ACHIEVING AUTOMOTIVE PRICING EXCELLENCE

More art than science, car pricing needs an overhaul

Automakers agonize over every penny when pricing a vehicle, but give billions of euros away in incentives and margins to sell it. Our data-driven analysis illuminates the status quo of car pricing and how automakers can outperform it.

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LEAVING CASH ON THE PRICING TABLE

Approximately 30 percent of a car's list price reflects distribution cost, including dealer margins. Automakers often fail to impose rigorous analytics on these expenses and so overspend. For example, on a typical new car sold in Europe with a list price of €25,000, roughly €17,000 represent the vehicle maker's cost and profit, while the other €8,000 are split in €4,000 sales cost and €4,000 for the dealer's margin. However, after customer negotiations, the actual transaction price usually drops to about €20,000, consuming both dealer and automaker margins. (See Exhibit 1.)

Although automakers wield considerable market experience, they partly lack data driven tools needed to make optimized pricing decisions. What this means is nothing less than a paradigm change in car distribution, from experience driven behavior to fact-based decisions. Several factors contribute to the industry's pricing problems. Automakers usually determine vehicle list prices with a cost-plus approach and comparisons to competitive pricing, but do not fully take into account customers' perspective. Additionally, they tack on significant sales incentives that lead to the typical transaction price levels. These incentives frequently do not follow a differentiated, systematic approach and do not optimally leverage customers' willingness to pay. Improper offer structures and vehicle configurations play a role, too. Cars stand unsold, manufacturers fail to realize vehicles' full profit potential, and dealers resort to additional incentives and discounts to "move the metal."

Inadequately set incentives and discounts undermine profitability. On top of that, strong intra-brand competition drives retail discount levels. Carmaker incentives can come to be misused resources, money spent in the wrong places, because they lack sufficient transparency regarding the total incentives vehicles carry across their sales system. Most promotional activities reflect limited quantified insights on the return-on-investment, and companies often fail to thoroughly analyze individual sales incentives for their effectiveness. Additionally, bonus and margin systems that emphasize volume, rather than profit, place an overwhelming pressure on making the sale while letting profitability deteriorate.

Traditional market allocation processes are also a widespread problem. Allocating car volumes within and across markets is complicated, with many allocation strategies favoring volume over profit considerations or else going with a "business as usual" approach. Finally, opportunistic steering can send pricing strategies into the ditch. In fact, pricing plans typically fail because they lack adequate steering and monitoring across vehicle types – tasks made more difficult by the local, decentralized nature of pricing decisions.

30%

OF A CAR'S LIST PRICE ARE DISTRIBUTION COSTS, INCLUDING DEALER MARGINS

ENSURING PRICING EXCELLENCE

Focused data analytics, smart optimization algorithms, and pragmatic IT solutions are the key enablers to ensure pricing excellence. With innovative insights and tools, automakers, national sales companies and dealers can improve their commercial distribution performance in several ways.

Create customer-centered list prices. Instead of adopting traditional inside-out, cost-plus pricing, develop differentiated and dynamic list prices, defined by customer expectations. Adopt customer-centered insights, such as willingness to pay and price elasticity. These ought to be the focus of pricing, not product production costs.

Rethink offer optimization. Option packaging, pricing and discounts ought to reflect market insights, with lower discounts and tailored incentives across vehicle lines and special editions. The opportunity for complexity reduction and cost savings is huge, especially across countries and vehicle categories.

Enhance vehicle configuration strategies. Because pre-configured vehicles often fail to reflect customer priorities, harness big data analytic capabilities to develop optimized configuration recommendations. Match these to customer needs and achieve clarity.

Optimize discounts and transaction prices. Stamp out intra-brand competition and optimize transaction prices by creating greater transparency through close steering and retail staff training. Design and execute discount schemes using insights derived from big data, and strive for higher differentiation levels based on customer data. Focus on four key areas: transaction price analyses, discount steering models, easy-to-use retail tools, and comprehensive and frequent training on retail best practices.

