

Transform Your Pricing Strategy into a



For pricing to become a competitive weapon in the corporate arsenal, the pricing strategy must be executed in a manner that is consistent, sustainable, and easily repeatable. The benefits are obvious, says author Steven Tom, a senior consultant in the Strategy and Operations service area of Deloitte Consulting LLP. Effective execution enables companies to respond more agilely to competitors and changing market conditions, thereby benefiting the bottom line. Steven provides a detailed roadmap for implementing a sophisticated pricing strategy that can follow either a centralized, decentralized or hybrid model, depending on the individual needs of a particular organization. For more information, contact: stom@deloitte.com.

The keys to sustainable pricing execution include a comprehensive pricing process, effective organizational design, robust tactical capabilities, and aligned people. Here's why:

- A comprehensive pricing process guides your stakeholders as to how and when to act, and provides a mechanism for feeding information and perspective into decision-making.
- The right organizational design—whether centralized, decentralized, or a hybrid model—enables you to tailor processes and decision-making to your company's needs.
- Strong tactical capabilities and a culture that embraces pricing can provide critical support for these other structural pieces.

Many executives view the path to sustainable pricing as a labyrinth. But by committing to a company-wide effort and by adopting changes in thinking, pricing can become a competitive weapon and so ease your navigation of the labyrinth.

Overcoming the Inertia of Past Pricing Practices

Picture an organization that stands ready to introduce a new pricing strategy into the marketplace. It has performed a thorough external analysis to arrive at the new schema, and internal leadership efforts have helped shepherd the initiative up to this point.

But having followed the pricing used for decades within its industry, do you really think the company is set up to execute its new strategy effectively over the long term? Experience has demonstrated that execution is where many companies fall short. It doesn't have to be this way, however.

You can bridge the gap between pricing strategy and ongoing, sustainable execution by employing disciplined processes, a supportive organizational structure, established capabilities for key pricing functions, and a culture that aligns incentives and goals. Here's how:

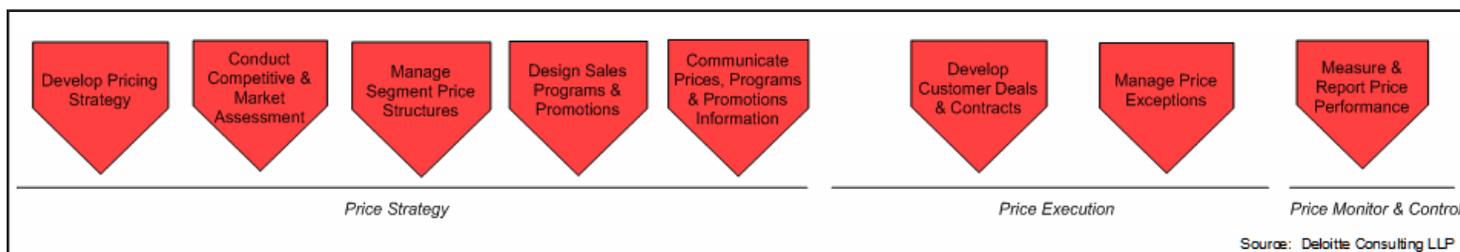
Step 1: Implementing Disciplined Pricing Processes

A comprehensive pricing process should include three phases: strategy, execution, and performance measurement (Figure 1).

In the strategy phase, your organization:

- Develops the framework of the price strategy;
- Assesses the marketplace;
- Translates the strategy into price structures and programs; and
- Communicates the decisions and structures to the organization and customers.

Figure 1: From strategy to performance monitoring, the pricing process is consistent, sustainable, and repeatable.



Competitive Weapon

In the execution phase, you tactically manage price negotiations and exceptions during the course of conducting business with customers.

The final phase involves measuring and reporting performance—creating a closed loop of feedback to link to the next iteration of the pricing process.

Within this end-to-end process, you are likely to encounter challenges at three key points.

