There's More to Life than Cutting Costs: Pricing Excellence for Media & Entertainment Companies

Executive Summary*: Media & Entertainment Companies are under earnings pressure and improved pricing may be the most important lever they have to improve their results. Improving pricing by 1% can lead to a 7.5% improvement in operating margin. And a rigorous pricing program can improve effective price by 2-3%, yielding a 15-20% improvement in operating margin. It's very painful to cut enough costs to get that kind of improvement.*

Proper pricing has many tactics and operates on four levels:

1. *A proactive Market Strategy– adapting to Macro forces that affect all competitors, like interest rates*
2. *Increasing perceived Customer Value– adding or communicating features that make the customer see the product or service as more valuable*
3. *Being disciplined about Transaction pricing– discounts are not forbidden, but they need to be used in a very disciplined manner*
4. *All this needs to be underpinned by a robust Pricing Infrastructure– the Management Operating System that takes in external information, compiles internal information, and ensures that executives and frontline employees are having the right conversations with the right data.*

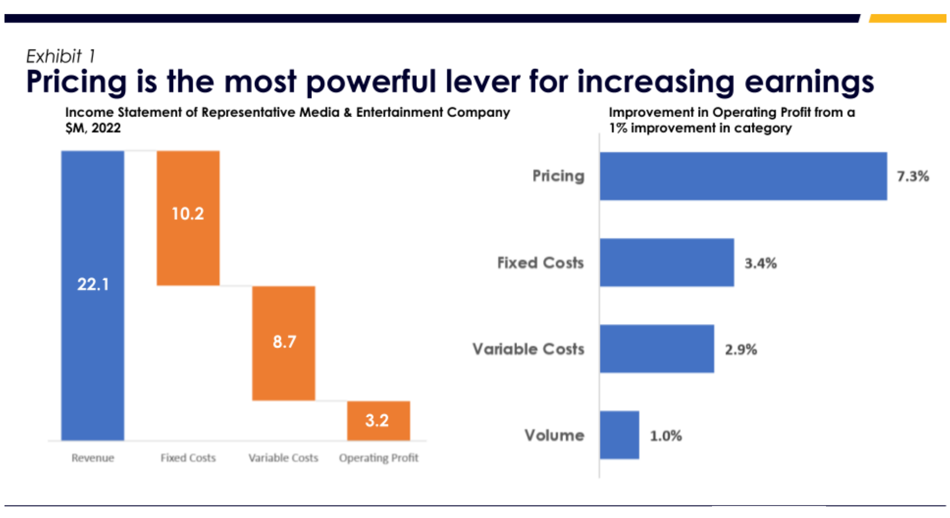
Price advantaged companies often treat their pricing function as a significant profit center and prioritize investing in the skills and assets that keep them thriving. Achieving Pricing Excellence involves understanding the economics, but is really a question of culture. Those organizations that have mastered pricing have made it a core part of "the way we do things around here."

"Price is what you pay; value is what you get"
–Warren Buffett

The Media and Entertainment spaces have had a tumultuous past few years. Rapid improvement in technology, an entire new distribution channel opening, competitors getting to scale faster, and disruptive technologies emerging have made it the curse of "interesting times." Most recently, earnings have come under significant pressure as the economy slowed down and the long online advertising boom ebbed. And many organizations have, understandably, begun cutting costs. **But there are other ways to solve the earnings problem.**

Pricing can be the most powerful lever in improving earnings. A 1% improvement in price has more impact on the bottom line than a 1% improvement almost anywhere else. There is a clear playbook for achieving these gains, but the way to retain these gains long-term is to build it into your culture. Great pricing organizations not only have the tools and systems in place to measure and optimize price, they have a culture that is committed to collecting, analyzing, and discussing real data with integrity.

Figure 1. Microeconomics mean pricing is a disproportionately powerful lever



Pricing is not a monolithic lever– it takes place at three levels, and there are several tactics that can be applied. The three levels where you can take action on pricing are–

- **Level 1. Market Strategy**– Adapting to the Macro- and Microeconomic changes going on across the economy. For most media & entertainment companies, these tend to be global economic changes like interest rates, unemployment, and disposable income, and the normal interplay of competitors in a particular arena.

  Example: Setting the price of a cinema ticket in a competitive city

- **Level 2. Customer Value**– Within each segment, what price level and structure best positions you versus competition while continuing to grow value? Do you offer distinctive value vis-a-vis your competitors? Are you perceived as being good value for money? Are you fully communicating all the sources of value you provide?

