

FOUR STEPS TO BECOMING FLUENT IN THE LANGUAGE OF PRICING

By Sudipto Banerjee, Amadeus Petzke, Just Schürmann, Matt Beckett, and David Langkamp

PRICING IS A POWERFUL language. Higher prices can signal different things: that a product or service is more valuable to customers than that of the competition or that a company's costs are going up.

As with other languages, achieving fluency requires day-to-day experience. In our work with companies in a wide range of industries, we have witnessed a select number of companies that can speak the language of pricing like a native. They do this not by accident but by carefully developing the right strategy, execution tactics, tools and insights, and organization.

These efforts yield impressive results.

Pricing-fluent companies are significantly more successful than their peers when it comes to enforcing price increases, our research shows. As a result of such wins, they achieve profits that are 3 to 8 percentage points higher than those of companies that do not speak the language of pricing fluently.

The Challenges of Pricing

To understand the pricing challenges that companies face and the approaches that fluent pricing organizations use to achieve superior results, The Boston Consulting Group, in partnership with the Professional Pricing Society, surveyed pricing executives at major companies from around the world in a variety of sectors, including industrial goods, technology, consumer, energy, financial services, and health care. Nearly half of the companies had annual revenues of \$1 billion or greater.

Across industries, the survey revealed a number of important gaps in the basics for many companies.

Strategy. More than half of the companies we surveyed do not have a well-defined pricing strategy in place. Even when a company does have a pricing strategy, in many cases it is not aligned with the company's business goals or is not communicated and known across the organization. Said one respondent, "A high priority for us over the coming year will be to define

and communicate a clear pricing strategy across business units to provide stronger guidance in pricing decisions. We lack that now.”

Execution. Many companies we surveyed struggle to achieve greater profits from their offerings. Typically, we find, pricing models vary significantly by industry. For example, large-scale industrial goods companies commonly use project-based pricing, whereas subscription-based businesses often use bundling. Regardless of how they price, about two-thirds of companies update their prices only once or twice per year. Others have trouble tracking prices and ensuring that they realize the prices they set. “We need to stop giving prices to our smallest customers that are lower than those we give to our key customers,” said a respondent.

Tools and Insights. Approximately 80 percent of companies we surveyed struggle to put in place the analytics necessary for effective pricing moves. Said one respondent, “We need a better understanding of competitive pressure on specific market segments and better tracking tools to understand top-line pricing all the way to gross price.” Industrial goods companies have the most problems in this area; they show the lowest scores in tools and insights across the industries we surveyed.

Organization. Many companies lack people with the right skills and training to make pricing a source of competitive advantage. Companies also grapple with where to place the pricing function inside the organization and how centralized it should be. Others wrestle with the size and leadership of the pricing organization.

Said one executive, “We have too few people for the pricing tasks at hand, and many projects get shelved indefinitely. This also stops us from taking the time to work on strategic projects, as the team is constantly fighting fires.” Often, companies lack a sufficient number of dedicated pricing employees. “Many people are involved in pricing, but no one owns it,” said one respondent.

How the Leaders Became Fluent in Pricing

The results of our survey confirm observations from our daily work with clients: fluent pricing organizations look and act differently from their less-fluent peers. As companies move up the ladder of pricing fluency, from reactive pricing to dynamic pricing, they achieve increasing profit gains. (See Exhibit 1.) For example, 74 percent of the most fluent pricing organizations have successfully increased prices to improve margin, compared with 39 percent of the less fluent companies.

Some industries and countries are ahead of the curve in pricing fluency. Nonetheless, companies in every industry and country have huge potential to improve. Even those that are more fluent in pricing still have room to create additional value. Organizations of all stripes can take the following critical steps to create the highest profit gains.

Craft a pricing strategy that creates value.

