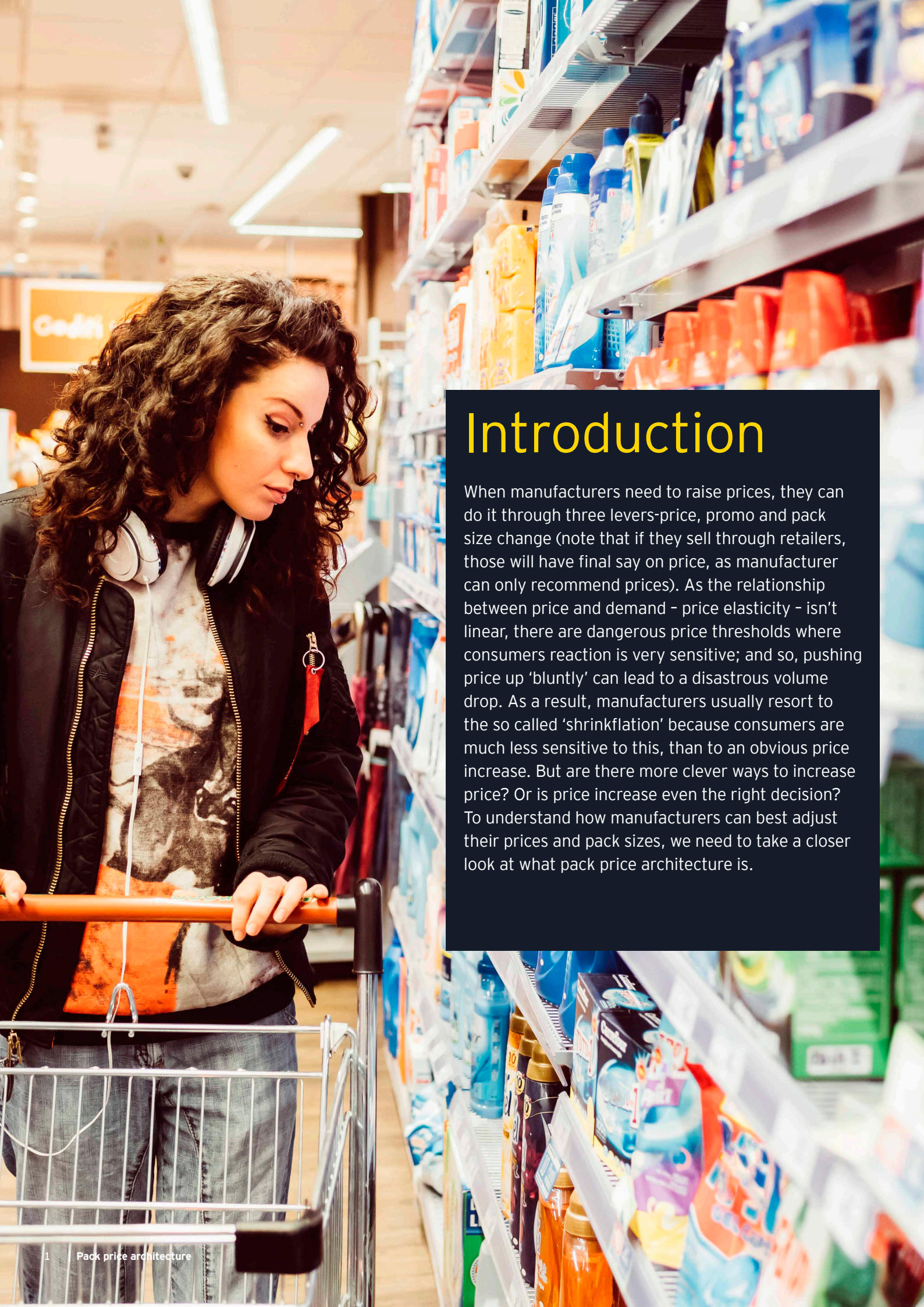


Pack price
architecture:
unwrapping
the secret
to profitable
product pricing



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Introduction

When manufacturers need to raise prices, they can do it through three levers-price, promo and pack size change (note that if they sell through retailers, those will have final say on price, as manufacturer can only recommend prices). As the relationship between price and demand - price elasticity - isn't linear, there are dangerous price thresholds where consumers reaction is very sensitive; and so, pushing price up 'bluntly' can lead to a disastrous volume drop. As a result, manufacturers usually resort to the so called 'shrinkflation' because consumers are much less sensitive to this, than to an obvious price increase. But are there more clever ways to increase price? Or is price increase even the right decision? To understand how manufacturers can best adjust their prices and pack sizes, we need to take a closer look at what pack price architecture is.



