

# Pricing and Profitability Management

A Practical Guide for Business Leaders



Julie M. Meehan

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*To Don, Jack, Charlie, and Theresa*



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# Foreword

**S**everal years ago, I was asked to lead the transformation of an organization with a record of success that spanned a century. In an effort to continue and to grow that success, we embarked on a comprehensive program to transform some areas within the company. One of the most important was pricing. The leadership team knew we could improve our pricing, and that the value this would create was larger than any other improvement initiative we could undertake. As a result, I had the opportunity to work closely with several of the authors. I have personally applied what you are about to read, and can attest to the value it will create.

I have more than a passing familiarity with pricing, from both my academic background and my career in business management. There are literally dozens of books on pricing theory, and I have read a fair number of them. Most address specific aspects of pricing; while helpful in addressing specific challenges, they do not provide an integrated, holistic approach to setting and managing price. If we were truly going to transform our organization, we needed an approach that incorporated theory, but also gave us a pragmatic and realistic roadmap for applying advanced pricing capabilities as quickly and efficiently as possible. This approach also had to take into account that the business would not stop while we determined the future. We needed a roadmap that told us where to start, gave us the right tools and techniques needed to improve our performance, provided a sequencing that both built capabilities and delivered early results, and most importantly, told us how to do this in a way that the organization would accept and adopt as quickly as possible. We also needed to know the challenges we would face and how best to address those challenges, as well as how to manage expectations both internally and externally, with internal stakeholders as well as with our customers and competitors.

We knew when we started this program that we would be changing, in some cases radically, how pricing is executed, and who would set and execute price. Traditionally, pricing has been managed in pieces across various parts of the business, and this cross-functional integration is an ongoing challenge within any organization. With pricing, sales often sets

base price and provides insights into customer behavior and competitive intelligence, marketing determines promotions, segmentation, channel, and brand positioning, operations determines cost, and supply chain drives cost-to-serve. Finally, finance sets hurdle rates, expected ROI and ROA, and holds the organization accountable for results. There are endless variations on the model I just described, depending on your specific circumstances. A key concept explored in this book is “how do these pieces all fit together? How should they fit together, and how do we align the organization to achieve and retain a high level of integration across pricing activities?” You will find the answers to these questions, and more, within this book.

When we started this journey, we were a relatively unsophisticated organization in terms of setting and managing price, especially in our field organization. Giving it tools that allowed them to understand and learn about the behavior/characteristics of its particular clients (willingness to pay), to understand the drivers of profitability (cost to serve), and to rank each different client (relative value) was especially valuable to us. I believe it attracts and identifies the “naturals” in the sales force that are at ease making analytically-based decisions, and also fosters the development of true business acumen in these same individuals. That by itself will be of significant benefit to the organization, and as the results become apparent, those talents become a core component of the organizational culture.

Another significant benefit comes with creating a framework and an environment where the organization can create experiments and learn. As an example, having an explicit methodology for testing various promotional and discount activities, and then using that information for developing better future pricing policies is a great way to get your people to think about what they are doing when they pull the various levers in sales and marketing, and how those actions can affect segmentation, willingness to pay, and so on. This is particularly valuable in exposing how apparently dissimilar, unrelated activities can and will affect other parts of the organization, and again, the customer in terms of driving behavior, both intended, and almost more importantly, the unintended consequences that often occur when potential pricing actions are not fully evaluated in terms of “what if” scenarios. The cultural impact of creating a “test and learn” environment should not be underestimated; removing the fear of failure will create a level of engagement and thinking that is not common in most organizations today.

Truly effective pricing requires a level of integration and analysis that has been and continues to be rare in most organizations. Driven by deep analytics, both from a price-setting and a price-execution perspective, companies now have access to information in a form and at a level of granularity that not only enables this integration, but demands it. This book is a practical guide, outlining why the integrated, holistic approach is essential, how to align disparate functions so that integration happens as planned,

and most importantly, how to make that integration sustainable within your organization.