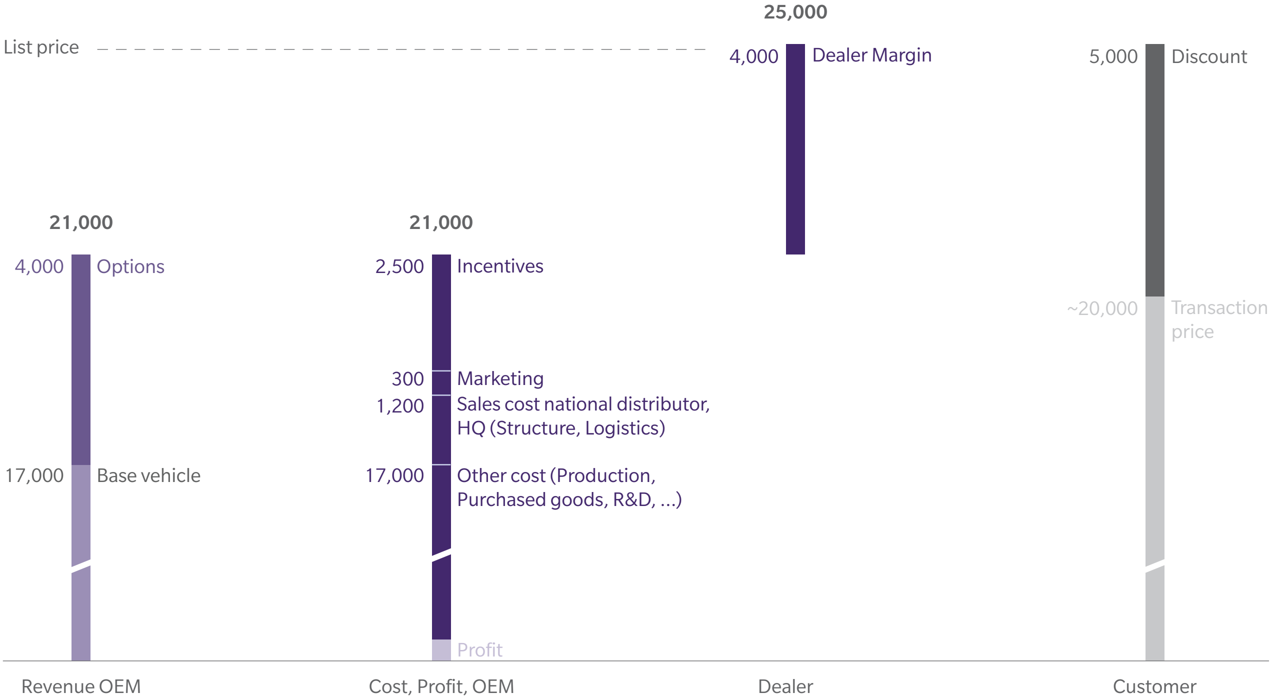
Rethink incentives. Stop rewarding consumers for the wrong things. Evidence suggests that carmakers can reduce incentive spending by up to 30 percent without compromising sales volumes. This requires detailed data analyses of incentive

EXHIBIT 1: THE ISSUE

Current pricing practices in the automotive industry result in significant discounts higher than dealer margins, requiring intensified OEM support

VEHICLE EXAMPLE: REVENUE AND COST IN EUR

LIST PRICE = 25,000 EUR



Source: Oliver Wyman distribution cost data base

histories, revised incentive allocation and steering, optimized offers and configuration, as well as pattern analyses regarding types of incentives, channels, markets, and brands.

Redesign channel and margin structure. Focus on profitability and on new sales channels, instead of emphasizing volume via traditional channels. Adding online and direct sales channels will reduce margin spend, while dealers can still play an important fulfillment role in a joint sales model. Margins for channel partners (including platform aggregators) need to reflect the specific role and value-add they play in the sales process.

Improve market allocation practices. Place a greater emphasis on system profit across markets. Create market transparency, employ data analytics, ensure data availability, centralize market intelligence, and identify and understand the triggers, drivers, and indirect effects of commercial decisions across geographies.

Introduce strong steering and monitoring. To avoid pricing “ditches,” effectively steer efforts to capture the greatest value. Consistent pricing, rates, and incentives across vehicle categories (build to order, build to stock, test drive vehicles, and used cars) are the starting points. Maintaining the price cascade from automakers to national sales companies to dealers is necessary for safeguarding consistent transaction prices and profit margins.

CAPTURING THE IMPACT OF PRICING EXCELLENCE

Companies often find it helpful to approach pricing excellence in different stages and modules. First, take action to capture quick wins and boost efficiency. This scenario enhances existing structures, creates transparency and therefore reduces incentives and discounts based on big data insights. The next step is to differentiate vehicle and option list prices and to optimize vehicle packaging and configuration decisions, with a specific focus on avoiding unnecessary discounts. Finally, to achieve full optimization firms need to adjust distribution channels and processes. This scenario builds on actions undertaken during the first stages and concentrates on introducing new distribution channels with online and direct sales elements, plus the according margin system adaptions. Capturing from €1,000 to €3,000 per vehicle, full optimization pursues all possible measures and can save up to 30 percent of total cost of distribution.

Facing growing competitive threats, disruptive technological shifts, and the intrusion of innovative new mobility business models, automotive players can no longer rely on the inefficient pricing strategies of the past. Instead, they will need to adopt analytically-based and customer-centered methodologies to make sure their offer, price, and incentive bundles are always on target. ●