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Going for Growth

The Role of Price and Cost in Driving High Performance in a Volatile Global Economy

• Consulting • Technology • Outsourcing

Introduction

During the most recent recession, companies experienced what has become standard operating procedure in downturns: a rush to slash costs in response to a dramatic slowdown in demand. Today, while the economy still is characterized by volatility, improving economic conditions in many parts of the world have companies once again considering growth (although cost reduction certainly has not left the executive suite's agenda). Thus, the question becomes: How can companies reignite growth in a time of uneven demand while continuing to make intelligent, and appropriate, reductions in cost to strengthen profitability?

In Accenture's experience, the answer to this question lies in appropriately aligning price and costs. When such alignment is absent, cost decisions not only can impede the achievement of profitable growth, they also can wreak havoc with the quality of service delivered and the overall customer experience. But when a company develops a deep understanding of how its different customers and customer segments perceive value in what the company offers, and then uses that insight to variabilize its cost structure so costs can remain in synch with revenue and value, it is better positioned to grow profitably in what is likely to remain a volatile economy for some time to come.

To explore this issue further, Accenture embarked on a comprehensive research effort in which we surveyed 1,000 executives in companies representing 12 countries and eight industries (Figures 1-3). Our data was collected from November 2010 through January 2011, a period during which economic prospects were beginning to brighten for most markets and industries, but companies still were hesitant to believe a full-scale recovery was under way. Today, with demand beginning to strengthen and commodity prices surging, our survey data provides a helpful context for companies seeking guidance on plans for 2011 and beyond.

In our survey, we asked participating marketing executives about their pricing strategies, practices and capabilities, and polled finance executives on their enterprise's recent and planned cost reductions. Our survey revealed the following key findings:

- Most companies are planning for growth, but that growth is likely to be modest.
- When it comes to pricing, companies tend to most frequently use actions by competitors and the balance between supply and demand as inputs in setting prices. Comparatively fewer consider value-based and cost-plus strategies.
- Price optimization was one of the three most important strategic priorities in the past 18 months for seven in 10 companies in our survey, but an equal percentage of companies do not have what Accenture would consider to be sophisticated pricing capabilities.
- Companies face a wide range of challenges in optimizing pricing, including sales execution, inadequate pricing analytics, unclear pricing strategy, inadequate decision support/ analytics, and governance and accountability incentives.
- In the past 18 months, 82 percent of executives globally said their company has undertaken a significant effort to reduce costs, and these efforts were seen as largely effective in creating sustained cost reduction by the vast majority of executives.
- Companies believe there are still opportunities to capture in cost reduction and, thus, more cost cutting is planned for the next six months (with strategic sourcing and enterprise rationalization being the most popular cost management actions).

In the following pages, we explore these findings in more detail. We begin by discussing how companies are positioned to use pricing to capitalize on emerging growth opportunities, then review how companies have used—and plan to use—cost reductions to maintain and improve profitability. We conclude by suggesting ways companies can integrate the two types of efforts to drive even greater competitive differentiation and profitable growth in the months and years ahead.



