Strategic Pricing

The key to winning in these uncertain times

Focus on B2B

How do you embed business objectives into your pricing strategies?

How do you link strategy and tactics in day-to-day sales transactions?

How do you achieve a successful transformation and implement a sustainable pricing model?

WhiteHeron Software

Executive summary

Companies must set a course to successfully navigate through turbulent times. The same imperative applies to Pricing. Indeed, companies experience numerous pain points around Pricing and without clear direction, the consequences can be dire, especially in these uncertain times. In addition, the sales context drives tactical pricing decisions which may not be consistent with longer-term objectives, making pricing a very complex exercise. Multiple pricing methods exist to address these challenges. The key is choosing the most suitable one for a given business strategy and executing it properly.

In this context, **Strategic Pricing provides a powerful framework for embedding business objectives into differentiated pricing strategies and setting relevant price guidance for day-to-day sales transactions.** Starting from current competitive position by segment, business objectives can be translated into growth, margin and price range targets. Strategic Pricing relies on In-depth cost intelligence to provide deep insights into cost and margin drivers, portfolio profitability and competitiveness. CO2 regulations create additional costing requirements for companies which will now have to disclose CO2 content by product and decide how to adjust their pricing strategies.

Comparing actual sales transactions with the Strategic Price Guidance highlights potential pricing gaps and improvement priorities. Pricing analytics, supported by sound business judgment, also delivers insights into price behaviors and their underlying price drivers. Tactical adjustments coming from the sales context can be applied to the Strategic Price Guidance in order to propose the right price for each transaction. A systematic feedback loop ensures the continuous improvement of pricing practices.

In leveraging an end-to-end strategic pricing solution, B2B companies will be well equipped to capture the full revenue and margin potential of their business and also gain a sustainable competitive advantage.

Companies must set a course to successfully navigate through turbulent times. The same imperative applies to Pricing.

The economic crisis caused by the COVID-19 pandemic has triggered massive and durable disruptions in global supply chains, a rapid upsurge of raw material and transportation costs as well as **ever-increasing volatility, which is here to stay.**

Uncertainty weighs on all decisions that business leaders must make, in particular how to price their products and services competitively while avoiding the major risk of margin squeeze.

B2B Pricing is, in fact, one of the areas where a lack of clear direction can have the most disastrous effects.

In situations where everything can change very quickly, **corporate management should not engage in guesswork or be content to follow market prices.** Rather, it is essential that they set a course, by choosing robust pricing strategies consistent with their business objectives, while carefully monitoring market signals and taking into account the context of each sales transaction.

Indeed, **companies experience numerous pain points around Pricing** and without clear direction, the consequences can be dire, especially in these uncertain times.

EXAMPLES OF PRICING PAIN POINTS
(not exhaustive)

- Pricing disconnected from **business strategy**
- Lack of structured and simple **price guidance** for sales reps
- Challenges in assessing sales force **pricing compliance**
- Poor insights into **true cost drivers** and profitability of product mix
- Difficulties dealing with a large number of **complex tenders**
- **CO_2** not addressed in costing nor in pricing
- No effective measure of **price performance**
- **Margin squeeze** due to partial pass-through of RM cost inflation

POTENTIAL CONSEQUENCES

- Lack of differentiated pricing strategies
- Unclear priorities
- Weak pricing power
- Uncontrolled price leakage
- No value-price trade-offs
- Loss of market share

In addition, **the sales context drives tactical pricing decisions** which may not be consistent with longer-term objectives, **making pricing a very complex exercise.**

EXAMPLES OF TACTICAL PRICING DECISIONS
(not exhaustive)

*Should you **lower prices** to stimulate sluggish demand?*

*Should you **increase prices** to take advantage of supply shortages?*

*Should you **apply surcharges** for ancillary services provided to key accounts?*

*Should you **follow your competitor's** aggressive price discount and risk entering a price war?*

*Should you **index your sales prices** to cover rising raw materials costs?*

*Should you **lower your on-line prices** to reflect a lower cost-to-serve?*

> **"Many tactical decisions seemingly appropriate in the short term may, in fact, jeopardize a company's future position and compromise its ability to meet its strategic objectives."**

Multiple pricing methods exist to address these challenges. The key is choosing the most suitable one for a given business strategy and executing it properly.

Numerous pricing optimization methods have been developed over time. Although they do not apply universally and often serve different purposes, they are actually complementary. In fact, a single company can use all of these methods simultaneously but in different sales contexts.

VALUE-BASED PRICING

Relevant primarily when it is possible to demonstrate differentiation and quantify the value of innovation for the customer. However, it can be difficult to operationalize as it requires an in-depth understanding of the customer's processes and cost structure to quantify the incremental benefits which justify a higher price. Despite these limitations, Value-Based Pricing creates the right mindset: by decoupling revenue from resources, it effectively removes limits on growth and profitability.

