



 [Print this document](#)

The Price Is Right

By Beth Stackpole

Posted on Tuesday, February 28, 2006 11:23:21 AM EST

Talk about a pendulum shift. In the 1990s, it was all about rampant revenue growth. Then as the economy took a dive in the early part of this decade, manufacturers regrouped and put their energies into cost containment. With industrial growth now making a moderate resurgence, manufacturers are refocusing their efforts once again. This time, the emphasis is on growth, but with an eye toward profitability.

Increasing sales, lowering costs, or squeezing suppliers can do only so much to pad the bottom line, however. That's why a number of cutting-edge manufacturers are endeavoring to get smarter about how they price their products. Armed with new end-to-end business processes and an emerging class of software -- dubbed price management -- manufacturers of all types are starting to gauge the price elasticity for their products, discover and analyze price leakages, and enforce and manage pricing policies with the goal of becoming more adept at contracts and negotiations.

Investing in new price management processes and technology can deliver dramatic, quantifiable results in fairly short order, meaning a matter of months, not years. Financial executives across all industries admit that they routinely leave between 1% and 5% of margin on the table because when pricing products they often lack visibility into such factors as volume terms and raw material costs, and because they have no way to enforce standard pricing practices. By identifying and then eliminating unprofitable business, manufacturers can bolster the bottom line. For example, inserting just 1% of margin back into the equation can increase a manufacturer's earnings by as much as 20%, notes Colin Masson, AMR's research director for supply network operations.

"If, at the end of the day, sales people or customer representatives are giving away margin in the form of discounts and rebates or taking orders for custom specs that can't be manufactured efficiently, there's a problem," Masson explains. "This category is about bringing that under control."

Price management software aims for control by creating end-to-end processes and putting visibility around pricing so that everyone -- from sales reps to logistics and operations managers -- is on the same page. Today, setting prices and negotiating and enforcing against those price points is done mostly in an ad-hoc manner, typically with spreadsheets and email. And while many functions in a typical manufacturing enterprise have an impact on pricing -- including sales, logistics, manufacturing, and procurement -- these groups often operate in vacuums when it comes to pricing products because, experts say, there's often no system or process in place for sharing price-related information.

"In manufacturing, nine times out of 10, the price that gets set for a particular product or deal is not a list price, but rather a custom price that reflects the fact there are multiple exceptions that exist for that deal with that particular customer for a specific product on a particular day," explains Eric Hills, vice president of marketing for price-management software provider [Zilliant](#) (Austin, TX). "These prices are maintained by sales reps and their assistants in a very distributed, uncontrolled fashion. When things in the marketplace change or cost drivers in a product change, it's difficult to figure out how to pass those costs on in a systematic way."

Price management initiatives often require significant change management and reengineering efforts. Manufacturers will need to map out their business processes and create workflows around pricing, and they'll have to do so with a multidisciplinary view so that all the disparate factors impacting price are accounted for in the process. Reengineering involves creating standard pricing processes so important information is shared beyond individual functional groups, changing incentive policies in order to encourage sales people to price products using the right processes and information and aligning metrics and incentives across functions so that everyone is on the same pricing page.

"Price management faces a lot of the same challenges as early ERP," Masson says. "Companies will have to go about reengineering, but in most cases, the process is broken so it's really an engineering process for price management."

The Science of Pricing

Price management software, meanwhile, is still a long way from mainstream. Currently, a handful of niche players, including [Zilliant Inc.](#) and [Metreo Inc.](#) and [Vendavo Inc.](#), both of Palo Alto, CA, are offering solutions. But the software is in use at less than 3% of manufacturers, according to a survey by AMR Research Inc. (Boston).

Price management's relative obscurity may be about to change, however. Software giant [SAP AG](#) (Walldorf, Germany) has drawn attention to the category by cementing a partnership to sell and support [Vendavo's](#) price management offering as part of [SAP's](#) enterprise application suite. AMR and other industry watchers see a big opportunity here for both vendors and customers, projecting a 45% annual growth rate for the category over the next five years.

Price management software can be broken down into three spectrums of functionality: Price execution, or the processes through which prices are delivered and communicated to salespeople and buyers, is an area ERP vendors have embraced over the last few years -- many adding these capabilities into their software suites. Price optimization, the processes through which prices are determined, and price enforcement, the tools and workflows that support deal negotiation and contract compliance, are the newer capabilities and the terrain staked out by the best-of-breed software companies.