The benefits that will be achieved by the application of these concepts are significant. When we started our program, our expectations were high, but not unreasonable. In reality, we have achieved many, many times the benefits we initially expected, totaling literally hundreds of millions of dollars. In addition, these benefits are recurring, and there is a first-mover advantage from adopting the integrated approach outlined in these pages. Integrated price management capabilities are iterative; the more you do it, the better you become at it. Companies who adopt these capabilities before others in their industry will create a sustainable competitive advantage through their ability to manage price, even in the midst of continuing economic uncertainty, and the growing complexity of the global economy.

There are several things this book is not. This book is not a comprehensive guide to cost management. Cost management has been an established discipline for decades, and this book would need to be an order of magnitude longer to include even an overview of leading cost management techniques. While the authors go into great detail in understanding costs associated with specific transactions, the techniques required to manage cost effectively are not covered in detail. What is covered is the ability to determine what value a customer creates for you and how your costs in attracting, serving, and retaining that customer align with the value they create for you as a customer. This is not only the value of higher margins; business leaders today need timely information for making strategic tradeoffs. As an example, when should I place brand or marketplace considerations on par with economic value? What if market share is how the analysts evaluate us? What will that cost us, and what can we expect in terms of a payoff, again, not just in margin, but across strategic considerations?

This book is also not intended to explain the theory of economic value. Theory, while required as a base for charting your course, does not give you practical advice for dealing with hundreds of salespeople, thousands of customers, and hundreds of thousands of transactions. The challenge addressed by this book is not the development or further evolution of pricing theory, but the pragmatic translation of theory into tactics, in a way that drives results for both you and your customers. A consistent theme within this book is how to identify and quantify the value you create for the customer, the value specific customers create for you, and how to align your organization and capabilities so that every interaction you have with the customer creates value for both of you. At its best, the holistic, integrated approach to pricing will enable you to identify and implement pricing programs that drive value for everyone in your value chain, from you, through distributors and retailers, and on to end customers.

As I stated earlier, I have seen firsthand the value created through this approach. It is challenging, and will require your organization to change long-standing beliefs, roles, and operating models. While challenging, the

value that will be created more than justifies the risks and effort required to make this real. Simply put, this works, works quickly, and creates tangible, measureable and significant improvements in both revenue and margin. Done well, it will also improve customer relations, and drive you and your customers into a much closer and mutually beneficial relationship.

Decades of research has shown that investing in improved pricing capabilities has a higher rate of return than any other improvement initiative you might launch within your organization. This book is a comprehensive guide to making that investment pay the highest possible rate of return as quickly as possible, while also giving you information you never previously had for making strategic decisions, and in time to make those decisions matter. You, your people, your customers, and your shareholders will all benefit. If you are responsible for the financial performance of your organization, it is imperative that you read this book.

**Juan José Suárez Coppel**  
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Chairman of the Board  
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# CHAPTER 1

## Introduction to Pricing and Profitability Management

*The moment you make a mistake in pricing, you're eating into your reputation or your profits.*

—Katie Paine, founder and CEO of KDPaine & Partners

**T**here is an old joke about a businessman who loses margin every time he sells his products. A customer asks, “How do you make money?” The businessman answers, “I make it up in volume.”

A company that routinely sells products below its margins would hardly seem likely to remain in business for long. Nonetheless, many firms follow this approach today. In some cases, this approach is an unintentional move, which results in the company losing money on every transaction. In other cases, it reflects a carefully considered decision to maximize profitability across a portfolio of product offerings. However, in other instances, this approach is adopted by business leaders who simply misunderstand which of their products and customers are actually generating margin and the factors that truly determine their company's profitability.

The field of pricing management has been growing steadily in recent years. If you mention the subject in a group, many people will assume the ensuing discussion will be limited to price setting. But the discipline involves much more than just prices themselves. Pricing management is a strategic competency that involves people, processes, technology, and information. Its reach extends into virtually every corner of an organization (i.e., marketing, sales, IT, operations, finance, accounting, and executive leadership). Effective pricing management is capable of changing the way a company views and operates its entire business; it helps ensure the

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overall profitability of an enterprise and it can affect the bottom line profoundly. This book is intended to serve as a comprehensive introduction to the discipline and a reference work for business leaders, managers, and students who want to deepen their understanding of and sharpen their capabilities in this critical function.

