

# Capturing the Price Advantage



*IIR Pricing Conference*

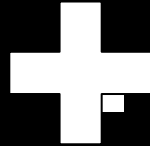
Michael V. Marn  
Craig C. Zawada

**June, 2004**

# ACHIEVING PRICING IMPACT REQUIRES TWO THINGS

**I**

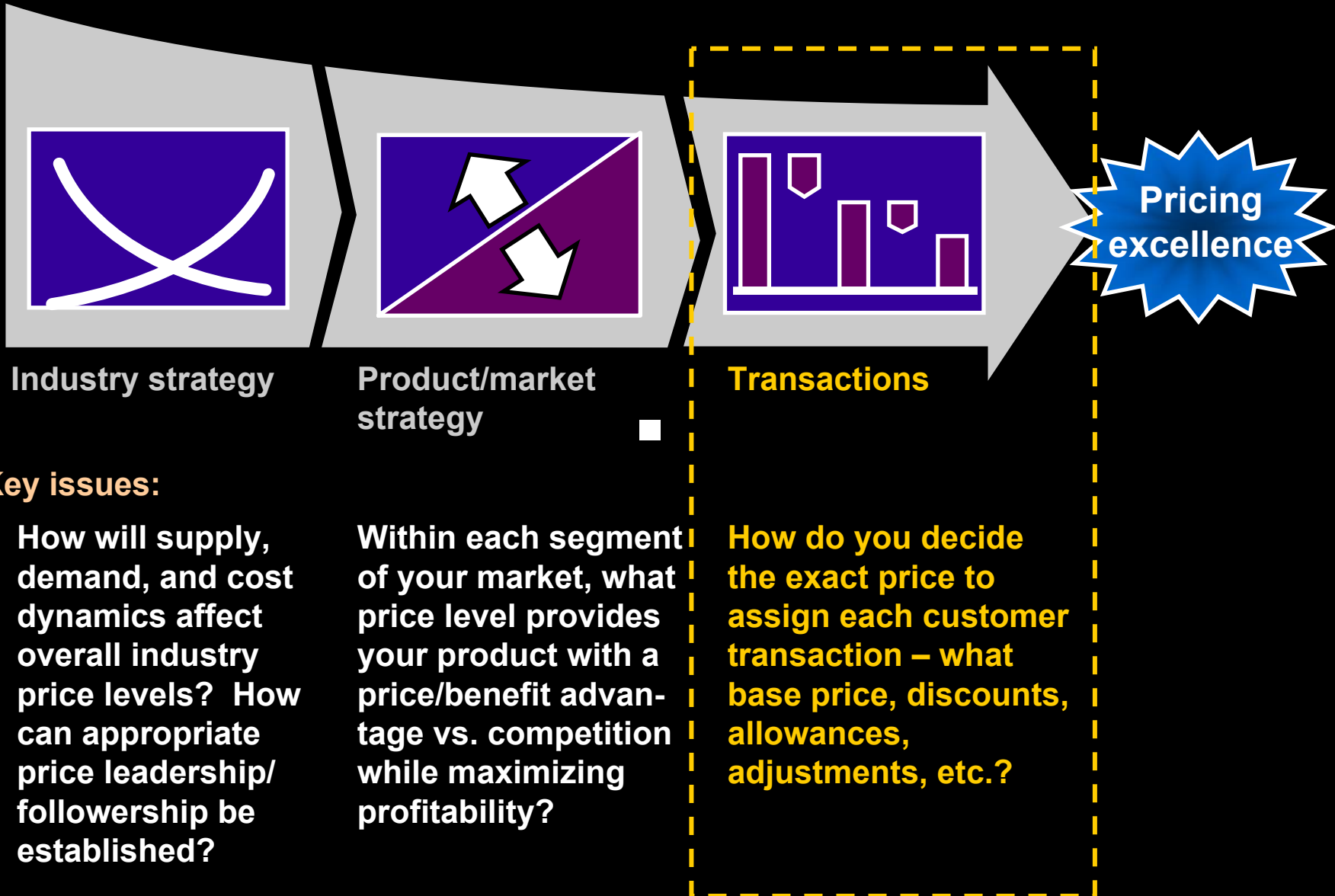
**Identifying and  
capturing pricing  
opportunities**



**II**

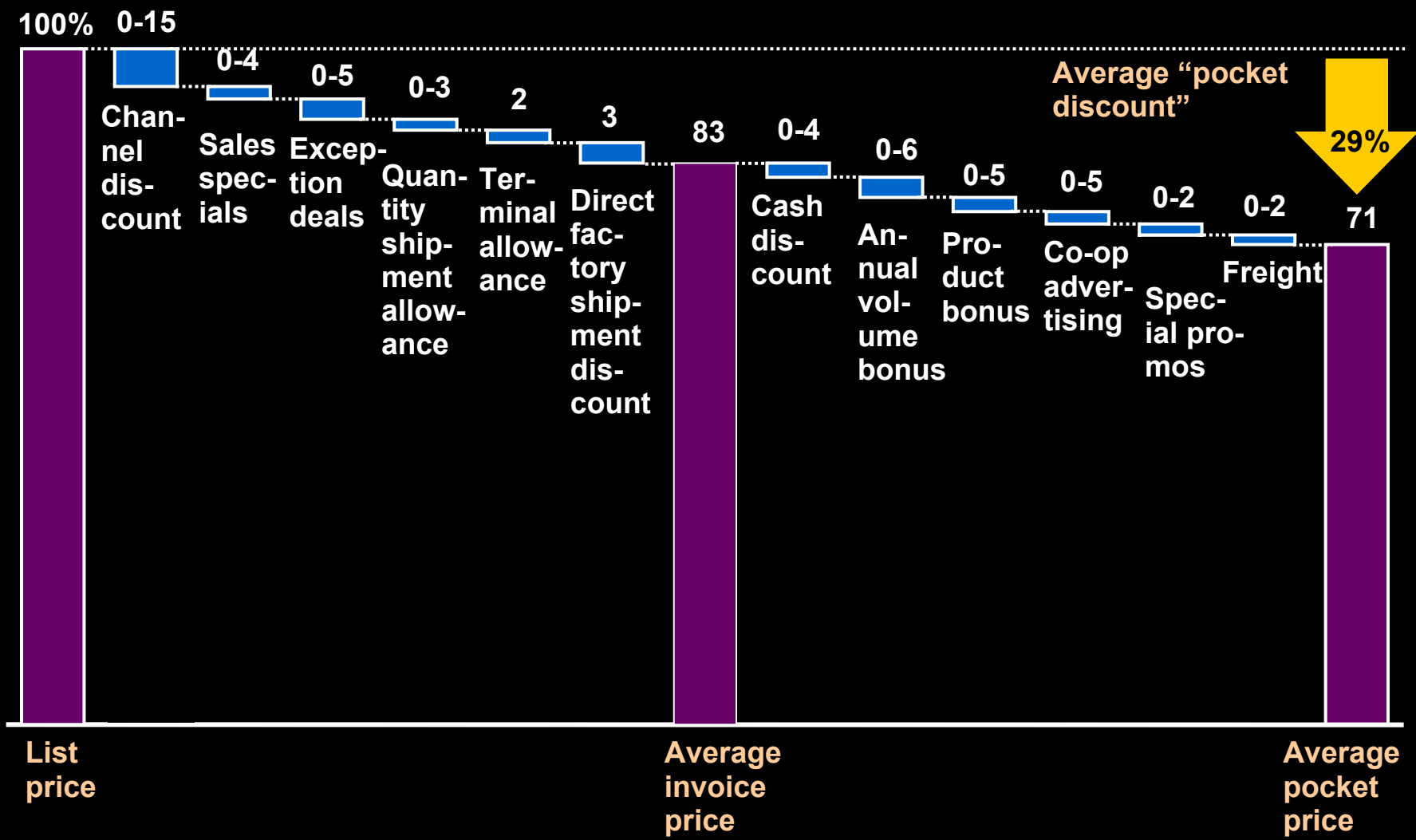
**Realizing cultural and  
organizational change**