COST-PLUS PRICING

Still frequently used across industries, **cost-plus pricing typically involves a homogeneous mark-up on direct costs.** Unfortunately, it is not designed to reflect business objectives. Worse, when applied to a distorted cost vision, its "one size fits all" approach can generate significant value leakage and lead to a dangerous erosion of a company's profitability over time. In-depth cost and margin intelligence is nevertheless critical for designing the right pricing strategies and setting appropriate price limits.

MARKET-DRIVEN PRICING

Relevant to any commodity product (such as aluminum, corn...) listed on an organized market. Prices reflect current or future supply-demand balances. Where possible, companies need to 'decommoditize' their offering by adding services around their products and other qualitative differentiation. In addition, they need to strictly protect their margins through indexing and ensure sales compliance.

COMPETITION-BASED PRICING

Prices can be set by reference to direct competition, either by matching competitor prices or by applying a systematic premium or discount on them. In B2B markets, knowing actual competitor prices is not easy even when they are public ; however, the rapid growth of digital sales is accelerating price transparency.

Competitors' prices should be monitored carefully but should not dictate your own price moves. This method should be used proactively rather than as a price follower while keeping in mind the risk of entering into a price war.

ELASTICITY-BASED PRICING

Largely used in on-line B2C, **the price is set to optimize price-volume trade-offs and maximize mass margin on variable costs.** It is data-intensive and highly analytical. In B2B sectors, it is quite difficult to apply due to the lack of comparative data and limited price transparency.

The alternative is to evaluate customer willingness to pay through the knowledge developed by the sales reps and to analyze the impact over time of price drivers on price spreads and, when available, the correlation between discount levels and win/loss rates.

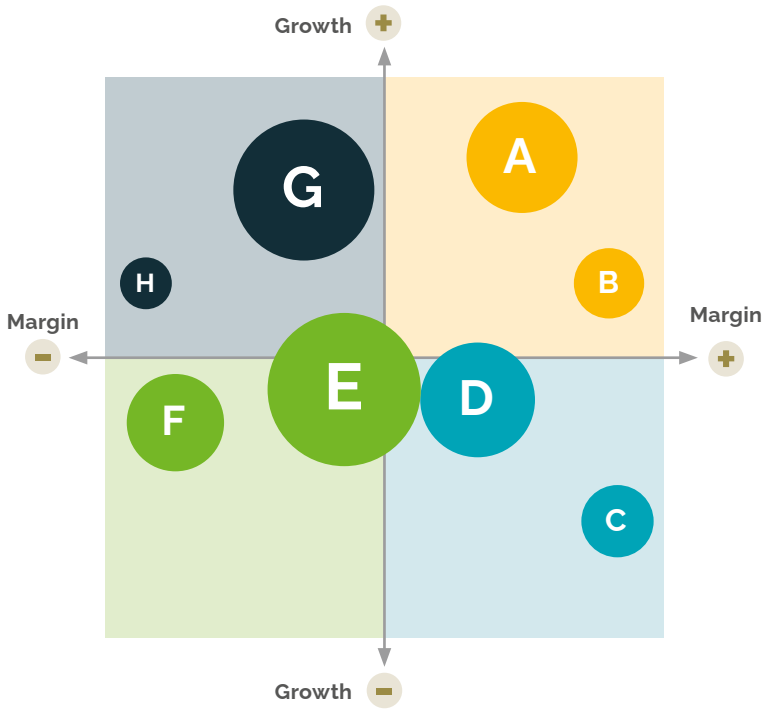
In this context, Strategic Pricing provides a powerful framework for embedding business objectives into differentiated pricing strategies and setting relevant price guidance for day-to-day sales transactions.

Whatever the method used, the most relevant question is **how to make sure that companies' business objectives are effectively taken into account when setting daily sales prices.** This is a particular challenge when dealing with SKU-heavy product portfolios, multiple market segments and thousands of customers and sales transactions across distribution channels. **The challenge of "Many to many, many times".**

However, although many companies successfully define their strategic objectives and related business targets across their customer and product portfolios, these **objectives are often not reflected in their pricing practices.** To solve this issue, Strategic Pricing provides an overall framework which translates growth and profitability targets by business segment into specific, differentiated pricing strategies adapted to each segment. It also provides a Strategic Target Price and price limits for each sales transaction.

By so doing, **Strategic Pricing ensures the needed consistency with longer-term business objectives** while maximizing companies' total mass margin across their portfolio of products and services.

