Professional Pricing Society

The PRICING ADVISOR

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Improving international sales and pricing power is a challenge for many multinationals – especially when local entrepreneurship is valued and needs to be preserved. This article presents four practical and proven solutions to increase sales and pricing power, resulting in a head to tail pricing process redesign. *Juriaan Deumer, MSc is a Senior Consultant at Simon-Kucher & Partners in Amsterdam. He specializes in price and profit optimization and in sales excellence. Alejandra Lugard, MBA is a Consultant at SKP and has extensive experience in international and corporate strategy, sales excellence and pricing power optimization and strategy implementation. Jos Mulder, MSc is a Consultant at SKP and focuses on accelerating change, long-lasting organizational embedment and sustainable bottom-line growth. They can all be reached via www.Simon-Kucher.com.*

In This Issue:

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Improving International Sales and Pricing Power

Which of the following statements apply to your organization?

- We operate in a B2B environment.
- We sell products in multiple countries at different price levels.
- Price levels are mainly historically grown and based on cost-plus pricing.
- Sales management and the sales force have little focus on improving price realization levels.
- Quotations are mostly prepared based on gut feeling.
- We monitor our sales results mainly based on revenue and volume.

If the majority of these statements is true for your organization, your sales and pricing power can be improved. Boosting your sales and pricing power will have an immediate positive impact on your profitability. Project experience shows that improved sales and pricing power typically results in 1%-2% ROS. This article presents four practical and proven solutions to increase your sales and pricing power, resulting in a head to tail pricing process redesign.

Improving sales and pricing power

Selling a broad product portfolio in multiple countries creates specific pricing challenges, especially when local purchasing power is (historically) incorporated into current discount rates.

Companies in this situation need a rigorous but practical approach for price setting, quotation development and monitoring. This helps them to structure processes and improve country benchmarking. Gut feel is replaced by fact-

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based decisions and more targeted steering becomes possible. Ultimately, it increases companies' overall sales and pricing power. To be most effective, this approach should be supported by practical, user-friendly tools that turn insights into action.

Best practices show that this approach should consist of a combination of solutions, impacting four stages in the deal pricing process:

1. **Value pricing:** setting prices and discounts based on market and data insights.
2. **Deal preparation:** preparing deals in a structured way.
3. **Deal assessment:** determining the feasibility of a price increase based on bargaining power.
4. **Monitoring:** monitoring sales and price performance using a specific key performance indicator dashboard.

These four sales and pricing power solutions are illustrated in figure 1 and described in more detail below.

