

Building Pricing Sustainability for Competitive Advantage Winning Where it Counts

A few years ago, a major company was lauded by analysts for its savvy pricing strategy. The company had overhauled its pricing practices at the advice of external experts, gaining a healthy margin advantage over its competitors and enjoying a resultant boost to stock price. However, once the consultants left, the company's margin advantage began to slowly erode. A new competitor entered the market, siphoning away several of the company's key accounts. Sales representatives dropped prices for the remaining customers, arguing that it was required to compete. The company introduced new products to stem the tide, only to find that they cannibalized higher margin traditional ones. Efforts to ramp up internal pricing expertise did little to stem the tide – the company's pricing experts quickly found that they lacked the political and organizational clout to implement their recommendations across the company's decentralized global operations. The CEO was beginning to worry that their pricing advantage was gone for good.

Unfortunately, most executives find themselves in a similar situation during the life cycle of a product. Over the last few years, there has been a lot of well-founded enthusiasm about the benefits of pricing, and companies are listening. As word has spread, more companies are using rigorous data analysis to set prices at product introduction. An increasing number of forward-thinking companies are conducting periodic product-by-product or portfolio-wide pricing reviews. However, less well known is that, as powerful as these strategies are, their benefits begin to erode at the very moment prices are set.

The power of pricing to drive revenue, profitability, and shareholder value is dependent on an increasingly complex and nuanced interplay of customer decision-making, market conditions, and competitor positioning. Because these variables are constantly shifting, and their

relationships vary widely across markets, static or formulaic pricing decisions may quickly become out of step with the marketplace. The result: money is left on the table.

We believe companies with the ability to read and react to these nuances are those that can extract the greatest value as the markets, competitors, and customers evolve. Pricing sustainability is the internal capacity to continuously adapt pricing strategies to the changing marketplace, and the organizational integration to execute against these changing strategies. According to a joint survey conducted by the Professional Pricing Society and Zilliant, 30% of respondents viewed the biggest challenge to overall pricing effectiveness as the related analysis and ongoing price planning.¹ This ability to analyze effectiveness and determine the next steps that sustain pricing is a rare competency. Because so few have mastered it, companies that cultivate pricing sustainability have a distinct competitive advantage. This type of flexibility requires an integrated system of technology, human know-how, and processes to capture and analyze the right data, make rapid pricing decisions, and execute across the organization.



Pricing sustainability is the new differentiator

We have observed that companies who have embraced pricing sustainability have reaped the benefits:

- **Winning in the marketplace.** By developing an internal competency for continually assessing pricing and the organizational alignment to execute pricing decisions, companies that master pricing sustainability are more agile. They are able to adapt to changing market dynamics more quickly than their competitors and, as a result, they win new customers or increase overall share of wallet from their existing customers.
- **Winning where it counts.** Pricing sustainability allows companies to identify which products and customers are most profitable, and continuously adjust pricing strategies to changing customer tastes and cost structures. The result is that companies who have mastered pricing sustainability capture value from their most profitable customers and products, and keep more of it. Almost half of survey respondents across over one hundred companies indicated a payback period of one year or less for such pricing management projects.²
- **Winning on Wall Street.** Independent research commissioned by Deloitte showed that companies investing in pricing transformation strategies saw stock price increases of up to 30 percent within 12 months and 42 percent after 15 months.³ While this increase is no doubt due in part to the quantifiable impact that pricing has on the first three drivers of shareholder value – revenue, profitability, and asset efficiency – the greater driver of continued growth is the boost to shareholder expectations. The continued growth in share price is the market’s vote of confidence that these companies have the ability to sustain their pricing advantage over time.

Building sustainable pricing

Why are so few organizations able to differentiate themselves through pricing sustainability? Most organizations rightfully recognize the importance of access to detailed data and the challenge of making sure the right data is available. However, the most common points

of failure in implementing pricing sustainability are the human and cultural elements. Conflicting objectives and a misaligned organizational structure can derail pricing efforts to an equal extent as limited data analytics capabilities.

