PROFESSIONAL PRICING SOCIETY

The PRICING ADVISOR

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If suppliers in the healthcare and MedTech industries cannot get a handle on pricing, price transparency should become an important tool to help healthcare providers take large chucks of supply costs out, as this article explains. This industry specific example provides pricing strategies that can be applied to multiple industries. Author Chris Provines is a 24-year veteran of the healthcare industry. He is the CEO of ValueVantage, and the author of Strategic Pricing for Medical Technologies (2012), *and his newest book* Healthcare Value Selling (2014). *He is on the PPS Board of Advisors and an Adjunct Professor at Rutgers University where he teaches in the MBA program. He can be reached at chris@valuevantagepartners.com.*

In This Issue:

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Is the Promise (or Threat) of Medical Supply Price Transparency Finally Here?

Depending upon which side of the table you are on, medical device and supply price transparency is either a long-standing threat to prices and margins or a potential opportunity to drive supply savings.

While there have been efforts and businesses focused on supply price transparency in the past, it finally appears that we may be at a tipping point where price transparency will have a major impact on suppliers and buyers.

What has changed? Why is price transparency finally going to have a big impact?

There are four big drivers to consider:

1. **Continuing Pressure for Cost Reduction:** Reimbursement cuts along with pay-for-performance programs and new business models will continue to put hospitals and other providers under pressure to be more efficient and reduce costs. Supplier related costs represent approximately 40% of total costs for providers, and should continue to be a big area of focus.

2. **Maturing of Supply Chain:** Hospital supply chain and procurement capabilities continue to mature. As this occurs, expect a much more proactive and sophisticated approach to reducing supplier costs and extracting more value from suppliers.

3. **Technology Provides Better Visibility to Spend Data:** One key enabler of any procurement transformation and supply cost reduction effort is gaining better visibility to spend data. This simply means understanding what is purchased, from which suppliers, at what prices, and why. This spend data informs sourcing strategies, supplier rationalization, supplier management, and