Starting from current competitive position by segment, **business objectives can be translated into growth, margin and price range targets.**



CURRENT COMPANY POSITION BY BUSINESS SEGMENT

Each bubble represents a business segment (size equals revenue)

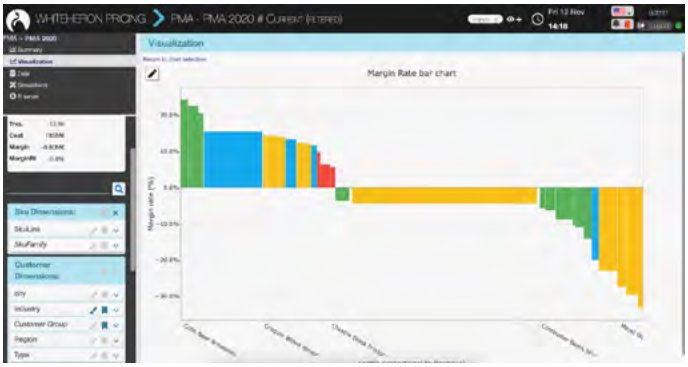
It is positioned in terms of margin and relative growth vs market (in other words the company's market share evolution)

	STRATEGIC OBJECTIVES BY SEGMENT (selection)	PRICING STRATEGIES (example)
A	**Fast growing market with strong competitive position:** maintain market share and increase mass margin, large marketing & branding investments.	**Premium pricing strategy vs competition:** maintain price position, limited discount policy, strict sales force compliance. ***High margin/limited price range.***
C	**Mature product line, profitable but declining market:** "milk" dominant position for the next 3 years.	**High target margins** but discount flexibility according to volumes per customer and per order. ***High margin/broader price range.***
E	**Large low margin, commodities segment:** Defend volumes to maintain capacity utilization and cover fixed costs.	**Market driven pricing plus service monetization:** Low margin but strict margin protection through indexing. Flexibility when lower utilization. ***Low margin/limited range.***
H	**New product line leveraging rupture innovation:** successful product launch followed by fast growth.	**Value-based pricing;** new price position vs existing product line, high margin expected in the mid-term; substantial penetration investment with strategic accounts.

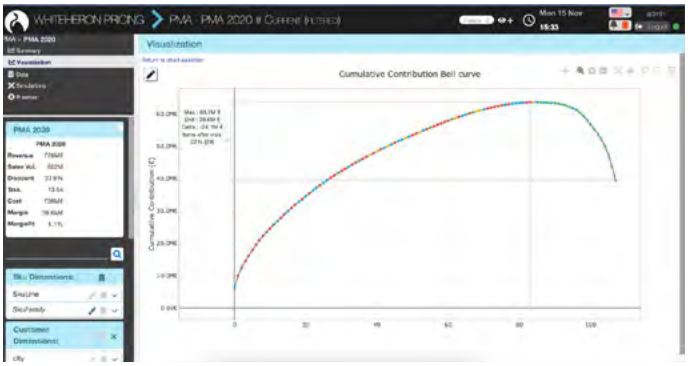
Strategic Pricing relies on **in-depth cost intelligence to provide deep insights** into cost and margin drivers, portfolio profitability and competitiveness.

In B2B industries, developing in-depth cost intelligence at a granular level, i.e. by product and by customer, is a key component of Strategic Pricing. **It is critical to:**

- **identify profitability gaps and resulting pricing improvement priorities;**
- **define relevant pricing strategies** and expected margin range by segment;
- **identify key cost drivers,** i.e. the single most impactful items **that influence positively or negatively company margins.** They are primarily related to product specifications or customer requirements, sometimes to specific transaction considerations;
- **equip sales teams with a solid understanding of cost drivers,** so that they can appreciate how customer requirements may influence costs and impact company profitability. For the most complex offerings, they can propose alternative value/price trade-offs to the customer while still protecting company margins.



Illustrative 'S-Curve' margin by segment



Illustrative 'Bell curve' (cumulative margin) by SKU

However, **implementing advanced cost intelligence in B2B sectors can be a real challenge.** Costing is often like a black box: it is difficult to comprehend and may even lack relevance because it relies on obsolete standards and/or flawed cost allocations. There are at least 3 root causes:

- **firstly, indirect costs –** which are in essence difficult to allocate to a specific product or customer order – **have been steadily increasing in the total cost structure of B2B companies** for the last few decades. This trend is due to the rapid development of technology, automation and robotics, sophisticated machinery and equipment as well as the growing importance of many indirect/support functions such as R&D, QA/QC, maintenance, IT, etc.;
- **secondly, so-called "fixed" costs are fixed only within a certain time horizon, and only at company level.** At product or customer order level, fixed costs are, in fact, highly variable from one product to another and from one customer to another, often in very significant proportions. The influence of product specifications on machine speed at any given step in the manufacturing process illustrates how capital costs can vary significantly from one product to another. This has a clear impact not only on margins, but also on revenues through capacity utilization, especially when there are capacity constraints. Hence the necessity to understand fixed costs consumption by product;

