Price Your Way to Better Profit Margins

A Simple 3-Step Approach to Effective Transaction Management

BY MIR ZAMAN

When times are tough and consumer demand drops, companies feel great pressure to reduce prices. The urge to manipulate pricing to hold or grow market share becomes unbearable. This knee-jerk response to a challenging economic environment often results in massive price discounts to customers across the board, with the attendant erosion in profit margins. There is a better way. In our view, only a price response backed by proper understanding of all the elements that create a transaction can positively impact your company’s net profit.

Companies can make sense of this challenge by looking at transaction-level profit margin in a “3S” process — *Sense, Set* and *Succeed*. This practical approach helps companies reach overall profit margin goals by analyzing the details of transactions, setting an informed pricing strategy, and taking incremental steps towards success.
Step 1: Sense – Analyze with Waterfalls, Price Bands and Value Maps

Four analyses are critical to sensing the competitive landscape. Each is important to creating a complete picture of the marketplace.

The first step is to diagnose how effective the company is at setting price and capturing value from products. Price Waterfall charts help determine pocket margins – the amount of profit left in the company’s “pocket” after all the transaction costs (discounts, rebates, promotion fees, freight charges, cost of goods, etc.) are subtracted from the list price. Waterfall charts can show if a particular product, customer, or segment meets the target pocket margin.

Price Bands plot sales volume at each pocket margin level, revealing price variation for particular products, customers, sales territories, or segments. Price Bands can often shine light on areas of inconsistent price execution and potential areas of misalignment with sales force incentive compensation.

Value Maps measure price against perceived benefits across comparable attributes and competitive alternatives. Value Mapping helps determine if your company captures appropriate value for its products and relative competitive position. Value Mapping can also foreshadow directional changes in market share across competitors, based on providing a value surplus or value deficit.

Value Waterfalls (altogether different from Price Waterfalls) provide a needed alternative to Value Maps and establish a rigorous financial measure of an offer relative to the next best competitive alternative. Value Waterfalls are essential when the main competitor is “status quo”. They quantify offers which have direct and measurable economic impact on the customer’s value chain.

The data for these analyses can be difficult to acquire, but the tools themselves are readily available from commercially available software providers. Bottom line, these are vital analyses which need to be employed to assess the health of your company’s value creation and value capture processes. The use of these analyses may vary based on the type of business (B2B, B2C, etc.), the industry, and whether the customer benefits are quantitative or perceptual.

There are opportunities to improve overall profit margin across the entire value chain, so a comprehensive pricing strategy must be created and understood at all levels of the company.
Step 2: Set – Put Tools and Processes in Place

Once the landscape analysis is complete, tools and processes must be put in place to set measurable goals and continually monitor margin improvement. The analysis also needs to be translated into meaningful and actionable pricing structures and policies. Initial pricing policies may also be set to determine the target, floor, and ceiling prices to the sales force so that the target pocket margin can be achieved. Ideally, pricing policies should be set by customer segment to reflect differences in cost-to-serve. Higher cost segments and channels should naturally have higher price targets than lower cost areas. Managing pricing policies by segment also forces a critical assessment of sales and marketing programs to ensure that higher cost sales and marketing programs are worth the investment. Finally, it is essential to communicate the value of the product to the target market for proper price acceptance and setting of the competitive landscape.

Step 3: Succeed – Think Big, Start Small and Build Incrementally

There are opportunities to improve overall profit margin across the entire value chain, so a comprehensive pricing strategy should be created and understood at all levels of the company. Since data important to pricing decisions is often held by many siloed organizations, executive alignment is critical to success. Start by establishing a pricing team to gather all the pricing data from different organizations and set pricing policies, maintaining consistency across brands and channels. For many companies, an investment in transactional price management tools provides the necessary foundation to ensure that the data and policies are managed effectively.

Proper change management and incentives must be in place to motivate sales teams to work with the company’s pricing strategy, not just focus on getting volume by giving deep discounts.

It may seem overwhelming, so start by putting a small set of products through the 3S process to show some gains and margin improvements. After the pilot is complete, efforts can be scaled up to look at transaction management and the efficiency of the overall pricing strategy across the board. This process is iterative and the benefits are incremental.

With a well-established approach, companies can avoid the knee-jerk responses to a drop in demand and can Sense, Set and Succeed in effective transaction management to reach their profit margin goals.

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