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PPS Happenings

Serving the Pricing Community Since 1984

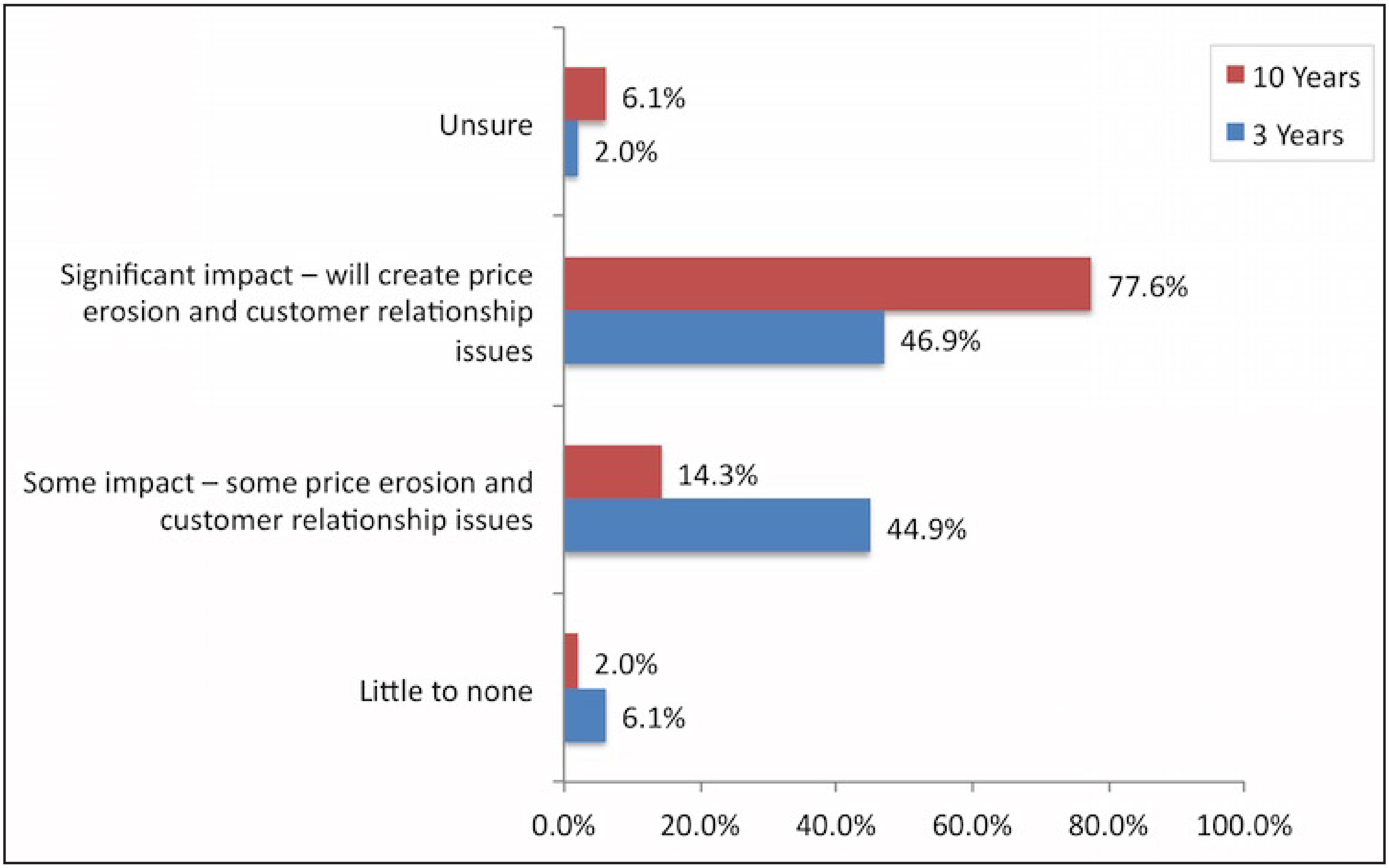
Upcoming Events

26th Annual North American Fall Pricing Workshops & Conference – The Palace Hotel – San Francisco / October 20 - 23, 2015

11th Annual European Pricing Workshops & Conference – Mövenpick Hotel – Amsterdam, Netherlands / 2-4 December 2015

For the most up-to-date information about PPS events and programs, please visit our website at www.pricingsociety.com frequently.

Figure 1: Impaact of Price and Value Transparency on Business in Three And Ten Years (% of respondents)



other procurement efforts. New tools such as cloud-based procurement software – provided by companies like Coupa, GEP, and others – are helping to provide greater spend visibility.

4. **Changing Supply Ecosystem:** There is an entire cost-out and value-in ecosystem of businesses trying to help providers reduce supplier related costs and bring value into supply decisions. In the area of price transparency, existing players like ECRI and MDBuyline appear to have ever more sophisticated tools and data. In addition, new players like Broadjump, which focuses on supplies as well as purchased services, are entering the price transparency market. Sourcing consultants and cloud-based sourcing tool providers like Curvo help to provide transparency to supply prices.

Suppliers' View – Price Transparency Will Be a Big Issue

Within the supplier community, many see the threat of price transparency as real. A recent survey of approximately fifty MedTech industry executives and participants shows that almost half believe transparency will have a significant impact in the next few years and over three-quarters believe price transparency will have a significant impact within a decade.

There are a lot of potential issues with using price benchmarks. Critics question the accuracy of prices and are quick to point out that the price of a supply item cannot be taken out of context (e.g., the price is tied to a relationship, level of service, purchased volume, share of purchases, etc.).

This context issue is especially important as suppliers start to unbundle (e.g., repless sales model). Over time, however, technology and the ecosystem of businesses providing transparency services should be able to continuously improve the data and address any context issues.

Most medical technology suppliers, as the survey shows, recognize that the real threat of price transparency is coming. Yet, experience shows that many suppliers still struggle with having clear pricing rules and disciplined price execution. If suppliers cannot get a handle on pricing, price transparency should become an important tool to help providers take large chucks of supply costs out.

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Negotiating With Savvy in the Arabian Peninsula

In this article, the author presents a five-point plan that can help companies to achieve higher prices for major orders in the UAE and throughout the Middle East, ultimately enabling them to extract greater value from projects and avoid costly mistakes from overly aggressive pricing tactics. Lovrenc Kessler is Managing Director of Simon-Kucher & Partners' Middle East office in Dubai. In Dubai, he and his team support companies in the entire Middle East by helping them to achieve better pricing. He can be reached at Lovrenc Kessler@Simon-Kucher.com.

The excitement was palpable as Dubai received the bid to host the Expo 2020. Everyone agrees that the world exhibition will generate an economic boom of whole new dimensions. Construction projects such as the Dubai World Center or the Mohamed Bin Rashid City, just to name a few of the mega-projects of the Expo 2020, are worth billions in investments. It's no surprise that companies from all over the world are in hot pursuit of these projects. To clinch these prestigious bids, companies will undersell themselves mercilessly. Blinded by the attractiveness of new projects, they give the cost calculations only a cursory glance. The harsh reality hits a few months later when it becomes clear that the order can no longer be fulfilled according to the budget, and "strategic" clients are no longer able to meet the financial demands of owners. This five-point plan can help companies to achieve higher prices for major orders in the UAE and throughout the Middle East, ultimately enabling them to extract greater value from projects.

