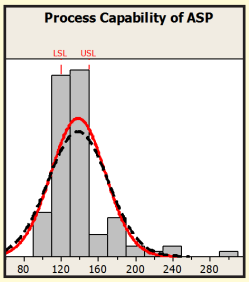
Pricing Project Management: Qualitative Evaluation for Project Implementation Success



This article illustrates how organizations in various industries combine pricing, Six Sigma tools and technology to enable some initiatives and, better yet, to measure their impacts on qualitative business results.
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Given the competitive nature of business today, firms are constantly seeking the best ways to improve productivity and maximize profits. More and more, they are demanding better control over their businesses management processes. As a bridge to improve corporate performance at the nexus of technology and human practices, pricing management reinforces sales force-effectiveness efforts, reduces order-approval times, diminishes inexplicable pricing variations, and provides more predictable results. This, in turn, makes businesses more successful and profitable.

Firms are discovering the benefits of combining pricing strategies with Six Sigma methods and tools to improve the performance of their pricing management processes. When pricing is based on Six Sigma principles, firms can better characterize, understand, and manage entire value chains. People and systems, as part of any pricing process, can now perform at unprecedented levels of control and predictability. Sustainable enterprise improvements that were previously unavailable are possible through the integration of pricing with Six Sigma tools and technology. This paper illustrates how organizations in various industries combine these three factors to enable some important initiatives and, better yet, to measure their impacts on qualitative business results. We offer examples of pricing projects from industries as diverse as heavy machinery, wholesale distribution, telecommunications, and manufacturing.

A Balanced Framework

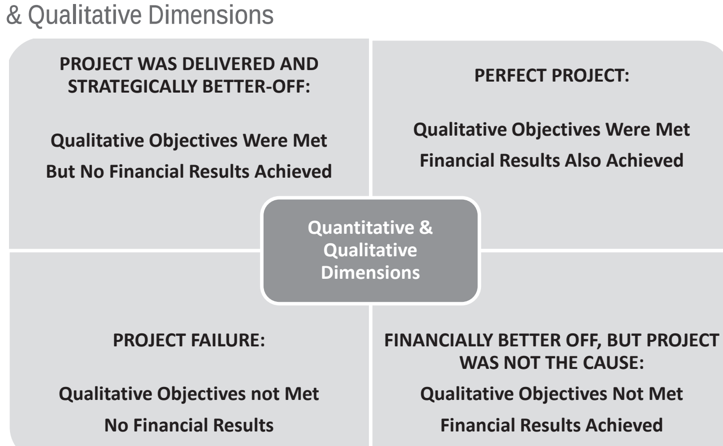
The results of aligning pricing strategies with Six Sigma tools and technology must not be a topic left silent. Some significant indicators can legitimately demonstrate the power and impact of pricing projects and initiatives. We propose a framework, shown in Figure 1, which is used to link the qualitative merits of any pricing project to quantitative measures of success and financial performance.

Project success is generally based on an agreed-upon set of qualitative metrics for each specific pricing project. In some cases a firm improves its financial results but the sources of these improvements are not related to predefined qualitative project indicators. In such cases, it is better to assume that the financial results are due to market variables unrelated to the scope of the pricing project. On the other hand, there may be projects for which the impact linked to these qualitative indicators is more visible but the financial results are not achieved, such as, for example, contribution margin objectives. In this second case, other market conditions may be preventing financial improvements, and exogenous factors may be in play; but there might still be an overall improvement in the firm's overall strategic positioning. In fact, the company might strategically be better-off.

We conjecture that pricing project success needs to take into account quantitative and qualitative project indicators. We generally incorporate some or all indicators from the following list:

1. Respect of project implementation timeframe
2. Channel or customers segmentation
3. Sales mix improvement
4. Percentage of sales within discount policies

Figure 1: The Balance between Quantitative & Qualitative Dimensions



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5. Supporting tools in place