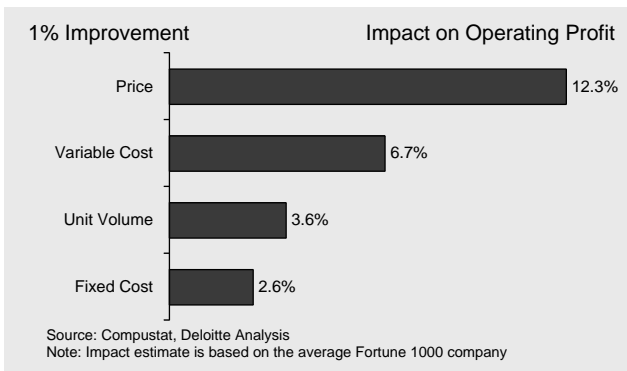
### Pricing: The Critical Lever for Raising Performance

Why make pricing improvement a focus for an organization? The answer is simple: the benefits are enormous. A study has shown that 90 percent of pricing investment meets or exceeds return on investment (ROI) expectations.<sup>1</sup> Put another way, *for any dollar invested in performance improvement, the greatest return comes when it is invested in pricing.*

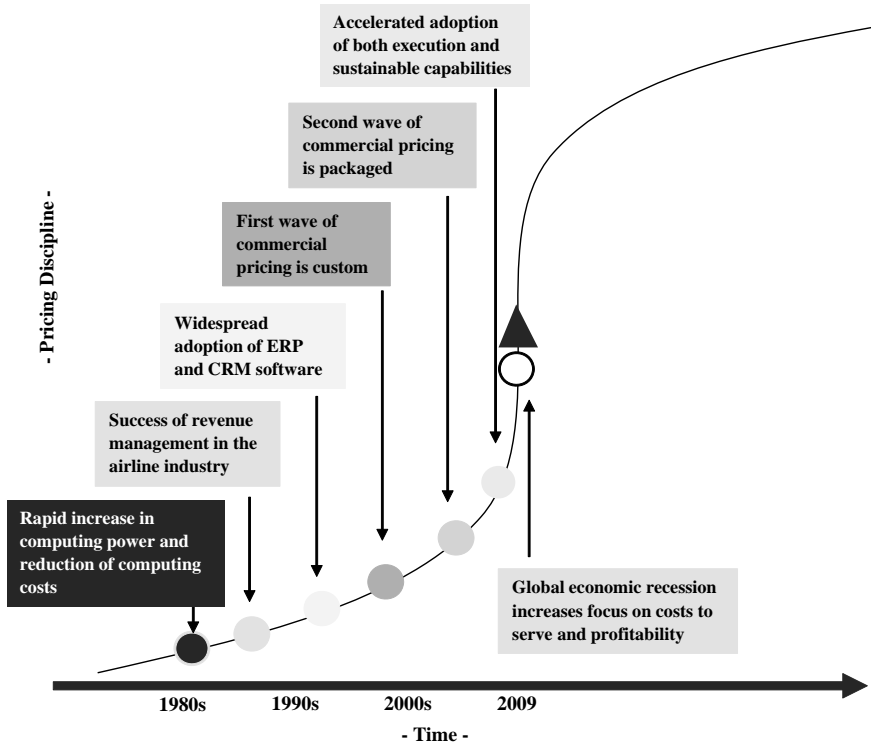
Figure 1.1 reflects one version of an often-replicated analysis.<sup>2</sup> All versions lead to the same conclusion: pricing is the most powerful lever available to raise performance. Despite this, the evolution of pricing management has, until recently, been slow. Although it has long been recognized as one of the traditional *four Ps* of marketing, systemic and structural challenges prevented pricing management from achieving the same level of sophistication or having the same capacity to improve performance as it has now. In its early days, practitioners focused on revenue/yield management and operated almost exclusively in the airline and hospitality industries. But recent developments have led companies to appreciate the breadth and critical importance of the discipline. We discuss three of these developments briefly in the following.

