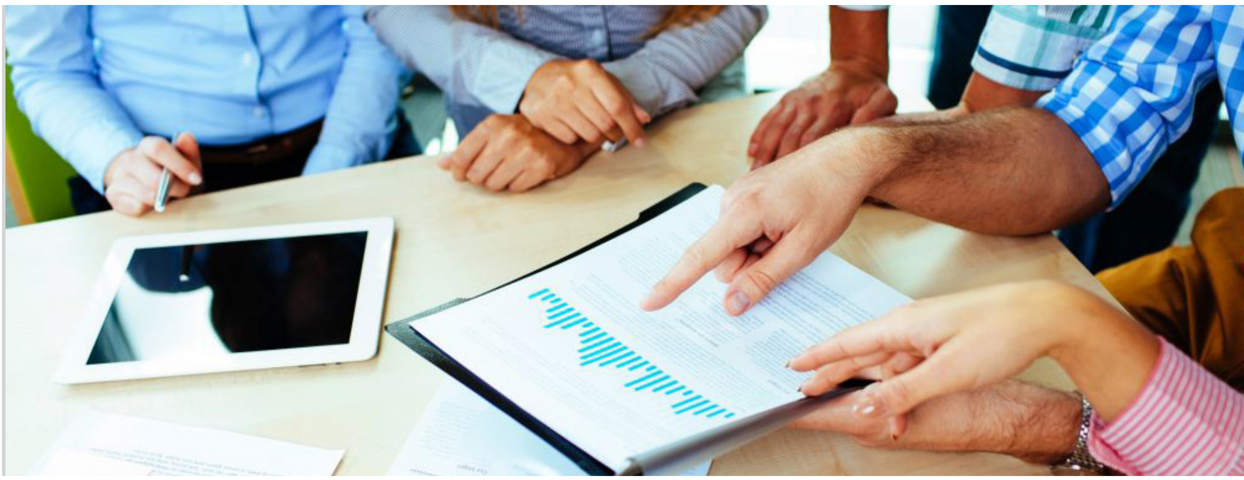
Working Capital Fund Pricing

Advancing Organizational Goals through Sophisticated Pricing Strategies



Introduction

Working Capital Funds (WCF) have emerged in the federal government as drivers of organizational innovation and mission acceleration. Their presence within widely-varied agencies highlights the need for federal CFOs to become increasingly adept at their structure, governance, and operation. As WCFs mature, CFOs are able to explore strategies to enhance performance and cost management. The opportunity to adapt and implement new pricing strategies is often overlooked by CFOs and fund managers, but can be a critical stimulant to innovative WCF management.

A WCF is a full-cost recovery operating model where support services costs are recovered through funds collected from supported customers. Due to the breakeven nature of Federal WCFs, CFOs and fund managers often approach price setting for products and services as the last step in long, arduous cost accounting exercises. Under these terms, pricing is merely a cost recovery mechanism to ensure revenue equates to the sum of an organization's operating costs. In Federal WCF environments absent of private industry incentives, CFOs may see their budgeting and pricing exercises as more than adequate to ensure cost recovery in the short-term. However, these organizations likely miss opportunities for growth, mission acceleration, and renewed efficiencies. CFOs and fund managers that approach pricing as a strategic opportunity can better align WCF products and services to their organization's mission, and improve their management of operating costs. More sophisticated pricing strategies can also drive additional investment opportunities and contribute to increased organizational sustainability.

Similarly to how private sector companies must mitigate and adapt to the market, Federal CFOs and fund managers must balance the influence of cost management, external price drivers, and current pricing ability. Enhanced pricing strategies can enable WCFs to drive mission success through risk management, long-term sustainability, and modified customer consumption.

When exploring pricing strategies, CFOs and fund managers must evaluate the operational and administrative landscape that governs the organization's pricing paradigm. Myriad factors influence the direction of a pricing strategy, including the ability to implement change within the agency, the relationship with the customers, and working capital fund regulations. As funds mature, CFOs should consider modifying pricing strategies to achieve new organizational goals as they emerge. Obstacles such as insufficient data collection, ineffective IT infrastructure, and inefficient billing mechanisms may hinder the potential of a new pricing strategy. Nevertheless, the value gained through advancing the sophistication of a WCF's pricing strategies will likely exceed the costs.

