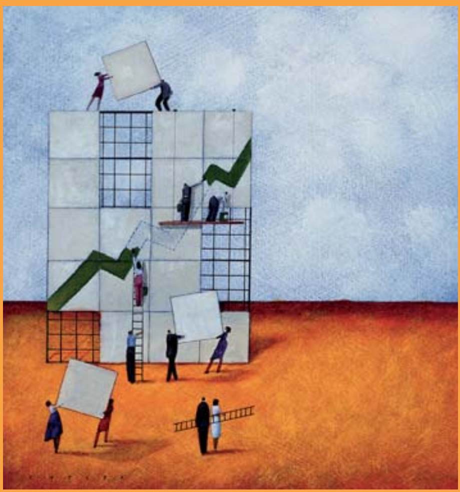
OPPORTUNITIES *for* ACTION

MARKETING AND SALES



■ *Pricing is the language of business. Through pricing, companies tell customers which products offer the greatest value or when costs have gone up.*

■ *Fluency requires discipline—yet few companies launch comprehensive programs to develop sustainable pricing fluency. Instead, they rely on narrowly focused projects with short-lived results.*

■ *A "pricing fluency" program for the entire organization focuses on two clear goals: improving the pricing model through better policies on how prices are set, and improving the pricing platform used to implement those policies.*

■ *Best-practice companies actively manage new pricing ideas, focus on defensible competitive advantage, and sustain a long-term price premium of 2 to 3 percent over competitors.*

Pricing Fluency

A Program for Pricing Excellence

Pricing is the language of business. Through pricing, companies tell customers which products have the greatest value or when costs have gone up. Through pricing, companies can "ask" customers to change their behavior. As with all languages, fluency matters in pricing. Organizations fluent in pricing can convince their customers to pay a little more or to buy a little more. Consequently, they routinely earn 1 to 3 percent more on revenues than their competitors do—an advantage that falls straight to their bottom line.

Fluency in the language of pricing—as in any other language—requires discipline. Yet it is not managed as a discipline in most organizations. Many people *touch* pricing, but no one *owns* it. Pricing decisions, expertise, and information are fragmented across a company's regions, business units, and functions.

Some organizations recognize this language barrier in pricing and try to address it. But too often they resort to narrowly focused initiatives—one-off pricing projects that provide only superficial results. To switch metaphors momentarily, that's like relying on a crash diet for a quick—and short-lived—fix when a lifelong regimen of exercise and discipline is needed to achieve sustainable goals.

One of our clients learned this the hard way. Convinced that the sales force was giving away too much in price negotiations in order to capture volume, this company undertook a pricing project in which it analyzed accounts, identified opportunities to raise prices, and provided a new set of pricing guidelines. The resulting profit boost was quick and significant. Unfortunately, a short while later, the company found itself back in its original position and in need of another pricing remedy. The problem resurfaced because the leaders of the sales force continued to drive a culture that emphasized volume, rather than profitability. Without changing its incentives, processes, and people, the company could not achieve sustainable impact from pricing improvements.

Pricing is multifaceted and requires significant change management to hardwire new approaches. The effort will take most organizations more than 12 to 18 months and require a comprehensive program, rather than a single project. Yet changing pricing strategy can be done in stages that yield significant value along the way. Below is a brief description of the program we use to help our clients' organizations become fluent in pricing and competitively advantaged in their price realization.

A Master Program for Pricing

A comprehensive pricing program for an entire organization focuses on two clear goals: improving the pricing model through better policies on how prices are set, and improving the pricing platform used to implement those policies throughout the organization.

Improving the Pricing Model. Companies have three sources of leverage for pricing improvement.

Tactical levers offer quick, no-risk fixes for pricing policies and anomalies. These solutions might include tightening the terms of payment, setting strict guardrails such as minimum profitability levels, increasing prices on products or product features that have low visibility, and monetizing giveaways (such as freight and service). Tactical levers can be decided upon quickly and rolled out for immediate impact.

Strategic changes in price levels involve moving prices on key items up or down—as much as 5 percent or more—by changing list prices or redefining the terms of trade promotion. This action is not to be taken lightly. To predict how customers or consumers will react, companies considering strategic price-level changes must make extensive use of analytic tools, such as conjoint analysis, price elasticity measures, profit parabolas, and in-depth customer interviews. These changes also require companies to use game theory and industry structure analysis to predict how competitors will respond. The investigation phase takes some time, but once a decision is made, implementation is fast—and so are results.

Fundamental reshaping of pricing schemes is a step change that requires a company to creatively rethink its overall pricing structure. It could lead to overhauling the product lineup or completely rebuilding the discount structure. It might also involve pricing-model innovations such as pricing for performance, subscription pricing, or dynamic pricing, which is pegged to an external variable, such as time of day. (In some vending machines, for example, the price of the products varies from the morning to the afternoon). These types of changes require managers to carefully segment their customers and opportunities. Piloting and testing are crucial before pricing schemes are rolled out; therefore, implementation takes longer than for other, less-complex moves.