  Example: Bundling more value into Disney+

- **Level 3. Transaction**– Are you maximizing value (and minimizing discount) on every transaction? Are you using discounts in a disciplined tactical manner? How do you decide the pocket price? Do your systems capture every adjustment to invoice price? There are myriad ways for value to leak out from a seemingly attractive transaction.

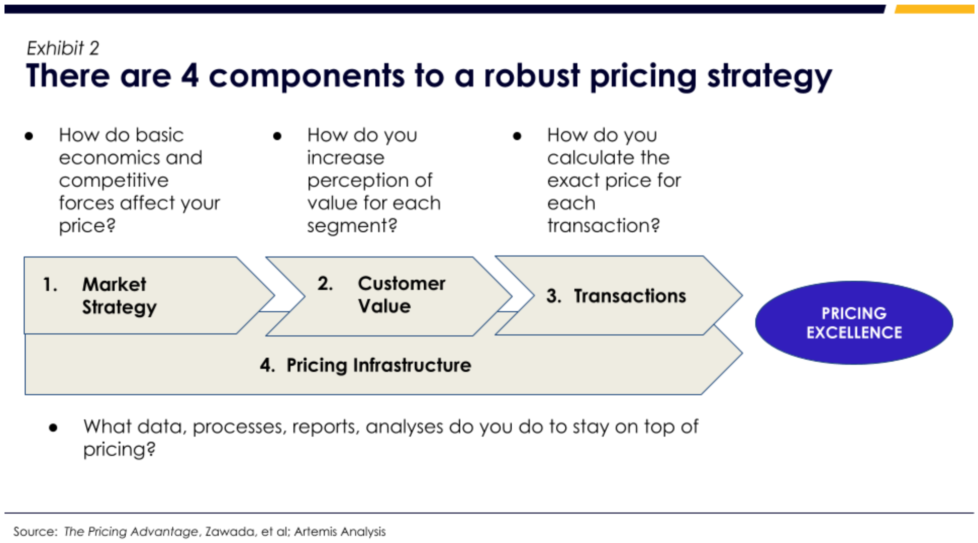
  Example: Ensuring that ad sales reps are not giving the wrong accounts meaningful discounts

The final ingredient, that supports all the others is:

- **Level 4. Pricing infrastructure**– What data, processes, reports, analyses do you do to stay on top of pricing? Do you understand on a granular level how you are setting and achieving price? How about your competitors?

  Example: The data, systems, and meetings in which you decide pricing

Figure 2. The 4 Components of Pricing Excellence



Level 1– Market Strategy

Market prices are largely determined by microeconomic factors. While some competitors may undercut prices for short periods of time, the overall market price level (e.g.,the price of a cinema ticket or a streaming subscription) is typically set by trends that affect all market participants. Specifically, they are:

1. Cost changes for inputs (e.g., vinyl for records)
2. Supply changes (e.g., writers' strike)
3. Demand Changes (e.g., Local Competition, TikTok enters advertising market and captures share)

Managing pricing factors requires keeping track of pricing changes in your industry, as well as in your suppliers and customers. Michael Porter's five forces can be helpful here. Regulatory changes can have a particularly powerful effect, particularly in the television distribution industry.

Tracking this data is most useful when it allows you to predict an upcoming price cut or increase by a competitor, or allows you to price tactically ahead of your competitors.

This lever is particularly important in industries depending on single source inputs like Oil or Basic Chemicals. (Note what impact the success of Adele's vinyl release did to the cost structure of vinyl records, a niche business now, but once the heart of the music business.) It also is relevant to any industry where interest rates matter, which certainly includes Media & Entertainment. Falling rates allow everyone to spend more on new content and taking risks; rising rates makes everyone more conservative. Being able to recognize these macro trends in the economy before your competitors allows you to proactively build in smarter pricing and capture value tactically.

Key Questions for Market Strategy

- Do you have an evidence-based forecast of overall pricing trends in the market for the short, medium, and long term? How accurate have these forecasts been historically? Have there been major discrepancies between expected and actual market price levels?
- Is your view shared across your organization so that your market pricing behavior is consistent with these forecasts?
- Do you have a mechanism in place to assess specific market events such as technological changes, capacity additions and reductions, new competitors, changes in input costs, and demand shifts, and their likely impact on industry prices?
- Has there been market-wide earnings pain? Are there competitors in your markets whose pricing behavior is considered irrational?

Level 2– Customer Value

Satisfied customers are willing to pay as long as the perceived value is greater than the price.