1. Set prices and discounts based on market and data insights

Figure 1: Four solutions to improve sales and pricing power

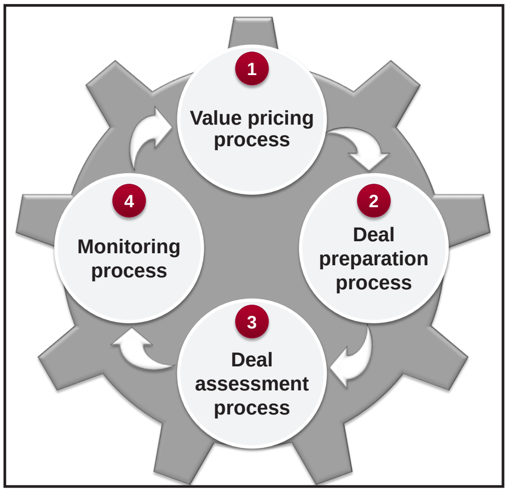
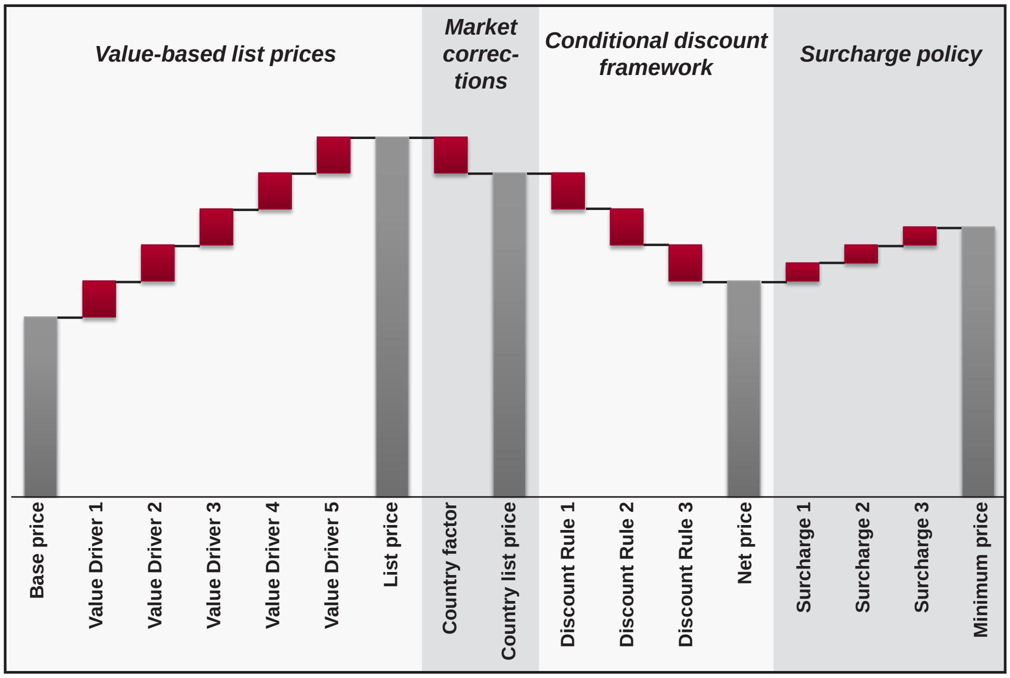


Figure 2: Value pricing process



The first step to improving sales and pricing power is to set a clear pricing strategy. For example value-based pricing, that prescribes prices based on the perceived value in the market, rather than just on cost or competition. When applying value-based pricing, the key is to obtain customers' willingness to pay and set the right price realization goals or net price targets. Commonly you will find that customers' willingness to pay differs from segment to segment. To fully exploit your customers' varying willingness to pay, a differentiated price realization goal per segment is essential.

To achieve the set price realization goals, the commercial organization requires a value pricing process with three main items:

I. **Value-based list prices** which reflect the value drivers of products/services both logically and consistently. The key here is to explore how much customers are really willing to pay. This can be done with expert interviews, price experiments and price surveys.

II. A **conditional discount framework** based on a set of discount rules. This helps sales to replace gut-feeling discounting with a transparent, structured approach.

III. A **surcharge policy** aimed at exploiting customers' willingness to pay for additional services.

Since the first three items create a one-size-fits-all value pricing structure, a fourth item is needed to account for differences in price levels between countries.

IV. **Country factors** translate a company's global list price into country list prices. They can be seen as a company-specific "Big Mac Index" that helps the sales organization to deal with differences in general price levels between countries.

These four items, illustrated in figure 2, replace gut feeling in the pricing process and exploit customers' willingness to pay. They form the starting point of the deal process.

2. Prepare deals in a structured way

When considering the total deal process

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(from client meetings and deal negotiations to order placement), only limited time is spent on the actual preparation of the deal. And yet, proper deal preparation is crucial as it increases the realized deal price and reduces the time spent on the total deal process.

A structured process is one of the most important prerequisites for proper preparation. Especially in more complex (international) sales processes or (international) environments with high sales force attrition rates, a structured approach for deal preparation is vital. The design of the process steps should be based on the knowledge of the senior sales force.

A highly effective solution in practice is a tool-based solution. The knowledge of senior sales is absorbed, combined and processed into a user-friendly deal preparation tool. This tool helps to assess customers, identify their needs, indicate the most relevant company and product USPs, determine cross-selling and up-selling opportunities, and direct sales toward the most suitable ways of quantifying the value story. In short, it structures and simplifies an extensive but highly relevant process.