The best way to begin improving the pricing model is to identify each of the dimensions along which customer value and competitive intensity vary and make sure that a lever for pricing is aligned specifically to each dimension. For example, as the U.K. health care system has sought cost reductions, several drug manufacturers have implemented price-for-performance approaches tailored to that market, offering refunds if medications do not meet specified benchmarks for outcomes or cost effectiveness. Adopting a new approach to pricing is a long-term strategy that requires targeted customer segments or product lines and cross-functional teams to align the company's economics.

Improving the Pricing Platform. In this cyclical effort, the company reviews its progress and redesigns its processes when necessary. It encompasses the following dimensions.

Roles and Responsibilities of Stakeholders. Actions in pricing will depend on a company's market and how the company is structured to serve it. Companies with fragmented customer bases, for example, should enable their field representatives to make informed pricing decisions by supplying them with effective tools. By contrast, business-to-business companies that focus on a few megadeals might appoint a "pricing czar" to manage price negotiations. Most companies lack sufficient pricing resources and would benefit from creating a central pricing-support team to raise the visibility of pricing positions at the business-unit level and to ensure that all key functions have input into pricing policy and final decisions.

Market Intelligence. Too often, managers are forced to make decisions on the basis of incomplete or inaccurate information, anecdotes, or even gut instinct. Establishing a clear process for collecting, analyzing, and interpreting market data is critical. Heavy industry players, for example, have created significant value by improving their ability to forecast market cycles and adjusting their price levels accordingly.

Business Processes. Surprising as it may seem, very few companies have hardwired pricing into their key business processes. Without adequate lines of reporting and fine-tuned key performance indicators (KPIs), companies can't use information to drive better forecasting and decisions. Research conducted by The Boston Consulting Group in 2009 indicates that although 70 percent of the global companies we surveyed expected customers to become more price sensitive over the coming year, 40 percent of these same companies projected an increase in price realization in their financial forecasts.[1]

Human Resources. Learning any language requires training by experts, and pricing is no different. Companies should be open to recruiting new expertise in pricing from outside the organization. For example, to prepare for auctions organized by large OEMs, an electronics manufacturer invested in a training program that taught the sales force game theory and had them role-play auction bidding. The training generated pricing rewards that totaled ten times the program's cost.

Information Technology. We've found that the best-performing companies outinvest their competitors in tools and technology to support stakeholders in pricing. For example, an industrial goods company purchased a tool that helped it set the best prices for its products by determining how much each product reduced labor costs for individual customers. The tool resulted in an immediate hike in profits and a big boost to the sales team's morale.

Incentives and Compensation. General managers and sales teams are more likely to be given incentives for increasing volume and EBITDA than they are for meeting explicit price-realization targets. Yet promoting price realization can be a powerful lever. A North American company, for example, introduced price-realization targets and publicized individual sales reps' performance on a monthly basis. It didn't take long to see the company's overall price performance increase by more than one percentage point, thanks to increased awareness and healthy peer pressure.

Implementing the Master Plan for Long-Term Success. So far so good. The goals are clear, as are plans for tactics, levers, and tools. But how do you get a pricing program started and then keep it going? All worthwhile transformations take time and effort: it's a several-stage process—albeit with rewards along the way.

The program we use consists of five phases, which can be piloted in selected business units that have high potential for success and then rolled out in waves to other units. The program begins by sizing the prize and developing a road map for pricing improvements. The next two phases, conducted in parallel, involve optimizing price levels in the pricing model and redesigning processes for the pricing platform. In the final two phases, we return to the pricing model to simultaneously reshape the pricing structure (a new product lineup and new pricing schemes, for example) and hardwire the new pricing platform. The exhibit on page 4 provides details for each phase and a rough estimate of timing.

Support for the Journey

Building a foundation for pricing fluency throughout the organization is a transformational effort that requires careful change management. Sales teams and business-unit management teams will need to revise the very "grammar" that guides their business practices—and it will take experience and hard work to get it right. The following principles have, in our experience, proven useful for creating the desired momentum, accelerating implementation, and keeping the effort running smoothly.