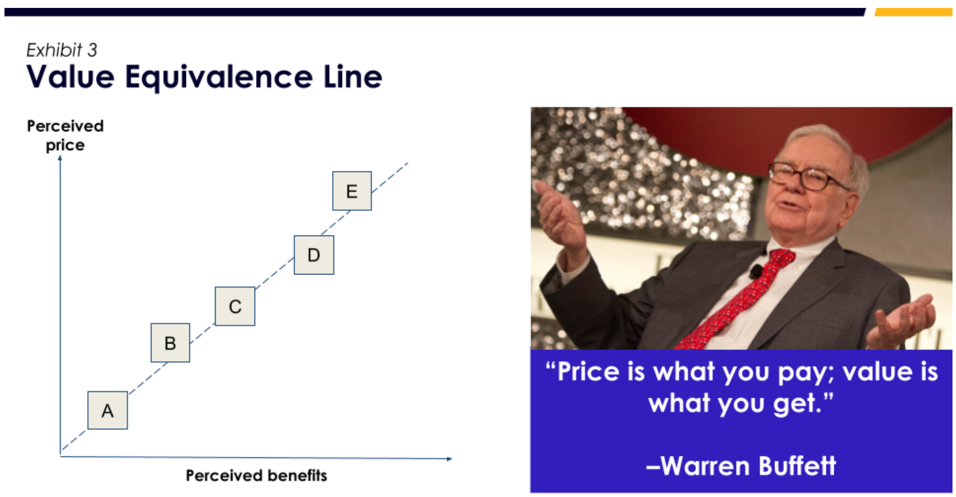
The key word here is "perceived." What matters is not the actual value of a product or service, but the customer's perception of that value. Smart organizations understand this and focus on increasing the perceived value of their offerings by offering excellent customer service, high-quality products or services, and/or a strong brand identity.

In principle, competitors offer a fair exchange of price and value. Low-value propositions are priced low, while high-value propositions are priced high. This relationship can be seen on the **Value Equivalence Line (VEL)**.

The VEL is a graphical representation of the relationship between price and perceived value. It shows that consumers are willing to pay more for products or services that they perceive to be of higher value.

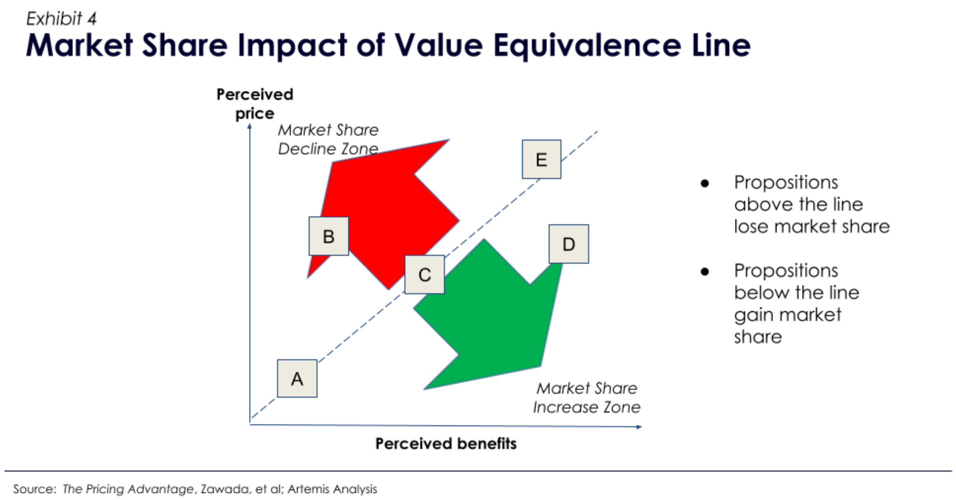
The VEL can be used by businesses to understand how consumers value their products or services. This information can be used to set prices and to develop marketing strategies that appeal to consumers.

Figure 3. Value Equivalence Line



A competitor can charge more if it can convince customers that its product or service is worth the extra cost. This can be done by offering superior quality, features, or customer service.

Figure 4. Market Share impact of VEL



Companies that consistently provide more value for the price will eventually win market share.

The trouble is Media/Tech companies often have products that are not easily compared. Is a subscription to MGM+ equivalent to a subscription to Disney+? What about BET+? Further, the value to one segment can be very different to the value to another segment.

There are three main types of benefits that customers, whether consumers or businesses, can derive from Media & Entertainment companies: functional benefits, process benefits, and relationship benefits.