Figure 1: Critical Success Factors for Pricing Transformation



1. **Evaluate Pricing Maturity.** Evaluate pricing maturity and define the organization’s end goal in terms of maturity. Establish short and long-term measures of pricing success.
2. **Create a Compelling Shared Vision.** Articulate a compelling, shared vision and business imperative for pricing transformation.
3. **Stakeholder and Leadership Alignment.** Recruit leaders with authority, power, and influence to visibly support and lead the change.
4. **Communications & Engagement.** Actively engage employees as pricing transformation advocates by providing timely, complete, and consistent information.
5. **Pricing Organization Structure.** Design organizational structures, performance metrics and resources, to support pricing transformation and reinforce new behaviors.
6. **Manage Pricing Talent.** Recognize pricing resources as a critical workforce segment that is strategically managed. Equip employees with the skills and tools to execute the pricing strategy.

² "Building a Bulletproof Business Case for Pricing Improvement Initiatives," AMR Research, August 15, 2008.

³ "Price Optimization Conclusions," Cleveland Research Company, May 2007.

For example, how do you execute a sustainable pricing strategy if:

- Incentives remain static as the relevant pricing metrics evolve with market dynamics?
- Employees do not receive the practical training necessary to perform in line with departmental goals?
- Leadership does not consistently apply pricing discipline across all related functions of the enterprise?
- Organizational structure, roles, and responsibilities are not aligned to maximize pricing return on investment (ROI)?

The reality is that a business cannot successfully sustain a pricing strategy if any of the above scenarios exist within the organization. Given the need to overcome resistance to change and sustain organizational capacity for pricing transformation, the two most critical requirements for building pricing sustainability are 1) Leveraging power and politics and 2) Building a pricing organization.

- **Leveraging Power & Politics.** Changing the way that your organization sets and evaluates pricing can be a lot like stepping on a bee hive. The required operational and ownership changes stir up a swarm of anxiety, resistance to change, and protectionism. Business unit or regional managers withhold data. Salespeople lobby against changes in incentive structures and look for loopholes in pricing guidelines. The finance and marketing departments each argue that they own pricing. Without an engaged and empowered leadership, pricing transformation efforts can quickly become distracted by delay tactics, obstructionism, and infighting.

Leveraging power and politics through engaged and empowered leadership can enable a company to create a sense of urgency, solidify a company's culture, and overcome the resistance to change in order to drive a sustainable pricing transformation. An executive driven mandate to adopt sustainable pricing is the cornerstone of gaining a competitive pricing advantage. Executive level leadership plays a critical role in focusing the organization on the inherent power of pricing to improve margins and drive profitable growth. They can provide a cross-organization strategic perspective on which customers are most valuable, which should be targeted for premiums, and where minimizing cost to serve is paramount. Perhaps most importantly, they can

hold their organizations accountable for implementing pricing changes and controlling leakages, and provide air cover for functional area owners to make unpopular but necessary changes. If there is not yet executive ownership for pricing sustainability in your organization, the first step is making the case for a CXO level champion. Make your case by clearly articulating that pricing is the single most powerful lever for performance improvement, and show back up data on where pricing benefit has eroded.

An equally important step is to identify mid-level executives that will act as agents of change to implement the pricing transformation objectives. These are the people that will truly make things happen if given air cover from above. The tasks for these change agents may include leading pricing initiative project teams, managing the day-to-day pricing transformation activities, and motivating employees to drive results.