Figure 1. Participating companies' annual revenue

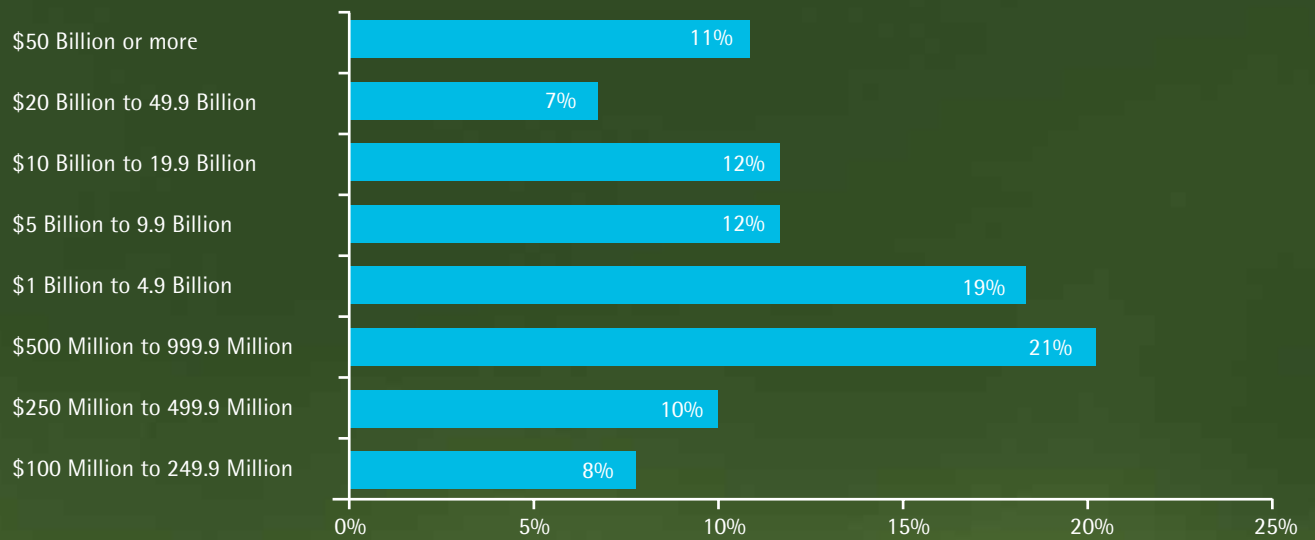


Figure 2. Participating companies' industry

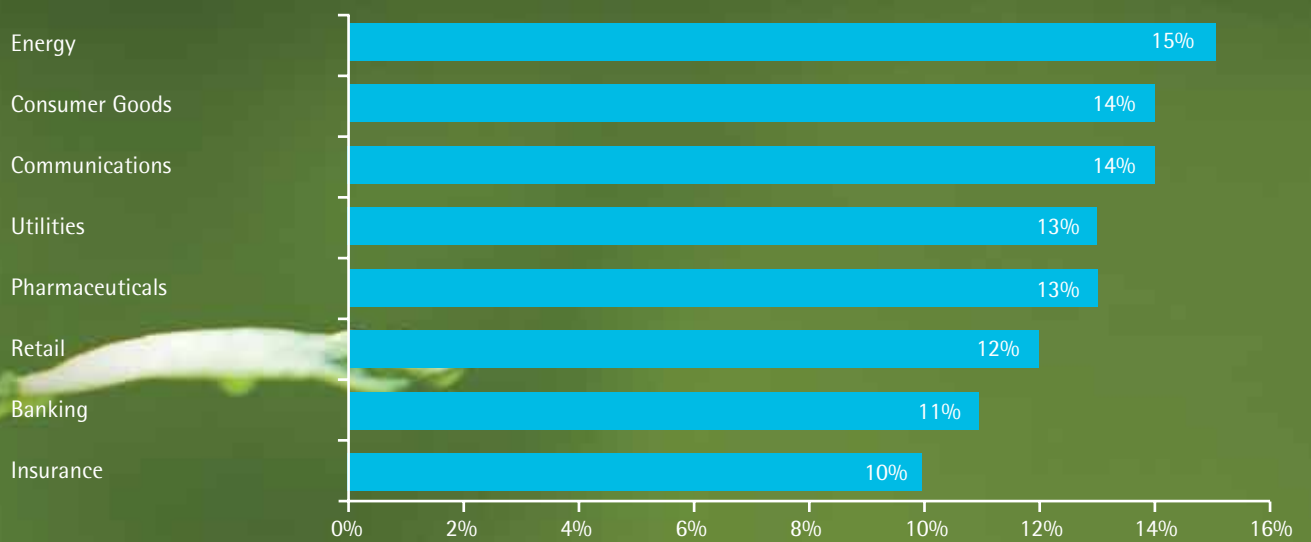
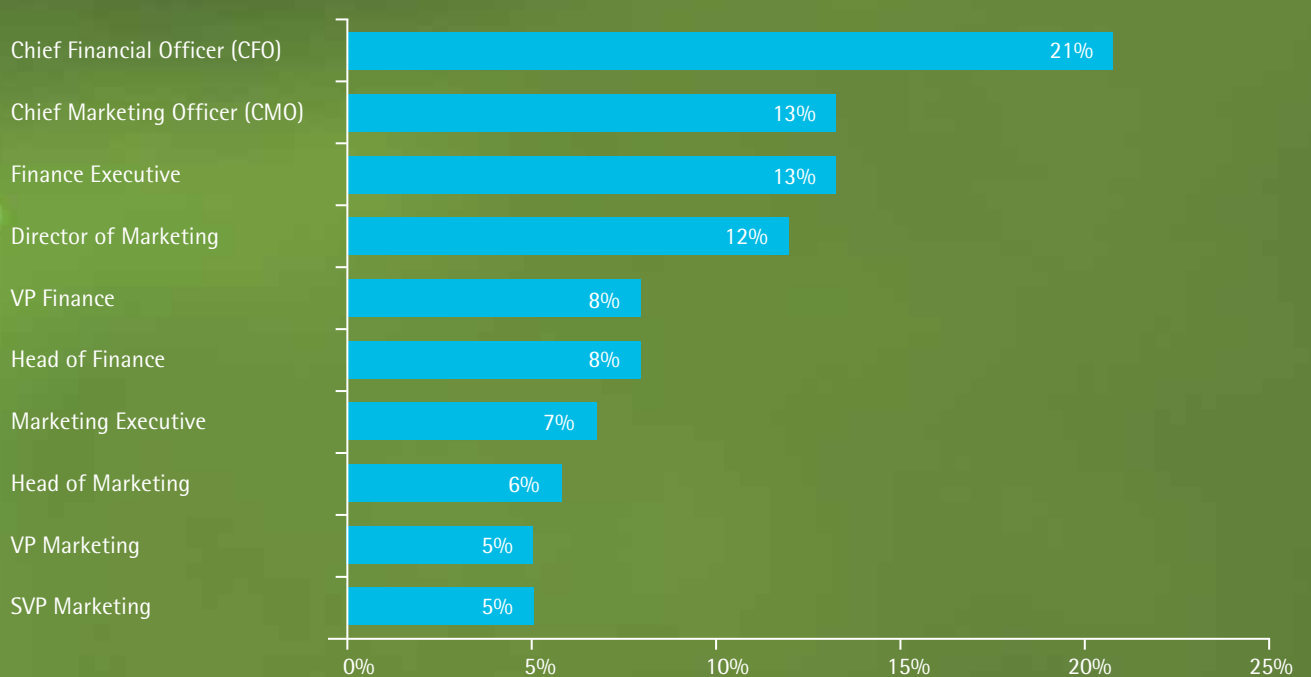


Figure 3. Respondents' title



A Renewed Focus on Growth



Most companies participating in our survey are anticipating revenue growth in the next 18 months, although their expectations are relatively modest—with the weakest growth being expected by mostly Western organizations. A majority of executives overall (56 percent) think their revenue will grow only by 5 percent or less in the next year and a half. About three in 10 anticipate growth to reach between 6 percent and 10 percent, and only 14 percent expect growth to top 10 percent (Figure 4).

As they prepare for growth, most companies appear to be operating in a position of strength from a cash standpoint. Indeed, virtually all respondents in our survey indicated their companies have enough cash to at least maintain their current levels of production. Twenty-seven percent of companies reported having adequate cash on hand to fund current operations, 47 percent said they have optimal levels of cash for delivering on their strategy, and 22 percent said they have excess cash and are considering the best way to deploy it.

Only 2 percent said they are struggling with liquidity (Figure 5).

There was no consensus across companies globally on how they would spend excess cash if they had it, or how they would raise money if they needed it. If they had additional cash, 36 percent said they would earmark it for capital investment, 36 percent indicated they would use it to fund required operational activities, 36 percent reported they would direct it toward investments in R&D and 34 percent said they would use the excess cash to fund new investments. Between 16 percent and 18 percent said they would service debt obligations, save it for future use, increase compensation to employees or buy back company stock.

Conversely, if companies found themselves in need of additional cash, most would either look to borrow the needed money (27 percent), recapitalize (24 percent), or implement tighter control of working capital (23 percent). Smaller percentages would

opt to sell some assets (15 percent) or otherwise squeeze their balance sheet (8 percent).