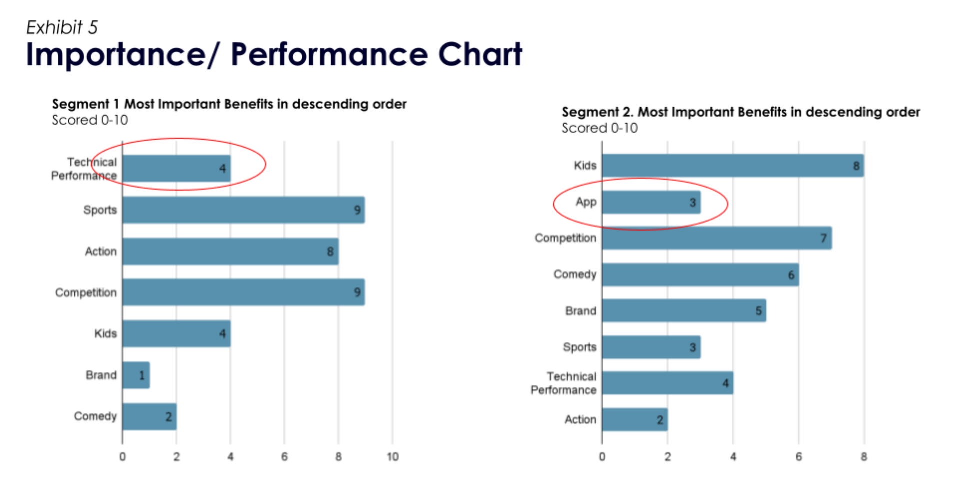
- **Functional benefits** are the most obvious benefits. For streaming services, the benefits include a wide variety of content, including movies, TV shows, documentaries, and more. They also offer high-quality streaming performance, with no lags or buffering.
- **Process benefits** are the benefits that come from the ease of use of streaming services. They are typically very easy to sign up for and use, and they offer a variety of features that make it easy to find and watch the content you want.
- **Relationship benefits** are the benefits that come from the emotional connection that consumers have with streaming services. For example, Apple fans may be more likely to subscribe to Apple Music because they identify with Apple and consider themselves part of the Apple tribe. A similar effect extends to Disney

and BET, where certain customers are broadly loyal to the overarching brand. (It's not clear whether this extends to Amazon Prime Video.)

Ultimately, the value of a streaming service is determined by the combination of functional, process, and relationship benefits that it offers.

These benefits can then be measured on an Importance v Performance Matrix, and segmentation here is critical. (At theme parks, what is more important to families with young kids may be very different than families with tweens and teens.)

Figure 6. Importance and Performance

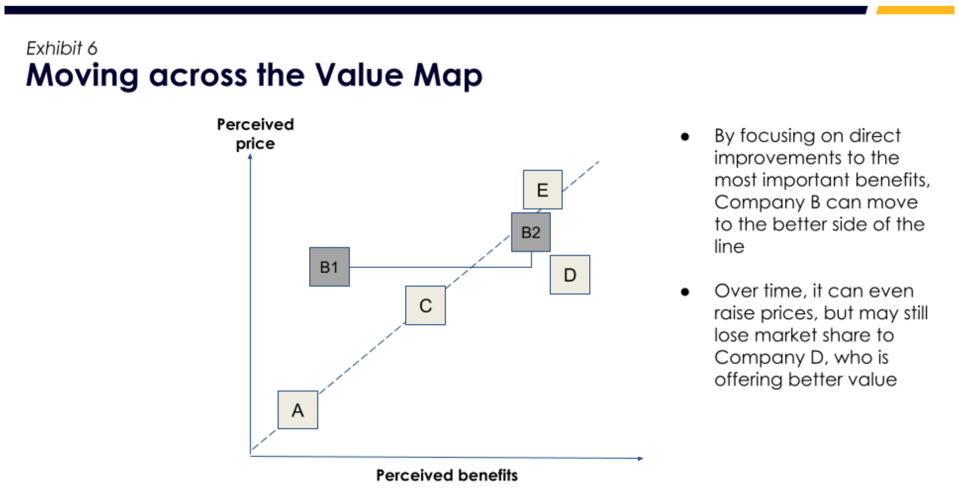


This degree of specificity requires significant market research but can be very illuminating, especially when broken out by segments. For example in this case, Segment 1 considers Technical Performance their #1 priority in a streaming service, but the perceived performance is weak. Equally, for Segment 2, having a robust app that delivers a good User Experience on phones and tablets is critical, but the performance is not what it should be.

By understanding your customers' needs and communicating your value effectively, you can reposition yourself on the value map and charge more for your services or capture market share.

Bundling can be a very useful tactic. While the Disney+ bundle (including Hulu and ESPN+ in the United States) has been a natural bundle of services from the same company, it is conceivable that a bundle that cuts across companies (for example Netflix plus Spotify or Amazon Prime plus BET+) might offer disproportionate value to different segments, and allow the bundler to get greater market share.

