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MAKING MORE MONEY FROM DATA

FIVE PRICING SECRETS OF B2B INFORMATION-SERVICES COMPANIES

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The B2B information-services industry has struggled to rediscover modest, let alone rapid, growth since the onset of the global financial crisis, as banks and other major customers closely watch costs. Many providers have resorted to heavy discounting to maintain volume and cost cutting to preserve margins.

There is a better approach. Pricing is a powerful tool that too few companies deploy to their advantage. It is one of the best ways for a company to grow organically and is especially relevant for products and services under development. Pricing is effective because information services tend to be "sticky." Once end users start to rely on a specific service, they are reluctant to switch. Try telling Wall Street professionals that they have to give up their Bloomberg terminals or Thomson Reuters Eikon desktops or lawyers that they have to switch from Westlaw to LexisNexis or vice versa, and watch the reaction. If information service providers—and, more generally, companies that sell software as a service—understand the distinct value that different segments of end users derive from their services—in other words, what makes those services sticky—they can price more effectively.

Because the cost of serving a customer is next to nothing, however, providers often discount indiscriminately to win or retain customers. At the extreme, one customer may pay five times more for an identical service than a customer purchasing the same volume. Pricing requires discipline during negotiations and is ultimately about a commercial transformation that rewards value creation. By pricing more effectively, B2B information-service providers can generate revenue gains of between 2 and 8 percent within 18 months. This extra revenue flows straight to the bottom line or can be funneled into new services. Either way, the provider has changed the dynamics of the market and set itself on a new growth trajectory.

The Commercial Landscape

The B2B information-services industry is composed of a collection of disparate vertical slices, such as financial, energy, health care, legal, and tax—each of which can be subdivided into smaller subsegments. Within these industries, account sizes can vary from $500 to $100 million, a range that intensifies the challenges of pricing both fairly and profitably. The industry generates about $195 billion in revenues globally and is expected to grow to $230 billion to $250 billion by 2018.

However, the industry is under pressure from several forces. Weak employment, especially in education and financial services, is straining per-user pricing models. Customers expect mobile access to information services, as well as other innovations that take advantage of big data and other digital trends. The growth slowdown in most emerging markets has also put a clamp on international growth plans.

At the same time, information services can be a highly profitable business. The most successful companies generate margins of 35 to 55 percent and retain 90 to 95 percent of their customers from year to year. These information-service providers have more than just great content. Their services become embedded into the work flow of employees. Their technology is sophisticated and can be scaled up.

Winning Ways

Here are five tips that will help you optimize the pricing of information services and other businesses with similar economies, such as enterprise and cloud software.

Discounting requires discipline. Discounting is a fact of life for almost every information-services company. The only exception may be Bloomberg's terminals. As the established leader in a premium category, Bloomberg can get away with a zero-discounting approach. In most market segments, customers expect and demand discounts.

Procurement managers frequently know the discounts offered to their competitors and threaten to cancel if they do not receive similar treatment. Since compensation is typically based on volume more than price realization, the sales force is not encouraged to push back. And discounts are difficult to retire. Rather than disappearing at the end of a contract, they become the starting point for renewal negotiations. The financial fallout of a pricing mistake is often felt a decade after the original deal was signed.

In addition, discounting is a difficult habit to break. There is nothing inherently wrong with offering price breaks to customers for volume purchases or to encourage adoption of new services. But discounting is too often random and discretionary and does not reflect the commercial value that customers receive or affect the purchase decision. After studying the price realization and volume curves of B2B information-service providers, for example, we saw wide variations in discounts offered to customers of similar size and commercial value. (See Exhibit 1.)