# 3 LEVELS OF PRICE MANAGEMENT

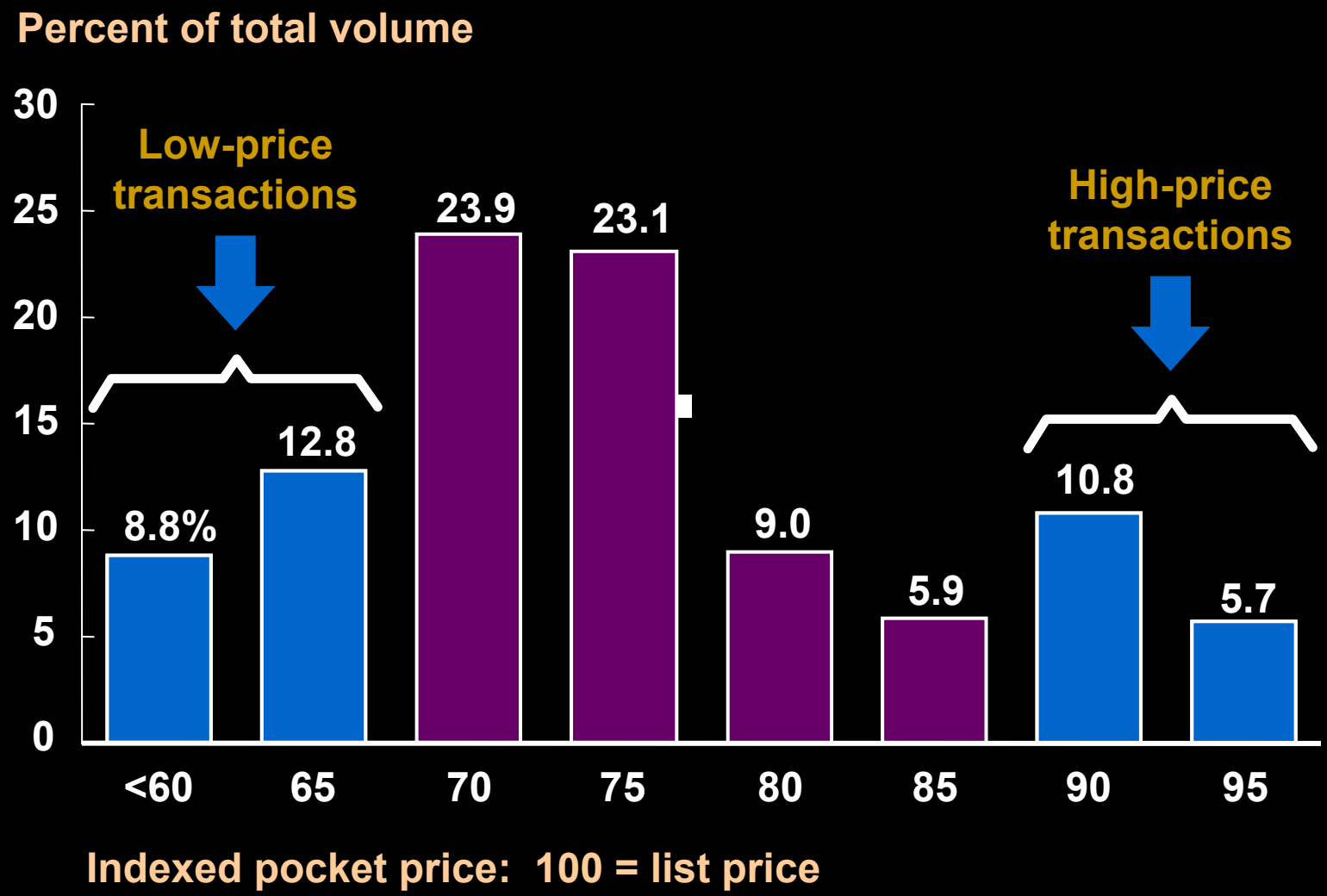


# POCKET PRICE WATERFALL – TIRE COMPANY

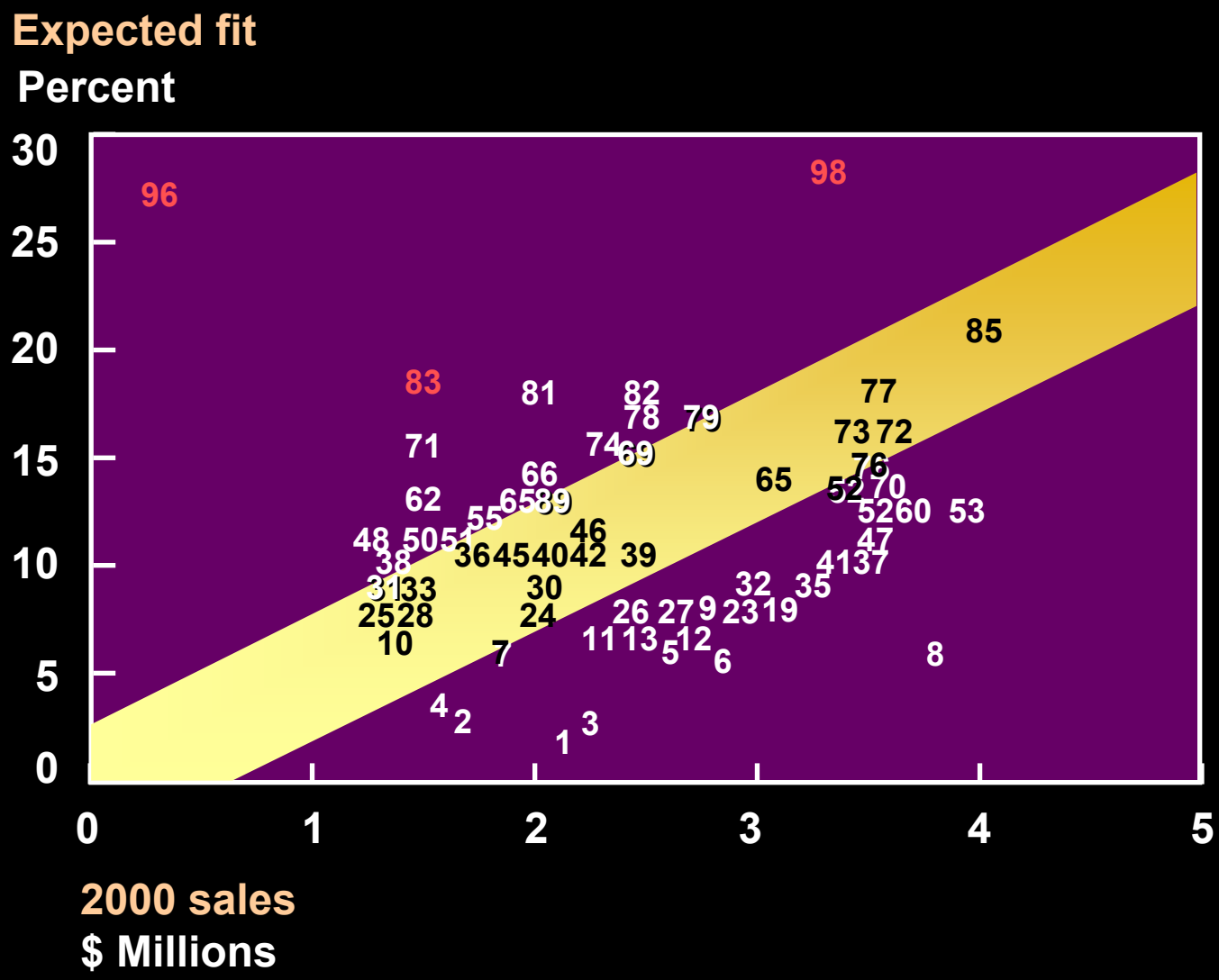
Percent



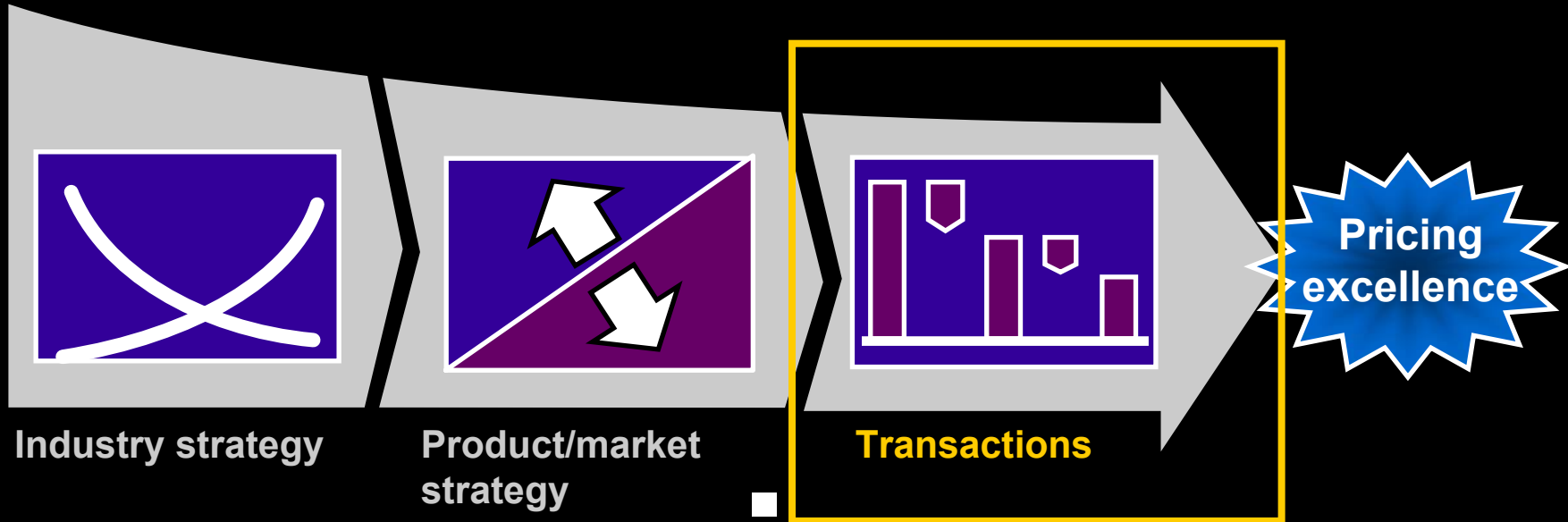
# POCKET PRICE BAND – TIRE COMPANY



# POCKET DISCOUNT VS. ACCOUNT SIZE – TIRE COMPANY

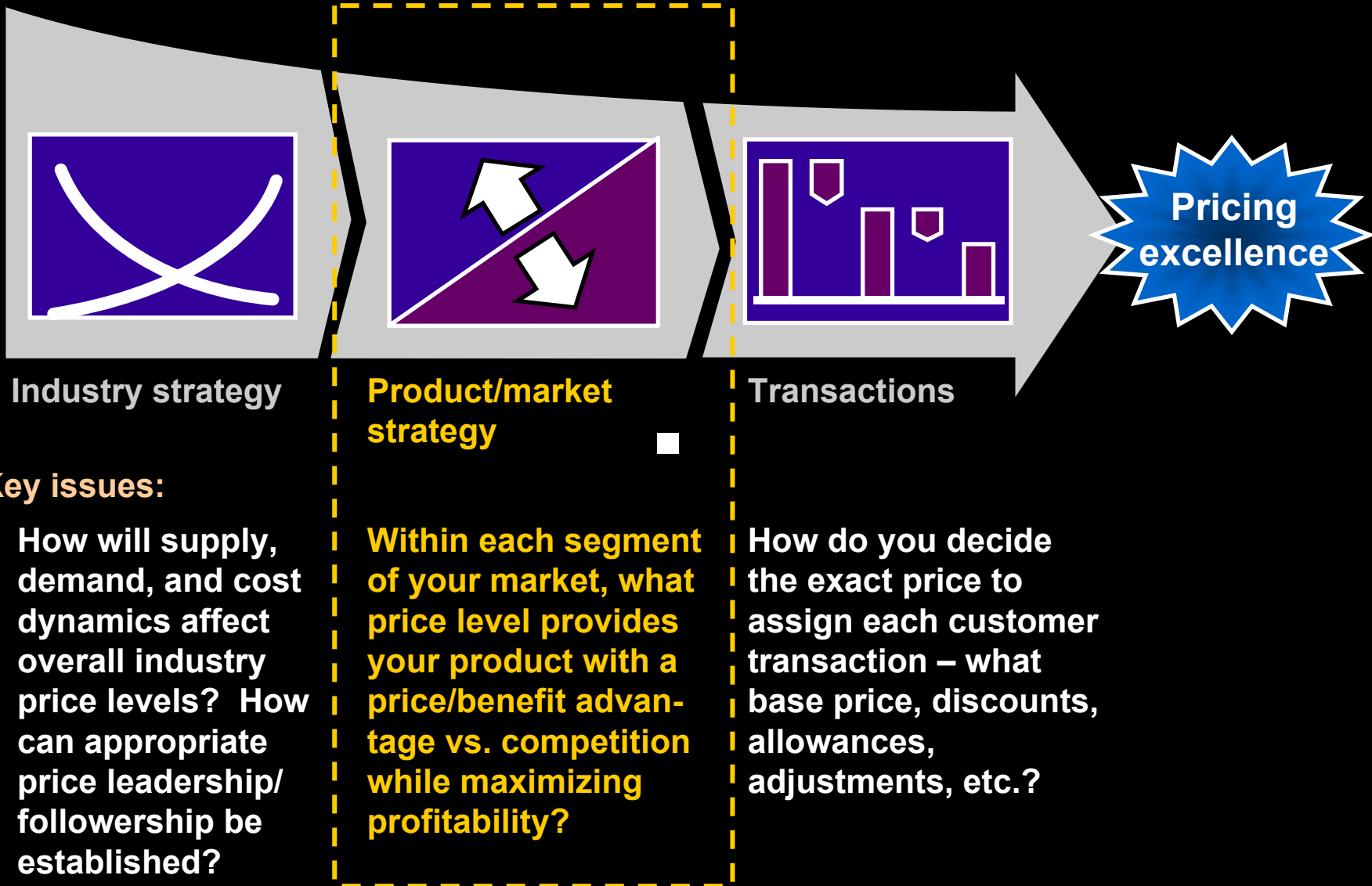


# WHAT "WORLD CLASS" LOOKS LIKE



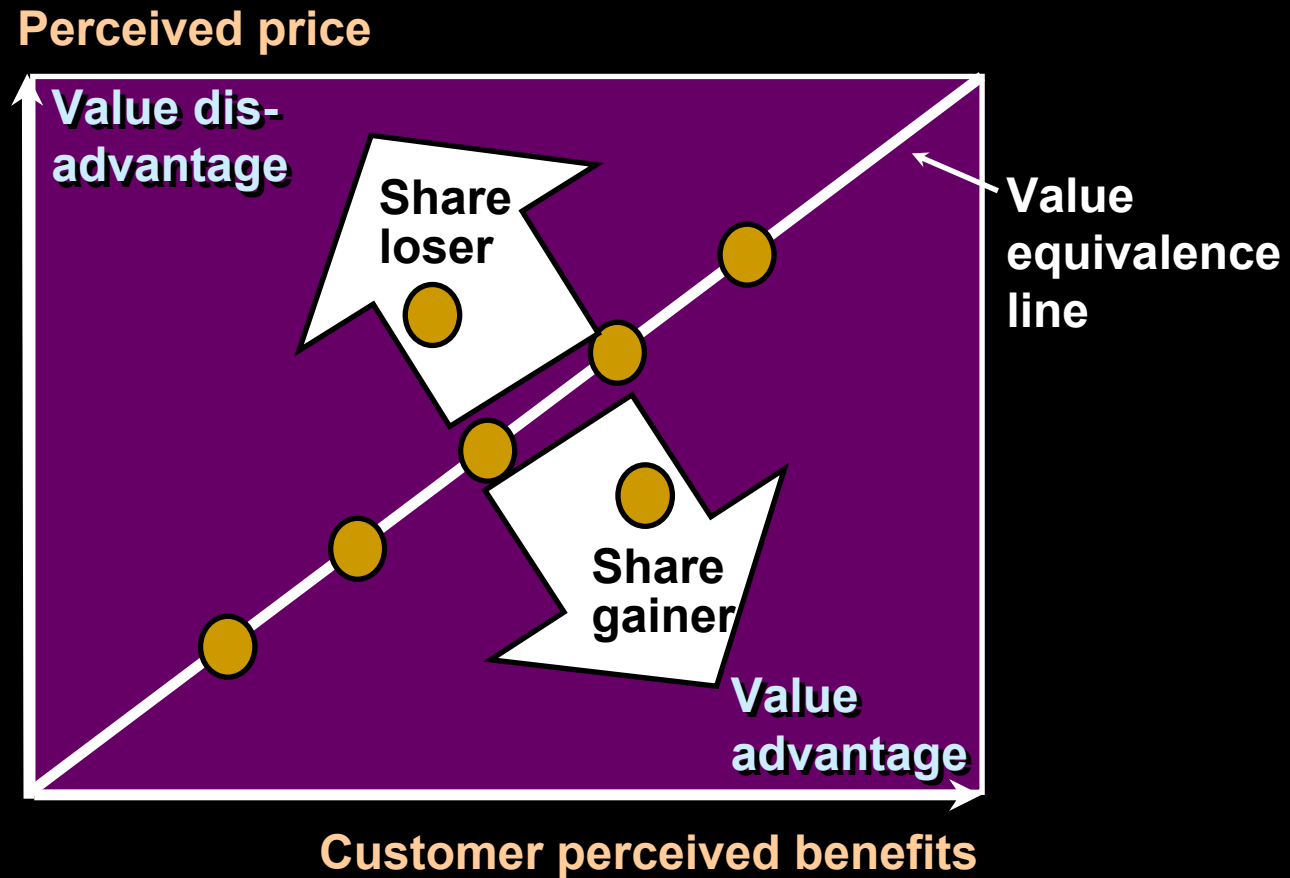
- Finger-tip real-time access to pocket price data by
  - Customer
  - Customer transaction
  - Region
  - Product market, etc.
- Pocket price target for each transaction
- Active management of profile of pocket price band
- Regular refinement of pocket price structure to help influence desired customer behavior
- Clearly defined guidelines and decision rules for each waterfall element
- Real-time tools to assess price exception requests
- Significant sales incentives for pocket price performance