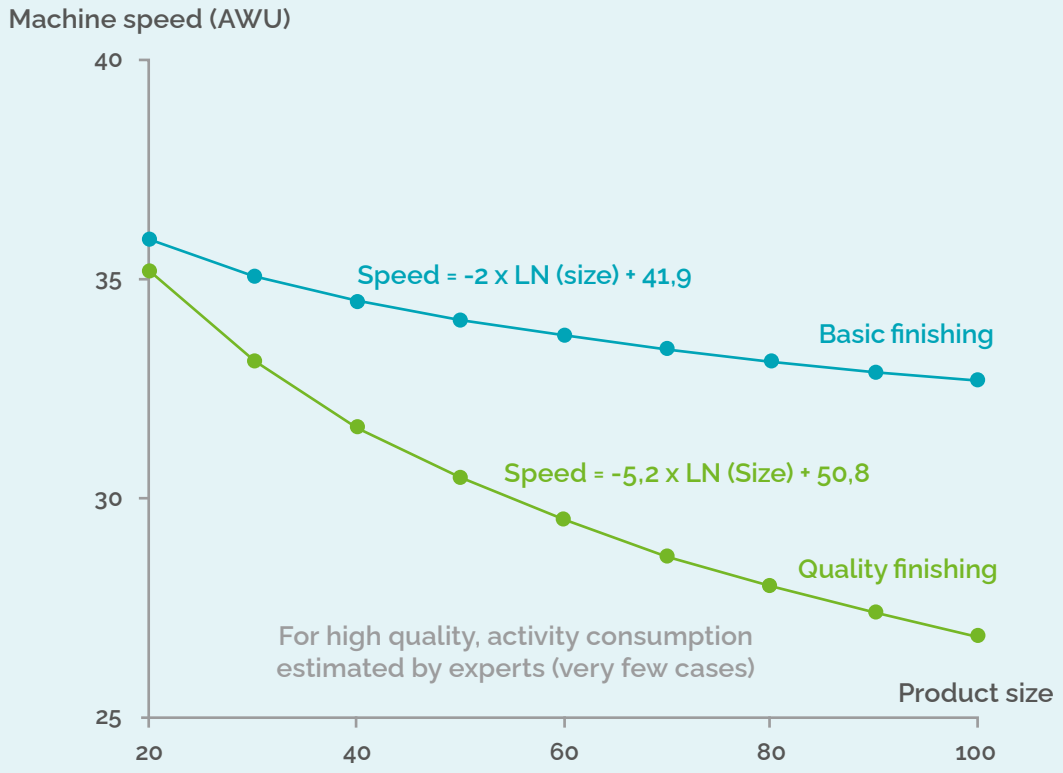
...

- **thirdly, B2B companies are not particularly skilled at assessing the impact of complexity.** They struggle to understand how it influences their costs and margins. Complexity costs are usually cross-subsidized with long runners, simple products and less demanding customers bearing the complexity burden of "exotic" products, short orders, urgent deliveries, special services and more demanding customers.

Management accounting tools typically measure some kind of operating margin by business line or product family, and gross margin or "added value" by product. In general, they **are unable to calculate margins after taking into account full variable and fixed costs at the product level.** Even large companies with sophisticated controlling processes face difficulties in this area.

In B2B environments, an end-to-end pricing solution integrating a simple and intuitive costing tool becomes extremely powerful. It can fully enable Strategic Pricing by providing deep insights into cost and margin drivers, fixed/variable cost splits at the product level, associated price limits (for instance zero margin on variable costs), full margin transparency, should cost models supporting complex quotations, competitiveness assessments by product family and technology, indexing of raw materials cost evolutions and pass-through monitoring.

Incorporating **advanced simulation capabilities** also enhances decision making through the modelling of **alternative cost structures** (next year budget, cost reduction plan, "ruthless competitor"...) in order to generate **alternative pricing strategies** (including possible competitor strategies) and assess their **overall impact on revenues and margins.**



Illustrative cost law: speed vs size, supporting should cost modeling

CO2 regulations create additional costing requirements for companies which will now have to disclose CO2 content by product and decide how to adjust their pricing strategies.

The price of CO2 now exceeds 60 € per ton, having more than doubled since the end of 2019. At the same time, **public regulations are tightening transparency requirements** on companies' carbon footprint. Governmental pressure will inevitably increase in order to achieve carbon neutrality by 2050. French companies with more than 500 employees must already include in their annual management report the carbon footprint of their activities as well as the carbon content of the products and services they deliver.