3. Assess deals based on bargaining power

Many of the quotations made in business are based on gut feeling, a cost-plus mentality and/or are historically grown. This is far from ideal as these quotations generally result in lower average deal prices. Moreover, gut feeling tends to make the quotation process blurry. Often, past deals or comparable customers are taken as a starting point for the deal at hand. But circumstances change and customer characteristics rarely really match. So the chances of finding the ideal starting point are slim – and it is therefore unlikely that you will end up with the best possible quotation.

A more systematic approach is essential. The value-based pricing framework, as described in solution 1, is used to set an indicative target price for the deal. Next, deal-specific bargaining power is determined and taken into account to set the actual deal target price.

Relevant factors in determining bargaining power include for example competitor pressure, time pressure, customer segment and the role of the product in the final consumer product. Bargaining power can be quantified by determining the relative importance of the most relevant bargaining power factors, based on the company's expertise. Keep in mind that (the importance of) bargaining power factors may vary according to region and product group. At the end of the day, having higher bargaining power in a negotiation, indicates room for you and your sales force to increase the actual deal target price.

> Bargaining power can be quantified by determining the relative importance of the most relevant bargaining power factors, based on the company's expertise.

A simple method can be used to support the deal assessment process described above. The method guides the salespeople in defining and quantifying bargaining power, resulting in a specific target price. Additionally, it defines an optimal floor price and walk-away price and can also include surcharge options. In many cases an Excel-based tool can fulfill these requirements, enabling you to choose a simple or more sophisticated design. This systematic approach allows you to easily monitor deals and use the knowledge you gain to improve the process itself.

4. Monitor sales and price performance

Although most companies have KPIs to monitor their business, pricing related KPIs are generally missing among them. However, to effectively monitor and improve sales and price performance, a dashboard with specific sales and pricing KPIs is crucial. The dashboard should enable the evaluation of a limited set of performance indicators (e.g. average price, discount percentage, volume, up-selling and cross-selling). It should benchmark these KPIs against target and/or the previous year's performance. Ideally, the dashboard also allows you to view multiple aspects of the KPIs (e.g. period, country, account manager and customers) in a flexible way.

The dashboard is designed to deliver clear insights into areas that require extra or other effort. Measuring both input and output performance indicators ensures that not only the results, but also the cause of those results, are known. In the end, however, it is not about the figures; they merely serve the discussion. It is about understanding the story behind them and jointly deciding on the right response.

Setting up and implementing such a dashboard might sound complex. It is not. The key is to start with a small selection of metrics and a simple (Excel-based) solution (see figure 3 on the next page). This will clarify which information you really need and what the next version of the dashboard should look like.

Case study: Improving sales and pricing power at a leading Dutch manufacturer

A Dutch multinational B2B manufacturer, with numerous subsidiaries, agents and distributors worldwide, concluded that it needed to improve its grip on sales and pricing. Local entrepreneurship was, however, highly valued and could not be undermined. Moreover, only one single list price was communicated to clients worldwide, whereas average realized prices varied significantly between countries. They needed to raise awareness