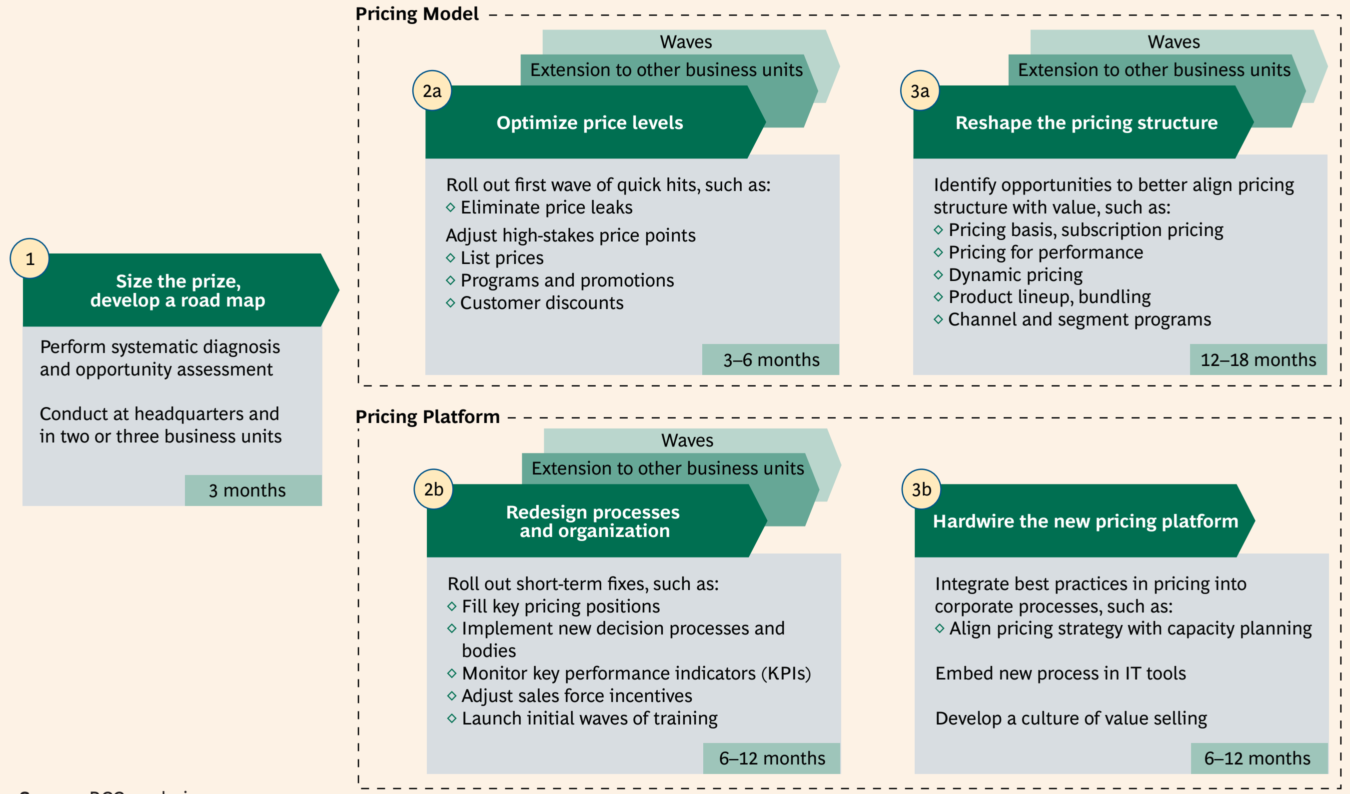
- **Invest heavily in early pilots to demonstrate success.** For instance, a country manager for an animal-health products company enrolled in the corporate pricing program and then took it upon himself to organize field tests with vets and conduct workshops to train sales reps. As a result, implementation of the pricing program went faster and more smoothly in his country than it had in any other market.

- **Plan for implementation from the first day and recognize that time is money.** To avoid missing important opportunities, the company should synchronize the new program's road map with the schedule of price negotiations with customers. To make sure everyone is prepared, the company should appoint pricing responsibilities within the first week of starting. And to build a results-driven momentum, it should aim to announce quick hits within three months.

- **Mobilize a central expert team.** High-stakes pricing decisions often require pricing expertise beyond the capabilities of the business units. The risk of failure should therefore be mitigated through the use of sophisticated tools, such as elasticity assessment and game theory. The central team should provide this support, as well as help monitor progress, track impact, develop tools, and communicate with other functions.

1. The BCG proprietary research was conducted in March 2009. The survey covered 439 executives from major companies based in seven developed countries: France, Germany, Italy, Japan, Spain, United States, and United Kingdom. Detailed findings were published in *Collateral Damage, Part 6: Underestimating the Crisis,* a BCG White Paper,.

A Good Pricing Program Should Be Developed in Phases



Source: BCG analysis.

- **Actively manage the human resources agenda.** Companies often move too slowly and tentatively to renegotiate sales force incentives and make key appointments effectively. Sometimes it's best to rip the bandage off quickly—communicate the difficult news and get on with the program.

- **Involve the legal department early in the process.** Too often, the legal department is brought in only at the end of a pricing program, to greenlight final proposals. To prioritize opportunities for legally complex pricing issues, it is best for companies to seek help from the legal experts early on.

Establishing an organization's fluency in pricing doesn't end even after an 18-month effort. Once well-run pricing processes are in place, best-practice companies adopt an agenda of continuous improvement. They actively manage the new pricing ideas in their "innovation pipelines," focus on defensible competitive advantage, and sustain a price premium of 2 to 3 percent over competitors. And because mastery of the grammar, vocabulary, and syntax of pricing is a capability difficult to imitate, achieving fluency in pricing can provide sustainable competitive advantage long into the future.

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