Four of the most commonly recognized pricing strategies are described below by degree of sophistication. While the more advanced pricing strategies deliver the most organizational benefits, they may not be an appropriate fit for every organization.

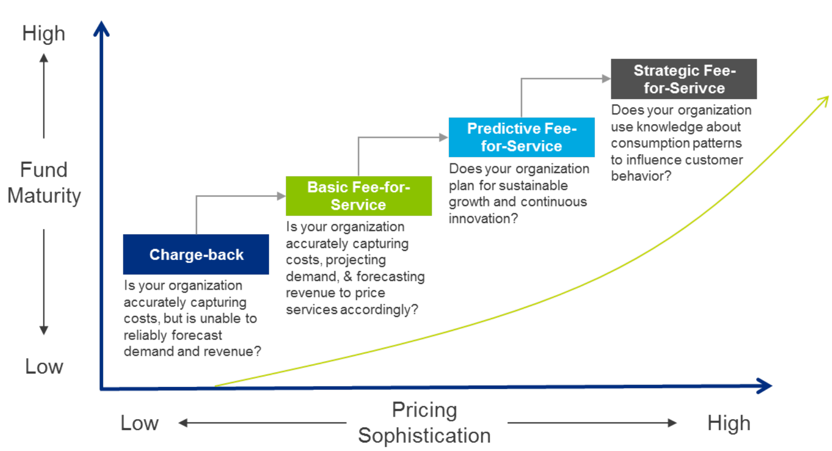
Chargeback Pricing

A chargeback pricing model is a method of transferring all costs directly to the customer. This pricing methodology employs a break-even approach and does not require extensive analysis of transactional data. WCFs incur costs and pass those on to the customer, along with the possible inclusion of administrative fees for overhead costs. Chargeback models are appropriate for discrete transactions, and in some cases offer a limited degree of flexibility to the customer by allowing costs and services to flow from third party vendors through the WCF to customers. Other than this exception, this approach does not provide much flexibility to the customer and does not give the organization an ability to modify prices. Due to its simplicity, it may be a good fit for an organization entering a cost-recovery environment, such as a new Shared Service Center, or an organization introducing a new product or service with uncertain demand and an inability to project volume.

Basic Fee-for-service Pricing

A fee-for-service pricing strategy prices each product and service in the WCF separately and only bills customers based at their request of a product or service. A fee-for-service approach follows a traditional cost-plus pricing methodology; the price of a product reflects direct and indirect costs to enable the entity to maintain revenue-neutral profitability. This model provides strong price realization for the organization and price certainty for the customer, however, pricing may not align to the customer's or the market's expectations for the products and services. Thus, an accurate projection of sales volume is crucial to maintaining profitability under the fee-for-service model. This model is a reliable pricing mechanism for an organization with a strong record of cost accounting and consistent sales projections.

Evaluate your organizational readiness for enhanced pricing



Predictive Fee-for-service Pricing

A predictive pricing strategy is value-based, adaptive, and forward-looking. This model accounts for the value of the product sold or service rendered while considering the price elasticity of the products and services. Mission critical services may be priced differently from administrative services because of the value they provide to the customer. Predictive pricing models build in investment and innovation within the organization's products and services. Entities utilizing predictive pricing have a strong understanding of demand projections with the goal of maintaining viability of the WCF program. An advanced understanding of customer consumption patterns, strong knowledge of how customers value the entities services, and consistent cost accounting bolster the success of predictive pricing strategies. This model is appropriate for WCFs seeking a sophisticated pricing strategy to build long-term viability

Strategic Fee-for-service Pricing

Strategic pricing enables organizations to maintain cost recovery, budget for innovation and investment, and seek to influence customer behavior by driving consumer demand and modifying prices to achieve desired outcomes. Organizations seeking to grow demand toward emerging technologies may lower prices and incentivize customers to shift to the new product. Implementing this strategy requires actively balancing costs to maintain viability, such as increasing the price of an older technology or increasing the cost of the emerging technology over time to more than its actual cost. Under this strategy, pricing becomes a tool the organization can use to influence customer preferences, accelerate the mission, and provide efficiencies across its product lines. For instance, an IT department may price new technology or software lower to encourage adoption among its customers and phase out legacy systems. Strategic pricing requires strong leadership, clear organizational goals, and a commitment to assertive pricing techniques. Strategic pricing may involve more operational and financial risk as the WCF diverts from traditional cost-recovery methods, but it rewards its organization with sustainable and viable business practices.