# 3 LEVELS OF PRICE MANAGEMENT





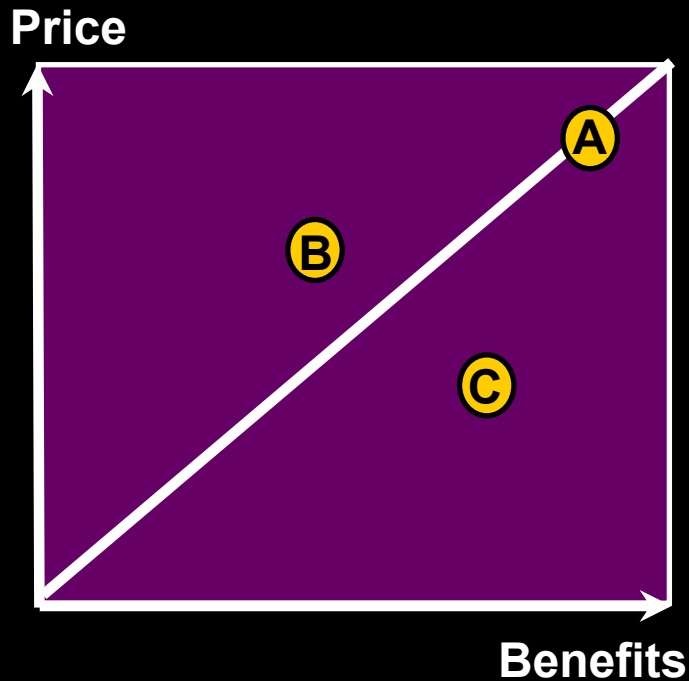
# VALUE MAP



$$\text{Customer value} = \text{Perceived benefits} - \text{Perceived price}$$

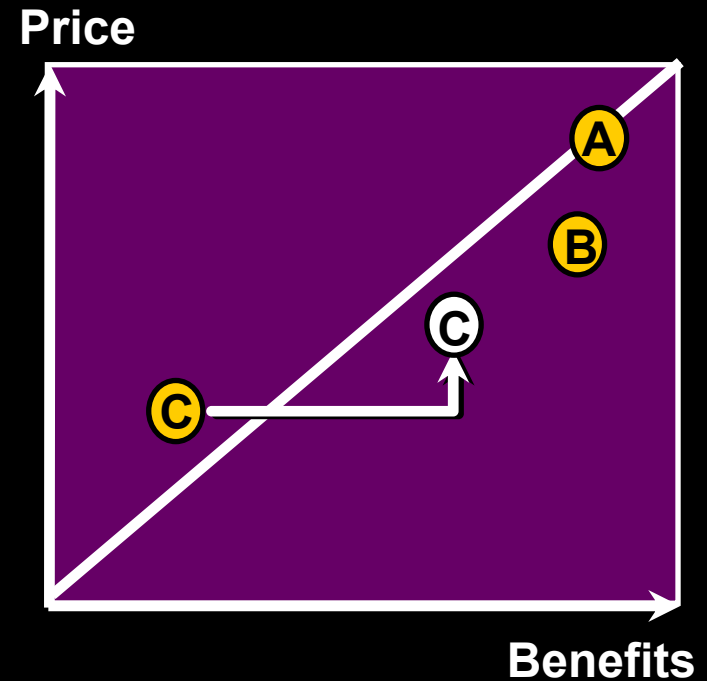
# VALUE MAP – PNEUMATIC PRODUCT

## Company perception



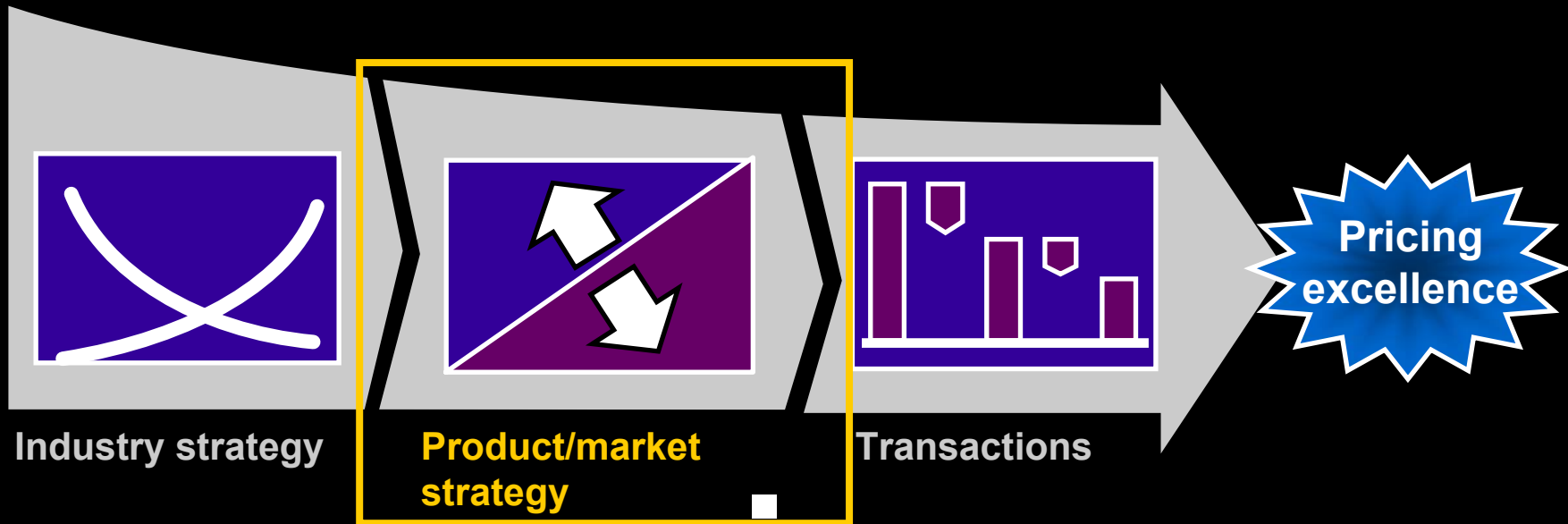
- Actuation speed
- Service life

## Actual



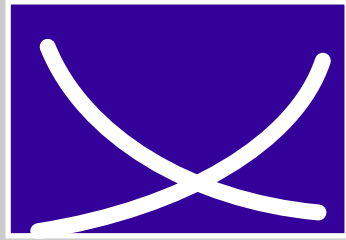
- Service ease
- Tech support
- Configuration flexibility
- Actuation speed
- Documentation
- Service life

# WHAT "WORLD CLASS" LOOKS LIKE



- Up-to-date customer value research (conjoint, discrete choice, value interviews)
- Current value maps (including key competitors) for important products and segments
- Continuous programs to improve value map position, including consideration of:
  - Most critical benefit attributes to build and communicate
  - Economics of price position alternatives
  - Likely competitive responses
  - Value equivalence line transition
- More sophisticated list price adjustments that reflect:
  - Differential value positions by product line
  - Differential elasticities by product and segment
  - Market research-based “zone of price indifference”
  - Market transitions from obsolete to new products
- Real-time tools for sellers to identify and quantify sources of economic value to customers

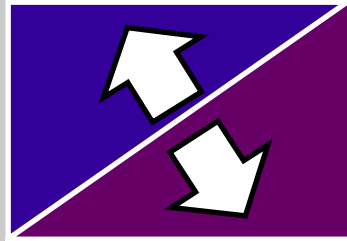
# 3 LEVELS OF PRICE MANAGEMENT



**Industry strategy**

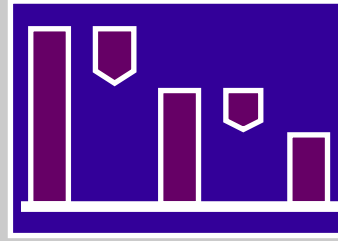
**Key issues:**

**How will supply, demand, and cost dynamics affect overall industry price levels? How can appropriate price leadership/followership be established?**



**Product/market strategy**

**Within each segment of your market, what price level provides your product with a price/benefit advantage vs. competition while maximizing profitability?**



**Transactions**

**How do you decide the exact price to assign each customer transaction – what base price, discounts, allowances, adjustments, etc.?**

**Pricing excellence**

# SUCCESSFUL PRICE LEADERS INFLUENCE THE OUTCOME



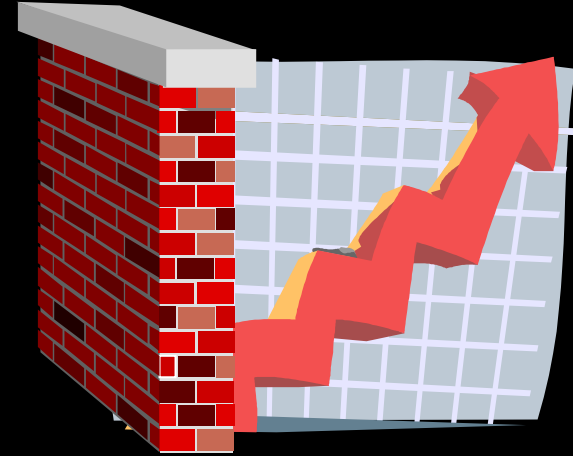
**Visibility** of pricing and the price leadership opportunity

- Understand past price behavior
- Find promising segments
- Create price transparency



**Motivation** to focus on price rather than share

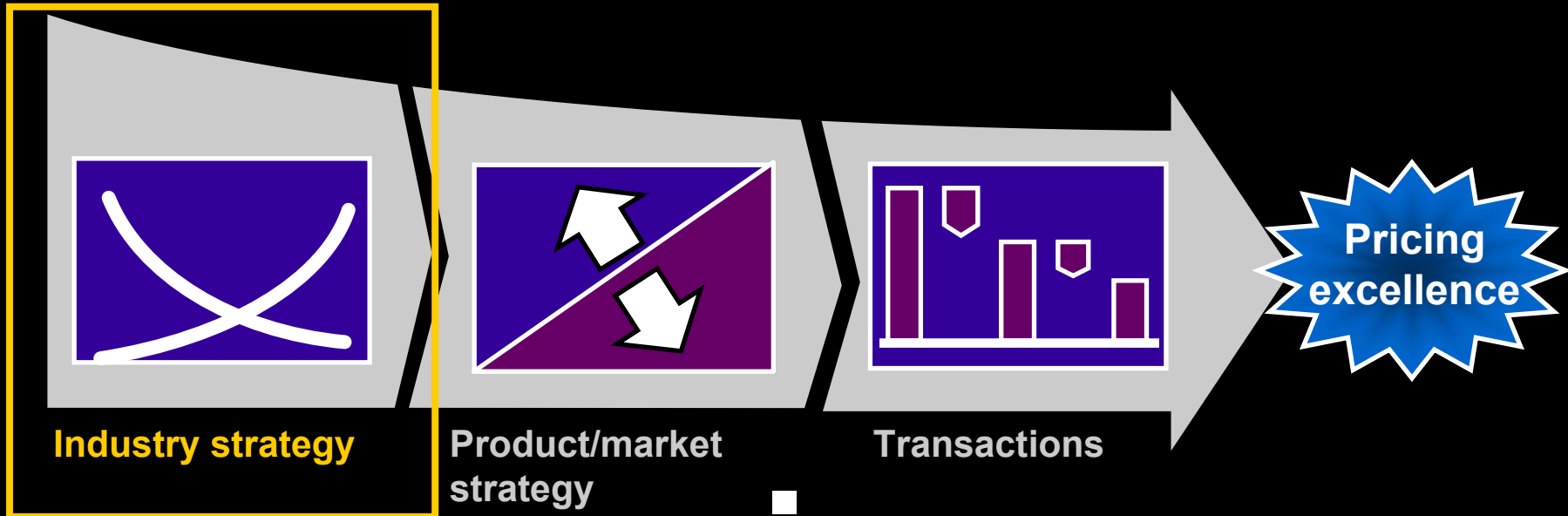
- Challenge assumptions about upside (company and competitors)
- Use the price increase strategically
- Communicate the stakes



**Resolve** to sustain benefits

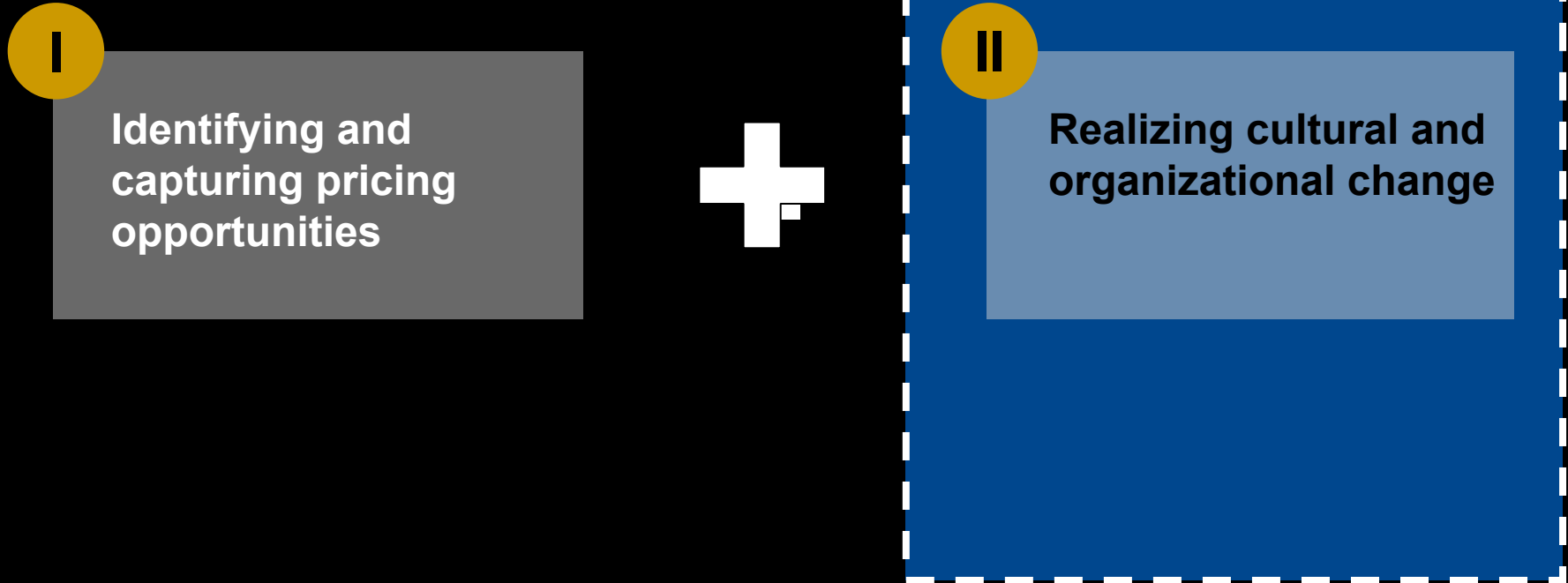
- Do not capitulate to the channel
- Instill transactional discipline
- Reinforce messages over time
- Monitor and adapt behavior

# WHAT "WORLD CLASS" LOOKS LIKE



- Analytic and fact-based forecasting of industry price trends
- Syndication of price trend forecasts (and desired messaging) across organization
- Central, unbiased collection of competitive pricing information, e.g.,
  - Transaction price levels
  - Changes in list price
  - Price leadership/followership behavior
  - Other price messages
- Thoughtful industry price communication approach, e.g.,
  - Clear bellwether price
  - Unambiguous communication of strategic intent
  - Tailored communication around price adjustments
  - Strategic bidding
  - Senior “jaw-boning”
- Firewall to prevent all forms of price destructive behavior