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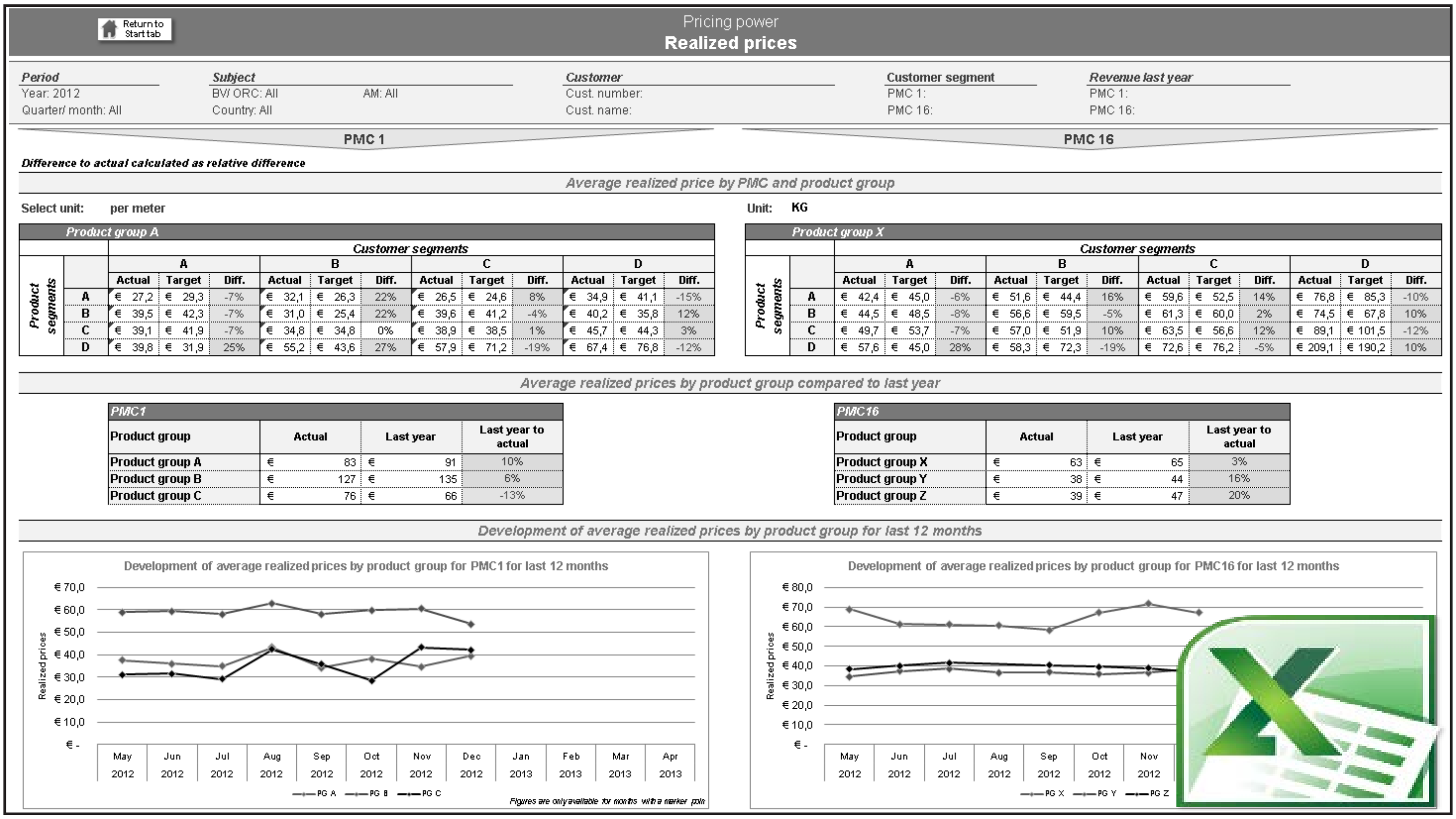
Figure 3: Example of an Excel-based KPI dashboard



Product group A		Customer segments A			B			C			D		
		Actual	Target	Diff.	Actual	Target	Diff.	Actual	Target	Diff.	Actual	Target	Diff.
Product segments	A	€ 27,2	€ 29,3	-7%	€ 32,1	€ 26,3	22%	€ 26,5	€ 24,6	8%	€ 34,9	€ 41,1	-15%
	B	€ 39,5	€ 42,3	-7%	€ 31,0	€ 25,4	22%	€ 39,6	€ 41,2	-4%	€ 40,2	€ 35,8	12%
	C	€ 39,1	€ 41,9	-7%	€ 34,8	€ 34,8	0%	€ 38,9	€ 38,5	1%	€ 45,7	€ 44,3	3%
	D	€ 39,8	€ 31,9	25%	€ 55,2	€ 43,6	27%	€ 57,9	€ 71,2	-19%	€ 67,4	€ 76,8	-12%

