The Margin^2 Pricing Partnership at CREAM – White Paper

The Pricing Journey – The Evolution of Approach and Execution as Organisational Pricing Capability Develops

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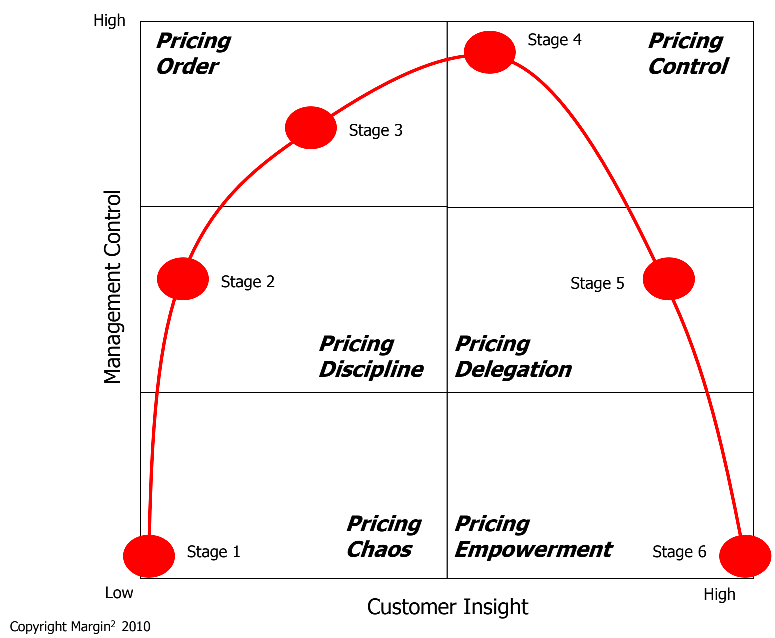
Introduction

An organisation's approach to Pricing can be seen as a competency in the sense that it is a combination of skills, behaviours and the application of knowledge. As the efficiency and effectiveness of pricing decisions improve, then a range of indicators highlight a more thorough, considered and generally more successful approach. Fewer mistakes are made, results are more visibility linked to previous actions, and implementation becomes quicker and more comprehensive.

This paper explores some of the characteristics of a better approach to pricing, and how behaviours change as an organisation develops its pricing skill set using our model that we name the Pricing Journey (Figure 1). In six separate stages, it will describe how knowledge, measurement techniques, decision making methods, technology utilisation and training needs all change, as an organisation travels on a journey toward pricing excellence.

Figure 1 - The Pricing Journey



Each of the six stages of the Pricing Journey can be seen as the development against 2 principle indicators;

1. **Customer Insight** – An organisation's efforts to understand customer needs, motivations and (in the context of pricing, most importantly) willingness to pay, can employ a number of qualitative and quantative techniques. However, real understanding of customer needs requires a processing of data to create knowledge and accessing a wide range of information sources and systemic thinking to create insight. In the context of the Pricing Journey, the nature of the customer insight changes from being transactional and lacking interpretation (i.e. doing what the customer asks for) to developing an in depth understanding of current and future customer motivations, wants and needs, in some cases at all stages of a supply chain.

2. **Management Control** – This aspect of the Pricing Journey reflects how pricing decisions are made, reflecting management style and the role of procedures, information systems and training. The model reflects situational leadership in the sense that the collective organisational pricing capability drives the level of control required to make effective pricing decisions. Managers in an organisation therefore have to adopt different leadership styles in order to optimise pricing performance in any given situation.

Performance in each of the two factors of customer insight and management control therefore help to identify at which of the six stages an organisation sits on the Pricing Journey.

Stage 1 – Pricing Chaos
At this first stage, pricing decisions are controlled by individual salespeople. Despite their best intentions, particularly where they make the effort to listen to their customers, the lack of meaningful support from management means they make a large number of commercially-damaging mistakes, not only offering the product at sub optimal prices, but also provoking unintended reactions such as price wars with competitors. In many respects the organisation can be seen to be letting down its own salespeople by failing to give them the required direction or providing any useful customer information. As a result, individuals are left to make their own gut feel decisions.

Organisations at the pricing chaos stage usually display two key characteristics; firstly, sales force targets are usually volume or transaction based, and secondly they rely exclusively on direct customer feedback for information. As a result, sales people are placed in an extremely weak negotiating position and usually offer unjustified discounts to secure deals. The number of organisations displaying pricing chaos characteristics is likely to be very low, because the damaging commercial impact of such poor decision making is likely to result in business failure.