# ACHIEVING PRICING IMPACT REQUIRES TWO THINGS



# CASE STUDY – INDUSTRIAL SERVICES COMPANY

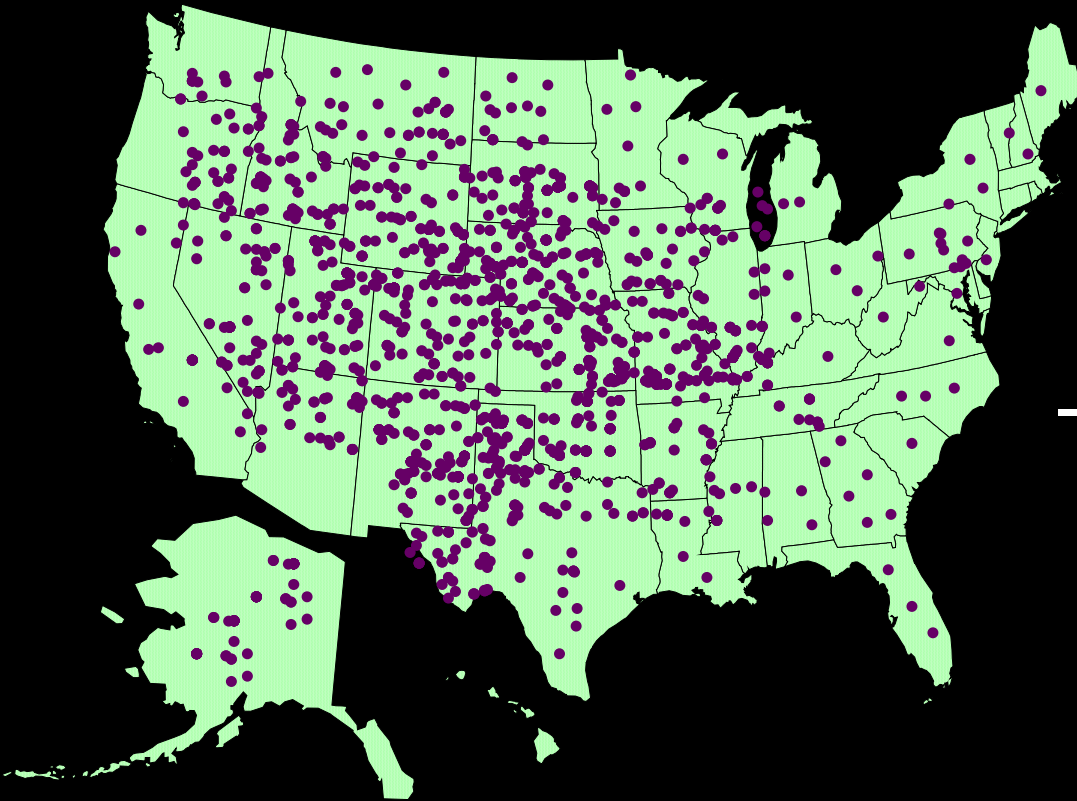
Services

Services company

Customers



300 branches



Small  
companies

Small  
contractors

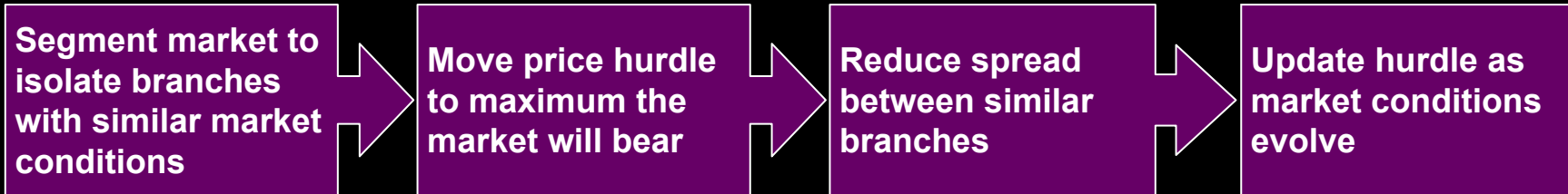
Institutions

Government

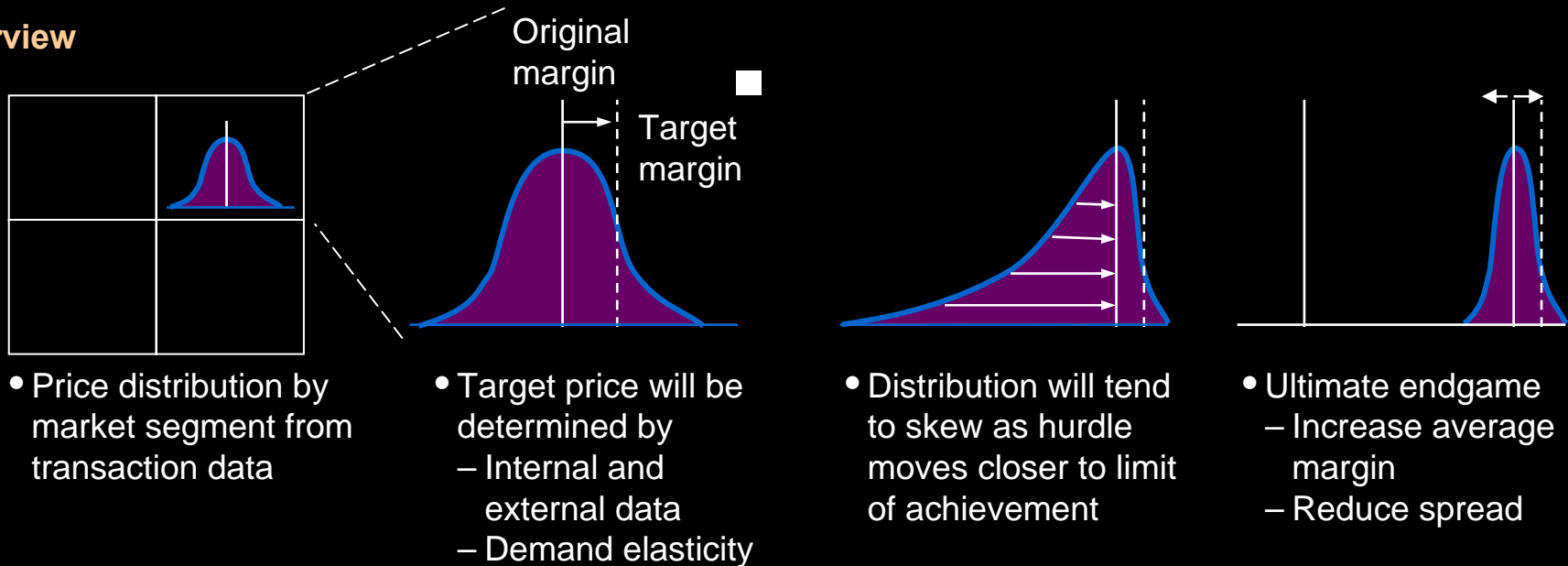
Large  
companies



# THE GOAL WAS TO TIGHTEN BANDS OF PRICING PERFORMANCE

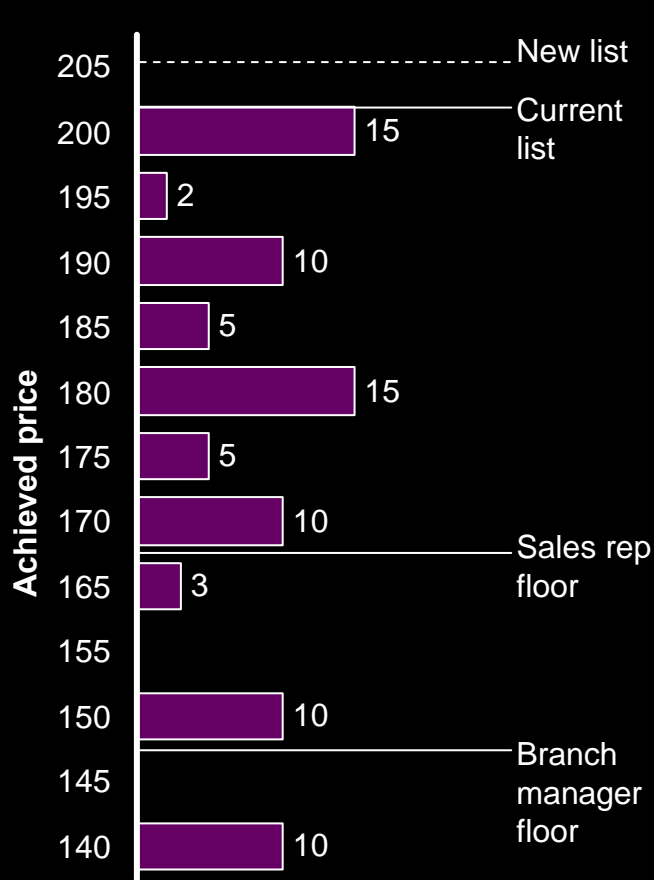


## Overview



# THE PRICE-SETTING METHODOLOGY VARIED FOR TOP OF MIND PRODUCTS AND OTHERS

## Top products Percent of sales



### List price

- Identify 95<sup>th</sup> percentile
  - Set list at this level
  - Revise upward by 2-5% if greater than 20% of contracts were within list
  - Review every 6 months
- Sales rep floor
  - Set at 40<sup>th</sup> percentile
  - Any sales below this, sales reps need approval
- Branch manager floor
  - Set at 10<sup>th</sup> percentile or fully landed cost, whichever is higher
  - Review as needed

## Other products

### Recommended change in list price

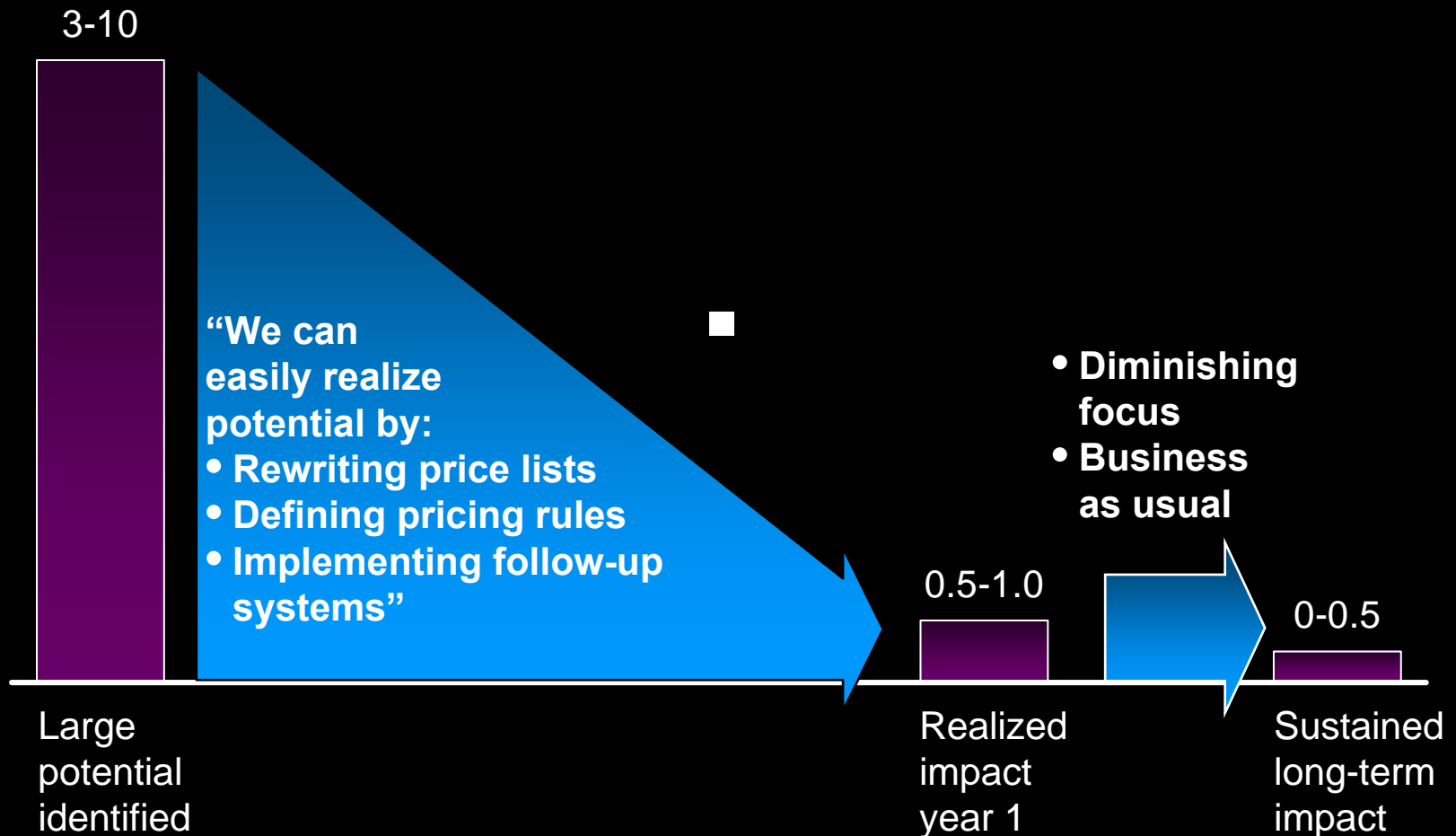
|                    |      |       |     |
|--------------------|------|-------|-----|
| High price product | +2   | +5    | +10 |
| Low price product  | +5   | +10   | +15 |
|                    | 0-30 | 30-70 | 70+ |