1. Systematically prepare yourself. 95 percent of success in price negotiations depends on the right preparation that starts with gathering the following information: Which of the client's departments are involved in the tender process? Who makes the decisions? On which criteria – aside from price − are decisions based? Is it possible to have preliminary talks before handing in the official tender documents? Who are the competitors? In this last point, it's helpful to analyze competitor products and offer portfolios so you can emphasize your own company's and products' strengths.

2. Be precise with the project cost calculation and factor in potential cost increases ahead of time. A major influencing factor in setting project prices is cost. Unfortunately, they are often insufficiently or overly optimistically calculated. When calculating prices, it's important to look both at the input materials the company has to purchase and the specific market and economic fluctuations. As tempting as it may be to make a cheaper bid due to the currently low price of steel, an even minimal price increase in purchasing could push the project into the red zone. That's why successful companies systematically list their project costs. All costs that cannot be influenced are passed on to the client.

3. Create a discount structure and practice negotiations internally. Once you've made it into the final round of the tender process, that's when the negotiations really start. In the Middle East, negotiating is a part of everyday life, and the client will try to squeeze additional price cuts out of you. It's not uncommon for potential contractors to feel overpowered by the direct demands of the client, which in turn causes them to make hasty price discounts to avoid losing the project so close to the finish line. In a comprehensive study and analysis, we determined that, without having a negative influence on getting the bid, companies lower prices in the last negotiation steps on average 4-8 percent points too many. Applied to certain industries, this would correlate to a margin loss of up to 50 percent. That's why preparing a set order of concessions and then internally simulating them is recommended. Based on the total price and the service scope, added services are first offered (a). The next step is to give a one-time discount (b) on a specific offer item. Then, and only if it's absolutely necessary, will the client receive a permanent discount (c), e.g. for service agreements, etc.

4. Provide several service options in your offer. Companies often complain that the tender documents are nowadays so minutely detailed that there is no leeway for various service levels/variations. These tenders intentionally strengthen the impression that only the bidder with the lowest price can win in the end. This in turn keeps prices low from the very start. But there is a way around this. Instead of concentrating solely on the specification sheet, companies can usually provide two or three additional offer options that give clients further services and benefits. The cheapest offer covers the requirements; the more expensive variants offer the opportunity to upsell. This gives companies the crucial opportunity to positively differentiate themselves from the competition.

5. Have the courage to say no. With such prestigious projects, it's easy to put aside your good business sense and give in to price cuts − even knowing that the project costs will exceed the budget. Large clients in particular woo contractors with the promise that the first project will be a door opener to the entire corporate group and that follow-up orders are likely to arise from a successful project conclusion. This is often only a tactic to lower prices. After all, if the first order is subjected to a tender process, the chances are high that further projects (if any occur) will be put through the same process and with similar price pressure. **In the end it's better to lose an order than to ruin your company with overly aggressive prices. Many bankruptcies in the UAE happen precisely for this reason.**

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Cross-Elasticity: A Powerful Way to Improve Your Pricing Decision

Price Elasticity of Demand is not an exact science due to many externalities that are mathematically difficult to model. Fortunately, there are many techniques to help you empower your estimation. The purpose of this article is to give you more hands-on tips to improve your pricing decisions with cross-elasticity. André Koeppl is a Certified Pricing Professional and a Pricing Project Manager at Quantiz Pricing Solutions. He can be reached at ako-eppl@quantiz.com.br.

Tip #1: Estimating Cross-Elasticity

The estimation of cross-elasticity considerably increases the accuracy of your competitive forecasting model. You must have a competitive database containing all your market's main player's prices and your volumes, at least.

Typically, a competitive database can be obtained by different ways:

- Official market information, such as government and sectorial reports
- Market surveys, such as Nielsen
- Collecting your own information, using the sales team
- Conjoint Analysis Research

So, let's remember the cross-elasticity formula:

$$Cross\ elasticity\ of\ A = \frac{\%\Delta Volume\ of\ A}{\%\Delta Price\ of\ B}$$

The formula above measures the impact of the price of the competitor B over the volume of the competitor A. If the cross elasticity is positive, then A and B are substitutes – they compete with each other on prices. If it is negative, then they are complements – they either need each other or one is used with the other. If the cross elasticity is equal to zero, then they are perfectly independent on prices – but that doesn't mean their volumes or shares are not correlated, by reason of other variables than price.

If you have information about the volume of your competitors, you can calculate some interesting measures:

$$Vulnerability\ of\ A = \frac{\%\Delta Volume\ of\ A}{\%\Delta Price\ of\ B}$$

And,

$$Punch\ of\ A = \frac{\%\Delta Volume\ of\ B}{\%\Delta Price\ of\ A}$$

The Price Vulnerability measures the impact of your competitors' prices on your own volumes, while Price Punch measures the opposite: the impact of your prices over your competitors' volumes.