Exploring PPA: a crucial aspect of product strategy

Understanding Pack Price Architecture (PPA)

Pack Price Architecture, or PPA, denotes the structure of a product range defined mainly by different pack sizes. Let's use orange juice as an illustration; it could come in 250mL, 1L, or 1.5L bottles. These varied sizes primarily target different customers and consumption needs, with smaller formats designed for convenience stores and larger ones catering to families.

When viewed through a manufacturer's lens, PPA is usually related to one brand with pack size as the

variable. However, for retailers it could be across multiple brands and their own brand, at which point, quality becomes another dimension and for a given pack size shoppers may see different price points based on the quality of the product, (e.g., the 'good better best' approach). Using the orange juice example again, an entry price point could be juice made from concentrate, a better version not from concentrate but pasteurised and an even better version 'freshly squeezed'.

The importance of getting PPA right

PPA directs the customer's perception of value since it combines product choice and price considerations. When the pricing architecture is flawed, for example, if a larger-sized product does not promise a cheaper price per kg than smaller counterparts, it could backfire, leaving customers with a negative brand impression due to the perceived lack of economic sense in upgrading to a larger pack.

The risk of redundancy escalates when promotions can make two small packs cheaper than a larger one, making it harder for the customer to differentiate or opt for larger packs.



The fixes: pulling pack size and price levers to improve PPA

Price changes: limited yet potent

Altering prices is typically the initial remedy for tweaking pack price architecture. It's particularly practical when products have diverse sizes that aren't directly comparable (like 200g and 300g packs

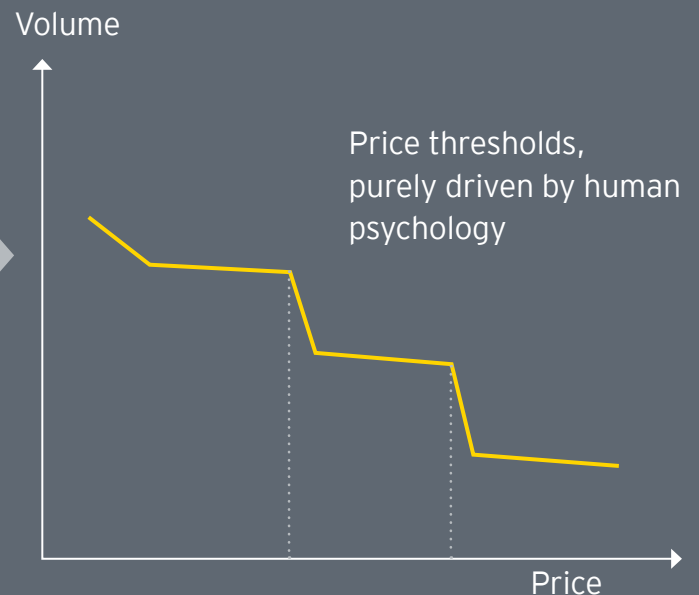
instead of 200g and 400g). However, due to nonlinear price elasticity, drastic price changes risk plummeting profitability and sales volumes if they cross key psychological price thresholds for customers.

Theory vs. reality in consumer goods pricing elasticity

Textbook price elasticity of demand



Reality in consumer goods



Pack size changes: more variables, greater scope

To avoid crossing price thresholds and to balance cost pressures, manufacturers resort to 'shrinkflation' – reducing pack sizes while the price remains unchanged. In essence, it is a hidden price hike that leverages consumers' irrational purchasing habits and their reluctance to pay more than specific price points. Nonetheless, shrinkflation has drawbacks. Firstly, customers are becoming savvier through social media exposure of the tactic, potentially leading to backlash. Secondly, it frequently only postpones inevitable price tweaks or further downsizing. Lastly, it is often counterproductive for high-margin products due to minimal cost savings that can be negated by volume loss.

An alternative often overlooked, can be to increase the pack size when price increase crosses a key threshold. Particularly apt for high-margin products, this strategy enhances customer perceived value and often justifies the price increase. This subtle approach bolsters pricing without notably skewing customer perception, providing a potential precursor for future price or pack shifts. This isn't confined to pricing up either. When price points are too high, shrinkflation is ill-suited, but downscaling both, the pack size and price can deliver a comfortable price point without damaging costs – potentially still realising a price per kg increase!