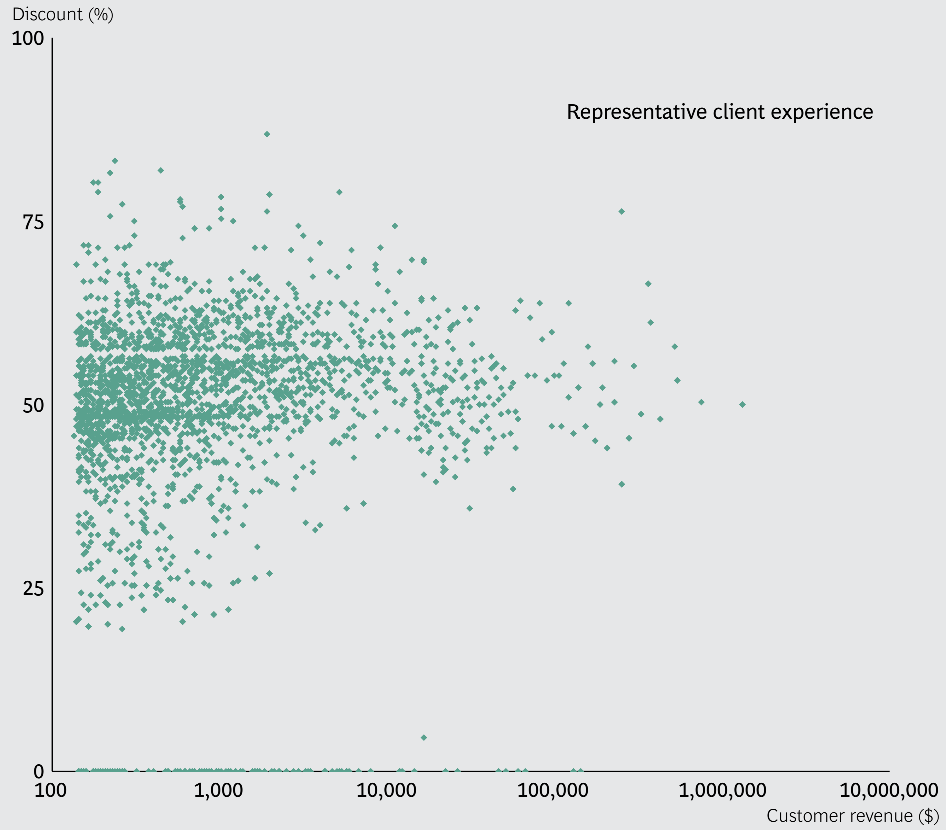
Discounting does not have to be haphazard. In our experience, companies that carefully manage discounting through guidelines, KPIs, and sales force compensation can improve their revenue realization by 2 to 4 percent or more without the loss of key accounts.

Promotions trump discounts. Promotions come and go, but discounts last forever. Information service providers are much better off offering customers 25 percent of their seats for free for one year than discounting the price by 25 percent. The two offers are economically equivalent in the first year, but the promotion disappears in the second year and discounts carry on.

The use of promotions is a basic tactic that often gets overlooked during negotiations. When information service providers do use them, it is important to remember that promotions are not foolproof. They need to be targeted, carefully tracked, and supported by billing systems. And, of course, they need to be temporary—otherwise they become another form of discounting. Fortunately, it is easier to frame promotions—such as free seats or additional services—as onetime events rather than discounts.

Bundling is a science. Bundling and cross-selling services are popular ways to win and retain clients. But not all bundles

Exhibit 1 | Discounts Tend to Be Haphazard



Source: BCG analysis.

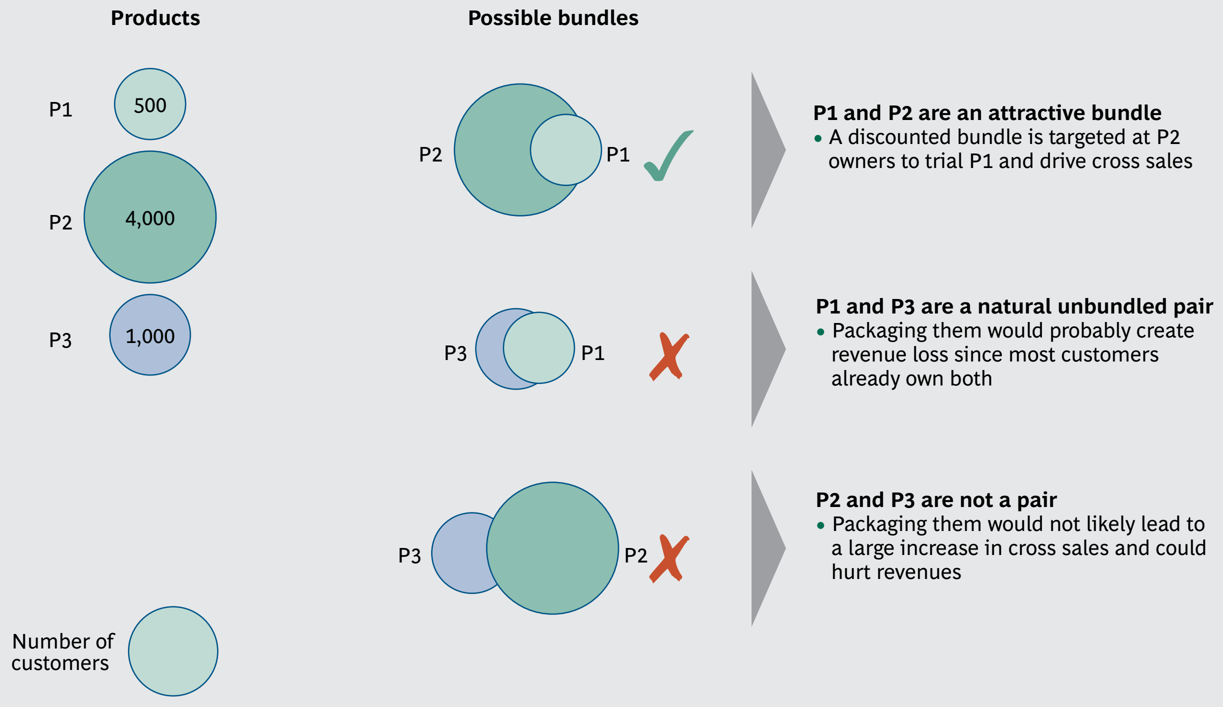
are created equal. Some bundles will do little to spur sales because there is minimal overlap in the user bases of the services. Other bundles will actually destroy value by offering discounts on services that customers are already buying willingly at full price.