To demonstrate, Figure 1 ranks a set of competitors by Price Vulnerability and evaluates the Price Punch over them.

This type of graphic is very useful tool for supporting strategic decisions, discov-

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Figure 1: Price Punch and Vulnerability Applied for A Brewery

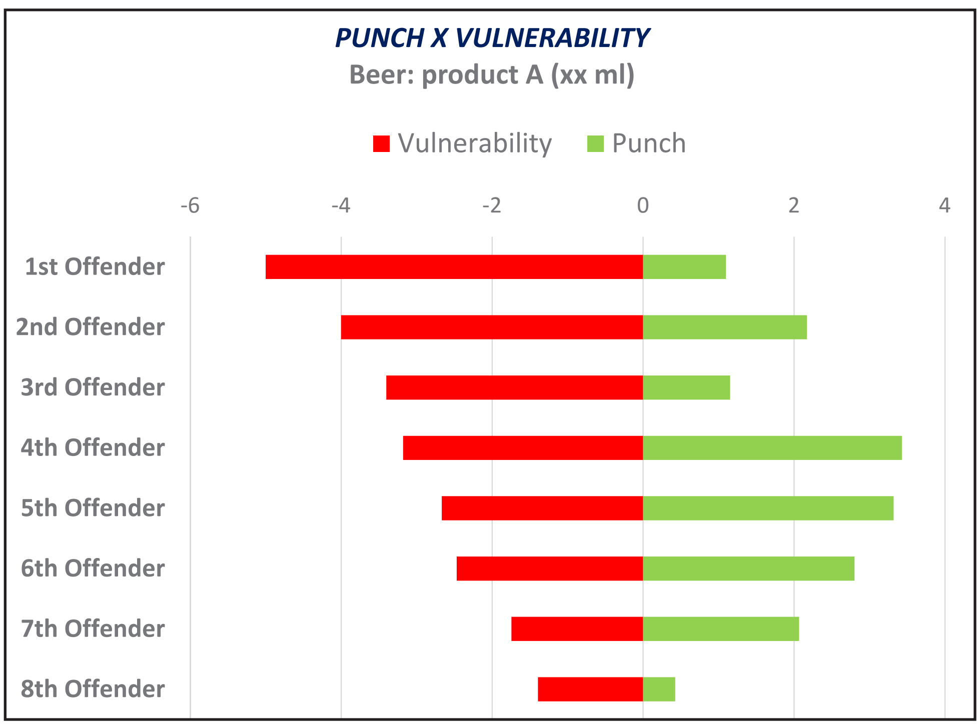

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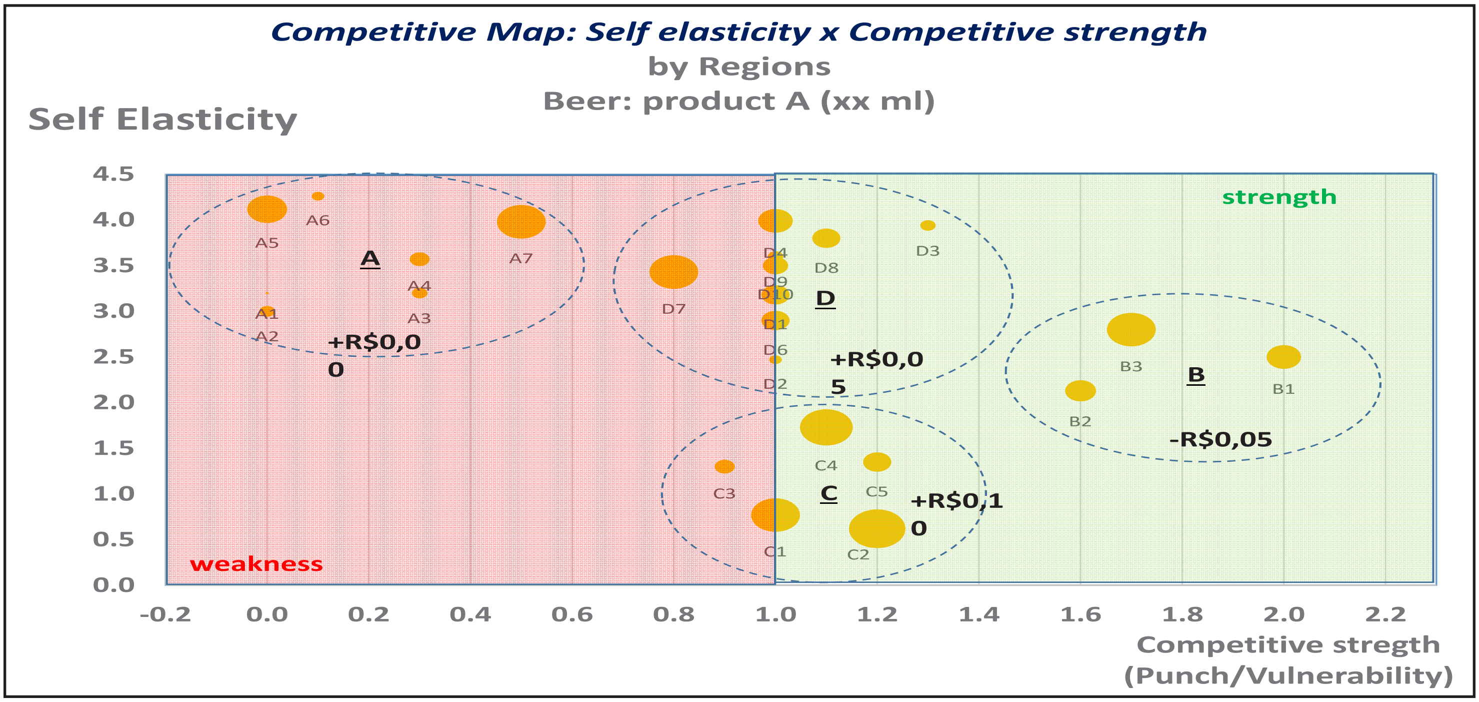
Figure 2: Competitive Map for A Brewery