Figure 7. Moving across the Value Map



Key Questions for Customer Value

- Are you guessing at what customers want, or are you actually doing the research to find out?
- Have you identified the different customer segments and what they value most?
- Have you repriced your products based on this understanding?
- Do you know how sensitive customers are to price?
- Are you using this knowledge to help resellers sell your products?
- Are you tracking your competitors' prices?
- Have you identified the premium or discount that is justified in relation to competitors' prices?
- Do you understand how customer segments vary in their sensitivity to price?
- Are your prices and price structure reflecting this understanding?
- Have there been any dramatic, unexplained shifts in market share or unexpected price and benefit moves by key competitors?

These are all important questions for businesses to ask themselves in order to ensure that they are pricing their products competitively and effectively. By doing the research and understanding customer needs, businesses can set prices that will attract customers and maximize profits.

Level 3. Transaction Pricing

Transaction Pricing is a game of inches, and the wrong discounts can cost you big.

Microeconomics tells us that every customer has a different price elasticity. Some customers are more sensitive to price than others, and they're more likely to switch to a competitor if they find a better deal. It also means that to fully capture the opportunity below the demand curve, you may have to offer the same goods at many different price points. This is particularly true in advertising, where individualized pricing and packages mean customers are rarely paying the same price as their competitors. That means getting transaction pricing right is critical. Overgenerous discounts can erode brand value and make it harder to win future business.

For example, if you offer a discount to a customer who was going to buy without it, they're likely to continue to expect discounts in the future. This can lead to a vicious cycle where you have to keep lowering your prices in order to keep customers happy.

As transactions grow more complex, the opportunity for value leakage increases. That's because there are more opportunities for discounts to be given out without proper justification. Accordingly, you need to have a clear and consistent transaction pricing policy in place. This policy should be based on sound economic principles and should take into account the different price elasticities of your customers.

If you don't have a clear and consistent transaction pricing policy in place, you're leaving money on the table. Every day hundreds or even thousands of customer-specific decisions (or even line-items on invoices) determines winning or losing. In most cases, the right policies may be in place, but they are not applied consistently.

There are several obstacles to better transaction pricing, most of which fall under the heading of Culture.

- Transaction volume and complexity
- Top management neglect
- Absence of reporting tools
- Unaligned incentives

All of these lead to cracks in your pricing policy, and discounts can appear in the wrong places. Discounts are a necessary evil to most Media companies, and a normal part of doing business. However, they should be reserved for the cases that move the needle– bringing in a large new account, rewarding customers who give you a disproportionate share of their ad buy, or an account making a big commitment to your risky new product. However, giving out discounts to ordinary customers as a standard sales-closing tactic will create value leaks that are difficult to reverse. Once a customer starts getting a discount, it can be very hard to wean them.

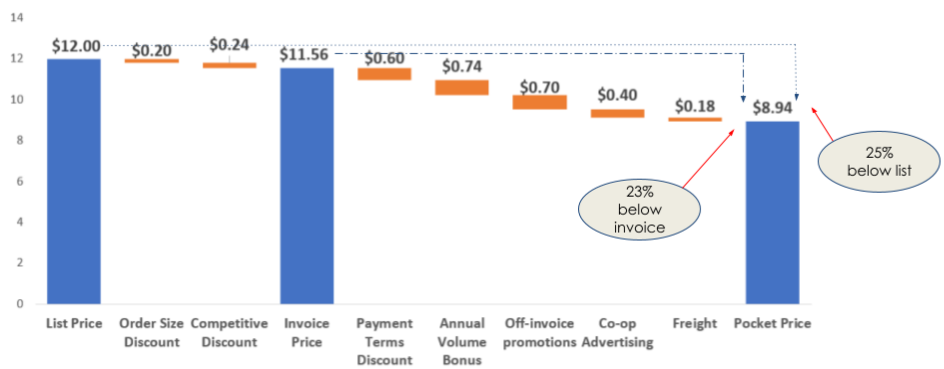
The use of discounts is best illustrated by the Pocket Price Waterfall. The waterfall shows specifically how categories of discounts are applied and how they drain value away from the list price.

Figure 8. Pocket Price Waterfall

Exhibit 7

The Pocket Price Waterfall reveals Discounts

Discounts between List and actual pocket price, Representative licensed merchandise



Source: *The Pricing Advantage*, Zawada, et al; Artemis Analysis

This example covers a sale of licensed merchandise, but it applies equally to DVD or CD Sales, Ad Sales, or any other B2B sale that goes through a professional procurement department.

