



Analyze This

Take the Chaos Out of Pricing

It is possible to take price management from disparate to optimized

By Laura Preslan

Monday, November 15, 2004

When asked the simple question, "How do you price deals?" salespeople respond with a look of terror that turns into a sheepish story involving inaccurate, ignored price lists and spreadsheets. Ultimately they drop prices to where the deal is no longer profitable. Across all industries pricing managers and CFOs admit that their firms leave between 1 percent and 5 percent of margin on the table.

It does not have to be this way. Adding even 1 percent of margin back into the equation increases earnings by as much as 20 percent. The way to get that margin back is through price management.

Price management is a combination of optimization (the process through which prices are determined), execution (the process through which prices are delivered and communicated to salespeople and buyers), and enforcement (the processes and tools that support deal negotiation and contract compliance).

Moving from the chaos of today's pricing processes to a disciplined, repeatable approach requires an investment in all three areas of price management (optimization, execution, enforcement).

The first step is to create a price strategy that documents the type of pricing that a company executes. It requires knowing:

- whether the company will be a price taker or a price maker;
- what the discount strategy will be;
- how customer segmentation changes pricing;
- what approval levels exist for pricing decisions;
- what the target profitability is;
- whether the company will sell unprofitable business;
- whether volume and revenue are more important than profit and earnings.

Once the price strategy is documented the remaining decisions become much easier to make, because they are tied to the strategy.

Most companies that achieve price management success start with homegrown systems as training wheels before they purchase and implement a packaged application to support their pricing strategy. Homegrown systems help implement process changes in a proof-of-concept, but to scale across multiple divisions, packaged software is usually required.

Use low-hanging fruit to develop momentum. For example, analyze the price index (the price paid divided by the list price) within a region to find anomalies. If this varies widely within the region, find the salespeople who are below the average and help them raise the price.

One way to do so is to realign incentives. Once a balance has been reached between revenue (volume) and profitability, best-practice companies look at the percentage of variable compensation. Companies that change sales incentive structures to include margin and volume will win the long-term price management war.

AMR research surveys have found that an average of 70 percent of revenue moves through price request approval workflow on an annual basis. Most companies were horrified at this number when they performed the analysis.

Fixing the target price issue addresses half of this problem; to fix the other half, provide decision support tools to help salespeople make better pricing decisions.

Price management is the last lever to pull to impact revenue and margin significantly, but be careful about pulling it. For every company that AMR Research surveys about price management initiatives, two others are struggling to make projects successful, because they did not document a strategy, could not make the requisite business process changes, or did not integrate technology properly. Companies that are prepared to make fundamental business process changes succeed. Companies that are not willing or able to make these changes fail.

Laura Preslan is the research director for AMR Research's CRM practice