Product group X		Customer segments A			B			C			D		
		Actual	Target	Diff.	Actual	Target	Diff.	Actual	Target	Diff.	Actual	Target	Diff.
Product segments	A	€ 42,4	€ 45,0	-6%	€ 51,6	€ 44,4	16%	€ 59,6	€ 52,5	14%	€ 76,8	€ 85,3	-10%
	B	€ 44,5	€ 48,5	-8%	€ 56,6	€ 59,5	-5%	€ 61,3	€ 60,0	2%	€ 74,5	€ 67,8	10%
	C	€ 49,7	€ 53,7	-7%	€ 57,0	€ 51,9	10%	€ 63,5	€ 56,6	12%	€ 89,1	€ 101,5	-12%
	D	€ 57,6	€ 45,0	28%	€ 58,3	€ 72,3	-19%	€ 72,6	€ 76,2	-5%	€ 209,1	€ 190,2	10%

PMC1 Product group	Actual	Last year	Last year to actual
Product group A	€ 83	€ 91	10%
Product group B	€ 127	€ 135	6%
Product group C	€ 76	€ 66	-13%

PMC16 Product group	Actual	Last year	Last year to actual
Product group X	€ 63	€ 65	3%
Product group Y	€ 38	€ 44	16%
Product group Z	€ 39	€ 47	20%

among the subsidiaries and to strengthen HQ's grip on sales and pricing power in a pragmatic way.

In three months a worldwide approach for customer and product segmentation, list pricing, discounting, deal preparation and deal assessment was developed as well as a complete sales and pricing KPI dashboard. This created the foundation for higher price realization and improved steering and monitoring of sales and pricing processes. Moreover, it left local entrepreneurs free in their market approach, but made benchmarking with and learning from other subsidiaries and the headquarter much easier.

Conclusion and recommendations

Improving international sales and pricing power is a challenge for many multinationals – especially when local entrepreneurship is valued and needs to be preserved. Three areas are particularly relevant:

- **Stop the use of economic differences as an excuse for low prices**
  When you optimize your international prices and discounts, account for the economic differences between regions by including country factors. Simplicity and intelligibility are key when it comes to acceptance. Inclusion of country factors will be rewarded with better company-wide price alignment.

- **Overcome unstructured sales approaches and reliance on gut feeling**
  Use a systematic approach and supporting tools that capture the know-how of the senior sales force to ensure that the sales force moves away from gut feeling when assessing deals. Your realized prices will increase, you will be better able to compare deals and your sales force will be more confident in setting prices.

- **Take action based on the right, commonly defined measurements**
  Your sales and pricing progress can be measured only with dedicated KPIs. You need those measurements to decide on the right actions to take. Commitment to KPIs starts with influence during the development process and results in understanding and acceptance of the actions taken to improve sales and pricing power.

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Steer Clear of Pitfalls in Pricing Research

In pricing it is important to develop an "outside-in" perspective, one which allows you to see your products, services and pricing through the eyes of potential customers. The best way to achieve this perspective is through pricing research. However, the success of your research depends on its design. In this article, the author outlines 4 pricing research pitfalls and provides tips for avoiding them. Paul Hunt is the president of Pricing Solutions and a frequent PPS contributor, instructor and presenter. He can be reached at phunt@pricingsolutions.com. He also writes a pricing column that appears monthly in the Financial Post *(www.financialpost.com).*

In pricing we talk a lot about developing an 'outside-in' perspective. The type of perspective that helps you understand what customers are willing to pay for. How do you gain that perspective? Well for starters, you ask.

Time and time again we've seen pricing and value research pay dividends for companies. **Think, consumer research is to value-based pricing, what a paddle is to canoeing. It's a pretty essential component.** Otherwise you may find yourself up a creek; lost in ad-hoc pricing processes and decision-making just to stay afloat.

So in a move to better understand pricing research here are 4 research pitfalls and tips for avoiding them:

Pitfall #1: 'One-size fits all' when it comes to choosing your methodology — **The success of your research largely hinges on the design.** There are pros and cons to every analytical methodology and methodologies are evolving too. Take conjoint analysis for one. It's by no means perfect, but it does ask respondents to make difficult tradeoffs in order to determine the features of a product or service that are valued most. Or rather, determines the features people will pay for.