#### ***The Search for Improved Data Management Solutions***

The widespread adoption of enterprise resource planning (ERP), particularly over the past 10 years, has enabled firms to collect, process, and store



**Figure 1.1 Profit Improvement Initiatives and ROI**



**Figure 1.2 Causes of Historical Growth of the Pricing Discipline**

more transaction-level data than ever before—a prerequisite for effective pricing management. However, management of this information has lagged behind. Data mining, transaction-level price analyses, demand-elasticity curves, price waterfalls, price-band analysis, customer segmentation, and transaction-level profitability measurement are all tools that require large amounts of clean, available data. Companies have aggressively sought new ways to manage this data, which, in turn, has led to an explosion in price optimization software (see Figure 1.2).

Traditionally, pricing software addressed demand curves, price optimization, and, at the highest level of sophistication, revenue/yield management. In the past five-to-seven years, however, the need for software to address price execution has been recognized and addressed. The software continues to evolve in response to market needs, as various packages leapfrog each other with improved capabilities. Overall, vendors have moved from offering purely custom solutions to providing true “off-the-shelf” functionality that can be implemented in months, not years. In addition, these vendors aggressively pursue the integration of stand-alone pricing software and core ERP systems.

## **4 Pricing and Profitability Management**

The response to these software developments has been striking. Every single competitor in the ERP space has bought or built software, or partnered with other vendors that have software, to bring advanced pricing capabilities to the market. This is true for both the business-to-business and the business-to-consumer markets.

As this book was going to press in 2011, the pricing software industry was well into a consolidation phase. Some of the small niche players had gone out of business or been absorbed by larger firms that coveted the specific capabilities they could add to their existing application portfolio. A few key players had emerged, but the true winners had not yet achieved dominance.

However, despite its obvious importance, software alone will not provide a competitive price advantage; good data can only serve as a basis for developing an effective strategy. In fact, if software is positioned as the “silver bullet,” it can actually decrease a company’s ability to set and manage prices because sales personnel will likely resist using the tool without careful preparation. For example, an advanced software application can help calculate customer-specific pricing, but if sales incentives are not aligned with the new prices, then discounting practices may arise that undermine them and make the new price list suboptimal. For this reason and many others, software must be part of a comprehensive strategy that can meet the demands of an increasingly complex world.

### ***The Growing Challenges of Global Markets***

Globalization (and the expansion of cross-border arbitrage and gray market activity) has increased the need for multinational companies to create worldwide pricing strategies. If not addressed effectively, gray markets will cannibalize sales for manufacturers and jeopardize relationships with distributors who own contractual rights within a region. The need to address these issues strategically in international markets will continue to grow as companies realize that other profitability initiatives have ceased to work.

### ***Reaching the Limits of Cost-Cutting***

An organization can only undertake so many cost-reduction initiatives without diminishing its ability to serve its customers effectively. For example, a manufacturing company can consolidate plants to slash expenses only so long as its production capacity is still able to meet demand. Similarly, a retailer cannot continue eliminating sales personnel if this strategy interferes with the running of the store, causing revenue to drop. Companies can never “cut” their way to prosperity. Pricing, in contrast, is a constant means to profitable growth.

The emergence of these three trends—improved data management solutions, the challenges of global markets, and the limits of cost-cutting—

has helped companies see the tremendous opportunities that pricing management can produce. The benefits are both sizeable and quickly realized. (There is also a first-mover advantage: the earlier a firm addresses pricing, the further along its learning curve and ahead of the competition it will be.) Yet while companies have more and more tools available to help them develop an improved pricing capability, many still have failed to act. Why?

## **Common Obstacles to Pricing and Profitability Management**

In a 2004 study, AMR Research found that fewer than 3 percent of companies effectively managed, communicated, and enforced prices.<sup>3</sup> Why? Because pricing, done correctly, is an extremely complex undertaking that requires a group of trained practitioners to view the business through a unique lens.

While executives may understand the benefits of improving their organizations' capabilities, the obstacles they face may seem insurmountable and can create institutional inertia. Many apparent barriers simply reflect the demands of pricing management itself. Other barriers reflect the natural confusion of an organization that lacks the structure and the personnel to handle the new strategic approach. A few of the common impediments follow.