- **Building a Pricing Organization.** Capturing the value exposed by data intelligence requires more than a pricing strategy; it requires alignment across the organization to systematically capture value through each stage of the value chain. From our experience, responsibility for pricing strategy and execution are usually diffused across the organization, and often across the globe. Aligning pricing strategy across functions, and linking execution to pricing strategy, is dependent on an effective pricing infrastructure – an actual or virtual organization with the responsibility to compile and analyze data, make pricing decisions, and enforce execution of these key pricing organizational decisions. Building a pricing organization provides a foundation to deliver the full potential of pricing process, people, and technological capabilities. The two key considerations for developing a strong pricing organization are:

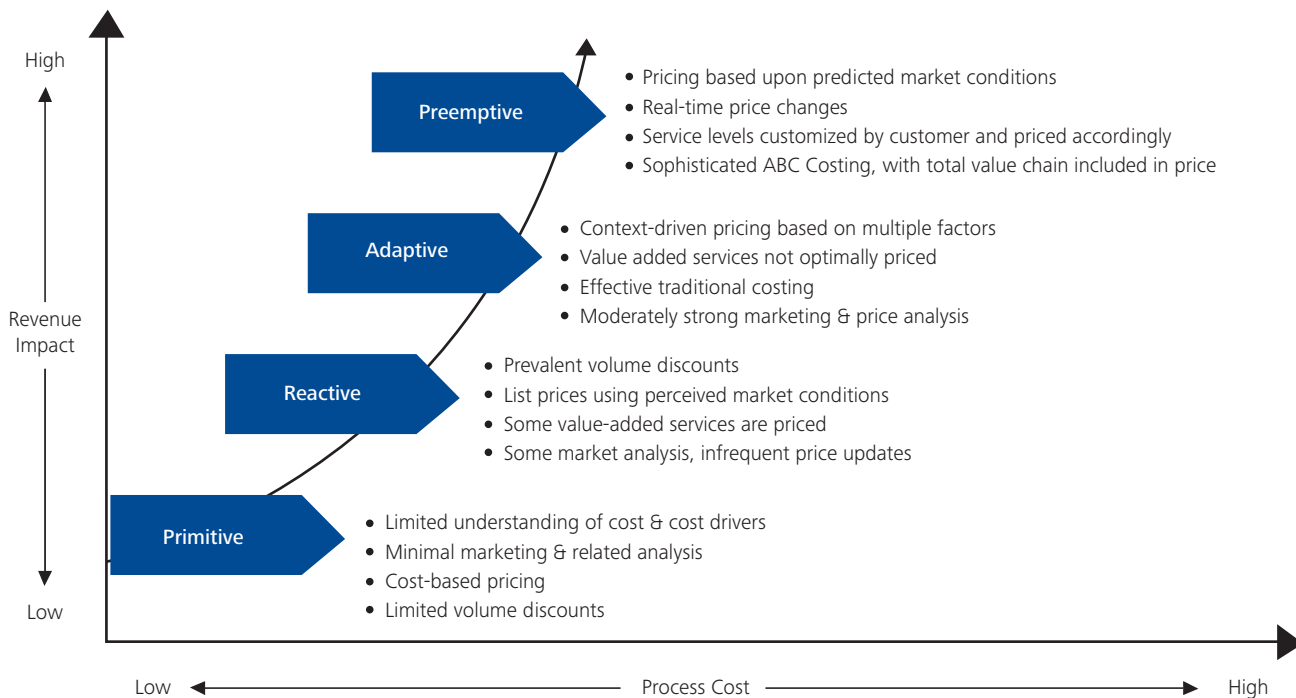
- **Roles and Responsibilities.** A carefully constructed pricing organization ensures that pricing responsibilities are clearly communicated, logically assigned, and efficiently executed through clear ownership and accountability. First, responsibilities are analyzed and grouped into specific roles, and then mapped to specific positions, job descriptions, and ultimately to the appropriate employees.

