Deloitte.

Connect the dots
To win in pricing, broaden your view

Most companies think of price as a noun, not as a process. All employees can tell you (or find out) the current price for a given product, most can tell you the last time the price was changed, and some can articulate the reason for differences in the prices between products. However, very few employees can describe the process by which prices are developed, the governance involved in making pricing decisions, or how pricing strategy supports their company's overall objectives. One theme that unites our varied work with clients across industries is that long-term results can be improved when the price isn't just "right," but when pricing is managed as a well-defined discipline and a sustainable capability.

In this article, we'll look at how business leaders can avoid the mistake of taking an overly surgical approach to pricing, acknowledge and understand pricing interdependencies, and generate more value from their efforts in the area of pricing. Specifically, we'll examine four components of pricing — elements that can make the difference when they're addressed collectively.

First things first

Setting price is clearly an important step to get value — but it's not the only one. When companies implement an integrated process that adapts dynamically as prices are set, distributed, negotiated, and measured, they can achieve incremental benefits. Yes, it may require changes to the current way of doing business, from rewiring sales commissions and updating service procedures to potentially redesigning processes and partner management programs. But the effort is

A question of execution

What happens after you set the price is every bit as important as the price itself. Here are some questions that can help your organization when it comes to execution.

Price distribution

- How do I keep my prices current?
- What information or tools should I communicate to sales?
- What tactics and policies need to be in place to execute prices at the field- or store-level?

Negotiation

- How do I provide all the information to the field that is necessary to make the right pricing decisions?
- How much authority should my sales force and store managers have?

Measuring expectations

- Am I achieving the margin, revenue, or market share I expected?
- Do I manage price exceptions consistently or ad hoc?
- What is the compliance to expected price at the register, or at invoicing?

generally worth it. Focusing on execution — essentially the entire chain of events that is set in motion from the moment the organization determines the desired list price, all the way through to invoicing — can help facilitate measurable, sustainable results.

Setting the price

Many companies use pricing "science" to determine willingness to pay and set prices accordingly. Other companies view themselves as price takers, allowing the competition or customers to dictate the price. In our experience, neither view is entirely correct. The science of pricing works when front-line realities, such as competitive pricing, customer preferences, cost considerations, and a host of intangibles, shape the final price.

For instance, using demand modeling to set prices should not stop with an estimate of elasticity. That elasticity should be combined with information about marginal costs, brand strategy, competitive strength, and category strategy to set prices that not only consider demand trade-offs, but also improve upon the businesses objectives goal (profits or otherwise) given all the competing effects and considerations.

This may sound theoretical, but in fact it's tactical. Here's what we mean.

We recently helped a client take a two-category business and build a pricing model to increase margin in one category, which was mature, and raise volume in another, which was growing. This category-level trade-off was consistent with the client's overall strategy for the market: harvest margin in the declining market and grow share in the new market. It went much further than simply estimating how much volume would be lost or gained by a shift in pricing. We also built different scenarios for pricing given a range of competitive responses (match, meet half-way, lower, and so on). As a result, the client monitored competitors' prices nearly as closely as their own, making periodic adjustments based on these scenarios.

When another client's raw material costs had increased by 7 percentage points in a year, but pricing (gross and net) remained flat over the same period, we built a model that considered price elasticity, current product-level margins, and expected share impacts. Using these insights, the company was able to determine which products should bear the brunt of the price increase, and how aggregate profitability could be increased with minimal margin loss during the price increase. Combined with analytics around market share and competitor pricing, this information also helped the client decide whether to lead with price increases — or to look for marketplace signals before acting.

Distributing a new price in the marketplace

The most effective price sometimes results from an advanced mathematical formula or by running a statistical package. But what happens after it is unveiled is just as important — and is based much more on fickle human behavior. What's the best way to get a new price onto a price list? How should you get it into the hands of the sales force? How will it be displayed on thousands of store shelves around the world? These

price distribution challenges can trip up even the most effective price-setting exercise. At the same time, we've seen that improvements in this area can generate a 1 to 2.5 percent increase in revenues. Distribution is also important because it can shorten the time between price setting and implementation. This can help companies get value faster and move when market conditions are still relevant.

Take the case of a company that had originally planned to take more than four months to get a new price implemented and into the hands of its sales team. This client also had a short-handed corporate staff and a complicated pricing hierarchy involving 200 products, more than 50 price zones, and 12 customer segments. Although they used demand modeling to set the most effective prices, the corporate pricing team still had to go on a "road show" to convince the sales force to accept the new pricing guidelines. The sales force could then alter prices or ask for adjustments. Each adjustment meant the corporate team had to re-run their models to understand the aggregate impact. Shortening that cycle was challenging.