Percent of current sales within 5% of list

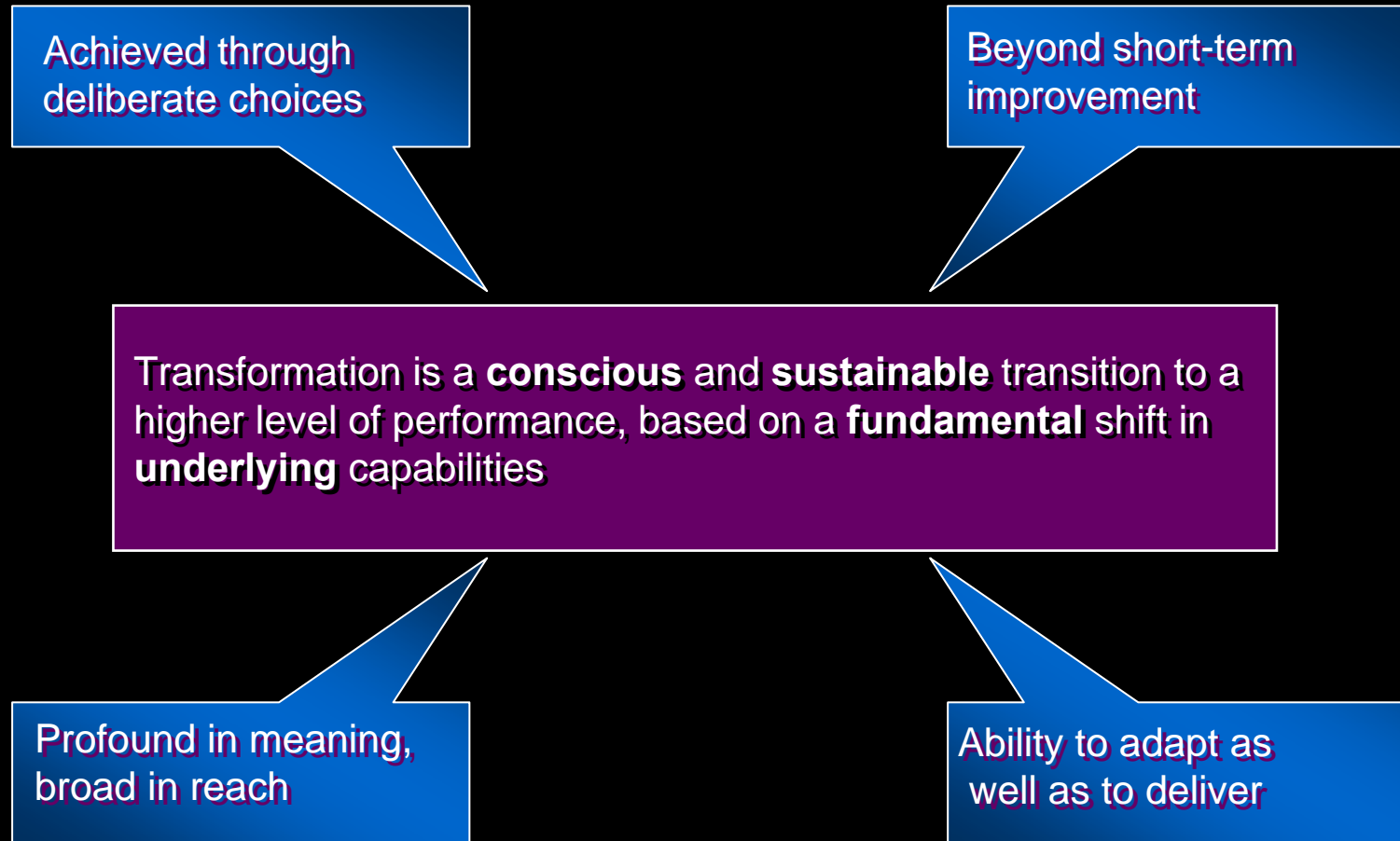
# BELIEVING IMPLEMENTATION IS EASY IS A COMMON PITFALL

ILLUSTRATIVE

Percent ROS



# TO SUCCEED IN PRICING, ORGANIZATIONS MUST EMBRACE TRANSFORMATION . . .



# FROM FAILURE TO SUCCESS – A DIFFERENT TOUCH AND FEEL

## Successes



“**Pricing charts** became standard pages in our management review”

“We have now built a **pricing office** to play the role McKinsey played initially”

“I (CEO) look at scatter plots and waterfalls and **question every deal** below our minimum margin target”

“This was a **high investment in people** – but with a much better return than any traditional investments”

## Failures



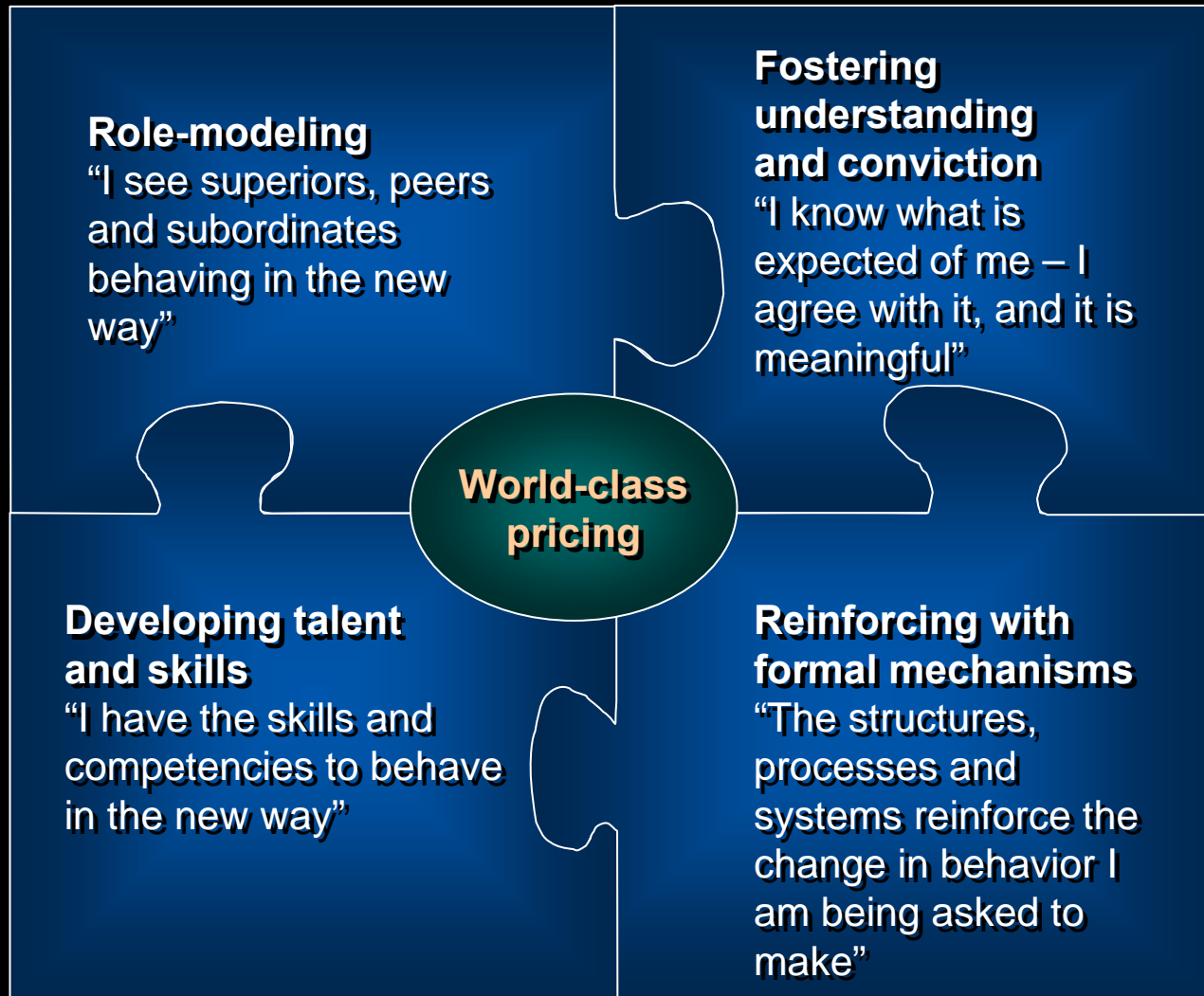
“Although it worked in one BU, we **never convinced other BUs**, to chip in – it is still a high risk for the MD to commit to such a big improvement target”

“Cost targets are easy to compare between BUs – we never compared **pricing targets** – there is no **common pricing KPI**”

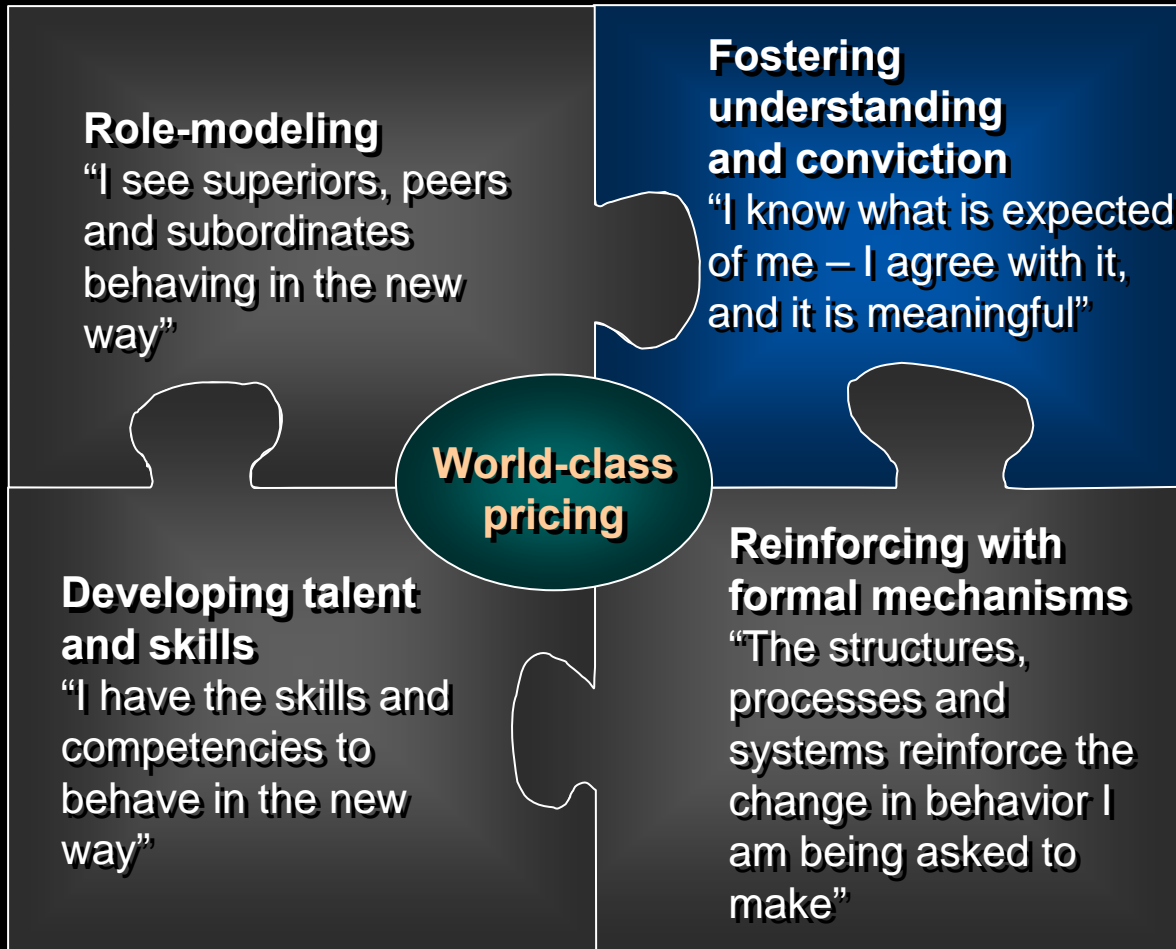
“How do you get away from **volume focus**, everybody in my organisation is thinking about tonnes?”

“We were never able to **track the impact**”

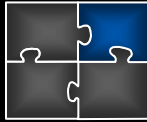
# MAKING PRICING CHANGE “STICK” – THE INFLUENCE MODEL



# MAKING PRICING CHANGE “STICK” – THE INFLUENCE MODEL (CONTINUED)



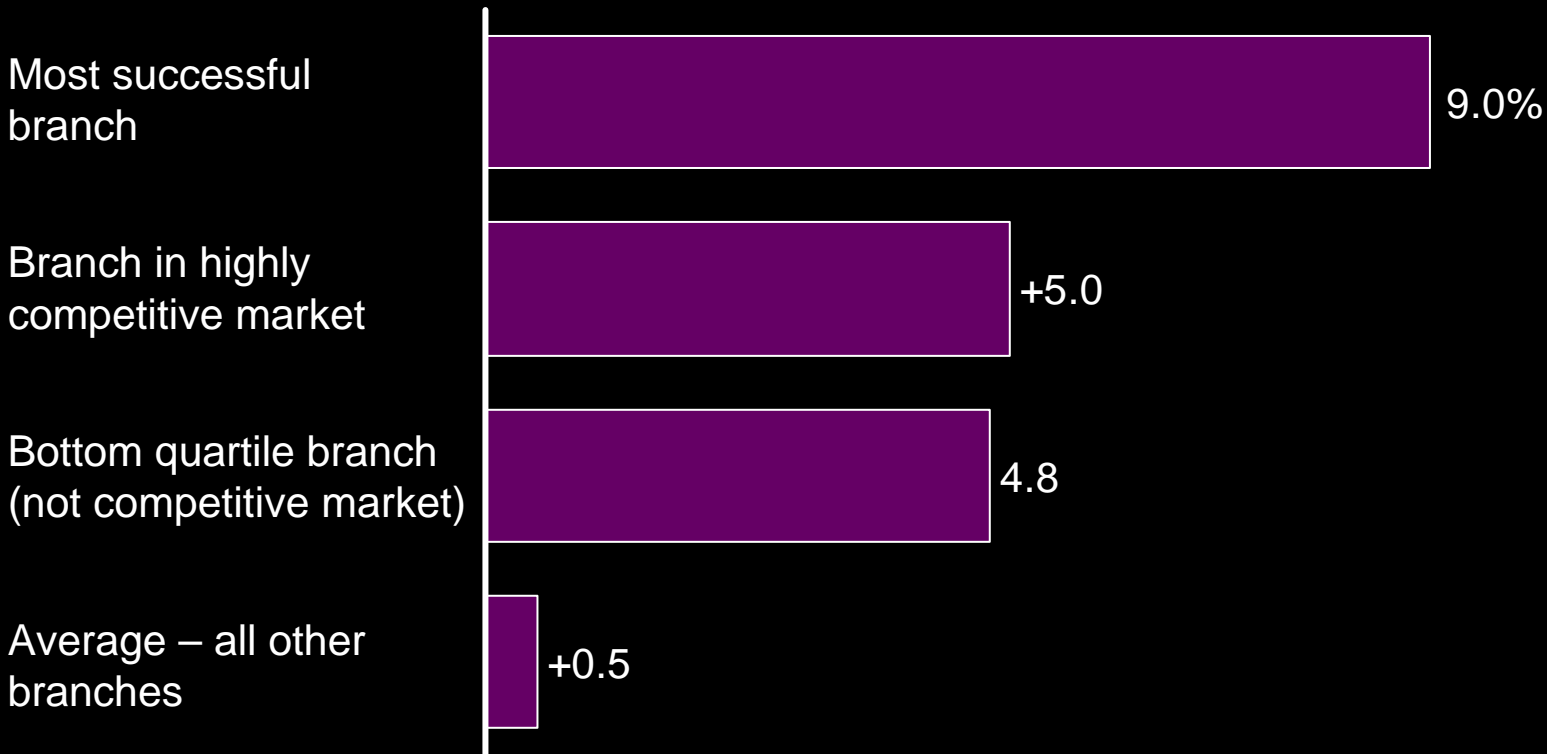
- Obtain buy-in from management team on the importance of pricing in driving profitability and ability to manage price upwards
- Clearly communicate pricing objectives
- Show the organization that the impact is real and substantial
- Communicate enhancements to pricing strategy in monthly/quarterly meetings



