



# Pricing Strategies: LEVERAGING THE POWER OF PRICING FOR INCREASED PROFITS

One of the most powerful — and most overlooked — levers manufacturers have to increase profits is the pricing they set for their products.

In an era of highly charged global competition, rising material and energy costs, and a shaky economic outlook, manufacturers of all sizes and types are faced with the prospect of significantly thinner margins. Cost-cutting measures and lean manufacturing efforts can stanch only so much of the runoff, however, and most manufacturers have already searched high and low for every conceivable advantage when it comes to remaining profitable.

One of those last areas of redress — and potentially one of the most rewarding — is product pricing.

Industry studies by AMR Research have shown sizable rewards from concerted pricing efforts, including revenue improvement of 1% to 3% and margin gains as high as 10% to 20%. The right pricing system can generate a broad range of improvements, including better cost recovery and concession control, operational efficiencies, improved pricing, and profitable supply and demand matching.

With the right processes in place, manufacturers can find and enforce the perfect price in every aspect of their business and enjoy the profitability boost that follows.

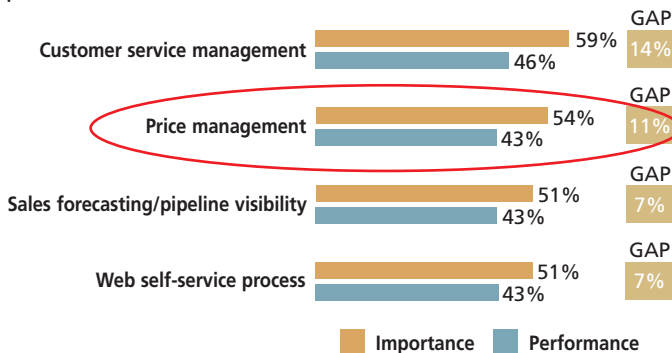
## Arriving at the Perfect Price

The challenge, of course, is to find that perfect price level — high enough to cover costs and turn an acceptable profit and low enough to attract customers and beat out the competition, as well.

Make no mistake, however: Determining the optimal price across a product line or an entire business worth of products, and then enforcing that pricing strategy, involves a bevy of moving parts. Behind the final quote issued for a specific job lies a web of interconnected processes, people, and technology.

The first step is to define the corporate goals related to the company's products, experts say. Growing market share, shaping market demand, introducing new products — all of these ends affect how a company adjusts its pricing. "The confluence of all of these goals makes the pricing process a very complex one," says Noha Tohamy, a research director at AMR Research specializing in the pricing process.

**FIGURE 1: CUSTOMER MANAGEMENT BUSINESS PROCESS AREAS** – Business process importance versus performance (overall)



% Respondents, n=190

Source: AMR Research, 2007

In addition, the pricing of products involves multiple parties, from finance and sales and marketing to product development and operations, making internal coordination a crucial skill.

Experts recommend a five-step path to better pricing: analysis, price segmentation, optimization, execution, and planning. Analysis involves an in-depth look at a company's historical pricing practices, with an eye toward defining price waterfalls — which establish profitability for each level of pricing — as well as areas where faulty pricing has led to margin leakage.

The goal of the analysis, according to Tohamy, is to expose the company's pain points. "If we're not as good in pricing as we should be, where are the culprits of this performance coming from?"

Armed with the intelligence gleaned from that historical analysis, a manufacturer can proceed to the second step, price segmentation.

Segmentation acknowledges that not all customers, regions, or products are created equal, and sets about dividing the main customer pool into segments with common traits. Depending on the size of the customer pool, segments can be as simple as the Midwest or the Northeast, or as complex as machine tool builders in New England that buy parts in bulk and have made more than one purchase in the past six months.

Once a company has performed its customer segmentation, the next step is optimization, the process by which a manufacturer defines "the best price out there that's going to ensure that we have the best win rate possible," Tohamy explains. The optimization process is where price and revenue

management software earns its stripes, slicing and dicing reams of customer and market data to determine the target price.

But determining the optimal pricing is only half the battle, experts say. Without a system in place to execute those prices, a manufacturer will miss out on the profitability boost it is due.