It may be that all these discounts are required to close the business. But in most cases, sales reps are incented to close deals, and if they have to use discounts, so be it. It is worth investigating (a) whether each one of the discounts in the illustration above were required, and (b) whether the depth of each individual discount could have been reduced to claw back margin.

Common Components of Pocket Price Deterioration

- Annual Volume Bonus
- Cash Discount
- Consignment Costs
- Co-op advertising
- End-user rebate
- Freight
- Market Development funds
- Off-invoice rebates
- Self-service discount
- Performance Penalties
- Receivables Cost
- Slotting Allowance
- Stocking Allowance

Most of this leakage is caused by poor alignment within the organization. It's partially a sales problem, but principally a culture problem.

Different power centers within an organization can unleash a number of forces that can tear apart pricing discipline and lead to considerable leakage. These forces are not inherently bad, but they can add up to significant problems if they are not managed intentionally.

The total transactions can be tracked on a bell curve, which gives us the Pocket Price band (Exhibit 9). Organizations need to understand this band and manage each transaction price intentionally in order to maximize profits.

Here are some of the forces that can lead to pricing leakage:

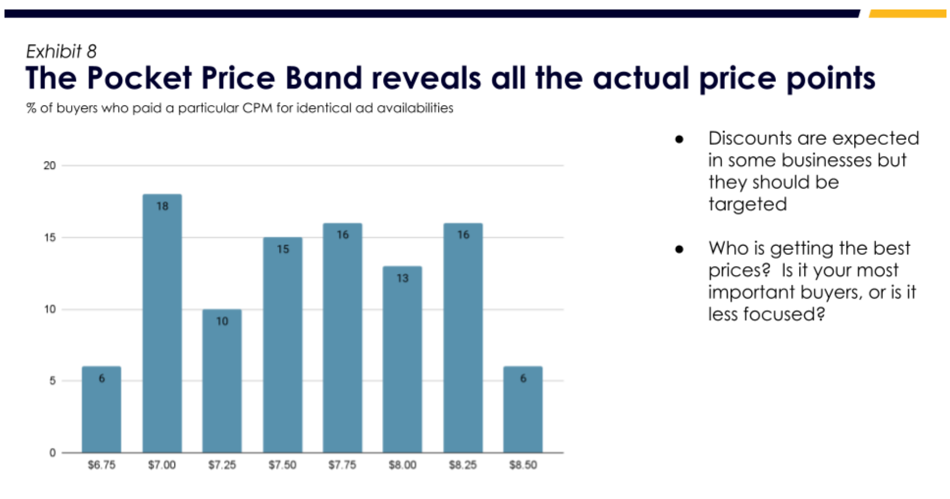
- Salespeople who are incented to close deals, regardless of price.
- Marketing teams that are focused on generating leads, regardless of their quality.
- Product teams that are focused on developing new features, regardless of their cost.
- Customer service teams that are focused on providing excellent service, regardless of its cost.

These forces can all lead to margin deterioration. Organizations need to be aware of these forces and take steps to mitigate them.

- Salespeople should be incented to close profitable deals, not just any deals.
- Marketing teams should focus on generating qualified leads, not just any leads.
- Product teams should focus on developing features that add value for customers, not just features that are easy to develop.
- Customer service teams should focus on providing efficient and effective service, not just high-touch service.

By taking these steps, organizations can avoid the pricing leakage that can lead to lower profits and customer dissatisfaction.

Figure 9. Pocket Price Band



Source: Artemis Analysis

A wide pocket price band isn't bad per se– sometimes you actually need the discounts to close certain customers at certain times– unless it's purely random. You should start to see correlations across segments or regions that help illustrate nuance in price sensitivity.

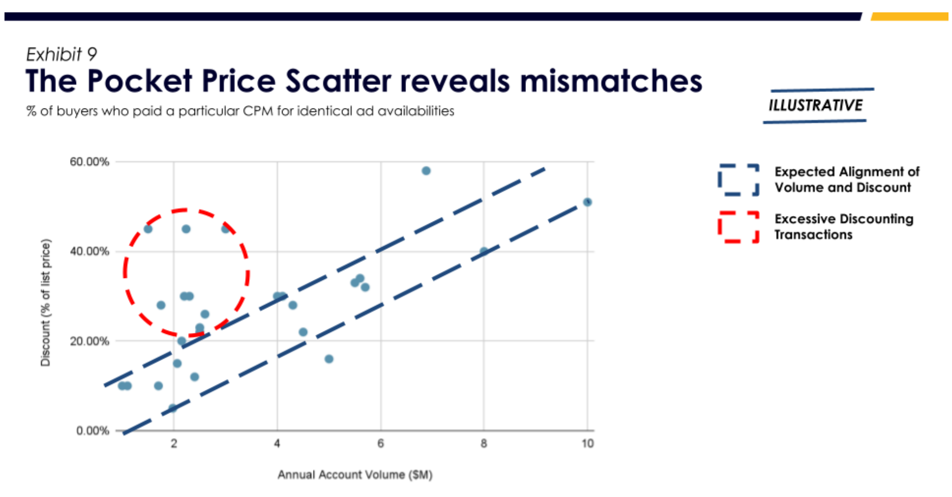
Two issues to watch out for– Variance between similar customers (who should be getting similar prices) and slippage, where terms that are agreed to are not actually honored. Between the sales floor, business affairs, and finance, sometimes non-standard terms that were agreed with the buyer can get lost. It's important to stay buttoned up on process.

