

Why Pricing Strategies Fail



Effective pricing strategy is essential to profitable performance. But when firms face difficulties in managing pricing policy, the problem may not be the pricing strategy. Often the problem lies with providing the “implementation infrastructure” that enables the business to pursue the pricing strategy, on which this paper focuses. Author George E. Cressman, Jr. is the Founder and President of World Class Pricing, Inc. and can be reached at George.Cressman@WorldClassPricing.net.

Managers are under increasing pressure to hold and even increase current price levels. The current economic conditions make this most difficult, with recessionary and customer stresses pushing prices down.

As challenges to price management mount, managers are paying much more attention to the development of pricing strategies. Effective pricing strategy is essential to profitable performance. But when firms face difficulties in managing pricing policy, the problem may not be the pricing strategy.

In any corporate effort, well defined strategy is critical, and this is especially so with pricing strategy. Developing pricing strategy is a necessary precursor to profitable performance, but the key to successful performance is not strategy development. Rather, the key to successful performance is the effective implementation of a well founded pricing strategy.

As difficult as development of pricing strategy is, the real work in building pricing policy is in providing the means to implement the strategy. There are two major components of the implementation means:

1. Providing the “implementation infrastructure” that enables the business to pursue the pricing strategy.
2. “Selling” the pricing strategy to the organization: that is, motivating the organization to implement the strategy.

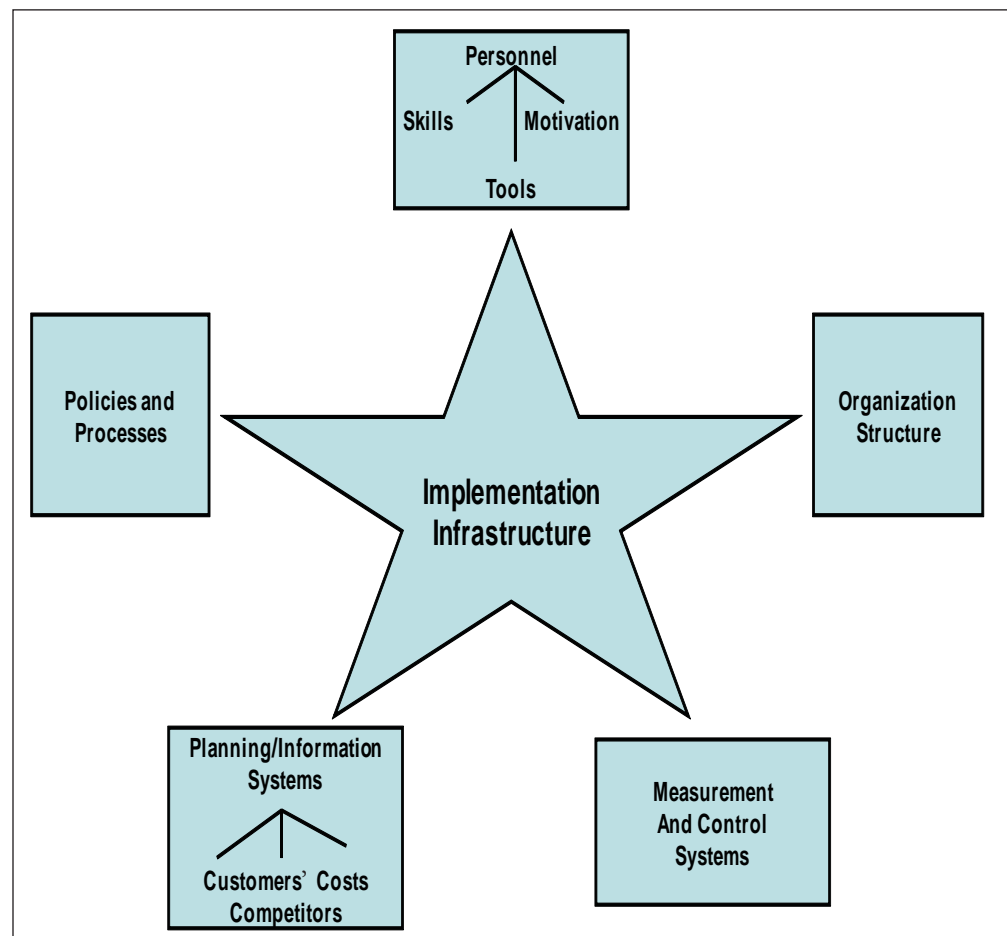
The focus of this article is the implementation infrastructure.