Stage 2 – Pricing Discipline
The role of sales management becomes much more prevalent as an organisation moves from chaos to discipline, resulting in a significant increase in management control. The requirement of managerial approval for pricing decisions introduces a degree of consistency and access to informal experience that reduces the number of errors, but there is still a lack of active effort to research customer needs and volume based targeting remains. Depending on the tenure of the sales team, informal shared experiences allow a degree of understanding of customer needs and commercial impacts, but the lack of rigour means that myths about the customer are just as likely to evolve as facts. The absence of suitable information systems means that the introduction of an approval process is likely to slow down the speed of decision making.

Stage 3 – Pricing Order

In many respects, pricing order is an interim step between discipline and control, as changes can be seen to take place on a number of fronts. The most notable of these is in the area of customer understanding, and are twofold: Firstly, the organisation starts to make much greater efforts to collect market and competitor intelligence in addition to customer feedback. Secondly, sales managers have built enough of a history of business cases and occasional post evaluation to have a broad, albeit informal, understanding of the impact of pricing decisions. Both of these factors strengthen the negotiating position of salespeople and give them a better chance of resisting customer demands for discounts.

There are also further developments in managerial control, volume based objectives are supplemented with additional revenue and profit targets (although volume based thinking remains) and the finance department starts to have a stronger influence on pricing decisions. As a result, cost of production or service delivery becomes a major influence on the prices offered to customers. An organisation's pricing process still has the capacity to make major pricing errors, particularly with new products, because it lacks real safeguards and can be subject to political pressure, but useful information and different perspectives start to support pricing decisions.

Stage 4 – Pricing Control

Pricing control is the stage on the Pricing Journey where directive, centralised management control is at its peak. Clear, but somewhat bureaucratic, processes are in place to evaluate and agree changes in price, with clear roles for managers in sales, finance, operations and marketing in the approval of price alterations. As a result, the visibility of pricing action plans and their anticipated effect is greatly increased within the organisation.

One of the key characteristics of the pricing control stage is the development of the pricing manager, who has clear responsibility for the operation of the pricing process and knowledge management of pricing decisions. From a customer insight perspective, the pricing manager's responsibility to ensure the post evaluation of price change effects is particularly important. This starts to create a databank of 'real world' effects when prices alter, helping the organisation make substantial progress toward identifying their optimum price. The pricing manager's process ownership responsibility also helps to identify key areas for improvement in the efficiency and effectiveness of pricing decision making, identifying the role of technology and staff training in delivering further improvements.

Stage 5 – Pricing Delegation

The move from the control stage to the delegation stage is probably the largest single jump in the level of customer insight in the pricing journey, but is based not just of the physical amount of customer data available but how that data is shared and applied. The role of the pricing manager changes from that of policeman to facilitator, as they share information on the customer's willingness to pay (from both internal and external sources) with individuals across the organisation. This has the effect of increasing the organisation's collective understanding of customer needs and spreads awareness of price issues into influence decisions in areas such as budgeting, new product development and marketing planning.

The role of training becomes much more prevalent at this stage, individuals have a need to learn how best to apply their newly discovered pricing knowledge. The pricing manager again plays a key role on supporting the planning of training efforts in order to allow the trusted delegation of pricing decision away from senior managers.

Stage 6 – Pricing Empowerment

The role of technology is critical to the delivery of pricing empowerment, as it is the competitive advantages delivered through faster decision making that encourage the utilisation of systems that deliver faster evaluation of pricing decisions. Technology that allows constant 'real time' updates of the customer response to changing price offers, combined with individuals who with a deep understanding of customer motivations and commercial impacts mean that senior managers are able to empower individuals to make pricing decisions. Up until this point, the necessary internal controls mean that customers can view the organisation as being slow to respond to their demands, but 'real time' technology can make an organisation significantly more responsive than its competitors (sometimes a justification of a price premium in itself).

Influences to consider when using the Pricing Journey

The Pricing Journey provides a tool for diagnosing where an organisations approach to pricing currently lies and points to how it could be improved. However, in some respects there are dangers to using it in isolation, without taking a benchmark of an organisation's competitors. The confidential nature of pricing processes and insights makes this challenging, but some 'industry-norms' provide an indication. In many cases, an organisation's pricing approach will be at later stages of the Pricing Journey but very similar to its competitors. This presents a good opportunity to build competitive advantage by moving to the next level.

The final consideration is that pricing by its nature remains dynamic. Customers will always demand more, competitors can catch up and an acceptable pricing process one year can be become obsolete the next. This is probably the biggest single reason why the Pricing Journey emphasises building deep insights into a customer's willingness to pay and a necessary delegation of decision making away from the centre to deliver a faster response. Just because an organisation holds the insight revealing each customer's exact willingness to pay and can offer the right price immediately does not mean the customer will not ask for more. The approach to offering it can become more effective but the right price will never stand still.