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One-Shot Pricing

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When you have only one shot at winning, you really need to make it count. All companies selling work through major contracts understand this urgency. Dealing with infrequent (and typically large) bids for each piece of business, these companies must master what we call "one-shot pricing."

Because no one-shot-pricing scenario is exactly the same as another, companies may wrongly assume that they can simply take an ad hoc approach. In reality, a sharply focused strategic lens and disciplined execution are just as important to one-shot pricing as they are to every other type of pricing, if not more so. In most cases, at least one or two percentage points of operating income are at stake.

A Different Animal

In traditional transaction-pricing situations, companies sell thousands of items per day, collecting robust data, estimating price elasticity, and tweaking price levels and promotions accordingly each week. It is a complex process but quite systematic.

By contrast, in one-shot pricing, companies must compete separately for each new piece of business through a bid or negotiation process. One-shot pricing means that prices generally have the following characteristics:

- They are tailored to each selling situation, with little or no meaningful reliance on published list prices
- Each negotiated price is good at only one point in time and for specific quantities
- Because pricing is defined before costs are fully known, such agreements are frequently plagued by unanticipated extras and cost overruns
- Prices are dependent on both opportunity costs (whether a contract is won or lost) and true costs

Many pricing-strategy experts focus on ways to improve transaction pricing. Relying on established methodologies, they create and dissect the "price waterfall" that descends from list price to invoice price to net realized price, and look for and decide how to minimize leakage (places where the company is disproportionately giving away value).

But in one-shot pricing, either there is no explicit list price or the list price is not meaningful. So where can managers find opportunity for improvement?

This is not a trivial question. Many business-to-business companies—in sectors as varied as construction, professional services, and industrial goods—use one-shot pricing. Each of these companies needs its own distinctive operating model to achieve pricing excellence.

Not Mission Impossible

Because so few companies excel at systematic one-shot pricing, managers may understandably conclude that there is no way to shine. Most trust instead in sales representatives' skills, negotiations, and luck—win some, lose some. But there is a better way.

Companies must view one-shot pricing in two ways: through a *strategic* and an *execution* lens. The strategic lens requires getting answers to specific and sometimes challenging questions about everything from customer motivations to competitive positioning, and it requires a highly nuanced understanding of both true and opportunity costs. Strategic input increases the accuracy of critical pricing decisions during the bidding or negotiation process. The execution lens requires discipline around an activity that currently lacks real rigor.

The Strategic Checklist

To achieve a comprehensive strategic approach to each new pricing opportunity, we recommend focusing on customer, competitors, competitiveness, costs, and capacity through what we call the Five-C framework.

- *Customer.* Why is the customer buying? To save money or to deploy your unique capabilities? What are the customer's key purchasing criteria or sources of value creation from this purchase?
- *Competitors.* Against which other companies are you bidding?
- *Competitiveness.* What is your relative cost position? Your relative value proposition versus that of your competitors?
- *Costs.* What are the true *and* opportunity costs associated with the bid?
- *Capacity.* What kind of impact will your bid have on the capacity dynamics of your own company and the overall industry?

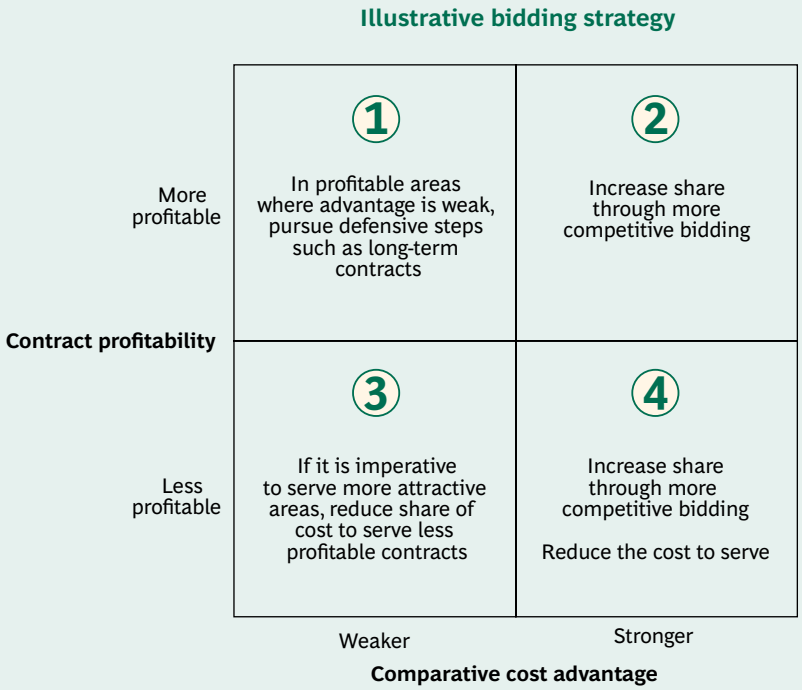
The following company examples illustrate how the Five-C framework can contribute to better results in one-shot pricing.