Bundles can make sense when two services are complementary and at least one of the services has low penetration but high potential. If few owners of one service (P2) own the other service (P1), it makes sense to discount P1 for the current owners of P2. (See Exhibit 2.) The reverse is not true. If P2 is discounted for the users of P1, revenues will decline because those users already own both services and paid full price in the last negotiations.

If you analyze the ownership populations of your portfolio, you will likely discover untapped opportunities for bundling and cross selling. You will also likely discover that current cross-selling deals ought to be curtailed. Bundles and cross selling have the added benefit of boosting overall sales. As companies buy more types of services from a vendor, they become more comfortable and buy more overall individual services. If a company buys three seats of service A, it will likely buy four or more seats if it adds service B. This is a valuable and little-understood advantage that can help to create additional traction with customers.

Power shifts as the relationship grows. During the initial sale of an information service, the customer's procurement or market-data manager will hold most of the power. Once an agreement has been reached on the levels of functionality and service, that executive will likely be the customer's primary negotiator and can influence the terms of the sale. His or her incentives are purely financial, and the negotiations will likely be, too.

Exhibit 2 | Not All Bundles Are Created Equal



Source: : BCG analysis.

During renewals, however, price is—or should be—just one of many factors on the table. As data becomes integrated in systems and work flow, usage will grow and end-user satisfaction will increase. The decision-making authority shifts sharply to the end users, whose work will likely be disrupted by a change in vendors.

Satisfied users are the strongest selling point of an information service. Quantitative analysis of user engagement and customer satisfaction helps identify both at-risk and satisfied customers and is invaluable during renewals. Satisfied customers spend more and are more profitable than average customers. Your sales executives will be stronger negotiators if they have surveyed end users, know how they view the product, and understand how well embedded the information is in customer work flow. Sales executives who do not understand the end-user perspective will be in a much weaker bargaining position and likely have to make concessions on price and other terms.

Renewals are a critical juncture in the life of a commercial relationship. As with any subscription business, it is much less costly to renew an existing customer than to win a new one. Sales executives understandably go to great lengths to preserve an account. Recognizing these dynamics, smart customers will often threaten to change vendors in order to get the sales executive to sweeten the terms. If your sales executive knows that end-user satisfaction is high, he or she can hold the line during this type of negotiation.

Conversely, if end users are dissatisfied and usage is low, price discounts will not repair the relationship. End users care about the quality of the service and whether it makes their work-life easier and more productive. If the service is not meeting those needs, a price break will not help. You are better off figuring out what is wrong prior to renewal—and fixing it.

Pricing is cultural. Pricing is more than coming up with a number that reflects the customer's view of value. It also requires a belief among the sales force and senior executives that customers will pay a premium since that belief determines how hard they will hold the line. It should be embedded early in product design and marketing-strategy decisions. Pricing touches everything, and changing pricing behavior requires a change in culture. If you think culture sounds too fluffy, you can call it the commercial context. Either way, you need to make sure that you are rewarding the right behavior, providing the right tools and training, and putting in place the right pricing policies.

Compensation should be tied to price realization and retention, not just volume. Pricing policies and governance generally should be centralized. Local markets should have wide freedom to understand what drives customer satisfaction and frustration but a narrow ability to vary pricing since a strong pricing system accounts for differences across markets and customers.

The most effective pricing programs are transformative. They fundamentally alter the overall sales and commercial approach. Although these programs can be a radical departure for sales forces accustomed to making their own deals, the payoff is worth the effort.

You can continue conducting business as usual, or you can boost your revenues by up to 8 percent. How is that for a sales pitch?

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