Strategy: Assessing the Marketplace

After determining an initial strategic pricing direction, you need to conduct competitive and market assessments for the upcoming year. The assessment process can be particularly difficult because it requires a combination of field “on the ground” knowledge of local markets and competitor sales tactics, as well as a macro view of global trends and competitor analysis.

Some guidelines for an effective marketplace assessment include the following:

- Involve all groups dealing with pricing and customer intelligence in the process to create alignment with the new strategy.
- Balance what is manageable versus what is expendable when designing an assessment process.
- Require the information needed to make decisions, but not information for the sake of centralized intelligence.
- Give your regions or divisions enough warning and time to complete an adequate assessment.

Don't repeat the mistake many companies make: rushing the assessment process by disconnecting the strategy decision-makers from those who will be executing the pricing tactics. Involving the right people is a critical element of devising a strategy that the entire organization will adopt.

Execution: Developing Customer Deals and Exceptions

Despite the most thorough planning and analysis, price exceptions and customer negotiations are a normal part of any pricing program. Although each situation is unique, you can effectively manage exceptions by applying a consistent process for analysis and review.

First, analyze the exception's implication on business results and assess the dynamics driving the request for a price change. You can create a standard template that outlines the requirements, as well as a stakeholder review process for exceptions and deal requests. This process will dictate the gates through which a request must pass and identify the person responsible for managing each gate.

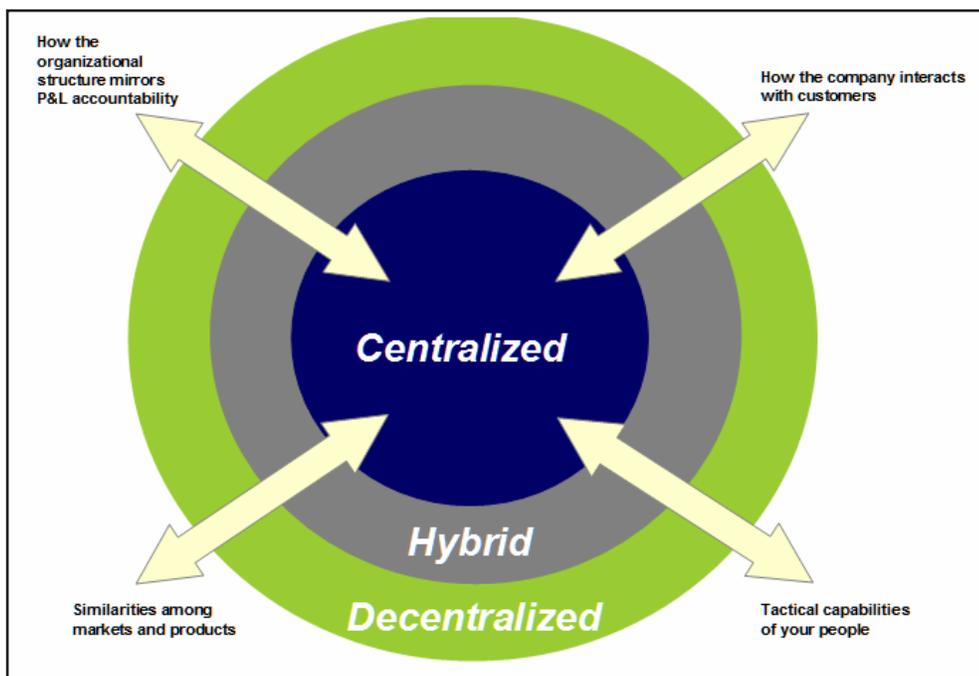
Many organizations build escalation levels into their price approval processes. If a price change has a small effect, it can be approved at lower levels. Larger changes could include more senior-level reviews. Such action helps mitigate a common fear that emerges as processes become more formalized: slower reaction to pricing changes.

Another mitigation step might involve creating pricing scenarios for key markets in advance. In this way, you can pre-approve price exceptions and execute them quickly if the scenarios become reality.