Key Issues

- Which buyers are at the ends of the curve? The extremes should be eye-opening, and if they're shocking you need to take action
- Where are the customers you assume are most profitable?
- Who is getting the discounts? If it's the right customers, you have a simple problem. If it's the wrong customers then you need to think about dropping them.
- What segments deserve a deeper dive? Are certain customers getting a deeper total discount than their peers?

You would hope that the correlation between volume and discounts is consistent, but it often is not.

Figure 10. Discount x Volume



Source: Artemis Analysis

How do you fix these? Three ways

1. Identify big problem accounts and either fix or drop them within a fixed time (6-9 months)
2. Stimulate sales volume in the more profitable accounts
3. New policies
   a. Clear rules for discounting every step in the waterfall
   b. Establish pocket price as the universal measure and align sales, finance, legal and IT to make sure systems are in place to reflect that

c. Cap discretionary discounts at 5% total, and make reps justify them via volume, margin, market impact, seasonality, et al.
d. Individual targets set up for each product in each account
e. Update reporting to make all pocket price elements transparent as well as slippage
f. Update comp plans to ensure pocket price realization is a major driver of comp

Key Questions for Transactions

- Do you monitor price performance for each transaction, including all discounts, allowances, rebates and other incentives, whether reflected on the invoice or not? Does that include promotional as well as pricing elements? Are these performance metrics at an aggregated level or can they be viewed by transaction, customer or segment?
- Do you understand how widely net realized prices vary? Do you know which customers or segments regularly pay the highest and lowest prices? Are programs in place to attract more of the best and fix or drop the worst?
- Do you understand how customers compare your prices to those of your competitors/ Do they use invoice price or list price– and do they fully value all off-invoice discounts, rebates and allowances that you provide?
- Do you specifically and thoughtfully differentiate price targets by customer type, size, segment, transaction size et al?

Level 4: Pricing Infrastructure

All the decisions to be made at Levels 1, 2, and 3 depend on having Pricing Infrastructure in place. And what is Pricing Infrastructure? It includes the processes, organization, performance management, and systems and tools necessary to support the pricing function within the business. It addresses questions like "How do we set prices and who is in the room?" "How do we stay aligned across Sales, Legal, Finance, and Marketing to ensure we are price hawks?" "What tools are required to perform at a high level?"

Price advantaged companies often treat their pricing function as a significant profit center and prioritize investing in the skills and assets that keep them thriving.

Pricing excellence is not an event, it's a process. A process that, if done correctly, can lead to significant improvements in profitability.

For example, a 1% improvement in return on sales can lead to a 7.5% increase in operating profit. And a serious price improvement process can create 2 to 4 points in RoS. That means that, for a representative media and entertainment company, getting this improvement and sustaining it over the long term can lead to a 15 to 30% improvement in total profits. (It's very painful to cut costs enough to have that impact.)

Of course, pricing excellence is not easy. It requires a commitment to continuous improvement, a willingness to experiment, and the ability to adapt to changing market conditions. But the rewards can be significant.

Pricing excellence is not just about numbers. It's about creating a culture that values pricing and rewards those who get it right.

A pricing excellence culture is one where everyone in the organization understands the importance of pricing and is committed to setting and managing prices that maximize profits. It's a culture where pricing is seen as a strategic function, not just a tactical one.

There are a number of things that organizations can do to create a pricing culture, including:

- **Define**. Everyone in the organization should know who is responsible for what when it comes to pricing. There should also be clear processes in place for setting and managing prices.
- **Target**. What do you want to achieve with your pricing? Do you want to maximize profits, increase market share, or something else? Once you know what you want to achieve, you can develop pricing strategies that will help you reach your goals.
- **Train**. Not everyone in your organization needs to be an expert in pricing, but everyone should have a basic understanding of the principles of pricing. You can train your employees on pricing through formal training programs, informal mentoring, or simply by providing them with access to pricing resources.
- **Reward.** When employees make good pricing decisions, they should be rewarded. This will help to create a culture where employees are motivated to think about pricing and make decisions that will benefit the company.
- **Measure.** How well are you doing at pricing? You can't improve your pricing if you don't know where you stand. Track your pricing performance and use the data to identify areas where you can improve.