In setting internal carbon prices, **companies are also developing their own carbon pricing initiatives.** In parallel, individual and corporate customers are starting both to demand transparency about the carbon content in the products and services they buy and to factor this into their purchasing decisions.

Advanced costing and pricing solutions are already able to include the quantity of carbon emissions into company costing models. They can then cost the CO2 emitted at the market price or at a normative price set internally, provide a carbon footprint by activity/process and by emission source, as well as calculate the carbon share in the total cost (accounting and extra-accounting) of each product or service.

As a result, **companies will immediately be able to measure the impact of the cost of CO2** on the profitability of their customer and product portfolios. Taking it a step further, companies will be able to define a pricing strategy that takes into account the cost of carbon and its potential fluctuations over time. Lastly, they will have the option to provide their customers with details of the carbon cost included in quotations or customer orders.

These new capabilities will allow companies using this type of solution to **distinguish themselves** in multiple ways:

- by **clearly communicating on the carbon content** of their products and services;
- by **adapting their pricing strategy** accordingly;
- and by progressively developing **products and services with a lower carbon footprint.**

All while **respecting mandatory transparency requirements.**

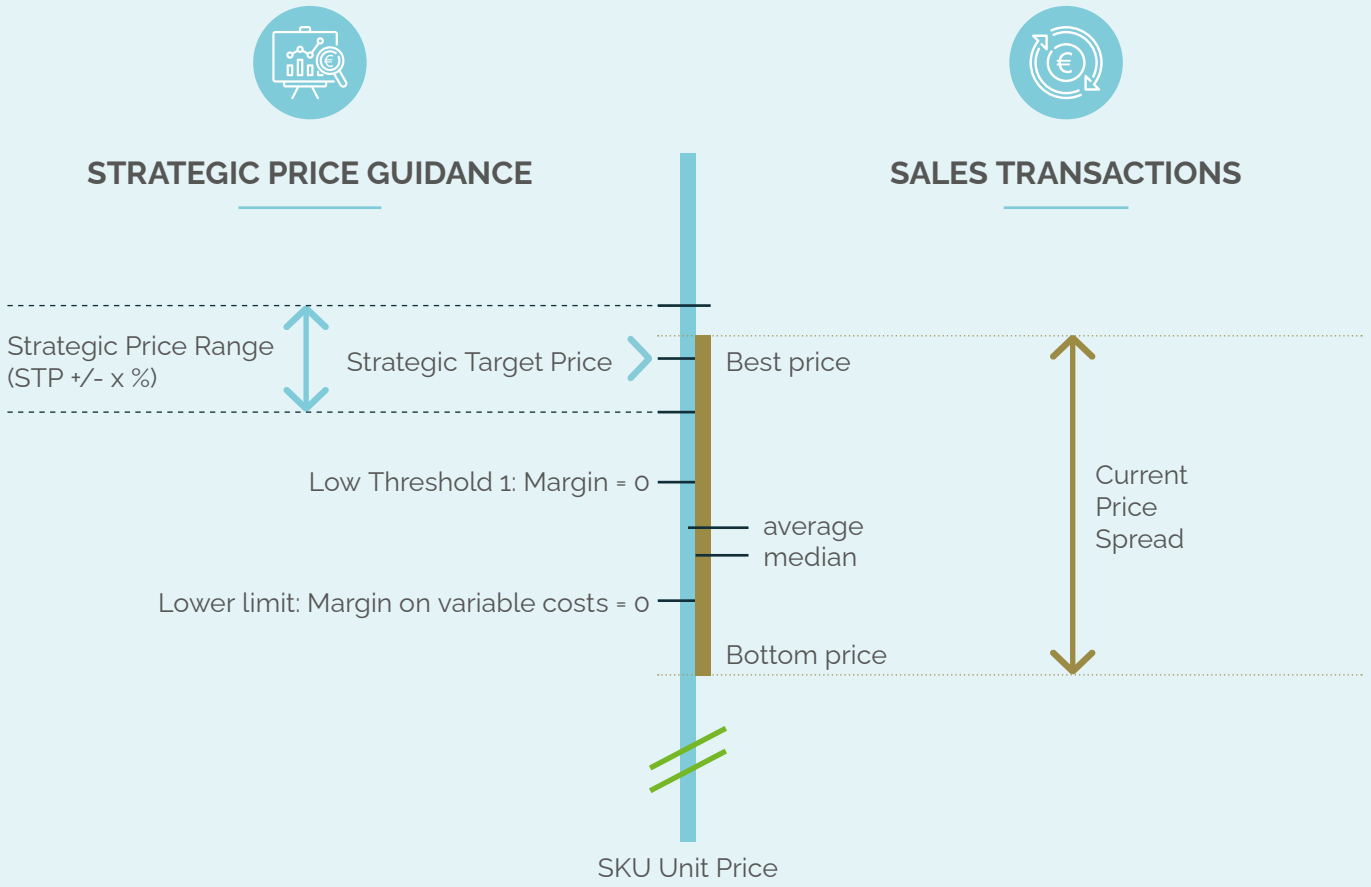
Comparing actual sales transactions with the Strategic Price Guidance highlights potential pricing gaps and improvement priorities.