Cash position notwithstanding, in an economic environment that, while improving, is still quite volatile and uncertain, understanding and maximizing the factors that drive growth becomes even more important than during more predictable and robust economies. Specifically, companies must identify and build on those things that differentiate themselves from competitors from a revenue (or demand) and cost (or supply) perspective, and that enable them to more strongly connect with fickle customers before other competitors do. However, as our survey found, while companies have experienced some success in using these levers to make themselves more competitive and attractive to customers, they still face some significant challenges in making those successes sustainable over the longer terms.



Figure 4. Companies' growth expectations in the next 18 months

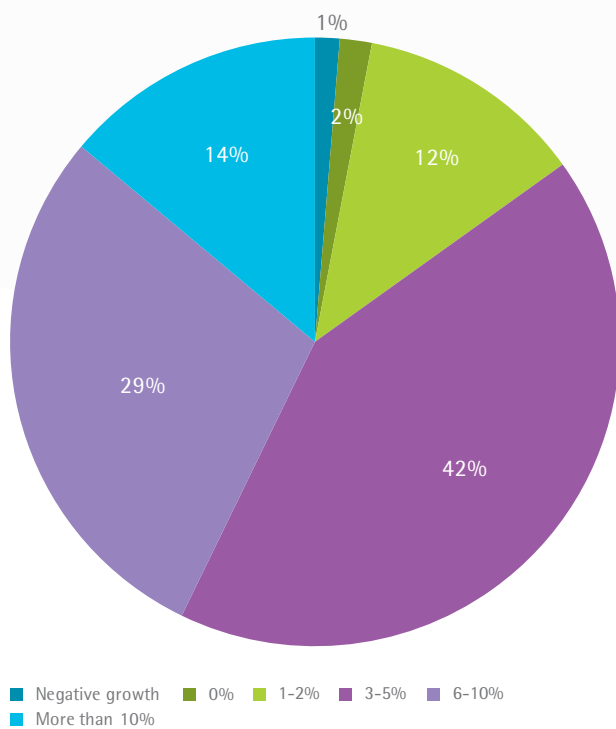
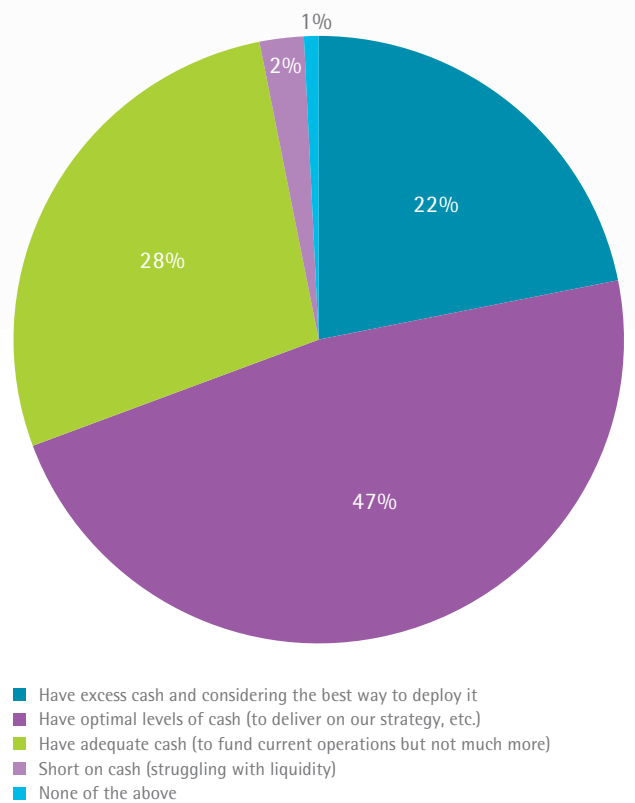


Figure 5. Companies' current cash position



Driving Growth via the Revenue or Demand Lever

Pricing is a critical tool for positioning differentiation from competitors and making offers attractive to customers. And for many companies, optimizing the way they make and execute pricing decisions is among their key strategic priorities. However, enterprises also face a number of challenges that prevent them from optimizing pricing and, for the most part, do not believe their pricing capabilities are sophisticated. Thus, opportunities do exist for companies to strengthen their use of pricing to help drive growth.

Service, innovation and pricing are the most common levers for driving competitive advantage

When seeking to drive competitive advantage and boosting revenue, companies have many options at their disposal.

According to companies in our survey, three of the most popularly used levers for driving competitive advantage are service, innovation and pricing (Figure 6). But companies tend to use more than one lever, and those levers tend to be strongly interrelated. Service was seen by the largest percentage as the primary or strongest factor (54 percent), but was followed closely by innovation/product differentiation (53 percent) and price position/price point (51 percent). Factors named by slightly less than half of respondents as a primary factor were marketing/brand (48 percent) and value proposition (47 percent).

These findings echo what Accenture has seen in its work with influential companies around the world. As products become more commoditized, enterprises are turning to service as a way to attract and retain customers. Yet in that drive to create value-added services, companies are finding that it's difficult to strike the right balance between "giving the people what they want" and ensuring that doing so doesn't erode profitability.

Similarly, remaining relevant to customers and differentiated from competitors requires companies to continually develop attractive new offerings. Yet in doing so, they need to excel in delivering meaningful innovation at an acceptable cost—and at a price that customers ultimately will pay.

Competitive and supply factors are used most often to set prices

When it comes to pricing, our study found that companies tend to most frequently use actions by competitors and the balance between supply and demand as inputs in setting prices—each of which was cited by approximately two-thirds of executives. Just about half said they use value-based and cost-plus strategies (Figure 7).

Business units and marketing are most likely to make pricing decisions

Business units and the marketing department tend to be the two most influential groups in determining a company's pricing. In 72 percent of companies, the business unit is always involved in making pricing decisions, followed closely by the marketing department (70 percent). Executives or executive committees (60 percent) and product managers (58 percent) are always involved in making pricing decisions in about six in 10 companies, while the finance department is always involved in setting pricing in only about half of companies (52 percent) in the survey.

Several challenges impede pricing optimization

We found companies face a wide range of challenges that make it difficult for them to optimize pricing (Figure 8). Among the challenges cited as having an extensive or moderate negative impact by a large percentage of respondents include challenges in sales execution (71 percent), unclear pricing strategy (70 percent), inadequate pricing analytics (69 percent), inadequate decision support/analytics (64 percent), and governance and accountability incentives (66 percent).

