Solactive Pricing Power Index

Interview with the Developer: Sebastian Alber

Sebastian, you have been working on the Pricing Power idea over the last few months, what is it all about?

This is a new index concept we have been working on, which focuses on selecting companies that display strong pricing power. That means these companies have the ability to dictate pricing for their products and are hence less dependent on general (adverse) economic circumstances, because they are better positioned to protect their profit margins from demand shocks or increases in raw material costs in times of inflation.

Can you explain how companies can achieve strong pricing power?

Sure, there are multiple sources of pricing power. A strong brand is a great indicator, as are unique products or product features through continuous innovation or a strong control of supply chains.

As we are putting this into an index, we must measure the pricing power somehow, how did you solve that?

This is where the product design kicks in. We have developed a unique approach that uses multiple input factors that are equally weighted to create a single pricing power metric that still considers the different potential sources of pricing power. We use 6 input factors for this: Profit Margin, Profit Margin Growth, Profit Margin Variability, Quality Factor Exposure, Input Cost Sensitivity , and finally total Sales.

That was a lot of information to digest, can you break that down a bit further?

Sure, effectively we are trying to determine if the company can consistently maintain a high profit margin. That is what all the profit margin related scores and the quality factor exposure are for. Additionally, we look at how input cost sensitive a company is, as this is another important source of pricing power and finally, we look at the total sales to ensure that the pricing power is applicable to a sufficiently large business to be relevant.

How does that differentiate from other pricing power or business model related approaches in the market?

What makes our approach unique is that we use a blended score that allows us to capture the various aspects of pricing power as well as focus on the consistency aspect of the profit margin. Most other approaches out there tend to use current profit margins as the key selection metric which – while important – does not wholistically cover all aspects of pricing power.

Maybe you can give an example to illustrate this?

One company that shows this quite well is Apple. Apple is not only the largest company by market cap in the world, it also has strong pricing power as most of us have probably experienced with Apple hardware consistently pricing above competitive offerings with similar technical specs. This pricing power is clearly built on a strong brand as well as innovation and seems obvious. However, if we go simply by the profit margin metric, Apple ranks around rank 500 globally and would not be selected into an index of the top names. Using the blended approach Apple comes out at number 10 and is a key component in our new index.

As a closing statement, why should investors take a closer look at the pricing power theme?

I would say that if I had the choice between two companies to invest in, I would always pick the one with the higher pricing power, regardless of the economic environment, inflation, or geopolitical uncertainties. Given that we have plenty of these going on now, looking at an index comprised of the companies with the highest pricing power using a blended metric makes all the sense in the world to me.

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