Monitoring and Control: Measuring and Analyzing Performance

Pricing-specific measurement is the essential step that completes the pricing process, reinforces accountability and facilitates continuous improvement. Specifically, your organization can benefit from a set of price performance measures that helps you evaluate variances in pricing strategy, analyze the number and magnitude

Figure 2: Four key factors impact whether a company chooses a centralized, decentralized, or hybrid organizational pricing model.



of price exceptions, and evaluate the accuracy of the marketplace assessment.

Towards the end of the year, the analysis of performance measures can focus more on planning. You should take the opportunity to understand from stakeholders any color or insight that adds perspective to the quantitative measures, as well as to plan for addressing pricing responsibility in the year ahead. With plans aligned and the loop closed, you should have the necessary inputs for developing the next year's pricing strategy.

Step 2: Design the Pricing Organization to Your Needs

To extend the effectiveness of the end-to-end process described above, you should couple it with complementary roles and responsibilities through organizational design. Obviously, no "one size fits all" organizational design exists. However, three common approaches are often used:

- A centralized model
- A decentralized model
- A hybrid model that borrows centralized and decentralized concepts.

When determining which model to use, consider these four factors:

- **How the Pricing Organizational Structure Will Mirror Accountability for Contribution Margins.** Control of pricing decisions needs to reside with the parties directly responsible for business performance. Your pricing program's effectiveness can be diminished when a mismatch occurs—for instance,

when a manager has direct accountability for profit and loss (P&L), but does not have the ability to influence pricing.

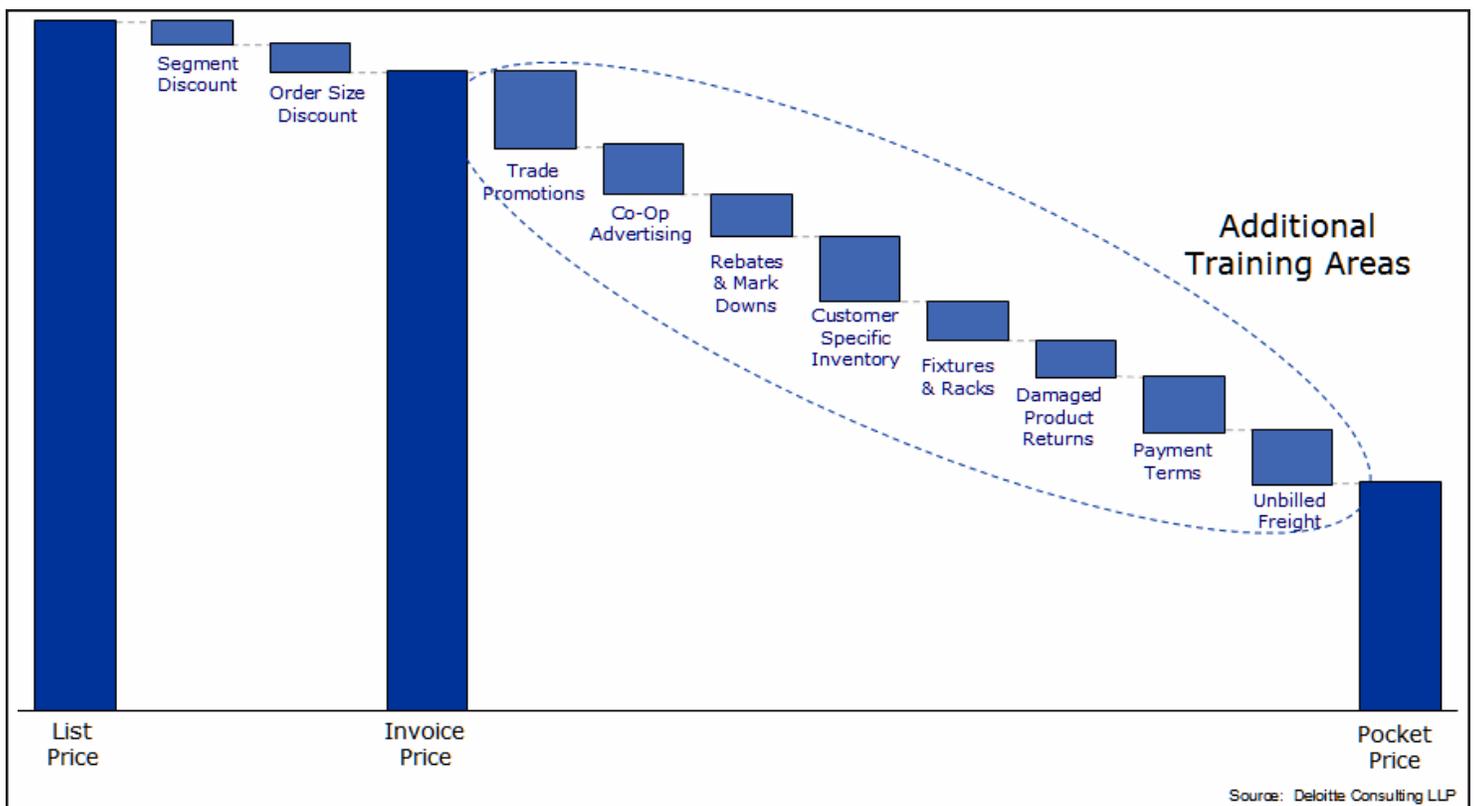
- **Similarities among Markets and Products.** The more similarities, the easier it will be to administer pricing on a centralized basis. Conversely, if markets and products are dissimilar, local pricing managers will have a greater need to understand the intricacies of local competition and market forces.
- **Tactical Capabilities of Your People.** In high-turnover businesses, companies are challenged constantly to educate new team members. Also, pricing programs may suffer when salespeople do not have sufficient training to enter into complex customer negotiations. Communication and training are critical elements of the program.
- **How the Company Interacts with Customers.** Are your customer interactions relationship-based? If so, an organizational design that does not allow your salespeople autonomy to negotiate may weaken their legitimacy.