ering your main offenders, and estimating levels of cannibalization.

Notice that product A is very vulnerable to the first three main offenders, but there's some balance between Price Punch and Vulnerability from the 4th to the 7th offenders. This leads us to a new measure:

$$Competitive\ Strength\ of\ A = \frac{Punch\ of\ A}{Vulnerability\ of\ A}$$

The Competitive Strength is the ratio of the Punch over the Vulnerability. This means that, if it is bigger than one, you can provoke more volume loss than suffer from it, which is very useful to evaluate if a price promotion is worthwhile in a first mover advantage perspective.

If it's less than one, you are more vulnerable than powerful in your pricing actions, so pay attention and follow your competition.

If it's equal to one, the competitive strengths are symmetrically balanced and you probably have to carefully estimate how your competitor will react to your pricing moves.

The example in Figure 2 was used to propose non-linear price positioning by regions, according to the Self-Elasticity of the brand in these regions and the brand's competitive strength. The size of the bubbles indicate the local market share. We have visually clustered the regions into four groups and proposed the price readjustments as shown in Figure 2.

Tip #2: Preparing the database

The cases above are easily applied when you have successfully estimated cross-

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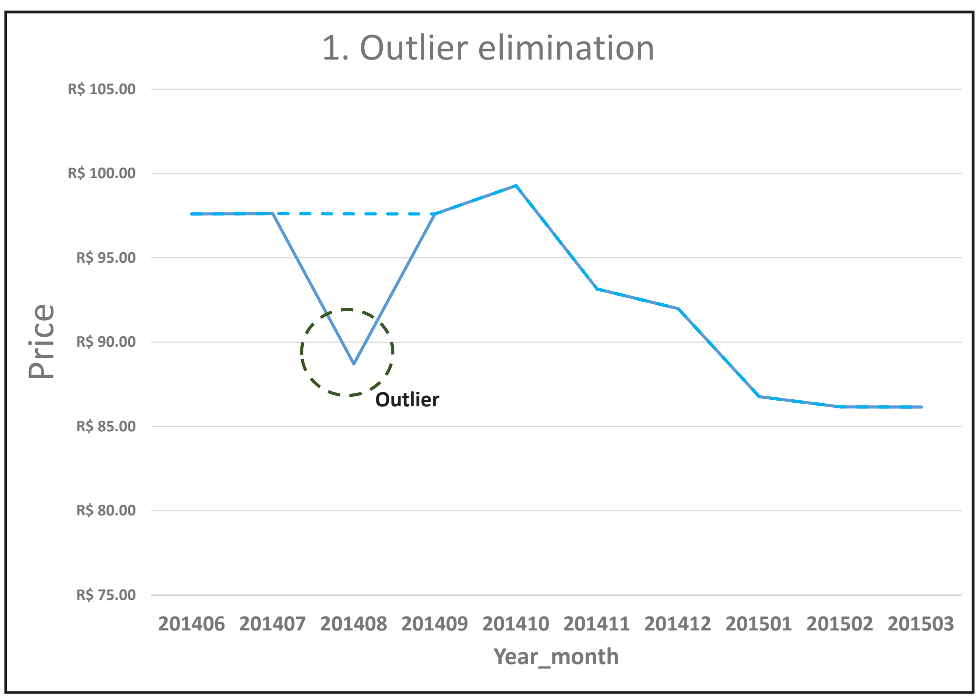
Figure 3: Outlier Elimination