# 1. USED PILOT TO CONVINCE MANAGERS OF UPSIDE

Percent

Change in pocket price – 2-month pilot





## 2. ESTABLISHED ONGOING, REINFORCING COMMUNICATION

**Pricing was focus of introductory remarks at analyst briefing**

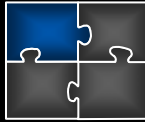
**Declared 1 of the top 2 priorities for 2003/2004**

**“Pricing corner” added to monthly newsletter**

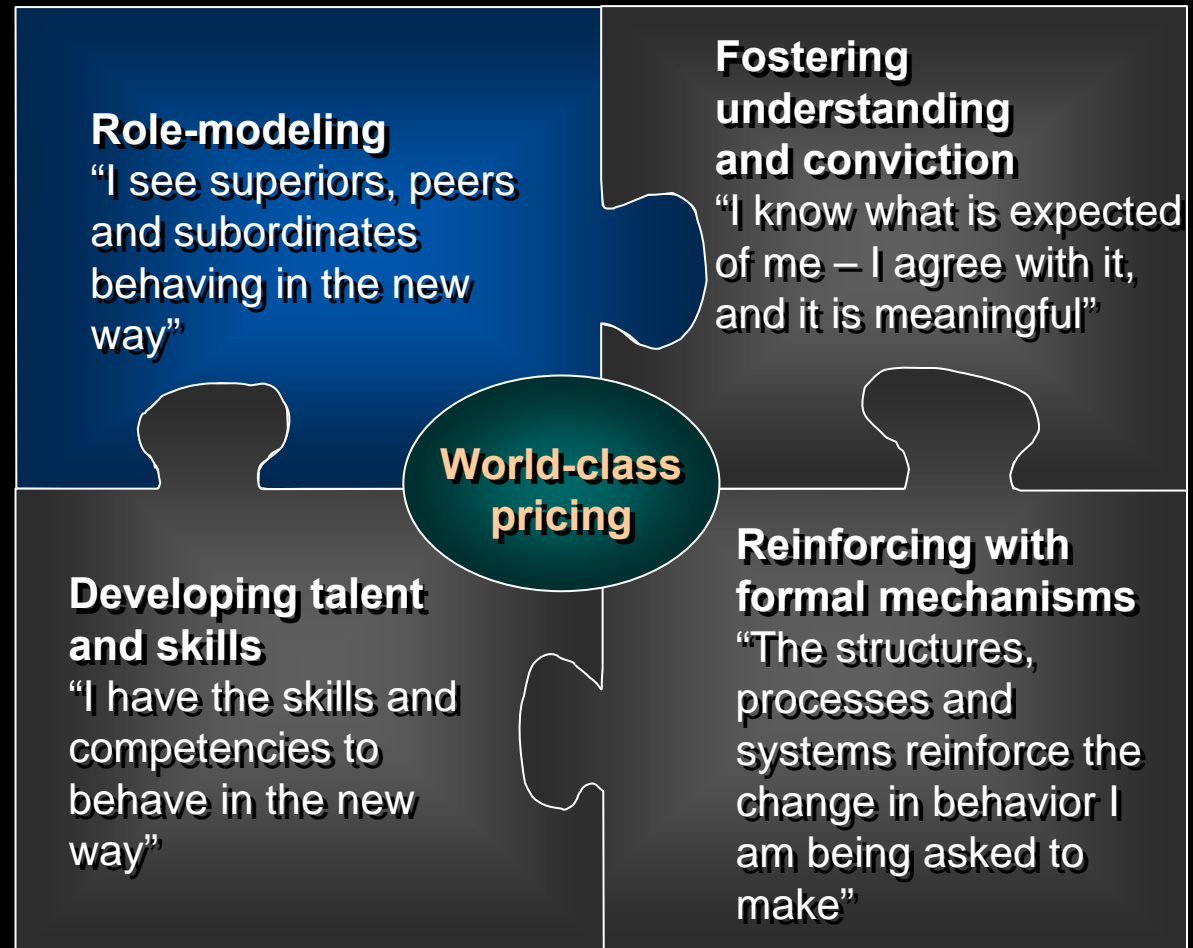
**Blast e-mails sent internally to highlight pricing successes**

**CEO called 4 top-performing and 4 bottom-performing branch managers every month**


# MAKING PRICING CHANGE “STICK” – THE INFLUENCE MODEL (CONTINUED)

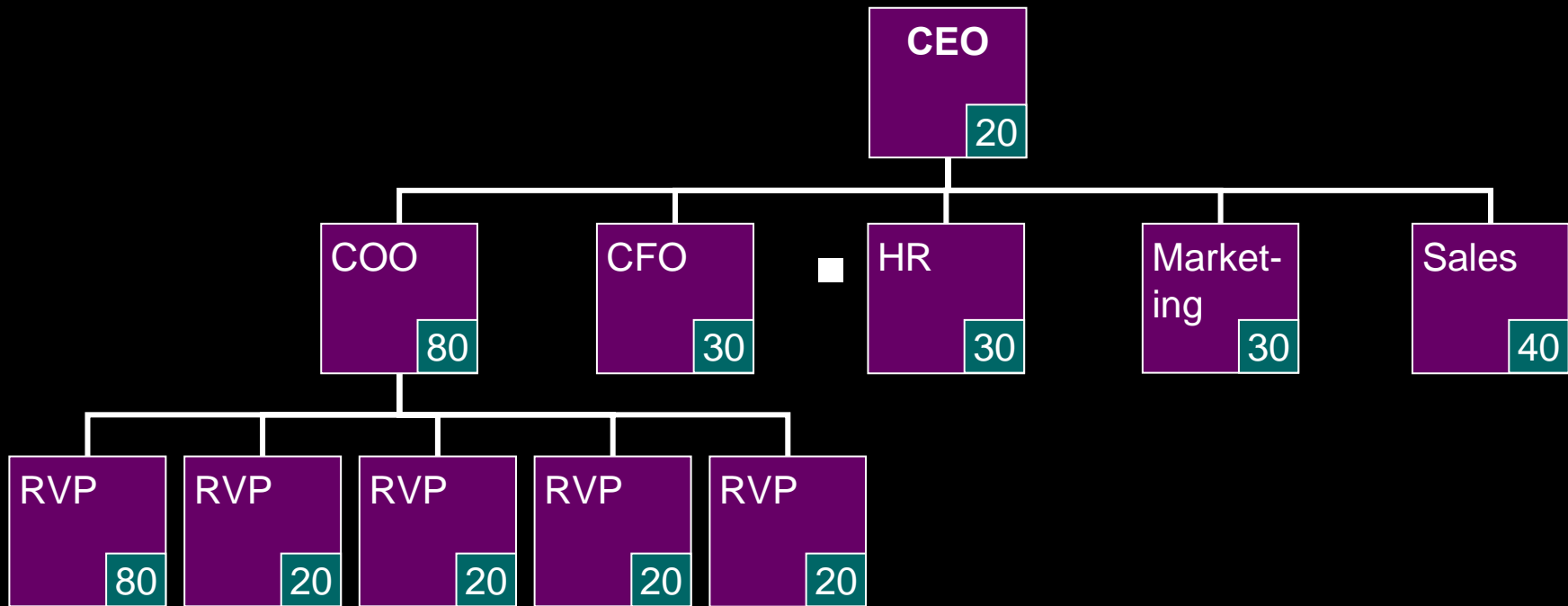


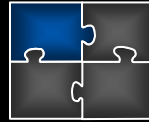
- Expect top team leaders to visibly engage in pricing activities
- Have senior management actively and regularly solicit feedback from frontline
- Demand consistency



# 1. DEMONSTRATED IMPORTANCE BY ACTIVE INVOLVEMENT

 Percentage of time spent on pricing initiative  
~5 months





## 2. ENHANCED PRICING ROLE FOR ALL FUNCTIONS

### Finance



- Pricing monitoring
- Pricing analysis
- Design payment terms and conditions

Enhanced  
pricing role and  
pricing capabilities

### Marketing



- Superior market/competitive intelligence, segmentation
- Distinctive product/service positioning
- Command of value maps, value-in-use

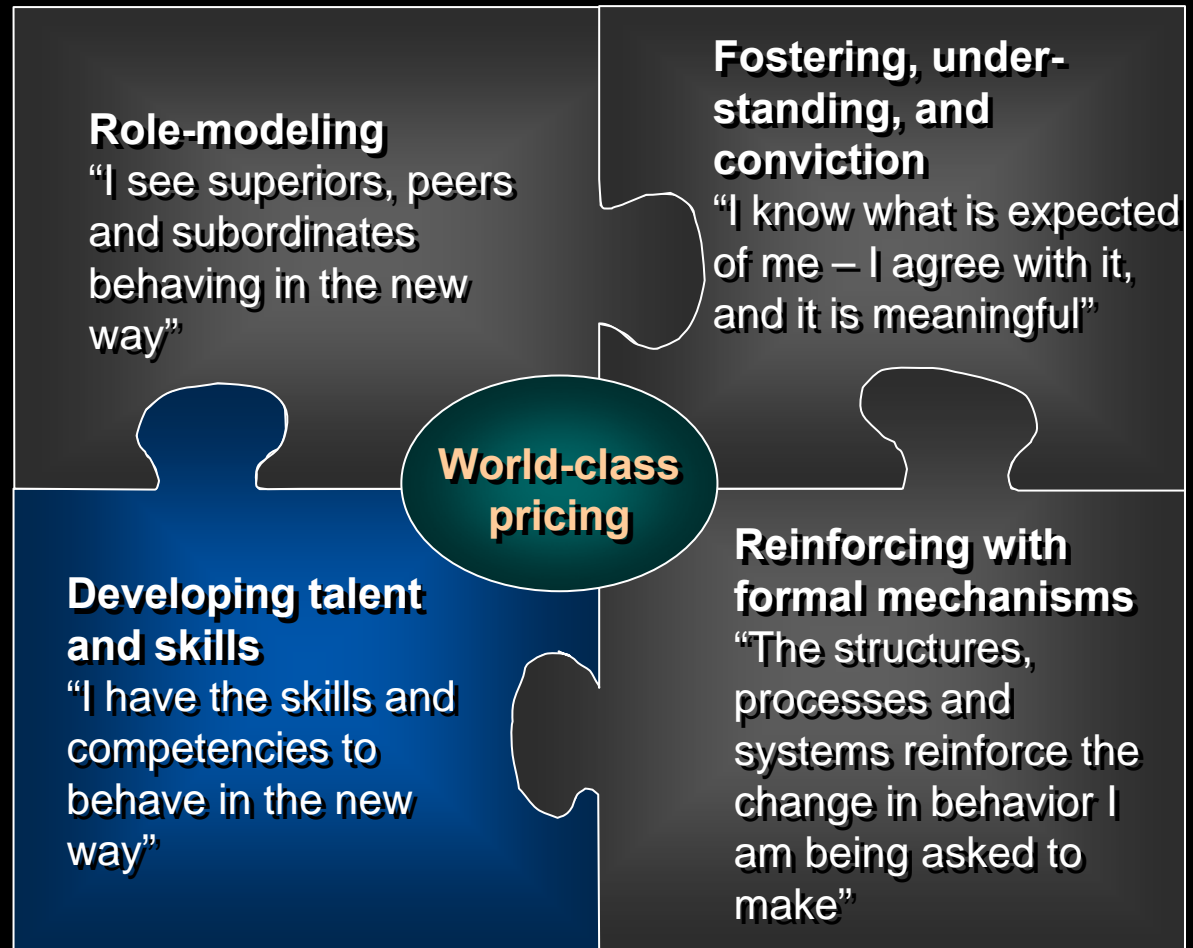
### Regional Sales



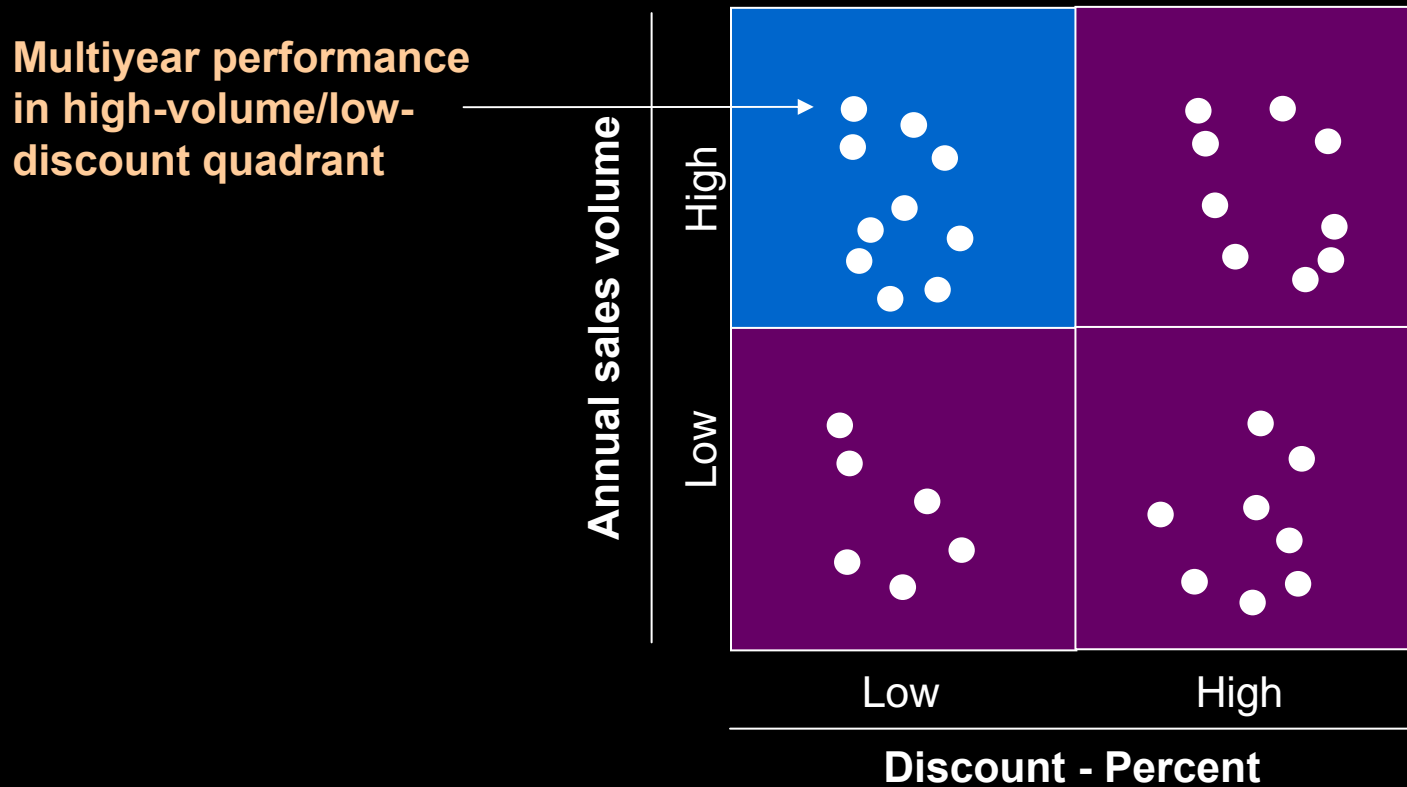
- Fact based/tool-supported transactional pricing
- Pricing performance comparison
- New negotiation capabilities

# MAKING PRICING CHANGE "STICK" – THE INFLUENCE MODEL (CONTINUED)

- Train managers and sales reps in customer-specific "bottom-up" pricing initiatives, e.g.,
  - Front-line transaction price management
  - Effective product/customer mix management
  - Price negotiation techniques
- Hold workshops with senior managers to discuss pricing strategies and processes



# 1. CHOOSE HIGH PERFORMING SALESPEOPLE FOR DEVELOPING CONTENT OF TRAINING





Trained Branch Manager

## 2. ROLLED OUT TRAINING TO ALL OF THE FRONT-LINE

### Implementation phase

Pilot

1st Wave –  
Regional VPs &  
District Mgrs.