6. 24/7 flawless overall pricing process

Pricing Project Qualitative Indicators

Respect of Project Implementation Timeframe

Use of the Six Sigma tools and technology allows a greater focus on improving firms' pricing processes on time and within an agreed-upon timeframe. Some might not consider this to be a qualitative indicator, but it is a critical indicator for real-life project implementation. Time and timing in business are critical success factors. Our experience after implementing more than fifty pricing projects in Brazil shows that being on schedule is a key factor that customers like to monitor and measure the pricing team against. In addition, delays add to project costs, and there are opportunity costs of not introducing needed changes in pricing. Another important aspect related to the dimension of timing is the overall level of confidence and the management of stakeholders' expectations. In general, a one- to two-week delay in a thirty- to fifty-week project might be acceptable as long as there is no important deadline associated with price-list changes or with a sales training event, for example. But if the pricing-project delay stretches beyond one to two weeks, there might be some major internal complaints about the impact of such a delay on the project and the risk of losing increased incremental results. Software customization and modifications represent the main sources of project delays. When these system modifications are not done in a timely fashion, are not tested for all necessary pricing scenarios, or lack reliability, parts or all of the pricing project are delayed. Regardless of whether a firm uses internal IT resources or outsources the IT work to an outside vendor, the relevant IT staff must be involved in the pricing project from day one. Their participation from the get-go allows the team to develop solutions that are better tailored to what the firm's software can handle in the areas of database segmentation, discount schemes, invoicing capabilities, and so forth. The main point here is to make sure a multi-functional team is created up front to ensure that deadlines and the overall project timeframe are respected. The success of a pricing project needs to be measured internally based on its timeliness. When a project includes a multitude of initiatives, time management within the overall project-management framework is critical, especially with respect to high-risk activities. A potential delay in one initiative might delay the entire project and reduce payback.

Channel or Customer Segmentation

A must-have in any pricing project is a good customer and/or sales channel price-differentiation strategy. Most firms already have segmentation in place, but some do not use their segmentation to charge different prices to different customer segments. Sometimes this is due to a lack of clear price fences. In other situations, it is due to a lack of clear policies for differentiating prices: some use segments just to drive investments or service levels, and there are many other reasons why a segment is not being used to differ price. We argue that customers within a segment should be receiving similar prices, but that different segments should have different prices. Usually, we see any price differentiation across segments as showing a lack of price policies. We have found that once a firm develops segmentation—charging customers from different segments different prices, but keeping the prices within segments similar—the firm can sustain both its segmentation and its price policy. There are also studies showing that a customer prefers paying more if he or she knows that a similar customer is paying the same price to paying less knowing that a similar customer may be paying even less. Hence, this human behavior helps us support a pricing differentiation based on customer segments. In general, the situation before customer price segmentation is similar to that shown in Figure 2. Sometimes, a firm will need to develop a different pricing segmentation approach from the one it is using because of other objectives, such as delivery services or marketing. While it might also bring additional complexity, a revised pricing segmentation can bring excellent opportunities to capture additional value, as shown in Figure 2. A comparison of actual average captured prices (Figure 2) after project implementation shows a 12% average price increase simply as a result of eliminating the lowest prices in all segments.

Sales Mix Improvement

One of the biggest lessons learned from working with a large medical products corporation is that there is no need to increase volume to grow a business if customers can be moved to buy-