In four months, we helped this client achieve a step-change in price distribution. First, we helped redesign the pricing process to reduce time to completion from four months to three weeks. We were able to achieve these results not only by building a model that produced better initial results that were calibrated to the marketplace, but mainly by providing the corporate team with a tool to perform these internal negotiations with the sales organization on the fly. We also changed the metrics for the top sales executives — each received a specific objective related to pricing in their balanced scorecard, and were trained on the basics of pricing for value. Now, each time the company sets new prices (an event that occurs about twice a year), it takes less than a month to realize more than $10 million in additional margin.

Sometimes price execution can be as simple as getting the right price tag in the right place, at the right time. In our work with one consumer electronics retailer, we found this task to be much more complex than

expected. Prices were changing on the more than 1,000 products in the stores at any given time on a weekly basis due to the highly competitive marketplace and frequent promotions that dominates this sector. To complicate matters, this retailer had cut store labor budgets in a bid to protect margins in a down economy. As a result, the company didn't have the requisite labor force in place to correctly place price tags and signs on this weekly frequency. Meanwhile, store managers were required to match the lower of the advertised or displayed price on any given product on any given day. After performing a series of audits on the stores, we found that compliance to actual weekly suggested pricing was less than 50 percent. To correct the problem, the retailer reduced the number of price changes allowed per store per week, and gave clear guidance to store managers on how and when to perform resets and audits. As point of sale price overrides started to fall, the margin savings (annualized) from this simple change totaled in the millions.

Negotiating an even better price

Once a price is distributed in the organization it must be communicated to customers. This step often involves concessions from the sales force, or some form of discretionary spending offered as an olive branch alongside any increase in price. Providing a tool to the sales force, or even educating the other parties on the benefits of value pricing, can significantly increase the benefits and the "stickiness" of a price change.

In one case, a large consumer packaged goods company used data it was getting from one of its largest retail customers not to produce the most effective B2B price for itself, but an effective B2C price for the retailer. This made negotiations easier since both participants' margins would be increased with the pricing action. And the results were significant — more than 1 percent of retail revenue as additional margin would be shared between the parties.

Win-win outcomes are not always possible, and tough negotiations are sometimes necessary. In another case, analytics insights suggested that our manufacturing

client exit an entire line of business with a specific channel partner, setting up what would likely be a series of bruising negotiations. But by modeling both the distributor's and the manufacturer's profitability, the client was able to inject hard facts into the conversation. So the distributor was able to clearly see the losses being sustained by the manufacturer in one business unit, not only making it easier to reach an agreement to terminate, but allowing both parties to negotiate a more profitable contract for the remaining lines of business. The resulting improvement in margin in that case was 2.5 percent of in-scope revenue.

Managing and measuring expectations

There are two familiar adages that apply in the world of pricing. One is, "I can't manage what I can't see." The other is, "What gets measured gets done." Take them both in stride. Pricing analytics requires data — the more the better. But often the data that's required is simply not manageable in common spreadsheet applications. Connecting that data in a rich repository — a profitability "cube," so to speak — can allow companies to see their business in new and different ways. In the same way, product profitability can be measured at a sales person, channel, or customer level.

For one retailer, we used their records to determine that 13 percent of their customers were unprofitable. Analysis of those customers' behaviors helped tell us the types of promotions they typically purchased, and what regions/store clusters they shopped at and when. This helped the company and its channel partners design promotions for the current year to attract customers more likely to blossom into profitable relationships. Creating visibility into customer behaviors can help lead to a more profitable outcome.

Internal measurements and metrics are also more important than ever before. For one company, we helped create specific metrics for each of about 4,000 salespeople based on their books of business. Goals ranged from product mix suggestions to discount guidelines to allocation of sales resources and were based on in-depth analyses of internal benchmarks. Performance measurements were published on a bi-monthly basis using a profitability cube like the one described above. The results were significant. After a period of change and acceptance, benefits began to accrue and exceeded expectations. Salespeople would voluntarily sign up to be reviewed by their superiors for having hit or exceeded their targets. The client achieved an additional 0.7 percent of sales (in addition to other initiatives) from other improvements that would not have been possible without this level of measurement and communication with the sales force.

Pulling it all together

A model that generates the most effective price is just that — a model. It doesn't always take into account the nuanced ways that prices are distributed, negotiated, and measured. From our study of the recently conducted pricing engagements, one thing has become clear: focusing only on one area in pricing will not give you the full benefits. Consider the specific elements we've outlined in this article and have a plan for connecting the dots.

This article originally appeared in the Professional Pricing Society's Pricing Advisor *newsletter and is the second in a three-part series. Our first piece analyzed 100 pricing projects to find out how long they took, what they delivered, and where results came from. Our final article examines the price one must pay for pricing effectiveness. To read the other articles in the series, or for more information on Deloitte's Pricing and Profitability Management practice, please visit www.deloitte.com/us/ppm.*

Contacts

Julie Meehan
Principal
Deloitte Consulting LLP
jmeehan@deloitte.com

Ed Johnson
Senior Manager
Deloitte Consulting LLP
edwjohnson@deloitte.com