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elasticities with your database. However, oftentimes the cross-elasticity is a multivariate problem, influenced by seasonality and price discontinuities, and polluted by statistical noise and growth trends. Here is some advice to apply in these cases:

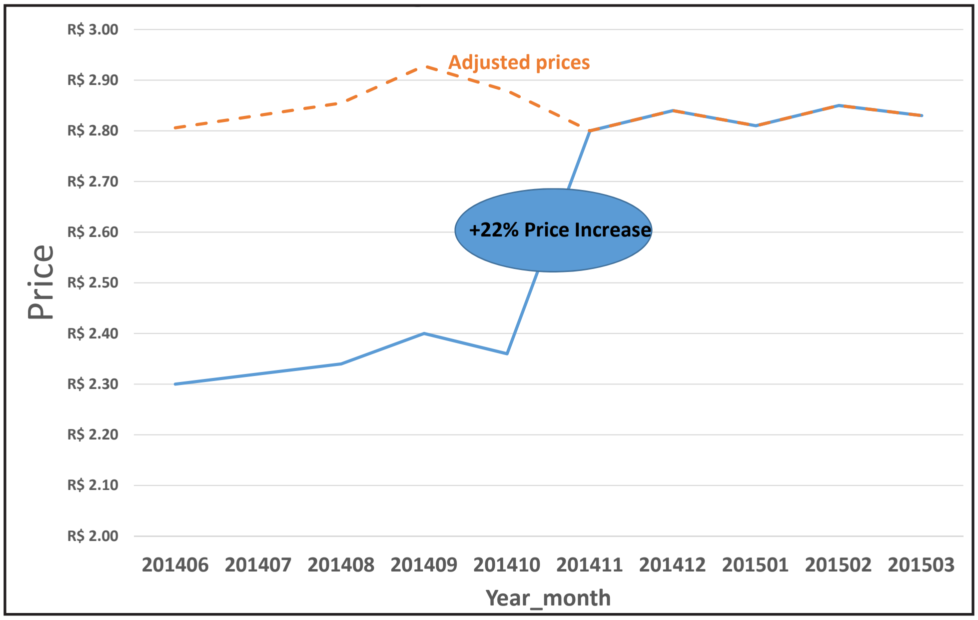
1. Identify and eliminate outliers

2. Check if there's price discontinuity, typically inflation or repositioning price readjustments, then correct it bringing prices to the same baseline

3. Check if there's volume trend and seasonality, then take them out. Sometimes there's more than one kind of seasonality in your data. There are good exponential models that take into account more than one seasonality

4. If your elasticity measure isn't good enough, try working with market share, instead of volume. This can filter some externalities from your model and sometimes works better than the traditional volume models

Figure 4: Correcting Price Discontinuities



5. If the list of the offenders and potential cannibalization products is vast, then run a correlation between price and volume, or shares, in order to select only the offenders whose prices affect your volumes

6. Try to use multivariate regression models when there is more than one main offender and it is not very clear who they are and which are their impacts on your volumes