Understanding your *customer* may not be as straightforward as it seems. In the ship-building industry, for example, understanding a customer and identifying the best total package of key components of a ship's economics—revenue generation capability, operating costs, lifetime maintenance costs, and initial investment—determine the shipyard's ability to price a particular ship. Because a superior ship concept can turn into superior economics for the customer, it is critically important to quantify the concept's value during the negotiation process. The ability to incorporate changes during the building process can be a key differentiator for customers, and this means that the expectation of change costs should be built into the pricing. At the same time, ship builders must keep their own economics in mind: selling the first ship in a series is all about getting production volume, and because the rest of the ships in the series may be the drivers of profit, the pricing strategy will be different for each.

Competitors and the dynamics of *competitiveness* add another layer of complexity. If you live in a cold climate, you may take for granted the routine appearance of chemicals, salt, and sand to clear the ice on your street. In fact, however, the deicing-products market is a great example of competitive one-shot pricing. Bids on exclusive one-year contracts to supply each locality are tendered in the spring for delivery in late fall. This timing presents a challenge to suppliers, who must produce a winter's supply of product before they have full information about contract wins and consumption levels, and who compete in a very concentrated market. Working with only manual and delayed data capture to understand competitive dynamics, most companies develop bids on the basis of factors such as past experience and incumbency.

One producer, however, has boosted profits by diving deep within the competitor and system level economics up front. This producer estimated its own delivered cost as well as that of its competitors, overlaid the current awarded volumes, factored in capacity levels, and conducted allocation optimization analyses to determine where it had—or lacked—strong competitive advantage. By compiling historical bid data, the company was also able to understand price-volume relationships and market attractiveness. A synthesis of all this information resulted in a defined bidding strategy for each market. (See Exhibit 1.)

Exhibit 1. A Strategic Lens Can Guide One-Shot Pricing Decisions



Source: BCG analysis.

Large-contract bids also require an understanding of both *costs* and *capacity.* Nutrition companies, for example, compete to supply infant formula to state government programs for needy families. These three-year exclusive state contracts are a loss leader that provide shelf space and deliver "pull-through" of subsequent incremental purchases for the winning bidder. Bidding typically occurs at a price level below production costs, so each company must understand the true value of the pull-through benefit in order to calculate an appropriate price. At the same time, these companies must monitor industry capacity. A higher bid might make sense, for example, when a competitor is reaching the limits at its factories or when more than one state contract is up for bid at the same time.

Execution with Rigor

In purely bid-based pricing, every deal is unique and one-off. Yet it is actually both possible and critically important to hard-wire the process, tools, and structure needed for execution.

Consider the experience of a national quick printer that creates pamphlets and materials for small-business customers across hundreds of locations. When each store manager was independently responsible for bidding, the result was a wide range of winning bid prices for identical jobs and very little price consistency across locations. Seeking a more rational approach, the company began tracking win-loss data and conducting customer research to understand the competition and what customers value most (for example, quality, price, or convenience). The company also established a central team to help impose better discipline and accelerate pricing-skills development.

A structured approach to improvement is illustrated by the example of a large, decentralized engineering company. Starting by carefully mapping the selling process from start to finish, the company found many opportunities for improvement. On the strategic side, information on competitor pricing and capacity utilization had not been systematically factored into pricing. On the execution side, gaps in cost information had meant inaccurate starting prices. The lack of systematic rules for setting target and walk-away margins to match a transaction's characteristics had led to a slippery slope of discounts during a long

negotiation process. Without metrics to create transparency in pricing behavior, management had trouble improving pricing. The company addressed all these issues by defining specific best practices at every stage of the process. To ensure that the process would be followed, the company also developed a centrally administered project-pricing tool that could replicate the desired pricing behaviors across a quite decentralized organization. (See Exhibit 2.)