### ***Daunting Complexity***

Pricing is an intricate and interdependent competency that affects all levels of an organization and the market it serves (including customers and competitors). At any given time, an organization must ask itself and address a multitude of questions:

- How can price be used as a competitive advantage, and how can we achieve results as quickly as possible?
- How do we position a price with our customers, and how do we differentiate our offering?
- What should our value propositions be for each customer segment?
- How does our product portfolio match the needs of our customers?
- What do we have to do to meet the promises made by our executives and our sales force, while still delivering the required margin?
- Can we use price to influence demand (and can we build that into our production and supply chain thinking)?
- What should our price be?
- Once we have the right price in place, how do we execute it effectively, and what will be the likely customer and competitor responses?

## **6 Pricing and Profitability Management**

### ***Internal Resistance***

Pricing data collection and cleansing can be a challenging and time-consuming task that requires specialized technical skills and a cross-functional and multisystem understanding of the data. Winning cooperation between the different functional groups involved may prove difficult. Initial improvement efforts are often viewed skeptically by organizations simply because they reflect a new approach. In addition, individual units may rely on different data sets to form their assessments of the organization's needs and market position, which can lead to strategic disagreements. Thus, many pricing initiatives fail before they truly begin because managers find various reasons to resist changing the status quo and are unwilling to adopt a fresh, objective view of the business at a transaction level.

### ***Fear of High Stakes***

Besides being costly, pricing errors can produce long-term (if not permanent) consequences for an organization. Any organization that has engaged in a price war with a competitor can attest that the brand (and/or the price levels) never fully recovers. Many firms fear the negative consequences of poor decisions, and conclude that maintaining the status quo with acceptable margins is a safer path than trying to achieve better margins and risking a catastrophic mistake.

### ***Unavailable, Inaccessible, or Unclean Data***

If data are missing or otherwise unusable, then companies lack the basic information they need to formulate a plan. For example, a company will have trouble performing a profitability analysis by customer segment if it lacks organized transaction-level data and customer-level, cost-to-serve information. This problem will remain if effective modeling or sampling techniques cannot be developed to address the issues.

### ***Human Resource Constraints***

Engaging the right people for pricing improvement (i.e., those with the appropriate authority, political connections, and skills) can be challenging as many managers are already too busy executing their day-to-day activities to take on additional responsibilities. Many organizations struggle to dedicate the necessary personnel required to mount an initiative as ambitious as pricing improvement.

### ***Hidden Problems***

Many weaknesses in a company's existing pricing strategy can be masked or obscured by the complexities of overlapping functions. Uncovering the trouble spots can be a challenging exercise. Table 1.1 identifies some of the major pricing issues and their common indicators.

**Table 1.1 Common Indicators of Major Pricing Issues**

Symptom	Description of the Problem	Impact
<b>Maverick Selling</b>	<ul style="list-style-type: none"> <li>• More than 30% of all deals are closed below the established discount guidelines or policies.</li> </ul>	<ul style="list-style-type: none"> <li>• Unwarranted discounts are issued.</li> </ul>
<b>Price Erosion</b>	<ul style="list-style-type: none"> <li>• Lack of visibility into historical pricing of comparable deals (or into historical trends) causes deeper than necessary discounting.</li> </ul>	<ul style="list-style-type: none"> <li>• Unwarranted discounts are issued.</li> </ul>
<b>Margin Erosion</b>	<ul style="list-style-type: none"> <li>• Below-the-line transactional expenses and incentives are not considered during deal negotiations or not recovered after deals close.</li> </ul>	<ul style="list-style-type: none"> <li>• Revenue leakage and lost profits.</li> </ul>
<b>Slow Response Time</b>	<ul style="list-style-type: none"> <li>• The time to respond to a customer's pricing request is relatively long.</li> </ul>	<ul style="list-style-type: none"> <li>• Deals are lost.</li> </ul>
<b>Unsegmented Pricing or Discounts</b>	<ul style="list-style-type: none"> <li>• Prices are not set at a level granular enough to capture the maximum profit from a transaction.</li> </ul>	<ul style="list-style-type: none"> <li>• Unwarranted discounts are issued to unprofitable customers.</li> <li>• There are revenue leakage and lost profits for price-insensitive customers.</li> </ul>
<b>Price Agreement Compliance</b>	<ul style="list-style-type: none"> <li>• A single customer has multiple agreements for the same product, but consistently makes purchases at the lowest price.</li> </ul>	<ul style="list-style-type: none"> <li>• Unwarranted discounts are issued.</li> </ul>
<b>Customer Volume Compliance</b>	<ul style="list-style-type: none"> <li>• Customers have an established agreement with volume commitments, but do not buy to their full potential.</li> </ul>	<ul style="list-style-type: none"> <li>• Unwarranted discounts are issued.</li> <li>• Revenue is not realized.</li> </ul>
<b>Less Productive Pricing Team</b>	<ul style="list-style-type: none"> <li>• The team does not have the ability to prioritize and analyze special pricing requests properly to have the maximum impact.</li> </ul>	<ul style="list-style-type: none"> <li>• Unwarranted discounts are issued.</li> </ul>