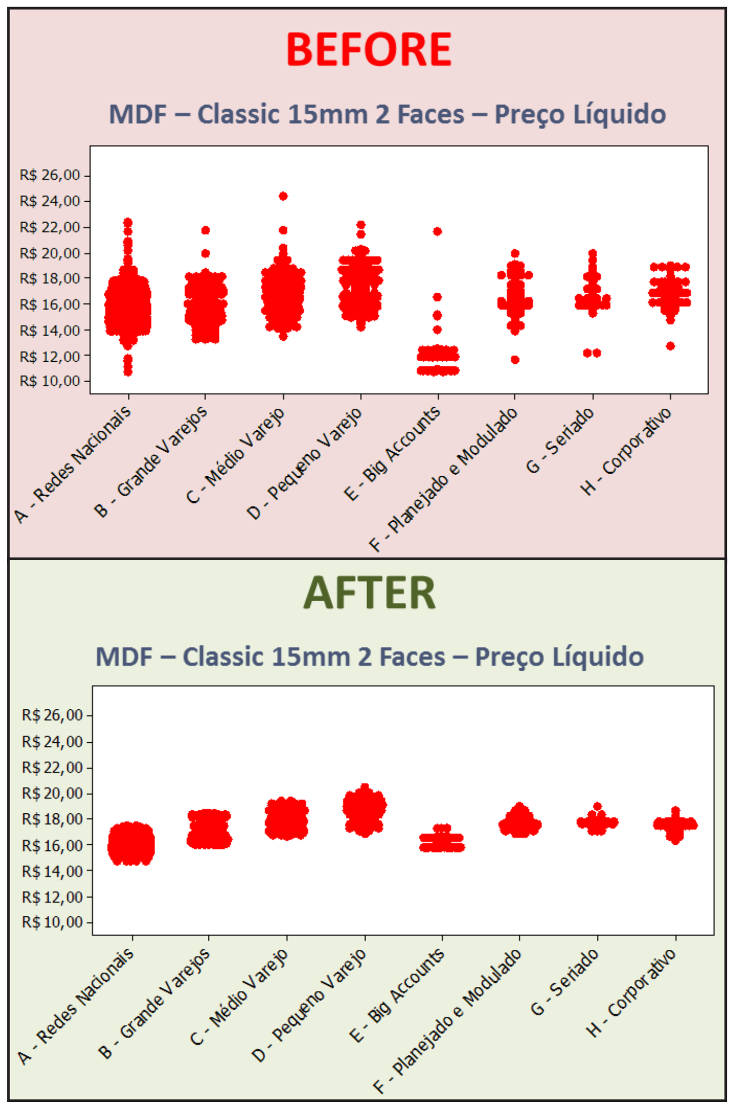

Figure 2: Price Dispersion across Customer Segments Before and After Project Implemented Six Months Later

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Figure 3: Sales Mix B2B Company. The More OM Products Sold the Better the ASP (Average Selling Price), and Profits!

	Customers	%	Vol (UM)	Value (US$)	ASP
Only OM	1.443	19,95%	262.209	11.476.083	43,77
Only DI	1.759	24,32%	446.264	14.093.715	31,58
Only MU	1.138	15,74%	239.861	4.949.116	20,63
OM & DI	629	8,70%	687.933	26.276.506	38,20
OM & MU	1.429	19,76%	892.289	24.583.512	27,55
DI & MU	246	3,40%	139.400	3.540.929	25,40
All Products	588	8,13%	3.368.497	108.314.873	32,16
Total	**7.232**	**100,00%**	**6.036.453**	**193.234.734**	**32,01**

ing products with a higher value-added. For example, in the suture business, a surgeon may choose a simple Nylon product to stitch the skin after surgery, or she might select a much better (and much more expensive) synthetic absorbable suture, such as Monocryl or Vicryl Rapid, with much higher profit for the same volume of sutures sold.

With this in mind, an effective pricing scheme is one that creates incentives for customers to upgrade their purchases. This may be accomplished with an attractive price list, bringing the more expensive products closer to regular ones, although it may hurt value perceptions and lead to leaving some money on the table as well. Hence, we try to stimulate customers to buy more expensive products by creating bundles that facilitate the buying decision. Over time, we start to measure the percentage of the selected premium mix out of total sales and the growth of those products compared with overall market growth (if data are available). This exercise might appear to be quantitative, but the measurement process of such an exercise is strategic for the profit growth of any organization. Hence, by allowing customers to receive a discount on a total purchase by adding selected products to their basket (or purchase order), we are giving them the correct incentive to select higher margin products. Figure 3 illustrates that the more premium products that are sold, the better the average selling prices. In this example, the items are versions of the same product, but with a marginal cost increase. Any pricing strategy that leads customers to upgrade their purchases is highly commendable. In the project shown in Figure 3, we created incentives for customers to upgrade to OM products, and we measured the percentage of customers using OM products and the growth rate of OM products sales compared with total sales.