For a given business segment, **Strategic Price Guidance defines a price corridor** for sales reps structured around:

- **a Strategic Target Price** reflecting aspirational long-term growth x margin expectations;
- **upper and lower price boundaries setting the acceptable spread** for day-to day sales transactions. The spread width (+/- x %) may vary according to the selected pricing strategy, especially expected margin levels. For instance, it could be narrower for commodities and broader for differentiated products;
- **additional thresholds** can be set at *"Margin @ zero"* and *"Margin on Variable Cost (MVC) @ zero"* [calculated at SKU level].

Moving outside recommended price ranges should require ad-hoc authorization supported by customized workflow.

When comparing actuals with past sales transactions, price gaps in terms of price level and price spread may be revealed and require adjustments.



This chart shows a majority of individual transaction prices for the given business segment outside the expected longer-term guidance, an issue to be resolved progressively over time.

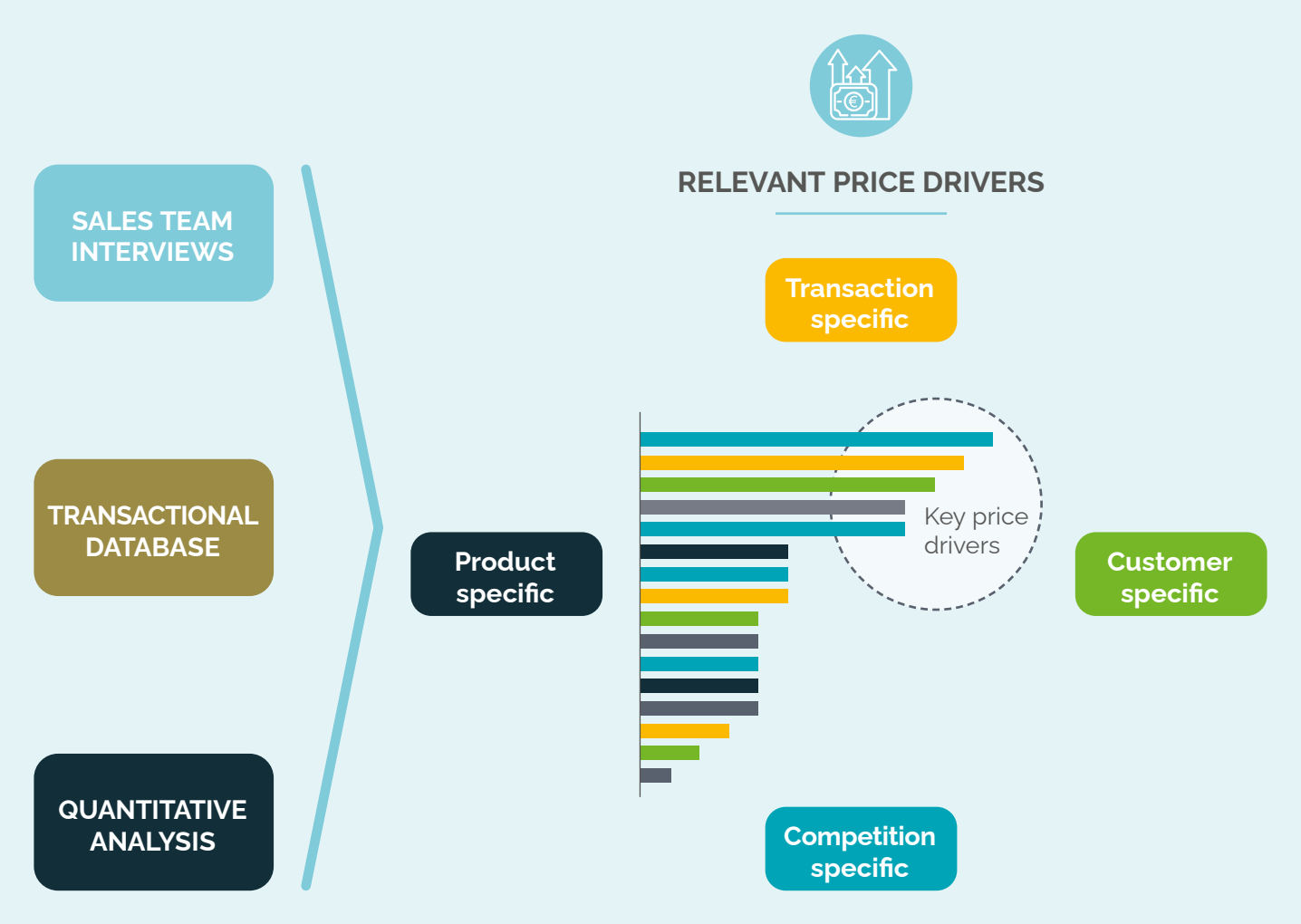
Pricing analytics, supported by sound business judgment, also **delivers insights into price behaviors** and their underlying price drivers