Figure 6. Strength of factors in driving companies' competitive advantage

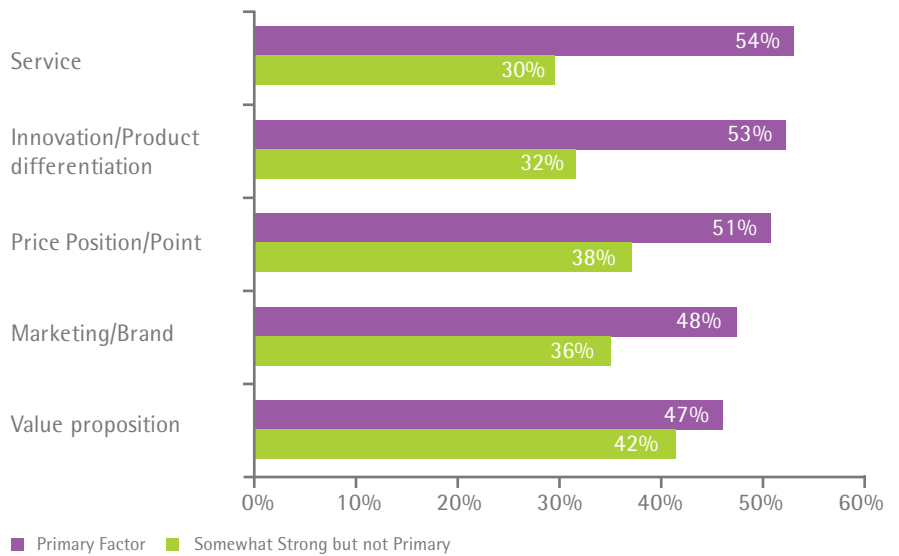


Figure 7. Companies' pricing strategies

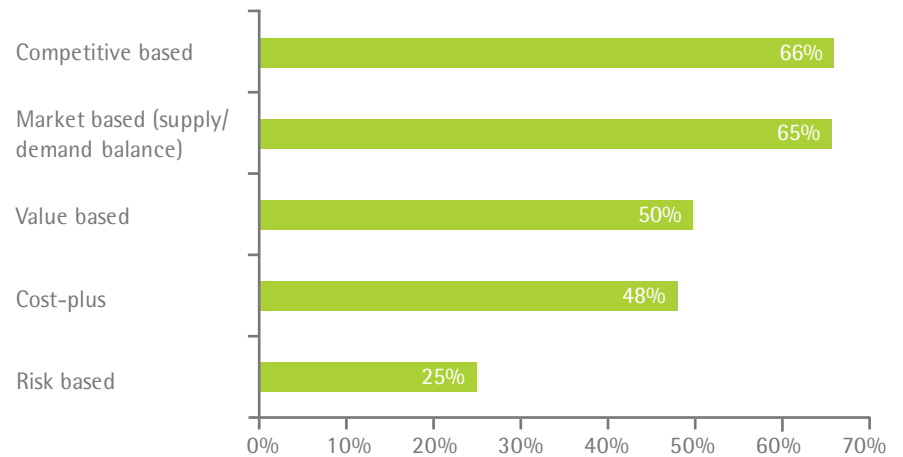
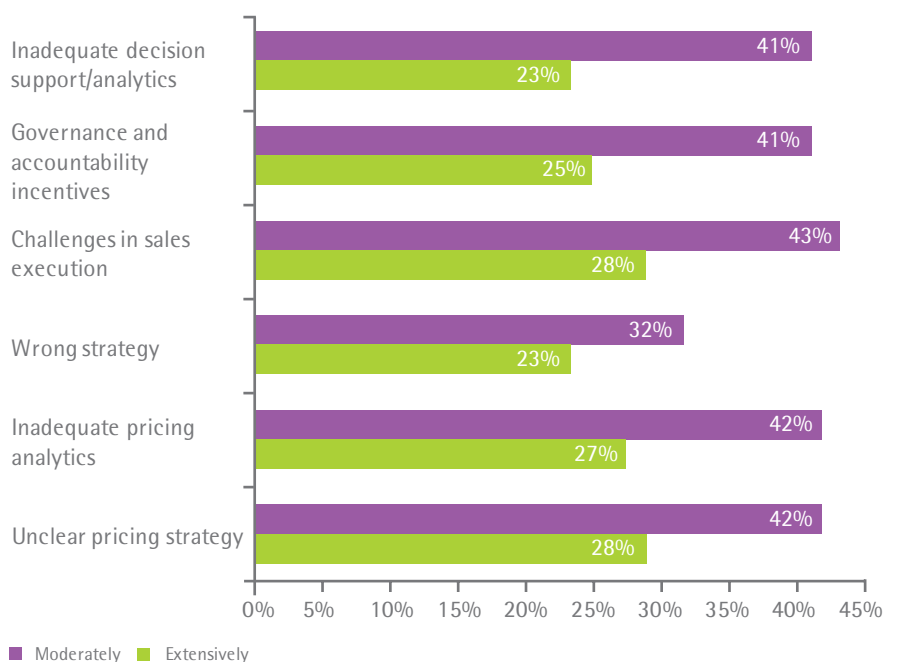


Figure 8. Extent to which various challenges impede companies' ability to be more successful in pricing



Price optimization is a priority

Given the importance of pricing to many companies' competitive positioning, and the major challenges they face in optimizing pricing, it's perhaps not surprising that price optimization was one of the three most important strategic priorities in the past 18 months for nearly three-fourths of companies in our survey. Thirteen percent ranked price optimization first, 34 percent cited it as second and 24 percent indicated it was third (Figure 9).

Pricing capabilities lack sophistication

However, despite the strong importance of price optimization, overall only about one-quarter of participating companies described their pricing capabilities as "sophisticated" (Figure 10). One area that seems to present a particularly strong challenge for companies is pricing technology. Three-fourths of companies do not have sophisticated pricing technology—meaning, they do not use ERP-class optimization and execution software for pricing. In fact, 36 percent said their pricing tools tend to be highly manual and fragmented, with the remainder stating they use automated tools but ones that typically are not integrated.

We found a similar situation with regard to pricing governance. Seven in 10 companies do not have clear accountability for pricing decisions and use rewards and incentives to drive the desired outcomes. Fully one-quarter said they generally have conflicting or unclear accountability for price and employ incentives that are not aligned to the desired outcomes.

