emerson nash

# Outline Pricing Review

| **Business** | **Product Company 1 Ltd** |
|---|---|
| Date | 20th January 2020 |

## Summary

### Overall health of pricing and profits

| KPI | | Notes |
|---|---|---|
| Revenue growth | 2.9% | There has been single digit revenue growth for the last 2 years in a challenging retail environment. |
| Volume v Value growth | 3.3% | Volume has been growing at a faster rate than revenue. This suggests that prices have decreased although it may also be driven by customer or product mix. This should be investigated further. |
| Discount % | -6.3% | Discount % of revenue has increased both this year and last year. This has resulted in a lower average revenue per item. This could be on a specific customer or product line and should be investigated and understood. |
| Margin % | 28.3% | Margins are in line with industry averages although behind selected key competitors. Margins have been decreasing over the last 2 years driven primarily by reduced average revenue per unit rather than increases in cost of goods. |



**Pricing impact on margin**

While Gross Margin in absolute terms increased from £14.23m to £14.25m it decreased in % terms. The drivers can be seen in the following chart. Had gross revenue rate and discounts not declined, the business would have seen an additional **£564,000** in gross margin and % margins would have increased year on year.


The Outline Pricing Review is a high-level review based on a business information provided by your team. The information contained in this report should be considered an initial indication only and should not be relied upon to make decisions about the business. For an in-depth analysis, please speak to us about a Detailed Pricing Review.

**Key Recommendations**

| | |
|---|---|
| 1 | Discounts: Levels of discounts have increased in all areas of the business except product range B. We recommend investigating the increases by product and by key customer or sales channel. This is to be able to understand in which products and for which customers discounts have increased and for what value in return. |
| 2 | Gross Revenue rate (Headline price): This decline has been driven by product range A and 'Other' product ranges. We recommend reviewing all products in these ranges. Have any had a decrease in list price? If so, was there a strategic business reason for this? If not, reinstate the former prices. |
| 3 | Gross Revenue rate (Headline price): The rate decrease may also have been driven by mix. To understand this, explore which products are driving the growth as it may be the ones with a lower price per unit. Are these products as profitable as others? |
| 4 | Cost of goods: Cost of goods per unit has decreased in all areas except in 'Other' ranges where it has jumped up significantly. These decreases have offset some of the increases in discounts. However, we recommend looking at the long term forecast of cost of goods to understand if likely to increase again? If the cost reduction has been a genuine long term reduction, we would suggest that quality is assessed to ensure that perceived value by the customer has not been compromised as this may lead to further price decreases or reduced customer demand. |
| 5 | 'Other' product ranges: Although small part of business, should identify what is not working in Other and why. It may be best to remove in order to focus on more profitable parts of the business. |

**Subcategory Summary**

To understand the drivers of the volume increases and the price decreases the business was split into its three principal product ranges.

| KPI | Total Business | Product Range A | Product Range B | Product Range C | Other |
|---|---|---|---|---|---|
| Revenue growth | 2.9% | 3.6% | 2.0% | 3.1% | 0.3% |
| Volume v Value growth | 3.3% | 4.5% | 2.0% | 3.1% | 1.8% |
| Discount % | -6.3% | -6.3% | -5.4% | -7.0% | -8.6% |
| Margin % | 28.3% | 28.2% | 30.0% | 29.5% | 13.1% |
| % of total business GM | 100% | 45% | 31% | 22% | 2% |
| Cost of goods per unit | ⬇ 1.94 | ⬇ 1.95 | ➡ 1.98 | ⬇ 1.87 | ⬆ 2.01 |

**Product Range A:**

Key notes:

- ✓ Good year on year top line growth
- ✓ Average cost per unit decrease
- × Decrease revenue for unit, increase in discounts
- × Decrease in GM%

In more detail:


This product group makes up 45% of the GM of the business and as such has a significant impact on the overall results. Revenue growth was strong this past year at +3.6% although volume growth was higher at +4.5% but GM only increased by 1.3%. There has therefore been a dilution in rate per unit from an average of £2.91 to £2.89. On top of this the discount rate has increased from 5.5% last year to 6.3% this year. Whilst the costs of goods have decreased to cover off some of this price decrease, it has not offset it all with gross margin % falling from 28.6% to 28.2%. Whilst these differences do not sound significant if we take a look at the chart above, we can see that the profit for Range A could have been **£370k** higher had price and discounts not increased. Whilst cost of goods have fallen this year, it would be prudent to examine what they are predicted to do in the coming years to make sure that margins are not eroded further. At this level it would appear that lower prices have led to increased sales albeit at a cost to profit.

The next steps would be to understand which products have been particularly impacted by the price cuts, discounting and cost decreases. This discounting may have been customer or channel driven. Ensure that this is understood, and any appropriate action taken to reduce any further increase in discounting unless for strategic purposes.

**Product Range B:**

Key notes:

- × Good year on year top line growth although slower than range A and C
- × Highest average GM per unit than other ranges
- ✓ Average cost per unit maintained
- ✓ Revenue for unit and discount level maintained year on year
- ✓ Discount % lowest out of the three core product ranges

In more detail:


This product group makes up 30% of the total profit and therefore also has a significant impact, albeit to a lesser extent than group A. However, at an average GM of 85p per unit this is over 10% more profitable per unit than any other profit group. Group B has also shown good growth whilst maintaining average revenue and discount rates. Not only is this the only area that has maintained its discount rates, it also has the lowest discount % of all the ranges. This is strong performance.

Whilst other ranges may have pricing issues to solve, the key with range B is to understand if there are particular products driving this strong performance and to work with Sales and Marketing to understand how the growth can be improved further.