As noted previously, **a robust segmentation structurally reflects competitive position, market attractiveness and intrinsic profitability potential by segment.** It is the foundation of differentiated pricing strategies.

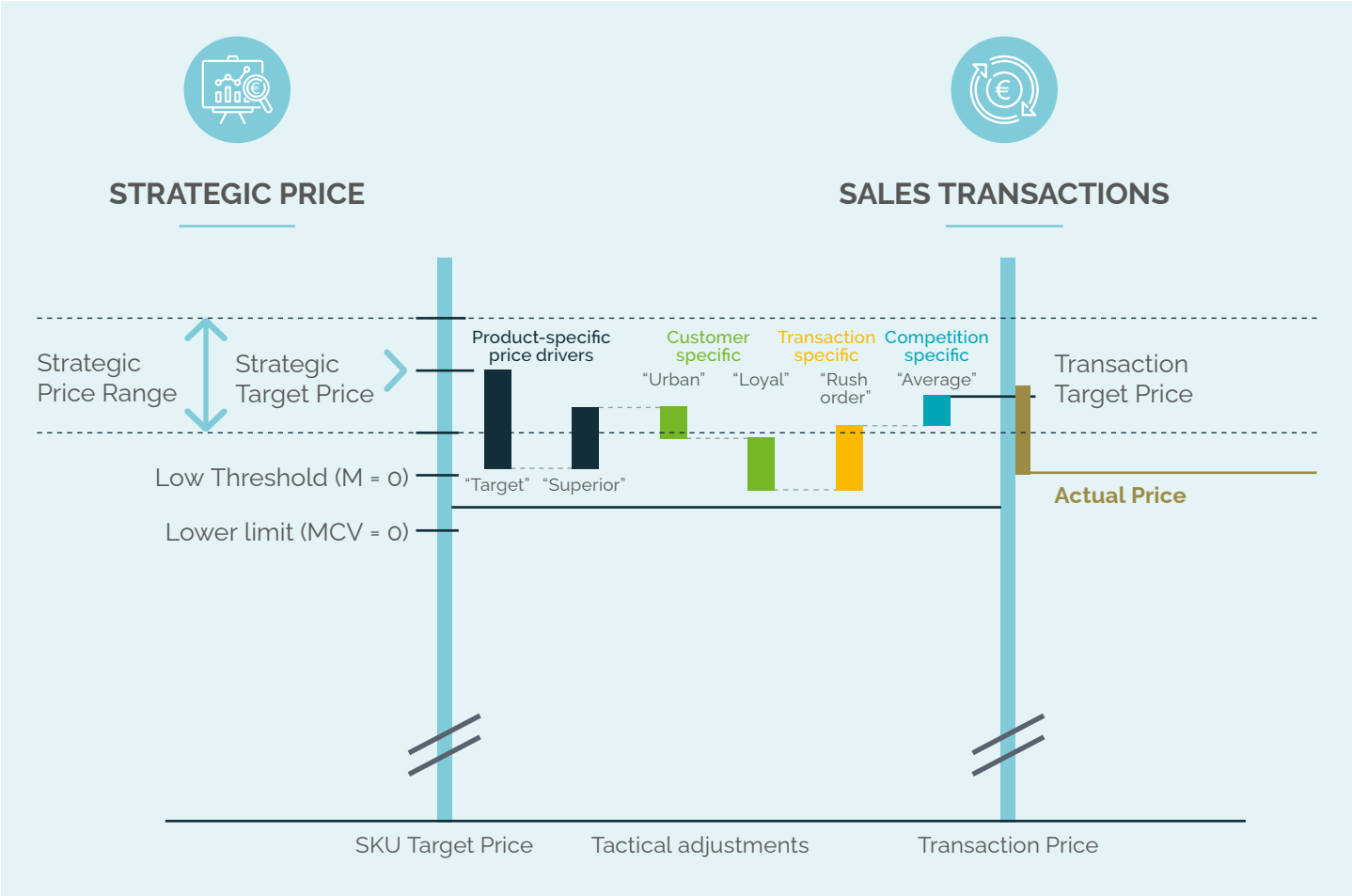
For each sales transaction, **external factors** such as customer willingness to pay, competitive landscape or transaction context **influence price levels and spread.**

Internal root causes also drive price behaviors, often significantly, with sales rep experience immediately coming to mind. This is where pricing management has a real role to play.