– **Centralized vs. Decentralized Pricing Organization.**

When designing a pricing organization, it is also important to consider the appropriate governance and reporting structures that best fit your strategic objectives and operating model. Pricing functionality can have varying degrees of centralization, depending on the business environment as well as the relationship between the corporate and field sales organizations with respect to the ownership of pricing decisions. For example, field sales contends that pricing decisions may require business-specific and on-the-spot interpretation to make a sale, thus making the case for a decentralized pricing organization. On the other hand, a corporate office asserts that pricing analytics, pricing policies, and price setting are necessary to achieve sales margin objectives, which lends itself to a more centralized pricing organization. So what is the right answer? Ideally, different organization structures should be blended to balance the levels of control and flexibility for an effective pricing function. A good first step is to

determine a suitable level of autonomy for the field sales organization for adjusting price levels at the point of sale. Centralizing pricing analytics arms an organization with deep insight into price setting and margins to create strategic price bands. This depth of insight not only helps to achieve financial objectives, but also allows field sales staff to continually meet sales targets, providing them with transparent price levels and margin impacts while maintaining their strategic ability to negotiate prices and deliver quality customer service. In fact, a survey of companies that recently implemented pricing management initiatives found that 54 percent of those surveyed centralized their pricing organization to facilitate the success of pricing management⁴. Communicating this message – and working collaboratively with field sales leaders to determine the best blend of autonomy and decision rights – is an effective approach to gain buy-in and migrate the sales force to the appropriate pricing organization model.

Figure 2: Illustrative Characteristics of the Four Pricing Maturity Phases



⁴ "Building a Bulletproof Business Case for Pricing Improvement Initiatives," AMR Research, August 15, 2008.

Getting it Done

For companies with less sophisticated or ad hoc pricing decision-making, the starting point is a traditional pricing execution project⁵. A typical pricing execution project is short in duration, providing a low-risk way to expose key stakeholders to the significant benefits that pricing can deliver. Each pricing execution project is tailored to the company's desired end goal with respect to pricing maturity. Pricing maturity is defined through four key phases as shown in Figure 2.

Attempting to quickly adapt the effective practices of a highly mature, or preemptive, stage of pricing maturity may not be the most cost effective and immediate solution for every organization. Determining an appropriate maturity level depends upon both company-specific market demands and the company's ability to adapt. Clarifying organizational goals using a pricing maturity model can support important discussions regarding short, medium, and long-term strategic objectives.

Regardless of the pricing maturity level selected, pricing execution projects can quickly deliver tangible results in both top line and bottom line improvements. Leadership and other stakeholder interest in the power of pricing also develops along the way. And because pricing execution projects involve stakeholders across the entire organization – Management, Marketing, Sales, Operations, Finance, Information Technology, and others – all the key players become aware and aligned to the pricing objectives at hand.

Developing the capacity to continually adapt pricing strategies and execution to changing market conditions is challenging at best. The good news is that any company can begin to build the competency for sustainable pricing. Pricing sustainability is not an “all or nothing” proposition. Companies can incrementally develop the tools, processes, and knowledge management to improve pricing optimization, execution, and enforcement. For those companies that adopt this incremental and continuous pricing improvement approach, pricing sustainability can be a powerful source of competitive advantage.

So, what happened to the CEO who faced the challenge of new competition and eroding margins? She realized that it was time to develop a strong, centralized pricing organization with the leverage to coordinate pricing decisions across the company's diverse portfolio and global operations. She charged the CMO with developing an enterprise-wide plan to improve the company's pricing execution, stressing the importance of cross-organizational alignment to the rest of her executive team. The company initiated an intensive, two-month assessment of its current pricing practices to identify points of failure in price setting and execution. The CMO then worked with his teams to develop a detailed plan to centralize the company's far-flung pricing analytics capabilities, redefine disparate roles and responsibilities, and align incentives across the organization to effective pricing execution. The result of the company's emphasis on pricing discipline: an immediate one percent margin improvement, with an additional three percent the following year. Perhaps more importantly, the company now has the internal competency to continually adapt its pricing strategy to changing market dynamics and sustain its pricing advantage over the long-term.

⁵ Price execution projects are used to uncover areas of margin leakage between the list price and the “pocket price,” or price that the customer actually pays.

www.deloitte.com/us/pricing
usdeloittepricing@deloitte.com

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