In terms of pricing strategy sophistication, more than three-fourths of companies indicated they do not have a pricing strategy for different marketing situations nor is their pricing strategy tightly aligned with their overall business strategy—characteristics that describe a sophisticated strategy. Conversely,

24 percent said they have one pricing strategy that fits all customers and that that strategy is not connected to the overall business strategy.

Overall, the fact that approximately three-fourths of companies do not have sophisticated pricing capabilities suggests most companies have considerable room for improvement in their pricing strategies, tools, analytics, processes, organization and governance.

Analytics are important, but not core

For the vast majority of companies, analytics plays some role in their ability to optimize pricing, although it is not core to price optimization

initiatives in a majority of companies. Forty-one percent of executives said analytics are core to their price optimization programs or initiatives, while 52 percent said analytics are one of several inputs.

In general, participating companies use analytics for a wide range of activities, the most popular of which are making pricing decisions (cited by 66 percent of respondents), generating insights (56 percent), and executing and monitoring the impact of pricing decisions on the marketplace (52 percent). About half said they use analytics to experiment and test hypotheses or to test underlying assumptions (Figure 11).

Figure 9. Rank of price optimization among companies' strategic priorities

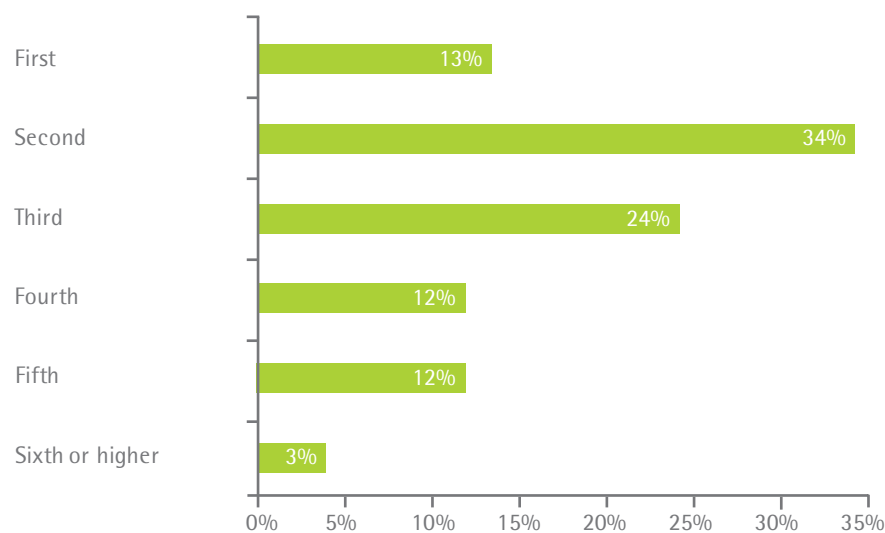


Figure 11. How companies use analytics

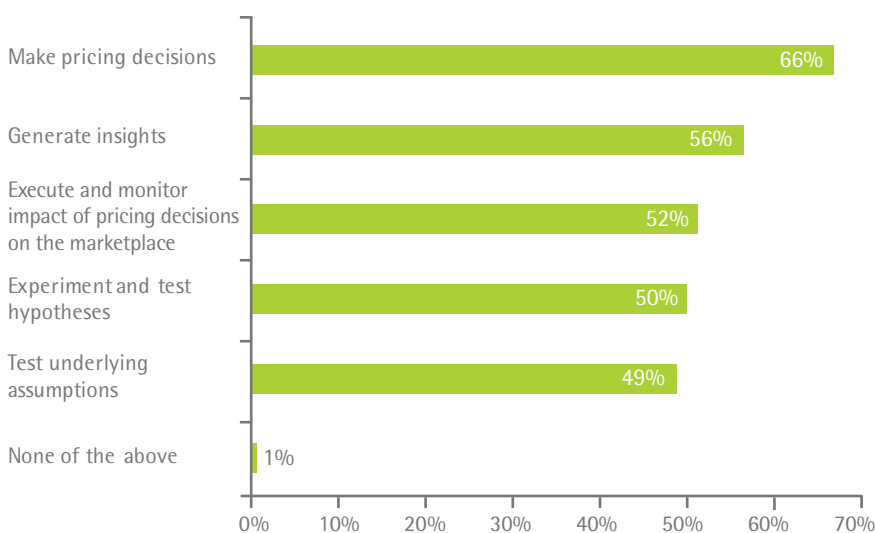
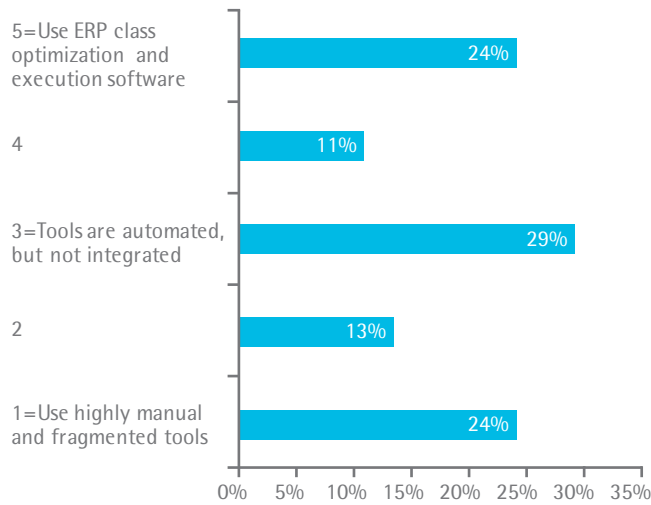
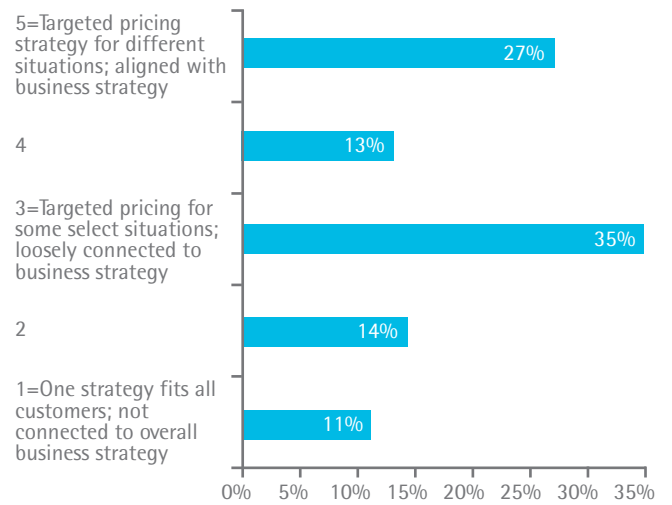