"Execution is about communicating the guidelines, but also about compliance — making sure that the guidelines are complied with, both within the organization and within your customer base," Tohamy says. That means disseminating details of the new pricing process to salespeople and installing a system that keeps them from reverting to old habits. This step has proved the undoing of many companies intent on bettering their pricing, because it demands that most onerous of tasks: culture change.

The challenge for manufacturers charged with executing a well-honed pricing strategy is to break from the maverick culture of old, in which salespeople are given substantial leeway in landing contracts, including offering sizable discounts that can eviscerate profits. Companies must at times use a heavy hand to ensure compliance with pricing policies, as the natural tendency among the sales staff is to maintain as much pricing power as possible, even at the expense of healthy margins.

**FIGURE 2: BEST PRACTICES EMERGING**

LEADERS	FOLLOWERS
• Project driven by the CFO or CEO	• Project driven by <b>one line of business</b>
• <b>Centralized</b> pricing function	• <b>Decentralized</b> pricing function
• Major <b>business process change</b>	• Automation of <b>existing business processes</b>
• Willingness to change <b>sales incentive structure</b>	• <b>No change</b> to sales incentives
• Intense <b>focus on analytics</b>	• <b>Minor</b> focus on analytics
• Price <b>optimization</b>	• <b>Subjective</b> price setting

**EFFECTIVE CHANGE MANAGEMENT IS KEY!**

Source: AMR Research

**Vendavo** is the leading provider of price management and optimization software for business-to-business companies worldwide. Vendavo Enterprise Pricing Suite solves pricing problems by giving businesses true enterprise-wide control of their entire pricing process. It combines pricing science, pricing best practices, and enterprise-class software to drive small improvements in average prices at every stage of the pricing process, from segmentation to deal close. Together, these improvements deliver big increases in profits — from 10% to 30%. Vendavo is the enterprise pricing solution of choice for some of the world's biggest companies in high-tech, industrial manufacturing, chemicals, consumer products, mill products, and distribution. SAP resells the Vendavo solution as SAP Price and Margin Management by Vendavo.

To learn more, or to request information, visit [www.vendavo.com](http://www.vendavo.com)

With a sound infrastructure in place to perform the first four steps, a manufacturer can close the loop on the process via the fifth: planning. As with any strategic initiative, a company should define key performance indicators for its pricing efforts and periodically take the time to determine whether it is meeting those benchmarks. Those performance evaluations give those involved the facts needed to plan future efforts.

## Tools of the Trade

“Whenever we talk about pricing a product or a service, we’re talking about using or leveraging data and technology,” AMR’s Tohamy says.

Although a company starting down the path to better pricing can use manual means to conduct some baseline analysis of its pricing, the real payoff typically comes from the deeper dive that software provides. And it isn’t just analysis where applications prove their mettle.

From its beginnings as an analytical engine focused on price optimization, price and revenue management software has grown to cover all facets of the pricing process. The cost can be significant, but the upside, according to Tohamy, is that investments in pricing projects tend to have a faster time to value than other enterprise applications projects, spanning four to six months as opposed to a year or more in the case of many ERP rollouts.

Emerson Electric has reported impressive results from its implementation of Vendavo pricing management software. Emerson executives, in fact, have a very telling way of measuring the return Emerson has experienced courtesy of Vendavo’s software. The technology, they say, has garnered the same improvement in margins — 1.5% to 2% — as three company-wide cost-containment efforts spread over the past two decades, including offshoring a large number of jobs in the 1980s, corralling materials costs in the 1990s, and an e-commerce initiative in the early part of this decade. Emerson’s payback from pricing software matched that of those three initiatives combined, a fact that has turned the company into an advocate for the technology.

The science behind the pricing software can also help companies in the tug of war with customers demanding price concessions. An application that can assess the profitability of a prospective deal can give manufacturers the intelligence they need to know when to push and when to yield — all while keeping their profit margin intact.

“And they see bigger returns as they implement more of the optimization and as they work on the quality and the availability of the data,” Tohamy explains. That ability of the software to improve its usefulness over time as it absorbs more pricing-related data makes it a sound investment, even — and perhaps especially — in a time of economic uncertainty for manufacturers.

“They definitely see increasing and significant returns out there that they can share with their stakeholders,” Tohamy concludes.

### About This Report

Information for this report originated from a Webcast held on this topic. The Webcast can be accessed at [www.managingautomation.com/vendavo](http://www.managingautomation.com/vendavo).