Using the four factors described above as a basic framework, decide which type of pricing model would be the most effective for your organization.

Centralized Model. This approach is effective when a centralized marketing organization is exploiting the similarities in markets, customers, and channels with a single approach. It can also make sense when a company takes a highly centralized approach to managing other aspects of the business, such as inventory management, production capacity, and accounts receivables.

With a centralized model, pricing control and decision-making stay at the higher levels of the organization. For instance, a global marketing team might centrally control pricing and decide on

Figure 3: Areas of the "Pricing Waterfall" in which training can help sales representatives.



regional price structures from corporate headquarters. Typically, in this structure a high-level executive is solely responsible for global P&L. Markets and products require less customization. Business with customers is less reliant on the relationship and can be more transactional.

Decentralized Model. This model works well for businesses that naturally operate in a decentralized fashion—whether the power lies within strong divisions or regions that maintain loose affiliation through a central body.

With the decentralized model, decisions are made at the lower levels of the organization. For instance, P&L accountability may reside with a regional or line manager. Typically markets and products are more customized, tactics are executed by local personnel, and companies tend to have close relationships with customers.

Decentralized organizations rely heavily on the ability of their tactical employees to develop and execute pricing strategy. Because even one independent activity by one representative may impact other surrounding units—or even the rest of the business—coordination and communication between groups is key.

Hybrid Model. The hybrid approach incorporates aspects of both types of organizations. This model is typically the most challenging to implement since lines of communication, roles, responsibilities, and processes must be understood and aligned across stakeholders.

Process discipline, organizational culture, and tactical capabilities must be highly developed to support a hybrid pricing approach. Here, executives at headquarters advise regional and divisional counterparts, yet all parties share in the P&L responsibility. Although markets and products may require localization, organizations using this model need to coordinate globally to manage non-localized aspects, such as costs and production capacity.

