

Manufacturing Business Technology

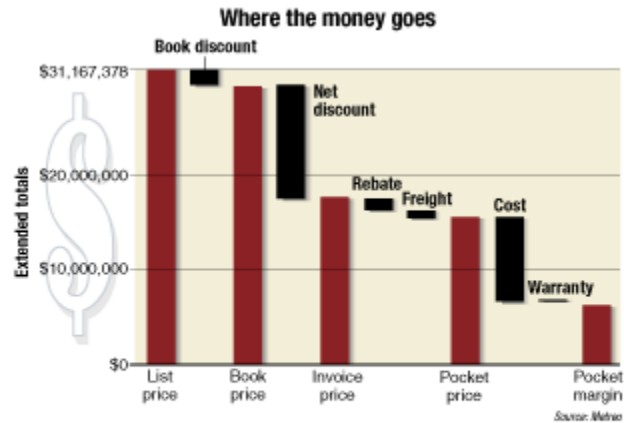
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The price is right

Airlines and hotels have done it for years; now manufacturers are discovering the benefits of optimized pricing

By Nancy Bartels

Experts say companies lose as much as 10 percent of their operating profit because they don't have the market and customer insight needed to use pricing to their best competitive advantage.



This "waterfall" chart gives a hypothetical example of what factors account for the difference between list price and "pocket" price—what a company actually gets—for its products. Visibility into these elements helps companies price their products more profitably.

Laura Preslan, an analyst with New York-based consultancy **Deloitte**, says price optimization software applies complex algorithms and econometrics to customer, sales, and product data to arrive at "what the price should be for a particular customer at a particular time."

To do so, price-optimization solutions typically gather data from enterprise resources planning (ERP); customer relationship management (CRM); and product life-cycle management (PLM) systems; analyze the resulting aggregation; and suggest possible pricing scenarios.

Applications segment customer data by characteristics such as geography and spending patterns, and product data by stock keeping units, product attributes, and location. Users gain insight to the value of their product portfolios at a given moment in time—as well as the total cost to serve customers, and what customers are willing to pay for their products.

"Some optimization software does segmentation to show companies what people have paid for a product historically, but that may not be the right price going forward," says Curt Lockton, VP of marketing for price optimization vendor **Rapt**. "You have to combine product attributes, life cycles, competitive data, and market dynamics to understand what people will pay for a product in the future."

Hotels—and most especially airlines—have optimized pricing for years, but only recently have manufacturers taken an interest.

One reason is that the manufacturing pricing environment is even more complex than travel or retail, where "it's relatively straightforward to use price to influence consumer behavior," says Rafael Gonzalez Caloni, VP of marketing for pricing software vendor **Vendavo**. "In manufacturing, lots of people have a say. The CEO and CFO want margin increase. The sales department has quotas to meet. Customers demand negotiated prices. Then you have the distribution channels—the wholesalers, the value-added resellers—and rebates, discounts, and other incentives."

Furthermore, says Deloitte's Preslan, "Only in the last four or five years have solutions been available. Until then, there were no manufacturing-based systems except spreadsheets."

Profits and beyond

Pricing optimization should "allow users to maximize the profitability of every transaction," says Preslan, "and profitability is grown one transaction at a time—especially in manufacturing. You might have 30 contracts a year for 15 or 20 years. One mistake can put you in trouble for a long time."

Pricing optimization's benefits include getting added value from all the data gathered in ERP and CRM systems. "Pricing is where supply meets demand," says Preslan. "It's a lens through which to view the other systems. For example, what are the tangible benefits of CRM? Until you look at it through the view of pricing, you don't know if you are getting the price you wanted in the market."

This also is the case for product-related data. "We can look at a line of, for example, MP3 players, and determine which one will sell the most based on product attributes," says Rapt's Lockton, "or we can work backward. If you have the price point, we can tell you what product will sell for that price. And many companies use us to derive the correct price at a given point in a product's life cycle."

Paul Loftus, North American managing partner for New York-based **Accenture's** industrial products practice, says, "Once a company has a fact-based understanding of its products, a lot of thought-provoking questions arise," he says. "For example, for low-cost commodity items, a company might want to do contract manufacturing and keep the brand, but you can't begin to make such decisions without the pricing information."