Figure 10. Sophistication of key pricing capabilities (using a scale of 1 to 5)

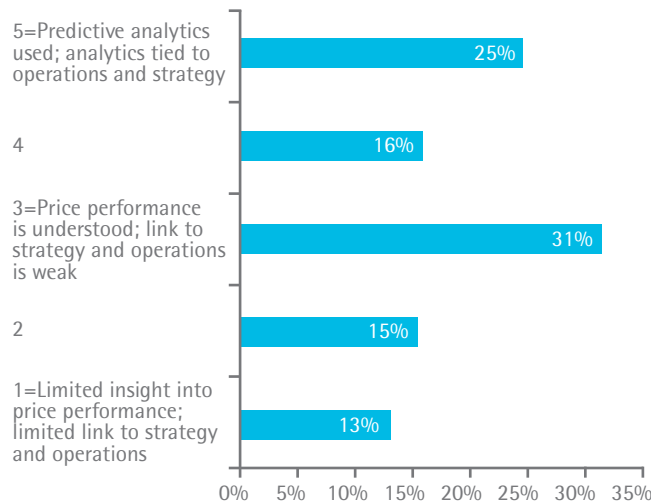
Pricing Technology



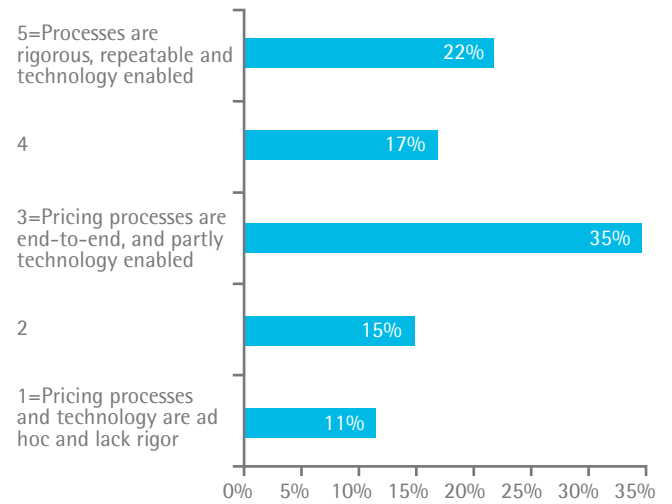
Pricing Strategy



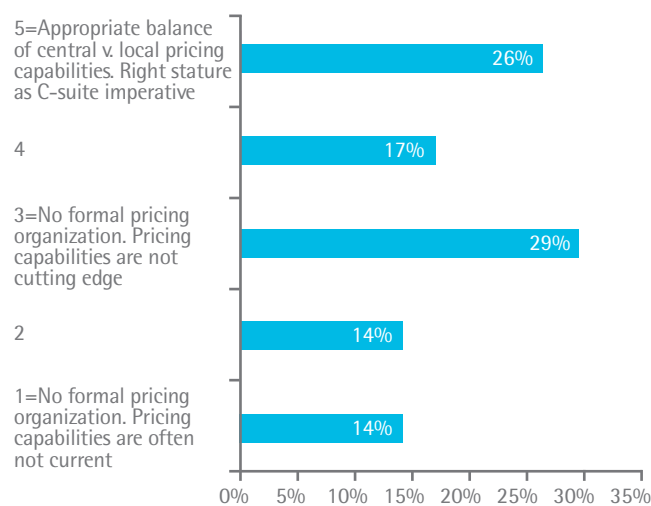
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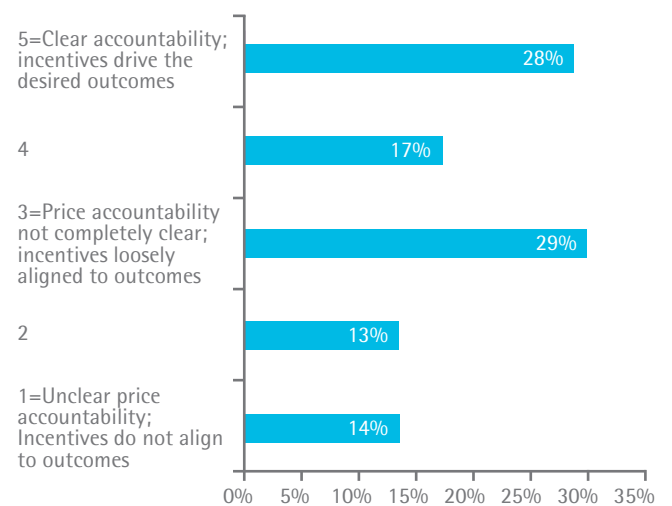
Pricing Processes