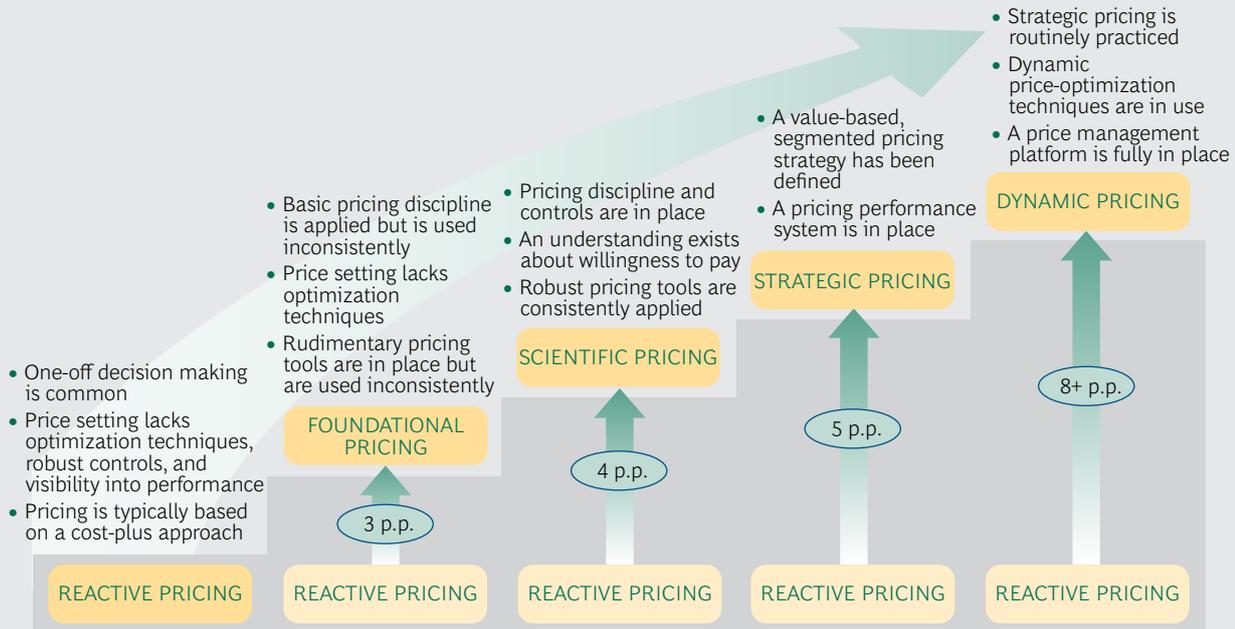
Admittedly, there is no silver bullet: formulating, communicating, and embedding a pricing strategy takes time. Yet almost all of the most fluent pricers we surveyed have put in place a well-defined and well-communicated pricing strategy that is fully aligned with their business strategy and objectives. (See “Pricing Fluency: A Program for Pricing Excellence,” BCG article, December 2009.)

These organizations tend to have a value-based pricing strategy focused on aspects such as willingness to pay, and they differentiate prices on the basis of geography and customer segment about twice as often as those with a more “foundational” approach based on elements such as costs.

Consider the case of a global specialty-chemical company with \$20 billion in revenues and a complex portfolio comprising more than 17,000 possible combinations of customers and products. The company served a diverse set of industries, with significant variations in price sensitivity, and it faced strong pressure from the sales organization not to increase prices. In re-

EXHIBIT 1 | Fluent Pricers Achieve Higher Profits

EBITDA DIFFERENCE BY STAGE OF PRICING MATURITY (IN PERCENTAGE POINTS)



Source: 2015 BCG/Professional Pricing Society Pricing Maturity Assessment survey of more than 300 major companies.

response, the company developed a pricing strategy based on an analysis of value-based factors such as customers' willingness to pay, products' market share relative to that of the competition, the level of product differentiation, and customers' focus on value versus price. An analysis revealed that the company's products were appropriately priced, but better price realization was possible in some areas. The company used this information to design a customized pricing strategy targeted to individual combinations of customer segments and products. As a result, the company improved its profit margin by 7 percentage points.

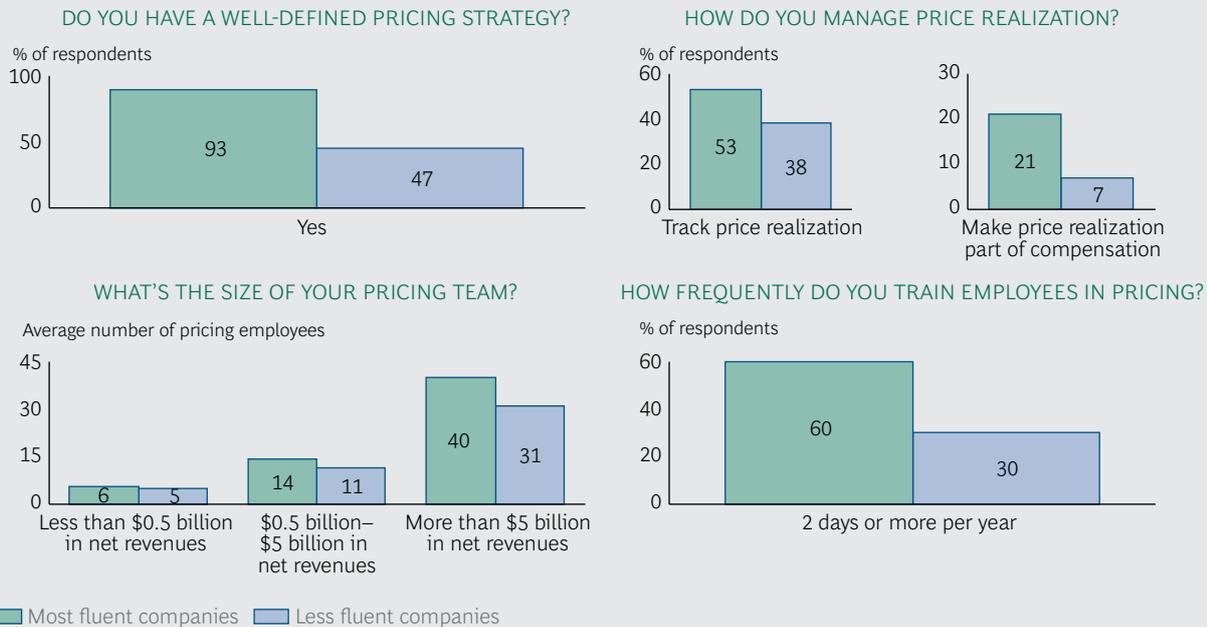
Execute in a consistent and forward-looking way. The best pricers in any industry experiment with alternative pricing mechanisms to a greater extent than their peers. About 70 percent of the best pricing organizations use alternative models, compared with about 40 percent of the less fluent companies. For instance, in the technology industry, the most successful pricers are almost twice as likely as other companies to use rapidly growing service-pricing models, such as SaaS (software as a ser-