Not the whole picture

The term *optimization* implies attaining the best possible price at any moment in time, but it's not the case that the goal is always to get the optimal price from every transaction.

"You need to think about price setting and optimization in a much broader context," says Caloni. "You have to develop price lists and terms that you offer to customer segments. Then you have to establish negotiation guidelines, and all that has to be executed on the front lines. If you don't execute optimally at the point of sale, whatever you did upstream is academic."

Pricing vendors referenced in this article	
Metreo:	Dynamic price analysis functionality via Symphony Technology Group acquisition
PROS:	Strong data-integration and price-analytics expertise
Rapt:	Focus on price optimization rather than analytics or execution, with manufacturing customers in consumer goods and electronics, and optimization performed from product attributes and product life-cycle data
Servigistics:	Price management specifically for service parts
Vendavo:	Focus on analytics and execution; customers in chemical, high-tech, industrial, mill products
Zilliant:	Focus on negotiated-price environments

That broader context is revealed through pricing analytics, and policy and procedure execution modules, says Steve Haskin, group VP at price-optimization vendor **PROS**. "Typically, manufacturers don't buy optimization first, or by itself. It is usually part of a larger software suite that addresses a variety of issues surrounding pricing."

Analytics enable visibility into past pricing decisions, says Haskin. "Users can see what customers are costing them money, what territories or sales representatives are performing poorly. Once companies know those things, they can make strategic decisions about prices," he says.

Vendavo's Caloni tells of a large global manufacturer that discovered, through pricing analytics, more than 20 percent of its transactions were money losers because of special terms, discounting, and rebates. "They didn't know about it because they didn't have the visibility."

Better visibility about past deals also makes for better negotiations. "Pricing information reduces opacity," says Caloni. "One of our clients claims—thanks to the information in the pricing system—their conversations with customers were the most intelligent they ever had because the sales staff had all the necessary information," say Caloni.

Enterprise pricing suites also contain execution applications that enforce policies and procedures around deal-making and pricing. These less glamorous applications often deliver the quickest early wins, suggests John Hagerty, VP for Boston-based **AMR Research**, "A combination of simple reporting tools and a streamlined pricing process delivers 80 percent of the price-optimization benefit in commoditized industries," he says.

PROS' Haskin argues that an integrated solution—with execution, analytical, and optimization functionality—offers consistently the highest return-on-investment. "We see numbers anywhere from a 2-percent to 8-percent revenue increase. A billion-dollar company can see between \$20 million and \$80 million in increased profit," he says.

Says Deloitte's Preslan, "The immediate short-term gain comes from stopping the counterproductive processes, such as giving a huge discount to an unprofitable customer. Long-term benefits come from the incremental gains you get from optimization."

Early trends

Pricing optimization remains an emerging market—one with solutions still found primarily in global corporations. The systems are expensive, and integration with other enterprise systems and the required data cleansing is a challenging, multiyear project.

While names such as Emerson, Honeywell, Sun, Hewlett-Packard, Seagate, Owens-Corning, Grainger, Eastman Chemical, Georgia-Pacific, and British Petroleum appear on vendor customer lists, users remain reluctant to discuss the details. Vendors say the reason is that the competitive advantage—and the increased profitability—is too good to share.

At present, the market is in the hands of a few best-of-breed vendors. Because pricing practices and standard operating procedures differ so much from industry to industry, companies have to look at what solutions fit their situation best. For example, "Price enforcement is a big pain for many companies," observes AMR's Hagerty, "but in high-tech, with its short product shelf life, you have to get the price right first and then worry about enforcement."

Pricing software as an application likely will follow the same evolutionary path as other enterprise systems. "Given the specialized nature of pricing software, it may tend to stay vertical, but, having said that, we are always looking to generalize its capabilities," says Eric Hills, VP of marketing for pricing suite vendor **Zilliant**. "Over time, broad industry-to-industry differences could be accommodated on a layer on top of the code. It's reasonable that our software could be used in any business-to-business environment where there is negotiated selling."

At some point, pricing solutions will be available to the midmarket. "The real roadblock is getting an out-of-the-box solution that can be deployed in the scope of a midmarket budget," says Hill. "Our vision is that we can ship the CD, and you can load it on the computer and go."

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