Because multiple levels and roles will influence pricing, processes with clearly defined roles and responsibilities are critical. Furthermore, the organization's culture needs to be collaborative rather than competitive.

Step 3: Arm Employees to Execute on Price

For effective pricing programs, knowledge is power. Here are some ways to empower employees with a better understanding of the pricing process.

Knowledge of the Pricing Waterfall. All employees involved in pricing decisions and tactics should have a basic understanding of “the pricing waterfall” (Figure 3), as well as of the impact of their actions on contribution margin. In many companies, employees dedicated to pricing are tasked with mastering these skills. However, this knowledge is a necessity for tactical executioners

as well. For instance, a company can train sales representatives on different pricing levers they can use in negotiations and how different customer deals, terms, rebates, and freight arrangements can affect pricing margins.

Price Visibility. Often a lag exists between when people take action on prices and when the results become apparent. That's why—in addition to pricing knowledge—employees at multiple levels in the organization also need adequate visibility into pricing performance. For example, in one organization salespeople offered price incentives to customers but could not fully see how these affected the volume of business until the end of the quarter. By contrast, when an organization provides relevant pricing performance data and reports, salespeople can make adjustments to strategy and tactics more proactively, sometimes even in real time. This visibility supports profit-enhancing behavior.

Analytical Tools. Many organizations find commercial software tools helpful to support pricing analytics. These can help companies sustain their focus on pricing for value on a more real-time basis, as well as enforce the pricing process, peer into pocket prices in the waterfall, and track pricing initiatives.

The speed, ability to report prices more broadly throughout regions or divisions, and built-in rigor of these tools can help organizations dramatically move forward in their pricing capabilities. However, companies should be aware that these tools require not only a financial investment, but an organizational commitment to maintaining data validity and alignment around the tool's metrics and reporting.

The Final Step: Selling Pricing to People

Here are some ways you can “win the hearts and minds” of your organization and encourage more of a pricing culture.

Leadership Alignment and Messaging

Experience shows that executive leadership must choose to make pricing a priority and possess some pricing knowledge to assess and drive an organization's pricing behavior. If the commitment is not long-term and steadfast, or if employees sense a hint of weariness or willingness to reverse course, pricing initiatives most likely will flounder.

Internal communication needs to extend beyond the standard memo into planned and targeted messages that outline group roles, responsibilities, and expectations for performance. Pricing objectives can be reinforced in training sessions, corporate meetings, and newsletters. The more decentralized your organization, the more committed leadership needs to be to deliver the information companywide.

Incentive Alignment for Sales Personnel

However, there can be a hitch. As one observer notes: “Even if companies set profitable prices, they often fail to enforce those through the sales process.”²⁴ Thus, in cases where sales personnel

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can have a tactical, direct impact on price—and therefore contribution margin—compensation models should also reflect impact on contribution margin to promote profit-enhancing behaviors. Many companies overlook the important distinction between gross margin and contribution margin. They find it easier to measure gross margin because costs can be difficult to allocate to calculate a transaction's contribution margin. Although simpler, the gross margin doesn't capture the other levers that may be negotiated in a sales transaction.

Socialization of the Pricing Culture

A third way to rally the troops extends beyond monetary compensation: employee recognition and rewards. These can boost support for price initiatives and help socialize the pricing culture. Consider including pricing in corporate newsletters or case studies when efforts are effective. Incorporate pricing into training and new hire orientations to emphasize its importance. Then reward

employees publicly when they effectively balance revenue and contribution margin.

Pricing: Putting it all Together

The secret to demystifying the pricing labyrinth and turning pricing into a potent competitive weapon is execution. To achieve effective execution, you need a structured pricing process, a refined organizational design, improved tactical capabilities, and a price-oriented culture. As your company transitions from strategy to execution and beyond, these improvements can help your organization generate additional profits and help sustain pricing momentum across the enterprise.

Endnotes

^a Chiappinelli, Chris. "Plugging Revenue Leaks," *Managing Automation*, 04/13/2007.