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Kai Bandilla is a Senior Partner and Member of the Board with Simon-Kucher. He leads the Simon-Kucher offices in Western & Eastern Europe, Asia and Australia. Kai is focusing his work on price strategy, price setting and price process issues covering a large number of industries (industrial, automotive, services, tourism, banking and FMCG's).

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Brad Soper is a Partner and Member of the Board with Simon-Kucher. He leads the Atlanta office where he specializes in pricing excellence and sales force transformations. While he has worked within most industry verticals, his recent focus has been primarily on the B2B sector with a particular focus on chemicals, building materials, industrial/capital goods and B2B service companies. Brad's areas of expertise include go-to-market strategies, customer segmentation, pricing strategies, value-based discounting and sales force effectiveness.

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Philip W. Daus is a Partner with Simon-Kucher in Houston, TX, where he specializes in results-oriented pricing and sales excellence programs. He has 14 years of consulting experience with a diverse background in both B2B and B2C industries in the USA, Europe and Latin America. His recent focus has been on B2B sectors such as drilling services, capital equipment, machinery, building materials, and B2B service companies.

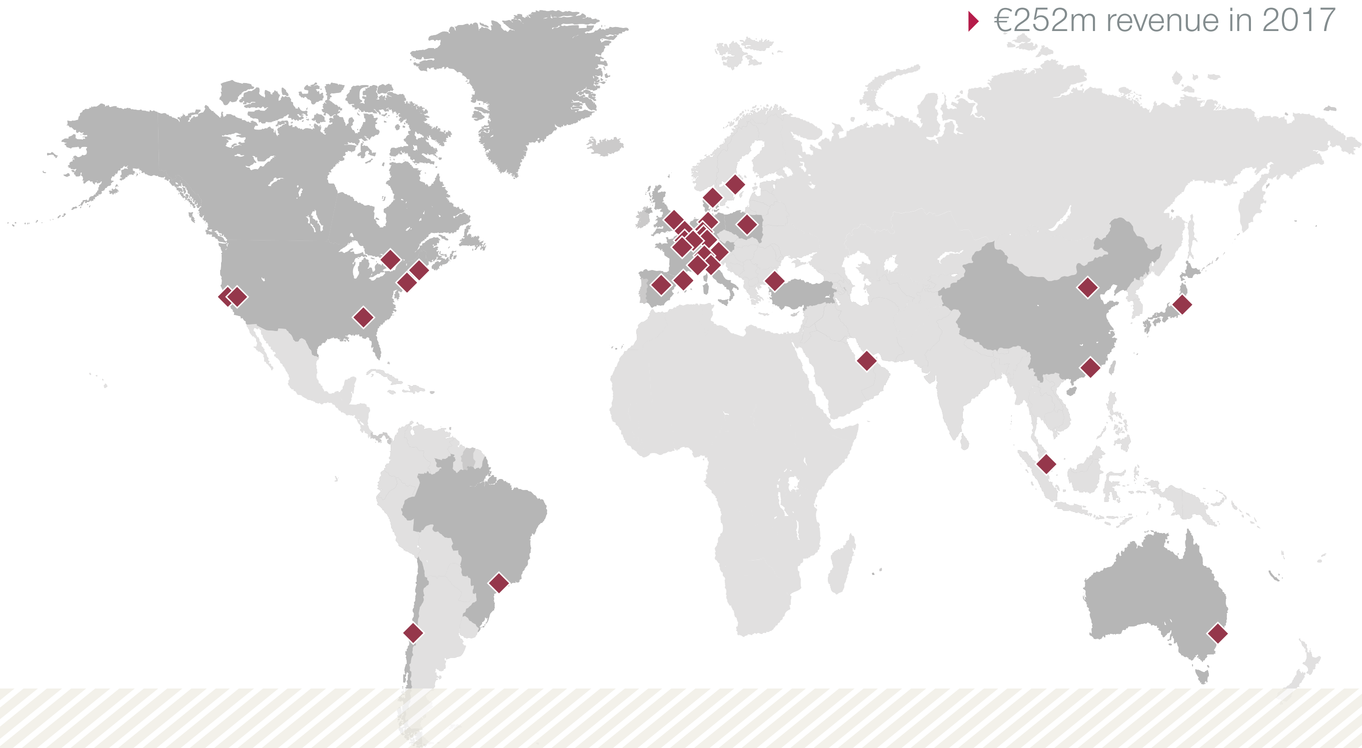
## Simon-Kucher & Partners at a Glance

### Simon-Kucher & Partners, Strategy & Marketing Consultants

Simon-Kucher & Partners is a global consulting firm focusing on TopLine Power®. Founded in 1985, the company has more than 30 years of experience providing strategy and marketing consulting and is regarded as the world's leading pricing advisor.

### Global presence

- 34 offices worldwide
- 1,100 employees
- €252m revenue in 2017



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