Price optimization has roots in the business-to-consumer world, where the model has been deployed successfully in the airline and hotel industries. Tools in this space leverage business intelligence and algorithms to interpret information around cost, market position, price elasticity, customer segments, and competitive data, and to understand demand and determine the best prices for a given product at a specific time. Price optimization, Masson contends, is best suited for specific industries -- for example, high tech and electronics or consumer products -- as well as for particular price-sensitive products.

[Zilliant](#), which works in this space, says it offers technology historically found in the consumer space to manufacturing companies, which typically lack the rich set of transactional data around pricing that is needed to do optimization. "We've developed technology that allows us to provide the best recommendations with a given amount of transactional data from CRM or ERP systems," Hills explains.

Price enforcement, the third subset of the category, is where entrants like [Metreo](#) and [Vendavo](#) operate and where [SAP](#) believes the lion's share of manufacturers struggle. The deal with [Vendavo](#), which uses [SAP's](#) NetWeaver services-oriented middleware in its solution, will help create an end-to-end process around pricing and compliance, says Chris Rooney, [SAP's](#) CRM business development principal. "This will be a major process for manufacturers to adopt, just like demand planning," he says. "In the next two to three years, manufacturers will have to have something like this in place."

The centerpiece of the [Vendavo](#) tool and others like it is the "price waterfall," a methodology created by McKinsey & Co. to define all the parameters affecting price, including the processes companies use to price their products. Price enforcement tools attempt to create a closed-loop

process so salespeople and other individuals don't negotiate away margin or step out of compliance with contracts.

"By creating a price waterfall with multiple inputs, you're trying to come out with one process that establishes upfront what you want to accomplish and what you're willing to do -- essentially putting all the policies into one system," says Rafael Gonzalez Caloni, vice president of marketing for Vendavo. "Today, that's basically in people's heads or in email. With no one to keep everything systemized, you end up having an exception pricing process, not a standard process."

Pay It Forward

At the \$4 billion Hexion Specialty Chemicals Inc. (Columbus, OH), the goal was to create an end-to-end business process around pricing to create visibility and ease the administrative burden. The company, which makes thermoset resins, was dealing with volatile raw materials costs and pricing practices that too often left money on the table. Using [Vendavo's](#) price waterfall paradigm, Hexion was able to understand all of the items that related to pricing -- things like freight costs or points related to pre-payments -- and define the appropriate policies to ward off leakages in those areas.

Creating the end-to-end business process around pricing also eased Hexion's tremendous administrative burden associated with adjusting prices relative to raw materials costs, and provided some discipline to help meet its compliance burden. "It's a costly system, but we have seen quick payback because we're dealing with the top line," says Dean Meyer, director of IT strategy and design. Meyer says Hexion has successfully identified and stopped many of the price leakages and can use the information to better structure new deals and the terms of existing contracts when they're up for renegotiation.

Just over a year into its implementation, one well-known manufacturer is seeing far more dramatic results. The company, which requested anonymity because of the sensitivity of pricing to its competitive edge, made a six-figure investment in price management software from Metreo, but already is measuring its return in "nine figures," according to a director-level executive at the firm. Price enforcement and pricing analytics have helped the manufacturer determine where money is being left on the table, and price optimization has led to a better understanding of what's important to customers -- benefits that have led to more profitable pricing. "Imagine two different deals that create the same value for the customer, but one loses money for us and one creates money for us -- this gives us a much better idea of what product to push," the director explains.

Analytics also delivered significant value to one large industrial manufacturer in the Southeast U.S., which also requested anonymity. The company applied analytics to identify problem areas in need of process change. Using the [Zilliant](#) offering, the company's officials were able to take a retrospective view around profitability. What they found was a trend toward maverick discounting, in part because the company had no formal procedures in place, according to a senior pricing manager. They also determined that profits were hurt because employees didn't adhere to an existing process around the handling of returns.

The [Zilliant](#) software identified the opportunities for making process changes and then supplied the back-end analytical capabilities to measure the results once changes were enacted. In the two years since the pricing analytics software was deployed, the company has made changes that effected savings of between \$60 million and \$70 million, resulting in a 6% to 10% margin lift. Phase two of the project involves using [Zilliant's](#) price optimization capabilities to set prices to drive profitable growth and eventually to deploy price enforcement tools.

"It wasn't like we identified an area, pushed a button, and automatically had enforcement," the pricing manager explains. "But without a system, we couldn't systematically enforce the rules, process policies, and structural changes we made."

 [Print this document](#)