Percentage of Sales within Discount Policies

Our rule of thumb is that if up to 10% of your sales are based on exceptions, you are in good shape. After all, in any business, we may have to live with outliers, customers that will not meet any specific segmentation criteria or who will not simply follow company policy. Typical examples might include legacy contracts in place, a need to keep a specific strategic customer, or a client that is too big to lose (as long as it is still profitable). Going one step further with this rule of thumb, we also assume that up to 20% of sales outside of your pricing policy and guidelines can still be acceptable. You must, however, be aware of allowing too many negotiations and the related sales volume to be authorized and classified as exceptions. Finally, for anything above 20% of sales that does not follow a specific pricing policy, we can conclude that there is no pricing policy in place. In this case, the risks of losing control of the pricing process and negatively impacting pricing power are very high, as customers become more aware of flexible terms given to other customers. The simple metric we propose is to focus on one simple item: percentage of sales within price policy. In general we recommend the use of a statistical platform such as Minitab to run the analysis called Capability Sixpack (an example is shown in Figure 4). Note that about 30% of sales were done at prices below the suggested lower boundary. And around 18% of sales were done above the suggested maximum price. In this case, we would strongly recommend the implementation of a more robust price-management process for pricing policies. At least 80% of sales should be within the US$120—US$150 threshold. At the moment captured in the graph, only 52% of sales fall within this range.

Supporting Tools in Place

A common objective in many pricing projects is to create and establish a pricing platform for customers. A pricing platform starts with a pricing structure in place and all the relevant resources necessary for pricing-project success. In analyzing more than 35 implemented and closed pricing projects, we find the following: the pricing manager in 17 of them reported to finance, either to the CFO or the finance head of the organization; 15 reported to marketing, generally the CMO or marketing director of the organization; one company had pricing reporting to the CEO directly when we left; and two remained with the sales department after the project, despite our suggestion to change this line of command. But a pricing structure is not only a pricing manager place and a reporting line. We also include other critical functions inside the pricing platform, such as pricing analysis, pricing intelligence, pricing surveys and data collection, field pricing monitoring, and so on. The size and functional levels of this platform depend on the complexity and size of the organization. Another issue important to defining a pricing structure is centralization, or the autonomy given to business units and sales organizations. Generally, in fast-moving consumer-goods companies, the pricing structure needs to be larger. In companies requiring heavy data, such as banks, telecommunications, and airlines, there is also need for a robust pricing structure that will have many activities and levels.

On the other hand, more stable, B2B businesses often require less complex and much smaller structures and therefore will have smaller resources needs. Whether projects require a team of 45 pricing professionals or just two does not really matter. What matters is that each project is different and that the platform that is designed and managed be right-sized for the dynamics of the customers. Within that well-defined platform, and with the structure that is available at time *t*, what is most important is managing customer expectations and delivering on these price expectations across all dimensions of the pricing process:

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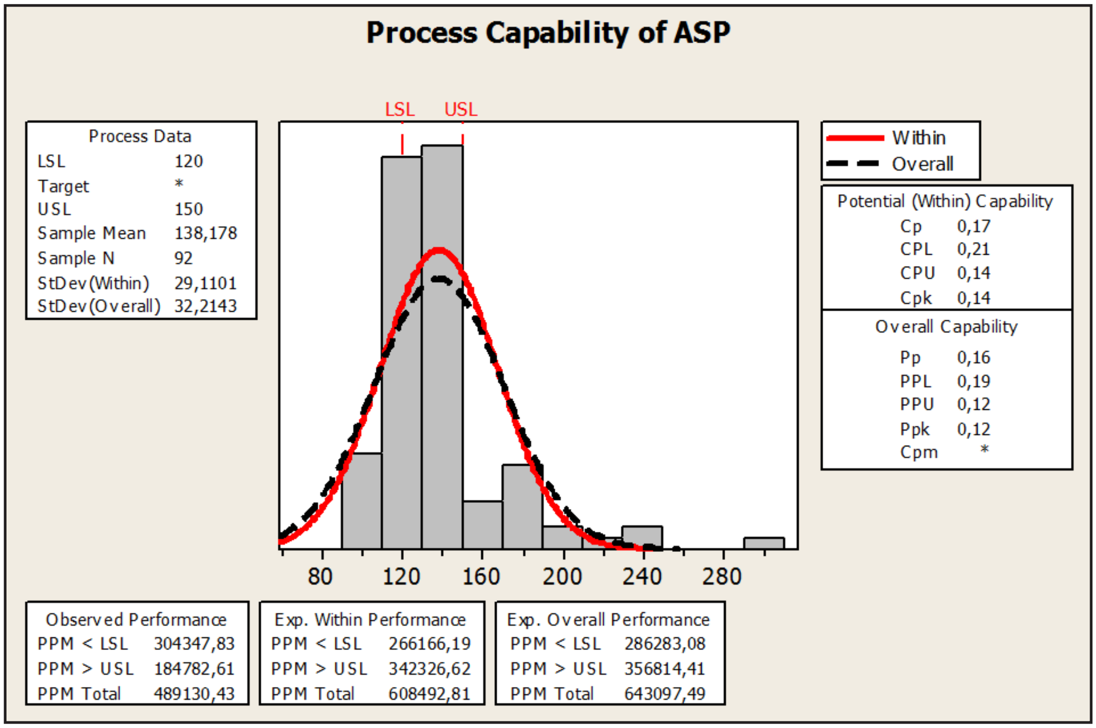
- **Price Setting and Pricing Policies:** channel margins, price variability, price discounts, minimum price, price promotions, etc.
- **Price Research and Data Collection:** pricing database, pricing surveys, price monitoring, etc.
- **Pricing Management:** correct invoicing, pricing audits, systems running with no errors, price adjustments, field visits, etc.