CFOs and Federal WCF managers should consider four key questions when evaluating the fit of pricing strategies for their organizations. These questions take into account the external and internal factors that affect their ability to modify prices to the benefit of the organization and their customers.

1.Is your organization accurately capturing costs, but is unable to reliably forecast demand and revenue?
Maintaining full-cost recovery is a primary objective of a WCF and a foundational goal of any pricing strategy. Organizations must account for all direct and indirect costs and pricing needs to ensure consistent year over year recovery of these costs. The inability to sustain cost recovery within a WCF exposes the organization to financial and operational risk. Long-term viability of a WCF begins with solvent financial management; products' and services' prices must cover the costs to run the business.

CFOs who can answer 'yes' should consider a Chargeback Pricing model. For a more advanced model inclusive of the elements discussed above, CFOs should consider the subsequent question.

2.Is your organization accurately capturing costs, projecting demand, and forecasting revenue to price services accordingly?
Like their appropriated counterparts, WCFs are vulnerable to economic, political, and technological changes affecting demand and revenue of services. In lean years, customer demand for the organization's products and services may wane as budget reductions limit spending capabilities. Technological change can disrupt continuous service delivery and render products obsolete. Political change can have vast impact on organizational structure, mission, budget, leadership, and direction. While these types of external pressures will inevitably influence WCFs and their operations, a fee-for-service approach enables organizations to adapt to these external drivers through the ability to modify pricing to influence customer preferences, accelerate the mission, and provide efficiencies across its product lines

3.CFOs who can answer 'yes' should consider a Basic Fee-For-Service Pricing model. For a more advanced model inclusive of the elements discussed above, CFOs should consider the subsequent question. Does your organization plan for sustainable growth and continuous innovation?
Self-sustaining WCFs should account for the need for capital improvements and service delivery enhancements during budgeting exercises. The onus of innovation rests on the organizational leadership's ability to devote resources to these activities. Forward-looking organizations price products and services to maintain sustainable growth. Organizations must go beyond budgeting for depreciation and commit revenue to invest in the development of new products, new approaches to service delivery, and research and investment toward enhanced Information Technology infrastructure. Leveraged correctly, renewed business processes can drive organizational efficiency and effectiveness.

CFOs who can answer 'yes' should consider a Predictive Fee-for-Service Pricing model. For a more advanced model inclusive of the elements discussed above, CFOs should consider the subsequent question.

4.Does your organization use knowledge about consumption patterns to influence customer behavior?
Customer consumption patterns offer insight into customer demand of products and services. WCFs can leverage this data to conduct value-based pricing or alter customer behavior. Under value-based pricing a WCF prices services to match the customer's perceived value of that service. Pricing becomes an instrument of change when WCFs employ pricing strategies to spur technological adaption or mission delivery. By leveraging the concepts of value-based pricing, WCFs can influence the demand of products and services, allowing the WCF to use pricing as a tool for innovation. With enough customer data, a WCF can better align its costs to demand and pricing becomes a tool organizations can employ to more accurately predict, adapt, and influence customer behavior.

CFOs who can answer 'yes' should consider a Strategic Fee-for-Service Pricing model.

Conclusion

Strategic pricing is for any organization seeking to enhance cost recovery mechanisms, create revenue for innovation and investment, and advance product delivery. Your organization's pricing strategy should optimize organizational and agency goals while creating a model of sustainability, innovation, and investment. One size does not fit all; the most sophisticated strategy is not appropriate for every organization. The CFOs best suited to tackle price changes are armed with an array of financial data points. CFOs should not only understand the impact of the price change on the WCF, but on the entire organization. Comprehensive knowledge of your business' financial performance and cost management practices enable smart decisions and effective strategies. An organization's success at deploying a new pricing strategy is defined not just by the approach, but by the implementation and execution that follow.

When pricing becomes a tool for change and growth it eclipses its traditional role as a cost-recovery instrument. Enhanced pricing strategies help mitigate external price drivers and optimize organizational goals. Under these circumstances, organizations can build viable and sustainable business enterprises.

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