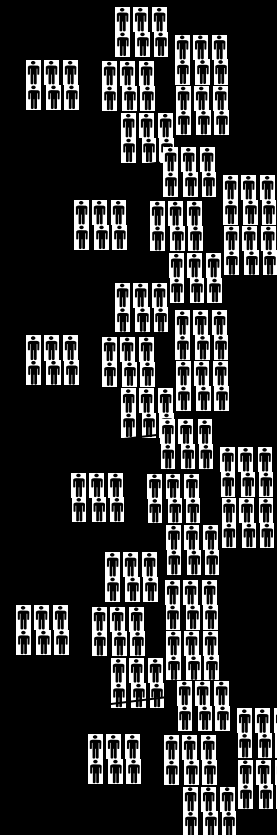
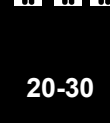
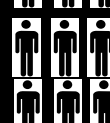
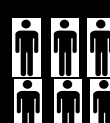
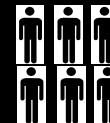
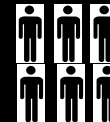
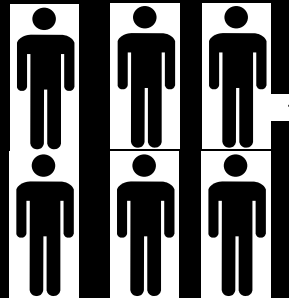
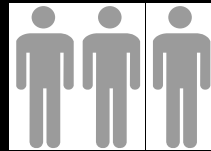
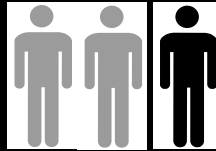
2nd Wave – First  
set of Branch  
Managers

3rd Wave –  
Second Set of  
Branch Managers

4th Wave – Third  
Set of Branch  
Managers

### Process Description

- 4-6 Executives trained on new pricing actions during project
- Training cascaded through organization leveraging Regional VPs and District managers
- ~8-10 branches used as cases during Wave 1 training
- Waves 2-4 branch managers trained in groups according to like segments
- First group becomes experts and can act as coaches



Branch implementations  
underway

2-3

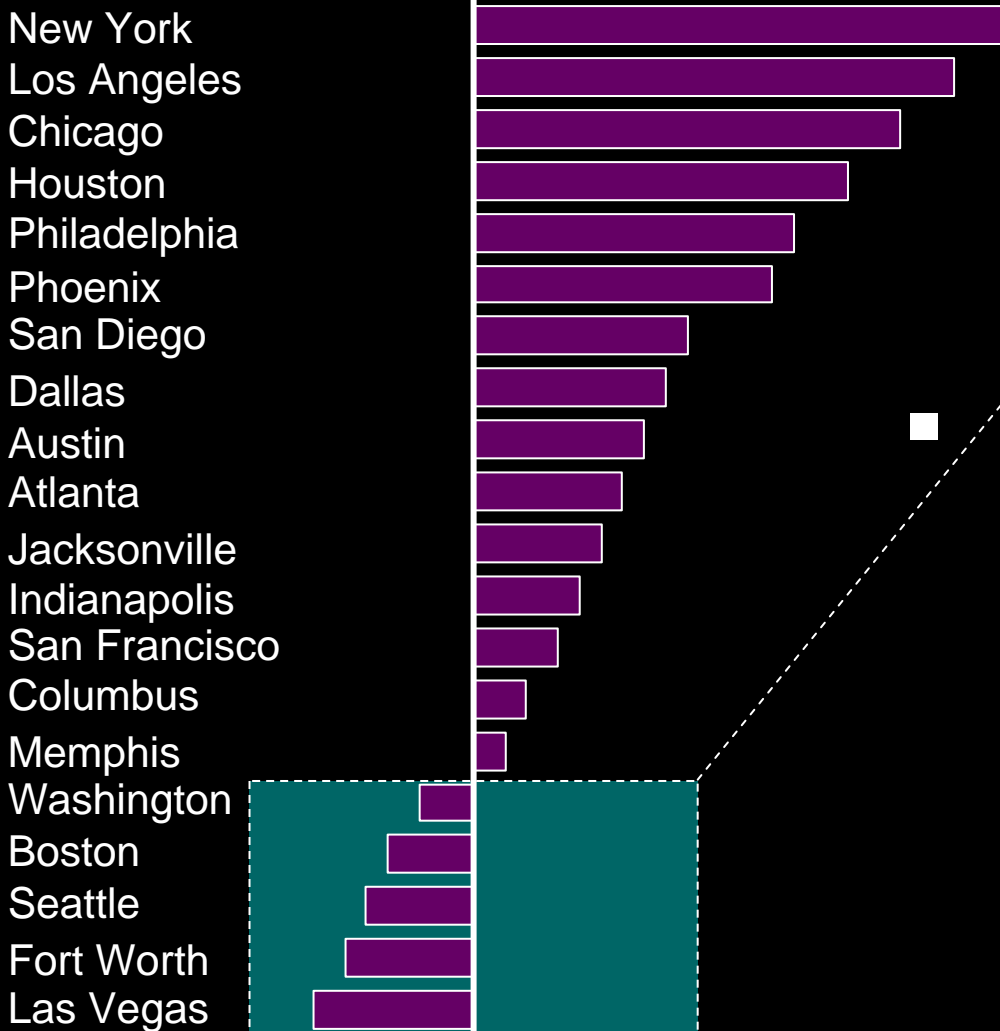
8-10

20-30

&gt;200

### 3. TARGETED FOLLOW-UP TRAINING ON BOTTOM-PERFORMING BRANCHES

Change in pocket price

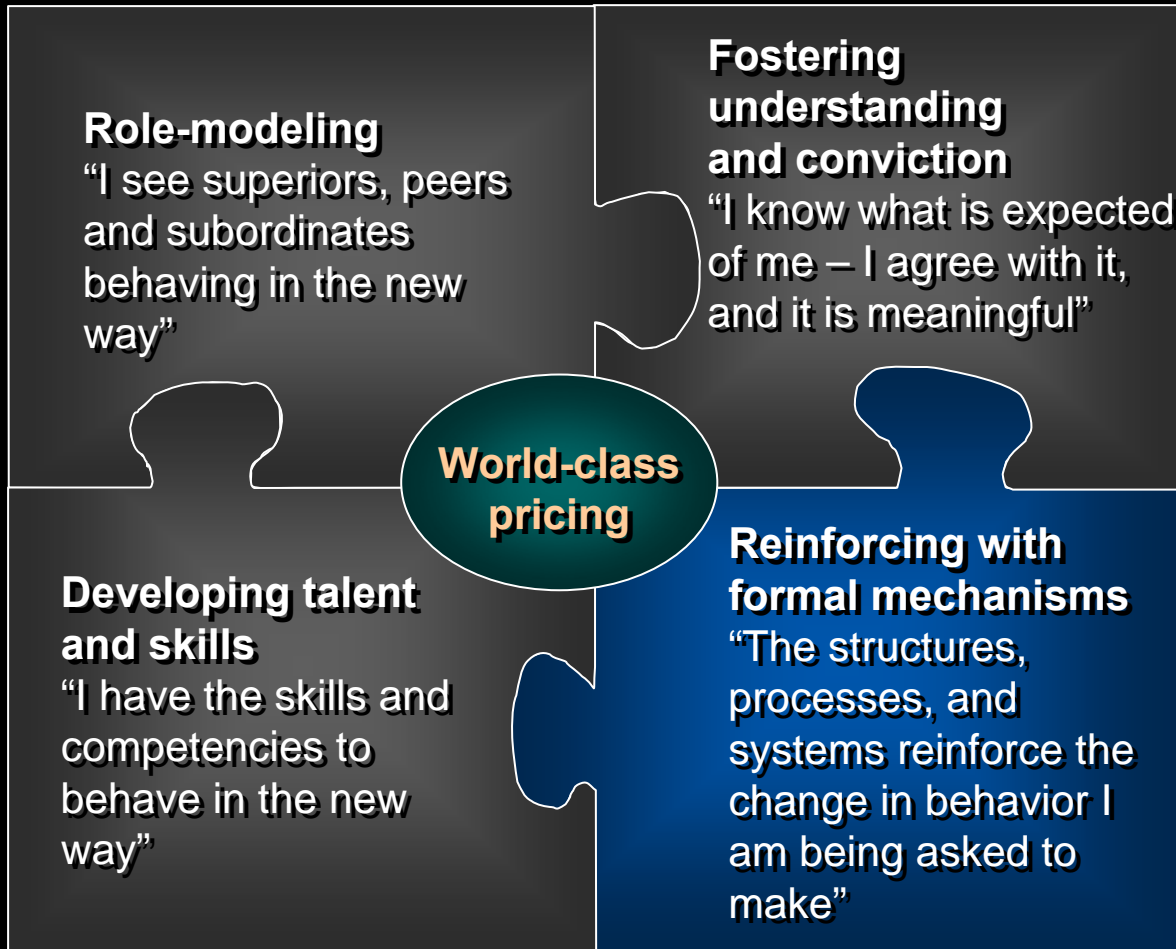


Pricing “SWAT” team

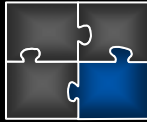




# MAKING PRICING CHANGE “STICK” – THE INFLUENCE MODEL (CONTINUED)



- Create pricing team with authority to monitor and influence all pricing decisions
- Add specific pricing metrics and set targets against them
- Link incentives to pricing results
- Build transaction-based information monitoring system
- Institute rapid knowledge-sharing mechanisms and processes to facilitate “real time” pricing decision support