Pricing Organization

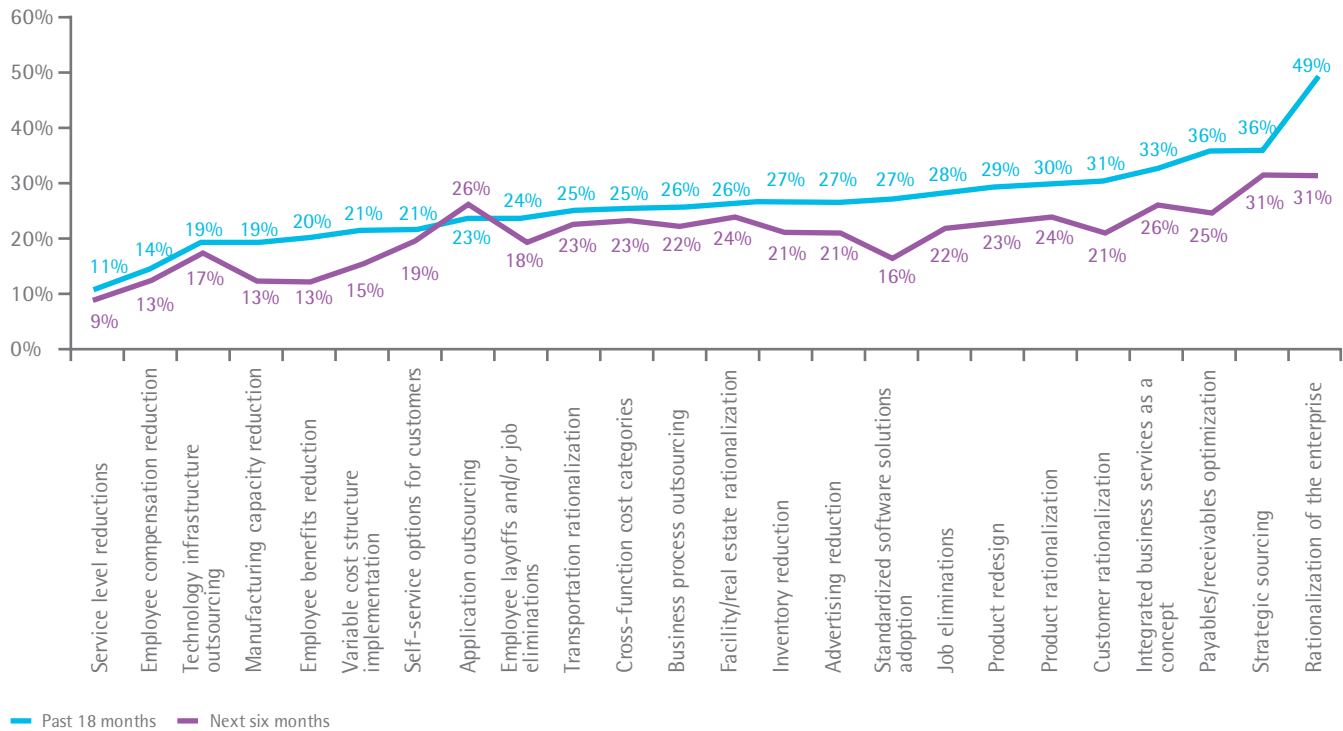


Pricing Governance



Driving Growth via the Cost or Supply Lever

Figure 12. Cost management actions companies have implemented in the past 18 months and those they plan to implement in the next six months



While companies appear to be struggling with building and leveraging pricing capabilities to strengthen growth and profitability, their track record in using the cost lever to stabilize their operations appears to be considerably better. Nearly all companies have reduced costs in the recent past, with many describing those efforts as successful in creating sustained cost reduction. However, many companies also believe they have additional opportunities to capture and, thus, cost-reduction efforts are planned to continue in the near future.

Companies have undertaken significant cost reductions

Given the ongoing challenges with economic recovery in many parts of the world, it's not surprising that a large majority of companies in the survey have been focused on reducing costs. Indeed, in the past 18 months, 82 percent of executives globally said their company has undertaken a significant effort to reduce costs.

These cost-reduction efforts took many forms (Figure 12): Forty-nine percent of executives said their company has rationalized some aspect of their enterprise in the past 18 months, which could include such actions as redesigning processes or consolidating back-office activities through global business services

or integrated business services, shared services, or outsourcing. Cited by approximately one-third of participants were initiatives such as payables/receivables optimization, strategic sourcing and integrated business services as a concept. A wide variety of initiatives were reported as implemented by between 20 percent and 30 percent of respondents.

For most organizations globally, competitive pricing pressures have had some influence on the level of strategic cost reduction measures they have taken. About six in 10 (57 percent) said the impact has been moderate, while 35 percent described it as extensive.



Cost-reduction efforts have generated positive results

In most companies, cost-reduction efforts are viewed as having been a qualified success (Figure 13). Fifty-five percent of executives said their efforts have been at least somewhat successful in creating sustained cost reduction—i.e., a permanent shift in their cost base and mindset about costs instead of a temporary change that will revert to former levels at some point in the future. Thirty-seven percent described such efforts as very successful and 7 percent indicated they were extremely successful. One measure of success is the fact that in most companies globally, executives believe they have captured the majority (45 percent) or virtually all (13 percent) cost reduction opportunities. That said, four in 10 executives believe there are still opportunities to capture.

Cost changes in specific functional areas in the past 18 months, however, were not consistent across organizations globally—with costs rising in some area and declining in others.

Cost decreases tended to be centered in the supply chain and procurement: Approximately four in 10 respondents said they have decreased costs in these two key functions in the past year and a half. Thirty-seven percent reported having reduced costs in operations/ production and 33 percent said they cut costs in corporate general management during that period.

On the other hand, increased spending was seen most frequently in R&D and IT, with 36 percent of executives reporting they have increased costs in the former and 34 percent saying they had boosted spending in the latter. Other functions, including marketing

and sales, customer service, strategy, and risk, were cited by between 20 percent and 25 percent of respondents as having experienced cost increases.

Cost reductions are expected to continue

Despite the success of companies in reducing costs, the focus on cost likely will continue in the foreseeable future. The next six months will see more cost cutting, with strategic sourcing and enterprise rationalization being the most popular cost management actions—each of which was cited by 31 percent of respondents (Figure 12).

Figure 13. Success of cost reduction efforts in creating sustained cost reduction

