

Outcome Based Pricing: A Practical Approach to Applying Value Based Pricing

In today's market, power has shifted to the buyers, who are more educated and socially connected than ever. As such, sales and pricing models must evolve to accommodate new buying behaviors and dynamic market conditions. This article provides practical examples of how Outcome-Based Pricing can offer a better way to work with your customers and stay ahead of your competitors. Author Robert Irwin is Vice President of Business Consulting at Vendavo, and has worked in Pricing for more than 10 years. He has an MBA from Wake Forest University and a BA (Hons) in International Business from Sheffield City Polytechnic. He can be reached at rirwin@vendavo.com.

There is a new corporate reality upon us that is driving the need for new pricing models.

On the one hand, there is a renewed top-down focus on profitable growth, with senior executives increasingly compensated on profitability. Sales leaders, almost half of whom report having profit as a component of their compensation, are looking for better, more profitable and more defensible Sales strategies.

At the same time, **tectonic changes have shifted the power from sellers to**

buyers, who are now fiercely independent, highly social and connected, and more educated than ever. Buyers have clearly evolved.

This new reality is changing the face of B2B Sales. Sales reps now need to be experts in their customer's business and be armed with new selling and pricing models that break with tradition.

The pricing function has an opportunity to step up to this challenge and support the organization with the development of better, Outcome-Based Pricing models.

Looking to the past, the Traditional Sales Rep....

- Sells from the list
- Understands his products and sells the technical features and their benefit
- Finds it increasingly hard to differentiate vs. the competition

... and lives with the draw backs of this traditional approach.

In comparison, let's take a look at examples of how Outcome-Based Pricing can offer a better way to work with your customers and stay ahead of your competitors.

Lighting Distributor in California

This distributor sold their products and services to supermarkets in a traditional way: per unit and then a fee per hour for any follow on services. As you can imagine, this is a fairly commoditized market and competitive offers were easily compared. Winning basically came down to the best price.

However, it was not light from the bulb

itself that the supermarket valued, but the security for their customers resulting from a well-lit car park. If one of the lights in the car park was broken, the supermarket would call for a service engineer to come out. If this took too long, customers would complain that the car park was not safe and eventually even take their business elsewhere.

One sales rep, after talking to a store manager, came to realize what the true value of his offer was and recognized an opportunity to change the game. He returned with a pricing model based on a per hour of fully lit car park. If a bulb is broken, the supermarket does not have to pay. Of course now, bulbs do not break. The distributor has his service teams running regular checks. The result is a significant reduction in costs, because staffing for emergency call-outs has declined and the supermarket is a happier customer, even using the guarantee of a safe car park as part of their marketing.

Explosives Supplier to the Mining Industry

Suppliers in this market sell explosives, blasting caps and ignition systems for triggering those explosives. These are traditionally sold on a per unit basis.

In response to downward margin pressures, suppliers have innovated by introducing outcome based contracts with invoicing based on a new unit of measure: ton of mine output. So, how does this work? The customer and supplier agree on a daily mine output and on an audit mechanism to measure output.

The Supplier:

- Delivers explosives, blasting caps and services.
- Manages inventory for the customer: they never run out of explosives.
- Consults on blast patterns, driving

efficiency and limiting waste. Ultimately improving the yield on the customer's operation.

- Takes ownership for the mine's actual explosive consumption.

The mine outsources blasting to the experts, who know how to maximize the yield of their products, while lowering costs and gaining predictable costing. The output based pricing mechanism has created value for both seller and buyer.

So, looking to the Future, the Outcome-Based Pricing Sales Rep:

- Understands his customers' needs
- Sells what the customer wants
- Prices based on customer value
- Finds it easier to differentiate vs. the competition

Outcome-Based Pricing clearly has its benefits, but if it makes so much sense, why isn't everyone doing it? In simple terms, it requires change – of your organization, in your customers and/or even in the industry – and it's never easy to lead change.

If however, you get there first, the prize will be well worth the effort.

So, where should you start?

- Think about what the customer values and what defines their willingness to pay.
- Review the applicability of the model. It will not be applicable every-

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where, for all customers in all countries.

- Look for opportunities to monetize services that have previously been given away for free in support of the per unit sale.
- Establish what type of outcome based pricing models should be employed and how you are going to structure the model.

- Review execution capabilities and ease of deployment. It is generally fairly easy to come up with the models, but much harder to deploy and execute them effectively.
- Ensure the model can be measured and most importantly accurately invoiced.

Think of all of these points in terms of market types, where different strategies will be applicable, and then be prepared to adopt a phased approach towards full deployment of a risk shared model. You may not be able to get there in one go.

Then, make sure you can monitor the effectiveness of the model. The type of analytics, KPIs and metrics you need, will change. Your perspective on profitability will need to change, to become more long term in its outlook.

With outcome based pricing models, you can arm your sales force with the tools to compete in the future.