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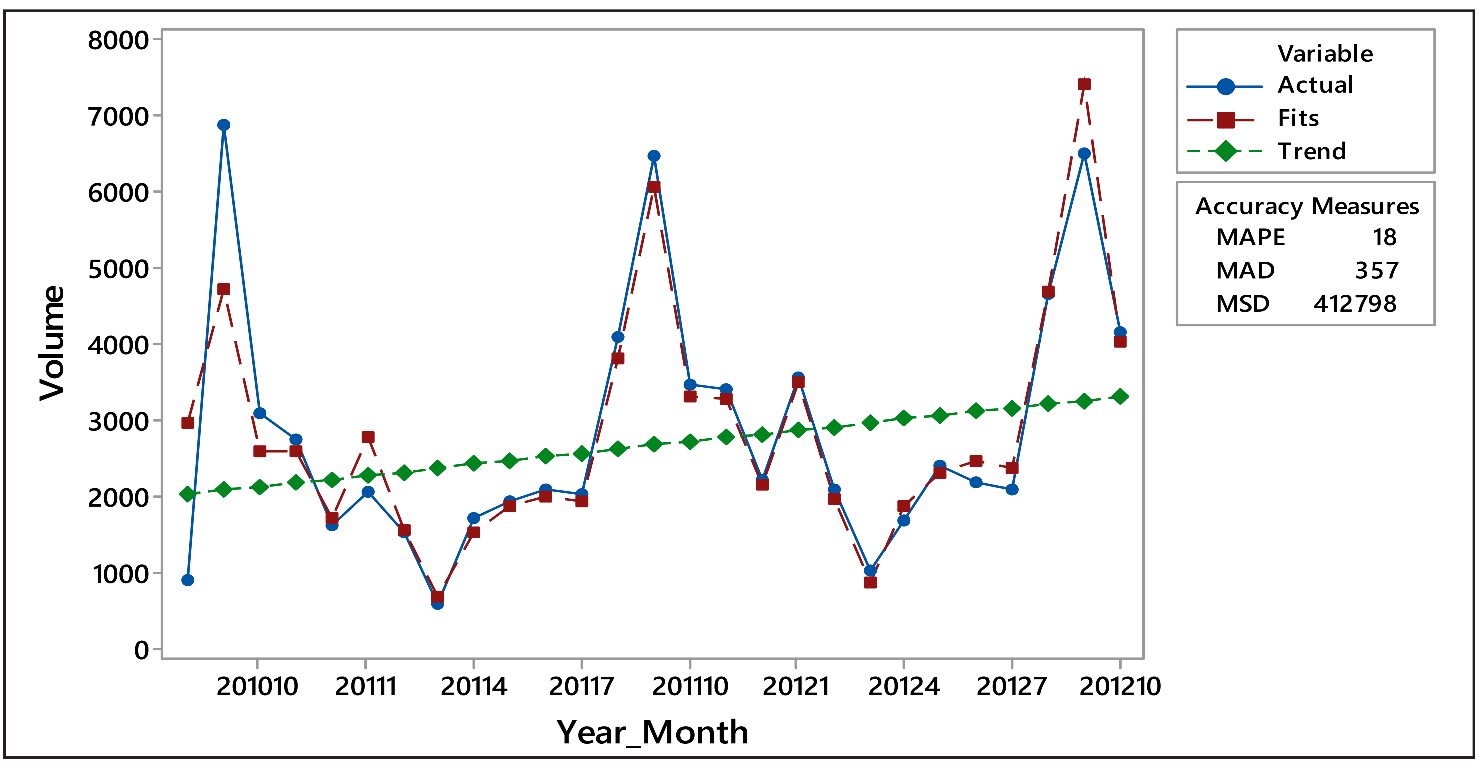
Figure 5: Time Series Decomposition - Taking the Trend and Seasonality Out - Multiplicative Model



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Conclusions

There are numerous analyses you can implement with Price Elasticity. Using databases for analysis is the first step before applying more complex models, like cross-elasticity. The second step is identifying your main competitors.

Once you know your competitors, their strength and vulnerability, you can apply many techniques, such as price regionalization, non-linear positioning, and discount tactics.

You can also create a statistical forecast model to estimate the impacts of your price moves on the market and the impacts of your main competitors as well. I suggest using good statistical tools, as they can save you a lot of time. I hope this article will help you to improve your Pricing Power.

Figure 6: Selecting Offenders by Correlations Price x Market Share

	Share A	Share B	Share C	Share D	Share E
Price A	**-0.64**	-0.70	**0.66**	**0.67**	0.46
Price B	-0.51	**-0.78**	0.52	0.43	**0.59**
Price C	-0.46	-0.82	0.33	0.43	**0.65**
Price D	-0.25	-0.38	**0.46**	0.01	0.26
Price E	-0.34	-0.52	**0.60**	0.28	0.26

- (blue) Correlation price x share of the same competitor
- (yellow) Moderate price x share correlation between different competitors
- (red) High price x share correlation between different competitors

Figure 7: Linear Multivariate Regression Vol. A Vs Price B, C, D & E

```
Coefficients

Term         Coef    SE Coef   T-Value   P-Value    VIF
Constant   0,8838    0,0314     28,11     0,000
B          -1,332     0,107    -12,42     0,000    2,74
C          -1,593     0,155    -10,30     0,000    1,55
D         -0,7070    0,0725     -9,75     0,000    1,80
E         -0,9144    0,0442    -20,70     0,000    1,75


Regression Equation

A = 0,8838 - 1,332 B - 1,593 C - 0,7070 D - 0,9144 E
```

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Does Change Management in Pricing Matter?

Pricing projects are hard to implement. Pricing transformations are even harder. If your organization is stuck in time or unable to embrace large organizational pricing projects, you have to think differently and bring in change experts, as this article explains. Stephan Liozu (www.stephanliozu.com) is Assistant Professor in Management in Strategy at Chatham University in Pittsburgh, PA. He is also the Founder of Value Innoruption Advisors and specializes in disruptive approaches in innovation, pricing and value management. He earned his PhD in Management from Case Western Reserve University and can be reached at sliozu@gmail.com.