Pricing Strategy Implementation Infrastructure

Enabling the business to implement a pricing strategy involves the creation of an implementation infrastructure. The elements of the infrastructure – shown in Figure 1 – are the building blocks that make it possible for the business team to successfully carry out the aim of the pricing strategy.

Why is it critical to pay attention to the implementation infrastructure? Pricing strategies can fail in many ways, and the roots

Figure 1: Implementation Infrastructure Elements



of failure are often buried in organizational processes, systems, and tools. Practices disguised in organizational activities can create significant pricing problems (see, for example, “Fixing Prices”¹ for a discussion of how some of these “hidden” organizational practices can impact profitable pricing policy). Rather than allowing poor practices to creep into business practice, managers should consciously focus their effort on creating the infrastructure necessary for pricing strategy implementation.

Active management of each of the implementation infrastructure elements in Figure 1 (on previous page) is critical to successful – and profitable – management of pricing strategy. When managers experience challenges to their pricing strategy, diagnosis should include a review of these implementation components.

Control Systems

Many firms have a healthy dose of financial controls. While absolutely necessary, the challenge is, of course, that these financial controls (e.g., period income or average realized price) often reflect systemic pricing performance without direct reference to actual pricing practices. This can leave the management team scrambling to discover underlying pricing problems.

Inadequate pricing control metrics are often exacerbated by a lack of planned pricing performance reviews. For example, a client had the system capability to develop price dispersion, price by sales territory, etc. And, when senior management asked about pricing issues, performance plots were examined. The problem with this ad hoc review system is the “out of sight-out of mind” phenomenon. Undetected pricing problems escaped management’s overview, and could have impacted profitability for a long period of time – until senior management asked another question!

What is needed is a regular, routine review of fundamental pricing metrics. As a minimum, management teams should routinely review:

- **Realized price-volume** plots for major products. The focus of a review of these plots is to develop understanding if customers are exploiting their bargaining power to leverage lower prices. Where there is little correlation between price and volume, negotiating processes are suspect.
- **Realized price by market.** This plot should be used to foster a discussion about why various markets have different price points and an assessment of individual market attractiveness. In addition, observing different market price levels should drive

the management team to consider how they will “fence” markets to prevent migration of customers to lower price points.

- **Realized price levels by sales territory.** This plot should be used to identify where additional sales training and/or incentives are required.
- **Price Waterfalls.** These plots show the various discounts customers are granted. The management team should use these plots to develop a discussion around discounting policies and the effectiveness of individual discount practices.

Organizational Structure

A major challenge to profitable pricing practices is that pricing authority is widely diffused across the business. It seems that everyone has a position and view in the pricing process. This diffused pricing authority often leads to conflicting goals and piece-meal implementation of pricing strategies. Perhaps most troubling with this diffused pricing authority is the granting of price discounting policy to the field sales organization. Studies² have shown that when price authority is granted to the sales team, price levels tend to migrate to the floor price the sales team may allow. But, there is much more to the price concession game!

Price concessions are a deadly game because they have a tremendous impact on profits: for the average firm, a 10% price cut drives bottom line profits down 50%! But, price cuts do drive sales. Price concessions are powerful motivators for customers; they often get the sale.

But what happens when a firm cuts price? There are three deadly consequences:

- 1 The customer learns that price aggression is rewarded. They discover the more price demands they place on their supplier, the lower their price. It’s entirely reasonable, then, for customers to demand more price concessions – they “win” with little effort.
- 2 So, price aggressive customers become more and more price sensitive. They realize that only price is important – not what they get from the supplier.
- 3 Suppliers who “successfully” negotiate price concessions find their customer discussions are focused only on price – and consequently have to spend more time in price negotiations to realize lower and lower price levels!

Perhaps most troubling with this diffused pricing authority is the granting of price discounting policy to the field sales organization.

This is a “self-reinforcing” cycle: the more a firm negotiates price, the more it must negotiate price. And, of course, price levels continue to decline with each succeeding price negotiation. And, profits continue to decline along with price levels. And, the beat goes on! The more “successful” a firm is at negotiating price, the lower its profits. Not a good recipe for business success!

Managing the discounting process through centralizing pricing authority is key to successful implementation of pricing strategies. A sole source and responsibility for the development and execution of the pricing strategy is a foundation stone for managing the pricing process.

Of course, there are multiple options for the structuring of this centralized pricing authority:

- **At the business unit level.** This form has the advantage of connecting the pricing authority directly to the profit center. This makes it easier to see the influence of pricing on business unit profitability. In corporations with many individual business units, however, this organizational form may prevent recognizing and spreading pricing “best practices.”³
- **At corporate level.** This organizational form facilitates standardizing on best practices across the entire corporation. The challenge to this organizational structure is that business unit leaders may feel they are distanced from pricing management – that pricing decisions are beyond their control.