Sales data, albeit imperfect and incomplete, **can bring a wealth of insights about these underlying factors,** i.e. price drivers. **In-depth Pricing analytics help in evaluating their impact** and identifying those with the greatest significance. In addition, business judgement and sales reps experience provide invaluable insights on customers and competitors, enriching data driven outcomes.



Tactical adjustments coming from the sales context can be applied to the Strategic Price Guidance in order **to propose the right price for each transaction.**



Strategic Target Price and its price range reflect the selected pricing strategy as well as the longer-term objectives that should apply to a given sales transaction.

The sales context, however, may lead to price adjustments driven by factors not initially included in the business segmentation, such as order characteristics (order size, special service requirements, linked sales…), individual customer profile (price history, customer hot buttons, …), existence and strength of the competition.

These **adjustments can be made either by a pricing algorithm** leveraging price drivers insights, **or by sales reps** filling out simple rating grids.

In the end, the adjusted Target Price is the proposed customer net price. In B2B environments, this is usually the starting point of negotiations. In that case, it is always preferable to propose low-cost value adds addressing customer hot buttons rather than straightforward discounts. Any additional discount should be counterbalanced with a customer commitment (volume increase, product mix extension, etc).

A systematic feedback loop ensures the **continuous improvement of pricing practices.**

Managing price performance starts with a Target Price, its associated price range and price limits for each sales transaction. As described earlier, the Target Price results from the chosen pricing strategy for the given business segment and sales channel as well as a number of tactical considerations. Without a Target Price, it is impossible to manage Price performance.

Continuous monitoring of Variance to Target Price and, when applicable, **win/loss rates** is key to validating the current pricing strategy or to deciding when and how it should be adjusted. It also helps in evaluating sales force compliance to the pricing guidance, in other words the quality of execution of the chosen price strategies. With such KPIs, **Price performance should become an essential component of the sales force incentive program.**

Such a full-fledged price performance system helps track the different sources of price leakage and supports **a virtuous improvement cycle based on a continuous feedback loop** from actual sales prices to Target Prices at the transaction level.

Case study: dealing with a large number of complex tenders for a glass packaging company.

SITUATION

- Make-to-order products for large multi-national customers.
- High level of customization.
- Significant product development costs and multi-year manufacturing commitment.
- High portfolio complexity generating massive cross-subsidies across customers and products.
- Long lead-times for preparing tenders and quotations.
- Limited customer confidence in quoted prices creating the need for multiple iterations and a negative price image.

APPROACH

- New costing model with cost laws reflecting resource consumption vs key cost drivers. Should-cost model leveraging key product specs.
- Redefined pricing strategy based on the revised business segmentation.
- Redesigned quotation process supported by an end-to-end costing and pricing tool.

RESULTS

- More transparency of product and customer portfolio profitability highlighting major margin discrepancies and clear pricing improvement priorities.
- More rapid preparation of quotations enabling a faster reaction to customer requests and a richer dialog.
- Improved sales force confidence, focusing on value-price trade-offs rather than discounts.
- Improved price image from the customer perspective.
- Higher win rates and gains in market share in a very competitive market.
- Significant boost in margins.

In conclusion

By embedding strategic objectives into the specific context of each sales transaction, **Strategic Pricing provides effective price guidance –** consistent with longer-term business targets – **to sales teams,** strengthening their pricing confidence and helping them to win in uncertain times.

Achieving this requires a **true cross-functional transformation,** involving operations, finance, IT & digital, marketing, sales as well as strong C-level sponsorship. **A progressive, step by step approach** is also recommended, together with strong support to sales teams, effective pricing governance and active communications during the entire journey.

In leveraging an **end-to-end Strategic Pricing solution** which integrates pricing strategy, advanced cost and margin intelligence, transaction price optimization and continuous price performance tracking, **B2B companies will be well equipped to capture the full revenue and margin potential of their business and also gain a sustainable competitive advantage.**

WhiteHeron Software

A French start-up

WhiteHeron Software is home to a **team of senior strategy consultants and dynamic, driven software engineers** who share the same commitment to unsurpassed quality as its founders.

Our integrated and modular solution helps **B2B companies to articulate and execute superior pricing strategies,** applicable to large product portfolios as well as complex project configurations in volatile and competitive environments.

The solution supports a **broad, cross-functional Pricing transformation** leading to significant benefits and a sustainable competitive advantage.

To learn more, visit
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