The world is changing. Business is changing at the speed of light. Business complexity increases, environmental dynamics evolve, and competitive strategies are continuously reshaped. One thing is for sure: change is the only constant!

"Change is the only constant" - Heraclitus

And the pace of change is accelerating. The field of pricing is not immune to change. New pricing technologies emerge every year and disrupt the way we price products and services (price optimization, dynamic pricing, scientific segmentation, CPQ, multi-channel pricing). Pricing and competitive pressure have definitely intensified since 2009. Pricing professionals are asked to do more with less and increase their level of productivity by quickly adopting some of the latest technologies, methods, and strategies available to them. More and more, pricing professionals have to act as change agents to deploy these pricing innovations and to collaborate with project managers to ensure deployment success. In order to do this, they have to become aware of and proficient in change management techniques as well as understand the importance of change leadership skills.

Change management represents the engine of change. It is composed of techniques, methods, and processes that are used to deploy new pricing resources or to conduct new pricing activities in an organization. Change management deals with the people side of change and ensures that things get done within defined process parameters, agreed upon budgets, and the required timeline. Change leadership is the fuel for this change engine. You can have the best change process you want, but it is change leadership intensity that will make this engine run at the required speed. That includes drive, conviction, and passion so that the organization understands why the change needs to be made. Not many organizations have a dedicated change management team. When this is the case, pricing professionals have to take over the change management responsibilities.

Here are five more considerations that are essential for organizational change:

1. **Change needs to be intentional and focused:** Change management cannot be reactive. It has to be intentionally designed and managed across the organization. Change requires a sense of urgency for doing things differently. It starts with an organizational realization that some pricing issues need to be fixed. It is easier to do when the organization is facing adversity or serious pricing problems. It is less easy to do when an organization is successful. Why should I change when we are doing great? How many times have you heard that?

> You can have the best change process you want, but it is change leadership intensity that will make this engine run at the required speed.

2. **The vision is critical for success:** Vision is critical to driving change. The vision rallies people around a goal and an outcome. This is may be one of the most neglected components of change initiatives. Yet all change management methodologies include a shared vision in their change process. Not many firms have a declared pricing vision. In fact, a 2012 survey we conducted with 557 CEO's showed that only 39% of them had such a pricing vision.

3. **Change management is not project management:** These are two different disciplines. They are often mixed up. You might hear "yes we do change management as part of our

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project" when in fact, business professionals focus solely on the technical aspect of their projects. Project management deals with the technical side of moving from current state to future state. Change management focuses on the people side of that transition. They need equal attention and work hand-in-hand in project teams.

4. **Pay attention to all relevant stakeholders:** A big misconception is that pricing changes only concern pricing teams and sales organizations. Organizational change deals with everyone who touches pricing (finance, supply chain, customer service, etc.) and who interacts with customers (technical support, drivers, sales, etc.). That requires different organizational road mapping exercises: from stakeholder analysis, to what's in it for me analysis, to holistic training plans.

5. **Change requires leadership support:** Our survey indicates that change without capable champions and top leadership support is difficult. Resistance to change might come from the top as well. The role of the top leaders is to identify and make resources available to change agents. They remove roadblocks and tackle bottlenecks.

Change in pricing is about learning and staying on top of the competition.

Pricing projects are hard to implement. Pricing transformations are even harder. If your organization is stuck in time or unable to embrace large organizational pricing projects, you have to think differently and bring in change experts.

Change management is a science and there are amazing training programs out there, providing important insights including:

1) Pricing people understand the need for change but their organization does not offer proper training. In fact, lots of certification workshop attendees conducted change management projects in the past and accumulated good practical experience in the topic.

2) All pricing professionals agree that change management in their organization remains an informal discipline that is not consistently used and deployed.

3) Very often, pricing professionals have to act as project managers and change managers on top of being in charge of pricing content. The reality is that not many firms can afford a full time change management team!

4) Change in pricing is about learning and staying on top of the competition. These pricing professionals quickly realize that all pricing tools, systems, and methods are readily available to all industry players. The key competitive advantage is how you learn to use them and how you embed them into the organizational fabrics.

5) Organizational change in pricing is very different than change at the individual level. While they are very much related, organizational change requires higher level change strategy, more system thinking, and strategic change road mapping.

Change is about survival. It is not optional. As pricing science and tools become adopted more frequently, there is greater need for change management to be included in the overall pricing tool box. So ask yourself this question: Why should your internal pricing consumers adopt your next project or system? What is in it for them? Join the change agent in pricing revolution!