vice). Across industries, fluent pricers are also much more likely to use licensing, auctioning, and other more-advanced approaches, in addition to the usual approaches of unit and project pricing.

The most fluent pricers also consistently track the actual price realized compared with what they planned to achieve, taking into account elements such as discounts, rebates, and payment terms. In addition, they use price realization as a part of compensation for the sales team, in addition to volume and revenues, three times more often than the less fluent companies. (See Exhibit 2.)

For a technology hardware and services company in the U.S. with \$2 billion in revenues, a closer look at price realization was revealing. Although the company had clear pricing guidelines in place, it offered much higher discounts to smaller accounts than to its key customers. This approach lowered profitability and created dissatisfaction among customers. Consequently, the company changed things: it now makes price realization a part of compensation, to ensure that the sales force adheres to dis-

EXHIBIT 2 | Fluent Pricers Outperform in a Number of Areas



Source: 2015 BCG/Professional Pricing Society Pricing Maturity Assessment survey of more than 300 major companies.

counts for both key accounts and smaller clients.

Invest in effective tools and insights. The best pricing organizations invest in advanced analytical solutions to make decisions. For example, 67 percent of the most fluent pricing organizations invest in specialized software, compared with 48 percent of the less fluent companies we surveyed. Many of the best pricers use advanced data-manipulation and -visualization tools such as those from Alteryx and Tableau Software. Many are tracking sophisticated metrics such as price realization, elasticity, and profit “leakage.”

That said, complex standardized software is not the be-all and end-all solution. Even simple decision-making tools, coupled with the right strategy and insights, can create enormous value. An Asian manufacturer of automotive supplies with €3 billion in revenues in Europe, for instance, created a step change in pricing with a minor investment in market data and a simple database tool that consolidated competitive information from disparate sources—including online price data from web crawling, off-line price data from scanners, and online and off-line

market-share information. Once combined into a usable form, the data proved invaluable: the company is now able to adjust prices for product categories on the basis of the competitive intensity of the market—something it wasn’t able to do before.

Build the right organization. To be effective, pricing employees require a diverse set of skills, including soft skills in influence and motivation and hard analytical skills in pricing. The most fluent pricing organizations offer employees pricing training to help them succeed: 60 percent of the best organizations train employees two or more days per year on pricing; only 30 percent of the less fluent companies could say the same.

We find that a “learn, do, teach” approach is the best way to build these skills. In this approach to learning, training participants master pricing concepts and strategies, and they eventually become “pricing coaches” who take their knowledge to the broader organization. Game-like simulations have also proven valuable. The manufacturer of automotive supplies mentioned previously put in place a comprehensive training effort involving a pricing war-game exercise

that simulated decisions involving trade-offs of price and volume, with corresponding effects on sales volume, market share, and profitability. Particularly interesting were the negative effects that downward price moves in one country could have on clients in other countries, a common issue in international pricing.

Fluent pricers also treat the pricing organization as a strategic business partner. The pricing organization is no longer seen as an administrative support center; instead, it is on the radar of senior management. The function leads decision making on the most important pricing dimensions, such as setting new product pricing, developing pricing strategy, and executing 360-degree competitive-intelligence gathering. Our survey results indicate that organizations treating pricing as a strategic business partner generate incremental profit gains of 1 to 2 percentage points from this organizational dimension alone.

To effectively embed pricing decision making in the organization, we find that small

companies with about \$500 million in net revenues typically need a pricing team of at least five full-time people (even smaller core teams can rapidly generate the business case for more resources to be added). With increasing company size, this number increases. Midsize companies with net revenues of \$500 million to \$5 billion need 5 to 14 full-time pricing employees at a minimum, and larger companies need to invest in an even higher level of dedicated resources.

PRICING FLUENCY IS a hard-won but invaluable skill. Just as with other languages, becoming fluent in pricing requires several building blocks.

By carefully developing the right pricing strategy, execution tactics, tools and insights, and pricing organization, any company can significantly boost its pricing fluency. Putting all these elements together takes time and effort but can create extraordinary value.

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