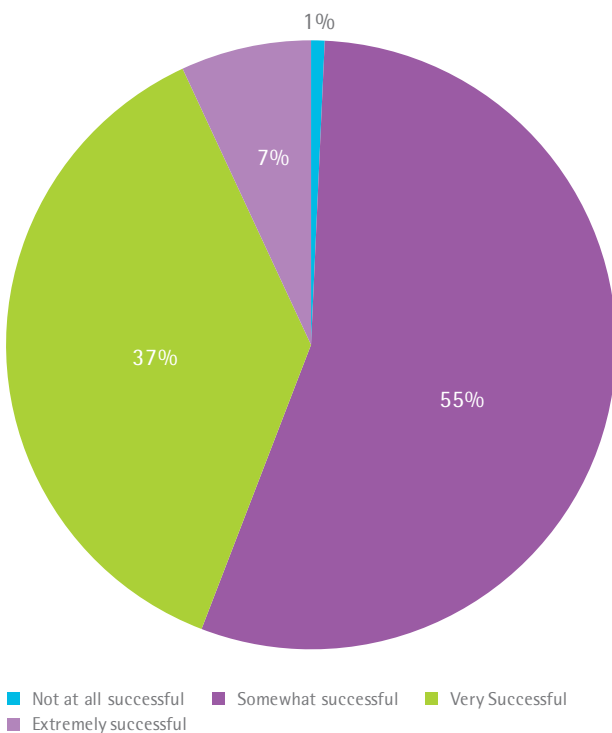
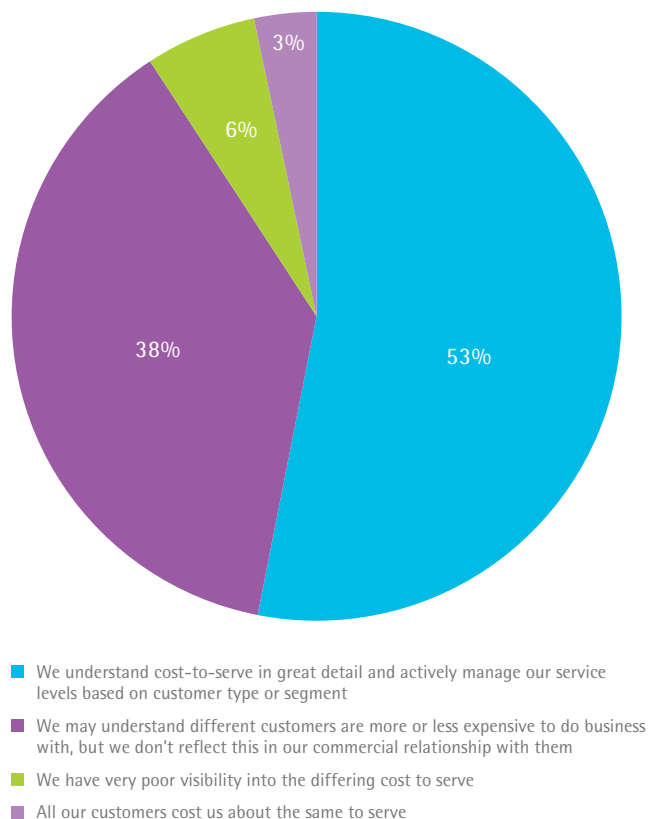


Figure 14. Extent to which companies understand cost to serve customers



Companies fall short in understanding their true cost to serve

While many companies participating in our survey actively try to match service levels with a customer's cost to serve, a large percentage are missing potential opportunities to improve margins by reflecting cost to serve in how customers are treated and managed.

Only about half of participating executives said their companies understand cost-to-serve in great detail and actively manage their service levels based on customer type or segment (Figure 14). A nearly equal percentage of executives said their companies either do not reflect the cost to do business with different customers in their commercial relationship with these customers—despite understanding different customers are more or less expensive to do business with (38 percent)—or have very poor visibility into differing cost to serve customers (6 percent).



Conclusion

The most recent recession was difficult for enterprises around the world and spurred an intense series of cost reductions—which took the form of significant layoffs in many developed-market countries. However, with the economy now improving, albeit unevenly, in most parts of the world, companies generally are now more optimistic about their prospects for growth in the short and long term.

However, to capitalize on growth opportunities, companies will need to address some shortcomings in their pricing capabilities. Indeed, according to our survey, while enterprises have experienced some success with pricing initiatives, their pricing capability levels remain average at best and lack full integration into key tools across the organization. Furthermore, although many functions or roles are involved in the pricing process, clear governance remains an issue and a balance between central versus local decision making is still lacking in a majority of cases. And companies need to increase their focus on how predictive analytics can help improve the accuracy and efficacy of their pricing decisions, especially at a time when volatility is the rule and benchmarks are scarce.

We also found that most companies employ a competitive-match pricing strategy or use it to balance supply and demand—but few are using value-based strategies and fewer still are approaching innovation with a “design to price” mindset. As a result, competitive actions—and, in essence, fear—have to some extent driven price changes and, therefore, cost reduction. This has placed companies in an unattractive position of being reactive and having their own moves dictated to them by other companies.

From a cost perspective, it’s clear that although past cost reductions have been effective, companies generally feel there’s still more “gold”

to be mined from their operations. Thus, cost cutting is expected to continue for the foreseeable future to help companies ensure more stable operations and higher margins.

But even if companies shore up their pricing capabilities and are successful in wringing more efficiencies from their operations, a company can only improve cost (or supply) and revenue (or demand) levers independently of one another so much until growth stalls. In our experience, achieving robust, sustainable profitable growth requires understanding how to use both levers simultaneously. In other words, during the recession, companies cut costs with an axe, and growth suffered as a result. Now, they need to fine-tune costs with a scalpel by gathering and acting on insight from the demand side to pursue profitable growth.

For example, instead of using a blanket approach to pricing, a company should use segmentation to understand which part of the business should be a competitive match on price, which should be cost-plus, which should be market-based, and which should be value-based. It also should implement capabilities that can help it understand the true cost to serve each customer segment—and where changes can be made in how each segment is served to reduce costs while enhancing value. And it should create a more variable cost structure based on company performance to help avoid the typical cycle of hiring and laying off in concert with economic swings.

Once a company gains a clear understanding of how various customer segments differ in their pricing needs, identifies the true cost to serve these segments, targets the right pricing approach to those segments, and increases its agility by variablizing its cost structure, it is ready to further improve profitability by managing the business portfolio.

By this we mean shifting resources to focus on higher-margin areas of the business to drive growth and away from those areas that are a drag on growth and profitability.

There’s no question that price is a leading competitive lever. It’s one of the main points that affect customers’ buying decisions. But raising prices in the current environment—especially in those markets where the economy is still somewhat fragile—will not boost sales, nor will dropping prices improve margins. Similarly, reducing costs—while important to many companies’ survival during the recession and vital to ongoing profitability—eventually can have a deleterious effect on a company’s ability to support growth initiatives. We believe the companies that are best positioned to capitalize on the growth opportunities today are those that use insights from the demand side to drive appropriate cost-reduction efforts on the supply side. These enterprises will be the ones setting the agenda for competitive differentiation, profitable growth and, ultimately, high performance in a volatile world.





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