



MAKING YOUR PRICING STRATEGY STICK

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As any experienced marketer knows, developing strategy is one thing – managing the change process to embed that strategy in the organization is quite another. All too frequently, companies make substantial investments in more effective pricing strategies and then fail to reap the expected return on that investment because they didn't sufficiently invest in implementation. Effective pricing strategy implementation involves changing the expectations and behaviors of all of the actors involved in the sales process. Customers must learn that they will be treated fairly and that abusive purchase tactics will not be rewarded with ad hoc discounts. Sales must learn that they will be rewarded for closing deals that increase firm profitability rather than using price as a tactical lever to increase sales volume. Finance must learn to look beyond cost as a determinant of price to better understand the trade-offs between price, cost, and market response. Successful implementation of pricing strategies requires targeting specific undesirable behaviors and devising a detailed plan to change them. Our experience has shown that there are three main ways to affect these behavioral changes: 1) provide effective incentives, 2) set appropriate expectations, and 3) develop the necessary organizational skills.

Provide Effective Incentives
When playwright Noel Coward said, "If you must have motivation, think of your

paycheck on Friday," he might well have been talking about how to motivate salespeople to move to a value-based selling approach. Financial incentives are, without question, one of the most powerful levers for behavioral change among salespeople. Today, most salespeople are rewarded for top-line sales instead of profitability. When faced with a choice between working harder to sell value to gain additional price or closing an additional deal at a lower price, most opt to close the additional deal because they receive far more commission for the additional, albeit less profitable, volume. It is nearly impossible to get salespeople to work harder to get higher prices without changing their commission structure so that total compensation is more closely tied to profitability. Making those changes, although often difficult, is a crucial first step toward more effective price negotiations.

Just as salespeople need appropriate incentives, so too do customers. Strategic pricing requires convincing customers to change deeply ingrained behaviors that have been reinforced by years of ad hoc discounting, poor pricing discipline, and poorly communicated value messages. Some customers will be asked to start paying for value received or accepting a lower value alternative. Other customers must be convinced to limit usage of high cost services or else begin to pay for them. Still others may be asked to change purchase

timing, volumes, or meet other conditions to qualify for continued discounts. Convincing customers to change behaviors like these requires discipline and thoughtful design of appropriate incentives. Fortunately, marketers have many tools available to get the job done. For example, pricing policies can be used to encourage service “abusers” to reduce their usage of high cost services or to begin to pay for them by aligning price paid with value received. Marketers in distribution, manufacturing, and retail frequently use this technique to control delivery and logistics costs by offering a free minimum delivery option and then adding a metric that increases price for additional delivery guarantees.

Another tool that pricers can use to incent more profitable behaviors on the part of customers is discount level. Consider the telecommunications manufacturer that had been giving costly support services away in order to match a major competitor’s offering. The practice was highly unprofitable because the company could not price for the services for fear the competition would not follow and, like most services, they were costly to deliver. Because the company could not change customer usage by increasing prices, it looked to discounting instead. A simple financial analysis showed that the company would improve profitability by offering a 5% product discount for every customer that opted to accept a restricted service package in which they had to use online support to solve technical problems. Price-sensitive customers found the package appealing, in part due to the lower price point, but also because they could purchase personal support for an additional fee if needed. As these examples illustrate, there are numerous opportunities to create incentives for more profitable behaviors on the part of customers and company personnel.

Set Appropriate Expectations

It’s a basic truism that individuals will change only to the extent that change is expected of them. Unfortunately, in many companies, precisely what those

expectations are is unclear. Pricing managers often receive mixed messages from senior management about the types of behaviors they ought to pursue. We recently attended a meeting of global pricing managers for a computer manufacturer at which the CEO spoke about the business goals for the coming year. On one slide of the presentation, the stated goal was to increase price realization by 6%. The very next slide described another goal of increasing market share by several points. When the CEO asked if there were any questions, one brave manager raised her hand to ask which of these seemingly conflicting goals they should focus on: price or market share. Caught off guard by such a penetrating question, the embarrassed CEO stammered, “Uuhhh, both I suppose.” Not surprisingly, the question and answer period ended a little earlier than planned. Although it is possible to increase price and volume simultaneously through value-based pricing and tighter discounting policies, setting such conflicting expectations for managerial performance usually leads to poor performance and conflicting messages to the market.