There are clearly advantages and disadvantages regardless of which organizational form is chosen. The key is to establish more centralized control while removing control for price concessions from field authority.

Personnel Skills, Incentives, and Tools

Skill development is a critical element in building a profitable pricing practice. The most effective pricing strategy is value based, but value based strategy requires a very different set of implementation skills than do cost based or competitor based pricing strategies.

As with any organizational effort, effective personnel management must look at both capability and motivation. Assuming the marketing and sales team is aware of the desired pricing strategy and the goals of its implementation, individuals can be in one of four action states (this is based on the “situational leadership model”⁴):

Ability	Unable	Able	Unable	Able
Motivation	Unwilling	Unwilling	Willing	Willing
Leadership Style	Telling or Directing	Selling or Coaching	Facilitating or Counseling	Delegating

When a marketing or sales team member is:

- **Both Unwilling and Unable** – Managers must define the tasks this person must accomplish, and continually monitor for compliance. If a person remains in this state for a long

time, managers must seriously consider whether employment should continue; the productive manager cannot afford to do both his or her job as well as the employee’s job.

- **Able, but Unwilling** – Managers must attempt to motivate, or sell, the employee to do that which the employee is able to do. Again, if an employee remains in this state for an extended time, managers should consider continuing employment.
- **Willing, but Unable** – Here the manager can train the employee to do that which they are willing to do. The manager’s role becomes that of facilitating to ensure the employee gains the required skills.
- **Both Willing and Able** – In this situation, the manager stands aside and empowers the employee to achieve objectives.

The critical assessment then becomes the state of readiness – seen as both ability and motivation – of the marketing and sales team.

When ability is the critical concern, skill development is best done in the “on the job context.” Here skill development is conducted using the specifics of the marketing and sales teams’ day-to-day jobs using real customer and market problem cases. The marketing and sales team are trained in value based pricing strategy development and implementation while practicing on projects that are part of their everyday work lives.

Motivation involves a mix of financial and non-financial incentives. Marketing and sales teams should be incented for driving profitable, not necessarily large, sales. Non-financial incentives should include appropriate use of recognition venues like corporate meetings, sales meetings, newsletters, etc.

A cautionary note: Senior management actions speak much louder than words. For example, consider this scenario: a client whose senior management espoused the use of value based pricing processes. A sales team had spent six months preparing for a negotiation with a customer who was known for their demands for price concessions. The sales team had built a powerful negotiating position, forcing the customer to give up really valuable offering components if they insisted on price cuts. When the customer refused to accept a lesser offering in exchange for a lower price, the sales team walked away from the negotiation. The customer’s president called the client’s president (who had supported the negotiation posture), arranged to play golf, and somewhere on the back nine a lower price deal was cut. The sales team was, of course, thoroughly discouraged; how could they ever again insist customers pay for delivered value?⁵

Sales teams should not be tasked to sell value

to customers if the appropriate value management tools are not in place. These tools must be developed by the marketing team, and include:

- Definition of customer targets, selected on the basis of the

firm's ability to deliver differential value at competitive advantage.

- Value delivery analysis for target customers.
- Offering definition, including a "menu" of offering options (see the "Price Menu" paper by Gary Ottley⁶).
- Value communication messages and selling script development.
- Definition of negotiation processes that force customers to shift from negotiating price to negotiating offering delivery.

Processes

Along with diffused pricing authority, many firms suffer from confused pricing processes. There are two aspects of this confusion:

1. Lack of a clear process for setting price levels.
2. Lack of a clear process (and authority) for changing price levels.

Consequently, in many businesses pricing is managed on a situational basis.

Effective pricing processes are value based. That is, they start with definition of target customers and development of offerings that deliver value based on the target customer's business model. Customer targets are selected on the basis of a supplier's ability to deliver differential value at competitive advantage. In this context, value is defined as economic impact on the target customer's business through increasing the customer's revenue flow and/or decreasing the customer's cost of doing business.

There are then two issues in choosing target customers:

1. **The ability to deliver differential value.** Differential value is unique value, value the customer cannot get from a competitor. Delivering differential value is the key to achieving premium prices, as well as negotiating with customers in a way that forces the customer to acknowledge and pay for the value (customers are forced to trade off offering elements that carry differential value if they insist on lower price).
2. **Competitive advantage.** Competitive advantage involves the productive use of the organization's resources; firms with competitive advantage are more productive than their competitors in use of their resources. An effective customer targeting process results in customer choices where differential value can be delivered at competitive advantage.