Creating a pricing culture takes time and effort, but it's worth it. A pricing culture can help you to maximize profits, increase market share, and improve your overall business performance.

Key Questions for Pricing Infrastructure

- Is your company's pricing performance a black box to senior managers?
- Are senior managers flying blind when it comes to pricing?
- Do your pricing decisions make sense?
- Are your pricing reports and information systems accurate and up-to-date?
- Do your sales and marketing teams have too much power to discount?
- Are your sales and marketing teams incentivized to maximize profits or to simply make the sale?
- Does your company have a dedicated pricing organization?
- Are your frontline employees trained in pricing?

<u>Prioritizing Pricing Levers for your business</u>

Most Modern Media & Entertainment companies have at least some of the following revenue streams. While you can get value from each of the three levers in any business, there are some levers that will have more immediate rewards in particular operating units. For example, Advertising remains complex transactionally, and different buyers may get very different prices for very similar availabilities. For most companies that sell advertising, Transactions will be a target-rich area to explore.

Revenue Stream	Model	Priority Pricing Levers	Example
Advertising	B2B	● Transaction	Minimizing unnecessary discounts to non-strategic accounts
Consumer Subscriptions	B2C	● Customer Value ● Transaction	Raising price on a streaming package because of key new content
Content Licensing	B2B	● Market Strategy	How are interest rates affecting an overseas network's ability to pay
Channel Licensing	B2B	● Market Strategy	Is the cable system's declining profitability affecting its ability to take a price increase for your channel bundle?
VOD	B2B2C	● Customer Value ● Transaction	Are you giving away too much in fees to the purchase channel?
Downloads/ Physical Copies	B2B2C	● Customer Value ● Transaction	Is your retailer taking too big a cut?
Licensed Merchandise	B2B2C	● Customer Value ● Transaction	Is your licensee shortchanging you or adding unnecessary fees?

Location-Based Entertainment	B2C	• Customer Value • Transaction	Can you do a better job of communicating the value of your new ride and increase price?

Pricing Excellence: A Disciplined Approach

In today's low-growth marketplace, pricing is more important than ever before. Companies that can set and manage prices effectively can gain a significant competitive advantage. However, pricing is a complex and challenging process, and it is often left to chance.

Companies that achieve pricing excellence are disciplined in how they manage the pricing process. They treat pricing as rigorously as they would product development or quality assurance. They understand that the enemy of pricing excellence is sloppiness.

There are a core set of pricing processes that cannot be left to chance. These processes include:

- **Setting and managing list and target prices:** This involves determining the right price for your products and services. It also involves setting target prices that you want to achieve.
- **Establishing pricing architecture:** This involves designing a pricing system that is fair and equitable to all customers. It also involves ensuring that your pricing system is easy to understand and use.
- **Setting allowed terms and conditions:** This involves establishing the rules that govern how you sell your products and services. It also involves setting limits on discounts and other concessions.
- **Managing special requests:** This involves handling requests for discounts or other concessions from customers. It also involves setting limits on the authority that employees have to grant discounts.
- **Monitoring pricing activities and impact:** This involves tracking the prices of your products and services over time. It also involves measuring the impact of your pricing decisions on sales, profits, and customer satisfaction.

- **Gathering competitive pricing data and intelligence:** This involves collecting data on the prices of your competitors' products and services. It also involves analyzing this data to identify trends and opportunities.
- **Communicating pricing:** This involves communicating your pricing strategy to your employees, customers, and other stakeholders. It also involves ensuring that your pricing strategy is consistent with your overall business goals.

Achieving Pricing Excellence is not a quick fix, but it is a skill that will yield dividends for years. If you maintain the discipline to optimize prices at the Market Strategy, Customer Value, and Transaction level and support it with a robust Pricing Infrastructure, you can weather very dark times that your competitors may not. As an added benefit, a focus on Pricing Excellence inevitably breeds a relentless focus on the Customer and what they consider valuable. It also allows your team members to know they are part of a winning team, creating a greater sense of teamwork and loyalty.

We would be delighted to discuss opportunities for Pricing Performance Improvement at your organization,

Adrian Blake

Note: Many of the basic frameworks were originally developed in *The Price Advantage*, Walter L. Baker, Michael V. Marn, Craig C. Zawada, John WIley & Sons.