Think about purchasing a new home. You make several tradeoffs before deciding to buy. For example, imagine two identical properties. One is ideally situated in the neighborhood of your choice, while the other is much further away but much less expensive. A simple example, but which you choose says a lot about what you value more in a home: location or price. By presenting respondents with realistic purchase scenarios you are more likely to unearth true consumer behavior. Perhaps things even your customers didn't realize. Pricing is a powerful lever of profitability and strategic, long-term pricing decisions depend on the number and accuracy of responses.

Pitfall #2: Design stops at methodology — Even if you've chosen an appropriate methodology, you still need to be aware of other bumps along the road. Framing effects for example, can be a particularly nasty bump. Think of the classic "25% fat versus 75% lean meat" study. The study showed how two descriptions – though essentially the same – can elicit very different emotional responses. Locally, a survey of Markham, Ontario residents came under fire for using framing effects to garner support for an NHL-sized arena in the area. So simply put, how are your questions asked?

Pitfall #3: Correlation must mean causation — **More often than not, research findings tell us whether or not a relationship exists between variables and not necessarily if one caused the other.** In actual fact there could be a third, fourth or fifth factor at play! Coffee studies are a good example of this. As a Starbucks enthusiast, I'm intrigued by the headlines: sometimes they claim coffee is good for my health, other times it's not. It was about this time last year I read a study in the New England Journal of Medicine that found coffee consumption to be associated with a lower risk of certain diseases. So although it may decrease the risk of some diseases, coffee consumption shouldn't be confused for health benefits outside the scope of the study. It's important to know the difference between correlation and causation in this case.

However, this type of research is important for defining areas where further investigation is needed. In pricing research, that means consumer preferences are continuously changing, as are the products and services within shoppers' consideration sets. Don't let early results sway you; clearly define the objective of your pricing research and stick with it. You may not get all the answers, but you will know which direction to go next. We always say pricing is a journey. If you make the mistake of stretching outside the limits of your research, you run the risk of facing even greater pricing challenges down the road.

Pitfall #4: Forgetting about the respondent — I recently bought a new laptop. Shortly after I received a customer satisfaction survey: how happy was I with the purchase experience? Seven survey questions later, the 3 months I spent 'doing my homework' suddenly didn't seem so impressive. It's been reported that respondents spend an average of just five seconds per question when asked to rate a product, service, feature, etc. on some form of scale. That equates to only sub-par data for statistical analysis.

How to improve responder engagement is an interesting question. Providing participants with almost real-time feedback is one possibility. For example, as sections of a survey are completed, respondents could see how they compare to other survey-takers (i.e. '50% of respondents also chose Option A'). Or perhaps the channels used to field a survey can be broadened, improving the compatibility with mobile devices for responders on-the-go. Whatever the answer may be for your research, improved responder rates help you and your organization make pricing decisions based on data, not gut-instinct.

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Is Amazon No Longer a Low-Price Ecommerce Leader?

There is a long-standing perception that dates back to the earliest days of the Internet that prices are always cheaper on the web at places like Amazon.com (AMZN). But is that the case? In this article, the author explores changes in large ecommerce pricing strategies and possible driving factors. David Dalka advises CEOs, boards and other senior level regarding organizational redesign to capture search and digital marketing benefits to maximize customer demand, revenue, cash flow and market share. He demonstrates leadership as a business keynote speaker and high stakes corporate retreat facilitator. He has been quoted in the Wall Street Journal *and served at BlackRock(BLK) during the 80 to 800 person hyper-growth phase redesigning business models that transformed an industry. You may contact him through his website www.daviddalka.com, follow him on Twitter @dalka or call him at (520) 223-4808.*

There is a long-standing perception that dates back to the earliest days of the Internet that prices are always cheaper on the web at places like Amazon.com (AMZN).

In some categories like books, Amazon is often the price leader, but book publishers could have flipped this on its head if they had joined forces, bought recently purchased goodreads.com before Amazon did, and offered books directly at lower prices while eliminating the middleman. Amazon preempted any potential forethought there, however, by buying goodreads.com first.

Michael Learmonth at adage.com stated the following in 2012: "There's no more customer-obsessed company than Amazon, which has long forsaken high profits in pursuit of giving shoppers the best possible experience and the lowest possible price." At one time, this was likely completely true.