As customer targets are selected, a value based pricing strategy then looks to understand the target customers' business models. Specifically, customer business models are examined in depth to understand how the customer chooses its customer targets, goes to market, defines its offerings, and achieves competitive advantage. In short, the value based firm develops an understanding of its target customers' business economics.

The next step in the value based process involves quantification of value delivery. In this step, the supplier learns how much it increases the customer's revenue flow, and/or decreases the cus-

tomers' costs. Based on this understanding, the value based firm then develops an array of offerings (combinations of products and services) that allow the customer to make offering choices that best fit their business model. The implication, of course, is that offerings are designed specifically for the target customers' business models.

The value based pricing process then examines the quantified value delivery of each offering in its choice array. The question managers must address in this step is "how much of the delivered value will we capture with our price points?"

Firms with effective strategy implementation efforts have a clearly defined process for how they will evaluate value delivery, how they will price based on this value delivery, and who has authority for making these decisions. These processes are documented in policies, which are not negotiable. Pricing decisions are not determined by who the customer is; they are determined by corporate policy.

Discount decisions are made in a similar fashion. All discounts should drive business the firm would not otherwise achieve. Discount levels are set by clear rules about how customers qualify for discounts and how the discounts are granted. Again, discounts are not driven by customer negotiating power; they are driven by clear rules that apply across the customer base.

Data Systems

Another challenge for many firms is a lack of on-purpose collection of customer, competitor, and cost information. The problem here is that much market information is stored in the minds of individuals in the business team, and is consequently not tested and validated. The result is a lack of consensus about the drivers of business success, and disjointed interactions with customers and competitors.

Purchasing organizations have discovered the power of integrated data systems. For example, suppliers selling into the automotive sector have found that offering a price deal in a specific geography can have almost instantaneous impact in all regions. Increasingly suppliers are hearing "I want the product delivered in Western Europe, but I want the price you offered in China."

Data that is not validated across the entire market place can drive dangerous actions. For example, a marketing team hearing from a sales person that a competitor has cut price is likely to respond with its own price cut if it does not test the competitor's move across its entire market. Testing for the reality of a reported competitive price cut, and if real, whether it is a strategic or tactical move, is a prerequisite to making profitable pricing decisions.

The implication is that managers need a centralized, validated competitive intelligence data base. The competitive data must be routinely reviewed and its validity assessed. Assessment should be done using both managerial judgment (based on analysis across the entire customer set) and routine inputs from third-party assessments.

Marketing and sales teams also need a centralized customer data system. The customer data system should include analysis of customer business models and quantified value delivery models. This

provides a starting point for development of negotiating packages as well as the basis for identifying potential new offerings.

Finally, the marketing and sales teams need a thorough cost data base. This data base provides the context for making profitable customer targeting and offering design decisions. Some marketing teams argue they don't want the sales team to understand costs because they are likely to negotiate away all profit margin. The cure is obvious: don't grant price negotiation authority to the sales force. What the marketing and sales teams should understand is which offerings are more profitable to sell, and which customers to sell to. This requires these teams have complete cost information.

Conclusion

Often the key to successful pricing strategy lies in understanding the underlying organizational activities that preclude successful implementation. If the business unit has articulated a value based pricing strategy, failures are often not a strategy problem. The real problem is often a failure to adequately develop the means – the implementation infrastructure – to successfully execute the strategy.

Endnotes

¹ "Fixing Prices," by George E. Cressman, Jr., *Marketing Manage-*

ment, September-October, 2006, pp. 32-37.

² See, for example, "Delegating Pricing Authority to the Sales Force: The Effects on Sales and Profit Performance," by P. R. Stephenson, W.L. Cron, and G. L. Frazier, *Journal of Marketing*, vol. 43, no. 2, 1979, p. 21.

³ Of course, the danger of failing to capitalize on best practices may be mitigated to some extent through establishing a central coordinating function or committee. Still, the "my business unit is unique" phenomenon may make capitalizing on best practices difficult.

⁴ See *Management of Organizational Behavior: Utilizing Human Resources* by Paul Hersey and Kenneth H. Blanchard, sixth edition, Englewood Cliffs, NJ: Prentice Hall, 1993.

⁵ There was much more to this case. The customer took our client's price cut to a competing supplier, and used the price deal to leverage a lower competitive price – and then place the order with the competitor!

⁶ "Value Based Pricing Strategy in Practice: The Price Menu," by Gary Ottley, *Journal of the Professional Pricing Society*, Spring, 2002.