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### **Cross-Functional Chaos**

“Pricing touches everything, and everything touches pricing.” This simple truism is recognized by pricing professionals, but it is not often recognized across an organization. In a typical organization, Marketing sets list (or market) prices and gathers customer and competitive pricing information; Sales negotiates prices with customers; IT provides data and maintains the systems that support pricing decisions; Finance shares costs and “profitability” data; Operations offers input regarding capacity; Order Fulfillment determines how best to process purchase requests (and generates the costs that flow from these decisions); and Executive Leadership monitors pricing and profitability, while reporting key metrics to external stakeholders. Lack of coordination and conflict between these functions (which have different agendas) can make it nearly impossible to set up a dynamic, informed, and integrated pricing competency.

Organizations that lived through the wave of reengineering in the 1990s still bore the scars, more than a decade later, of attempting to manage processes across functional boundaries. The results were impossible to quantify and simply set various functional groups against each other. The good news is that pricing, unlike other options, drives immediate and recurring results and produces measurable improvements to the bottom line. Effective pricing gives a place at the table to all the internal groups affecting, or affected by, its policies. Unlike many cross-functional initiatives, pricing does not require one function to win and others to lose. In fact, the balancing of each group’s objectives creates a natural tension that, when used effectively, actually improves pricing performance by ensuring that the various functions’ needs and goals are addressed.

### **Differing Organizational Pricing Perspectives**

The internal debates on pricing are endless. The level of real insight into customer buying behavior is limited; value propositions are nonexistent (or worse, come from an internal perspective); and the real margins by customer, product, or salesperson are poorly understood and difficult, if not impossible, to calculate. Thus, there are several distinct perspectives, which generally follow functional lines:

- *It’s all about the numbers.* According to this school of thought, deep analysis of the numbers (derived either algorithmically or by regression) will produce profound insights into customer behavior; the product or service value proposition; and, ultimately, what the optimal price offering should be.
- *The sales force should be given complete freedom.* Advocates of the sales team believe that the sales team, because of its daily interaction with buyers and direct insight into customer behavior, should be the sole determiner of price. One senior vice president once summed up this perspective nicely: “My sales force needs total flexibility at the point of

contact with the customer.” Is this ever really true? And, if it is, at what cost? Getting pricing right inherently requires the ability to make fully informed tradeoffs.

- *Get your costs right, and price will take care of itself.* Seasoned managers who have built successful careers on cost management believe too much effort is spent on the “soft side” (i.e., attempting to understand customer behavior). The real answer to any pricing issue, they believe, is to move further down the cost-experience curve, using production efficiencies and statistical process controls to produce goods more cheaply than the competition. This group tends to favor a cost-plus pricing approach, which determines margin (and ultimately selling price) by taking the cost to produce and adding a “fair” or “reasonable” markup.
- *Customers will pay us a premium if we create a better product.* Little emphasis is placed on pricing during the new product development process; innovation for the sake of innovation is valued. Yet while many products are high function and top quality, manufacturers are generally unable to recoup a margin that warrants their investments in development.
- *Better information systems are the silver bullet.* The failure to meet pricing challenges is often framed as the result of a lack of relevant information. If the IT systems delivered the right information, advocates believe, then setting and negotiating price would be easy, and deals would almost close themselves. (Of course, good data can serve as only the basis for developing a strategy—this should not be confused with actually having a plan.)
- *The customer rules.* For some in the organization, the voice of the customer represents the final word on what prices should be. Little or no effort is made to evaluate the value a product creates for buyers, let alone to determine if the offered price takes into account the value the customers create for the organization. Focus groups, surveys, and, above all, anecdotal insights from the sales force are used as the basis for determining what to charge and what a customer is willing to pay.