I had some experiences recently that might cause me, Mr. Learmonth and everyone else to start a wide debate on this and ask if this perception of Amazon always offering "the lowest possible price" is actually now a myth?

Those who know me well know that I make great pot roast and that I am buying a considerable number of used books for a research project. Every once in a while I need to get a new pan. I put Fat Daddio's Anodized Aluminum Sheet Cake Pan, 9 Inch x 13 Inch in my cart and then saved it for later purchase. After I did that, I continued to buy used books on occasion.

I noticed that the price of the Fat Daddio Cake Pan was changing price rather frequently and dramatically and I started to take screen prints. Imagine my shock when I saw one price change take the price of the cake pan from $13.99 to $18.99, an increase of 35.74%, see figure 1 below!

A summary of the price changes I recorded are on the following page, see figure 2 on the next page.

So the question then becomes, why are the prices of this particular item changing so much? Let's explore some theories:

- **Search Engine Optimization** – It is well known that some ecommerce merchants change prices a few cents here and there to make a page appear "changed and fresh" to a search engine crawler bot. If this was what was going on here, the price changes would be much, much smaller, so we'll discount that theory.
- **Conversion** – It is possible that small changes in price could cause someone to convert the item in the cart at a higher rate. This again seems unlikely due to the size of the price swings.
- **Low Quantity in Stock with Backorder** – This scenario would make sense, but I'll discard it as the price was moving up and down in relatively rapid time frames.
- **Automated Price Comparison Tools** – There are now many automated price comparison tools that look at competitors' sites and change prices based on a highly questionable benchmarking premise. As Harvey Mackey argues, it is foolhardy to compete with a fool. An automated tool, often not rooted in proper business or pricing strategy is foolish. It is even more foolish when technologists with no business acumen programmed it

Figure 1

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and don't understand the business nor consumer impacts.

I consider the last item to be most likely and that is both sad and unfortunate, as it means that organizations are acquiring software with questionable benefits while adding to costs. Senior management is likely not in touch with pricing strategy and the ability for prices to dip below profitable levels exists.

Ultimately, pricing is a senior-level business strategy issue that requires proper business acumen and life experience to manage successfully. Leaving the decisions to low-level employees and/or questionable tools and software is poor corporate governance and proves a dysfunctional management team.

Figure 2

	Old Price	New Price	Difference	% Change
2/25/2013	$15.90	$14.23	($1.67)	-10.50%
3/18/2013	$18.21	$16.01	($2.20)	-12.08%
3/18/2013	$16.01	$15.35	($0.66)	-4.12%
4/5/2013	$13.99	$17.79	$3.80	27.16%
4/6/2013	$17.79	$14.30	($3.49)	-19.62%
4/7/2013	$14.30	$13.99	($0.31)	-2.17%
4/8/2013	$13.99	$18.58	$4.59	32.81%
4/9/2013	$18.58	$13.99	($4.59)	-24.70%
4/12/2013	$13.99	$18.99	$5.00	35.74%
4/13/2013	$18.99	$14.75	($4.24)	-22.33%
4/14/2013	$14.75	$14.12	($0.63)	-4.27%
4/16/2013	$14.12	$14.20	$0.08	0.57%
4/19/2013	$14.20	$13.30	($0.90)	-6.34%

Great companies compete on great service. It is time to have an open discussion about whether the low-price ecommerce consumer perception is frequently a myth instead of reality. Might this debate lead to an acceleration of the various incarnations of the 'Buy Local' movement? Could it lead to an erosion of trust of ecommerce companies? I welcome this debate and encourage it to also include a conversation about replacing traditional brand marketers with proper strategic marketers in leadership roles across corporate America.