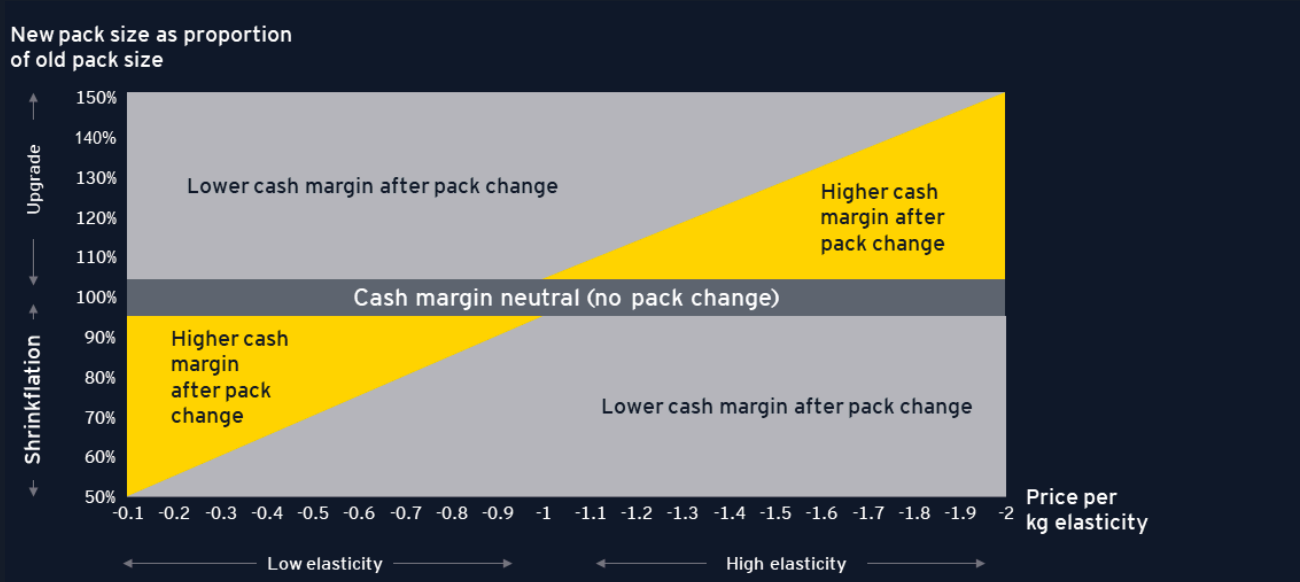
Prices and pack size changes for manufacturers consideration

Price

	Down	Constant	Up
Down	Downsizing Use to cross below price threshold, ensure net price increase when margin is low.	Shrinkflation Use for low margin products to avoid crossing price thresholds.	High inflation Use only when margin is critically low for inelastic categories.
Constant	Price decrease Use for elastic products and/or when crossing below price thresholds.	Starting point	Price increase Use for inelastic product when not crossing price thresholds.
Up	Give away Use only when margin is very high and category is very elastic.	Better value Use for elastic products when far from crossing a price threshold.	Upsizing Use when crossing above price threshold, ensure net price increase when margin is low.

Volume/revenue optimisation Margin/revenue optimisation

Cash margin opportunity by price elasticity when changing pack size – initial margin per unit of 50%, price constant



Shrinkflation is not always the solution. As an example, for a margin per unit of 50%, at low elasticity, then shrinkflation presents an opportunity to grow the cash margin; however, when elasticity is important (<-1), then the only way to increase cash margin is to actually increase the size of the pack without changing the price, in other words reducing the margin per unit. The volume gain makes it up for the margin per

unit loss. More generally, the higher the margin per unit the lower the elasticity needs to be for shrinkflation to deliver a positive cash margin impact. Conversely, for margin per unit lower than 40%, then shrinkflation can be effective even for fairly high value of elasticity while upgrading the pack at constant price would need extremely strong elasticity to generate incremental cash margin.



Conclusion

Getting pack price architecture wrong upsets customers and reduces manufacturer's room for manoeuvre, so it is crucial to make the right decision. Luckily, manufacturers usually have several options to remediate their PPA if these are sub-optimal. Ultimately, the type of change hinges on the KPI they aim to improve. For instance, to optimise volume, either lower the price or increase the pack size (e.g., +X% free). When focusing on revenue, a price increase or a pack size reduction could benefit, depending on the overall volume sold. Profitability optimisation will be sensitive to price elasticity and current margin per unit. Interestingly, shrinkflation can be detrimental to high-margin products, while reducing unit margin (e.g., by increasing pack size at a constant price) might boost cash flow. In our experience working with CPG manufacturers, this balance can only be struck if companies have a clear understanding of their current margin and price elasticity in their respective markets. This in turn will help identify effective pack size changes, leading to significant improved cash margins.

Contacts



Sylvain Bertrand
EY-Parthenon Director,
Pricing and Commercial,
Ernst & Young LLP

T: +44 20 7806 3425
E: sylvain.bertrand@parthenon.ey.com



Duncan Brewer
EY-Parthenon Partner,
Retail and Consumer Products,
Ernst & Young LLP

T: +44 20 7951 6378
E: duncan.brewer@parthenon.ey.com



Ivan Segrt
EY-Parthenon Partner,
Pricing and Commercial,
Ernst & Young LLP

T: +44 20 7951 5726
E: ivan.segrt@parthenon.ey.com

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