Each of the perspectives listed above is a key indicator of a corporate culture dominated by a certain function: the first by finance; the second, sales; the third, manufacturing; the fourth, innovation or engineering; the fifth, IT; and the final, marketing. Each perspective can produce important insights but offers only a fragmentary view of pricing. In this case partial answers will yield only partial results. The more one view predominates, the less effective pricing will be.

Why is it that a book on pricing begins with a discussion of corporate culture? Because the human factors are so significant that they can make or break the entire process.

## Understanding—and Leveraging—the Human Side of Pricing

Price lies at the heart of the buyer–seller interaction, and an inherent conflict exists between a company’s desire for long-term customer relationships

## 10 Pricing and Profitability Management

and its effort to get fair value for its products and services. Most organizations encourage their sales teams to build strong relationships and to know their customers on a personal as well as a professional basis. Unfortunately, these bonds often become ends unto themselves, obscuring their original purpose, which was to establish profitable, long-term customers. Companies must continually analyze customer interactions at the transaction level and determine the value to both them and their customers. By understanding the worth of a product to buyers, a manufacturer can better differentiate its offerings from the competition. Similarly, by quantifying the buyer's value to the company, the company can decide which relationships warrant investment and which should be treated as opportunistic transactions. Both analyses contribute to a balanced, healthy customer portfolio.

A key driver of the buyer–seller relationship is sales force compensation, because poorly aligned incentives result in weak margin performance.

Consider the experience of a medical device manufacturer that compensated its sales team by unit volume. The products were new and evolving rapidly, so the company pushed for high rates of market penetration. Competition was fierce, and, for the sales team, getting buying groups to choose the products carried nearly as much weight as physician preference. Critically, compensation was entirely volume driven with no cap placed on sales earnings. The more you sold, the more you earned. The results were predictable: the sales team constantly pushed for prices to be reduced to challenge the competition.

At one point, as prices continued to fall, senior management actually believed a competitor had discovered a cost or manufacturing advantage. In reality, the company (the market leader) should have looked at the behavior of its sales team: it, not a competitor, was driving the perceived price war. Eventually, a careful analysis of the situation led to an important policy change. Margin was included, for the first time, as a key compensation metric. This single change quickly altered sales behavior, and the decline in price began to level off almost overnight. Unfortunately, two other consequences of the volume-driven compensation policies were not so easily remedied. First, customers, taking advantage of every new price discount, had purchased supplies to last for years. Future sales had been pulled forward, skewing demand elasticities. Worse, buyers had been conditioned to expect that every sales visit would result in fresh price reductions. The situation took years to reverse. New products were affected by the effects of the earlier price war, while the existing product set suffered from chronic low profitability. The unintended consequences of a misguided focus on volume were far reaching, long lasting, and severe.

Another human challenge for pricing involves countering the tactics customers use to drive down price. *Strategic sourcing* is a practice that has been in existence for decades. Today, every well-performing company follows this approach to achieve the best possible price when purchasing goods and services. If you are a manufacturer, it is likely your sales force has been subjected to painful interactions with procurement agents who know and have quantified every aspect of their relationship with you as a supplier. Consider how often a member of your team has been hit with a variation of the following comment: “I know we don’t buy large volumes of this particular product, but our aggregated spend across your portfolio is well over \$100 million. We therefore expect a 5 percent price reduction across the portfolio for this, and every subsequent, year. After all, our volume is helping you move down the cost-experience curve, and we should reap some of those benefits.”