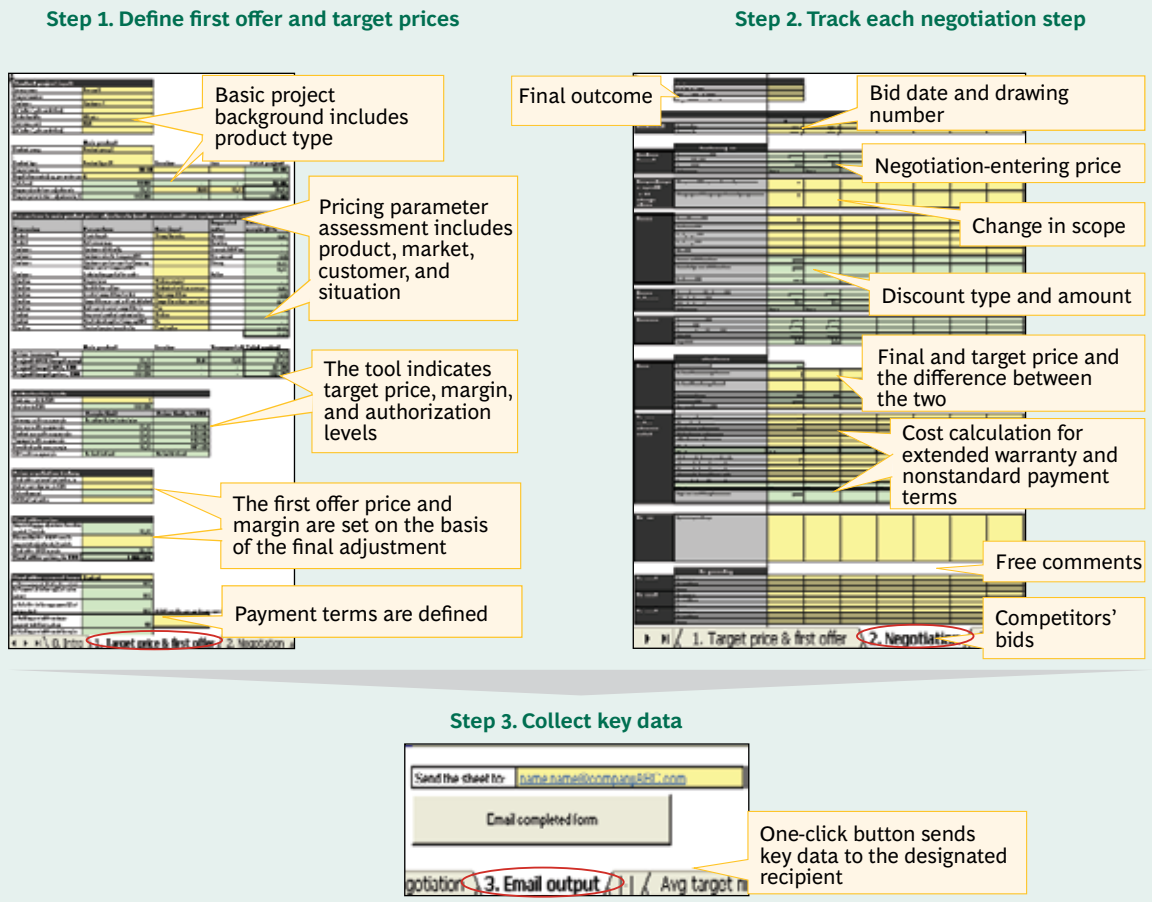
What It Takes

Managers seeking to improve the effectiveness of their one-shot pricing have some changes to make—and they will face some roadblocks to change. Fortunately, solutions do exist.

One challenge stems from the infrequency of transactions. Like a seasonal athlete without the enforcing mechanism of year-round practices to stay in shape, a company may let its pricing muscles atrophy with disuse. As a result, the strategic side of the sales process ends up underdeveloped. For each bid, a simple review of a checklist such as the Five-C framework can start to address this issue effectively.

Another roadblock can emerge in the form of a decentralized organization structure. Like the printing and engineering companies described above, companies divided by geography or business unit face a major rollout challenge to any new pricing approach. The answer lies in the use of dedicated resources to manage the change process, a rigorous approach to implementation, and the development of detailed tools. We recommend that some companies establish a permanent central pricing office to support local

Exhibit 2. Tools Can Help Hard-Wire Desired Pricing Behavior Across the Organization



Source: BCG analysis.

pricing decisions and continuously refine policies, guidelines, and tools going forward.

A clear set of actions adds up to one-shot pricing that outperforms: Clearly articulate why each customer is buying and what impact that should have on your bid response. Know your competition and, therefore, how aggressive you should be. Accurately quantify your position relative to the competition. Factor in both your true and opportunity costs. Understand how the bid will impact your capacity as well as overall industry capacity. And, finally, use clear metrics and well-defined targets to measure the effectiveness of your bidding strategies.

Now is a good time to act. The downturn changed the game for one-shot pricing—from a sellers' to a buyers' market, from undercapacity to overcapacity. Many companies were caught by surprise and scrambled to adjust. Now, as developed markets turn the corner to recovery, we are approaching another inflection point in the economy.

It is time to anticipate change rather than react belatedly. Rethink your commercial strategy and, accordingly, the guiding principles of your pricing strategy. In which products, locations, and customer segments do you want to grow, protect share, or manage for profitability? Companies that take these steps will have what it takes to win.

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