Pricing discipline cannot be viewed as an oxymoron in your organization. That means that senior management must specify clear, consistent business objectives and provide the necessary resources for managers to achieve them. This can be one of the most challenging aspects of strategic pricing because it forces managers to explicitly consider the long-term costs of pricing actions. It can be incredibly tempting for a sales or pricing manager to approve a pricing exception to close a deal with a new account that has been negotiating aggressively, but doing so can have significant long-term costs. First, it teaches that account that you are not serious about getting paid for your value and that they can win concessions by being aggressive. Second, and oftentimes more importantly, it can place your relationships with long-time customers at risk if they find out that they are paying a higher price than a first-time purchaser. Finally, competitors are likely to

copy this approach if it wins market share in the short term, with the result that overall industry price levels start to decline and profits shrink for everyone.

Failing to have a consistent message to customers that they will have to pay for value received sets the expectations that they can “win” by negotiating aggressively or simply waiting you out until the price comes down. Instead of setting prices based on short-term needs, companies need to set policies designed to enforce price discipline and send a clear message to customers that they cannot win special treatment through clever tactics. Ideally, policies are transparent and consistent. With transparent policies, customers need not engage in threats and misinformation to learn the trade-offs you are willing to make. Consistent policies communicate that it is impossible to “game the system” by shopping within the company for the best deal.

Develop the Necessary Organizational Skills

Creating incentives and setting appropriate expectations are necessary, but not sufficient, conditions to change individual behaviors. Even when customers and company personnel are willing to change, the key question is whether they have the knowledge and skills that make them *able* to change. In negotiated environments, all of the work to create a proactive, profit-driven and value-based pricing strategy comes to fruition when the deal is signed and the final price is set. Too much is riding on the outcome to simply admonish sales to “sell value” and defend price. Harvesting the fruit of your pricing labors requires teaching salespeople how to change from a fixed offering – variable price approach to the more profitable, fixed price – variable offering approach to negotiation. Training alone is often not enough; success requires developing tools to help customize and communicate the value message in a way that makes it relevant for customers.

Salespeople aren’t the only ones in the

company that need new skills to implement strategic pricing in the organization. Product managers must learn how to collect the data necessary to estimate economic value, analyze relevant costs, and set profit-maximizing prices. The first step to develop these skills is education. However, true skills development requires putting the concepts to work on real products on multiple occasions. As we have already noted, strategic pricing is challenging, and many companies do not have the level of commitment necessary to make the transition. That’s good news for those companies that persevere to develop the skills needed to change because it means that pricing can become a source of competitive advantage that delivers incremental profits over time.

Communicating the rationale and benefits of a value-based pricing strategy is one of the most critical steps to convince customers to change how they set prices. Customers must understand that the prices they are paying are fair and that other customers are not getting better deals through the use of aggressive price tactics. This communication happens through the use of transparent pricing policies that clearly define the ways in which customers can earn lower prices. Companies must also explain to customers that they will benefit from more choices about the types of offerings and ways that they engage with you. When the customer receives high value or increases service usage, they will be expected to pay more. But strategic pricing does not equate to higher prices for all customers – low value customers or those that are willing to purchase in a way that reduces costs may receive lower prices. Understanding these options is essential to setting the stage for a new pricing approach.

Conclusion

To say that pricing strategy is challenging would be an understatement. It requires analyzing data on costs, customers, and competition, and integrating that analysis into prices that lead to long-term profitability. Moreover, the impact of

pricing is felt throughout the organization, leading to contentious decisions driven by conflicting performance metrics and biased views of the market. Managing this conflict requires thoughtful and proactive steps to ensure that employees and customers are empowered to respond to the behavioral incentives built into the pricing strategy.



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