**Product Range C:**

Key notes:

- ✓ Good year on year top line growth in line with revenue growth
- ✓ Revenue per unit maintained year on year
- ✓ Average cost per unit maintained
- × Discount % highest out of the three core product ranges and has increased year on year
- × Decreased GM% for second year in a row although still higher than other ranges in the business

In more detail:


At 22% of the business range C has less of an influence on the total business but still has impact. While it is positive that volume has increased while revenue rate has been maintained, unfortunately, any benefit has been offset by a significant increase in discounts and profit has stayed the same as prior year. Whilst the previous year held the discount rate flat whilst growing in volume, this has not been achieved this year. Therefore, the sudden increase in discounts in the biggest area for focus in this range.

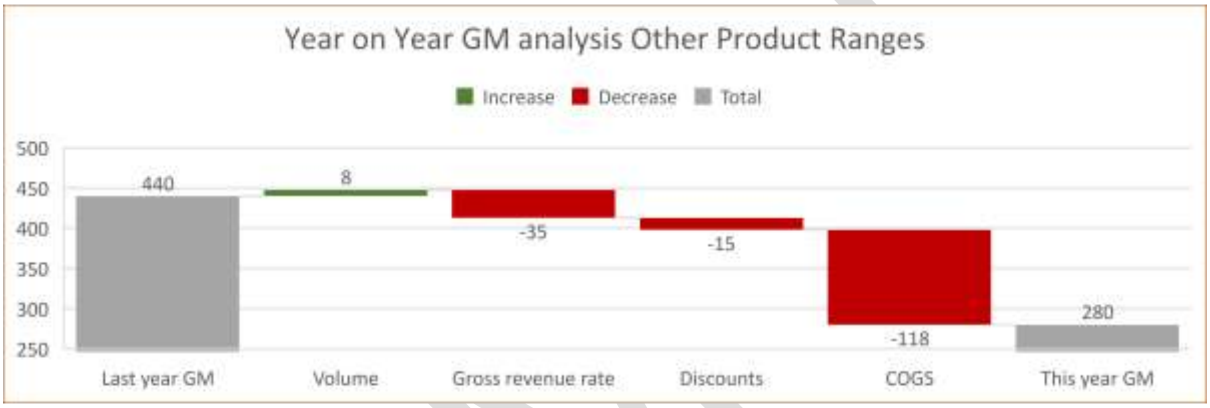
It is recommended that the range should be looked at by product and by customer to see where the most significant discount increases have taken place in order to take steps to control this so that the increase does not continue uncontrolled into future years.

**Other Product ranges:**

Key notes:

- ✓ 1.8% year on year volume growth although slower than 3 core ranges
- × Average cost per unit increased, biggest driver of profitability decline
- × Revenue per unit decreases and discount level increases year on year negatively impacting profitability
- × Discount % higher than the three core product ranges
- × Maintained GM% which is higher than other ranges in the business

In more detail:




All other ranges make up only 2% of the total business GM and therefore have limited impact on total performance. However, it should be a concern that the area has not seen any growth, yet the average price has fallen, and the discount rate increased. It is the increase in the average cost of goods per unit that has had the most negative impact with gross margin 36% lower than last year.

Although relatively small, this area should be looked into further to understand the role these products play in the business and its future strategy. From these top level numbers, it would appear that there would be benefit in SKU rationalisation in order for the team to focus on the more profitable and higher growth areas of the business.

To note, we are also able to look at this split in terms of key customers and brands.

**Competitor Benchmarking**

| | Company | Competitor 1 | Competitor 2 | Competitor 3 |
|---|---|---|---|---|
| Revenue | 50,270 | 35,425 | 41,108 | 53,549 |
| COS | - 36,020 | - 21,838 | - 29,026 | - 37,578 |
| **Gross Profit** | **14,250** | **13,587** | **12,082** | **15,970** |
| | | | | |
| Admin Expenses | - 6,029 | - 12,032 | - 6,344 | - 7,123 |
| Distribution costs | - 6,889 | - | - 4,818 | - 7,026 |
| **Operating profit** | **1,332** | **1,554** | **920** | **1,821** |
| | | | | |
| Rev growth | 2.2% | 19.6% | 14.1% | 2.2% |
| GP % | 28.3% | 38.4% | 29.4% | 29.8% |
| OP % | 2.6% | 4.4% | 2.2% | 3.4% |

*All information taken from Companies House as at 31st December 2019*

The company is among the largest in terms of Revenue amongst its peers and growing at a similar rate to Competitor 3. However, Competitor 1 and Competitor 2 are seeing significantly higher levels of growth albeit from a smaller base. If growth rates continue as they are, all four companies will be similar size within 24 months.

What is notable in differences between the companies is that Competitor 1 is the smallest yet has the highest Gross Profit% by a significant margin. It is recommended that this is understood and further benchmarking in terms of price and quality should be carried out. As they are also growing the fastest, it would appear that there is strong demand for their proposition in the market.

The Company's gross profit of 28.3% is the lowest of all the competitors. Two years ago, Company's gross profit % was at 29.6% which is in line with Competitor 2 and 3. It is, therefore, expected that profit levels should be higher, at least in line with competition and at previous levels. We would recommend a focus on pricing and promotion to drive a positive impact in this area.

**What this report does not cover**

We have not analysed the accuracy of information provided.

The analysis does not take into consideration the opportunity to increase prices. This is often a significant opportunity and can create a "step change" improvement in profitability as a well-known study by McKinsey showed, just 1% increase in price results in an average 11% increase in profits.

For a more detailed analysis, including steps of **how** to make the changes please speak to us about a Detailed Pricing Review.