Figure 4: Example of Volume within Limits of Price Policy



For each of the pricing sub-processes above, there is a need to develop specific metrics to track the work done by each individual (or process) within the structure, and to develop another set of indicators to measure the quality of the work of the area as a whole. Examples of such indicators include percentage of sales below minimum price, current ASP (average selling prices) against projected or suggested ASP, price dispersion within segment, and so forth.

24/7 Flawless Pricing Process

Pricing is a complex, dynamic process. This level of complexity is a product of the multi-functionality of the function across several processes. We believe that one of the biggest challenges for a pricing manager is to balance all stakeholders' needs within the organization. Finance is always asking for higher percentage margins and lower payment terms. Sales is usually more focused on volume and quotas than on prices. Marketing sometimes overvalues brands and sets prices much higher than what customers are willing to pay. Most of the time these functions work in silos, not only with respect to their pricing activities but also in achieving their functional objectives, even if these hurt overall company performance in the end. A sound pricing process should minimize internal conflicts, create greater alignment, and establish integrative financial goals for the success of all. In order to qualitatively account for this dimension of complexity and to measure how well it is operationalized, we recommend a set of 25 indicators including, but not limited to, dimensions of pricing strategy; how the organization develops its pricing strategy; discount policies and guidelines; managerial reports; and specific KPIs.

Any firm has a pricing process in place, whether that process is formally managed or not. Otherwise, prices would not be set, displayed, or communicated. Firms would not be able to sell or to invoice their transactions. The key of a pricing project is also to understand whether profits are growing, price and transaction data are collected and analyzed, prices lists are correct, invoices are error-free, KPIs are met, the pricing team changes prices in a rational way, competitive movements scenarios are defined, and value maps are clear. In sum, all of these pricing actions and activities must be improved on an ongoing basis. Maintaining a flawless pricing process 24/7 requires making sure that the process is stable and dynamic but also improving to reach superior performance over time. Qualitative improvements may not lead to a higher financial result, but certainly they are a critical foundation for getting there eventually.

Conclusions

This article presented a realistic and grounded view of how pricing-project success can be viewed through both quantitative and qualitative lenses. Measuring the impact of specific pricing projects or initiatives solely in terms of quantitative return might lead to disappointment and erroneous conclusions, especially during turbulent and unpredictable times. Introducing qualitative indicators and objectives into the measurement of the impact of pricing and overall ROI is a must. At times, the incremental performance reaped by a firm might prevent a collapse of profits due to increased pricing discipline. Deploying pricing tools and methods is part of the overall process orientation of the firm that leads to greater pricing discipline and greater management of profitability. But pricing is a journey, and sometimes projects take longer to implement. Firms might take up to four years to be truly confident that they have a solid pricing structure and process in place with the right set of key performance indicators being monitored, with data collected in a timely manner, with a superior level of pricing, and with sales effectiveness and adequate pricing systems. Despite this potential long pricing journey, projects might not deliver 100% of the impact or return, because of uncontrollable factors. But overall the pricing projects included in the journey might still be a success because they were concluded on time and because they allowed these firms to capture much more value for their products and services than their competitors. Managing prices in a structured and strategic way is a major step towards achieving a sustained advantage over competitors that are not able to do the same.