The flip side of strategic sourcing is understanding what drives profitability at the transaction level with a particular customer. Firms need to arm their sales force with the information that lets them counter the traditional procurement approach. In many cases, they may still be able to provide that 5 percent discount while actually improving margin performance.

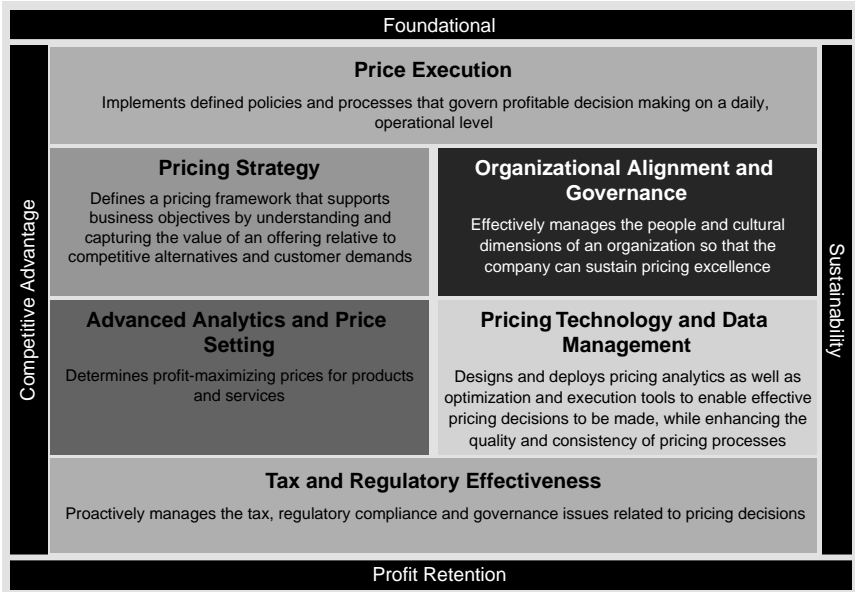
In general, successful pricing management requires a company to build the right sales team and to provide it with the correct training and tools, while aligning compensation with the desired outcomes. Once again, the need to take an integrated approach to pricing is obvious. A company can create the best, most optimally priced offering in the world, but if its sales force cannot execute it (or worse, the company’s compensation structure incentivizes its salespeople to negotiate outside established guidelines), then the company’s investment in price-setting capabilities has been wasted.

## **An Integrated Approach to Pricing: The Six Core Competencies**

To meet the pricing challenge, companies cannot rely on any single internal or external perspective. Rather, all views must be combined in a way to maximize each of their strengths and to minimize each of their weaknesses. The following six organizational competencies are needed to achieve this (see Figure 1.3).

### **1. Price Execution**

Price Execution refers to all of the processes and policies by which a company delivers its prices to the marketplace. These include everything from sales policies and procedures—for example, guidelines on how big a discount a salesperson can offer without checking with a manager—to the way products are tagged for sale at a retail store. Execution is the ability to



**Figure 1.3 The Integrated Pricing and Profitability Management Model (The Six Core Competencies)**

meet strategic goals efficiently, effectively, and consistently. If even one process operates poorly, then overall performance will suffer. An organization can have world-class capabilities in the remaining five competencies, but price and margin will be lost if execution fails (which is why Price Execution falls on the foundational axis of Figure 1.3). Put another way, the best salesperson can be armed with the optimal price derived from the best technology, but he or she still needs to get the price to the right customer at the right time with the right message about value to be successful. This is why firms should start by understanding, at the transaction level, what truly drives sales and profits. This understanding will enable them to develop the strategies they will need for their specific markets, products, and competitors (while improving other pricing capabilities).

**2. Pricing Strategy**

Pricing Strategy articulates the guiding principles behind a company’s efforts to price its goods and services. At the highest level the strategy must be aligned with the overall business plan. Pricing leaders may assume, for instance, that prices should be set to maximize profitability when the company has, in fact, made increasing market share its priority. An effective strategy should be focused, nuanced, and dynamic. It should be regularly reviewed and revised, as needed, so it can meet evolving corporate goals.