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The Problem with Price Gouging Laws

Many states have anti-gouging laws that curb price increases during disasters. While many view this policy as fair, gouging laws have two key drawbacks. In this article, the author explores these drawbacks and offers a hybrid solution for managing pricing levels and consumer demand during in extraordinary situations. Rafi Mohammed is the founder of Culture of Profit LLC, a Cambridge, Massachusetts-based company that helps businesses develop and improve their pricing strategy, and author of The 1% Windfall: How Successful Companies Use Profit to Profit and Grow. *This article originally appeared on the Harvard Business Review web site at HBR.org.*

When I meet people at parties, I'm often asked, "What do you do for a living?" After sharing that I help companies improve their pricing strategies, many smirk and flippantly retort, "Oh, ripping off the consumer." Sometimes, when I'm not in the mood to share my more benevolent philosophy of offering consumers a selection of pricing options, I simply reply, "As long as the product is not an absolute necessity, everyone always has the right to say 'no.'" This response seems to neutralize criticism and most people nod in agreement.

But what if products are absolute necessities, such as critical supplies after a natural disaster?

Many states have anti-gouging laws that curb price increases during disasters. In California, for instance, the maximum that retailers can raise prices after an emergency is 10%. Since this minimal upcharge won't effectively temper demand, limited supplies end up being rationed on a first-come, first-serve basis. **While many view this policy as "fair," gouging laws have two key drawbacks:**

Encourages Hoarding: Those lucky enough to be at the front of the line tend to buy more than they really need. These "just-in-case" purchases — an extra loaf of bread or perhaps filling up both cars with gas — exacerbate a shortage. In contrast, doubling the price will make customers think twice about buying another gallon of milk, for example, thus leaving supply for those who didn't arrive at dawn.

Discourages Businesses from Boosting Supplies: If prices are capped, there's little incentive for businesses to hustle to increase supplies. It's costly to find and transport extra products in hazardous conditions. If these extra costs eat up the profit associated with a fixed retail price, Adam Smith's invisible hand won't work; there's no financial carrot. As a society, we want incentives, for instance, that divert gas tanker trucks from neighboring unaffected states to disaster areas where fuel is in short supply.

A well-known gouging case involves the invisible hand actions of John Shepperson. After the Hurricane Katrina disaster, John bought 19 generators, rented a U-Haul truck, and drove 600 miles from Kentucky to Mississippi. In return for his efforts and risk, he hoped to sell the generators at double his purchase price. Instead, he was arrested for price gouging, spent 4 days in jail, and the generators were confiscated. It's a tricky issue: while Mr. Shepperson's morality can be debated, his initiative would have unequivocally added supply and made some people better off. We all are charitable, of course, but how many of you would have rented a truck and driven twelve hundred miles round trip to sell generators for the price you purchased them?

To be clear, I did not come up with the above points (hoarding, discourages boosting supplies) — economists commonly use them in price gouging discussions. In fact, I paraphrased these arguments from papers written by two economists associated with the Federal Trade Commission (a government agency whose mission includes preventing business practices that are unfair to consumers), David Meyer and Michael Salinger. It's interesting to note that a past FTC Chair, Deborah Majoras, is on record as being against Federal gouging laws.

This long-simmering "hold vs. raise prices" debate is polarizing. I've found that no amount of persuasive argument can change one's views. As a society, we are at stalemate on this issue. The good news is there is another option which bridges these two opposing points of views.

Consider the following hybrid policy. During states of emergency, price gouging laws go into effect. However, federal and state governments provide subsidies to retailers on essential products such as gasoline, primary food stuffs, and relevant construction materials. **This combination of price controls and subsidies yields a best of both worlds scenario during emergencies. Prices are kept in-check and just as importantly, there are financial incentives for retailers to entrepreneurially boost stocks.**

How could this be implemented? Many states have tax holidays where certain products are not taxed. The same process/technology that identifies products sold at retailers which fit the tax holiday guidelines — and then reports it to governments so they aren't taxed — can be used to identify essential products sold during emergencies. This reporting will trigger subsidy payments.

Most politicians favor price gouging laws during a disaster over allowing market clearing prices — it's a safe and seemingly fairer pricing choice. As a consequence, shortages and the accompanying personal miseries/health risks are inevitable. While I am rarely a fan of government subsidies, in this case — when used in conjunction with price controls — they provide both a political and economic remedy to a life-affecting pricing dilemma.