# 1. LINKED COMPENSATION DIRECTLY TO PRICING

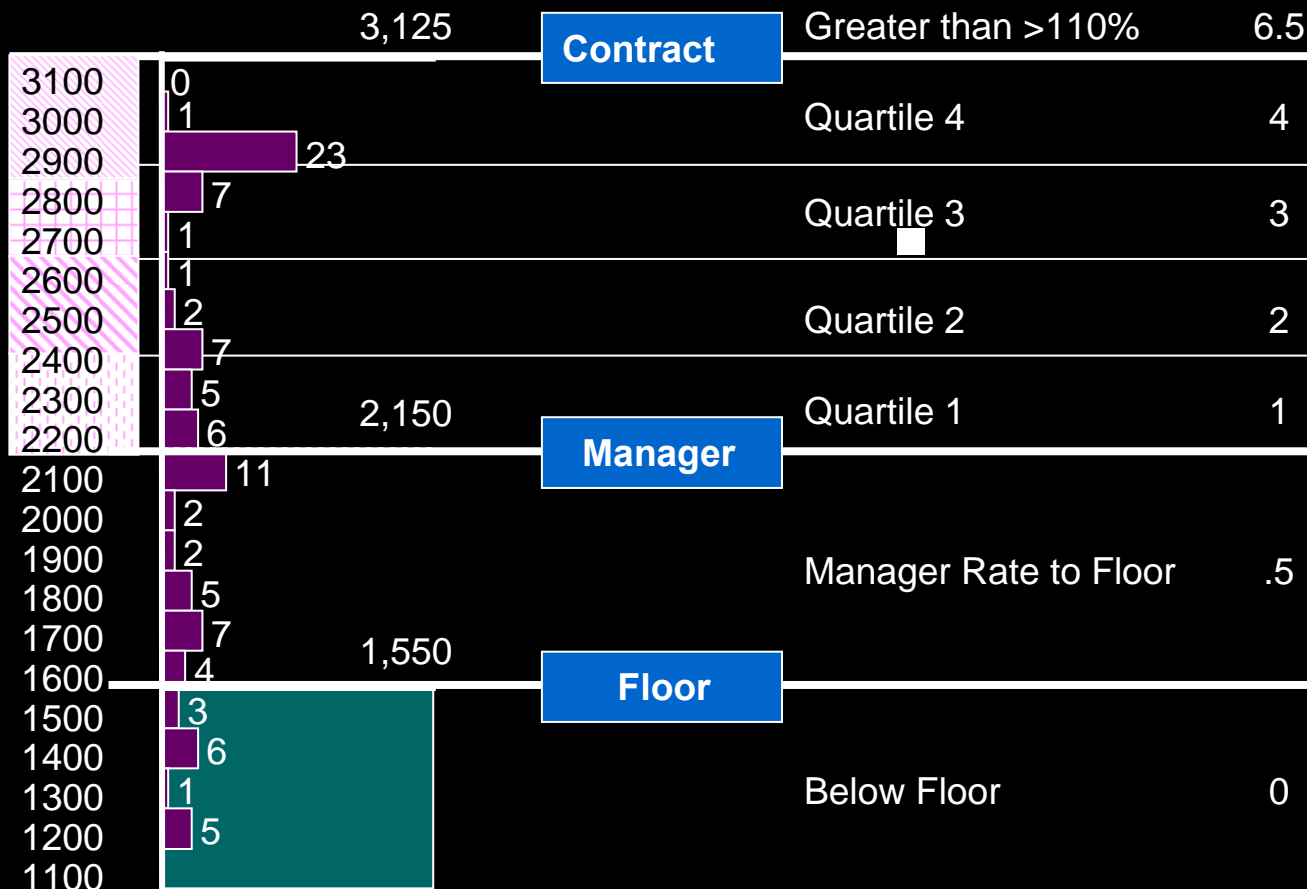
## GENERAL SERVICES

### LA Zone

### Commission Rate



Price

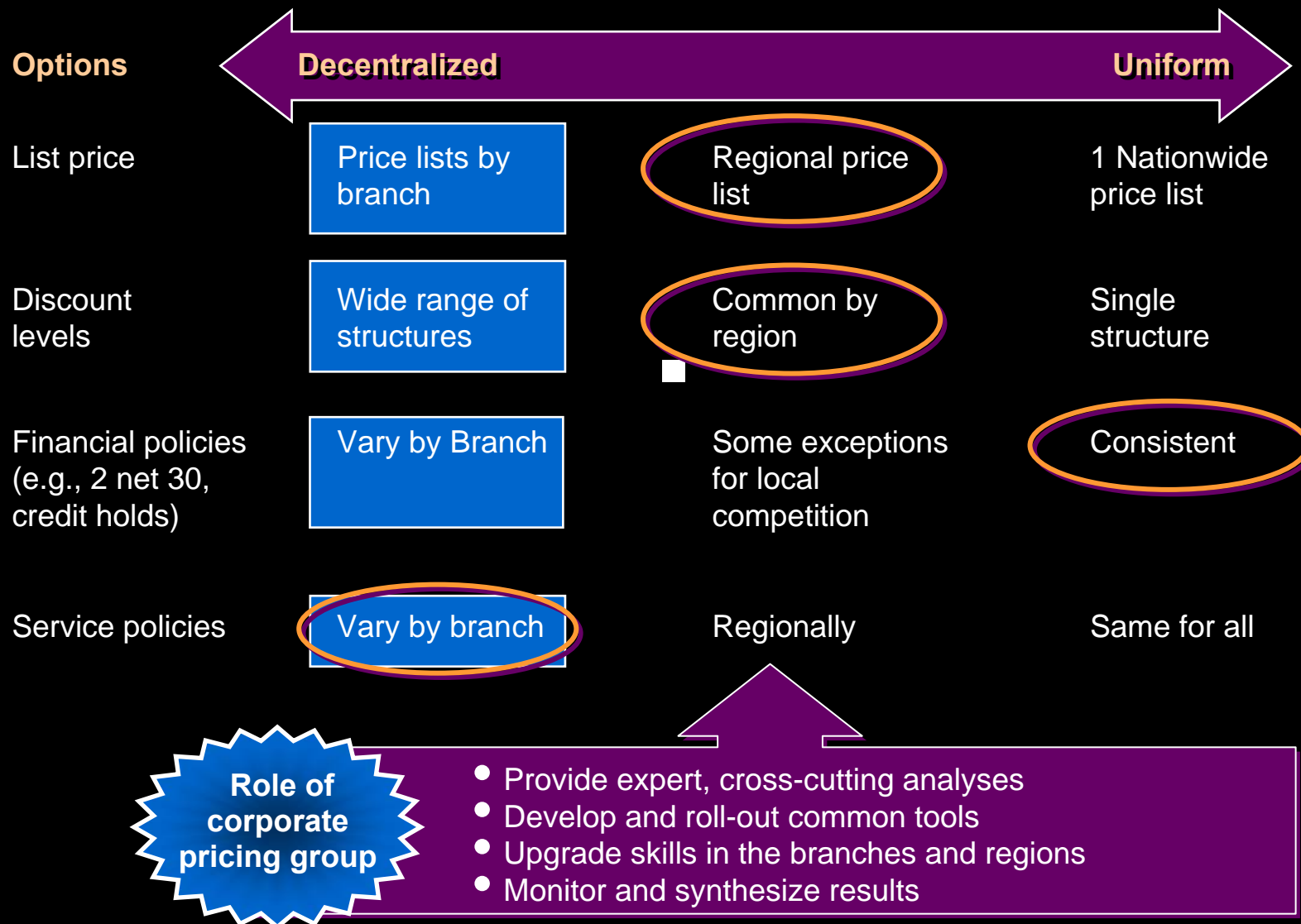
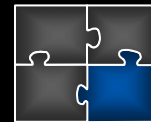
U.S. \$ Percent of contracts

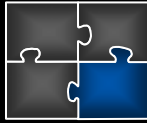


- Seven commission tiers are used
- Difference between contractor and manager rate is split in to quartiles
- Quartiles account for differences in difficulty of achieving prices between cat classes and zones
- Quartile method is built around three rates and specifically targets improved pricing performance between manager and contract rates

## 2. DEFINED THE RIGHT PRICING GOVERNANCE MODEL

 Current approach  
 New approach





### 3. MEASURED PRICING PERFORMANCE AT ALL LEVELS IN THE BUSINESS

#### Objectives

#### Metric example

**Transactional pricing performance**

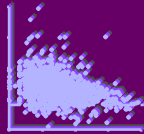


**Pocket price ratio**

=

$$\frac{\text{Pocket price}}{\text{List price}} (\%)$$

**Customer portfolio**



**Cumulated gross contribution**

=

$$\sum \left( \text{Pocket price} - \text{Variable cost} \right)$$

**Mix optimization**



**Average premium**

=

$$\text{Target list price} - \text{Base price}$$

**Incremental price adjustments**

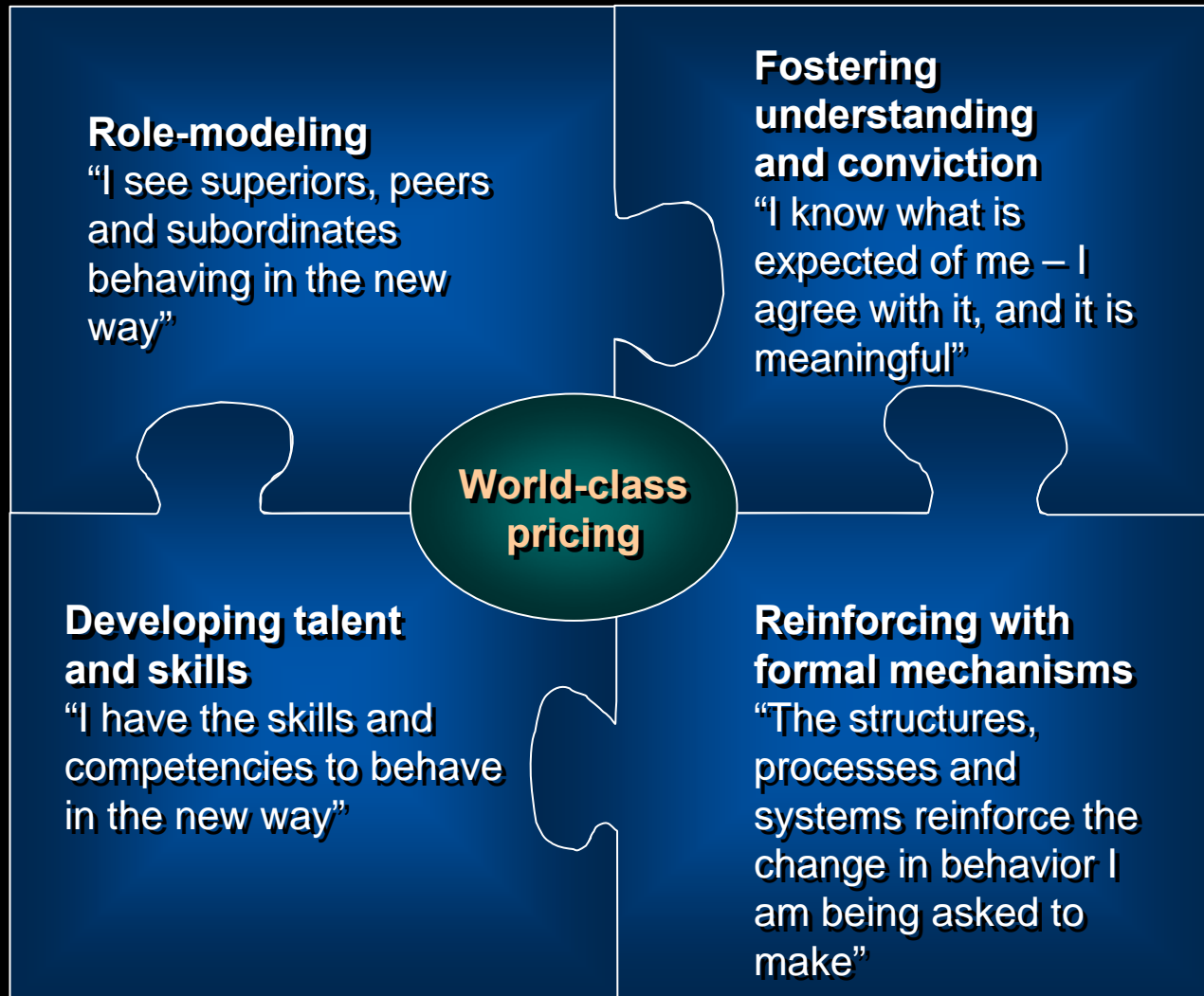


**Weighted price index**

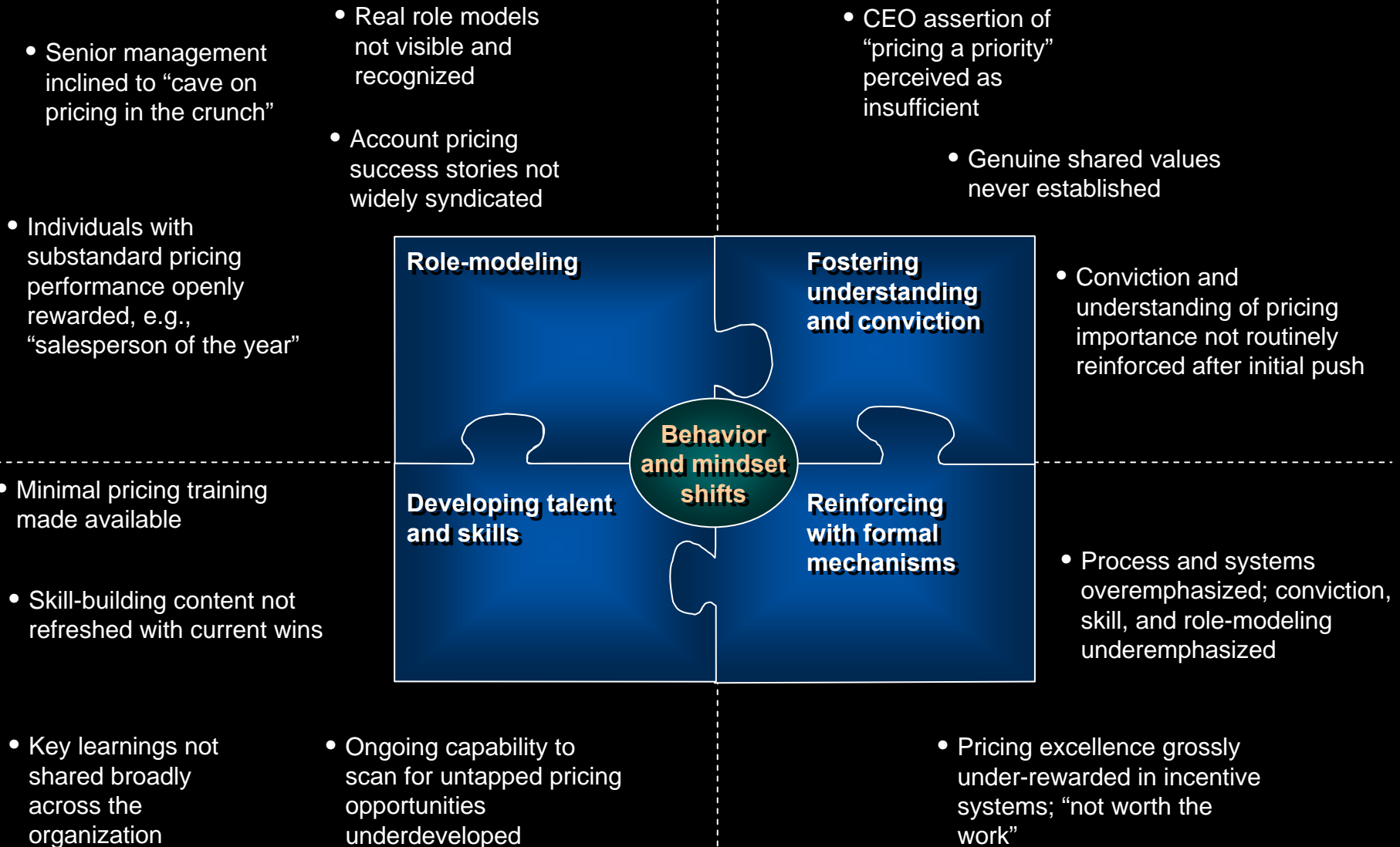
=

$$\sum \left( \frac{\text{Sales per product}}{\text{Volume per product}} \right)$$

# MAKING PRICING CHANGE “STICK” – THE INFLUENCE MODEL



# DRIVING SUSTAINABLE PRICING PERFORMANCE – TYPICAL FAILURE MODES



# A ROUGH ROAD, BUT WORTH TRAVELLING

There is considerable potential to be captured from pricing, but it is not easy

Analytical tools and techniques can support the identification of opportunities and pricing efforts, but pricing is both art and science ■

To really achieve lasting impact, major cultural change is required, supported by explicit process improvement and capability development